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CROSS-BORDER Rx: PHARMACEUTICAL MANUFACTURERS AND U.S. INTERNATIONAL TAX POLICY

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CROSS-BORDER Rx: PHARMACEUTICAL MANUFACTURERS AND U.S. INTERNATIONAL TAX POLICY

THURSDAY, MAY 11, 2023

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:09 a.m., in Room SD–215, Dirksen Senate Office Building, Hon. Ron Wyden (chairman of the committee) presiding.

Present: Senators Stabenow, Cantwell, Menendez, Cardin, Casey, Whitehouse, Warren, Crapo, Grassley, Scott, Lankford, Young, Johnson, Tillis, and Blackburn.

Also present: Democratic staff: Ursula Clausing, Tax Policy Analyst; Jonathan Goldman, Senior International Tax Counsel; Sarah Schaefer, Chief Tax Advisor; Joshua Sheinkman, Staff Director; and Tiffany Smith, Deputy Staff Director and Chief Counsel. Republican staff: Courtney Connell, Chief Tax Counsel; Kate Lindsey, Tax Policy Advisor; Mike Quickel, Policy Director; and Gregg Richard, Staff Director.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The Finance Committee will come to order.

The Finance Committee meets this morning to discuss the Byzantine, intricate tax schemes of some of the largest U.S. pharmaceutical companies, and the immense handouts that these companies got from the 2017 Republican tax law. In short, it goes like this. When most Americans travel to some faraway land, they get a sun tan. When big pharma's profits travel overseas, they get a really big tax break.

The tax break got a whole lot bigger as a result of those 2017 Republican reforms. Two years ago, the Finance Committee Democratic staff began investigating these issues. We asked five big pharma companies for answers to questions that really are pretty straightforward. They are not complicated. Where do you make your sales? Where do you report your profits? Where do you stick your intellectual property? The reality is, these are not nuclear secrets, but big pharma pulled out all the stops to keep the details of their tax schemes hidden in the shadows.

Nonetheless, the committee is updating the public on our ongoing investigation today. Here is what big pharma does not want the American people to know about. Our investigation obtained data from the Joint Committee on Taxation, and of course they are the nonpartisan experts on the effective tax rates the largest pharmaceutical companies paid before and after the Republican tax law went into effect.

The numbers are eye-popping. Republicans delivered big pharma a tax cut of more than 40 percent. From 2014 to 2016, the industry paid 19.6 percent on average. In 2019 and 2020, it paid 11.6 percent. Pharma got a substantially lower tax rate than most industries, specifically because the 2017 Republican tax bill essentially green-lighted the kind of tax gaming that the biggest drug companies pursue day in and day out.

They stash their intellectual property in other countries. They stick manufacturing offshore. They use accounting tricks to shift money to foreign subsidiaries. Republicans in that tax bill could have put a stop to these tax games. They did not. Here is what makes this so appalling for taxpayers and all of the patients who are waiting in line for affordable medicine.

The U.S. is by far the biggest market for these drug companies. For some companies, this is where they do the vast majority of their sales. For Amgen, it is 74 percent. For AbbVie, it is 72 percent. These are American companies selling to American patients whom we have the honor to represent here in the Senate.

But their profits show up somewhere else. Amgen reported 60 percent of its profits offshore in 2019. AbbVie reported 100 percent of its profits offshore. Colleagues, think about that number: 100 percent. In many cases, these companies charge American patients and taxpayers staggering amounts for prescription medicines—sometimes double, triple, quadruple what they charge in other countries—and then report the profits on these huge U.S. sales somewhere else.

For example, the list price for Keytruda, a cancer drug produced by Merck, is $175,000 per year. Merck sold more than $37 billion of the drug in the U.S. between 2019 and 2022. According to the committee's investigation, Merck reported virtually all of the profits on the sales overseas.

The level of profit-shifting industry-wide is enough to leave you slack-jawed. According to the Joint Committee on Taxation, colleagues—this is not made up by some group that has partisan views—according to the Joint Committee on Taxation, big pharma reports 75 percent of their income offshore.

The update to our ongoing investigation, which the Finance Committee made available this morning, goes deeper into specific cases of big pharma's tax games. That information is available to the American people to read on our website right now. Without objection, I will enter a copy of our report and the accompanying JCT analysis into the record.*

[The report appears in the appendix beginning on p. 98.]

The CHAIRMAN. Now, I will close by saying there is a big interest on our side of the aisle in fixing this broken system, cracking down on tax gaming, and ensuring that these big corporations pay a fair share. In 2021, Senator Brown, Senator Warner, and I introduced

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*For more information, *see also,* "Present Law and Economic Background Relating to Pharmaceutical Manufacturers and U.S. International Tax Policy," Joint Committee on Taxation staff report, May 9, 2023 (JCX–8–23), *https://www.jct.gov/publications/2023/jcx-8-23/*.

a comprehensive proposal that addresses all of the issues that the committee is going to discuss today.

We spent a lot of time on putting together the Brown-Warner-Wyden proposal to deal with the kinds of questions we are talking about. Senator Whitehouse has been a leader on this topic. Obviously, Treasury Secretary Yellen has led a major effort to crack down on tax schemes all over the world.

So obviously, the Finance Committee has a lot to discuss today. I look forward to hearing from our witnesses, and we recognize our friend, Senator Crapo.

[The prepared statement of Chairman Wyden appears in the appendix.]

OPENING STATEMENT OF HON. MIKE CRAPO, A U.S. SENATOR FROM IDAHO

Senator CRAPO. Thank you, Mr. Chairman.

Almost 8 years ago before the Republican-enacted Tax Cuts and Jobs Act, this committee's bipartisan working group concluded our international tax system was clearly broken. Inversions were on the rise, used as a defensive strategy by U.S. companies to fend off foreign takeovers.

Mr. Chairman, you rightly observed this inversion virus was multiplying every few days. Ironically, the bipartisan report cited the pharmaceutical industry to illustrate how the pre-TCJA tax code made U.S. companies more valuable in the hands of foreign acquirors. In seeking to put TCJA on trial, today's hearing ignores facts that have flipped the competitive edge in our favor.

Fact: TCJA completely cured the inversion virus. By enacting competitive tax rates and reforming how we tax foreign income, U.S. companies and their workers can now win in the global marketplace. Prior to the pandemic, TCJA's reforms led to one of the strongest economies in generations. Unemployment dropped to a 50-year low. Economic gains flowed to all demographic groups and income levels, and American businesses reported record R&D investment.

But TCJA was far from a corporate giveaway. It significantly broadened the tax base, including introducing the first global minimum tax of its kind. The result of that prescription: record-high tax receipts. I will say that again: record-high corporate tax receipts. In short, TCJA is a vast improvement over the prior system.

Of course, we should not rest on our laurels. In the changing global landscape, we should consider refinements that would allow U.S. companies to further invest and expand domestically without harming their ability to compete globally.

Cherry-picking data from an industry to defame the TCJA ignores how the threshold question has dramatically changed since 2017. No longer is the question whether our tax code drives our companies overseas, costing American taxpayers billions; rather, the critics' chief complaint now appears to be that the U.S. fisc deserves a bigger slice of the success that our companies are now able to achieve, in large part due to TCJA.

I agree we should examine how international tax policy impacts our tax base, while ensuring we remain an attractive place for investment to boost our workers' job opportunities and wages. In that context, Congress must seriously examine the commitments this administration has made in OECD international tax negotiations. The last 2-plus years, this administration has used those negotiations in an attempt to compel domestic law changes, disregarding the effect on U.S. revenue, companies, and workers.

