Testimony for the Hearing "Cross-border Rx: Pharmaceutical Manufacturers and U.S. International Tax Policy"

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Good morning Chairman Wyden, Ranking Member Crapo, and distinguished members of the Committee. My name is Diane Ring. Thank you for the opportunity to testify before you today on the pharmaceutical industry and U.S. international tax policy.

The past 6 years have witnessed significant shifts in the regulatory and economic structure of international taxation of multinational enterprises. That said, the United States continues to face a number of familiar challenges in ensuring that U.S. multinationals contribute to U.S. tax revenue collections at an appropriate level consistent with fair business taxation.

The 2017 Tax Cuts and Jobs Act (TCJA) dramatically reduced corporate tax rates and embraced "territoriality" in significant ways, pursuing a mixed policy of exemption, and current taxation of foreign income that failed to end significant profit shifting.[1] In some cases, new tax rules rewarded U.S. businesses for making investments offshore and the overall rules maintained significant advantages for offshore income. The GILTI regime was introduced as a floor or minimum tax on the most mobile of U.S. multinationals' foreign income. However, notable design features severely hampered its ability to function as a meaningful minimum tax, a costly failure given the significant reduction in corporate tax rates and the even lower U.S. rate of tax on much foreign income. As detailed in the Senate Finance Committee's interim report, "Big Pharma Tax Avoidance" (July 2022), U.S. pharma leader AbbVie Inc. explicitly anticipated and then achieved significant effective tax rate (ETR) reductions post-TCJA. The multinational reported ETRs of 8.6%-11.2% on book income from 2018-20, far lower than the new low statutory corporate rate of 21%. During this same period, AbbVie was generating the vast majority of sales in the U.S. yet reporting most of its book income offshore.

The next rounds of tax reform in the United States should increase revenue from those with the ability to pay and recognize the ongoing capacity of U.S. multinationals to strategically offshore, to minimize their income taxes in ways not consistent with broader U.S. tax policy, and to accomplish these feats while profiting from a predominantly U.S. market base. But in this next round, the U.S. will not be pursuing its tax policy goals alone. Despite the continued offshoring

[1] For further analysis of continued profit shifting post-TCJA, see Javier Garcia-Bernado, Petr Jansky, & Gabriel Zucman, "Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinationals?," NBER Working Paper No. 30086 (May 2022), http://www.nber.org/papers/w30086; Kimberly A Clausing, *Profit Shifting Before and After the Tax Cuts and Jobs Act*, 73(4) Nat'l Tax J. 1233-1266 (2020), https://ssrn.com/abstract=3274827.

problems following the 2017 reform, GILTI served nonetheless as a springboard globally for the international tax community to collectively pursue, design and ultimately agree to a stronger global minimum tax under the OECD/G20 Inclusive Framework's Pillar Two. In that way, the vision articulated by the U.S. designers of the GILTI regime in 2017—a minimum tax to curtail serious profit shifting—was one that more than 140 countries ultimately signed onto and tried to improve upon.[2] Not surprisingly any agreement in the tax and fiscal arena involving over 140 jurisdictions will inevitably entail compromises and complexities, but the feat is notable as we can appreciate, given the challenges domestically in reaching bipartisan agreement on budgets and debt limits. That said, the most recent Pillar Two guidance released in February 2023 has furthered key U.S. objectives in the design of Pillar Two rules.[3]

At this point the United States has the opportunity to advance its 2017 embrace of a minimum tax that will meaningfully counter long-standing profit shifting by U.S. multinationals. To the extent the United States has played a leadership role and wanted to see the global community come on board, that has now happened. To ensure that these achievements are not wasted, that U.S. multinationals cannot avoid tax on significant revenues, and that the U.S. secures important tax revenue streams, tax policy reform in the United States should focus on strengthening GILTI and revising the rate structure.

