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The Future of the New International Tax Regime

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The Future of the New International Tax Regime

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SYMPOSIUM

THE FUTURE OF THE NEW INTERNATIONAL TAX REGIME[†]

WELCOME AND INTRODUCTORY REMARKS

*Linda Sugin*ⁱ

Fordham University School of Law

KEYNOTE ADDRESS

*Rosanne Altshuler*ⁱⁱ

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[†] The symposium was held at Fordham University School of Law on October 26, 2018. It has been edited to remove minor cadences of speech that appear awkward in writing and to provide sources and references to other explanatory materials in respect to certain statements made by the speakers.

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ⁱⁱ Rosanne Altshuler is a Professor of Economics at Rutgers University. She was formerly Chair of the Department of Economics and Dean of Social and Behavioral Sciences in the School of Arts and Sciences at Rutgers University. She started her career as an Assistant Professor at Columbia University. Professor Altshuler has been a Visiting Professor at Princeton University, New York University School of Law, and the Robert F. Wagner School of Public Service at New York University. Professor Altshuler's research focuses on federal tax policy and has appeared in numerous journals and books. Professor Altshuler is currently the president of the National Tax Association, and she has served as an editor of *The National Tax Journal* and editor of the Policy Watch section of *International Tax and Public Finance*. Professor Altshuler has been a member of the Board of Directors of the National Tax Association, the Panel of Economic Advisors of the Congressional Budget Office, and the Board of Trustees of the American Tax Policy Institute. She has also been active in the policy world as Director of the Urban-Brookings Tax Policy Center, as Senior Economist to the 2005 President's Advisory Panel of Federal Tax Reform, and as Special Advisor to the Joint Committee on Taxation. She has testified both before the Senate Finance and House Ways and Means Committees.

PANEL I**Moderator**

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^v Rebecca Kysar is a Professor of Law at Fordham University School of Law. Prior to joining the Fordham faculty, Professor Kysar spent nine years at Brooklyn Law School, where she taught federal income taxation, international taxation, legislation and statutory interpretation. Professor Kysar's recent scholarship examines tax treaties, the tax legislative process, as well as the new 2017 tax law. Prior to entering academia, Professor Kysar clerked for the Honorable Richard J. Cardamone on the U.S. Court of Appeals for the Second Circuit, and she worked as a tax associate at Cravath, Swaine & Moore.

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PANEL II

Moderator

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^{viii} Jeffrey Colon is a Professor of Law at Fordham University School of Law. Professor Colon teaches courses in federal income taxation, corporate taxation, international taxation, partnership taxation, taxation of derivatives, corporate finance, and corporations. Prior to joining academia, Professor Colon practiced international tax in Washington, D.C.

^{ix} Richard Phillips is a Senior Tax Analyst for the U.S. Senate Budget Committee. At the time of the Symposium, Mr. Phillips was a Senior Policy Analyst at the Institute on Taxation and Economic Policy. Mr. Phillips' work focuses on corporate and international tax policy. He is the author of numerous reports on the international tax system. He has also testified on individual and corporate tax issues before the Maryland state legislature and recently before the U.S. House Ways and Means Tax Policy Subcommittee.

^x Danielle Rolfes is a partner in KPMG's Washington National Tax Practice. She has also served as International Tax Counsel at the Department of the Treasury. Prior to her work at the Department of the Treasury, Ms. Rolfes was a partner at the tax and employee benefits law firm of Ivins, Phillips & Barker in Washington, D.C., where she advised multinational companies on international tax planning, controversy, and compliance matters, as well as tax accounting methods.

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CLOSING REMARKS

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^{xii} Stephen Shay is a retired partner and consultant at Ropes & Gray LLP. He was a tax partner for twenty-two years with Ropes & Gray before serving as Deputy Assistant Secretary for International Tax Affairs at the United States Department of the Treasury. He is currently a Senior Lecturer on Law at Harvard Law School.

^{xiii} Steven Dean is currently a Professor of Tax Law and the Faculty Director of the Graduate Tax Program at New York University School of Law. At the time of the Symposium, Professor Dean was a Professor of Law at Brooklyn Law School, and also previously served as the Vice Dean of Brooklyn Law School. Professor Dean's scholarship and teaching focus on tax law. Professor Dean is a member of the Executive Committee of the New York State Bar Association's tax section, and he practiced tax law at two global law firms before joining the Brooklyn Law School faculty.

WELCOME AND INTRODUCTORY REMARKS

LINDA SUGIN: Good afternoon, everybody. I am Linda Sugin, the Associate Dean of Fordham Law School, and it is my great pleasure to welcome you all here. Fordham is very honored and excited to be hosting such a fantastic group of international tax thinkers, and I am really excited for today's program.

For those of you who do not know me, I have been in the tax academy for a long time. I have taught tax here for twenty-five years, and I cannot think of another time in my career when so much change seemed to be happening so quickly. I think all of today's speakers will agree that we are seeing a regime change now in international tax—for better or for worse, or maybe for better and for worse. I look forward to this afternoon so that we can think more clearly about what will be better and what will be worse.

Reform of the international tax provisions may have been a long time coming, but that does not mean that we were prepared to deal with it and the aftermath when it occurred. This is a new environment for all of us—for our students, for our clients, for our country, and for our global economy. The effects will be far-reaching and lasting, and I look forward to the views of all the experts gathered here today.

Today's speakers come from all corners of the tax community and include academics, practitioners, lawyers, and economists. We have a full-court press to make sense of where we are going and to make sure that we like wherever we are heading.

I want to acknowledge the *Fordham Journal of Corporate & Financial Law* for sponsoring this conference and, in particular, the Editor-in-Chief; the Managing Editor; the Symposium Editor, Oliver, who will speak in a minute; and the Journal's Faculty Advisor, Professor Caroline Gentile. They have done a great job putting this together. Shanelle Holley and her staff in the Office of Public Programs make the logistics look easy, and I want to thank them as well.

My greatest thanks, of course, go to Professor Rebecca Kysar, who has been the driving force behind this conference from the beginning. It was her idea to do this before she even joined our faculty. Rebecca put together today's incredible roster of speakers, some of whom I have been trying to invite to Fordham for a long time without any success, so I

cannot believe how lucky I am that Professor Kysar has joined our faculty. I am so proud to be your colleague.

Without further ado, I want to call up Oliver Phillipson, the Symposium Editor of the Fordham Journal of Corporate & Financial Law, to introduce all the speakers for today.

MR. PHILLIPSON: Hello and good afternoon. Welcome one and all to the 2018 Fordham Journal of Corporate & Financial Law Symposium: “The Future of the New International Tax Regime.”

Our event today is divided into four parts. First, you will hear from our keynote speaker, Professor Rosanne Altshuler of Rutgers University. Then, you will hear from two panels. Professor Fadi Shaheen, Associate Professor of Law and Professor Charles Davenport Scholar at Rutgers Law School, will moderate the first panel, which is composed of leading academics in the field of international taxation, including Michael Graetz, Wilbur H. Friedman Professor of Tax Law and Columbia Alumni Professor of Tax Law at Columbia Law School; Rebecca Kysar, Professor of Law at Fordham University School of Law; Susan Morse, Angus G. Wynne Sr. Professor in Civil Jurisprudence at the University of Texas at Austin School of Law; and Daniel Shaviro, Wayne Perry Professor of Taxation at New York University School of Law. Professor Jeffrey Colon, Professor of Law at Fordham University School of Law, will moderate the second panel, which is composed of practitioners in the field, including Richard Phillips, Senior Policy Analyst at the Institute on Taxation and Economic Policy; Danielle Rolfes, partner in KPMG’s Washington National Tax practice; David Rosenbloom, member at Caplin & Drysdale and James S. Eustice Visiting Professor of Practice and Taxation and Director of the International Tax Program at New York University School of Law; and Stephen Shay, retired partner and consultant at Ropes & Gray LLP and Senior Lecturer on Law at Harvard Law School. Professor Steven Dean of Brooklyn Law School will provide closing remarks.

Please join me in welcoming our keynote speaker, Professor Altshuler.

KEYNOTE ADDRESS

PROF. ALTSHULER: Thank you very much for inviting me. It is an honor to be here today. I keep thinking that there has been some sort of mistake and that I should be in the audience while one of the luminaries on this afternoon's panel gives the keynote speech.

I thought it would be fun to come up with a provocative title for my talk and settled on "Why I'm Guilty of Liking the Global Intangible Tax on Low-Taxed Income (GILTI): The Case for a Minimum Tax on Low-Taxed Foreign Income." I hope to stimulate a conversation on the minimum tax in GILTI that continues throughout the afternoon.

Much of what I am going to say today is based on my work with Harry Grubert from the Office of Tax Analysis of the U.S. Treasury Department, who we unfortunately lost last summer. Harry introduced me to the idea of pairing a dividend-exemption system with a minimum tax. Harry and I did an in-depth paper published in *The National Tax Journal* comparing dividend exemption with a minimum tax to other systems of taxing international income, including the flawed—at least in my view—system that was in place until this year.¹

We came away from our comparison between the prior system and various different alternatives convinced that dividend exemption with a minimum tax would improve the system along many dimensions and dominated the other systems that we considered.²

That was a few years ago. Now, we have a new system that has features similar to what Harry and I proposed and analyzed in our paper. The topic of my talk today essentially revolves around how we came to the conclusion that a territorial-type system—one that exempts some types of foreign-source income from home-country taxation—combined with a worldwide-type system—one with accrual taxation of some other types of foreign income—was a worthy alternative for consideration. Simply put, I want to explain why I like GILTI.

1. See Rosanne Altshuler & Harry Grubert, *Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax*, 66 NAT'L TAX J. 671 (2013).

2. *Id.*

The previous system for taxing the international income of U.S. multinationals was worldwide with a foreign tax credit and deferral.³ As everyone knows, we were the only major country with this type of system in place before the Tax Cuts and Jobs Act, which Congress passed in December 2017 and became effective in January 2018.⁴

There were many problems with the previous system.⁵ One problem was profit shifting and its effect on investment distortions.⁶ The evidence on profit shifting is extensive, and the problem seemed to have been getting worse.⁷ Aggressive tax planning is more than just a revenue concern; aggressive tax planning distorts investment decisions by magnifying the benefits of low-tax locations.⁸

The other problem was the lockout effect, which was attributable to both the actual and the implicit tax costs of repatriation. U.S. companies use various techniques to avoid the repatriation tax such as having the U.S. parent borrow using accumulated financial assets abroad as implicit collateral.⁹ All repatriation-avoidance schemes come at a cost. For example, the case of borrowing that I just mentioned would have a ballooning balance sheet to raise the company's cost of capital. The repatriation tax in the prior system was extremely wasteful and it is well known that there was something like \$2.3 trillion of "trapped" earnings sitting abroad.¹⁰ The repatriation tax may also have induced U.S. companies to acquire foreign companies in part because of the cheap source of locked-out capital that was available.¹¹ In short, the lockout effect was a major problem.

There is also the problem of complexity. Of course, it is an open question whether the new system is more complex than the old one, but the prior system certainly was complex, requiring extensive calculations

3. *Id.* at 675-76.

4. *Id.* at 672.

5. *Id.* at 675.

6. *Id.*

7. See Harry Grubert, *Foreign Taxes and the Growing Share of U.S. Multinational Company Income Abroad: Profits, Note Sales, Are Being Globalized*, 65 NAT'L TAX J. 247, 248 (2012).

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

and adjustments involving foreign tax credits, allocated expenses, and more.¹²

In addition, there were competitiveness concerns with the prior system. While the prior system of credit and deferral provided many advantages to low-tax locations, there may have been cases where the potential repatriation tax and other rules in the U.S. system put some U.S. companies at a disadvantage and could have resulted in an allocation of capital that was inefficient.¹³

Finally, the prior system raised very little revenue, virtually none from dividends.¹⁴

I will now briefly discuss the Tax Cuts and Jobs Act (“The Act”).¹⁵ The Act made major changes to the international tax system.¹⁶ It made enough changes to easily keep us busy for a generation and to keep many of us out of retirement. Right now, there is room for scholarship looking at the early effects of the Act and, when data becomes available, on how firm and government behavior changed in response to the Act.

The Act lowered the corporate tax rate from thirty-five percent to twenty-one percent.¹⁷ That is a big deal and is important for all behavior that is distorted by the corporate tax.

I just taught my undergraduate economics majors about the distortionary effects of taxes. I showed them that the deadweight loss of a tax rises with the square of the tax rate—when you double the tax rate, you quadruple the excess burden.¹⁸ The result, of course, is symmetric.¹⁹ If you cut the tax in half, you lower the excess burden four times.²⁰ Therefore, the deadweight loss of the corporate tax should certainly decrease with this large reduction in the statutory rate.

The new system, much like the previous system, has worldwide and territorial elements.²¹ We now have a 100 percent dividends-received

12. *Id.* at 676.

13. *Id.*

14. *Id.* at 675.

15. *See* Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017).

16. *Id.*

17. *Id.* at 43.

18. Rosanne Altshuler, *The Case for Fundamental Tax Reform*, 2012 KAN. J.L. & PUB. POL’Y 399, 404 (2012).

19. TED GAYER & HARVEY ROSEN, PUBLIC FINANCE 332-333 (McGraw-Hill ed., 10th ed. 2014).

20. *Id.*

21. *See* Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054, 2189 (2017).

deduction for the foreign-source portion of dividends received by a U.S. corporation from their own foreign corporations.²² Credits are not allowed for foreign taxes associated with the dividends eligible for the dividends-received deductions.²³

We have three new provisions with fun names. The first new provision is called GILTI, which is an acronym for Global Intangible Low-Tax Income. Under this new provision, controlled foreign corporation (CFC) income that is formulaically determined to be global intangible low-tax income is taxed on accrual but with a fifty percent deduction.²⁴ This fifty percent deduction is scheduled to be reduced to a 37.5 percent rate after 2025.²⁵ With the deduction, the tax on GILTI income is 10.5 percent initially, and then the tax increases to 13 and 1/8 percent after 2025.²⁶ The new law requires familiarity with fractions.

GILTI is a bit of a misnomer. The income the GILTI provision catches is not necessarily low-tax, and it is not necessarily from intangible assets.²⁷ As I mentioned, a formula is applied to determine what income is taxed currently and what GILTI catches.²⁸ Very loosely speaking, income taxed currently is the excess of a CFC's income over ten percent of its adjusted basis in depreciable tangible property.²⁹ Simply put, corporations can deduct a ten percent return from their active income, and the remainder is currently taxed and considered an excess return, a return to holding intangible assets.³⁰

It is important to note that this is an overall calculation, it is not calculated country by country. The ten percent return and losses are netted across CFCs, and the foreign tax credits of CFCs with losses are lost altogether.³¹ Also, it is crucial to note that firms do not receive full foreign

22. *Id.*

23. *Id.* at 2190.

24. *Id.* at 2213.

25. *Id.* at 2213-14.

26. See H.R. Rep. No. 115-466, at 626-627 (2017).

27. Simcha David, *Innocent Until Proven GILTI—Not Anymore: The New Global Intangible Low Taxed Income Regime*, EISNER AMPER (Nov. 14, 2018) <https://www.eisneramper.com/gilti-income-tax-ami-1118/> [<https://perma.cc/2RFX-F8ZD>].

28. *Id.* at 2214.

29. Paul Sczudlo & Megan Lisa Jones, *Bring it Home*, 41 L.A. LAW. 22, 25 (2018). See also 26 U.S.C.A. § 951A(b)(2)(A) (West 2017).

30. Sczudlo & Jones, *supra* note 29, at 25. See also 26 U.S.C.A. § 951A(b)(2)(A) (West 2017).

31. Deborah Tarwasokono & Jose E. Murillo, *GILTI or Not GILTI?*, 100 PRAC. TAX STRATEGIES 29, 31 (2018).

tax credits on their GILTI income. Only eighty percent of the foreign taxes attributable to GILTI income are allowed and there is no carryover of excess credits.³²

U.S. interest, general and administrative expenses (G&A), and research and development (R&D) expenses are allocable against GILTI income.

If you put it all together, you see that U.S. residual tax is going to be due on your GILTI income if the foreign tax rate is less than 13.125 percent, which will be approximately 16.4 percent after 2025. Therefore, there is no residual U.S. tax if foreign taxes are at least 13 and 1/8 percent. The experts in this room will tell you, however, that—due to expense allocations being retained in the new law—you could have U.S. taxes due on your GILTI income even if your foreign tax exceeds twenty-one percent.

Research is required to determine the extent to which the GILTI provisions will bite. According to the Joint Committee on Taxation, the provision was not a large revenue raiser.³³ It is possible that very few multinationals will pay residual tax on GILTI income. I do not believe we know yet. At this point, it is clear that GILTI is a minimum tax, and that it adds a worldwide feature to our new territorial tax system.

The second new provision is FDII, which stands for Foreign-Derived Intangible Income. FDII is a tax expenditure for foreign-derived intangible income and, like GILTI, is determined formulaically. It may or may not be compatible with World Trade Organization (WTO) rules.³⁴ FDII certainly does look like an export subsidy.

Finally, there is the third new provision, BEAT—the Base Erosion and Anti-Abuse Tax—which is an add-on minimum tax.³⁵ The BEAT applies to U.S. corporations with more than \$500 million of average annual gross receipts and with base-eroding payments related to foreign persons exceeding three percent of total deductions allowed.³⁶ This

32. Barbara Rasch & Joshua Kaplan, *INSIGHT: Fundamentals of Tax Reform: GILTI*, BLOOMBERG BNA (Nov. 16, 2018), <https://www.bna.com/insight-fundamentals-tax-n57982093912/> [<https://perma.cc/86SR-TB69>].

33. Kimberly A. Clausing, *Profit Shifting Before and After the Tax Cuts and Jobs Act 2-3* (Oct. 29, 2018), <https://ssrn.com/abstract=3274827> [<https://perma.cc/UY2J-Q93N>].

34. See Rebecca M. Kysar, *Critiquing (and Repairing) the New International Tax Regime*, 128 YALE L.J. FORUM 339, 350-351 (2018).

35. See Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054, 2226 (2017).

36. *Id.* at 2230.

provision also may not be fully compatible with WTO rules and may have treaty problems.³⁷

I want to focus on the GILTI and talk about minimum taxes that are designed to put a brake on the income-shifting behavior of home-country multinationals. I think non-international tax experts may find the motivation for the minimum tax puzzling and question why it was necessary.

No one likes the idea of a minimum tax. One always likes to think that there are better ways to deal with the problems that the minimum tax is trying to solve. Where did the idea of a minimum tax come from? Why stick a worldwide feature onto a territorial system, and how is it possible that I might like this?

Economists typically use three efficiency criteria to evaluate international tax systems: capital export, capital import, and capital ownership neutralities.³⁸ These concepts, however, do not get us very far in any analysis. The problem is that each standard is based on very special assumptions for which there is very little empirical evidence. An extreme example is a firm that has a locational intangible, such as a fast food trademark that requires that the company produce locally in order to supply its customers. In that case, you would want to ensure that all firms competing in the same location face the same tax rate. You would want to ensure capital import or capital ownership neutrality.

But you can have another extreme: a mobile intangible, such as the design of a computer chip. The chip can be produced anywhere for the worldwide market. In that case, you would want capital export neutrality. It is impossible for us to come up with standards that are going to fit all the cases, and tax policy cannot possibly be calibrated to have different rules for different cases.

What a reform can hope to accomplish is to eliminate the unnecessary waste and the possibility of extremely high or low tax burdens that are not justified under any standard concept. If we are able to get rid of the extremely low or high tax burdens, then we can know we are moving toward an optimum without overshooting it and running the risk of making things worse.

When you do an analysis of tax reform alternatives, what margins should you consider? Harry Grubert and I examined the lockout effect of the repatriation tax, changes in incentives to shift income, distortions of

37. *Id.*

38. *See* Altshuler & Grubert, *supra* note 1, at 674.

investment location incentives, changes in incentives to expatriate, and then a potpourri of other concerns, including revenue complexity and the reaction of foreign governments.³⁹

The question that we pondered—and that the minimum tax is designed to answer—is whether or not we can make improvements in all of these areas or whether the goals are inherently in conflict.⁴⁰ Must eliminating the lockout of foreign earnings exacerbate incentives for income shifting? Can income shifting be limited without an unnecessary burden on productive foreign investment? It turns out that the goals are not inherently in conflict.⁴¹

What reforms did we consider as worthy alternatives to the old system? The baseline was the prior system, the worldwide with credit and deferral, but with a thirty percent rate because there was consensus that the United States needed to lower its rate in response to the dramatic and continuing decline in corporate tax rates abroad.⁴² We considered a decrease in the corporate statutory rate from thirty-five to thirty percent.⁴³

We included the repeal of deferral as one extreme for our analysis.⁴⁴ Under this extreme option, the worldwide system in place would be retained and the deferral privilege for active business income would be repealed.⁴⁵

The other extreme was dividend exemption.⁴⁶ Of course, the devil is in the details. We considered a system with no allocations of parent overhead expenses to exempt foreign income.⁴⁷ We assumed that passive income and other income under Subpart F would continue to be subject to the current tax.⁴⁸ Then we looked at dividend exemption with the Japanese effective tax rate test.⁴⁹ If the effective tax rate is below the threshold, which was fifteen percent in our proposal, the income is currently includable in the U.S. taxable income base and subject to the

39. *See generally id.*

40. *Id.*

41. *Id.* at 676, 678.

42. *Id.* at 676.

43. *Id.* at 672.

44. *Id.* at 708.

45. *Id.* at 676.

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

full corporate rate.⁵⁰ The subsidiary's income "could escape inclusion if it passed an active business income tax test."⁵¹ If it failed the test, it is subject to full taxation. This version of dividend exemption takes away the incentive to shift income to a pure tax haven as exists with check-the-box planning.⁵²

We considered dividend exemption with a per country minimum tax of fifteen percent, with a credit for foreign taxes up to fifteen percent.⁵³ "Dividends both from countries subject to the minimum tax and those above the minimum are fully exempt, including dividends from previously taxed income."⁵⁴

We also considered a per country minimum tax with expensing.⁵⁵ "Expensing" means you get a full immediate deduction for the cost of investment and results in taxation of only what we call "excess" or "supernormal" returns to investment.⁵⁶ This is the same as the treatment of domestic investment under the new tax law, at least for the next five years.⁵⁷ Prior law had expensing for fifty percent of adjusted basis, and it would have phased out in 2020.⁵⁸

Note that, by allowing expensing, firms that are facing the most competition—those that are earning just normal returns—would be competitive in foreign locations under a minimum tax.⁵⁹ U.S. firms would face the same rate as their competitors with headquarters in countries with territorial tax systems and their competitors with headquarters in the foreign location.⁶⁰ Note that the minimum tax with expensing is similar to GILTI.

We also examined dividend exemption with an overall foreign minimum tax.⁶¹ Here, the minimum tax is calculated on an overall basis, instead of country-by-country.⁶² "A company would be subject to a tax of

50. *Id.* at 676, 677.

51. *Id.* at 677.

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.* at 679.

57. 26 U.S.C. § 168(k) (2012).

58. *Id.*

59. See Altshuler & Grubert, *supra* note 1, at 673.

60. *Id.*

61. *Id.* at 677-78.

62. *Id.*

fifteen percent on active foreign income with a credit for the company's overall effective tax rate up to the fifteen percent threshold.⁶³

As with the per country minimum tax, we also examined a variant with expensing. This variant is similar to GILTI. Allowing a deduction of ten percent of adjusted basis is not the same as expensing, but if the normal return happens to be ten percent, you would be taxing only the excess return with GILTI.⁶⁴ I can only guess that this was the idea behind the ten percent of adjusted basis deduction under GILTI. The attempt seems to be to define an excess return, which is the income believed to be easily shifted and base eroding.⁶⁵ The excess return to intangible assets is the villain in the income-shifting story. Our proposal is a much cleaner path to excess returns.

How did we evaluate the reforms? We did a comprehensive analysis of the different options, but today I will focus on our effective tax rate simulations.⁶⁶ The effective tax rate simulations show the impact of the proposals on investment location, income shifting, repatriation planning, repatriation incentives, and revenue.⁶⁷ The simulations illuminate the role of excess returns and income shifting under the different reform alternatives.⁶⁸

Next, I will show you effective tax rates under the different options. The setup is a firm that has existing investments in two foreign countries.⁶⁹ There is a low tax country with a five percent corporate rate, a high tax with a twenty-five percent corporate rate, the United States with the thirty percent rate, and a pure tax haven with no corporate tax rate at all.⁷⁰

Simulation analysis requires researchers to make some simplifying assumptions. Before I discuss the assumptions, let me explain more about the way in which the model is set up.

The multinational has a subsidiary in a low-tax country that is producing a high-tech good using a U.S.-developed intangible asset.⁷¹ We simulate the effective tax rate of that discrete investment. The investment

63. *Id.* at 678.