Without consulting Congress, much less obtaining its consent, it collaborated with the OECD on a cartel-like global tax code with a trilogy of new taxes which appear to put America last. The first piece mandates a global minimum level of tax on large companies. The U.S. already has one, thanks to the TCJA. But at our own administration's urging, it was not deemed good enough for the new world tax order.

The second is the enforcement mechanism, the UTPR. This extraterritorial tax greases the skids for a foreign revenue grab and blatantly undermines important job-creating tax policies passed by Congress on a bipartisan basis.

And the final one drains the U.S. fisc. The global tax code sanctions a pathway for a domestic minimum tax, and Treasury agreed to give priority to those taxes over the TCJA minimum tax, essentially handing each foreign country a model vacuum to suck away tens of billions of dollars from our tax base.

But the most indefensible position agreed to by Treasury is the disparate treatment of investment incentives for each tax in the trilogy, tilting the scale in favor of our competitors. Investment incentives historically enacted by Congress—for example, the nonrefundable tax credits such as the R&D tax credit—are treated punitively by the UTPR compared to refundable tax credits and government subsidies more commonly used in other countries. In other words, the OECD high priests have condemned tax competition but blessed government subsidies. That is why the administration's narrative of the global tax code halting the so-called race to the bottom rings quite hollow. In reality, if one adopts that rhetoric, the global tax code creates a more supercharged race to the bottom, a race for increased subsidies in government-favored industries.

Even President Biden's former lead OECD negotiator recently acknowledged this. Maybe most concerning is which country may benefit the most from this failed game of Whack-A-Mole. China bestows hundreds of billions of dollars in subsidies every year upon its favored domestic companies, and they do it far better than any other developed country.

Given the administration's failure to subject this deal to careful public scrutiny and analysis, this global tax code could result in an America Last policy that cedes ground to China. Congress should seriously probe whether the administration agreed to a global tax code that materially harms our businesses, workers, and the fisc. In the interim, Mr. Chairman, I look forward to hearing from today's witnesses on their perspectives on international tax challenges that we face in this global economy.

[The prepared statement of Senator Crapo appears in the appendix.]

The CHAIRMAN. Thank you, Senator Crapo.

The first witness is Brad Setser. He is a senior fellow at the Council on Foreign Relations and previously served as the senior advisor to the United States Trade Representative, and as the Deputy Assistant Secretary for International Economic Analysis in the Treasury.

The second witness is Daniel Bunn. Mr. Bunn is president and CEO of the Tax Foundation, where he has worked since 2018. Previously, he worked in the Senate as the Joint Economic Committee individual leading on these kinds of questions, and he also worked for Senator Mike Lee and Senator Tim Scott.

Our third witness is Diane Ring, international tax expert and professor of law at Boston College. She also worked as a consultant for the UN's project on tax-based protections for developing countries.

The fourth witness is William Morris. Mr. Morris is PriceWaterhouseCoopers' deputy global tax policy leader. He also worked at GE, working on these issues as well.

Our witnesses bring an awful lot of experience on these kinds of international policy issues. We are glad that you could be here today. I would like to ask you all to keep your remarks to 5 minutes or so, and we will put your full statements into the record.

Mr. Setser, please go ahead.

STATEMENT OF BRAD W. SETSER, WHITNEY SHEPHERDSON SENIOR FELLOW, COUNCIL ON FOREIGN RELATIONS, WASHINGTON, DC

Mr. SETSER. Chairman Wyden, Ranking Member Crapo, distinguished members of this committee, it is an honor to testify here today. I am Brad Setser. As noted, I am a senior fellow at the Council on Foreign Relations.

Tax avoidance by American pharmaceutical companies is a very real problem. Most of America's leading pharmaceutical companies currently have structured their businesses to shift profits from their U.S. sales to their offshore subsidiaries. In order to shift profits abroad, many of these companies have offshore production and jobs, at a real cost to our biopharmaceutical manufacturing base.

Tax avoidance by American pharmaceutical companies is also a very solvable problem. Straightforward changes to the U.S. tax code would encourage American and global pharmaceutical companies to onshore rather than offshore their global profits, and to produce more patent-protected pharmaceuticals in the United States.

My testimony divides into three parts. The first examines the incentives in the tax code that favor offshoring. The second reviews empirical evidence of profit-shifting in the pharmaceutical sector. The third lays out needed reforms.

The 2017 Tax Cuts and Jobs Act changed the structure of the U.S. tax code without, unfortunately, changing the underlying incentive to move profit and jobs offshore. The tax system put in place in 2017 was designed so that income earned in the United States will be taxed at a 21-percent rate, and income earned abroad would typically not be subject to U.S. tax. In an enormously inadequate attempt to build guard rails against the abuse intrinsic to such a system, the U.S. Congress created two special tax regimes: a 10.5-percent GILTI tax on some global profits of U.S. companies, and a special U.S. tax preference for export earnings above 10 percent on U.S.-based tangible assets.

By institutionalizing a large gap between the headline U.S. corporate tax rate and the low GILTI rate, the new tax code generated strong incentives for firms to transfer production and profits abroad. My friend, Dr. Kimberly Clausing, has rightly called this "an America Last tax policy."

The reform structurally favored foreign income over domestic income. Thus, the last place an internationally mobile firm will want to book its profits on its tangible assets is in the United States. Five years have passed since this reform was enacted; the results are clear. They are particularly clear in the pharmaceutical sector.

A systematic examination of the annual financial reports of six large U.S.-listed pharmaceutical companies shows that this set of companies reported $215 billion in U.S. revenue in 2022. This set of companies reported earning only $10 billion in U.S. profits. The same companies generated $170 billion in revenue abroad, and reported, amazingly, $90 billion, a huge sum, on those profits.

Of the $100 billion in global profits earned by American pharmaceutical companies in 2022, they appeared to have paid about $2 billion to the U.S. Treasury. The U.S. trade data tells the same story. The U.S. now runs a massive trade deficit in pharmaceuticals, largely with countries like Ireland, Singapore, Belgium, and Switzerland. Major U.S. pharmaceutical companies have announced significant new investments in Irish production, often explicitly for the U.S. market.

Given that the Tax Cuts and Jobs Act only reinforced prior incentives to offshore pharmaceutical production and profits, I unfortunately do not think it is unfair to call the Tax Cuts and Jobs Act the Pharmaceutical Tax Cuts and Irish Jobs Act.

There are a number of reforms that are necessary to change the incentives in those systems. They are outlined in detail in my testimony. They very much align with the proposals put forward by Senators Wyden, Warner, and others.

To conclude, there is an urgent need to reform the U.S. corporate tax code, both to assure that some of America's most profitable companies pay their fair share and to strengthen our industrial base. Americans pay the world's highest prices for lifesaving medicines. American companies should not systematically shift the profits on those sales out of the United States. I applaud the members of the Finance Committee for calling this hearing.

Thank you.

[The prepared statement of Mr. Setser appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Setser.

Mr. Bunn, welcome.

STATEMENT OF DANIEL BUNN, PRESIDENT AND CEO, TAX FOUNDATION, WASHINGTON, DC

Mr. BUNN. Thank you, Chairman Wyden. Chairman Wyden, Ranking Member Crapo, and distinguished members of the Senate Finance Committee, thank you for the opportunity to testify today. I am Daniel Bunn, CEO and president of the Tax Foundation.