Questions about the revenue implications of these new directions and developments in international taxation are valid and important – but they need to be focused on the right issues. Global adoption of the Pillar Two minimum tax should result in other countries taxing businesses operating in their jurisdictions (including U.S. multinationals). This is a global minimum tax regime operating as it should: providing a floor of taxation, leveling the playing field, eliminating a race to the bottom, and enabling countries to collect corporate tax revenue from businesses operating in their jurisdiction. Moreover, this outcome is what was requested by U.S. policy makers who wanted to see other countries commit to a minimum tax before the U.S. took further steps – they sought to guarantee that the U.S. and its multinationals would not be alone in making this move. The U.S. has long advocated for a coordinated global tax base to ensure a level playing field for our multinationals and to encourage efficient global investment and trade. The Pillar Two implementation timetables[4] of the European Union, South Korea, and a host of other jurisdictions

[2] At the release of the OECD/G20 Inclusive Framework Guidance on Pillar Two, 142 jurisdictions agreed to the guidance. See Treasury Dept., "Treasury Welcomes Clear Guidance on Pillar Two Global Minimum Tax, Tax Credit Protections," (Feb. 2, 2023), https://home.treasury.gov/news/press-releases/jy1243.
[3] OECD/G20 Inclusive Framework on BEPS, "Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), (Feb. 2, 2023), https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf.
[4] See Bloomberg, "OECD Pillar Two Country-by-Country Implementation Roadmap," (2023), https://pro.bloombergtax.com/reports/pillar-two-implementation-roadmap/?trackingcode=BTXI22109098; OECD, "Global Pillar Two Developments Tracker," https://oecdpillars.com/pillar-two-tracker/.

have resolved that question of international commitment and now enable the United States to work toward establishing minimum tax rules that successfully curb profit shifting and base erosion.

The benefit to the United States of this global agreement on a minimum tax extends far beyond enabling the U.S. to continue on its 2017 minimum tax path without fear of being alone. The United States also benefits as other jurisdictions, who historically have struggled to collect meaningful corporate tax revenue from multinationals operating in their own country, are finally able to do so. The tax on income earned by foreign multinationals operating in these other countries is legitimately these countries' tax revenue. Additionally, U.S. security, economic, and strategic interests are furthered by these countries' ability to collect their tax revenue. When other countries face ongoing tax revenue constraints, they are limited in their capacity to address critical issues including economic stability and growth, climate change, democratic functioning, and political security. Failures on these fronts generate flows of economic migration, fragile and potentially concerning political states, and fewer partners to help combat the serious global issues facing the United States in the coming decades including climate-related health and economic disruptions, pandemic and global health issues, and wars of aggression. In no way is the United States' future improved by the continued existence or proliferation of states unable to respond to these problems or to meet the needs of their citizens, residents, and the world.

Finally, as countries adopt Pillar Two, less income should be shifted out of the United States, thus increasing U.S. tax revenues. Moreover, any tax revenue collected by other jurisdictions on U.S. low tax operations (whether through the IIR in the case of foreign based multinationals, or UTPR for US multinationals) would not reduce U.S. tax revenues.

At this stage, the U.S. focus should be on making its international tax rules more effective in protecting the U.S. tax base by narrowing or closing off the rate gap with the global minimum tax and allowing more efficient and effective taxation of U.S. business operations of U.S. and foreign-parented multinationals. This will entail bringing the GILTI rate closer to the statutory corporate tax rate, eliminating gaps in the GILTI regime that significantly reduce its capacity to enforce a minimum tax, coordinating U.S. tax rules effectively with Pillar 2, and bringing the corporate tax rate more in line with historic U.S. rates and tax burdens borne by other U.S. taxpayers. The United States almost certainly is a net revenue winner from other countries' adoption of Pillar Two. Adoption of the Administration's proposals would assure that this is the case.

This testimony proceeds in three parts: (1) brief overview of pre-2018 U.S. international tax and profit shifting; (2) impact of TCJA; and (3) implications of Pillar Two for the United States and the taxation of U.S. multinationals. Finally, the testimony supports several recommendations going forward.

1. U.S. International Taxation and Profit Shifting Pre-2018

Although well documented, it is worth noting that U.S. multinationals have engaged in successful profit shifting for decades through a mix of tax strategies. Tax reforms adopted during these years (ranging from the CFC regime to enhanced transfer pricing regulations to section 367(d)) ultimately failed to sufficiently curb the shifting and strategies. Some new rules, such as check-the-box regulations,[5] actually exacerbated and facilitated profit shifting and the creation of what became known as stateless (no-where taxed) income.[6] Multinationals in all business sectors could and did pursue profit shifting, but businesses with substantial intangibles were distinctly well positioned to do so given the mobility of income from intangible assets, including, as a result of cost sharing, intangible assets that continue to be legally owned in the United States while generating income reported offshore. The U.S. pharma industry was a highly profitable, intangibles-driven sector reporting foreign profits disproportionately high relative to foreign sales—that is, much or most of their sales were in the United States but corresponding profits were shifted to low tax jurisdictions.[7]