64. *Id.* at 679.

65. *Id.*

66. *Id.* at 685.

67. *Id.*

68. *Id.*

69. *Id.* at 686.

70. *Id.*

71. *Id.* at 694, 705.

earns an excess return of thirty percent before paying royalties for the parent for its contribution to its intellectual property, and the normal return of investment is ten percent.⁷² These parameter estimates are based on an examination of U.S. tax returns.⁷³ For example, the profit margin on sales earned by Irish subsidiaries after the payment of royalties was three times the average margin of all subsidiaries in the 2000s.⁷⁴

There is also a routine investment in the high-tax location earning the normal return to capital.⁷⁵

We simulate effective tax rates with and without check-the-box. Before check-the-box, you could shift income out of the United States through the underpayment of royalties to the low-tax subsidiary, and you could shift income from the high to the low-tax subsidiary.⁷⁶ Check-the-box gives income shifting a supercharge.⁷⁷ The multinational could shift to the haven from both the high-tax and the low-tax subsidiary.

To examine how effective tax rates change with dividend exemption, we need to know the burden of the repatriation tax that we are removing. Based on analysis of U.S. tax return data, we estimated a repatriation burden of seven percent of income.⁷⁸ We used a rate of five percent in the analysis to be conservative.⁷⁹

To calculate the effective tax rate, you add up all the taxes paid on an investment and divide by the normal return to capital.⁸⁰

The first system we considered was full inclusion.⁸¹ Under this system, the effective tax rate would be thirty percent.⁸²

I think the next results are eye-popping. Remember, we are looking at a discrete, high-tech investment abroad in a low-tax country. Making the investment enables income shifting and, in our model, we shift the tax savings to the investment in the low-tax subsidiary.⁸³ Allowing for check-the-box, we see an effective tax rate of -23.6 percent under the prior

72. *Id.* at 686, 695.

73. *Id.* at 688-89.

74. *Id.* at 678.

75. *Id.* at 690-91.

76. *Id.* at 686.

77. *Id.* at 688.

78. *Id.* at 696.

79. *Id.* at 685.

80. *Id.* at 678.

81. *Id.* at 687.

82. *Id.*

83. *Id.* at 686.

system.⁸⁴ The prior system gave quite a big subsidy to investing abroad.⁸⁵ Check-the-box, as you can see, had a large effect on lowering the rate.⁸⁶

Low tax investment (statutory rate = .05)		
	Before Check-the-box	After Check-the-box
Prior law (with 30% rate)	-.182	-.236

Check-the-box also had an impact on the high-tax investment.⁸⁷ The effective tax rate was twenty-four percent before check-the-box and is thirteen percent after.⁸⁸ Income shifting makes the high-tax investment more attractive.⁸⁹

High tax investment (statutory rate = .25)		
	Before Check-the-box	After Check-the-box
Prior law (with 30% rate)	.242	.130

Dividend exemption removes the repatriation tax and, as a result, makes income shifting more attractive and provides a larger subsidy to investment abroad.⁹⁰

Low tax investment (statutory rate = .05)		
	Before Check-the-box	After Check-the-box
Prior law (with 30% rate)	-.182	-.236
Dividend exemption	-.236	-.295

Finally, we get to minimum tax options that are similar to GILTI. First, you can see that the per country minimum tax with the fifteen percent corporate tax rate raises the effective tax rate closer to the

84. *Id.* at 687.

85. *Id.* at 688.

86. *Id.* at 688-89.

87. *Id.* at 687.

88. *Id.*

89. *Id.* at 688-89.

90. *Id.* at 689.

statutory rate in the low-tax country.⁹¹ In this case, the income will be “taxed at fifteen percent whether it is shifted to the tax haven or not.”⁹² The effective tax rate is closer to the undistorted rate in the low-tax country, but is not as high as fifteen percent since there is still a differential between the fifteen percent and the U.S. rate.⁹³

Low tax investment (statutory rate = .05)		
	Before Check- the-box	After Check- the-box
Prior law (with 30% rate)	-.182	-.236
Dividend exemption	-.236	-.295
Japan minimum tax (15%)		-.236
Per country minimum tax (15%)		.056

As you can see, the per country minimum tax is offsetting the income shifting under pure dividend exemption.⁹⁴ In the high-tax country, the effective tax rate is below the twenty-five percent rate because there is still a tax benefit from using the tax haven, so we end up with an effective tax rate of 12.1 percent.⁹⁵ In the tax haven, the firm is paying fifteen percent compared to twenty-five percent, so there is still an incentive for income shifting.⁹⁶

High tax investment (statutory rate = .25)		
	Before Check- the-box	After Check- the-box
Prior law (with 30% rate)	.242	.130
Dividend exemption	.214	.107
Japan minimum tax (15%)		.214
Per country minimum tax (15%)		.121

Next, I want to look at the per country option with expensing. The expensing alternative exempts the normal investment return from home

91. *Id.* at 687.

92. *Id.* at 690.

93. *Id.* at 687.

94. *Id.*

95. *Id.*

96. *Id.*

country taxation and results in a negative effective tax rate.⁹⁷ Firms that are only earning a normal return are on the same playing field as their competitors from other countries.⁹⁸ From the minimum tax with expensing, we calculate an effective tax rate of -4.4 percent.⁹⁹ Even with expensing, the minimum tax results in a much higher effective tax rate in a low-tax country than under the previous system: -4.4 percent versus -23.3 percent.¹⁰⁰

Low tax investment (statutory rate = .05)		
	Before Check-the-box	After Check-the-box
Prior law (with 30% rate)	-.182	-.236
Dividend exemption	-.236	-.295
Japan minimum tax (15%)		-.236
Per country minimum tax (15%)		.056
with expensing		-.044

High tax investment (statutory rate = .25)		
	Before Check-the-box	After Check-the-box
Prior law (with 30% rate)	.242	.130
Dividend exemption	.214	.107
Japan minimum tax (15%)		.214
Per country minimum tax (15%)		.121
with expensing		.121

With the overall minimum tax, if the parent is above the threshold, it owes no minimum tax and we are back to dividend exemption.¹⁰¹ If the parent is below the threshold, then all additional income is taxed at fifteen percent, so there is no longer any incentive to shift foreign income to the haven or from the high-tax country to the low-tax.¹⁰²

With the overall minimum tax, the effective tax rate goes up a small amount because there is no shifting from the high-tax to the low-tax

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.* at 690.

102. *Id.* at 682.

operation.¹⁰³ The overall minimum tax generates effective tax rates that are much closer to the undistorted country rate than under the previous system.¹⁰⁴

Low tax investment (statutory rate = .05)		
	Before Check- the-box	After Check- the-box
Prior law (with 30% rate)	-.182	-.236
Dividend exemption	-.236	-.295
Per country minimum tax (15%)		.056
Overall minimum tax for parent with ETR<15%		.060

High tax investment (statutory rate = .25)		
	Before Check- the-box	After Check- the-box
Prior law (with 30% rate)	.242	.130
Dividend exemption	.214	.107
Per country minimum tax (15%)		.121
Overall minimum tax for parent with ETR<15%		.150

We also examined the overall minimum tax with expensing. Of course, expensing is going to lower effective tax rates.¹⁰⁵ Because you are below the threshold for the high-tax investment, the effective tax rate is going to be zero with expensing.¹⁰⁶

Low tax investment (statutory rate = .05)		
	Before Check- the-box	After Check- the-box
Prior law (with 30% rate)	-.182	-.236
Dividend exemption	-.236	-.295
Per country minimum tax (15%)		.056
with expensing		-.044

103. *Id.* at 690.

104. *Id.* at 691.

105. *Id.* at 679.

106. *Id.* at 691.

Overall minimum tax for parent with ETR<15%		.060
Overall minimum tax for parent with ETR<15% with expensing		-.040

High tax investment (statutory rate = .25)		
	Before Check-the-box	After Check-the-box
Prior law (with 30% rate)	.242	.130
Dividend exemption	.214	.107
Per country minimum tax (15%)		.121
Overall minimum tax for parent with ETR<15%		.150
Overall minimum tax for parent with ETR<15% with expensing		.000

I think these simulated effective tax rates are extremely informative. I would like to subject GILTI to this analysis.

With GILTI, there are many extra provisions that must be modeled. There is the eighty percent foreign tax credit, no carry-forwards, and no carry-backs of foreign tax credits.¹⁰⁷ There is the lower corporate tax rate, which I think is important, and there is no expensing.¹⁰⁸ In addition, there is the exemption for the ten percent return.¹⁰⁹

We did ask whether or not the overall minimum tax would be successful at targeting low-tax income. We look at the distribution of effective tax rates on new investment for a CFC, and we divide it into effective tax rate categories.¹¹⁰ If you look at the zero to ten percent category, you see that forty-five percent of total earnings and profits was in CFCs with effective tax rates of less than ten percent.¹¹¹

107. 26 U.S.C. § 904 (LexisNexis, Lexis Advance through PL 115-442, approved 01/14/19).

108. Dylan Matthews, *The Best Economic Case for the GOP's New Tax Plan*, VOX (Sep. 29, 2017), <https://www.vox.com/policy-and-politics/2017/9/29/16375160/gop-tax-plan-ryan-corporate-cut-full-expensing> [<https://perma.cc/8PTS-X7ZB>].

109. 26 U.S.C. § 904 (2012) (LexisNexis, Lexis Advance through PL 115-442, approved 01/14/19).

110. See generally Altshuler & Grubert, *supra* note 1.

111. *Id.* at 698-700.

The overall minimum tax would successfully target low-tax income. Under the overall minimum tax, only 16.5 percent of the total earnings and profits were held in CFCs with effective tax rates of less than ten percent.¹¹² The per country minimum tax reduces that percentage even more.¹¹³

Distributions of ETRs on New Investment			
ETR category	Percentage of total income		
	Prior law	Overall minimum tax at 15%	Per country minimum tax at 10%
0 to <5%	36.8	12.6	
5% to <10%	9.1	3.9	
10%	0.4	0.3	42.3
Greater than 10% to < 15%	7.4	5.3	11.0
15%	0.3	37.1	0.3
Greater than 15% to < 20%	8.6	7.5	8.1
20% to < 25%	6.9	6.1	7.4
25% to < 30%	6.5	5.7	6.8
30% and above	24.0	21.5	24.2

We conclude that overall minimum tax does target companies that have the greatest opportunities for income shifting.¹¹⁴ One of the things that we know based on tax return data is that multinationals that are R&D intensive and earning high worldwide profit margins have the low effective tax rates, so the overall minimum tax is hitting the right firms.¹¹⁵

Formulas are not the answer to the income shifting problem. I think the answer is something such as GILTI. We now have to work on figuring out what design elements need to be changed and how to change them.

To wrap up, I am guilty of liking GILTI. Better put, I am guilty of liking the idea of pairing a minimum tax with a territorial tax system. The idea of GILTI in the first place was to strike a balance between income-

112. *Id.* at 699.

113. *Id.* at 700.

114. *Id.* at 708-09.

115. *Id.* at 700.

shifting concerns and competitiveness concerns, and—because I think both of them are important—I am guilty of liking it.

Details do matter. The impact of GILTI depends on the facts of each multinational. That was true under the prior system, but it is true with a vengeance in the new system.

What design elements of the GILTI do I think need to be reconsidered? I think we need to think about everything. Why not have expensing? Why keep the expensing allocations? Why a fifty percent deduction? While there are a lot of design elements to study, I think that the minimum tax with and without expensing has important advantages over the prior system.

It turns out that we can make progress in several directions with the minimum tax relative to the extremes of the pure worldwide and pure territorial. You end the lockout effect, you improve the efficiency of investment location decisions with no loss of competitiveness. You reduce income shifting and tax planning, and you increase revenue.

So, I am guilty of liking GILTI! I hope you found that informative.

MR. PHILLIPSON: Thank you, Professor Altshuler. With that, we will take a short break and then we will hear from the first panel.

PANEL I

PROF. KYSAR: First, I want to thank everyone for coming and to the students and advisors to the *Corporate Journal* for allowing me to host this symposium. The *Journal* has a tradition of bringing together practitioners, legal academics, policymakers, economists, and present and former government officials for this conference, and I think that format is well suited to the subject matter because the subject demands a mixture of viewpoints. I think it is a very good fit, and I am happy to have a forum to focus specifically on the international provisions of the new bill. I think they deserve their own forum given their depth.

The international provisions, although they were described as reducing base erosion and profit shifting, actually lose revenues going forward.¹¹⁶ According to the Congressional Budget Office (CBO), eighty percent of profit shifting is going to be maintained—but even this estimate might prove optimistic because the CBO does not take into account, for instance, investor reactions to the instability of the Foreign-Derived Intangible Income (FDII) regime due to potential World Trade Organization (WTO) challenges, investor reactions to the political instability of the legislation in general, and the potential for tax competition for other countries.¹¹⁷

Now, it may be in the United States' interest to tolerate some profit shifting—as I think Dan is going to discuss—but, it is probably unlikely that we have settled on the right amount. Indeed, recently reported tax rates following enactment of the bill—such as AbbVie's rate of nine percent down from twenty-two percent—confirm that many profit-shifting opportunities may exist.¹¹⁸

The 2018 balance of payments data suggests that firms have not lost their desire to book profits abroad in low-tax jurisdictions.¹¹⁹ Bloomberg recently interviewed tax lawyers who were advising the big

116. Rebecca M. Kysar, *Will Tax Treaties and WTO Rules "Beat" the BEAT?*, 10 COLUM. J. TAX L. 140, 146 (2018).

117. *Id.* at 145.

118. Michael Erman & Tom Bergin, *How U.S. Tax Reform Rewards Companies that Shift Profit to Tax*, THOMSON REUTERS (June 18, 2018, 7:08 AM), <https://ca.reuters.com/article/businessNews/idCAKBN1JE12Q-OCABS> [<https://perma.cc/D9V6-G8J2>].

119. Laura Davidson, *Trump's Tax Law Failed to Kill Off Corporate America's Prized Dodge*, BLOOMBERG (Oct. 15, 2018), <https://www.bloomberg.com/news/articles/2018-10-15/trump-tax-law-fails-to-kill-off-corporate-america-s-prized-dodge> [<https://perma.cc/BV7B-J8YS>].

multinationals.¹²⁰ The lawyers all said that the law has not removed incentives to shift profits abroad and that their clients are proceeding with business as usual and that the new law causes them only to “tweak around the edges” of planning.¹²¹

The U.S. Commerce Department’s Bureau of Economic Analysis has concurred, saying that there is reason to believe that the incentives for profit shifting are still there.¹²²

What about the fact that they have all these trapped earnings overseas, and now companies have deemed repatriation and can use them to fund domestic activities? Well, there is more bad news here. The effects of the repatriation may be small, according to CBO.¹²³ In fact, the data that has come in suggests that the repatriations are only trickling in.¹²⁴

The further irony is that, by pursuing dramatic corporate rate reduction and not raising more revenues in the international provisions, we have created massive deficits.¹²⁵ These deficits are going to contribute to political instability with regard to the legislation, which, in turn, makes companies even less willing to invest here.¹²⁶

All of this suggests that the reforms are a token effort at reforming the taxation of our multinationals and that real reform would have been more ambitious about tackling these problems.¹²⁷ So, perhaps we were doing this to appease our trading partners who were up in arms over the low rate our high-profit multinationals face.

Pause here to think about the price that we paid for this progress—that the need for international tax reform was the tail wagging the dog. But, by shrinking revenues over the next decade, we have left the country with fewer resources.¹²⁸ By so doing, rather than achieving real reform of

120. *Id.*

121. *Id.*

122. Derrick Jenniges et al., *Strategic Movement of Intellectual Property Within U.S. Multinational Enterprises*, CENSUS BUREAU ECON. ANALYSIS 1, 2 (Oct. 2018), https://www.bea.gov/index.php/system/files/papers/WP2018-8_0.pdf [<https://perma.cc/JK9K-4Y8N>].

123. Rebecca Kysar, *Unraveling the Tax Treaty* 23 (Jan. 29, 2019) (unpublished manuscript) (on file with the author); *See also* CONGRESSIONAL BUDGET OFFICE, *THE BUDGET AND ECONOMIC OUTLOOK: 2018 TO 2028* (Apr. 2018), <https://www.cbo.gov/system/files/2019-04/53651-outlook-2.pdf> [<https://perma.cc/58E4-WC7D>].

124. *See* Kysar, *supra* note 123, at 23.

125. *Id.* at 36.

126. *Id.* at 34.

127. *Id.* at 55-56.

128. *Id.* at 54.

business taxation, we have created instead incentives like the pass-through deduction, which was aimed at creating parity with the lower rate available on corporate income but allows for distortive tax planning.¹²⁹ In turn, the lower corporate rate was the *quid pro quo* for all of the purported base erosion and profit-shifting protection.¹³⁰

I think it is fair, then, to ask a lot of the international tax regime; yet, the provisions, I think in many respects, are falling short. So, perhaps we could see this as a missed opportunity. If, on the other hand, you have an optimistic view of the legislative process, then further reforms can be made. Perhaps this Act could be viewed as a bridge to true reform.

Should we be optimistic about the ability to make improvements here? I think, on a fundamental level, I would argue that even if Congress is able to break through to enact bipartisan legislation in this area, we are stymied by the web of thousands of international agreements that comprise the international tax system.

Tax treaties, which I am going to talk about for the remainder of my time, are interesting creatures. They have essentially remained fairly fixed over the past 100 or so years.¹³¹ Since the 1920s, our treaties have retained the same basic structure wherein the source country, where the income arises, cedes substantial jurisdiction to the residence countries where the taxpayer resides.¹³² The world has changed a lot since the 1920s, to say the least. We have had a massive growth in capital flows. The global economy and multinational corporations have arisen, and, more recently, the digital economy has been created.¹³³

So, even with the modest reforms that we have enacted, we are seeing the many ways in which the new law interfaces poorly with the tax treaty system, particularly the jurisdictional provisions of the treaties.¹³⁴ The Base Erosion and Anti-Abuse Tax (BEAT) may violate nondiscrimination provisions, such as the requirement to offer double tax relief, for instance—I will go into that if people want to talk about it, but I may be more skeptical of those arguments than David or Fadi might be.

Essentially, if we are thinking about strengthening source-based taxation, we are doing so with these treaties still in place. That is affecting

129. *Id.* at 15, 18.

130. *Id.* at 48.

131. *Id.* at 27.

132. *Id.* at 5.

133. *Id.* at 2, 5.

134. *Id.* at 9.

our reforms in this area. For instance, the more ambitious excise tax originally proposed by the House would have left room for much less circumvention.¹³⁵ This is partly because—unlike the BEAT, which exempts costs of goods sold, including embedded royalties—the House excise tax applied to costs of goods sold.¹³⁶ Unfortunately, because it applied to costs of goods sold, it likely would have violated the arm’s-length principle of the treaties.

Prior to the Tax Cuts and Jobs Act, the proposed destination-based cash flow tax was also heavily criticized for it being incompatible with the treaties.¹³⁷ For instance, it was said that the tax would have violated the permanent establishment requirement in treaties, which requires that there be physical presence in order for the source country to assert jurisdiction over a business income, and this is because the destination-based cash flow tax (DBCFT) would have taxed goods where they were sold versus where income was originating.¹³⁸ The idea behind the DBCFT was that taxing based on destination is less gameable than taxing where value is created.¹³⁹ So the very feature that made the DBCFT desirable is the same trait that made it incompatible with the treaties—taxing at destination versus origin.

This problem is not particular to the United States. Currently, European countries are exploring ways to tax digital services.¹⁴⁰ Just recently, the EU Council Legal Service issued an opinion asserting that the digital services tax is not an indirect tax, which makes it harder to contend that tax treaties are not in conflict with it.¹⁴¹ The digital service tax—although it is, in my view, fundamentally flawed because it focuses

135. *Id.* at 42.

136. Lisa Mascaro & Jim Puzanghera, *Complicated Foreign Excise Tax for U.S. Could Pose Problems for House Republican Tax Bill*, L.A. TIMES (Nov. 6, 2017), <https://www.latimes.com/business/la-na-pol-gop-tax-border-20171106-story.html> [<https://perma.cc/BK7N-4F86>].

137. Kysar, *supra* note 123, at 39.

138. Alan J. Auerbach, *Demystifying the Destination-Based Cash-Flow Tax*, 409 BROOKINGS PAPERS ECON. ACTIVITY 418 (Fall 2017).

139. Steve Lohr, *New Approach to Corporate Tax Law Has House G.O.P. Support*, N.Y. TIMES (Dec. 12, 2016), https://www.nytimes.com/2016/12/12/business/economy/new-approach-to-corporate-tax-reform.html?_r=0 [<https://perma.cc/9AYL-8FBJ>].

140. Daniel Bunn, *A Summary of Criticisms of the EU Digital Tax*, TAX FOUNDATION, FISCAL FACT NO. 618 (Oct. 2018).

141. Orbitax: The Tax Hub, *EU Council Legal Service Finds Legal Basis Issues with Proposed Digital Services Tax*, <https://www.orbitax.com/news/archive.php/EU-Council-Legal-Service-Finds-33815> [<https://perma.cc/N4CS-PWTZ>] (last visited Mar. 20, 2019).

only on digital companies—is also likely to suffer from design problems because its proponents have attempted to enact it within the treaty-based context of a permanent establishment, stretching that concept to the point of disbelief, and also justifying it by using notoriously vague concepts of value creation which also set no reliable architecture for the new tax.¹⁴² The common theme here is that countries are looking at ways to tax at destination or to strengthen their inbound taxation, but this is antithetical to the fundamental deal cut in our tax agreements and, as a result, I think the proposals have suffered.

In short, reform would have looked different without these agreements in place, and until we rethink the treaty system, I think we are perhaps likely to only obtain meek reform. So, rather than critiquing all these new taxes for violating the treaties and trying to shape them to conform to the treaty system, I argue that it is the tax treaties we should critique for not being able to accommodate fundamental reform.¹⁴³ This critique is made even worse because tax treaties, I think, do not fulfill their stated purposes.

The conventional account is that tax treaties are there to alleviate double taxation.¹⁴⁴ Without tax treaties, multiple countries would tax the same amount of income, yet, unilateral methods of alleviating double taxation exist.¹⁴⁵ Foreign tax credits and exemption systems mean that the resident's country is foregoing tax on at least a portion of foreign-source income (FSI).¹⁴⁶ Moreover, tax treaties by and large do not resolve problems of double taxation that are left open by the domestic statute.¹⁴⁷

We see here that, with regard to different kinds of double taxation, jurisdictional provisions of the treaties do little work. Essentially, the tax treaties are solving problems that are already solved by the domestic statute and are not solving problems that are not solved by the domestic statute.

142. Michael Devereux, *The Digital Services 'Sutton' Tax*, OXFORD U. CTR. BUS. TAX'N, http://business-taxation.sbsblogs.co.uk/2018/10/23/the-digital-services-sutton-tax/?dm_i=17AR,5XL76,ELTIXU,N8496,1 [https://perma.cc/6TXW-WX2S] (last visited May 15, 2019).

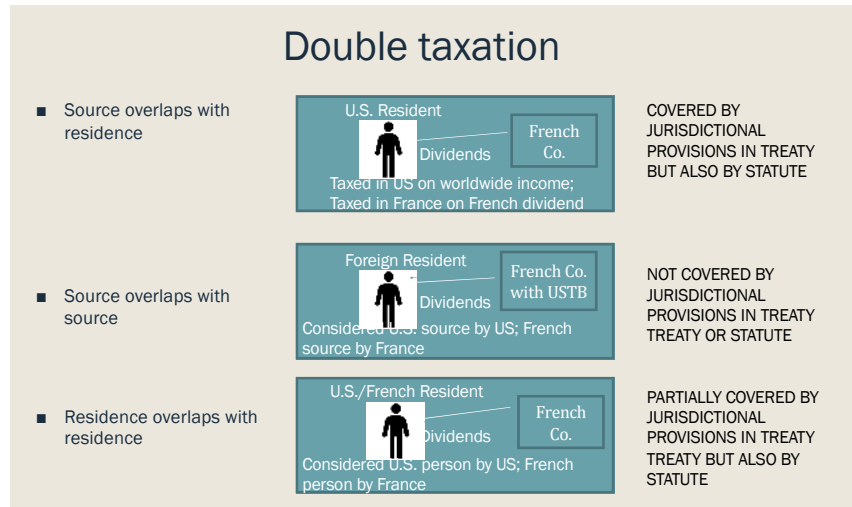
143. Kysar, *supra* note 123, at 2.

144. *Id.* at 10.