Washington's attention is understandably on the debt ceiling, but unless we protect the Nation's tax base, it will make our efforts to achieve fiscal sustainability that much harder. Today, if you are concerned about U.S. companies paying a certain amount of tax to the U.S. Government on their foreign profits, then you should focus on what the U.S. Treasury Department has agreed to at the OECD, which directly reduces the amount of taxes U.S. companies would pay to the U.S. Government on their foreign operations. Other countries, particularly in Europe, have often eyed U.S. companies with the desire to tax their profits. There was bipartisan concern in this committee when the digital services taxes were introduced, exposing U.S. companies to extraterritorial taxation.

Now, the current global minimum tax rules do just that. They expose U.S. companies to extraterritorial taxation. Today, I will share my views on the effects of the reforms brought in by the 2017 Tax Cuts and Jobs Act. Then I will discuss tax uncertainty that is connected to the global minimum tax rules, and finally I will talk about a strategic approach to changing the U.S. cross-border rules.

The 2017 tax reforms were not perfect, but they moved the U.S. in the right direction. In the 5 years immediately following the TCJA, companies repatriated $2.1 trillion in foreign earnings. Intellectual property was also reshored. One indicator of this is exports of IP services to foreign jurisdictions, particularly to Ireland. From the start of 2020 to the end of 2022, Irish entities imported $268 billion worth of IP services from the U.S., more than triple the amount in the prior decade. Much of the IP that has been shifted back to the U.S. has come from offshore financial centers such as Bermuda and the Cayman Islands.

Leading up to the passage of the TCJA, we saw dozens of U.S. companies move their headquarters outside the U.S., the so-called inversion wave. Since tax reform, the inversion wave has all but stopped as the competitiveness of U.S.-headquartered companies has improved. Now, however, companies and lawmakers are facing significant uncertainty stemming primarily from the global minimum tax rules.

These rules do not match U.S. tax rules, and many U.S. companies are preparing to comply with them, representing yet another layer of minimum taxes on U.S. multinationals. Additionally, foreign top-up taxes are likely to undermine U.S. tax incentives through rules that give away our tax base to foreign jurisdictions. And the global minimum tax rules that Treasury has agreed to also undercut the revenue that GILTI, the tax on global and tangible low-tax income, would raise by allowing foreign top-up taxes to stand in front of GILTI.

While Treasury has not sufficiently coordinated its international negotiations with Congress, it will be Congress's responsibility to minimize the disruption caused by the implementation of this global minimum tax. Three goals should guide lawmakers. First, simplify the taxation of U.S. multinationals. Second, promote investment and innovation in the U.S. in ways that protect the U.S. tax base from foreign top-up taxes. And third, aim for revenue-neutral reforms.

The tensions between our hybrid system that is neither truly territorial nor worldwide, and layers upon layers of anti-avoidance rules, this tension will create complexity and enforcement challenges for years to come. Congress should aim for reforms that maintain competitiveness and simplicity, while avoiding friction between the U.S. rules and foreign minimum taxes. This should be done alongside permanent growth-oriented reforms like returning to expensing for research and development costs and capital investments, and maintaining a competitive corporate tax rate. To prevent companies that operate in the U.S. from losing tax benefits to foreign top-ups, this committee should review existing tax credits and prioritize them for reform or elimination.

Additional tax revenues from eliminated tax incentives could be used to extend investment-friendly policies that are more compatible with the global minimum tax, such as full expensing for capital investment. Again, as difficult as it might seem, Congress should aim for revenue-neutral reforms.

The international tax system can and should be simplified. Even in the face of a global minimum tax, Congress has a chance to develop a strategic approach in support of U.S. investment and innovation, and it should take that chance.

I look forward to your questions.

[The prepared statement of Mr. Bunn appears in the appendix.]

The CHAIRMAN. All right.

Next is Diane Ring. Welcome.

STATEMENT OF DIANE M. RING, PROFESSOR OF LAW, BOSTON COLLEGE LAW SCHOOL, BOSTON, MA

Ms. RING. Good morning, Chairman Wyden, Ranking Member Crapo, and distinguished members of the committee. My name is Diane Ring, and I am a professor at Boston College Law School. Thank you for the opportunity to testify before you today.

The 2017 Tax Cuts and Jobs Act dramatically reduced U.S. corporate tax rates and pursued a mixed policy of exemption and current taxation of foreign income that failed to end significant profit-shifting. New tax rules rewarded U.S. businesses for making investments offshore. The GILTI regime was introduced as a floor or a 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 other testimony explores in more detail, U.S. pharma companies have reported low ETRs on book income, with much or most income being reported offshore despite being generated by sales to U.S. customers. 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 alone. GILTI served as a springboard for the international tax community to collectively pursue, design, and ultimately agree to a stronger global minimum tax under Pillar 2. The version articulated by the designers of GILTI 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.

Not surprisingly, any agreement in the tax and fiscal arena involving over 140 jurisdictions will inevitably entail compromises and complexities. But the feat was notable as we can appreciate, given the challenges domestically in reaching bipartisan agreement on budgets and debt limits. To ensure that these achievements are not wasted, that U.S. multinationals cannot avoid tax on significant returns, 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 are valid, but they need to be focused on the right issues. Global adoption of Pillar 2 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, leveling the playing field, eliminating a race to the bottom, and enabling countries to collect corporate tax from businesses operating in their jurisdiction.

The Pillar 2 implementation timetables of the European Union, South Korea, and a host of other jurisdictions have resolved the question of international commitment, and now enable the U.S. to work towards establishing minimum tax rules that successfully curb profit-shifting and base erosion. But the United States also benefits, as other jurisdictions that 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 the 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 continued existence or proliferation of states unable to respond to these problems or to meet the needs of their citizens residents in the world.

Finally, as countries adopt Pillar 2, less income should be shifted out of the United States, thus increasing U.S. tax revenues. The United States almost certainly is a net revenue winner from other countries' adoption of Pillar 2. Adoption of the administration's proposals would assure that this is the case.

Thank you, and I would be pleased to answer any questions the committee may have.

[The prepared statement of Ms. Ring appears in the appendix.]

The CHAIRMAN. We will have some momentarily.

Mr. Morris?

STATEMENT OF WILLIAM H. MORRIS, DEPUTY GLOBAL TAX POLICY LEADER, PwC, WASHINGTON, DC

Mr. MORRIS. Chairman Wyden, Ranking Member Crapo, and distinguished members of the committee, my name is Will Morris, and

I work at PwC. I appreciate the opportunity to appear this morning to testify as the committee considers important international tax questions. I appear solely on my own behalf and not on behalf of PwC or any client, and the views that I express are my own.

My testimony is focused on the OECD's two-pillar project, which would reallocate more taxing rights to market jurisdictions and establish a global minimum tax of 15 percent. My testimony describes the two pillars, their impact on the United States and U.S. companies, issues on how the two pillars operate, and the need to address those issues, particularly for Pillar 2.

I will start with three key points. First, the desire on the part of market countries for the right to tax global profits that give rise to Pillar 1 will not go away and must be addressed, whether or not Pillar 1 is broadly adopted. Second, Pillar 2 is now being implemented in the EU and a number of other countries. There are ways in which it disadvantages the United States, but opportunities do remain to address those issues and create a better-functioning system. Finally, we need to find a balance between international cooperation and national sovereignty. Measures preventing conflicts between countries' tax systems are important, but so is the ability of each country to use their tax system to meet the needs of their citizens, including to foster economic growth, create jobs, and protect national security.