2. Impact of TCJA on U.S. Taxation of Multinationals

The TCJA introduced a host of significant corporate reforms. As noted, the statutory rate dropped from 35% to 21% and the mix of international tax reforms embraced the goal of lessening profit shifting while simultaneously creating explicit categories of U.S. multinationals' foreign income that would never be subject to U.S. income taxation. The net effect for some multinationals, notably pharma corporations, was a major reduction in ETR that compromised the new GILTI minimum tax role. Additionally, the 2017 reform introduced new provisions which created undesirable incentives to shift assets and operations offshore.

Testimony before this committee in March 2021[8] by Chye-Ching Huang identified in some detail the defects in the 2017 reform. Here I reiterate some of those key points[9] and reference the

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[5] For a recent empirical examination of check-the-box, based on the Irish government's closure in 2015 of the Double Irish structure which had been greatly favored by U.S. multinational pharma and software companies, see Navodhya Samarakoon, "The Effect of the Closure of the Double Irish Loophole on the Location of U.S. Multinational Companies' Profits," (April 2023), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=4285001.

[6] Roseanne Altshuler & Harry Grubert, *The Three Parties in the Race to the Bottom: Host Countries, Home Countries, and the Multinational Corporations,* 7 Fla. Tax. Rev. 137 (2005): Harry Grubert, *Foreign Taxes and the Growing Share of U.S. Multinational Company Income Abroad: Profits not Sales are being Globalized,* 65 Nat'l Tax J. 241 (2012); Edward Kleinbard, *Stateless Income*, 11 Fla. Tax. Rev. 699 (2011). A series of studies was recently reviewed in Congressional Research Service, "Tax Havens: International Tax Avoidance and Evasion," R40623 (Jan. 6, 2022).

[7] See Martin A. Sullivan, *Pharma Profits Are Mostly Overseas, But Only Amgen is in Tax Court*, Tax Notes Int'l (Mar. 20, 2023), p. 1618, https://www.taxnotes.com/tax-notes-international/audits/pharma-profits-are-mostly-overseas-only-amgen-tax-court/2023/03/20/7g7hr?highlight=Pharma (reviewing pharma industry data from 2010 to the present).

[8] Chye-Ching Huang, "Testimony for the Hearing 'How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment,'" (March 25, 2021), (testimony before the Senate Finance Committee), https://www.finance.senate.gov/imo/media/doc/Huang%20testimony%2003220221%20rev.pdf.

[9] See also Kimberly Clausing, "Testimony Before the U.S. Senate Committee on the Budget" (April 18, 2023), https://www.budget.senate.gov/imo/media/doc/Dr.%20Kimberly%20A.%20Clausing%20-%20Testimony%20-

remainder: (1) the GILTI regime explicitly authorizes a permanent exclusion from U.S. taxation for a significant portion of a controlled foreign corporation's (CFC) income; (2) the size of this exclusion turns on the amount of assets (QBAI, or Qualified Business Asset Investment) held offshore[10] thus incentivizing U.S. multinationals to shift or locate tangible assets in their subsidiaries offshore and encouraging production activities outside the U.S. The incentive is significant given that income earned in the U.S. would bear the 21% corporate rate, whereas income securing this exclusion abroad would bear no U.S. income tax; (3) the GILTI regime's global, rather than country-by-country, approach to determining a U.S. multinational's effective tax rate on its (CFC) income perversely encourages U.S. multinationals to invest in high tax foreign jurisdictions over the U.S., because of the GILTI benefits achieved from blending the foreign high tax income with the foreign low tax income;[11] and (4) the GILTI rate remains significantly below the U.S. statutory corporate tax rate and thus even when it applies, the taxpayer still enjoys a significant rate advantage by shifting or generating its profits offshore.

Data post-TCJA's implementation reveal that the anticipated harm from these defects in the new provisions (combined with existing rules) can be seen in pharma industry operations. These taxpayers were able to secure exceptionally low effective tax rates on what was in large part income on sales to U.S. customers. Other testimony will address this in more detail. Here, I offer a snapshot to demonstrate the scale and significance of the tax design failures and the importance of further reform.