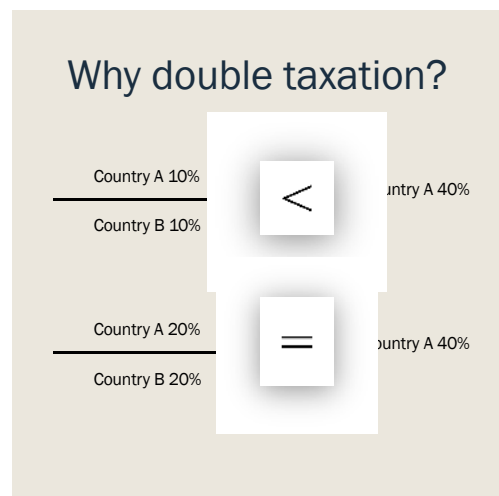
145. *Id.*

146. *Id.*

147. *Id.* at 12.



Even if we assume tax treaties solve problems of double taxation, is this something for which we should strive? Dan has written that this is a fairly arbitrary marker.¹⁴⁸ Investors care about the total level of taxation. They could be paying less tax if they were paying *Country A* and *Country B* at ten percent on the same item of income than if they paid forty percent to *Country A*. Economists aim for creating neutrality between investment decisions, but double taxation may create the means to do so if taxpayers face, for instance, twenty percent in *Country A* on cross-border income versus forty percent in *Country B* on their domestic income.



148. Daniel Shaviro, *The Crossroads Versus the Seesaw: Getting a 'Fix' on Recent International Tax Policy Developments* 45 (N.Y.U. Law & Econ. Working Paper No. 408, 2015).

Theoretically, if you have identical tax systems and identical investment flows, then there should be economic surplus resulting from establishing neutrality between single-country and cross-country income through the bilateral agreements. But, countries do not have identical tax systems, and they do not have identical investment flows.

Additionally, the original bargain was for the source country to relinquish jurisdiction so the residence country could tax the income, but the residence country is not taxing the income for the most part, in part because it needs to attract corporations.¹⁴⁹

Instead of alleviating double non-taxation, which is a new purpose of tax treaties under base erosion and profit shifting (BEPS),¹⁵⁰ tax treaties contribute to it.

Troublingly, there are no formal economic or revenue estimates of tax treaties. This may not have been much of a concern to the United States in the early years of the treaties when the United States was a net capital exporter.¹⁵¹ Since the 1970s, however, the United States has become a net capital importer,¹⁵² meaning it may lose revenues under the treaties because its revenues lost as a source country are not offset by the revenues it gains as a residence country.

We should consider two offsetting considerations when we think about revenues under the tax treaty. First, the treaty country gets increased residual taxation sitting as the residence country. Secondly, however, the source country gets reduced source taxation. If you are a capital-importing nation, you are generally losing revenues; if you are a capital-exporting nation, you are generally gaining revenues.

I am in the process of trying to shed some light on this question by examining data from the Bureau of Economic Analysis and the U.S. Department of Treasury.¹⁵³ Of sixty-four out of sixty-six treaty countries, thirty-seven countries had more holdings by that country's residence of U.S. securities than U.S. holdings of those countries' securities; so, in

149. See *id.* at 10 (discussing theoretical reasons why a residence country lightly taxes foreign source income).

150. See, e.g., Hugh J. Ault, Wolfgang Schon & Stephen E. Shay, *Base Erosion and Profit Shifting: A Roadmap for Reform*, 68 BULL. INT'L TAX'N 275 (2014).

151. H. David Rosenbloom, *Toward a New Tax Treaty Policy for a New Decade*, 9 AM. J. TAX POL. 77, 83-84 (1991).

152. Ault et al., *supra* note 150.

153. See generally TREASURY DEP'T: FOREIGN HOLDINGS OF U.S. SECURITIES (2018), <http://ticdata.treasury.gov/Publish/shlhistdat.html> [<https://perma.cc/XYH5-VYMP>] (last visited Mar. 20, 2019).

total, the amount of inflows among these treaty countries exceeded outflows by \$4.5 trillion last year.¹⁵⁴

Data analysis

- 2017 BEA Bilateral Balance of Payments
 - Of 17 treaty countries, U.S. was net borrower with 12, amounting to net borrowing of \$166B
 - Remaining 5 produced net lending of \$47.79B
- 2017 Treasury Annual Survey
 - Of 64 treaty countries, 37 had inflows greater than outflows
 - Inflows exceeded outflows by \$4.54T

So, it seems like we may be in danger of losing revenues under the treaties. This highlights what I think is a major danger of tax treaties: they become so entrenched and, yet, economic flows can reverse rather quickly and dramatically to the point where the treaties no longer are in the national interest.

One way to pare down the treaties is to get rid of these jurisdictional provisions that allocate taxing jurisdiction in a way that preserves double nontaxation and prevents true reform of our inbound system. Specifically, I propose in a forthcoming paper that we could use the multilateral instrument to scale down those provisions or allow nations to opt out of them while still maintaining other treaty provisions, such as nondiscrimination and dispute resolution.¹⁵⁵ Essentially, the idea is that this could lead to a more heterogeneous international tax system that reflects the diversity of countries, their tax laws, and their investment flows.

Leveraging the multilateral instrument in this manner would be essentially a deliberate and ordered unraveling of the tax treaties, which may make some of us uncomfortable, but I suggest that we should not panic here. If we do not intentionally unwind the treaties, I think nations

154. *See id.*

155. *See Kysar, supra* note 123, at 1.

are going to start simply turning to self-help circumventions of the treaties as we are already starting to see. Yet, those self-help circumventions are going to be less effective because they are influenced by the treaty structure, resulting in uncertainty without good tax design.

Thank you.

PROF. SHAVIRO: One thing I liked about the international tax provisions in the 2017 Act was that they may have helped put to rest a way of thinking about the issues that I have been saying for a long time is misconceived. There is all this talk about worldwide and territorial systems—which should we have?

Virtually no country has a full version of either. I do not know of any pure worldwide systems with no current taxation of foreign subs' income. So-called territorial systems generally have controlled foreign corporation (CFC) rules that tax some foreign-source income.¹⁵⁶ So, we really have neither type of system in anything like their pure forms.

People in the United States were debating whether we should go to a territorial system; there was a lot of rhetoric about that.¹⁵⁷ Then, you get a Republican Congress unilaterally making new tax policy, and that is friendly with business interests, so you might think this is when it is actually going to happen. But then the dog caught the bus. Once Congress actually had to pass a statute that would take effect, the Republicans decided immediately that a territorial system was not what they wanted, because they were worried about things like profit shifting.¹⁵⁸

This was not just something that happened in midstream, such as changing the corporate rate in the legislation from twenty to twenty-one percent.¹⁵⁹ To the contrary, the very first statements of principles made it clear that they had—well, as you read the Act, it is not clear exactly what they had in mind—but you could see, *ex post*, they had in mind the provisions they actually ended up enacting. They were never going to go to a pure territorial system, because it would not have satisfied their

156. Thornton Matheson, Victoria Perry & Chandara Veung, *Territorial vs. Worldwide Corporate Taxation: Implications for Developing Countries* 9 (IMF Working Paper, WP/13/205, 2013).

157. See, e.g., Kyle Pomerleau & Kari Jahnsen, *Designing a Territorial Tax System: A Review of OECD Systems* (Aug. 1, 2017).

158. This helps explain, for example, the enactment of GILTI and the BEAT.

159. See, e.g., Alexander Bolton & Scott Wong, *GOP Eyes Raising Corporate Rate to [Twenty-One] Percent, Lowering Top Individual Tax Rate*, THE HILL (Dec. 12, 2017, 3:46 PM), <https://thehill.com/homenews/senate/364510-gop-eyes-raising-corporate-rate-to-21-percent-lowering-top-individual-tax> [<https://perma.cc/6HTG-Y73N>].

aims.¹⁶⁰ Even in earlier years, when the Republican Ways and Means Chair Dave Camp proposed a “territorial” system, it was not truly territorial.¹⁶¹

Repealing deferral—which, of course, pure worldwide and pure territorial people both dislike—does not amount to going territorial.¹⁶² What the United States did was replace now-or-later taxation of foreign source income with now-or-never taxation.¹⁶³ But, they significantly expanded the “now” category by adding things like Global Intangible Low-Tax Income (GILTI).¹⁶⁴

Without endorsing or condemning what Congress did in the international tax frame, I think it does help to show that a lot of this talk about worldwide versus territorial taxation was simply missing the issues that countries care about. I have been beating this drum for a while, and I have said that worldwide and territorial are a bad way analytically to think about international tax systems. One reason is that they differ at two margins, not one. It is not like: “should we have ice cream or should we not have ice cream?” or similarly, “should we tax the normal return to capital like an income tax does or should we not do it like a pure consumption tax does?” Instead, the two types of international tax systems differ at two margins. The first is the tax rate for foreign-source income. In a pure worldwide system, it is the same as the tax rate for domestic-source income, while, in a pure territorial system, it is zero.¹⁶⁵

Then, they differ at a second margin—what I call the “marginal reimbursement rate” for foreign taxes. In a pure worldwide system, the marginal reimbursement rate is 100 percent.¹⁶⁶ You get a foreign tax credit that fully offsets your foreign tax liability and makes the net after

160. *Id.*

161. PWC, WNTS INSIGHT: WAYS AND MEANS CHAIRMAN CAMP RELEASES DISCUSSION DRAFT FOR CORPORATE RATE REDUCTION, TERRITORIAL TAX SYSTEM 1 (Nov. 1, 2011).

162. Deferral means “we will tax you now under the CFC rules of Subpart F or else we will tax you when you have dividends.”

163. See Daniel N. Shaviro, *The New Non-Territorial U.S. International Tax System*, TAX NOTES (Jul. 17, 2018).

164. See generally Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054, 2208 (2017).

165. See Kysar, *supra* note 123, at 18.

166. *Id.*

domestic tax cost to you zero. By contrast, in a pure territorial system, foreign taxes are ignored.¹⁶⁷

In earlier work, I have pointed out that this makes territoriality a pure deductibility system for foreign taxes.¹⁶⁸ That is a system in which the marginal tax rate for foreign-source income and the marginal reimbursement rate for foreign taxes are the same, which is exactly what you get from a deduction.¹⁶⁹ It causes the taxpayer to try to maximize after-foreign tax income rather than pre-foreign tax income.¹⁷⁰

If you take a territorial system in which you think you are just ignoring foreign taxes rather than deducting them, and convert it to a tax system with a 0.00001 percent rate in which foreign taxes are expressly deductible, you would see the two are rather similar. That can help persuade you, I hope, that territoriality is an implicit deductibility system for foreign taxes.¹⁷¹

I do not think it is a good analysis to have two different margins that you should think about in two different ways, and conflate them together. The literature does not clearly distinguish between these two margins sometimes.¹⁷² I think it is better for clear thinking to have the two things distinguished, though I am not urging a particular policy conclusion.

So, why would you have these two frames? Why would you only consider polar alternatives at each of the two margins? Why does the tax rate on foreign-source income have to be either zero percent or the same as the domestic rate? Can it be in between—which, of course, as Rosanne pointed out, GILTI does?¹⁷³ How about the treatment of foreign taxes? Could they be treated as better than deductible but worse than fully creditable? Why do you only have polar alternatives? Why would you have an arbitrary linkage between the two approaches?

People have done some very good work in which they looked at different countries' tax systems. For example, it was a very nice job by Altshuler, Toder, and Shay, two of whom are in the room today, in which they look at differences, and they say: "Everyone's a hybrid. No one is

167. *Id.*

168. *See* Shaviro, *supra* note 148, at 9.

169. *Id.*

170. *Id.*

171. *Id.* at 8.

172. *Id.* at 48.

173. *See supra* Keynote Address, at 238-39.

pure worldwide, and no one's pure territorial."¹⁷⁴ This is a good point—but, of course, if everything is a hybrid, the term does not tell you very much. It is not a very descriptive term if it fits all systems. Also, it does not tell you why the United States would have changed from one hybrid system to another hybrid system. The motivation for that obviously lay outside the standard framework.

The worldwide-versus-territorial framework also fails to illuminate margins about which countries actually seem to care. I think the 2017 Tax Act, regardless of whether one endorses it or not—and I do agree with Rosanne that it is a potential improvement or could be turned into an improvement and maybe already is—is a nice marker of the concerns that countries actually do appear to have.

Here is an important question that many countries care about: how should effective tax rates for multinationals compare to those of purely domestic companies? The pizza parlor at the corner is not going to move to Paris or to the Bahamas, but, by contrast, multinationals are more mobile.

It is quite clear that, rightly or wrongly, countries often are motivated to try to tax multinationals at a lower effective rate than domestic companies.¹⁷⁵ The way to do it, without admitting to it and having explicit ring-fencing, is to allow them to do some profit shifting. You decide that you are happy with them doing some of it. This is an important reason why countries traditionally have tolerated some profit shifting—because they thought they had something to gain from making inbound investment more attractive to multinationals than it would be if the effective rate equaled the full domestic rate. I am not arguing here whether that is right or wrong, but I suspect it might be right. It seems very clear that countries often have thought that way.

The OECD-BEPS process presumably reflected that countries had started to think, “Hey, you are doing too much profit-shifting now,” and that helps show the other side of it. Even if you want to give multinationals a little bit of a break, that does not mean you want them to go “too far” in avoiding your income taxes.

174. Rosanne Altshuler, Stephen Shay, & Eric Toder, *Lessons the United States Can Learn from Other Countries' Territorial Systems for Taxing Income of Multinational Corporations*, TAX POL'Y CTR.—URB. INST. & BROOKINGS INST. 1 (Jan. 15, 2015), <https://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000077-lessons-the-us-can-learn-from-other-countries.pdf> [<https://perma.cc/S9VM-F2HS>].

175. Jennifer Blouin, *Taxation of Multinationals Corporations*, 6 FOUND. & TRENDS ACCT. 1, 4 (2012).

There are many reasons for taxing multinationals at a positive rate, and perhaps even a significant one: they may be earning rents that you can capture, you are worried about domestic companies being taxed at a lower rate than multinationals which creates various problems like tax reasons for mergers with foreign companies, or you are worried about resident individuals' labor income. For example, how are you going to tax Steve Jobs when he is getting one dollar a year of salary from Apple? When he was alive, the answer was that you tax Apple. Since he is a shareholder with stock and options, that is how you tax Steve Jobs, via Apple. Of course, we were not doing that much, and Apple was moving most of its profits abroad.¹⁷⁶

So, you may want to tax foreign-source income at between zero and the full domestic rate, and you may also want to over-measure multinationals' domestic-source income because you think they are understating it through profit-shifting, and even if you like some shifting, you may think they are doing too much.

Again, this does not mean that GILTI and BEAT are good, but they clearly are responding to this type of concern. They create a foreign tax rate on foreign-source income for domestic companies that is in between the domestic rate and zero.¹⁷⁷ Also, through the BEAT, you effectively over-measure companies' domestic-source income, by assuming that the correct transfer price is zero.¹⁷⁸ You are only doing this under the BEAT, which has a ten percent rate, but that is in response, I presume, to the belief that, through transfer pricing, they are excessively lowering their regular income tax liabilities.

Here is a second question countries care about, and are right to care about: taxing resident versus foreign multinationals. As soon as you have CFC rules, you are treating your resident companies worse than foreign companies—at least in this respect—because the latter are not subject to

176. Daisuke Wakabayashi & Brian X. Chen, *Apple, Capitalizing on New Tax Law, Plans to Bring Billions in Cash Back to U.S.*, N.Y. TIMES (Jan. 17, 2018) <https://www.nytimes.com/2018/01/17/technology/apple-tax-bill-repatriate-cash.html> [<https://perma.cc/PF8M-62VB>].

177. Gary Clyde Hufbauer & Zhiyao Lu, *Corporate Tax Reform Favors Domestic Production, Not U.S. Multinationals*, PETERSON INST. FOR INT'L ECON. (Jan. 12, 2018), <https://piie.com/blogs/realtime-economic-issues-watch/corporate-tax-reform-favors-domestic-production-not-us> [<https://perma.cc/5ZMS-C9XK>].

178. The BEAT wholly disallows deductions for certain payments made to foreign affiliates of the U.S. taxpayers, which is equivalent to assuming here that the correct transfer price was zero.

CFC rules, as they cannot be taxed, at least explicitly, on their foreign subsidiaries' foreign-source income.¹⁷⁹ Very often, the reason for CFC rules is that you are concerned about profit shifting.

If you have CFC rules, you have decided in that respect to treat resident multinationals worse than foreign multinationals. Why would you do that? Suppose that the two types of companies are not systematically different. If they are, then you might have further reasons for doing it. You might think, for example, that the resident ones are the ones that are really earning income at home because they are in Silicon Valley and so forth. But, you may want to treat the resident companies worse, even if they are not systematically different from the foreign companies, on the ground that CFC rules give you the ability to identify and tax what you deem to be “bad” foreign-source income. Both conventional CFC rules and GILTI make use of this arguably more refined tool.

You may think that some types of foreign-source income are more indicative of undesired profit shifting than other types. For example, with stuff that shows up in the Cayman Islands, you may be suspicious that it has been shifted excessively out of the domestic tax base than, say, if someone has a car factory in Germany. The availability of a more refined tool may alone cause you to tax the resident multinationals more than foreign multinationals, even if you have no direct desire to do so. You might wish you could use it for them all, but since you cannot, at least you may use it for the ones you can, resulting in a tradeoff. You are using this better tool to accomplish what you want toward these companies, but you are also disfavoring them against foreign multinationals, which you may not want to do.

I think it is clear—and I have argued this in print—that the United States, pre-2017 Act, whether we did too much or too little to fight profit shifting overall, was concentrating the effort too much on resident versus foreign multinationals.¹⁸⁰ The reason is that we were relying on our CFC rules, whereas countries like Germany and the United Kingdom, as I understand it, had tougher rules on earnings stripping, which can potentially hit all the multinationals more equally.¹⁸¹

179. The foreign source income of a foreign company's foreign subsidiaries is subject neither to residence-based nor source-based domestic tax jurisdiction.

180. See Shaviro, *supra* note 148.

181. *Id.* at 15.

Obviously, the BEAT is an attempt to address that. It applies to foreign as well as domestic multinationals, unlike GILTI. Again, not to say it is a good or bad rule, but it was addressing a real concern.

A third point that countries care about is specifically defining bad FSI, perhaps in cases where it seems indicative of profit shifting that is beyond the amount that you want the companies to do. This is something that comes out of papers such as Altshuler, Toder, and Shay.¹⁸² They, and several other papers, as well as a Joint Committee on Taxation (JCT) study, found the same thing: before GILTI, there was a considerable similarity between different countries' CFC rules.¹⁸³ In general, they are anti-tax haven rules. They focus either on the fact that you paid very little tax because the income was in fact reported as arising in a tax haven, or they focus on its being the type of income that is easily shifted.¹⁸⁴ For example, income that gets run through conduits, along with passive income, generally can be put wherever you like.

Countries seem to agree with each other, to a considerable degree, on what is "bad" foreign-source income that you might want to tax. What they do not agree on, and what people just within the United States do not agree about, is whether we should hit this stuff relatively hard or relatively lightly.

There is a tradeoff to consider. On the one hand, from a unilateral standpoint, why would you want your companies to pay high rather than low taxes on foreign-source income? If U.S. shareholders own a U.S. company and you are acting unilaterally—we are not thinking about other countries' welfare and we are not engaged in strategic cooperation with them—why are we not glad that they avoid German taxes? Just considered for itself, from a unilateral standpoint, we should be glad, because we do not get the money from German tax payments. On the other hand, when we see stuff in a tax haven, we may think it indicates undesired profit-shifting from the United States, whereas, again, if you have the car factory in Germany, we may not think that is going on to a comparable degree.

So, determining how to treat low-tax foreign-source income involves a tradeoff, and this is the flip side of how to treat paying high foreign taxes. I think we saw evidence of concern about these things in Rosanne's

182. See Altshuler, Shay & Toder, *supra* note 174, at 13.

183. *Id.*

184. *Id.* at 13.

talk.¹⁸⁵ She noted the desirability of focusing on low-tax foreign-source income despite the fact that it might be good to pay lower rather than high foreign taxes.¹⁸⁶ Additionally, she was glad that there is only an eighty percent rather than a 100 percent foreign tax credit in GILTI.¹⁸⁷

Again, it is a tradeoff. Do we want our companies to avoid foreign taxes? There might be reasons to be glad that they are doing this. On the other hand, when you see it happening, you might think other bad stuff is going on, so you want to tax the low-taxed foreign source income more heavily. Obviously, GILTI is in the ballpark of addressing this issue.

Finally, I will mention the marginal reimbursement rate for foreign taxes. I think it is nuts to have a complete lack of cost sensitivity regarding foreign tax obligations. When people were thinking about a simple global minimum tax, they thought: what if we make you pay fifteen percent globally, and companies that are paying zero respond by now paying fifteen percent more to other countries? What is in it for the United States? I think that is why they came up with the eighty percent foreign tax credit in GILTI.

Foreign tax creditability, if allowed immediately and in full, is simply too generous from a unilateral national welfare standpoint. By contrast, foreign tax deductibility—going back to Peggy Musgrave’s famous national neutrality standard, but without assuming that one must apply the full domestic rate on foreign source income—would be unilaterally optimal except: (1) if there are strategic interactions with other countries, and (2) if low foreign taxes indicate that you have engaged in “too much” sheltering and profit shifting. That provides a selfish unilateral reason to target tax haven income, which I think countries feel.

Fadi and Mitchell Kane have both written about how you can have a tax rate that is greater than zero, and offer less than 100 percent foreign tax credits, without violating tax treaties.¹⁸⁸ Since Fadi is here, I will not say anything more about that. Again, GILTI is in the ballpark of doing this.

The problem with all these issues is that there is no consensus about any of them. Their bottom line merits are not well understood. We do not

185. See *supra* pp. 234-41.

186. See *supra* pp. 232-41.

187. See *supra* pp. 236-40.

188. Mitchell Kane, International Tax Reform, the Tragedy of the Tax Commons, and Bilateral Tax Treaties 21-23 (May 1, 2018) (unpublished manuscript, on file with author).

know what the right answers are, or whether current law burdens are too high or too low at a given margin. Right answers also may vary between countries and across time.

I like to say that each of them offers a Goldilocks question. The little girl in the bears' house is quite confident about judging the porridge that she tastes. One is too hot, one is too cold, and the third is just right. But until we get her working for the JCT doing revenue estimates or policy analysis, we are not as lucky as she is. We do not know when a particular tax burden is too hot, too cold, or just right.

I did want to do one more thing: a quick word on the 2017 Act changes. FDII and GILTI are in the ballpark of addressing significant concerns that lack clear answers. If I had another twenty minutes, I would talk in detail about what I think is right and wrong about them. They each have significant conceptual and design problems, even taking as given the aims and the degree of rigor, which again—too hot, too cold—is very hard to answer. Each could be significantly improved. I do not know if they will be because I do not know where our political system is going. Even when I think of no-brainer improvements that could be done without changing their rigor—there are a bunch of things again I could talk about if I had the time—I do not know if that will happen.

FDII would also be in the ballpark if it were just a patent box. As Rosanne said, there are arguments for a patent box.¹⁸⁹ Michael Graetz has said that it is probably not a great idea, and that is based on a careful analysis.¹⁹⁰ I think he would agree that, in theory, it would be possible for a patent box to be a good idea for a given country.

Unfortunately, however, FDII is an export subsidy. That makes it indefensible economically because countries do not benefit from export subsidies. It makes it hard to defend legally under the WTO. It makes it hard to defend administratively because there is simply no good answer to the problem of round-tripping—you export to get the subsidy and then bring it back in. FDII is just a bad rule, but if you had a patent box, once again, it might be in the ballpark of something we could debate and see whether we like it or not.

PROF. MORSE: What I want to propose and explore is that the 2017 Act and the international provisions have a lot to do with cooperation. It

189. *See supra* pp. 235-39.

190. Michael J. Graetz & Rachel Doud, *Technological Innovation, International Competition, and the Challenges of International Income Taxation*, 113 COLUM. L. REV. 347, 375 (2013).

is funny because their headline was not cooperation. Their headline was competitiveness and a huge reduction in the corporate tax rate, and I do not deny that that was expensive. Nor do I deny that that may be problematic, a drag that results from a big extra deficit. But I am an optimist, so I hope you will permit me to explore something more cheerful, which is the possibility that the international provisions and especially GILTI will perhaps end up saving the corporate tax. This is so not because of the stated intention of the 2017 Act, but rather because the statutory framework of GILTI is fundamentally cooperative.

In order to like this argument, you have to like the corporate tax. Some of you may depart from me here, but there are reasons to like it. Perhaps you think it must exist because the individual income tax exists, and you take the point that I think Rosanne made, which is that if tax rates are more equal around the world, there will be less distortion.¹⁹¹ Or, maybe you like the idea of having a positive corporate tax rate in the United States, and you believe that, in order for that to happen, there have to be positive tax rates elsewhere. If you are in that camp or you can accept the assumption for the purposes of the next ten minutes, then you can listen to my cheerful presentation, and perhaps see if you agree with it.