There are three issues for the U.S. with Pillar 2 covered in my testimony. The first is the large divergence between Pillar 2 and U.S. tax rules, in particular with respect to the treatment of U.S. tax credits and incentives such as R&D and energy incentives. Pillar 2's favorable treatment of credits is limited to refundable credits and cash grants. If credits are not refundable, they are treated as reducing a company's tax paid, thus increasing the exposure to tax in other countries. Congress, of course, took a different approach when faced with the same design issue when CAMT was enacted last year, so further global consideration is needed of credits and incentives under Pillar 2.

The second issue is the Under-Taxed Profits Rule or UTPR, which after changes in December of 2021, no longer requires a deductible payment from a high-tax country to a low-tax country. Instead, under this modified rule, every country in which a group operates can tax income arising in other countries, including in the home country of the group. This effectively allows other countries to tax U.S. credits and incentives.

The third issue is the ordering rules with respect to Qualified Domestic Minimum Top-up Taxes or QDMTTs. Under rules issued earlier this year, the QDMTT in another country will apply before GILTI, so U.S. GILTI revenue will decline. On Pillar 1, the basic issue is a lack of widespread agreement on some key issues. This means that Pillar 1 will be hard to implement in the short term, but if it is not in effect by January the 1st, 2024, we face the prospect of a new round of digital services taxes, DSTs, largely focused on U.S. corporations.

So, what can we do? While the talks are ongoing, change is still possible, and I am completely convinced that the active engagement of this committee could play a vital role in bringing about that change. I offer three suggestions for your consideration.

First, the foreign taxation of home country income under the UTPR because of nonrefundable credits has to be solved. Congress, Treasury, and other countries must all be involved in this. The most promising route may be agreeing to a safe harbor that treats R&D and energy credits as qualified under Pillar 2, or a safe harbor that exempts home-country income, based on a number of factors including home-country statutory tax rates and a domestic minimum tax such as CAMT. This will need hard work but is preferable to a tax or trade war.

Second, we still need to address the calls for allocating taxing rights to market countries in a digitized world. For this, there first needs to be a comprehensive discussion, however, of the rationale underlying the right to tax. What gives that right and what creates value? That is something that the Treasury, with this committee's encouragement, including through hearings, could undertake.

Finally, we must ensure that, in any future negotiation, Congress is fully involved in helping shape the parameters for Treasury's negotiating position. Only then can the Treasury and other countries have a realistic view about what can be achieved in the United States. Given Congress's constitutional role in the origination of tax legislation, I suggest that there needs to be a formal way for the Congress, including this committee, to provide direction to the Treasury over such negotiations. Senators, it is still vastly preferable that we sort out these problems by agreement, rather than find ourselves in a conflict. I believe that this committee and the Congress can play a vital role in advancing that goal.

I thank you for holding this important hearing and the privilege of appearing, and I look forward to your questions.

[The prepared statement of Mr. Morris appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Morris, and we will have questions for all of you.

I was home last weekend in Oregon, having open-to-all town hall meetings, something that I have done throughout my time in public service. I told my constituents that we had just completed a report that indicates that the big pharmaceutical companies pay lower tax rates than the school teachers who live in their neighborhoods. People were just kind of stunned to hear it put that way, and, Mr. Setser, you did an excellent job laying out so much of what we are dealing with here.

This investigative team for the committee spent 4 years looking at these issues, and they found that Merck sold $37 billion worth of Keytruda, which is the important cancer drug, to patients in the United States at a price of $175,000 each year per patient. Now, this is an American company selling to American patients, yet little to none of the profits showed up in the United States. Virtually every dollar was offshored, and the story was essentially the same for these other big pharmaceutical companies. Why don't you—because a lot of this complicated tax lingo does not really resemble English; it is so complicated and Byzantine.

So, tell us something that those folks who came to my town hall meetings and come to other sessions around the country will understand in response to the question: how is it possible that none of Merck's Keytruda profits show up in the United States?

Mr. SETSER. Senator Wyden, it is a great question. I think I share the sense of outrage expressed by your constituents about this very fact. With Merck and with Keytruda, we actually have a pretty good idea of the ways in which Merck moves profits earned on U.S. sales out of the United States.

My understanding is that Keytruda was developed out of research that was done in the United States. It was actually done by a small Dutch company. Merck bought that company and apparently kept the intellectual property in Europe, perhaps in an innovation box in The Netherlands, perhaps shifted it to another low-tax jurisdiction. We do not know. Pharmaceutical companies do not like telling us. But we do know, based on this example, based on AbbVie—which moved Humira's patents to Bermuda—we know the basics. The first is to move the intellectual property out of the United States one way or another. The second step is to produce the drug in a low-tax jurisdiction outside the United States.

Merck produces Keytruda in Ireland. The Central Bank of Ireland actually has issued a report that warned that Ireland was relying so heavily for its export revenues on a small set of patent-protected drugs that it was a future risk to the Irish economy. A number of U.S. pharmaceutical companies are increasing their investments in Ireland, precisely to sell back into the U.S. market. Now, when those drugs are sold back to the U.S. market, they have already been inflated and marked up. They already have that really high price, and the profit is attributable to the subsidiaries outside the United States.

The U.S. only collects the GILTI tax revenue on that. The bulk of the available tax revenue right now is already being shifted to Europe. That is why, out of the $100 billion of profits that the six large pharmaceutical companies that report detailed data, of that $100 billion, they only paid about $10 billion in tax on it, and $8 billion of that tax was not paid here. Only $2 billion was paid here.

That is a real problem. It is not a future theoretical problem with Pillar 1 and Pillar 2. Those are the kind of problems that Pillar 1 and Pillar 2 are meant to solve and can solve. So, I think I do share that outrage.

The CHAIRMAN. Well said.

A question for you, Ms. Ring. You know there is talk about cherry-picking a little bit. The Joint Committee on Taxation does not do any cherry-picking. They do it by the book, and they provided us data showing that the average tax rate of large U.S. pharmaceutical companies declined by more than 40 percent—40 percent—after enactment of the Republican 2017 tax cut. So this, of course, was a deficit-financed Republican tax cut. The big pharma companies pay a tax rate of less than 12 percent. Some have tax rates in the single digits. The teachers and small business owners that I am honored to represent who come to town meetings, they pay higher rates than these multibillion-dollar multinationals.

Question for you, Ms. Ring. Republicans said that their transformation and international tax work would pay off for the American people. But the evidence shows massive tax cuts, offshoring, and tax avoidance by the pharmaceutical industry. Do you agree that it is the 2017 tax law that led to these ultra-low tax rates for the big pharma companies?

Ms. RING. Thank you for the question. It is clear that pre-TCJA, we already had profit-shifting, but TCJA, the 2017 act, made a number of additional moves that contributed to the increasingly low ETRs that we are seeing. I will just highlight four; first, as we have heard already, the significantly lower corporate statutory rate, brought down to 21 percent, and then three features in the design of GILTI.

First, the ability to have an initial chunk of income taxed at a zero-percent rate. That is your QBAI, so zero. Then in theory, the remainder of GILTI will be taxed at half of the already now lower corporate tax rate, and then you add on top of that the fact that GILTI was designed as a global regime, not country by country, which allows offsetting between high- and low-tax countries, and also increases the incentive to offshore. So clearly some major features that are——

The CHAIRMAN. I am over my time.

Senator Crapo?