First, as referenced above, the Senate Finance Committee's July 2022 report[12] highlighted AbbVie's low ETR on taxable income from 2018-2020, the same years during which it reported major sales in the U.S. and mostly offshore income. A look at AbbVie's 2022 10-K reveals these patterns continued. The pharma corporation reported negative book earnings before tax (EBT) in the U.S. in 2020, 2021, and 2022 and significant positive EBT outside the U.S. Despite these earnings numbers, and consistent with prior years, AbbVie reported predominantly U.S. book revenues: 76% of 2020 net revenues were based in the U.S., 76% in 2021, and 78% in 2022.[13]

%20Senate%20Budget%20Committee.pdf; and James Repetti, *International Tax Policy's Harm to Manufacturing and National Interests*, 2023(4) Wisc. L. Rev. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4368322.

[10] This is accomplished through the GILTI exemption for 10% of QBAI (qualified business asset investment) – essentially this can be understood as an exemption for an amount of income equal to a 10% return on U.S. multinationals' foreign tangible assets. I.R.C.§ 951A.

[11] Similar incentives to locate offshore were incorporated into a companion provision to GILTI, Foreign-Derived Intangible Income or FDII, which offers reduced tax rates for foreign income earned by U.S. corporations according to a formula which rewards having fewer tangible assets in the United States. I.R.C.§ 250.

[12] Senate Finance Committee, "Interim Report: Big Pharma Tax Avoidance," (July 2022), https://www.finance.senate.gov/imo/media/doc/Pharma%20Tax%20Report.pdf.

[13] AbbVie Inc., 2022 10-K, at 37, at https://investors.abbvie.com/static-files/b348f3b1-84d1-41f6-ba6e-4cd17953fd8d.

Given this mix of earnings and sales data, the reported low book ETRs of 11.1% in 2021 and 12.1% in 2022,[14] were not surprising.[15]

Second, the success of U.S. pharma companies in offshoring profits despite significant U.S. sales is not limited. For example, in its 2022 10-K, Merck & Co., Inc reported the percentage of its sales that were U.S. based as 46% in 2021 and 45% in 2022.[16] At the same time Merk reported the percentage of its book income that was U.S. as 13% for 2021 and 6% for 2022.[17] With such reported numbers, the resulting reported book ETRs are not surprising: 11.7% for 2022, 11% for 2021.[18]

The Senate Finance Committee's ongoing investigation in Amgen Inc.'s tax practices[19] reveal similar patterns: per the corporation's 2021 10-K, it reported effective tax rates on book income consistently below the U.S. statutory rate (ETRs of 12.1 % in 2018, 14.2 % in 2019, 10.7% in 2020, and 12.1% in 2021), despite having most of its customer base in the United States.[20] For example, during 2021, 70% of Amgen book sales revenue derived from the U.S.,[21] while the corporation reported only 28% of its pre-tax book income in the United States.[22] As the Senate Finance Committee letter to Amgen observed, by placing 70% of corporate profits and pre-tax book income outside the U.S. (a substantial portion of which were generated by U.S. sales), Amgen would have achieved the goal of having what in reality were profits from U.S. customers escape the U.S. statutory corporate rate of 21% and face only GILTI regime 10.5% or perhaps exemption.

Congress revisited corporate minimum taxes in the Inflation Reduction Act of 2022 with the enactment of the Corporate Alternative Minimum Tax (CAMT).[23] CAMT imposes a minimum tax on corporations with more than $1 billion in book profits for the three year period ending in the current tax year and is anticipated to affect fewer than 150 corporations.[24] Under CAMT, a 15% tax on the corporation's adjusted book income applies when that tax exceeds the regular corporate

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[14] Id. at 90.

[15] The underlying tax planning here is not unexpected. Less than a decade ago, AbbVie sought to do more than offshore its profits to reduce U.S. tax. It pursued an inversion which it ultimately abandoned when the anticipated tax benefits were no longer available. Josh Beckerman, *AbbVie, Shire Terminate Year's Biggest Deal*, Wall St J. (Oct. 20, 2014), https://www.wsj.com/articles/abbvie-shire-terminate-what-was-years-biggest-deal-1413841225.