After the 2017 Act, what the United States says to CFCs is this: either pay corporate income tax to a foreign jurisdiction, or we will tax you.¹⁹² This is not what the United States said before the Act. Dan calls the Act a “now-or-never” tax, with which I agree.¹⁹³ But I would characterize the prior-to-the-Act regime as a “maybe-later” regime, not “now-or-later” but “maybe-later,” and in fact probably-not-later because there is no reason that U.S. multinationals had to distribute dividends and pay taxes on the

191. See *supra* pp. 228-29.

192. *2017 Tax Reform: Checkpoint Special Study on Foreign Income, Foreign Persons Tax Changes in the “Tax Cuts and Jobs Act,”* THOMSON REUTERS TAX & ACCT. (Dec. 18, 2017), <https://tax.thomsonreuters.com/news/2017-tax-reform-checkpoint-special-study-on-foreign-income-foreign-persons-tax-changes-in-the-tax-cuts-and-jobs-act/> [https://perma.cc/86SC-5ENP].

193. See *supra* pp. 255-56.

profit of their non-U.S. subsidiaries. In fact, there were many reasons for U.S. multinationals not to repatriate.¹⁹⁴

Basically what the GILTI provision does is to take a piece of CFC income that previously, perhaps, would never be taxed and tax it at least to some extent.¹⁹⁵ GILTI does not claim all the resulting revenue for the United States. But at least it ensures that more CFC income is taxed somewhere, and that is what I view as the cooperative headline of the international corporate tax that we have after the 2017 Act.

If the core message is this cooperative message, that corporate income ought to be taxed somewhere, then one question we can ask is, “So what? Why do we really care about that?” The answer is that the cooperative framework affects what should happen now. One current discussion involves concerns about treaty violations or WTO obligations, as I think Rebecca and Fadi will discuss with respect to different elements of the Act.¹⁹⁶ Another current discussion involves what the United States should do for guidance. I am going to focus on the second part, and specifically on expense allocation, to illustrate how the proposed idea about cooperation might influence government guidance.

There is language in the legislative history which says that under GILTI there should not be any U.S. residual tax on foreign income if that foreign income is taxed at 13.125 percent¹⁹⁷ or, by implication, 16.4

194. Financial accounting, in particular, discouraged the declaration of dividends by foreign subsidiaries to U.S. parents. Firms did not have to accrue U.S. tax expense on offshore profits designated “indefinitely reinvested” until repatriation. *See* Vipal Monga, *Sheltering Foreign Profits From U.S. Taxes is No Big Feat*, WALL ST. J. (Apr. 25, 2016), <https://www.wsj.com/articles/sheltering-foreign-profits-from-u-s-taxes-is-no-big-feat-1461627831> [<https://perma.cc/V85D-55VD>].

195. Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054, 2208 (2017).

196. *See supra* p. 228.

197. *See* H.R. Rep. No. 115-466, at 627 (2017) (“At foreign tax rates greater than or equal to 13.125%, there is no residual U.S. tax owed on GILTI.”).

percent after 2025.¹⁹⁸ The reason this is interesting for current guidance questions is that there is an inclination among tax practitioners to say that the legislative history means that you, the Treasury, must make sure that we, the taxpayer, if we pay 13.125 percent or more in foreign tax, we do not pay U.S. residual tax.¹⁹⁹ That is what taxpayers suggest that the legislative history statement means.

What I want to point out—and this is illuminated by the idea that the GILTI advances a cooperative goal—is that there is another way to read that legislative history statement. The other way to read that legislative history statement has to do with the tax base—not the tax rate, but the tax base. The better interpretation is that the legislative history implicitly assumes the same tax base for U.S. and non-U.S. purposes or in other words for calculating both the U.S. foreign tax credit limitation and the non-U.S. foreign income tax base.

That could mean that the Treasury is expected to go around and equalize everybody's tax base, U.S. and foreign, but I do not think it means that. I think it should be read as an observation that GILTI works as intended if tax bases coordinate, so that there is the same tax base for U.S. foreign tax credit limitation purposes and for non-U.S. foreign income tax calculation purposes. But the legislative history does not imply that the Treasury is responsible for fixing discrepancies.

I do not think the Treasury should try to fix all tax base problems. The reason is that they are going to mess it up. They cannot do a good job with it because, no matter what rule they make, it will not work for everybody, and it will be able to be arbitrated. But I do think that there is a group of people who would do a pretty good job trying to make sure the tax bases are equal, and that is taxpayers. Right now, taxpayers face some

198. Assume equal tax bases for calculating foreign income for U.S. foreign tax credit limitation purposes and for foreign tax base purposes. Also assume a general U.S. statutory corporate income rate of 21%. Then, the rates of 13.125% and 16.4% are calculated as follows. If the I.R.C. § 250(a)(1)(B) 50% GILTI deduction applies, the maximum U.S. tax rate on GILTI is 10.5%. It is fully eliminated by the 80% foreign tax credit when the foreign tax rate equals 13.125%: $13.125\% * 80\% = 10.5\%$. See Tax Cuts and Jobs Act, 131 Stat. 2054, 2214. In 2026, the GILTI deduction decreases to 37.5%, so that the maximum U.S. tax rate on GILTI is 13.125%. It is fully eliminated by the 80% foreign tax credit when the foreign tax rate equals 16.40625%: $16.40625\% * 80\% = 13.125\%$. See *id.*

199. See, e.g., Alexander Lewis, *Taxpayers Nervously Await GILTI Expense Allocation Regs*, TAX NOTES INT'L 851, 852 (2018) (noting comments from MasterCard, the Semiconductor Industry Association, and others).

U.S. rules, for instance for interest allocation, that allocate deductions to foreign source income for foreign tax credit limitation purposes even if taxpayers cannot deduct those amounts for non-U.S. foreign income tax base purposes.²⁰⁰ This tax base problem is in safe hands, because taxpayers have a strong incentive to align their tax bases so as to also deduct amounts for foreign income tax purposes and align their non-U.S. foreign income tax obligations with their U.S. foreign tax credit limitation. U.S. multinationals might, for instance, add their CFCs as co-borrowers to facilitate foreign income tax deductions for interest.

So, how about this for an idea? Do not issue guidance. Do not worry about the interest expense allocation. Do not try to fix a problem that taxpayers have the incentive to fix. Is there not enough room in the foreign interest allocation provisions and other expense allocation provisions for taxpayers, if they so choose, to equalize the tax bases, both in the United States and foreign? Then there is no reason to complain, for example, that if interest is allocated against foreign income for U.S. foreign tax credit limitation purposes but not for non-U.S. foreign income tax base purposes, then the foreign tax credit limitation is less than the foreign tax liability and everything gets messed up. Taxpayers should change their interest allocation tax planning. Do what you need to do to get there.

I do not know exactly how far this argument goes because I am not conversant enough with all of the limitations that foreign law imposes, but my guess would be that there is some flexibility.

That is what I would like to leave you with—that, in the midst of all this confusion, in my cheerful simplicity I see basically a classic cooperative message of, “there is foreign tax, and if there’s not, there’s U.S. tax.”

It is not unlike the effect anticipated when the United States first unilaterally adopted the foreign tax credit.²⁰¹ As we move forward with the implementation of this Act, cooperation on tax base and tax rate can be guiding principles. But it is not necessarily the Treasury, in my view, that will be the only responsible party or the only source of action in getting there.

200. See Treas. Reg. § 1.861-10T(e) (2009).

201. See Michael J. Graetz & Michael O’Hear, *The “Original Intent” of U.S. International Taxation*, 46 DUKE L. J. 1021, 1046 (1997) (noting the “unprecedented” “generosity” of the unilateral foreign tax credit).

PROF. GRAETZ: I used to be an optimist, and contrary to Rosanne's suggestion that the new bill will keep you from retiring early, I am rapidly moving in the opposite direction.²⁰²

I have to say—I am sitting next to Susie, and she says, “Don't fix it, Treasury.” That leaves two other places that could fix it: (1) Congress—well, good luck with that—or (2) taxpayers. I just read in *The New York Times* in 14,000 words that Fred Trump took a ninety-five percent discount on his valuations for estate tax purposes, so he fixed it pretty well.²⁰³ So, I am not sure I want to rely on taxpayers to fix everything either, although I do understand the point about interest allocation.

There has been some discussion about fundamental issues. Let me say something else about fundamental issues. When Congress undertook to write the 2017 legislation, it faced many daunting challenges, and you should take comfort in the fact that it messed up a lot of other provisions worse than it messed up the international revisions—although the international revisions are the most daunting challenge faced by Congress, the OECD, individual countries, or the European Union because of the kinds of compromises and conflicts that Rosanne and Dan and others have mentioned.²⁰⁴

Let me just say one other thing. I have a book—Dan's book was mentioned; I did not mention mine yet. I would like to mention mine. It traces the history of the tax treaties, talks about patent boxes, has some interesting data, and is titled *Follow the Money: Essays on International Taxation*.²⁰⁵ I published it before the 2017 Act, so it just gives you the background of existing law, and the one thing all of us agree on is that preexisting law was terrible and needed to be fixed. I think that we all would agree that the efforts to fix it are better on a whole host of grounds than what was in place.

In addition to the fact that the underlying norms that were supposed to be guiding international tax policy—what Rosanne mentioned in terms of capital export neutrality, capital import neutrality, and capital ownership neutrality—do not work and we have no good replacement for

202. See *supra* p. 228.

203. See generally David Barstow, Russ Buettner & Susanne Craig, *Trump Engaged in Suspect Tax Schemes as He Reaped Riches From His Father*, N.Y. TIMES (Oct. 2, 2018), <https://www.nytimes.com/interactive/2018/10/02/us/politics/donald-trump-tax-schemes-fred-trump.html> [<https://perma.cc/N4KQ-NMTV>].

204. See *supra* pp. 225-26, 253-57.

205. See generally MICHAEL J. GRAETZ, *FOLLOW THE MONEY: ESSAYS ON INTERNATIONAL TAXATION* (2013).

them yet; concepts of corporate residence and corporate income source, which have been the fundamental building blocks of the international system, also do not work well.

You can change residence, you can create corporations that are resident anywhere, you have inversions and foreign acquisitions or domestic acquisitions. These have been common ways to reduce taxes, especially on foreign income. With regard to corporate income source, you have mobility of intellectual property ownership and income, you have locations of supply chains whose income is difficult to sort out, and the source for financial income is very difficult to limit. So, in addition to reducing taxes by changing the location of a corporation's residence, companies can avoid or reduce taxes by changing where income is sourced. This is why people are struggling toward destination-based concepts of one sort or another. That has been briefly mentioned here, but we have not talked about it a lot.

We are also struggling with many concepts that came into the law in the early part of the 20th century—between 1918 and 1928—such as permanent establishments, arm's-length pricing, and so forth.²⁰⁶ The base erosion profit-shifting (BEPS) efforts of the OECD, which have not been mentioned, stuck with all of those 20th century concepts. I think we are at a moment now where we are going to move away from many of those concepts. You can see such movement most obviously in the efforts in Europe, particularly with digital companies, but you also see it around the world in a whole host of unilateral efforts.

The last thing I would say is that the politics for multinationals, particularly U.S. multinationals, are terrible around the world. Nobody wants to give up taxes on U.S. multinationals. If you are a foreign country, you do not want to give them up, and if you are the United States, you do not want to give them up. The politics are bad, whatever the economics are.

Having said all that, I have argued since it was enacted that the 2017 Act is unstable.²⁰⁷ The 2017 Act is unstable for a number of reasons: it includes many temporary provisions, it was enacted only by Republicans,

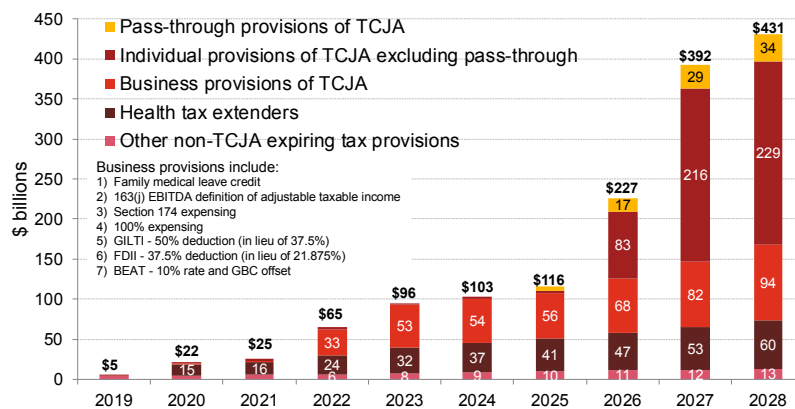
206. See Graetz & O'Hear, *supra* note 201 (discussing the “permanent establishment” safeguard and the “arm's length standard”). See also Benjamin Hoffart, *Permanent Establishment in the Digital Age: Improving and Stimulating Debate Through an Access to Markets Proxy Approach*, 6 NW. J. TECH. AND INTELL. PROP. 106, 108-10 (2007).

207. Michael J. Graetz, *Foreword—The 2017 Tax Cuts: How Polarized Politics Produced Precarious Policy*, 128 YALE L.J. F. 315, 337 (2018).

the debt and deficits it causes will be great, and many provisions that are supposed to terminate are not going to for a whole host of reasons.

This graph demonstrates the costs of extending provisions that are supposed to expire. What you see here is that the costs grow dramatically over time. I will not go through all of them, but many include business provisions. The largest ones, of course, are the individual tax cuts and the pass-through provisions that are both supposed to expire, but you see the costs of the 2017 act increasing over time. The bottom line illustrates what happens if you do not believe that everything that is supposed to expire will expire—and, if you lived through the 2001, 2003, and 2013 negotiations over the expiration of the Bush tax cuts, you cannot believe that they will all expire—then this Act is going to cost about \$3 trillion rather than \$1.5 trillion. That is for starters.

Annual revenue cost of extending various tax provisions: 10-year cost \$1.5 trillion (2019-2028)

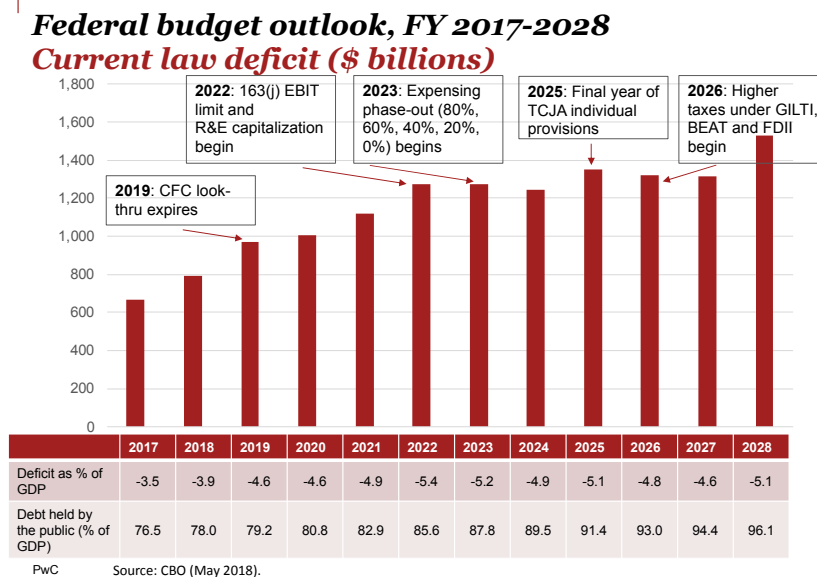


CBO (April 2018) and PwC calculations.
PwC

The next slide shows the federal budget outlook with some of the scheduled expirations at the top. You see that they begin as early as 2019 and then, in 2022, the interest rules change. Research and development is scheduled to capitalize, which is not going to happen, expensing phases out, and so forth. If you look at the bottom of the slide, you will see the deficit as a percent of gross domestic product (GDP) in these years—assuming that the law is actually followed, which I do not assume—and

you are still talking about deficits in the range of five percent of GDP pretty quickly.

If you look at the debt held by the public, you will see that we are up around ninety percent of GDP in terms of debt held by the public. All I will say about that is that we are now at the highest rate of debt held by the public that we have had since the end of the Second World War, and, at that time, we owed ninety-five percent of the debt to U.S. people.²⁰⁸ Now, we owe nearly half of it to foreigners,²⁰⁹ so we are going to have to transfer money abroad, and interest on the federal debt is going to become a bigger and bigger piece of the budget, and this is going to create enormous pressures on both the tax and the spending sides including on international tax. So, there is a lot of work to be done going forward.



Now, I want to turn to the provisions of this Act and say a few words about issues that we have talked about before. One issue is—and this goes back to what Rosanne started us with, and what others have said—that

208. Jeffrey Bartash, *Here's Who Owns a Record \$21.21 Trillion of U.S. Debt*, MARKETWATCH (Aug. 23, 2018, 11:26 AM), <https://www.marketwatch.com/story/heres-who-owns-a-record-2121-trillion-of-us-debt-2018-08-21> [<https://perma.cc/JB87-DG-HY>].

209. *Id.*

there was going to be a minimum tax and that we should have a minimum tax. We must have a minimum tax. Dave Camp had a minimum tax in his bill.²¹⁰ He did not call it that, and that was a Republican bill. The business community insisted there would not be a minimum tax; there could not be a minimum tax because it was going to hurt the competitiveness of U.S. multinationals versus foreign multinationals. So, what did they get? They got two minimum taxes—one with the GILTI and one with the BEAT—which tells you something about lobbying.

GILTI is supposed to address outbound issues, and we have talked a lot about the GILTI, but I want to talk about it a bit more. The BEAT was enacted originally, and it was described by Rosanne, to tax inbound business investments, but it misses inbound transactions in two ways.²¹¹ First, it misses transactions involving goods where royalties are embedded in the cost of goods sold because you can exclude costs of goods sold from the BEAT tax. The BEAT meant to tax royalties, and it misses them on goods. It hits them on services, and it is very hard to know in which services royalties are very important, so it hits a lot of things that it did not mean to hit.²¹² It also applies to outbound transactions where there is a U.S. multinational parent and not a foreign multinational.²¹³ So, it misses a lot of its intended targets, and it hits a lot of targets that I think it meant not to hit.

This is one provision that nobody had talked about much before the enactment. The legislative process was rushed in the fall of 2017. The BEAT was not vetted. There is a question as to whether it ought to be fixed or ought to be eliminated. I do not think it can be fixed in its current form. Enactment of the BEAT tells you that Congress does not believe that transfer pricing works. But maybe destination-based kinds of transfer-pricing alternatives will work. The BEAT does not allow a foreign tax credit, which is, I think, very bizarre. It gives you neither a deduction nor credit for foreign taxes—to use Dan's framework.

The GILTI also has many issues that we have not discussed. The eighty percent rule on foreign tax credits is obviously not the correct percentage. You have a fifty percent deduction and an eighty percent

210. See generally Tax Reform Act of 2014, H.R. 1, 113th Cong. (2014).

211. See *supra* p. 264.

212. *Key Elements of the U.S. Tax System: Taxes and Multinational Corporations*, TAX POL'Y CTR.—URB. INST. & BROOKINGS INST., <https://www.taxpolicycenter.org/briefing-book/how-does-current-system-international-taxation-work> [<https://perma.cc/C2TC-Y7CV>] (last visited Apr. 17, 2019).

213. *Id.*

credit.²¹⁴ One might have thought that maybe you would start with a fifty percent credit or something else. We do not know what the right percentage is.

The allocation of deduction rules, I think, are going to have to be dealt with by the Treasury, despite Susie's desire to leave them to taxpayers. While she talked about interest—and I think this does raise a lot of important questions about the role of the interest limitations compared directly to how you deal with it on allocation—the other two big items are R&D and G&A. When I was at the Treasury, we had many discussions about allocation of R&D in calculating foreign tax credits. One question that I think is worth asking is: why do you want to allocate R&D to foreign tax credits if you want to subsidize domestic R&D? I think you need to separate out these expenses and think about them separately. G&A or headquarters expenses raise similar issues, I think.

GILTI was put into Subpart F, or the CFC rules.²¹⁵ I said at an OECD meeting that I knew of good cars that have been built on a truck chassis—the Acura MDX and the Honda Pilot would be two examples. But I do not know of a good vehicle where you have built a truck on a car chassis. Putting GILTI into Subpart F and therefore interacting with the other parts of Subpart F, as opposed to treating it as a standalone minimum tax and deciding what you want as a set of minimum tax rules, I think creates lots of problems.

If you read the literature—and I am sure you will hear about some of this from the next panel—it also creates opportunities. If the GILTI foreign tax credit is limited and you continue to keep, for example, base company income as Subpart F income, you may decide you want Subpart F income rather than GILTI income. For those of you who are thinking about a career in tax accounting or tax planning and tax advising, the good news is that there is going to be plenty of business in the years ahead because these issues will need to be straightened out, and if they are not straightened out, taxpayers will certainly beat you over the head and shoulders if you are the government.

I just want to make two final points. First, there are a whole host of unilateral source-based developments that are happening now. They are in the United Kingdom under diverted profits tax, they are in Australia, they are in Japan, they are in India, they are in a whole host of countries.

214. Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017) (to be codified at 26 U.S.C. § 951A).

215. *Id.*

If everybody is acting unilaterally, I think we are going to have to think anew about how to achieve cooperation, even if you accept Rebecca's well-founded view that the bilateral tax treaty system which emerged in the 20th century may not exactly be the best way to go forward.²¹⁶

Finally, there are a whole host of non-neutralities and differences in treatment among these provisions that were not intended. I mentioned the BEAT treatment of goods versus services.²¹⁷ I do not think that was intentional. Embedded services versus explicit services may be treated differently. Branches and subsidiaries are treated differently in a whole host of these provisions.

We have talked about foreign-owned versus domestically-owned companies being treated differently.²¹⁸ The GILTI treats tangible and intangible assets differently. Because of the QBAI exemption, GILTI treats high-basis tangible assets differently than it treats low-basis tangible assets.²¹⁹

Your tax will vary depending on how you disperse your profits and losses across a number of countries because of the way in which the mechanics work. Whether ownership of your intellectual property is foreign or domestic will change many outcomes. Whether you are a C-corporation or whether you are a large, privately held flow-through entity will create large differences. So, you have a whole host of unjustified differences in the international context, and, in other contexts, you will find that people are going to be taxed differently depending on whether they are employees or independent contractors, whether they are doctors or health clubs, whether they are partnerships or whether they are corporations.

The distinctions that this Act alone has produced mean that it really needs to be rethought in a systematic, comprehensive way going forward. This law is an invitation to everyone to say: "Yes, this is an improvement" or not. It is not always an improvement, but in the international area, on balance, I think I would rather have it than what came before.

On the other hand, there are many opportunities for improvements going forward, and I do hope that groups like this and all the students I see in the room will take this opportunity and begin to assess the tax

216. See *supra* pp. 244-46.

217. See *supra* p. 269.

218. See *supra* pp. 255-56.

219. See Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (to be codified at 26 U.S.C. § 951A).

reform of 2017 relative to its goals and then evaluate potential improvements that might be made and create the kind of intellectual background that is necessary for Congress to act when the moment comes—which I am optimistic, just to ring an optimistic note—when Congress is ready to act in a sensible and thoughtful and bipartisan manner.

PROF. SHAHEEN: I do share the frustration that this panel expressed, but I do not share targeting it at treaties. Maybe they have to be updated, but I view treaties as a good and beneficial thing. This may be evident in that the current administration has no problem terminating international agreements when they deem them not good, but tax treaties are not on the list of international agreements that the administration wants to terminate, and the question is why. I think it is because there are benefits.

PROF. SHAVIRO: We were wondering if the administration knows what international tax treaties are.

PROF. GRAETZ: One answer is that President Donald Trump does not know anything about them.

PROF. SHAHEEN: Let us give them the benefit of the doubt. I have been thinking about the benefits of treaties. One benefit is fiscal cooperation. I do not think anybody would disagree with that.

Another thing is that treaties do signal some legal stability that business needs, and I say “signal legal stability” because they can be terminated, but they are there still. Yes, I agree with Rebecca that the stated purpose of treaties is a bit weird because, yes, definitely we can avoid double taxation unilaterally.²²⁰ We do not need treaties for that.

But, I view the substantive purpose of treaties as more of an instrument that facilitates the inoffensive, non-uniform allocation of taxing rights. You can just tax different items of income of different residents or residents of different countries differently without offending anyone. Good luck doing that statutorily. What would you say? That Germans are taxed less than French? It will not fly, I think. So, there is that.