Senator CRAPO. Well, thank you very much, Mr. Chairman. The discussion you just had does not take into consideration the fact that TCJA increased the base, and that corporate tax receipts were at record highs after the passage of the act. But that is not what I want to get into.

Mr. Morris, I want to get into Pillar 2's disparate treatment of investment incentives with you. You talked about that.

There are many egregious pieces of the OECD deal, but one piece I just cannot wrap my head around is why the administration agreed to the arbitrary and disparate treatment of investment incentives in calculating the minimum tax, and that the nonrefundable tax credits that have historically been used by Congress, such as the R&D tax credit, receive punitive treatment under the agreement compared to refundable credits, subsidies, and other grants that are used more commonly in other countries, particularly China.

Mr. Morris, what is the tax policy rationale for treating two tax incentives differently even if they are incentivizing the very same activity, and how does this disparate treatment impact the U.S. companies and their workers compared to foreign countries?

Mr. MORRIS. Thank you very much, Senator. That is a great question. I wish I could give you the past policy rationale for that. There is an accounting rationale apparently—that is the way that refundable credits are treated as against nonrefundable credits. But that does not seem to fully answer the question.

As to the effect of that, as you say, if somebody is granted a nonrefundable credit, then the way that that impacts them is that it reduces the tax which they can claim. And as I said, there is a big difference between the U.S. tax base and how Pillar 2 is calculated. And what that means is the credit, when taken out, will lower the ETR, the effective tax rate, and therefore other countries under the UTPR, this other provision, can then be taxed by the countries. However, if you receive a grant or a subsidy, that is added onto the income line, and the benefit of that does slightly increase your tax, but is much, much less than what happens if you pull it out of the tax line.

So what that means, in short, is that businesses in those countries which receive grants or incentives will be advantaged, whereas businesses in countries which receive nonrefundable tax credits will be disadvantaged, with the result effectively that credits in countries such as the United States can be taxed in other countries.

Senator CRAPO. Well, thank you.

And I will follow this same general line of thinking with you, Mr. Bunn. The administration says the OECD Pillar 2 model rules are final, and they use that to try to justify why they cannot negotiate improvements to them, while at the same time the OECD continues to roll out new administrative guidance, which in reality modifies Pillar 2 rules in significant ways. For example, earlier this year OECD's administrative guidance provided for the first time that a foreign country's QDMTT, their Qualified Domestic Minimum Top-up Tax, has priority over controlled foreign corporations such as the U.S. GILTI regime. The bottom line here is that OECD sanctioned a pathway for each foreign country to enact its own 15-percent domestic minimum tax, and Treasury agreed to give this tax priority over U.S. GILTI taxes. What do you believe will be the impact on the U.S. fisc?

Mr. BUNN. Thank you for the question, Senator. So, there is one point about the dynamic nature of the guidance, which has been essentially a moving target since the original model rules came out back at the end of 2021, and we are actually not sure when the final, static nature of those will be complete.

As for the GILTI regime, the original model rules put controlled foreign corporation rules ahead of the domestic top-ups, and then this more recent administrative guidance moved GILTI down the line. I am not sure why our Treasury agreed to that, but I think the effect, to your question, will be a reduction in GILTI revenues.

Back in 2017, the Joint Committee scored the changes, and the adoption of the GILTI regime towards the end of the budget window would be raising more than $20 billion in tax revenue. I am not sure how much that should be scaled down based on the adoption of Qualified Domestic Minimum Top-up Taxes, but even back in 2021 we were modeling changes in U.S. tax revenues based on an assumption that countries would react and increase their rates, even though we did not know what a QDMTT would look like. And in every scenario we looked at, even current law or proposed rules at the time, the introduction of foreign top-ups or foreign changes to corporate taxes would increase those countries' share of revenue and decrease GILTI revenues.

Senator CRAPO. Well, thank you. My time has expired, but it just seems to me that the outcome, as you described, is going to be that a foreign country can collect revenue that would be in the United States under its QDMTT from its companies and could literally funnel money back to those same companies in the form of government subsidies. So it seems to me that we have agreed to a very bad deal.

The CHAIRMAN. Thank you, Senator Crapo.

Senator Stabenow?

Senator STABENOW. Well, thank you very much.

I would like to really return to what I think, for the American people, is the most important part of this discussion, because it is a really bad deal. But the bad deal is that the American taxpayer is still paying the highest prices in the world for prescription drugs, even though big pharma was one of the biggest beneficiaries, as we have all been talking about, of the Republicans' 2017 tax law, which amounted to about a 40-percent tax cut for the industry.

My small businesses did not get that. Individuals certainly did not get that in Michigan. But what adds insult to injury for me is that pharma argues that they need to be able to fund research, but taxpayer-funded research contributed to every single one of the 356 drugs approved between 2010 and 2019. We helped pay for that, while we are still paying the highest prices in the world.

Taxpayers gave these companies more than $230 billion in research funding during that time—research funding—and I support that. I support getting these new prescription drugs and treatments on the marketplace. But at the same time, our Republican friends gave them a 40-percent tax cut, something that everyday Americans did not get.

And did prices go down for prescription drugs? No. So that is my concern. Drug prices have increased by three times the rate of inflation. We pay three times higher in the United States than other countries. Insulin costs 800 percent more than any other developed country, even though it was developed over 100 years ago. And so, we could go on and on.

But I will say this. It is important to know that there is some good news here on the price front. Several months ago, Democrats took action to lower prescription drug prices in the Inflation Reduction Act. We capped, as we know, the cost of insulin for people on Medicare at $35 a month—$35 a month—hundreds of dollars in savings for seniors and others. We capped out-of-pocket costs for Medicare beneficiaries at $2,000 a year, which we phased in. We are empowering Medicare to begin to negotiate drug prices finally, and we capped Medicare Part D—which is the prescriptions that you get in a doctor's office or in the hospital, infusion treatments, cancer treatments, and so on—at the rate of inflation, which already in 3 months has resulted in prices being reduced by as much as $370 per dose.

So, we are moving forward to try to put the American people first on all of this. But at the same time, we have to go back again and talk about big pharma paying their fair share of taxes like everybody else. And so, let me ask on that point, Ms. Ring, we did put in place a corporate minimum tax of 15 percent, and we are trying to move forward to actually make sure that big pharma is paying their fair share. But how would you suggest that Congress build on the corporate alternative minimum tax so that big pharma is no longer able to run from truly paying its fair share of taxes?

Ms. RING. Thank you for the question. We already have GILTI, and so that is one place. If we make the moves to shore up GILTI, both in terms of the tax rate and the country by country, that will go a long way towards, I think, addressing the concerns that have been identified here today.

Also, just with reference to CAMT, the corporate alternative minimum tax, at present it is anticipated it will probably apply to no more than 150 companies. In terms of its actual operation, it is also not on a country-by-country basis. So the same kinds of underlying operational concerns that we had with GILTI being effective as a minimum tax resurfaced there as well.

Senator STABENOW. Thank you.

Mr. Setser, you know we have spent a lot of time—President Biden and Democrats in Congress in a number of bipartisan bills are focusing on bringing jobs home. That is what we have been focused on, whether it is Buy American provisions in the infrastructure law or the incentives for manufacturing that have been done in the CHIPS and Science Act and the Inflation Reduction Act.

We are working to bring supply chains, bring jobs home. But you have been talking about how the 2017 Republican tax law actually spurred big pharma to do the opposite, and other industries to offshore instead of onshore. I wonder if you might speak a little bit more about what the incentives were in those policies to move production and profits offshore?