[16] Merck & Co., Inc, 2022 10-K, at 48, https://s21.q4cdn.com/488056881/files/doc_financials/2022/q4/b390be48-92bf-4595-96da-ac5cd7c3d92e.pdf

[17] Id. at 119.

[18] Id.

[19] Letter from Senate Finance Committee Chair Ron Wyden to Robert Broadway, Chairman & CEO, Amgen (Dec. 8, 2022, https://www.finance.senate.gov/imo/media/doc/Chairman%20Wyden%20letter%20to%20Amgen%2012-8-22.pdf.

[20] Amgen, Inc. 2021 10-K, at F-17, https://investors.amgen.com/static-files/918646ad-1110-40cb-a220-140944850c34.

[21] Id.

[22] Id. at F-21.

[23] I.R.C. § 55.

[24] See, e.g., Staff of the Joint Comm. On Tax'n, "Proposed Book Minimum Tax Analysis by Industry," (July 28, 2022); Martin A. Sullivan, *Tax Credits and Depreciation Relief Slash Burden of New Corporate AMT*, 176 Tax Notes Fed. 1185 (Aug. 22, 2022).

tax liability plus any tax due under BEAT (Base Erosion and Anti-Abuse Tax). Importantly, though, for comparing CAMT to Pillar Two and for identifying continued offshoring incentives, CAMT applies on a global, not a per country basis and would be less effective at addressing profit shifting.

The ability of U.S. multinationals to achieve low ETRs post-TCJA, even where their income is substantially or predominantly derived from a U.S. customer base, reveals the degree to which TCJA reforms have failed to meaningfully address offshoring. The pharma industry is not the only one able to achieve these tax gains, but it has been both highly profitable and especially able to secure major ETR reductions through these defects in the U.S. international tax rules.

3. Implications of Pillar Two for the United States

Pillar Two, as a global agreement to support and implement a corporate minimum tax, marks a major advance in the international tax community's ability to respond to a collective problem. Within the U.S., some who recognized the severity of the profit-shifting problem and the need for an effective and comprehensive minimum tax, resisted a truly effective regime on the grounds it would disadvantage U.S. businesses. Rather than proceed any further on reinforcing a unilateral minimum tax, the goal was to wait until other countries committed to it as well. With the anticipated widespread adoption of Pillar Two and the timetable commitments made by a host of jurisdictions, that last barrier to effective U.S. international tax reform has been removed. Yet now that this moment has arrived, resistance to eliminating the offshoring of profits (and assets and functions) persists in the form of objections to the terms and details of Pillar Two. The objections generally reflect a misunderstanding of Pillar Two, a retreat from the goal of preventing offshoring, and/or an unrealistic assessment of the current global tax landscape.

QDMTT

Tackling one of the most common critiques first – that the Pillar Two Qualified Domestic Top up Tax (QDMTT) is problematic because it encourages other countries to tax U.S. multinationals before the U.S does so. The QDMTT is essentially a top-up tax imposed by an otherwise lower tax country in which a subsidiary operates. The country would impose such a tax to ensure that the ETR for the subsidiary in that jurisdiction is 15% and thereby block other Pillar Two taxes (IIR or UTPR) from being imposed by other countries.

To the extent Pillar Two leads other countries to step up and implement a minimum tax through a QDMTT — (A) this is what the United States presumably wanted when politicians said that the U.S. should not lead too quickly on the minimum tax front because it might harm the competitiveness of U.S. MNEs — and now that global implementation would be happening under Pillar Two it seems odd to identify it as a problem; and (B) this is tax revenue appropriately taxed by the foreign jurisdiction in which the subsidiary is operating. The United States did not move before (in closing the gaps in our GILTI regime)—precisely because it was believed (incorrectly) that other countries would not make the same moves to limit profit shifting and secure minimum

tax. Accordingly, as other states implement the global minimum tax regime in their own country — it makes no sense to further delay. It is time to collect the revenue that properly should be paid to the United States instead of another country.

Additionally, to reiterate a central point made at the outset, it is in the United States' interest that other countries be able to implement an effective corporate income tax on businesses operating and earning income in their jurisdiction. Their failure to do so creates a cascade of fiscal challenges that undermine the country's ability to maintain well-functioning economic, social, political, and regulatory structures. Such failures do not stay within the country's borders, but rather reverberate across the world including especially the United States. Moreover, as evident in the past few years the community of nations worldwide should expect to face continuing global health and environmental crises requiring the capacity for action from all of its members.