To go back to the legal stability point, treaties provide some framework that is based on negotiation that takes into account the tax systems of both countries, and when that balance is distorted by radical reform, we have a problem with treaties. Maybe the purpose is, again, within the context of legal stability: “Okay, there is a limit to what we can

220. See *supra* pp. 249-50.

do in terms of reform without amending treaties, and if we want to do something radical, let us all think about it together and find a way to do that.”

Back in the day, this was hard to do. Renegotiating treaties could take a lot of time, but the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“Multilateral Instrument” or “MLI”) introduced a much faster way of renegotiating treaties. I am not worried about this concern anymore. There are provisions in the new Act that have treaty problems. You think about those and you say, “Okay, what is happening here, and what is the United States doing?”

I do have a problem with unilaterally doing something against treaties, especially when the Treasury introduced two new model provisions in the 2016 U.S. Model Treaty that the OECD talked about before: the Special Tax Regime (STR) and subsequent change in law provisions. The new provisions essentially say that if treaty partners will reform their systems such that they will unilaterally allow nontaxation, we are going to basically suspend the effect of treaties until we negotiate better treaties that would address the concern or until the treaty partner changes their own laws.

That tells you something. Yes, it addresses the issue of nontaxation, but the concept is there: “We do not like unilateral acts that are in conflict with the spirit of treaties,” and what the United States is doing, on the other hand, is exactly that.

The BEAT is the main provision with which I have an issue.²²¹ To me, the BEAT is a clear violation of the treaty. Others might disagree, but it certainly has treaty problems, and it is a unilateral step that is completely inconsistent with the Treasury’s approach of being against unilateral steps like that. With regard to the problems that Rebecca pointed out, I do not attribute them to treaties as much as I attribute them to politics.²²²

PROF. GRAETZ: Fadi, if the United States were to say that there was a limit, for example, on the amount of royalties that could be deducted—to avoid the nondiscrimination problem that you raise—by both the United States and a foreign multinational, is that something that

221. See Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054, 2226 (2017)(to be codified at 26 U.S.C. § 59A).

222. See *supra* pp. 245-52.

would be, for you, an unfortunate unilateral act, or is that simply a way of protecting the U.S. tax base?

PROF. SHAHEEN: So, you are saying we are limiting the deductibility of certain payments without regard to who the recipient is?

PROF. GRAETZ: I do not have to worry about it if they are domestic.

PROF. SHAHEEN: That is the nondiscrimination issue, right?

PROF. GRAETZ: I am only worried about it if they are abroad because that is when you are going to get them out of the U.S. tax base if they are in the U.S. tax base. I can write that rule in a way that would not be violating the nondiscrimination rules. I do not believe that the BEAT violates the nondiscrimination rules, but if it does, maybe it is a treaty override of some sort. We have done that before.²²³

My question is: how are you intending to constrain U.S. unilateral action, or how do you view treaties as appropriately constraining U.S. unilateral action? Especially given the fact that we see the European Union, the Germans, the United Kingdom, the Australians—I can go on, but I will not—the Koreans, the Indians engaging in unilateral action?²²⁴

PROF. SHAHEEN: My criticism is not focused only on the United States. I do not like what is going on globally, and I think everybody should sit down as adults and figure out a way that is beneficial to everybody. I think that is what Susie is saying.

PROF. MORSE: But they do not need to sit down.

PROF. SHAHEEN: Okay, fine. Let the market do that?

PROF. MORSE: That is right. There has been something happening unilaterally that sets that up.

PROF. SHAHEEN: Let us terminate the treaties. We cannot benefit from them when we like them and then go against them when we do not like them. Why not terminate the treaties, then?

PROF. GRAETZ: We have done that before.

PROF. SHAHEEN: I know we have done that before, but Congress did not express an intent to do that this time, and that is a problem.

223. See, e.g., *Whitney v. Robertson*, 124 U.S. 190 (1888) (holding that when an act of Congress and a treaty relate to the same subject matter but are inconsistent, the instrument enacted most recently will control).

224. *U.S. Companies Urge EU to Refrain from Unilateral Moves on Web Tax*, REUTERS (Sept. 26, 2017, 5:56 AM), <https://www.reuters.com/article/us-eu-tax-digital-usa-idUSKCN1C113B> [<https://perma.cc/4HM4-6AZF>].

PROF. GRAETZ: The problem, though, is that the U.S. Congress can override treaties under the U.S. Constitution²²⁵ with the last in time rule that governs, you know this well, and, to take a contrary example, the French cannot.²²⁶ The French treaty holds. So, that gives us a little edge in overriding treaties. I understand the point in saying that maybe we should not take advantage of that edge, or maybe it is not fair for us to take advantage of that edge.

PROF. SHAVIRO: Because once other countries know we are doing it, that is going to affect their—

PROF. GRAETZ: They can terminate the treaty when they want to if they feel like it has become imbalanced.

If you are worried about the loss of the U.S. tax base (royalties on intellectual property is my favorite example), I am worried about intellectual property royalties, why can I not stop it if I am the United States? I should be able to stop excessive deductions for royalties paid abroad, and I should not have to renegotiate bilateral treaties with every country around the world in order to stop that.

PROF. SHAHEEN: Why is the United States complaining about what other countries are doing?

PROF. MORSE: What I cannot figure out is why other treaty countries would complain about this Act. I do not understand that. It seems to me that what the Act does is it protects the corporate tax bases of other countries. Why would they fuss about it? I just do not understand that piece of it.

PROF. SHAHEEN: I do not think countries—

PROF. MORSE: And if they do not complain about it, then are we not okay?

PROF. SHAHEEN: Susie, countries—

PROF. MORSE: Also, Lee has a question.

QUESTION [Lee Sheppard, *Tax Notes*][off-mic]: No, it is not a question. They are complaining because their banks are going to have to pay tax on the BEAT.

PROF. MORSE: With regard to the BEAT, is it confined to banks?

QUESTIONER [Ms. Sheppard]: It is mostly banks.

PROF. MORSE: Mostly banks. My understanding of the BEAT had been that it would shelter most regular deductions, because it allows up

225. See *Edye v. Robertson*, 112 U.S. 580 (1884).

226. 1958 CONST. art. 55 (Fr.).

to half of your otherwise taxable income before you get to BEAT territory, but I understand—

AUDIENCE [off-mic]: Because you do not get the credit, though, if you have any serious GILTI, that ends up not being true because of the cliff. Once you are in BEAT. Before that, it is fine.

PROF. MORSE: Once you are in BEAT, it is bad. Agreed.

QUESTION [Danielle Rolfes, KPMG][off-mic]: But, if you just go over three percent, I understand the rationale about what they are doing and the fact that the rate is only ten percent, and I had the same first reaction—

PROF. MORSE: The point is a deduction-stacking point. I would have thought that you stack all the deductions to say high-tax countries first—those are business frictions, you keep those—and the ones that get eliminated so that you can avoid the BEAT are the ones paid to the low-tax or tax haven jurisdictions.

QUESTIONER [Ms. Sheppard]: If you are a bank, it is a two percent ceiling, and you are paying and paying and paying to related parties all the time. That is what you do.

PROF. MORSE: The bank point—I understand that. I am not sure on the nonbank issues, but I have much to learn, I think.

QUESTIONER [Ms. Rolfes]: We could talk, but, for one thing, it is not as simple as just giving up deductions. There is a real question under the law about whether you can just give up deductions. So, you are talking about: “I will keep my deductions for the good countries, and I will give up my deductions to bad countries,” and you cannot do that.

PROF. GRAETZ: Meaning, you just would not claim the deductions.

QUESTIONER [Ms. Rolfes]: Yes, yes. And that is not—

PROF. GRAETZ: The big problem that you all are talking about with the BEAT, just to be clear for the people in the room who are not as familiar as you are with it, is that it does not allow a credit for any of the foreign taxes that you pay. That is the big problem with the BEAT.

QUESTIONER [Ms. Rolfes]: Which means that if more than three percent of your deductions are to related persons, you lose all your credits, and that seems like a legitimate concern.

PROF. GRAETZ: Exactly, but that is why I raised the question the way I did, which is to say that if what you really are arguing is that income is U.S.-source income because the related-party deductions for royalties are too high, you should disallow those deductions because they are too high. This is what you would do under transfer pricing if you could do it, right, if you thought they were overstating U.S. deductions. Then, the

problem is that the foreign country should not be imposing a tax on those royalties, and they should be giving credit for the U.S. tax. It is a complicated question.

The problem with the BEAT is that the BEAT was created because Congress had enacted the GILTI to deal with outbound base erosion. They needed to do something for inbound base erosion. The excise tax in the House bill did not work, so they came up with this idea about which nobody had thought or vetted, which came out of Congress in three weeks and has huge problems.

The question that I would ask is whether you want to try to save the BEAT by amending it or whether you want to ask what are you worried about in terms of U.S. base erosion and start dealing with deductions that are eroding the U.S. base or about arrangements, maybe cost-sharing arrangements, that are eroding the U.S. base directly. That seems to me to be the right question that this legislation has posed.

I am not taking a position on what the answers should be because I do not know the answers to that question, but I do think—and this goes back to your point, Fadi—that there is no reason on earth that our treaties should prohibit us from doing that. We should be able to decide that issue.

We should not be able to dramatically overtax income that belongs to another country. If we do that, then they are going to start saying, “Well, we are going to terminate our treaties,” or “We are going to do something to you,” or “We have to go back and renegotiate,” or you all go to the bargaining table because what they are likely going to do is overtax U.S. companies, starting with digital services and going well beyond that.

This is an ongoing process, but I think the question that you are raising and where your disagreement and Rebecca’s becomes stark is, how much should we be bound by the treaties that we now have? My answer, I think, is somewhat, but not when we are seeing our base eroded the way that I think our base has been eroded by both U.S. and foreign multinationals.

QUESTIONER [Ms. Sheppard]: The BEAT is not the only thing we did about royalties. We did a whole mess of things around royalties.

PROF. GRAETZ: I know, I know. It is enough to talk about the BEAT.

QUESTION [David Rosenbloom, NYU]: I finally had to come out of my chair. The treaties, whether we like them or not, are the supreme law of the land. What Michael is saying is that we could override the treaties, which is constitutionally certain. We could do that. But denying

the deduction—what you suggested with respect to royalties, we have actually done in the 2017 Act with respect to interest.

What we did—I think, correctly—is we denied deductions for interest in excess of thirty percent of Earnings Before Interest and Taxes (EBIT) or, for the next three years, Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA). This is interest paid to everybody, payments to U.S. people, payments to foreign people. Clearly, we can do that.

It sounded to me, however, as though you were suggesting denying a deduction just for payments to foreign people and not to U.S. people. We cannot do that. To me, that is a blatant violation of what we have agreed to in the nondiscrimination clause.²²⁷ We may not like it, but that is what the nondiscrimination clause says.

I have a little bit of a story. I remember dealing with the Australians many years ago. For twelve years, the Australians refused to enter into a treaty with us because they would not sign a nondiscrimination clause. By the way, there is still no normal nondiscrimination clause in the U.S.-Australia treaty.²²⁸ It is a government-to-government agreement.

I was thirty-seven years old and I said to John O'Reilly: "That seems very unreasonable. We have a nondiscrimination clause with everybody. Why do you not agree to it?"

He said: "It is real simple. We want to discriminate." He paused for a second, then said: "And so do you."

You know, he was right. We have discriminated repeatedly, starting with the Foreign Investment in Real Property Tax Act (FIRPTA),²²⁹ Section 884,²³⁰ Section 367(e),²³¹ and Section 163(j).²³² We have always had an excuse as to why this is not really discrimination. Section 882-4 of the Treasury Regulations, in which deductions are denied if you do not file a return on time, only applies to foreign people.²³³ You would think

227. See, e.g., U.S. DEP'T OF TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF FEB. 17, 2016, art. 24(4), <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf> [<https://perma.cc/CU8F-CELD>].

228. Double Taxation Taxes on Income, Austrl.-U.S., art. 23, Oct. 31, 1983, 1982 U.S.T. 236.

229. Foreign Investment in Real Property Tax Act, 26 U.S.C. § 897 (2012).

230. 26 U.S.C. § 884 (2012).

231. 26 U.S.C.A. § 367(e) (West 2018).

232. 26 U.S.C.A. § 163(j) (West 2018).

233. 26 U.S.C.A. § 882-4 (West 2017).

that is discrimination, but no—the Internal Revenue Service has come up with an argument that it is not discrimination.²³⁴

Let me finish one thought, which is I agree with you that you could do what we did in Section 163(j). You can clearly pass something that limits the royalty deduction if it applies to everyone. What I thought you were saying is that we might pass a royalty limitation that only applies to foreign people. That is a violation of the nondiscrimination clause, in my judgment. Assume it is—we can override the Nondiscrimination Article in the treaties. It is possible constitutionally to do that.²³⁵

The problem is that the price to be paid for that kind of action is going to be paid by our multinationals.²³⁶ I do not believe the rest of the world will sit still while the United States systemically repudiates its treaty commitments. We may not like those treaty agreements. I agree completely with Rebecca that the modern treaties are way out of sync, and that has been true for years. But, we need treaties—we have no means of resolving international tax disputes otherwise. What are we going to do? Face the world alone? That is beginning to sound awfully familiar to me.

Facing the world alone is not something we want to do in the tax area because there are other countries out there that have serious interests. They will retaliate, and not against the U.S. government. Instead, they will retaliate against U.S. companies, and, I believe, notwithstanding all the influx of investment in the United States, in the multinational world there are a lot more of us than there are of them, and we will pay a price, a big price.

PROF. KYSAR: I will just say briefly I am not against treaties; I am just against these treaties.

PROF. SHAHEEN: But they need to be updated.

PROF. KYSAR: Yes, and I think the fundamental allocation of taxing jurisdiction needs to be revisited.

PROF. SHAHEEN: Can I still say a couple of words, or are we out of time?

PROF. GRAETZ: You can say something. I just want to respond to one thing David said, which is that Section 163(j) applied to U.S. tax-exempt entities as well as to foreigners as a way of avoiding the

234. See, e.g., I.R.S. Field Service Advice 199944026 (Aug. 6, 1999).

235. See U.S. CONST. art. VI, cl. 2.

236. See *Key Elements*, *supra* note 212.

nondiscrimination clause.²³⁷ If you want to do that with my royalty provision, I am happy.

PROF. SHAHEEN: Just to add to what David said and to follow up on the point you made, Michael, yes, it is possible constitutionally to override treaties, but the Supreme Court decided long ago—and that decision is still good law—that you cannot override treaties without expressing a clear intent to override.²³⁸

This did not happen in this Act, and there are good reasons for that Supreme Court decision. One of the reasons a clear intent to override the treaties is required is because we want to make sure that Congress considered the implications of overriding treaties, and the concerns—for example, that David raised—are clearly ones that should be taken into account. Not expressing such an intent to override implies that Congress did not consider the implications and concerns, and that is a bad thing.

On the foreign tax credit point: that is not a violation of the treaty. That is not even a conflict. The BEAT does not give foreign tax credit, but also it does not deny foreign tax credit.²³⁹ There is a reconcilable inconsistency with the treaties, and the law on that is very clear. You reconcile the treaty with the statute,²⁴⁰ and it is very easy to do that: you allow a treaty credit.

I have not heard anybody saying that there is, and I cannot think of, any policy reason not to allow foreign tax credit against the BEAT. Luckily, we have the treaties to do that. David and I wrote about this, and I stand behind that.²⁴¹ What the statute did is to say there is no Section 901 credit.²⁴² It did not say, “credits are not allowed.”

Okay, fine, no Section 901 credit. But, when there is a treaty in effect, the treaty gives you credit, and you can give foreign tax credits without any conflict and without any problems there. It is not an override question here at all. That is on the foreign tax credit part.

237. 26 U.S.C.A. § 163(j) (West 2018).

238. See *Cook v. U.S.*, 288 U.S. 102 (1933); *Trans World Airlines Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 252 (1984).

239. Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017) (to be codified at 26 U.S.C. § 59A).

240. *Whitney v. Robertson*, 124 U.S. 190 (1888) (holding that where a treaty and a statute “relate to the same subject, the courts will always endeavor to construe them so as to give effect to both, if that can be done without violating the language of either.”).

241. H. David Rosenbloom & Fadi Shaheen, *The BEAT and the Treaties*, 92 TAX NOTES INT’L 53 (Oct. 1, 2018).

242. See *id.* at 61.

Here is a way to think about treaties in a positive way. I think we are lucky to have them in this respect. Maybe in other respects, yes, they are outdated, but let us renegotiate them and not unilaterally go against them.

PROF. KYSAR: As a policy matter, I agree with you that it would be great to have foreign tax credits against the BEAT—I do not see why that came out the way it did—but, as you know, I disagree with you about the lay of the constitutional law. It is something I am writing about, so I will not take much time, but it is coming in the online *Columbia Journal of Tax Law*.²⁴³

Basically, when I look at that case, *Cook v. United States*,²⁴⁴ which is what you are referring to, I see that as applying to a very specific set of facts. Essentially, the Court there was interpreting the reenactment of statute that preceded a later-enacted treaty.²⁴⁵ In those rare circumstances, I think it could be inferred that Congress's intent was not to override the treaty, but I do not think that *Cook* stands for a general proposition that Congress must expressly override a treaty before it effectuates an override.

Instead, I think if there is no foreign tax credit in the statute, then that is an expression of Congress's will to override the treaty, even though it does not mention the override in the legislative history. But, I know you and I disagree about that, and we can take that to maybe another symposium.

PROF. SHAHEEN: Just one second on your reading of *Cook*. The Supreme Court dealt with *Cook* later on—the last time being in 1984 or so—and they read it completely differently than what you said.²⁴⁶ That is the law. And even if it were bad law, it is still the law.

PROF. KYSAR: In recent years, Congress has overridden treaties without expressing its intent, and there has been no Court that reverses that—but, again, we can take it to the law review pages.²⁴⁷

PROF. SHAHEEN: I wanted to say other things, but my time was well-spent differently, so it is fine.

PROF. KYSAR: Let us take a five-minute break, and we will reconvene since we are running late. Thank you.

243. See Kysar, *supra* note 125.

244. *Cook v. U.S.*, 288 U.S. 102 (1933).

245. See *id.*

246. *Trans World Airlines Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 252 (1984).

247. See Thomas S. Bissell, *Treaty Overrides Where the Code's Legislative History is Silent*, BLOOMBERG (July 14, 2016), <https://www.bna.com/treaty-overrides-codes-n73014444693/> [<https://perma.cc/5ACH-KPZA>].

PANEL II

PROF. COLON: Welcome back. We are going to start the last panel now, and our first speaker will be Stephen Shay from Harvard.

MR. SHAY: I am going to touch on only two of the points that I planned on discussing, as some of the other topics have been adequately discussed. I am just going to focus on convergence of tax rates and how I think the law works in a respect that is a little different. I will come back to the deficit and sustainability at the very end.

First, regarding convergence. I put together some numbers some time ago. For this part of the discussion, the top half of this number set are what we think of as peer countries, and the bottom half are what we think of as low-tax or enabling low-tax countries.

Convergence of tax rates and foreign tax credit (FTC) implications

Country	Fed./Prov. Statutory Tax Rates Combined (OECD)			2014 ETR of CFCs (FTC/Cur. E&P) *
	2000	2018	2000-18 Pct. Pt. Chg.	
Selected Trading Partners				
Canada	42.43%	26.80%	-15.63%	14.55%
Germany	51.61%	29.83%	-21.78%	18.46%
Japan	40.87%	29.74%	-11.13%	23.28%
United States	39.34%	25.84%	-13.50%	--
Selected Low-Tax Countries				
Ireland	24%	12.50%	-11.50%	3.10%
Netherlands	35%	25%	-10.00%	7.50%
Switzerland**	24.93%	21.15%	-3.78%	7.74%
United Kingdom	30%	19%	-11.00%	7.71%

OECD Tax Database - Table II.1 dataset (6-18-18). * Author calculations based on 2014 IRS Statistics of Income for profitable CFCs. ** Does not take account of companies eligible for special tax status, proposed to be repealed, or proposed tax reforms and rate reductions.

In each case, there have been substantial reductions in tax rates. Whenever you look at Organization for Economic Cooperation and Development (OECD) data,²⁴⁸ it helps to know what really goes on in the country. For example, I put two asterisks next to Switzerland. This is taking the relevant federal rate and the relevant average cantonal rate. Nobody that I know of actually operating in Switzerland pays twenty-one percent—and if you have, you can come see any practitioner in the room, because Switzerland has special regimes that allow you to implement a much lower rate. Those regimes are now in the process of being amended

248. See, e.g., *OECD Data*, <https://data.oecd.org/> [<https://perma.cc/LUN9-TE75>] (last visited May 15, 2019).

out of the law under pressure from base erosion and profit shifting (BEPS).²⁴⁹ That is a reminder that all of these rates are going to change as countries implement BEPS and as the European Union's Anti-Tax Avoidance Directive (ATAD)²⁵⁰ is implemented.

We are in an incredibly fluid tax environment right now for carrying on a global business. I would caution all of us who are trying to draw conclusions at this stage about the effect of this Act, in part because there are so many moving pieces in other parts of the world.

The last column—and, again, take this data with a grain of salt—was simply my taking the foreign tax credits that were shown as paid by country in 2014 statistics of income (SOI) data for the universe of profitable CFCs over the total earnings and profits of CFCs reported for that country. I view this SOI actual tax data as the best data. But, these effective rates are for countries as a whole. In our peer countries, not surprisingly, they are well below the statutory rates that you get on the left-hand side, but they are nontrivial. In the bottom half of the slide, they are much lower—particularly for Ireland. There is a lot of noise in those numbers, but it is important background to understand the U.S. law changes.

What does this tell us? It tells us that the effect of the Tax Act was to bring our headline rates much closer to the rates of the rest of the world. That is no surprise, but it is a very big deal. I want to emphasize something that Rosanne said: going to a twenty-one percent corporate tax rate affects a lot of different margins, and that is something on which we want to keep an eye.

Today I am just going to focus essentially on Global Intangible Low-Tax Income (GILTI).²⁵¹ If you have a controlled foreign corporation (CFC) and it carries on foreign business, what happens under the Tax Act? Just to show you how much I am learning, I presented a version of these

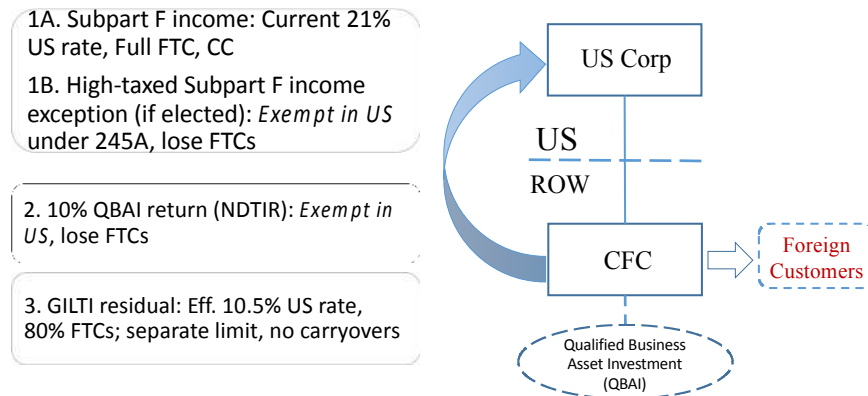
249. See IMF, *Taxation of Corporations in Switzerland* 4-10 (May 31, 2018), <https://www.imf.org/en/Publications/CR/Issues/2018/06/18/Switzerland-Selected-Issues-45995> [<https://perma.cc/D3CL-3CFR>]. See also OECD, *Harmful Tax Practices – 2017 Progress Report on Preferential Regimes*, OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT (Nov. 2017), <https://www.oecd-ilibrary.org/docserver/9789264283954-en.pdf> [<https://perma.cc/B96N-Q386>].

250. See generally Council Directive 2016/1164, 2016 O.J. (L 193) (EU), <http://data.europa.eu/eli/dir/2016/1164/oj> [<https://perma.cc/D5VS-2KEU>] (last visited Apr. 17, 2019).

251. Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017) (to be codified at 26 U.S.C. § 951A).

slides earlier this week, and they have already been changed because I learned something between Monday and today, and that is the way I view our understanding of this Act. It is a very dynamic situation.

Foreign tax credits (FTCs), FTC limitations and implications



First, this slide is saying, “What is your order of application in a sense of the statute?” If you have Subpart F income—any Subpart F income—it dominates, in a sense, your deemed tangible income return, which is an exception from GILTI and dominates GILTI. What I had not focused on until somebody pointed it out is that, even if you have Subpart F income, there is an election that treats something as outside of Subpart F if the effective foreign tax rate in relation to that Subpart F income exceeds ninety percent of the U.S. rate; this is why you are going to see a funny number later in these slides, 18.9, or ninety percent of the U.S. rate of twenty-one percent.²⁵² If your effective foreign tax rate is higher than 18.9%, you can elect out of Subpart F and into exemption.²⁵³

The other thing to which I am going to come back is that, in my professional experience, you can also create Subpart F income. We tend to think, “Oh, Subpart F, it is what it is.” It is not. I can make it when I want it; I can avoid it when I want to avoid it. And if I have a high enough

252. Internal Revenue Serv., *LB&I International Practice Service Concept Unit*, (Sept. 3, 2014), https://www.irs.gov/pub/int_practice_units/DPLCUV_2_01.PDF [<https://perma.cc/P3FL-NYM2>].