Mr. SETSER. I will try in a very short period of time. The incentives fundamentally are the fact that you can get a GILTI 10.5–percent tax rate, or even a less than GILTI 10.5–percent tax rate if you have some big tangible assets like factories offshore, and you are going to be paying 21 percent in the U.S. So a pharmaceutical company that developed a drug in the U.S., that produced the drug in the U.S., that kept its intellectual property in the U.S., would basically be taxed at 21 percent minus any research and development incentives. That same company using an offshore intellectual property structure, an offshore production structure, would bring its tax rate down to around 10 percent, exactly what we observed with all the big pharma companies paying tax rates of about 10 percent, and actually not paying any tax in the U.S.

We see this in the size of our trade deficit in pharmaceuticals. It has gone nothing but up. We saw $100 billion as a trade deficit with Switzerland, as a trade deficit with Belgium, as a trade deficit with The Netherlands. It is a trade deficit with Ireland. It is a trade deficit with high-wage countries which we can compete with.

The reason why we do not is because the tax law now in place strongly incentivizes pharmaceutical companies to produce outside the United States. I said in my testimony, and I really believe it, that offshoring a biopharmaceutical manufacturing base is in the long run a threat to our national security. I think, on a bipartisan basis, we should find solutions to this.

Senator STABENOW. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Grassley, you are next.

Senator GRASSLEY. Yes. Thank you, Mr. Chairman. Thanks to all of you for testifying. I am leading up to asking a question of Mr. Morris. The United States originally entered the OECD negotiations with bipartisan support in response to the nations implementing the so-called digital service taxes that unfairly got U.S. companies.

The U.S. Trade Representative determined these extraterritorial taxes to be discriminatory and inconsistent with international tax principles and our bilateral tax treaties. Now, just over 2 years later, foreign countries continue to threaten digital service taxes.

At the same time, foreign countries are threatening to impose additional extraterritorial taxes on U.S. companies, at the invitation of the Biden administration, pursuant to Pillar 2 of the so-called Under-Taxed Profits Rule.

So, Mr. Morris, I kind of see the OECD as kind of a super world government trying to impose something against the Constitution of the United States. You can tell me if I am wrong on that. But could you elaborate on how the so-called Under-Taxed Profits Rule runs afoul of our bilateral tax treaties? And if it is a violation of the tax treaties, you would think that whatever they are proposing to do would have to be presented to the Congress of the United States for our approval or disapproval.

Mr. MORRIS. Thank you very much, Senator Grassley, for that question. Let me first thank you for the leadership you gave as chair of this committee and as ranking member, I believe, in relation to digital services taxes. Those remain a problem, but let us put those to one side.

So, on the UTPR, a number of distinguished lawyers and academics have expressed the strong view that, yes, that UTPR is contrary to U.S. and many other countries' tax treaties, specifically to Article 7, Article 9, and Article 24, which is to say business profits and the nondiscrimination clauses. In short, what they argue is that the UTPR allows other countries to tax profits not arising in that country, but arising instead in the home country, and that is totally contrary to treaty policy. Now obviously, as you all have read in other testimony, these are honestly held opposing views, which is why I indicate that there probably will be litigation.

But to the point that you make, Senator, it is absolutely the prerogative of the Congress and, in the case of treaties, of the Senate, to make those changes. And so far, those changes have not been made. One of the problems with Pillar 2 and the UTPR is that that takes place with national legislation. There is not at the current point a treaty involved in this. So making those treaty changes will have to be done on a bilateral basis, and obviously, so far that has not been done.

Just one final important point. Really any damage to the tax treaty network should be avoided, because it will only damage cross-border trade and investment, and the growth in jobs that that creates. So I applaud you for raising this question, Senator, and I do hope that we can all work on it.

Senator GRASSLEY. And now I am going to lead up to a question for Mr. Bunn. The administration claims that the Pillar 2 global tax framework will end, and I quote, "a global race to the bottom" with respect to corporate taxes. However, in reality Pillar 2 simply shifts the focus away from a competition based on low tax rates and traditional tax incentives towards one based on providing direct cash subsidies. Can you discuss how Pillar 2 places its thumb on the scale in favor of direct cash subsidies, and how that advantages global competitors like China?

Mr. BUNN. Thank you for the question, Senator. You are absolutely right. The design of the global minimum tax rules puts a preference towards cash grants, direct subsidies, and a preference against the nonrefundable credits that the U.S. tax code has generally used to incentivize different business activities.

It is pretty transparent, looking at some jurisdictions and the way they are planning to implement the rules, that they are planning to use some of the revenues they raise from the top-up taxes and turn those into direct subsidies for businesses. There are some countries that have large state-owned enterprises that receive all sorts of direct subsidies and support, or below-market-rate loans from the state, that will be essentially outside of the scope for these effective tax rate calculations. So, whereas a U.S. company that is benefiting from either Foreign-Derived Intangible Income or nonrefundable credits or some other policies, might see a top-up. Other countries might just be giving cash directly to businesses, and not having those subsidies subject to a top-up.

Senator GRASSLEY. Thank you, Mr. Chairman.

Senator CARDIN [presiding]. Let me thank all of our witnesses.

Mr. Setser, you point out very clearly that the 2017 tax bill, with a differential rate of 10-plus for offshore income, will set up an incentive that companies have figured out how to use in order to reduce their overall tax rate. And then we are now talking about the Pillar 2 global minimum tax, and we should not be surprised that because the United States tax code does not really harmonize with the international taxing regimes, we are finding it challenged based upon the way that we have constructed our tax code.

But let me point out a fundamental problem in this debate. The United States, among the industrial nations of the world, relies less on governmental services than most of our other countries that we compete with, but we do not harmonize in the way that we collect our revenues. You will not be surprised, my fellow members of this committee, that I think we should move to a progressive consumption tax.

Now, I want to differentiate that from some of the discussions that are taking place in the House of Representatives today. That is not something I would subscribe to. I am talking about a progressive consumption tax. So on the corporate side, when we recognize that we have higher marginal rates than the industrial nations of the world, if we had a progressive consumption tax, we could have lower rates than the other countries of the world, therefore removing the challenge we have as to how we can make sure that American companies or foreign companies that are relying on American consumers pay their fair share of taxes.

So, Mr. Setser, I agree with you that we have a challenge. I am not so sure it is as simple as you think for us to correct it, because every time we correct it, there is some ingenious way that companies figure out to get around this taxing system.

But the question I want to ask is more fundamental to the pharmaceutical industry, and that is this. It is inconceivable for me to believe that the pharmaceutical industry is not producing the drugs that we need here in America, considering the profits they are making in America. But in 2022, there were an additional 100 and some, 160 drugs that were now national shortages in America, in the United States, adding to what we already have, for a total of 295 drugs that are in drug shortage in America—that are not complicated to produce. But the profit margins are not as good as other drugs, so therefore, we do not have the treatment for, in some cases cancer and other diseases, that these are the drugs of preference for.

So, we provide incentives for investment, and we do it in the international arena as well, where we give certain incentives for investment, but there is no accountability. How do we bring accountability into the system, so that we know American consumers are going to have the medicines they need? You mentioned the national security issue, on which I happen to agree with you. How do we make sure that that is included in how we develop our international taxing regimes?