UTPR

A related, though slightly different, critique is offered against the UTPR (Under Taxed Profits Rule). Under Pillar Two, the UTPR plays the role of the backstop for situations in which income is earned/shifted to a low or no tax jurisdiction and the Parent entity jurisdiction(s) does not impose an IIR (income inclusion rule) to ensure minimum taxation at the 15% rate. In this case, other Pillar Two jurisdictions which have businesses (subsidiaries or permanent establishments "PE") related to the undertaxed entity operating in their jurisdiction can implement the UTPR and secure a level playing field. Effectively, the UTPR allows these other jurisdictions to collect a portion of the undertaxed amount through limitations on deductions or other measures applied to the subsidiary or PE in their state. The UTPR has been described as "an additional tax, in the nature of an excise tax, imposed on the constituent entities of an MNE group in a UTPR jurisdiction by virtue of their being members of that group."[25]

Objections to the UTPR have been both legal and policy based. A primary legal challenge is whether the UTPR is legal under U.S. income tax treaties. For a detailed examination of this question, I reference a recent analysis by Stephen Shay and Allison Christians.[26] However, here, I would highlight two major points. First, to the extent the jurisdiction imposing the UTPR does so on a subsidiary of the multinational group, it is taxing its own resident entity. Second, regarding treaty claims on behalf of a PE, the UTPR is unlikely to qualify as an income tax, leaving only discrimination claims as grounds for dispute under treaties. With respect to discrimination, UTPRs,

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[25] Allison Christians & Stephen E. Shay, *The Consistency of Pillar 2 UTPR with U.S. Bilateral Tax Treaties*, Tax Notes (Jan. 23, 2023), https://www.taxnotes.com/featured-analysis/consistency-pillar-2-utpr-us-bilateral-tax-treaties/2023/01/20/7fvmc.

[26] Id. See also Tarcisio Diniz Magalhaes, *Give us the Law: Responses and Challenges to UTPR Resisters*, 108 Tax Notes Int'l 1257 (Dec. 5, 2022); Reuven Avi Yonah, *UTPR's Dynamic Connection to Customary International* Law, 108 Tax Notes Int'l 951 (Nov. 21, 2022); Allison Christians & Tarcisio Diniz Magalhaes, *Undertaxed Profits and the Use-It-Or-Lose-It Principle,* 108 Tax Notes Int'l 705 (Nov. 7, 2022); Heydon Wardell-Burrus, *Four Questions for UTPR Skeptics*, 108 Tax Notes Int'l 699 (Nov. 7, 2022).

where enacted, apply to both residents (i.e. subsidiaries in the jurisdiction) and permanent establishments. Claims of discrimination seems unsupported.[27]

For objections sounding in policy, the charge is something to the effect that the U.S. is allowing another jurisdiction to tax U.S. source income (under some possible fact patterns). This would occur where the U.S. did not tax its own multinational residents at the level of a 15% minimum, whether initially or through a QDMTT or IIR where appropriate. That is, this would happen when the U.S. failed to participate in the global plan for a minimum tax. But this conduct is precisely the kind of exit strategy and competitive behavior from which some U.S. politicians sought to protect the U.S. when they advocated halting GILTI reforms until other countries had committed meaningfully to a minimum tax. Pillar Two offers participating states the same kind of security—by joining the minimum tax they are not putting their corporations at a disadvantage over competitors who might shift profits to a low tax jurisdiction and face no top up tax in their parent jurisdiction. If such low tax competitors enter a Pillar Two country, that country now has a tool (UTPR) to level the playing field and combat that transfer pricing, profit shifting and resulting low taxation.

Finally, as a practical matter, the UTPR would be an improbable equilibrium under Pillar Two. Multinationals earning income in a low tax jurisdiction should anticipate that quickly such states will implement a QDMTT to assure that they secure any top up tax that would otherwise be imposed by another state. But if that state, for some reason, fails to implement a QDMTT, then a parent entity or one down the chain would likely impose an IIR. But even if a multinational looks at its current global entity structure and is concerned that no state positioned to impose an IIR will do so, it is not without options.