253. Lowell D. Yoder, *Subpart F High-Tax Exception: Impact of Recent Foreign Tax Credit Legislation*, BLOOMBERG LAW (Feb. 4, 2011), <https://www.bna.com/subpart-high-tax-exception-n17179888952/> [<https://perma.cc/ZV5L-ZSCT>].

foreign tax rate, then I can elect out of Subpart F. That is important, and that is one piece of the enormous complexity of this Act because there is so much electivity.

Again, this part of our discussion is assuming we are servicing foreign customers through a foreign corporation, and that it has some qualified business asset investment, on which you earned your ten percent return.

Foreign tax credits. If you have deemed tangible income return and it is exempt because of the dividend received deduction (DRD), you cannot have foreign taxes associated with that income now or ever. I do not think they stay in a pool—they go away.

Subpart F, NDTIR, GILTI and FTCs

Variations in Foreign Tax Credit Limits					
Category of foreign Income	Credit allowed	Separate Limit (SL) or Cross-credit (CC)	Expenses allocated	US Tax - FTC Limit	Carryover (back/forward)
NDTIR - Exempt (DRD)	0%	NA	NA	0%	NA (None)
GILTI	80%	SL	Yes	10.50%	None
Foreign branch	100%	SL	Yes	21%	1 and 10
General category income					
Sub F and other FSI	100%	CC	Yes	21%	1 and 10
Foreign-source FDII	100%	CC	Yes	13.125%	1 and 10
Passive (w/high tax kick-out)	100%	SL	Yes	21%	1 and 10

If you have GILTI, you also have the twenty percent haircut on GILTI foreign taxes as was mentioned earlier. If you have Subpart F income on which you are being taxed currently, you pay the full twenty-one percent rate instead of the GILTI effective 10.5% rate, but you get to credit all of your foreign taxes. Also, you get to cross-credit taxes if you happen to have other general-basket foreign-source income. Passive income is always separated for credit purposes.

Now, we come to the fun stuff.

I tried to create a table in the middle of this slide. If you have a foreign effective rate on income of less than 13.125%, a number you heard earlier today because that is grossing up 10.5 for the twenty percent haircut on foreign tax credits, then you would rather have exempt income because anything under that effective foreign rate means you will have some residual GILTI inclusion. Your second choice would be GILTI, and

the last choice would be Subpart F because it is taxed at twenty-one percent.

“It’s the tax rate, stupid.” FTCs and tax planning

- Foreign taxes drive planning:
 1. Reduce foreign taxes as much as feasible.
 2. CFC planning into income categories based on effective foreign tax rates after allocation of US expenses for FTC purposes:

<u>FTC Eff. Rate</u>	<u>Order of Income Category Preference</u>
< 13.125%	NDTIR → GILTI → Subpart F
13.125% - 18.9%	NDTIR or GILTI → Subpart F
18.9% - 21%	Deferred Subpart F → NDTIR or GILTI → Subpart F
>21%	Subpart F → NDTIR or GILTI
- Note that these categories effectively are blended at the shareholder level, so these effective rates are blending of a US shareholder’s positive earning CFCs.
- Review the effective foreign tax rates in Slide 4. There likely will be some increases in the lower foreign effective rates because of ATAD 1 and 2 and foreign country responses to BEPS and some reduction in higher foreign effective rates because of statutory rate reductions.

I can usually avoid Subpart F, so, keeping that in mind, it creates some marginal incentive with a low enough foreign tax rate to have foreign tangible investment. If I am in this next range between 13.125% and 18.9%, GILTI and exempt income are the same at that point, and it is only Subpart F that I want to avoid.

I have decided that I should change the arrow in the next category from deferred Subpart F to net deemed tangible income return (NDTIR). High-tax Subpart F that still is taxed at less than twenty-one percent (i.e., between 18.9% and 21% effective foreign rate) for which I elect out of Subpart F is the same as and does not dominate NDTIR. So, I have been editing slides yet again as I go along as I have been learning more.

If your foreign effective rate is over twenty-one percent, then you may actually prefer Subpart F because you have no residual U.S. tax. It is wiped out by the foreign tax credit. But, you get to carry over your credits, and you do not lose them. Again, this table may be the most useful thing in this whole package for some people in the room. You need to look at whether you get the credit, whether it is limited separately—I am going to ignore the expensing column for the moment—what is the tax rate you are paying on it, and, only then, can you understand the value of a credit and where you want to come out on that.

I do less practice and more writing now, so take all of this with a grain of salt, but I am keen to hear from the practitioners whether there are things in here about which I am actually incorrect.

Now, I am going to put this together. All I have done in this slide is show how these rate breaks compare with the old effective rates from the 2014 Statistics of Income (SOI) data. You will see there are a lot of countries in the bottom half of this slide that are below 13.125%.

FTCs and tax planning – From Slides 7 and 4

<u>FTC Eff. Rate</u>	<u>Order of Income Category Preference</u>
< 13.125%	NDTIR → GILTI → Subpart F
13.125% - 18.9%	NDTIR or GILTI → Subpart F
18.9% - 21%	Deferred Subpart F → NDTIR or GILTI → Subpart F
>21%	Subpart F → NDTIR or GILTI

<u>Country</u>	<u>CFCs (FTC/Cur.</u>
	<u>E&P) *</u>
Selected Trading Partners	
Canada	14.55%
Germany	18.46%
Japan	23.28%
United States	--
Selected Low-Tax Countries	
Ireland	3.10%
Netherlands	7.50%
Switzerland**	7.74%
United Kingdom	7.71%

I do not see any reason from the change in our law why the aggressiveness of trying to reduce foreign taxes will change. That is my big takeaway from this slide. As long as I want to beat foreign taxes below 13.125%, I am going to continue to do the kind of international planning to be sure I am below that rate.

If you think it is easy to calibrate foreign taxes to within a percentage point or two, you have not done real-world taxes. For one thing, I may have an audit adjustment that may push it up. There are all kinds of things to consider. You have to leave a lot of leeway around both edges of whatever margin in which you want to maintain your foreign taxes.

I want to be in the seven percent range if I have confidence to be below 13.125%, especially if, as any legitimate reading of the law will get us, we are going to have allocation of domestic expenses against that income because then the effective foreign rates from a U.S. perspective are going to be much higher. Once we get to real allocation of expenses, general and administrative (G&A), and interest, we are going to have quite high foreign effective tax rates. That is another takeaway.

I hope that is useful, but I also think it is important to understand how the Act actually works in order for us to then step back and say what is going to happen in the future, what do we want to change.

I am not going to discuss Foreign-Derived Intangible Income (FDII) because I do not think we need it. I am going to skip the foreign tax slides to make a few observations at the end of the deck and hand the panel on to my next colleague.

The sustainability issue is that there is a real possibility that income tax rates will increase. If you listen to some things that were said earlier today, that spoils a lot of hypotheses. The hypothesis that expensing is a good thing is not correct if your tax rates go up. You are getting your deduction at twenty-one percent, and your later income is going to be twenty-five percent.

It is not a good thing if you plan on having FDII and effective rates increase because they are going to reduce or take away the deduction. But, deficit pressure means that if I am planning into these things—expensing, FDII, GILTI—am I going to count on those deductions being around as they are advertised to be? I am not so sure.

We have talked about convergence of rates. The big issue is that the payoff from tax planning has been reduced by moving down to the twenty-one percent U.S. corporate rate. That is a very dominant effect. Even though I have emphasized the planning we can do, it is all planning under a twenty-one percent rate. It is just not that important, I am sorry to say. We will all be employed, but our compensation may have to be reduced.

I have talked about credits. Lowering the rate and these crazy limits bring us back to the still substantial pressure to keep foreign taxes down. I do not see a meaningful change of this dynamic between old law and this law.

Then, there is a crazy incentive to put tangible investment outside the United States if I can keep my foreign taxes down. Why? Because I still get a depreciation deduction—not expensing, but 168(g). I get a ten percent exemption return. Plus, I never have a U.S. rate above 10.5%. That is a substantial potential tax benefit.

That is it. The last point on my slide shows us that this Act has made America great again. Thank you.

PROF. COLON: Thank you. David Rosenbloom from NYU.

MR. ROSENBLUM: I tried to answer the question that I thought was implicit in the conference, which is the future of the new international tax regime, so I am focused on what actually happened.

I will go right to the core of the matter. I think this is all a bunch of hokum. It seems to be a generally accepted notion in this room that the 2017 Act was a vast improvement over prior law and, frankly, I may be the only dissenter. There are improvements in the Act, but a significant portion of this statute strikes me as quite irrational. This statute would have been improved with about a year's further reflection before it went public.

One of the first items I want to discuss is that the TCJA statute substantially rejected three items that have been in tax law in the United States for nearly a hundred years. It strikes me that these items were dismissed with very little recognition and very little discussion.

First, as a statutory matter, the abolition of Section 902 significantly diminishes the role of the foreign tax credit. Second, GILTI operates without an earnings and profits test, which results in a situation that is—to my way of thinking—slightly nuts.

There is an increasingly famous example in the new GILTI regulations in which, with actual income of 100, the taxpayer is required to include 200 in income. A foreign corporation earns 100 net and the U.S. shareholder includes 200. That flows—logically, I am told—from the fact that there is no earnings and profits concept in GILTI. GILTI depends solely on income. We have precedent for this in the passive foreign investment company (PFIC) rules, but GILTI is a much bigger operation, and is more important, than PFIC; it applies to many more people.

Third, nobody has specifically mentioned that GILTI, like Section 965, operates by ignoring the separateness of entities, which is something that we have always had.²⁵⁴ There have been some exceptions but, generally speaking, we do not combine deficits in one controlled foreign corporation with positive income in another. That creates large-scale technical problems.

There are certainly errors in the statute. There are also weird policy choices and illogical consequences—BEAT, in particular. Let me spend a moment on this because some people have praised BEAT. BEAT is an irrational statute. It has at least three characteristics that are truly bizarre.

254. See generally Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017) (to be codified at 26 U.S.C. § 951A).

First, BEAT applies when the income received by the recipient is fully subject to U.S. tax.²⁵⁵ You have a deduction for a payment to a related foreign person, with full U.S. tax, and the BEAT still applies. That is crazy, but that is the way it works. A payment from a U.S. person to a foreign taxpayer is fully taxed because the payment is effectively connected with the U.S. trade or business—there is no relief from the BEAT on that, and that is a realistic example.²⁵⁶ Many foreign banks are in precisely that situation.

Second, people say the BEAT is wonderful because it addresses all of these base erosion deductions—but, in a noncredit world, you can have fifty-two percent of your income offset by base erosion payments and have no BEAT liability.²⁵⁷ Fifty-two percent is a broad tolerance.

The third bizarre characteristic of BEAT is that you can have a very low base erosion percentage—enough to trigger the statute, which is three percent generally, two percent for banks—and you could owe hundreds of millions of dollars in tax because of the denial of the foreign tax credit.²⁵⁸

I think those three aspects of the BEAT are very strange.

Additionally, there are certain things that are carved out of the BEAT, such as qualified derivative payments and this fight that is occurring regarding transfer pricing for services subject to the services-cost method.²⁵⁹ These items are rejected from being base erosion payments, but they are thrown out of both the numerator and the denominator in the base erosion percentage.²⁶⁰ For some people, that is going to leave a base erosion percentage that reflects only the residual deductions, which could be much smaller. Think of how many payments may go out as qualified derivative payments. They could be a large percentage of the payments for a financial institution. You will have a base erosion percentage that only depends on the rest.

255. See generally John DerOhanesian & Kimberly Majure, *INSIGHT: Fundamentals of Tax Reform: BEAT*, BLOOMBERG LAW (Sept. 21, 2018), <https://www.bna.com/insight-fundamentals-tax-n73014482752/> [<https://perma.cc/QSY9-VQFM>].

256. Proposed regulations would rectify this oddity by extra statutory fiat.

257. See generally FIN. ACCT. STANDARDS BOARD, FASB STAFF Q&A TOPIC 740, NO. 4: ACCOUNTING FOR THE BASE EROSION ANTI-ABUSE TAX, (2018) https://www.fasb.org/cs/ContentServer?c=Document_C&cid=1176169883520&d=&pageName=FASB%2FDocument_C%2FDocumentPage [<https://perma.cc/J2W2-PBYM>].

258. See generally Tax Cuts and Jobs Act, 131 Stat. 2054 (2017).

259. *Id.*

260. *Id.*

The problem here with the BEAT is that there is no connection between the modified taxable income base and how you get there. In other words, the penalty for being in the BEAT is not connected with the base erosion focus of what throws you into the BEAT. I will stop with that because I could continue to discuss the BEAT for a long time.

Two sets of regulations have emerged thus far: one under Section 965, which is the repatriation provision, and another under the GILTI rules of Section 951A.

What we are involved in now are micro-technical issues, and there is a lot of money that turns on them. One of the things that happens as a result of Section 965 is repatriation. For the first time ever, we are swamped with previously-taxed income. Because of the Section 965 rules, a significant number of multinationals have millions, or hundreds of millions, of dollars of previously taxed income (PTI), and the preexisting rules on PTI are having a hard time under that pressure; they were not sufficiently developed to deal with this situation.

Because the new rules are augmenting the old rules, we must examine sections of the Code on which we never spent enough time, such as Section 961, with which people are discovering all sorts of problems, the basis rules under Subpart F. The rules were adequate as long as we encountered Section 961 issues only occasionally—but now, everyone is going to encounter Section 961 issues frequently throughout the system, and there are many unanswered questions.

Another area in which you will encounter issues is with regard to Section 962. How many Section 962 issues were there in the past? Not very many. But now, because the entire statute treats individuals as forgotten taxpayers, we have people asking: “Well, what about Section 962? Can I use Section 962 to claim the GILTI deduction?” The answer may well be no.

There is a lot of pressure on Code sections that have been with us since 1962 about which nobody spent a lot of time thinking before, and Congress did not spend a lot of time thinking about them in drafting this statute.

Finally, just to cap it all off, we have an entire Code section that is very familiar to international people—Section 956, investment in U.S. property²⁶¹—but no one quite knows what its function is under the new law. What is that statute doing there? Marjorie Rollinson at the Internal Revenue Service (IRS) called it an “attractive nuisance” at an NYU

261. 26 U.S.C.A. § 956 (West 2018).

conference last year. I think that is a good term. Nobody seems to know why it is there.

The statutory situation may result in instability. That instability is matched by worldwide instability because I think BEPS has set off a chaotic series of actions in other countries. To me, it is hard to make long-term plans on the basis of this statute.

That brings me to the Treasury. The Treasury is charged with making sense out of all this, but the General Counsel's Office in the Treasury does not like straying too far from the statutory language. Because the statutory language in certain places does not make any sense, the Treasury is hamstrung in trying to make this all work.

The question I have is how far the Treasury can go to be a hero here. The one place where we are going to see this dynamic is in the question of allocating and apportioning domestic deductions against the GILTI foreign tax credit limitation. To me, it is clear from Section 904(b)(4) that you need to allocate and apportion deductions. That is old, black letter, law.

That is the single biggest issue right now under this statute. Will there be an allocation and apportionment of deductions against the GILTI basket? I predict that the Treasury definitely will come out with that. I think there will be fierce lobbying to get Congress to change it. Watch that space; this is a big issue.

A secondary, but still significant, issue is how do you determine what is deductible from the income of a CFC and, in particular, do the new Section 163(j) rules, which limit the interest deduction, apply at the CFC level? There are a lot of issues like that lurking around, and the question I ask is: how far can the Treasury go?

I will point out one interesting thing that nobody has mentioned: it is not quite true that, in determining GILTI, you take up to ten percent of your tangible assets off the top as exempt income and then everything in excess of that amount is tested income and potentially GILTI. The ten percent tangible return is reduced by allocable interest, and that is a big number potentially. In the newest GILTI regulations, the Treasury essentially made a gift to taxpayers. The statute says that you take into account all interest expense that is apportioned against tested income in the hands of a CFC, except to the extent that that interest expense is matched by tested income in the hands of the interest recipient. This means that the only interest expense not taken into account to reduce the ten percent return is interest expense matched by tested income that may, in turn, be GILTI for the U.S. shareholder. It is a huge gift for the Treasury

to say you take all interest allocated against GILTI and net it against interest income before applying the result to reduce the ten percent return.

Think about a CFC that has interest income and interest expense only to unrelated parties. Under the statute, all interest reduces exempt income except for interest to related parties that is tested income in their hands. The Treasury is allowing taxpayers to take into account interest income, and to subtract only a net negative result from exempt income. This results in more exempt income from Qualified Business Asset Investment (QBAI).²⁶²

A taxpayer wants a return on tangible assets that is as high as possible. The statute envisions that there will be a lot of interest allocated against it.²⁶³ As far as I am concerned, the Treasury has contravened the words of the statute in saying that netting is allowed.

Thank God we have the Internal Revenue Service, right? Because they will clean all this up since we have geniuses out there administering the laws.

I think this is the big unspoken weakness of this statute. To me, the statute looks to be highly unadministrable. As I have asked in other settings: what could go wrong with four foreign tax credit baskets, including two new ones and thousands of pages of regulations? Nobody has talked about what the implications of foreign adjustments are for BEAT or GILTI. There are not going to be any of those, right? Foreign countries are not going to adjust the income of U.S. multinationals.

Another point—which is a point that I would like to talk about, but I do not have any time to go into it—is if we keep cutting the budget of the IRS, what difference will the rules make? There is nobody around to administer the law.

The statute is one surprise after another—all dependent on the facts of specific taxpayers. There are some remarkably formidable provisions in the statute. You can increase your export income by adding to your non-export income, which is an odd result. There is an article on that by one of my colleagues called *The Nitty-Gritty of FDII*,²⁶⁴ which is very good regarding the problems with FDII.

262. See generally Guidance Related to Sect. 951A (GILTI), 83 Fed. Reg. 196 (proposed October 10, 2018) (to be codified at 26 C.F.R. pt. 1).

263. See 26 U.S.C.A. § 951A(b)(2)(B) (West 2017).

264. See generally Jonathan S. Brenner & Josiah P. Child, *The Nitty-Gritty of FDII*, TAX NOTES (Sept. 17, 2018), http://www.capdale.com/files/24250_the_nitty-gritty_of_fdii.pdf [<https://perma.cc/23WU-836V>].

If you find yourself unexpectedly in BEAT territory without a foreign tax credit, it is a cliff effect. If you exceed the credit by two or three percent, you could end up with huge liability.

Finally, how is the rest of the world going to react to this? Potential World Trade Organization (WTO) challenges have already been mentioned.²⁶⁵ Somebody is going to say that FDII is an export incentive, and I agree.

There will be copycat rules out there. Other countries may say, “Hey, GILTI looks pretty good to me,” but perhaps on a per-country basis.

The big thing about GILTI that people have to realize is that GILTI implies a great deal of averaging, including CFCs positive and negative, CFCs being netted against one another, or QBAI from one company being used against tested income in another company. This 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.

I asked previously: is it really in the interest of the United States to trade leadership in international taxation for outlier status?

My final point is, what has really happened with the TCJA? In my opinion, the statute leaves us with two things that have enduring value. First, the lower corporate rate is the most important aspect of international taxation. We have lowered it to twenty-one percent, and I cannot see us increasing it anytime soon. We may need to do it for budgetary reasons, but we are not going to increase it dramatically. The other real game changer here is GILTI. With a few strokes of a pen, GILTI could result in the end of deferral as we know it. We may be forced into that. I think many people realize that GILTI was a dramatic change in the rules.

This statute contained twenty-seven provisions in the international area; we have focused on only a few of them. There are some good things in the rest of these international provisions that nobody has mentioned, such as new material in the transfer-pricing area²⁶⁶ or the anti-hybrid

265. See generally Ivana Kottasová, *Does Tax Overhaul Violates Global Trade Rules: Europe Thinks So*, CNN (Dec. 19, 2017), <https://money.cnn.com/2017/12/19/news/economy/us-tax-overhaul-wto-trade-europe/index.html> [https://perma.cc/8NNA-GRQ8].

266. 26 U.S.C.A. § 482 (West 2017)

rules.²⁶⁷ But, generally speaking, I do not believe that this statute, as we have come to understand it, is sustainable. It has too many problems, it is not administrable, and it lacks widespread support. Thank you.

PROF. COLON: We will hear from Danielle Rolfes next.

MS. ROLFES: Thank you. I feel lucky to be here with this esteemed group. When I was invited, I wondered what I could contribute to the academic discourse on the TCJA? Because I was working in the Treasury Department when President Obama developed a minimum tax,²⁶⁸ I think I can best contribute to this panel by focusing on the Obama Administration proposals, and what the thinking was behind the development of particular aspects of those proposals in the Green Book. The Green Book is what we call the President's budget, where he sets forth his proposals for new fiscal laws.²⁶⁹ I am talking about proposals that we made several years ago.²⁷⁰

When I saw Rosanne's speech on the agenda, I wondered for a moment whether we might be redundant, because we each worked with Harry Grubert in developing our work on minimum tax.²⁷¹ After listening to Rosanne's very informative talk, we will certainly not be redundant because Rosanne is an economist.²⁷² I am a tax lawyer, and we have different perspectives and ways of talking about the proposals coming out of the Obama Administration.

267. 26 U.S.C.A. § 267A (West 2017).

268. See *Treasury's Rolfes Joins KPMG as Partner and Co-Head of Washington National Tax Practice's International Tax Group*, KPMG (Sept. 13, 2017), <https://home.kpmg/us/en/home/media/press-releases/2017/09/treasurys-rolfes-joins-kpmg-as-partner-and-co-head-of-washington-national-tax-practices-international-tax-group.html> [https://perma.cc/5U8H-YAAS].

269. See generally U.S. DEP'T OF TREASURY, ADMINISTRATION'S FISCAL YEAR REVENUE PROPOSALS, https://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx [https://perma.cc/7EUC-D7YH] (last visited Mar. 20, 2019).

270. See generally U.S. DEP'T OF TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2015 REVENUE PROPOSALS, <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf> [https://perma.cc/7778-Q949].

271. See generally Rosanne Altshuler & Harry Grubert, *Repatriation Taxes, Repatriation Strategies and Multinational Financial Policy* (Rutgers U., Dep't Econ., Working Paper, No. 2000-09, 2002).

272. Rosanne Altshuler, *Curriculum Vitae* (Dec. 1, 2018), <http://econweb.rutgers.edu/altshule/Altshuler%20CV.pdf> [https://perma.cc/P9W3-RUC3].

The reason that I think my perspective on old proposals is still relevant is that our current version of GILTI is not sustainable. As David pointed out, the OECD is talking about minimum taxes. This is surprising to me, because when I represented the Obama Administration at the OECD, and we were working on the BEPS imperative, the United States advocated for a minimum tax, asserting that a CFC-based approach could be part of the strategy to address BEPS. I think it was Rosanne who said that you can be more targeted in a CFC-type regime to address the behaviors that you do not like.

We were laughed out of the room. The United Kingdom was completely opposed to endorsing really any CFC regime for the reasons we are all familiar with.²⁷³ If a country tries to solve base erosion by just taxing subsidiaries of companies with parents located in that jurisdiction, you end up with an inversion problem, or the problem of foreign companies potentially being more attractive bidders for your companies so that the United States would never win the jurisdictional choice for the parent company following a business combination.

That is a problem with minimum taxes. It could be a risk with GILTI. I do not think it is a significant problem for GILTI—but if you start expanding its impact, as would have been the case under the Obama Administration's proposal, you need to consider whether you have entered into that territory.

At the OECD, this conversation is now somewhat serious. I think Germany is the primary advocate of taking a minimum tax-style approach to address the base erosion and profit shifting concerns that remain for some countries following BEPS.²⁷⁴ Germany has advocated for pairing any new minimum tax with a source-based defensive measure to try to address the inversion issue. For example, the source-based defensive measure could deny a deduction to companies that make an otherwise deductible payment to a related person located in a low-tax jurisdiction if the ultimate parent of the recipient does not impose a minimum tax regime on foreign subsidiaries.

273. *The UK: Always the Bad Guy on Anti-Tax Haven Rules?*, ACTIONAID (June 8, 2016), <http://www.actionaid.org/2016/06/uk-always-bad-guy-anti-tax-haven-rules> [<https://perma.cc/VE8R-VDEV>].