Mr. SETSER. Well, Senator, I think you have identified what is indeed a very important issue, one I have actually given some thought to. I think, when thinking about how to strengthen our biopharmaceutical manufacturing base, we need to differentiate a bit between those who are producing generic medicines at low profit margins and generally are not offshoring to Ireland or Switzerland—to the extent that they are offshoring or drawing on foreign production, it will be from India or from China—and the subset of companies with patent-protected medicines that charge very high prices and that generally now produce in low-tax jurisdictions.

For the generic medicines, I think we need to be creative. I think we really need to think about how we create national capacity for emergencies that assures there is enough capacity here in the United States to meet our vital needs for that subset of essential medicines. I do not think we have quite gotten there. I think the Biden administration's work on supply chain security is making important steps.

For internationally produced high-cost patent-protected medicines, changing the corporate tax code is the most efficient way of bringing production back in the United States. The current incentives have obvious effects. We see it in the trade data. We see it when all the large American pharmaceutical companies are now making investments in Ireland and their capacity.

That capacity could be here, and that makes it easier to develop other offshoots, other drugs as well. I am over time, but I would note that in my testimony, I did suggest linking a restructured research and development expensing provision, making it Pillar 2-compatible, but also limiting it so that companies that move the intellectual property that is created with our help, with taxpayer help, to their offshore subsidiaries lose the benefits of that expensing.

Thank you.

Senator CARDIN. Thank you.

Senator Johnson?

Senator JOHNSON. Thank you, Mr. Chairman.

Mr. Bunn, in your testimony I think you laid out the success of the 2017 tax reform by saying that we pretty well stopped inversions, and we had an enormous amount of repatriation of earnings. I mean, weren't those two primary goals of the 2017 tax reform?

Mr. BUNN. I would say those were part of it: additional growth and investment in the U.S. In addition, bringing those earnings back and broadening of the base were also kind of part of the goals.

Senator JOHNSON. Now I think one of the goals of what we are trying to do here is, we want to maintain the freedom of individuals to be able to invest globally wherever they want to invest, right? And isn't that the problem we are grappling with here, because people have that freedom? They are going to invest where it makes most economic sense for them to do so.

So we have to create incentives for them to invest here. My problem with the 2017 tax reform is, we reformed the code, but we did not take the opportunity to simplify and rationalize it. And that is what I would like to talk about, because I mean, this discussion here today is unbelievably complex.

I am an accountant. My wife is an IRS agent. You guys might understand this; I do not think anybody listening to this possibly could. So I am asking people to start thinking outside the box. How can we simplify and rationalize this, recognize the fact that we want to maintain the freedom of individuals to invest wherever they want to globally? And from my standpoint, the way we recognize revenue here is based on the power of our market.

Senator Cardin talked about a consumption tax. That would be certainly one way to simplify everything and make sure that we get our fair share, and people cannot really game the system because you are going to tax consumption. Working with the Tax Foundation, you may or may not be aware of one thing I proposed back in 2017. Ninety-five percent of American businesses—close—are pass-through entities. I do not think these problems exist that we are talking about here—I mean, I know this is a big deal. Let us beat up our big pharma, who I am not a real fan of. But I do not think this really exists with pass-through entities, does it, these issues in terms of international taxation?

Mr. BUNN. There are different challenges for partnerships and pass-throughs. But usually the C corps have different opportunities with the corporate code than what you would have with the individual code.

Senator JOHNSON. So again, my proposal was to turn all businesses into pass-through entities. In other words, maybe a simpler way of talking about it is, tax all business income at the ownership level. It is entirely possible to do. There are some complications, but somehow 95 percent of American businesses figure out how to do it.

We have talked to the shareholder services companies that service large corporations. This would be a relatively simple thing for them to do versus other things that they do for their big corporations. I would not be surprised if you have not really thought about this, but thinking about it now, would that be a possible solution here?

Mr. BUNN. Senator, I like that you are thinking outside the box here, because we like to do that at Tax Foundation as well. Earlier this year, we released a report on a type of corporate integration which is similar to what you are proposing, that would tax business profits when they are distributed from the business, and dramatically overhaul and do some base-broadening on the individual side. But this would be a revenue-positive and pro-growth reform that simplifies things dramatically. Our kind of model for this is Estonia. We use a ranking of the tax codes of different countries around the world, and for years Estonia has been at the top of our list. So we looked there for tax simplification proposals, and we modeled that for the U.S. economy.

Like I said, it is revenue-positive over the budget window and pro-growth. I would recommend that you continue this work.

Senator JOHNSON. Mr. Morris, do you have any comments? Have you thought about this at all in terms of—again, how do you simplify and rationalize our tax code? To me, that is the direction we ought to be moving. I mean, first talk about simplifying, rationalizing, and so many of these problems, I think, would go away.

Mr. MORRIS. Senator, it is a great question. I would agree with that in many ways. We take tax legislation. We then build something on top of that, we build something on top of that, and then we build something on top of that. We do not always take the time to strip stuff away and to figure out what might be sensible.

I am obviously biased here, but I do think occasionally stepping back and having a tax policy discussion about what makes sense, as opposed to how we do the next thing, would be appropriate. Again, I would just echo Mr. Bunn and thank you for doing that thinking.

Senator JOHNSON. Could I just give the other two witnesses an opportunity, if you want, to comment on simplifying or rationalizing our tax code and encouraging this committee to do that?

Ms. RING. I will take you up on that. So I think, without doubt, the tax code is exceedingly complicated, and I see that every day. I would say it did not happen overnight, and it happened because taxpayers are creative. We go back to the 1930s and we see the initial antiabuse regime starting to be layered in, as we try to figure out what to do.

So, it is a longstanding problem, and it is one that, collectively we as taxpayers, individual and corporate, have contributed to. With respect to your specific suggestion on pass-throughs, I think I will highlight two quick concerns, but I think any sort of deeper conversation about reform is always, always important.

A true pass-through is challenging, and I agree we do it now with many, many businesses. But we also see that our ability to audit complex partnerships is exceedingly poor at present. So, if you move the remaining large multinationals into that structure, I am not sure that we are going to land where we hope to be without other kinds of reform, either both partnership rules and IRS resources.

Senator JOHNSON. Well, I am happy to scrape the hull of the ship of state clean, rather than add additional barnacles. So I am happy to look at all this stuff in terms of simplification.

Thank you, Mr. Chairman.

Senator CARDIN. Senator Lankford is next, followed by Senator Casey.

Senator LANKFORD. Thank you to our witnesses. Thanks for being here and being able to walk through this. I have expressed a lot of concerns on just international tax, and what Treasury is currently proposing with Pillar 2 especially. Lots of concerns here, and I apologize—we had some other things going on, and I was not able to hear some of the other conversations earlier on this.

But I am just going to ask some pointed questions on this so I will be able to figure it out. Mr. Morris, I want to talk a little bit about just the international portion of this, and the treaty aspects, and the current treaties we have on tax, and how Pillar 2 is being addressed here. Pillar 2 seems to be an agreement of how we are going to do taxing on American companies, but the U.S. Congress does not get to be a part of it, and it does not have to be consistent with previous tax treaties, and we can violate other tax treaties to be able to create this new agreement.

I am trying to figure out the legal standard that is being addressed here, and the major problems that are here for American companies that are coming, based on international tax policy that did not come through Congress, that will definitely cost them billions of dollars in new taxes to other countries, as well as how that stands with our existing treaties. Do you have any comments on that?