Calculations under Pillar Two

Working through Pillar Two requires both taxing authorities and multinationals to engage in various calculations and determinations. In calculating a multinational's ETR in a particular jurisdiction it is necessary to decide on the "base" as well as the treatment of assorted expense, deduction, credit, timing, and allocation issues. The OECD/G20 Inclusive Framework has continued to release guidance on these details. Some issues are moving in a favorable direction from a U.S. perspective, while others may require the U.S. to explore alternatives:

(1) *Nonrefundable Tax Credits*: Although nonrefundable credits are unlikely to be treated as the more advantageous Qualified Refundable Tax Credits (QRTC),[28] a number of options for

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[27] Allison Christians & Stephen E. Shay, *The Consistency of Pillar 2 UTPR with U.S. Bilateral Tax Treaties*, Tax Notes (Jan. 23, 2023), https://www.taxnotes.com/featured-analysis/consistency-pillar-2-utpr-us-bilateral-tax-treaties/2023/01/20/7fvmc.

[28] A tax credit that fails to be labeled a QRTC reduces a corporate taxpayer's ETR more than a QRTC. For a quick explanation, see, Karl Russo, Aaron Junge, Damien Boudreau, Florian Holle & Peter Merrill, *Where Credit is Due: Treatment of Tax Credits Under Pillar 2*, Tax Notes International (March 20, 2023) Special Report, https://www.taxnotes.com/special-reports/credits/where-credit-due-treatment-tax-credits-under-pillar-2/2023/03/17/7g743.

redesigning credits are available.[29] For a subset of nonrefundable credits –tradeable credits such as U.S. renewable energy credits– negotiations continue for treating them like refundable credits.

(2) *Ordering Rules*: The recent OECD administrative guidance concluded that GILTI comes into the ETR calculation after QDMTT and thus would not protect a U.S. multinational from the imposition of QDMTT in a country to the extent the multinational's ETR in that jurisdiction is below 15%.[30] Although some U.S. observers have objected strongly to this result, it is a coherent understanding of the QDMTT as an operating country's effort to tax the income first and bring it up to 15%. The outcome of ordering rules now shifts the question to one of creditability of any QDMTT for purposes of GILTI and U.S. taxation. This is an issue well within the purview of the U.S. to address and is currently under consideration.

(3) *A U.S. IIR*: At present GILTI does not qualify as an IIR but instead will be considered a qualifying Blended Controlled Foreign Company Tax Regime.[31] GILTI taxes can be allocated to the appropriate underlying foreign jurisdictions as U.S. multinationals calculate their ETRs in each country in which they operate. The guidance offers a simplified and favorable allocation methodology which will be re-evaluated in 2027.[32] This window for the simplified allocation also provides a window for the U.S. to consider aligning GILTI with Pillar Two.

Without doubt, Pillar Two is a complex global tax framework, and its details are still being finalized. But it is also a remarkable foundation for an important global response to decades of serious profit shifting. By engaging with the Pillar Two process, the United States has the opportunity to be part of a response that can stem profit shifting and level the playing field for U.S. businesses.

Conclusion

As the United States pursues international tax policy reform in the near term, the combination of dramatic profit shifting by many U.S. multinationals (reflected in data on U.S. pharma corporations), the U.S. commitment to a minimum tax, and the global adoption of Pillar Two, collectively provide a roadmap for reform recommendations. These recommendations are familiar as they have been the foundation of various proposals over the past few years, which is not surprising. They reflect clear next steps as the U.S. moves forward with the world in curbing profit shifting, dampening the corporate tax race to the bottom, and securing a fairer system of business taxation.

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[29] See, e.g., id.

[30] OECD/G20 Inclusive Framework on BEPS, "Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)," 67-70 (Feb. 2, 2023), https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf.

[31] Id. at 67. As noted above, CAMT is also applied on a global, not country by country, basis and thus inconsistent with the Pillar Two approach.

[32] Id. at 68-70. The allocation formula is favorable in that it would not allocate available GILTI/Subpart F taxes to a jurisdiction in which the U.S. multinational already has an ETR of 15%; rather such taxes would be directed to its low tax jurisdictions. Id. at 69, Ex. 4.3.2-1.