274. *UPDATE 1-Germany Looking to Coordinate Global Minimum Corporate Tax*, REUTERS (Oct. 19, 2018), <https://www.reuters.com/article/oecd-tax-germany/update-1-germany-looking-to-coordinate-global-minimum-corporate-tax-idUSL8N1WZ2RA> [<https://perma.cc/TM5W-MVH4>].

The idea at the OECD currently seems to be: “We could implement minimum taxes as part of our solution to BEPS, and we can deal with countries that do not adopt such a system by denying deductions for payments to companies that are not subject to such a regime.” So, the OECD may be taking a cue from BEAT. This would then make other jurisdictions think: “What would be better for my companies—to be subject to a minimum tax or to be subject to the harsher measure of having deductions denied?”

It is also interesting to note that the United States has pivoted to advocating for a different proposal at the OECD, which is focused on increasing market-based taxing rights as a way to address some of the income shifting that I think the minimum tax is trying to address. Nonetheless, this is a long way of saying that I think the minimum tax proposal developed during the Obama Administration is still relevant because the OECD is considering once again the optimal design features of an effective minimum tax.

In designing the Obama minimum tax, everyone agreed from the outset that we were going to end lockout by taxing income either immediately or not at all. I do not think that is controversial.

The way we talked about the minimum tax, and what everyone has said here, was that it is not worldwide versus territorial—it is something in between. We talked about the rate as a “split-the-baby” approach to the two common ways of measuring efficiency, capital export neutrality, and capital import neutrality. Because you can never reconcile both at the same time, we recommended establishing a compromise rate for the minimum tax in order to “split the baby.” This phrase is the best explanation of the thinking process behind the policy. The economists talked about it that way, and the tax lawyers talked about it that way. We were splitting the baby.

Why were we doing that? We did not care about foreign-to-foreign base erosion, at least not for the sake of any foreign government’s coffers. That was not our goal—we were not trying to be the world’s policeman by enforcing taxing rights for other jurisdictions—it was not about making sure Germany collected its tax bill.

Two things are important, however. First, we did not think we could reliably distinguish U.S. base erosion from foreign base erosion. If a company can strip income out of Germany into a haven, it makes shifting income from the United States to Germany more attractive. Accordingly, we did not think we could write rules to reliably distinguish U.S. base erosion from foreign-to-foreign base erosion. Second, we believed that

taxation of foreign earnings at the full U.S. rate would make U.S. multinationals less competitive, and we did not seriously consider going there. Once you accept those two premises—that no- or low-taxed foreign earnings are correlated with U.S. base erosion, but it would be uncompetitive to tax foreign earnings at the full U.S. rate—from there, it is just a question of where to set the compromise rate. There were many in the Office of Tax Policy who did not think the nineteen percent rate that President Obama ultimately proposed was the right rate in terms of balancing those concerns, but that rate was settled on as the opening negotiating position, and you saw where that went.²⁷⁵

Importantly, we did retain Subpart F. The Obama Administration made a deliberate choice to retain Subpart F as a regime that would trigger tax at the full U.S. rate instead of at the compromise rate.²⁷⁶ The view was that Subpart F, properly tailored, was focused on acute U.S. base erosion. And that it made sense for the income of an invoicing company that is just stripping distribution profit out of the United States—or for a royalty that is paid to a CFC holding company for IP that is being used in the United States—to be taxed at the full U.S. rate rather than at the compromise rate. I imagine this reasoning may have been part of the decision to retain Subpart F as part of the Tax Cuts and Jobs Act (TCJA),²⁷⁷ although there is complexity in doing that.²⁷⁸

I will say that Subpart F was originally enacted to also address foreign-to-foreign base erosion, not simply to address acute U.S. base erosion. The check-the-box regulations, however, had the effect of largely turning Subpart F off for a lot of foreign-to-foreign base erosion. In enacting section 954(c)(6),²⁷⁹ Congress embraced this idea that Subpart F should just be focused on U.S. base erosion. The Obama Administration would have made section 954(c)(6) permanent as part of any reform based on the view that the minimum tax, the compromise rate, was the appropriate way to address foreign-to-foreign base erosion.

275. *Obama's FY 2017 Budget Builds on Previous Tax Proposals*, ERNST & YOUNG (Feb 9, 2016), <https://www.ey.com/Publication/vwLUAssets/EY-tax-news-2016-02-16-01/%24FILE/EY-tax-news-2016-02-16-01.pdf> [<https://perma.cc/4U77-C9J2>].

276. *Id.*

277. Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017).

278. *US Tax Cuts and Jobs Act Significantly Affects US Private Companies with Outbound Investments*, ERNST & YOUNG (Feb. 5, 2018), <https://www.ey.com/gl/en/services/tax/international-tax/alert—us-tax-cuts-and-jobs-act-significantly-affects-us-private-companies-with-outbound-investments> [<https://perma.cc/3JYA-YDPK>].

279. 26 U.S.C.A. 954(c)(6) (West 2017).

There is a lot more you could do with Subpart F to focus it on acute U.S. base erosion. Subpart F takes a country-by-country approach, which sometimes causes subpart F income that cannot be ameliorated by check-the-box or section 954(c)(6). It has been suggested, “Why not treat all foreign countries as one country if you really are trying to make Subpart F just be about protecting the U.S. base rather than foreign-to-foreign?” When we were working on the Obama proposals, we just did not get to that level of fine-tuning, which I think is also an explanation for a lot of the choices that were made in the TCJA.

We have talked a lot about the ten percent return on QBAI, and I do not think I am going to say anything that has not already been said here, but I will say it a little bit differently. The Obama Administration proposal would have given a return based on a measure of Treasury rates, a risk-free rate, on all investment in active assets. That is, a return on all of your invested equity in the company.

There were a number of policy reasons the Treasury economists thought about it that way. It was not a ten percent rate—which many people have suggested is too high—but it was also not limited to tangible assets. If the minimum tax is really trying to get at profit shifting from excess returns attributable to intangibles, which most have focused on as being the source of profit shifting, then you have to consider: “If you buy a patent, the first dollar of income that you earn from that patent you purchased is not an excess return.” It did not seem right to us to focus exclusively on depreciable property. Instead, we provided an exemption from the minimum tax for a fixed return on all active assets.²⁸⁰

I take Rosanne’s point that the ideal way of exempting a normal return would be through expensing. I learned from Harry Grubert that expensing only does that if you *refund* the net operating losses (NOLs). Maybe you get close enough to giving a current benefit for NOLs in a worldwide tax system when one CFC’s losses are permitted to offset another CFC’s income, but we were designing a country-by-country system, so that was not the case in the Obama version. We were not refunding the losses, so I do not think we could have said that we were giving an exemption on a normal return by simply implementing expensing.

280. See U.S. DEP’T OF TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2016 REVENUE PROPOSALS, <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf> [<https://perma.cc/8WBV-VG49>].

Instead, the Treasury economists stated that providing a fixed return on the invested capital is the next best thing, even though we had to substitute our own generally applicable rate for a more tailored, company-specific rate, which expensing uniquely would have accomplished.

I now turn to the idea that giving any exemption on tangible assets located abroad gives an incentive to locate assets abroad. My perspective, however, is that companies do not relocate actual activities abroad in order to save taxes on the normal return from those activities. My experience as a tax planner is consistent with this, and all of the companies and advisers who came into the Treasury Department complaining about our proposals consistently stated this. What has been wrong with our tax system is that it encourages companies to locate actual activities abroad, not because of any favorable tax treatment for the normal return on those activities, but rather because the conduct of those activities abroad opens the door for taxpayers to avoid tax on intangible-related returns associated with the activity.

Take our Subpart F system, for example. You get an exception from Subpart F if you actually manufacture in the jurisdiction. As long as you manufacture in the jurisdiction, all the intangible-related return associated with the manufactured product can escape U.S. tax.²⁸¹ It is those kinds of rules that give companies an incentive to shift assets and activities abroad.

Of course, exempting the normal return on actual investment enabled us to say that we had a territorial system—at least for some sliver of income. It was important to most in the tax reform debate to be able to say that there was this token of territoriality. It also turned out that it did not cost very much under the Obama proposal. Because we were doing a country-by-country minimum tax, and most investment in active assets tended to be in high or medium-tax countries (reinforcing the point that those investment decisions were not driven by tax rates), the modeling suggested that there would not have been much minimum tax imposed on earnings attributable to the countries where the assets were located. Of course, check-the-box planning had nonetheless made it possible for investment in any country outside the United States to facilitate the shifting of intangible returns to low-tax countries.

Because we were not focused on the normal return from these activities, but rather on the excess returns that we believed were indicative of profit shifting, we thought it made sense to exclude from the minimum tax an appropriate rate of return on actual investment in active assets. We

281. Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054, 2213 (2017).

structured that tax-free rate of return differently than the TCJA's approach of allowing a ten percent return on QBAI.

Honestly, in my experience, I think this is all a bit of noise. Ten percent may exceed the normal return and in that sense be too high, but I do not think that is the biggest or even on my top-ten list of things that are wrong with GILTI, but I am sure it is going to be a stalking horse politically, so it may change.

I was an advocate of the fifteen percent haircut in the computation of the foreign effective tax rate (ETR) that was included in the Obama proposal,²⁸² and I did not realize I had a fan in Dan Shaviro until later. The origin of that aspect of Obama's proposal was actually Senator Max Baucus's proposal.²⁸³

Senator Baucus proposed a version of splitting-the-baby that was not a minimum tax. He proposed instead to impose U.S. tax on sixty percent of CFC income and allow only sixty percent of the CFC's taxes as foreign tax credits.²⁸⁴ That is not a minimum tax because there is no rate above which you do not owe U.S. tax. A company would always owe residual tax under that approach.

When the Treasury looked at it, though, we liked the fact that it gave companies an incentive to lower their foreign taxes. Again, we were not trying to get companies to pay foreign taxes. Instead, we wanted companies to have some skin in the game on this question. There is a rule in the code that says, for a foreign tax to be creditable, you are supposed to first "exhaust all practical remedies" to not pay more than you owe.²⁸⁵ The IRS has difficulty enforcing that rule. There is also a rule against countries enacting soak-up taxes,²⁸⁶ but countries could still enact tax holidays that would be geared to set the rate at the minimum rate but no higher, based on a view that companies would be neutral to paying a tax

282. See U.S. DEP'T OF TREASURY, *supra* note 270.

283. Ryan Carey & Sean Neary, *Baucus Unveils Proposals for International Tax Reform*, U.S. SENATE COMMITTEE FIN. CHAIRMAN'S NEWS (Nov. 19, 2013), <http://www.finance.senate.gov/newsroom/chairman/release/?id=f946a9f3-d296-42ad-bae4-bcf451b34b14> [<https://perma.cc/756M-8XX4>].

284. *Summary of Staff Discussion Draft: International Business Tax Reform*, U.S. SENATE COMMITTEE FIN. (Nov. 19, 2013), <https://www.finance.senate.gov/imo/media/doc/Chairman's%20Staff%20International%20Discussion%20Draft%20Summary1.pdf> [<https://perma.cc/EY9Y-PHPA>].

285. 26 C.F.R. § 1.901-2 (2017).

286. 26 C.F.R. § 1.903-1 (2018).

up to that amount. We wanted to make sure companies had some skin in the game.

I will turn now to discuss the Obama Administration's decision to propose a country-by-country approach for measuring the foreign effective tax rate, with the result that the top-up tax would be imposed whenever the earnings in a particular country were subject to foreign tax at a rate below the minimum tax rate. GILTI, of course, is different because it allows companies to effectively mix earnings from low-tax countries with those from high-tax countries in determining whether residual U.S. tax is owed.

I recall that Harry Grubert suggested in a paper he wrote with Rosanne that a fifteen percent country-by-country tax would be equivalent in terms of revenue raised to a twenty percent overall tax.²⁸⁷ What we got in the TCJA is a 13-1/8 global tax. For the vast majority of companies, of course, their foreign effective tax rate exceeds 13-1/8—so, on the margin, GILTI is not going to make much of a difference in terms of the base erosion incentive to shift income out of the United States's twenty-one percent environment into a tax haven, unless and until such shifting would cause the overall foreign rate to drop below 13-1/8. Because the Obama Administration was focused on the incentives for U.S. base erosion at the margin, including for companies that had some high-taxed foreign earnings, it ultimately decided to go with a country-by-country approach.

Of course, companies responded to the Obama proposal that a country-by-country regime would be overly complex, and there remains a question about whether that complexity is warranted. Some advisors also asserted that the ready availability of hybrid instruments would make such a regime impossible to effectively implement. The suggestion was that companies would use hybrids to shift income from a low-tax jurisdiction into a high-tax jurisdiction solely for U.S. tax purposes such that the transferred income would not be included in the high-tax jurisdiction's tax base. The income would only have been shifted from the perspective of the United States.

In response, we wrote two rules in the Green Book which appeared to address the concern, and which curtailed the suggestion that a country-by-country minimum tax would be gamed by hybrids. Thus, I think that policymakers could write rules to address hybrids if they wanted to implement a country-by-country tax.

287. See Altshuler & Gruber, *supra* note 1, at 39.

For the students in the room, the new law is not a minimum tax.

There is no foreign rate above which you do not owe residual U.S. tax. That is, in part, because of the requirement to apportion expense U.S. shareholder level expenses to foreign source income, but there are some other reasons, too, and I will turn to expense allocation in more detail shortly. Before I get there, I will say the Obama Administration proposal was fundamentally different in that it was only a “top-up tax. As a result, you would test the foreign effective tax rate for earnings in a country, and if the foreign ETR in a country was above our rate, the income never came onto the U.S. return. We relied on old law about what is a creditable tax to determine the foreign taxes that would be considered, and I am sure a lot of the foreign tax credit rules would have been implicated in running this foreign ETR test. It certainly was not simple, but this approach was generally more favorable to taxpayers because they did not have to rely on the ability to claim a foreign tax credit on their U.S. tax return in order to not owe additional U.S. tax when the foreign ETR was sufficiently high.

We also thought it was important to have some smoothing in this system over time. Under prior law, we had foreign tax credit carry-forwards that allowed for some smoothing if the foreign base was different than the U.S. base—for example, due to timing differences in when income and expenses are recognized. Because the Obama proposal would not include that mechanism, we thought it was important to replace it with something, so we proposed to determine the foreign ETR based on a rolling five-year weighted average. It is a little better and fairer, but in this brave new world of rough justice, you could probably get rid of that aspect of the Obama top-up tax and nobody would even notice.

GILTI is not a minimum tax, for quite a number of reasons.

The compromise rate for GILTI is not a scheduler tax system. It is not, in fact, a lower rate. It is achieved through a deduction, and the deduction is not available if the company has overall losses, like from its U.S. activities or from its branches, such that its total taxable income is less than its GILTI and FDII.

If total taxable income is less than GILTI plus FDII, then the income that is available for the FDII or the GILTI deduction gets scaled down. It is not just that your deduction is limited by taxable income. If you have an overall loss, you will lose part of your GILTI deduction, and you will lose it forever. It does not make a great deal of sense that, if we enter a recession such that more companies have losses, all of a sudden, that will be the moment that the appropriate foreign effective tax rate on CFC

earnings is twenty-one percent because no deduction is available to companies with overall losses. That is kind of nutty.

I should also note that there are no foreign tax credit carry-forwards under GILTI. Of course, no taxpayer can claim a foreign tax credit in a year when they do not have taxable income. That is, you do not get a foreign tax credit if you do not have tax on your U.S. tax return against which to claim that foreign tax credit. In this recessionary scenario, then, my loss companies could be taxed on their foreign income at an effective rate of twenty-one percent if they are offsetting that income with U.S. NOLs, and get no foreign tax credit. So, twenty-one percent U.S. tax, and it is all just double tax because there is no foreign tax credit. I am sure the foreign jurisdiction is not amused by any of this.

That is just nuts and seems incredibly counter-cyclical. I assume that the first stimulus proposal that we will get in the recession is to undo all of this. I have asked people on the Hill, “Why did you use a deduction subject to a taxable income limit?” They respond: “Oh, there are just different ways to do it. We could have done it as a rate. We could have done it as a deduction. We just had to pick among the different ways.” Wow. One might have hoped for a more satisfying explanation of such a draconian policy.

Now, let me turn to deductions. The Obama Administration proposal matched the treatment of deductions with the income. Under the proposal, if a CFC’s income was exempt—because of active investment in the CFC, there is income that is never going to be subject to U.S. tax—the Obama proposal denied the U.S. deduction for the interest that was allocable to the activity. The Obama proposal took this approach to avoid subsidizing the exempt income by taxing it at a negative effective tax rate. In addition, if income was subject to the minimum tax, the deduction was haircut to equate to the U.S. rate at which the related income was taxed. Thus, we matched everything. If the income was taxed at twenty-one percent, you got a twenty-one percent deduction. The deductions were effectively scheduled based on the rate at which the income was taxed. Our goal was to be neutral on foreign activities by allowing deductions at the same tax rate as the related income.

There is no hint of that in the TCJA.²⁸⁸ They did not deny any deductions for expenses allocable to exempt income. Recall that back in the early Camp days, the proposals only provided for a ninety-five percent dividend received deduction (DRD) to implement a territorial system. The

288. See Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017).

other five percent was described as a proxy for the fact that there would not be a disallowance of deductions. The Obama Treasury Department was not convinced by that proposal because ninety-nine percent of the time five percent was not going to be the right number, and it was also not the right average. I think the overall statistics suggested that the right average was something more like eight percent, which, again would not be the right percent for the vast majority of taxpayers.

I think it was a good decision to not retain a disincentive to repatriate through a small residual tax of five percent. I think that was a great simplification, and I loved that they went with a one hundred percent DRD.²⁸⁹ But, the TCJA only deals with expenses in a backhanded way. The TCJA did not provide for any express expense disallowance until you get to the foreign tax credit limitation for GILTI. Because GILTI is not a minimum tax and is instead implemented through the foreign tax credit, all of our old rules about allocating expenses for purposes of determining the foreign tax credit limitation apply. Under those rules, if a company's foreign ETR is above 13-1/8, every dollar of expense that is allocated against the GILTI basket costs twenty-one cents.

For companies whose foreign ETR is above 13-1/8, TCJA is effectively denying the deductions allocable to GILTI, assuming the company could have otherwise claimed the foreign tax credit because they are not in a loss. But then, oddly, for a company with a foreign ETR sufficiently below 13-1/8, maybe because all its foreign operations are in Cayman, it gets to keep its deductions at a full twenty-one percent rate. Such a company might be paying some GILTI tax, a little top-off, but at a rate below twenty-one percent, and they still get twenty-one percent deductions. The Obama Green Book made a different policy choice—to match the treatment of the deductions to the income. This is all in the context of making revenue choices and determining how you want to raise revenue.

I think the Treasury is now considering whether to give some relief on expense allocation; we do not expect it to be complete, but they might give some relief. It is interesting in that it gives back some of those deductions for the high-tax taxpayers. I am not disagreeing with that policy choice in the context of a statute that was passed with a legislative history that said, “companies will not owe residual tax for CFCs with a

289. *New Tax Law: International Provisions and Observations*, KPMG (Apr. 18, 2018), <https://home.kpmg/content/dam/kpmg/us/pdf/2018/04/international-mini-aem-april18-2018.pdf> [<https://perma.cc/N7N7-DB3R>].

foreign ETR above 13-1/8” and that did not expressly disallow deductions such that the Cayman company gets all their deductions. I cannot make any sense of it.

For the most part, my colleagues have focused more on the incongruities, where it is just fun to make fun of the bill, and I have tried to talk more about the policy choices. I cannot help but start to go there now.

The economists—this was all Harry, I never understood how we would make it work—wrote the rule in the Obama proposal to address dispositions of stock. They said it was imperative to avoid creating incentives to retain or sell assets to ensure that when you sell an asset, the gain on the sale is taxed the same way as the income from the asset would have been taxed had it been retained. You should have the same treatment either way. Therefore, we proposed that the rate of tax on a sale of stock should be a composite rate based on the extent a CFC’s underlying assets give rise to income that is subject to the minimum tax, the exemption for the normal return, or the full-tax Subpart F regime.

The TCJA does not say anything about that.²⁹⁰ They basically left out of the new “quasi-territorial system” dispositions of stock gains; so, unlike other countries that have a participation exemption—which generally also extends to the treatment of dispositions of stock—the TCJA does not say anything about that. Of course, if you sell a CFC with retained earnings, you get to treat that as a dividend, but to the extent there is built-in gain (i.e., appreciation) in the assets, that portion of the gain or loss presumably would be taxed (or result in a tax benefit) at a twenty-one percent rate. If it is a loss, that would be good. Economists would, of course, say, “that means there is an incentive then to hold onto gain assets rather than sell them.” Enter the tax planners: no one is going to do that. We just trigger the gains before you sell the assets, and then the gains can be taxed as a 10.5% rate.

I do not give them much grief for the lack of branch-versus-CFC parity. I think it was hard to treat branches like CFCs. We would have wanted to have parity in Obama, but there is a difficult issue about transitioning branches to being treated as CFCs, and I think some of the complexity around having a new branch basket, new recapture rules, is that it was a reasonable attempt to try to wall off branches to limit that optionality, so I do not give them much grief for that.

290. See Tax Cuts and Jobs Act, 131 Stat. 2054.

I suspect a minimum tax is part of our future, for better or worse, because incremental change tends to be the name of the game. I think that we will get changes to our minimum tax, and it will become tightened probably over time because of the deficit reasons that we have discussed today. That puts a lot of pressure on residence rules and having a residence-based taxing system, and it does seem like it might be worth it for Congress to revisit residence rules and try to provide a little less optionality.

I would note that our 2006 Model Tax Treaty—in the context of the limitation on benefits article—includes a real management-and-control test for residence.²⁹¹ We know management and control in Europe can just mean where you golf once a quarter, but our 2006 Model has a template for how you would write a real test for where a company is actually headquartered. I think the provision is also in the U.S.-Dutch Tax treaty,²⁹² which is why you do not see inversions to the Netherlands. The C-Suite would actually have to move to the Netherlands, and it turns out that is not as attractive as it sounds to the tax lawyers. Revisiting the U.S. test for corporate residence is not something the Obama Treasury really thought about much.

Picking up on a theme from earlier, I think a minimum tax is a halfway solution to the idea that we cannot directly protect the U.S. base, and I do think more should be done to shore up the U.S. base.

I do think our treaties are problematic in that we have given up source-based taxation in situations where the income on the other side is not subject to tax, and that creates wild incentives to overstate the income. I am intrigued by the idea of revisiting the debate on what is the right model treaty for the United States, and even thinking about subject-to-tax requirements on the other side. Although such a rule may be inadministrable, so there are reasons we have not done it before.

PROF. COLON: Thank you. Richard Phillips from the Institute on Taxation and Economic Policy (ITEP).

MR. PHILLIPS: First, I want to say I am so very happy to be here. To a lot of the folks that were on the panel before, and even this current panel, your work has informed what I have been doing for a long time, and I have learned a lot today, so I wanted to mention that.

Just to start out, because I am not like a lot of the other panelists—I am not a professor; I am not a lawyer. I guess there was one economist

291. U.S. Model Income Tax Convention, art. 4 (Nov. 15, 2006).

292. Tax Convention with The Netherlands, art. 26 (Jan. 1, 1994).

and then a lot of lawyers. I want to mention what ITEP is.²⁹³ We are a nonpartisan research and advocacy organization, but we do have two big principles in mind: adequate revenue and a fair tax system. That informs how we look at things, and you will see how that works.

I think there are two big things for which we are known. One is our tax incidence analysis. We have a micro-simulation model that is very much in line with the Joint Committee on Taxation and also with the Tax Policy Center. I think what also makes our model unique is that we can do state-level analyses. When Governor Cuomo, for example, proposed the “millionaire’s tax,” we were able to say, “here is how it impacts folks in New York.”

The other thing that makes us unique is that we are the ones digging into a lot of the 10-Ks and a lot of the reports. There is not a lot of great information—which I will talk about later—but, to the extent that there is information, we are the ones coming up and showing that a lot of these corporations, such as General Electric or Verizon or Boeing, are not, in fact, paying much in taxes.

The last thing I should mention is that we are part of the FACT Coalition, which is the Financial Accountability & Corporate Transparency Coalition, which has a lot of different focuses, but one of the focuses is cracking down on tax havens and working on international tax issues.²⁹⁴ The proposals I am talking about today are what we have been pushing over the past few months in Congress.

I will go through this quickly because we have already talked a lot about how the previous system was broken, but I just want to underline how we think about it. The way we saw it before was that we were losing about \$100 billion in revenue from the previous system, so when we think of international tax reform or what should have been, we see that there is \$1 trillion over ten years that we should be getting back. What ultimately happened was that we actually lost \$14 billion more.