In broad strokes, the primary recommendations include:

(1) Reform the GILTI regime: to reduce profit shifting to protect the U.S. tax base, allow more efficient, effective, and fair business taxation, and bring it in line with Pillar Two:
    a. GILTI should shift from a global to a country-by-country method of determining effective tax rates. In combination with other GILTI regimes changes multiple estimates project significant revenue would be raised.[33]
    b. Eliminate QBAI: U.S. multinational's ability under GILTI to permanently exclude some foreign source income from U.S. taxation encourages offshoring of not only profits but assets and activities. The companion 100% dividends received deduction in section 245A should be eliminated.
    c. The GILTI rate should be increased to above 15% to preserve the U.S. claim to undertaxed income. Additionally, given the revenue concerns (see below) and need to reduce the rate gaps, GILTI should be increased (via reduction in the Section 250 deduction) above 15% as the U.S. statutory rate moves to 28%.

(2) Continue to work with OECD/G20 Inclusive Framework on implementation details of high priority to the United States (including tax credits) and make necessary adjustments to current U.S. rules to ensure a smooth transition for U.S. businesses as the world moves to implement Pillar Two.[34]

(3) Impose a higher U.S. statutory corporate rate: International tax rules cannot be considered in isolation from the overall U.S. taxation system – particularly as we navigate the ongoing realities of budget deficits, inadequate revenues, and the debt ceiling. The overall fiscal system does not raise sufficient revenue for our current expenditures – a reality that is not surprising given decades of tax cuts (direct and indirect) that have undermined our fiscal flexibility and stability. A reinstatement of the corporate tax rate to 28% is a sensible place to start, bringing the corporate rate more in line with the top individual rate, countering the lack of progressivity in the current tax system, and bolstering the primary mechanism for taxing U.S. corporations' tax -exempt owners (tax-exempt entities and foreign owners).

[33] A country-by-country GILTI regime is one proposed reform (with raising the GILTI rate and ending QBAI) that would raise tax revenue in the range of $442 billion to $692 billion over a nine/ten-year window, according to four independent revenue estimates reported by Clausing. Kimberly Clausing, "The international tax agreement of 2021: Why it's needed, what it does, and what comes next?" Peterson Institute for International Economics, 23-4 p.3 (April 2023), https://www.piie.com/publications/policy-briefs/international-tax-agreement-2021-why-its-needed-what-it-does-and-what (citing studies and estimates by the Treasury Department, Joint Committee on Taxation, Tax Policy Center and the American Enterprise Institute). Even with Pillar Two, which should curb benefits from global averaging, U.S. multinationals would continue to have some incentive to offshore under a GILTI regime (with a rate over 15%) that permits global averaging. Moreover, converging with Pillar Two on country-by-country reduces some administrative burden on U.S. multinationals and foreign multinationals operating in the U.S.

[34] Key examples include ongoing efforts to secure agreement that tradeable credits (such as U.S. renewable energy credits) will be treated as QRTC under Pillar Two. Other steps are domestic including reviewing credits that don't secure favorable status and determining the creditability in the U.S. of Pillar Two taxes paid abroad such as a QDMTT, both currently under consideration at Treasury and IRS.

The obvious challenge to a corporate tax increase – even one that returns the U.S. to its previous 28% rate– is that it will undermine U.S. multinational competitiveness. The question is legitimate, and I would offer a few quick points here: There is little objective evidence that U.S. tax rules have prevented U.S. multinationals from competing effectively globally in open market competition.[35] U.S. multinationals benefit from a significant number of features in the U.S. legal, economic, and capital markets systems which are in part the result of investments in infrastructure by the United States. Additionally, claims, for example, that state-owned companies in China have an advantage in China misunderstands competition. Subsidizing Chinese activity to meet Chinese state subsidies is just giving money to China. Moreover, the U.S. economy loses out where current tax rules encourage operations and assets to move or be established offshore.[36]

(4) Revise or eliminate check-the-box regulations that have been the foundation for highly successful profit shifting strategies for U.S. multinationals.

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[35] For a more extensive discussion of market-based evidence that U.S. multinationals have a materially lower cost of equity capital as compared to non-U.S. companies outside the United States, see Stephen E. Shay, Comment on International Tax Reform Framework Discussion Draft by Senate Committee on Finance Chair Ron Wyden and Senators Sherrod Brown and Mark Warner, (Sept. 2, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3918037.

[36] See, e.g., Kimberly Clausing, "Capital Taxation and Market Power," (April 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4419599.