What I would have liked was a system that actually raised a substantial amount of money instead of losing a little bit, so we obviously did not end up in a great place. Then, the Congressional Budget Office said, “To what extent did we crack down on tax avoidance?” They said

293. *About*, INST. ON TAXATION AND ECON. POLICY, <https://itep.org/about/> [<https://perma.cc/M7R5-LLP6>] (last visited May 15, 2019).

294. *About Us*, FACT COALITION: FIN. ACCOUNTABILITY & CORP. TRANSPARENCY, <https://thefactcoalition.org/about> [<https://perma.cc/R7QT-AZW2>] (last visited Mar. 20, 2019).

that we cracked down maybe by about twenty percent.²⁹⁵ They had said that there was about \$300 billion worth of profit shifting. Now, they are estimating about \$235 billion, which is about a twenty percent reduction.

The last thing I will say before jumping into our recommendations on how to deal with this would be to say I think it is important to emphasize why we are talking about this: (1) I think it is important to have a fair and efficient system and one that really makes sense; but (2) we are talking about revenue. We are trying to raise money to pay for things, and every dollar that we lose to international tax avoidance means higher taxes on other things—so, you have to raise taxes on businesses, you have to raise taxes on individuals. It means higher deficits, or it means cuts to spending. That is why we are talking about this.

If you come up with a new rule that loses a lot of money on the international side, you have to make that up somewhere, and we think it is important to make it up on the international side.

There are three big principles. I will spend a lot more time on the first one, but there are three principles we have been pushing on how to fix: 1) equalize the rates, 2) eliminate corporate inversions, and 3) create transparency. I will go through each of these.

What do I mean by “equalizing the rates?” In a big-picture sense, I think the problem that we have right now is that if a company is deciding where to put either its intangible income or, in many cases, its tangible investments, we want it to be so that if you have a choice between building a factory in Indiana or building it in Ireland or anywhere else, you would choose Indiana; or, at least, we do not want you to have a tax incentive to put it in Ireland.

How do you equalize the rates? Basically, we would eliminate a lot of deductions; so, we would eliminate the ten percent deduction for offshore assets, which is how GILTI is defined.²⁹⁶ Although I am surprised to hear a lot of people do not think this is the worst provision, I still think it is the worst provision because you have this bad incentive. I will be interested to see how the numbers work out as soon as more companies release this information because some folks have been saying they do not think there is going to be a lot of this income. I looked at a handful of companies, particularly manufacturers, who are the ones we are concerned about politically because they are moving factories. I saw

295. See CONGRESSIONAL BUDGET OFFICE, *supra* note 123, at 127.

296. See Tax Cuts and Jobs Act, 131 Stat. 2054, 2208.

that they do get a big tax break on the back end, but I will be interested to see more data on that.

The second thing would be to eliminate the fifty percent deduction on GILTI. Instead of having a 10.5 rate, you should have a twenty-one percent rate. That way, you have an equal rate either way. One thing about which we have been talking to lawmakers is the fact that the Obama Administration's tax had a minimum tax of nineteen percent and a top rate of twenty-eight percent.²⁹⁷ We talked to one lawmaker, and they said, "Well, why do we not do the Obama proposal and keep the current rate?" I said, "At the point at which you are at nineteen percent minimum tax, you might as well just do the twenty-one percent and have it be even." That is the way we have been looking at it.

One of the other two smaller things that are also important is that I think you would need to eliminate the break for Foreign Derived Intangible Income ("FDII"). This does not seem to be that effective. We are not hearing about lots of corporations moving their intangible income back to the United States—it is simply not effective in that regard. I think it is more of a windfall way of losing a bunch of money and not getting anything out of it. Again, as Danielle talked a lot about, we would apply the U.S. tax rate on a country-by-country basis. This has been one of the things that has gotten the most attention from lawmakers when we talked to them or staffers when we talked to them. They seem to like this idea.

Second, I think we need to eliminate corporate inversions. I think this is important for two reasons: (1) it is self-serving because, as part of a comprehensive package, what I am proposing would create a real risk of companies expatriating, so you need some ways to crack down on that; and (2) I think it is something that is low-hanging fruit that should have been done. I do not understand why they did not put some of these provisions in their new code. Maybe they figured that it is the Democrats' job to take care of that. But I think you need to put those final pieces in there. For example, we even saw Dana Holding, an auto parts supplier, is doing an inversion under this current system. So, I think you need to take the low-hanging fruit.

I divide the ways in which you can eliminate inversions into two buckets. One is what was in the Stop Corporate Inversions Act,²⁹⁸ which had more to do with the definition of a foreign company. You put in these

297. See U.S. DEP'T OF TREASURY, *supra* note 270, at 20, 156.

298. See Stop Corporate Inversions Act of 2017 S. 1636, H.R. 3434, 115th Cong. (2017).

management-control provisions about which we have talked. Also, if the company is held by a majority of the same U.S. shareholders once they do a merger, then they still should be considered a U.S. company.

The second bucket is ways in which foreign companies are advantaged over U.S. multinationals. I think it would be good to crack down on that in general, but I think it is a disincentive to invert. You need to curb deductibility of excess interest payments. I would go along with the Obama proposal. You get some of this by cracking down on interest payments in general, and you get some of this in the 385 regulations.²⁹⁹ I think it would be good to have it as a permanent part of the code. I have a continuing worry that they will just strip that out of the regulations, so I would like it to be part of the code. Also, I think it should be stronger.

The other thing that I would look at along these lines would be enhancing the BEAT.³⁰⁰ I guess I am on the team of: “I really like the idea of the BEAT.” I think it needs to be reformed to include costs of goods sold; this would be a big piece in fixing it.

Finally, one thing that has not been mentioned, which is something we would like to see in the future system, is to require public disclosure of country-by-country financial information. I think one of the things that underlies a lot of the discussion we have had today is that we do not have a publicly available system of looking at how much companies are paying or where their payments are. In many cases, the companies themselves, or the accounting firms, know what they are doing and have a lot of opinions about it, but the public does not.

In many cases, when we have these high-profile cases of tax avoidance like Apple, it is because the U.S. Senate subpoenaed a company and forced them to do that. We should not depend on Senate subpoenas to figure out what is going on with the international tax system, so I think it would be good to have a public debate. But, I also think that there is momentum behind additional disclosure in the realm of corporate taxes, as opposed to other areas of corporate disclosure—it is just a question of how much additional disclosure will be required.

The reason that additional disclosure is likely to happen is because investors have been pushing for this for a while because they, over the past several years, have had lots of big surprises. You have cases where, to use Apple again, suddenly the investors did not know that there was

299. See generally 26 U.S.C. § 385 (2012) (authorizing regulatory discretion for determining when an interest in a corporation will be treated as stock or indebtedness).

300. See Tax Cuts and Jobs Act, 131 Stat. 2054, 2226.

going to be a \$14 billion charge for the European Commission,³⁰¹ and maybe if they had had some information showing that \$100-and some billion had zero tax on it, they would say, “Well, there might be a tax risk there.”

There are numerous other examples like Facebook³⁰² and Caterpillar,³⁰³ over and over again, where suddenly investors are not told that there is this huge tax risk. I think some additional information definitely is going to be disclosed. Right now, the Financial Accounting Standards Board is going through a whole review process of looking at income tax disclosures.³⁰⁴ We have been pushing for full country-by-country reporting to be required, but, at a minimum, I would expect them to break out more foreign tax and foreign income, which is what their latest draft proposal said.³⁰⁵

The last piece of this about which I was going to talk, and getting to the theme of the conference is, what is the future? Right now, I do not think you have seen too many proposals from Republicans so far. I would be interested to see what their proposals are. I think a lot of their focus has been on the regulatory piece of it and on defending the current system

301. Sean Farrell & Henry McDonald, *Apple Ordered to Pay €13 Billion After EU Rules Ireland Broke State Aid Laws*, THE GUARDIAN (Aug. 30, 2016), <https://www.theguardian.com/business/2016/aug/30/apple-pay-back-taxes-eu-ruling-ireland-state-aid> [<https://perma.cc/97HC-B625>].

302. See, e.g., Facebook, Inc., Annual Report (Form 10-K) 17 (Jan. 31, 2019), <https://www.sec.gov/Archives/edgar/data/1326801/000132680118000009/fb-12312017x10k.htm> [<https://perma.cc/356R-7XVJ>].

303. See, e.g., Peter J. Reilly, *Lawsuit Against Caterpillar For Inadequate Tax Disclosure Dismissed*, FORBES (Oct. 4, 2018, 6:13 PM), <https://www.forbes.com/sites/peterjreilly/2018/10/04/lawsuit-against-caterpillar-for-inadequate-tax-disclosure-dismissed/#1d95e2561166> [<https://perma.cc/9NPT-EH9N>].

304. See FIN. ACCOUNTING STANDARDS BD., PROJECT UPDATE: DISCLOSURE FRAMEWORK-DISCLOSURE REVIEW: INCOME TAXES (Mar. 27, 2019), https://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdateExpandPage&cid=1176170683850 [<https://perma.cc/UBB4-U9W5>].

305. See FIN. ACCOUNTING STANDARDS BD., EXPOSURE DRAFT: PROPOSED ACCOUNTING STANDARDS UPDATE (Jul. 26, 2016), https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168335332&acceptedDisclaimer=true [<https://perma.cc/NV7R-STMZ>]. After the Symposium was held, the Financial Accounting Standards Board issued an updated Exposure Draft. See FIN. ACCOUNTING STANDARDS BD., EXPOSURE DRAFT: PROPOSED ACCOUNTING STANDARDS UPDATE (Mar. 25, 2019), https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168335332&acceptedDisclaimer=true [<https://perma.cc/4RJV-XX5W>].

because it is hard to immediately reform the tax system and then immediately say we messed up and here is a lot of legislation to fix it.

The Democrats have had several different proposals that fit in with the outline of proposals through which I have just gone. The most comprehensive is the No Tax Breaks for Outsourcing Act from Representative Lloyd Doggett and Senator Sheldon Whitehouse.³⁰⁶ I will note that this one in the House has seventy-seven co-sponsors right now, so it is not a fringe piece. It is getting a lot of attention in the House.³⁰⁷ What it would do is eliminate the fifty percent deduction on GILTI, eliminate the ten percent deduction on offshore assets, take a run at curbing the inversions, and eliminate the FDII as well.³⁰⁸ The idea is to try to shift to an area where we will have more equal rates and curbing inversions.

The second piece of legislation is the Close Tax Loopholes that Outsource American Jobs Act, which eliminates the fifty percent deduction on GILTI.³⁰⁹

Finally, the Per-Country Minimum Act by Representative Peter DeFazio sets the GILTI break to match the FDII rate, so it just raises the rate a little bit.³¹⁰ But, more importantly, it does take a stab at applying this on a per-country basis.

Although I think there is still some work we need to do on filling in the details of how it will work, conceptually, the idea is to rebuild the GILTI into an Obama minimum tax. For additional information, I have a longer report on all this.³¹¹

PROF.COLON: I wanted to comment on a couple of things that have been addressed. Everyone here has said that it is unstable. My view is that we should give it a shot.

I think Rosanne says, “we should get some data, even if after a few hours of reflection, people here can find some huge holes in this.” My

306. See No Tax Breaks for Outsourcing Act, S. 2459, 115th Cong. (2018).

307. See *Cosponsors: H.R. 5108, 115th Cong. (2017-2018)*, CONGRESS.GOV <https://www.congress.gov/bill/115th-congress/house-bill/5108/cosponsors> [https://perma.cc/65YJ-5NV3] (last visited May 16, 2019).

308. See generally *id.*

309. See Close Tax Loopholes That Outsource American Jobs Act H.R. 5145, 115th Cong. (2018).

310. See Per-Country Minimum Act H.R. 6015, 115th Cong. (2018).

311. Richard Phillips, *Understanding and Fixing the New International Corporate Tax System*, ITEP (Jul. 2018), <https://itep.org/wp-content/uploads/fixinginternational-system0718.pdf> [https://perma.cc/LZL8-JS6G].

view is that I think they are going to be fixed in some way or another and, of course, all legislation can be improved. It took us thirty years to get here, so I think waiting and seeing how it works out and trying to obviously make some administrative changes can improve the outcome. Ultimately though, we know it is going to have to be done legislatively because the problems are too profound.

Another thing which people have started talking about is that this Act gets rid of any pretense of taxing similarly investment returns earned through different legal entities. Almost all of the benefits for foreign source income—the GILTI deduction, the DRD, and the foreign tax credit—are limited to U.S. corporations.

If you look into the legislative history, you do not see why everything has to be run through a U.S. company. If you want to operate as a pass-through—there is no one here raising their hands for the venture capital (VC) people—but there are large closely held companies in the United States that do a lot of business abroad. It seems ridiculous to me that they have to consider running everything through a C-corporation in order to get the benefits of the fifty percent deduction or the DRD or the foreign tax credit.

Another thing is that now we have created this system where we have thrown the GILTI and the territoriality of the one hundred percent DRD on top of the old system, the Subpart F. It is not clear to me why we care about base company sales or base company services anymore when those are a foreign issue rather than a U.S. issue—although, maybe they were a 482 inbound/outbound issue originally. Additionally, I am not sure why they should continue to be in Subpart F and why they are not thrown into GILTI, especially, as Stephen says, when people, particularly the high-taxed entities, are thinking it is very easy to go back into Subpart F. The planning the last ten years is to jump out of Subpart F. It is not too hard to go back in, especially for sales, and that to me seems somewhat of a concern.

MS. ROLFES: Affirmative Subpart F planning would be irrelevant in a per-country system.

PROF. COLON: Which we do not have.

MR. SHAY: I want to mention at least two things. One is how the U.S. should think about taxes its taxpayers pay to foreign countries, which is a deeper question and not easily dealt with in the time we have available. I respectfully disagree, however, that the United States does not get welfare benefits from our taxpayers paying taxes in foreign countries. I do not think that is a zero-welfare situation. Some of the discussions we

have had formally present it that way. I do not think anybody believes that ultimately, but I do not know how much benefit we do get. In an interconnected world with migration and terrorism, I think that is an issue worth thinking more about.

The same analysis goes to the question of, “Oh, why should we do anything about foreign-to-foreign?” I was interested to hear that it was not relevant to much of the analysis when you were doing the Obama minimum tax, but that raises the same policy issues. What those issues ultimately get to is: if we do not protect other countries’ taxes, they are not going to protect ours. It is driving us toward this unilateralist, every-person-for-themselves approach to the world, and that is worthy of much deeper thought.

Another question that came up earlier—and I am very concerned about the facile answers that have been given to this question over a long period of time—is: do we think this is an improvement over prior law? I would make two observations: 1) if you ignore the reduction in corporate tax rate, if the question is, “Do I think the international provisions are an improvement over prior law,” essentially, I am trading immense complexity for getting rid of the so-called “lockout.” Again, I am a bit of a dissenter. I never thought lockout was all that important, and even if we give it a five percent value as we were talking about earlier in the model that Rosanne was using at one point, the question is, “is it worth the transition?”

So the question is not just, “is one better than the other?” It is, “is the new one worth adding to the transition cost of getting there?”

Everything is going to be changed. Every model is going to be changed. Every accounting system will need to be adjusted. The cost of transition is very substantial. I do not think we are going to show that the benefits of getting rid of lockout are economically significant at all, and I think that will prove out over a couple of years.

Having said all that, my second observation is that we have already spent much of the cost of transition. We cannot take back the mandatory tax. We cannot take back the cost that has already been spent. It is not a helpful question, “is it better than prior law,” without thinking about transition, but, frankly, that question is too late. That question has to be asked during the legislative process.

Which brings me to what this bill was all about. I was at the Treasury in 1984 through 1986, working three years on the Tax Reform Act.³¹² This

312. See Tax Reform Act of 1986, 26 U.S.C. § 1 (2012).

bill was done in three months. The first text was introduced in October of 2017; it was passed on December 22nd of the same year.³¹³ It was all about one thing; having a tax act to show voters for the midterm elections.

PROF. COLON: And donors.

MR. SHAY: And donors, and now we are seeing that it is not having much of an impact electorally. This is an enormous squandering of national wealth for political objectives that are not even proving out. I think part of the lesson here is remember this for next time. Do not let this happen again.

PROF. SHAHEEN: I have a question for Danielle. I am happy you mentioned the expense allocation importance. When you started talking about it, I thought you were going in one direction, but then you said something, and I have a question about that. We have, I think, three policy choices regarding exempt income: 1) allocate expenses to exempt income and disallow it, 2) allocate and allow, or 3) allow and allocate away. That is what current law is in general; it is Section 904(b)(4).³¹⁴ We are allowing the deduction and allocating away expenses from exempt income for the foreign tax credit limitation. There is no express provision to disallow the expense. We have Section 265.³¹⁵ That does not apply here, and that is a problem.

Before the Act, the only exempt income we had, I think, was interest on municipal bonds. The DRDs we had were outside the scope of Section 265. They were not about exempt income because their purpose was to prevent the United States from taxing the same corporate income twice, so the income was taxed. That was not a problem. Now we have Section 245A,³¹⁶ which is exempt income, and GILTI, which is fifty percent exempt effectively, and both are not subject to Section 265, and I think that is what you were saying before—that the Camp proposal considered five percent to be proxy for that with a participation exemption.³¹⁷ What is happening today is we have a full participation exemption subject to GILTI. GILTI itself is fifty percent tax, fifty percent exempt, and my

313. See, e.g., Caroline Rand Herron & Martha A. Miles, *Tax Bill is Signed, And Its Revision Gets Under Way*, N.Y. TIMES (Oct. 26, 1986), <https://www.nytimes.com/1986/10/26/weekinreview/the-nation-tax-bill-is-signed-and-its-revision-gets-under-way.html> [<https://perma.cc/Z8TM-9QVP>].

314. See Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054, 2191 (2017).

315. See generally 26 U.S.C. § 265 (2012).

316. See generally Tax Cuts and Jobs Act, 131 Stat. 2054, 2192.

317. See Lydia Austin et al., *Description and Analysis of the Camp Tax Reform Plan*, TAX POL'Y CTR.—URB. INST. & BROOKINGS INST. 18 (2014).

question is: is that not the problem? Allocating and disallowing seems to me the most normatively correct option with which to proceed.

MS. ROLFES: I think you have said a few different things. First is to separate between having a primary rule that says, “if a deduction is allocable to exempt income or to income that is taxed at a reduced rate, we are going to disallow the deduction or disallow part of the deduction,” and we have no such rule in the code to say that. That is your Section 265, and there is nothing like that. All that we have is foreign tax credit rules. The allocation of expenses to exempt income or to GILTI basket only becomes relevant if you are foreign tax credit limited. You are right to point out that I blew past the fact that there is a rule saying that you get to allocate expenses to the exempt portion.³¹⁸ That is generally a taxpayer-favorable rule because it takes deductions away from GILTI, where I am relying on a foreign tax credit basket.

But that allocation of the deductions that are relevant to the exempt income is only relevant for foreign tax credits that are being claimed against GILTI and the branch-basket income because that is my high-taxed income that is limited.

PROF. SHAHEEN: Because you do not have a Section 265—

MS. ROLFES: Because we do not have a Section 265. The Obama proposal would have had the equivalent of Section 265, so it would have matched the treatment of deductions to the way we treat the income. Did I answer your question?

PROF. SHAHEEN: Yes. So here is my question: is there any policy rationale for current law, for not doing—

MS. ROLFES: For not having an allocation? There is—and I have had this debate on panels before—which is that other countries allow those deductions, in particular with respect to interest. Other countries allow the interest deductions that support CFCs. There are papers written saying that it is anticompetitive for the United States to be an outlier by denying those deductions, among others.

MR. SHAY: That is just a subsidy, though, is it not?

MS. ROLFES: I have had this conversation with taxpayers where I say, “That is a negative rate, so you are saying you need that subsidy?” They finally just come down to saying: “Yes, that is my argument. That is what I am asking for.”

318. See generally 26 U.S.C. § 162 (2012) (outlining the business expenses that are allowable as a deduction).

That is the policy argument, though, that other countries are providing that subsidy, so we should match it. That argument in this world of the United States being an outlier seems like it is not relevant anymore. But that is the argument, that we should have that negative rate because other countries allow it.

PROF. SHAHEEN: So that is the policy rationale for what is happening now?

MS. ROLFES: I do not even know what they thought.

PROF. COLON: What you are saying is that is the policy.

MR. SHAY: Can I just read you the first sentence of Section 265? “Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest, wholly exempt from the taxes imposed by this Subtitle . . . no deduction should be allowed.”³¹⁹ The fact is the application of Section 265 to non-interest expense has been totally cut back by regulation. The issue that students who want to be provocative might think about is that we do not have to have the outcome we have in this legislation. It could be changed by regulation with respect to non-interest expense. That is the hypothesis. I am not stating that as a correct statement. I am saying that is a paper for somebody to write. Thank you.

PROF. COLON: I think we would like to hear the final concluding remarks from Steven Dean of Brooklyn.

319. 26 U.S.C. § 265(a)(1) (2012).

CLOSING REMARKS

PROF. DEAN: I want to thank Fordham for sponsoring this event, Dean Sugin, Professor Kysar, and especially the *Fordham Journal of Corporate & Financial Law*. I do not know what made you think tax would be a fun way to spend your afternoon, but I am glad you thought so.

I am going to direct my remarks to the students in the room—apologies to the folks who have thought deeply about the TCJA—because, for all of you who have not spent decades thinking about tax law, I want to underscore that we are all excited here. We are not an excitable bunch, but we are excited, and I want to help you understand why what is happening now is a big deal.

When you think about the rules that we have today, the treaties we have been fighting about—are they good, are they bad, are they indifferent?—all date, as we mentioned, from the early 20th century, by way of the League of Nations Covenant. The same team of internationalists who, before World War I, thought war was obsolete and who brought you Esperanto.

My argument is that there is effectively, and has been for almost a century, a cross-border tax constitution. Very simple. It just says we are not going to double tax. That unwritten constitution grew out of the post-World War I concerns that drove the creation of today's tax treaties. It was not the adoption; these treaties were not adopted until after World War II, but there was broad consensus among experts that tax treaties were a good idea. There was agreement that double taxation posed a threat to cross border ties, and in the wake of World War I, such a threat was not to be taken lightly.

Given how much has changed over the last century, it should not be too surprising that we find ourselves in—and this is why we are all so excited—what is referred to as a “constitutional moment.”³²⁰ I think we are redrawing the basic contours of international tax landscape. The trigger here was the financial crisis. Before the financial crisis and the austerity that followed, there were not many headlines—certainly not in the popular press—about international taxation. After the financial crisis

320. See generally BRUCE ACKERMAN, *WE THE PEOPLE: FOUNDATIONS* (Harvard Univ. Press ed., 1991) (describing a “constitutional moment” as a period of heightened concern and deliberation about the Constitution).

and the austerity that changed, it became commonplace, at least something about which you might talk.

Now, we have a European Commission pointing out something new. Simply put, it is the controversial idea that what states do in the cross-border tax context can create tax subsidies. Paired with tax rates around the globe, including in the United States finally, that are quite low, that focus on double non-taxation when the risk of double taxation has diminished creates the possibility of a profound shift. For a century, the focus fell on the threat of too much tax—but that may change.

We are in a moment where the world—at least our small corner of it—may pivot. We had a heated discussion about whether tax treaties were harmful or not. That did not happen fifteen years ago. That was not a conversation. A small minority might have viewed treaties with skepticism, but treaties have never been the subject of widespread criticism. I want to emphasize this to the folks who are not tax specialists, I cannot tell you how mind-blowing it is that there is a real scholarly discourse about whether tax treaties are helpful. That is earth shattering. I do not know if I can convey that to all the folks out in the room.

But while change is possible, it is not inevitable. Which brings us to the TCJA. When you have a constitutional moment, a moment when the basic contours of the consensus that we live with can change, there can emerge what some have referred to as a “conservative counter-mobilization.”³²¹ In a nutshell, this represents an effort to preserve the status quo. And the TCJA could be seen as an argument that: “Everything is pretty much okay. We just need to maybe make a few bureaucratic fixes. Maybe we will add a minimum tax or target certain abuses, and everything will basically be fine.”

Amending a constitution, of course, is not easy. In this case, the conservative counter-mobilization may well win on the day. We may end up with very incremental changes to our basic framework. But, today, it is possible to imagine a world without tax treaties, which I assure you, would have been almost inconceivable just a few decades ago.

I urge you all, even if you do not end up being tax lawyers—and we want you all to become tax lawyers—to keep an eye on this. I think you all, after spending a whole afternoon learning about the TCJA, are in a unique position to understand what is happening. Tell your friends! It is very exciting.

321. See *id.* at 287.

Thank you very much, and thanks to all the panelists. A really interesting afternoon, Rebecca.

PROF. KYSAR: Thank you again everyone for coming.