Mr. MORRIS. Yes, Senator Lankford. Again, it is a great question. Those are very powerful observations. We do know, or at least we think we know, that one of the problems with Pillar 2 is that it is enacted through national legislation. There is not an overarching treaty. Such a treaty would obviously come before the Senate, and were it to be consented to, that would resolve those issues. But we have not gone through that process, and therefore everything has to be done by national law. And as you look at it, that does appear to conflict with tax treaties, with tax treaties that the U.S. has and indeed many other countries have with each other, which will be potentially overridden by this, or at least pushed aside, I should say.

And there are a number of issues with tax treaties. There are at least three provisions, one relating to business profits, another to associated enterprises, and then a final one to nondiscrimination. There have been a number of lawyers and academics who have pointed out problems relating to all three of those.

Again, these are issues which should be straightforwardly addressed by the Congress, by this committee, by the Senate Foreign Relations Committee, to work through those issues, because again, as you say, there are benefits to other countries. There are, potentially, disadvantages to the U.S. and countries like the U.S. in this process.

Senator LANKFORD. Yes, significant disadvantages to U.S. companies that are in this. And every time that we have had anyone from Treasury come before this committee, we have asked, “What is your plan to bring a change in tax treatment for American companies to Congress,” and it has always been, “We are working on other options.” And “other options” are not consistent with this pesky document called the United States Constitution, and the other treaties that are out there.

Mr. MORRIS. I have a copy of the Constitution in my bag, Senator, I promise you. But let me address that issue about the Treasury, because I do talk about that slightly in my testimony. I do think—because, as you have pointed out, not just the treaty power but also the origination clause and the power to amend taxes lie firmly with the Congress, and in part with this committee—that it would be entirely appropriate, in fact it might be desirable, for there to be a formal process for the Treasury to work with the committee, to be instructed by the committee and the Congress on how to proceed in the future, and then hopefully this type of issue would not arise.

Senator LANKFORD. Yes, and it should be. And what seems to be amazing when you deal with national law is, then we are actually dependent on the election in every one of those countries at any point. Two years from now, there can be a new leadership that is elected in any one of those countries, and their platform could be, "We are going to tax less in our nation to be more competitive," and suddenly you've got outliers in there.

So this new national law is dependent on consistency in every single one of the nations that are in it. There is no binding effect on this. So it is confusing to us to try to figure out how they are trying to be able to create this new treaty-like something without actually having a treaty, and without actually coming back through Congress in the process on this.

Mr. Bunn, I want to ask you a question on this as well. I am also amazed that the way that this is set up and being negotiated currently by Treasury is that they are focused on other nations that can do subsidies. But if we do Low-Income Housing Tax Credits going to an entity, or if we get back to doing R&D tax credits—which we need to do again—if we do those, those are not counted.

So literally, American companies that then get the benefit, a Low-Income Housing Tax Credit or an R&D tax credit, are going to now have to pay an additional tax to a foreign entity because they get to decide if we are paying enough taxes in the United States, even though their companies are doing subsidies.

So, it is this bizarre system where other countries decide what is best in our tax code, and the big economic competitor here, China, is left completely out of this negotiation. So we are trying to figure out—this hurts American companies. Typically, tax law actually benefits the United States and United States workers. This new tax policy seems to benefit other nations, especially China as the outlier, and literally undercuts every company that has Low-Income Housing Tax Credits and everything else. Where am I wrong on this, Mr. Bunn?

Mr. BUNN. You are not wrong, Senator. I think the challenge here comes with what we were discussing earlier with the decision to, okay, well, if there is going to be an effort to harmonize tax rules, well, maybe we use an accounting tax base. Then once you have accounting rules in play, then accounting rules do not match up with normal tax principles, and therefore the refundable credits and the subsidies get treated differently than the nonrefundable credits, and that is a loss to the U.S. tax incentives and U.S. taxpayers.

Senator LANKFORD. Thank you, Mr. Chairman.

Senator CARDIN. Senator Casey?

Senator CASEY. Thanks, Mr. Chairman, very much. I appreciate our witnesses here, and I am sorry I was not here earlier for the full measure of your testimony. I think it is not shocking for Americans to hear that, unlike the average family out there paying taxes, corporations have just raw power to design and to implement legal maneuvers and other tricks they can use to lower their taxes.

The offshoring and profit-shifting that we have seen in the pharmaceutical industry is just emblematic of a much wider problem.

In 2017, the Congress rewrote the tax system to prioritize shareholders over average Americans paying taxes, and international corporations over workers. So there is an awful lot of frustration and anger out there, and I think we all understand that.

Mr. Setser, I am going to direct maybe two questions to you. The IRS reports that American companies booked $60 billion with a "b," billion in profits in the Cayman Islands in 2019, more than Canada and China combined, as you made reference to in your testimony.

Only 68,000 people live in the Cayman Islands. Do you think it is possible U.S. companies actually generated nearly $1 billion per person in the Cayman Islands, or is that American money they should be reporting here?

Mr. SETSER. Well, I guess there are two logical possibilities, Senator. One possibility is that workers in the Cayman Islands are just so much more productive than workers in the United States, and every worker in the Cayman Islands, and every hour they work, seems to generate something like a million dollars in profits.

I think the other possibility is, what should be America's tax base is showing up in the Caymans. I believe that is America's tax base. I think we have let a very large share of our tax base migrate into offshore, low-tax jurisdictions. We make it far too easy for companies to take intellectual property developed in the U.S. and move it abroad, and I honestly think a lot of that intellectual property and the royalties on it, if it is moved abroad, probably should be taxed at the U.S. tax rate, the headline tax rate, not the special tax rate.

Senator CASEY. Yes. Well, it is abusive, and it is destructive when we do not have tax laws that result in higher revenue, when we could.

I was also going to ask you about the tax bill that Congress passed in 2017. It lowered the top rate on certain corporate foreign income from 35 percent down to 10.5 percent. Did these tax cuts succeed in getting companies to report their revenues in America instead of tax havens like the Cayman Islands?

Mr. SETSER. The overall answer is clearly "no." In aggregate, American companies are still reporting something like $300 billion in profits in the main tax havens around the world and only like $50 billion in profits in France, Germany, India, Japan, real countries.

Now there are a couple of companies, to be precise, that have repatriated some of their intellectual property. Both Google and Facebook, and I think Qualcomm, did repatriate their intellectual property to now have a more U.S.-based tax system. But there are some really big, really important companies that have not. Apple has not; still an Irish-based tax system. Microsoft largely has not, and best I can tell, all of the large pharmaceutical companies have not.

Moderna, which is a much newer company that grew and developed a really innovative vaccine with a lot of American taxpayer support, is a bit of an exception. Their tax structure is based in the U.S. They have not offshored a lot. But there is an enormous amount of offshoring in the pharmaceutical industry, and there is still a decent amount of offshoring of profits and the like in the tech industry.

Senator CASEY. Finally, Ms. Ring, last year we had the Inflation Reduction Act passed, with a 15-percent corporate minimum tax. This reform ensures that the largest corporations are paying taxes on the profits they report to their shareholders. In your view, will this corporate minimum tax help reduce both avoidance and force companies to pay more of what they owe?

Ms. RING. It is a first step. I think CBO scored it to reduce the deficit by $238 billion. But as you noted, it is going to apply to not an enormous number of companies, probably less than 150. It also has a design that is still global and not country by country.

So the same concerns we see with GILTI resurface here in terms of incentives to offset high- and low-tax jurisdictions. So I think it is a starting point, but really, we would be looking forward to thinking about those kinds of questions again.

Senator CASEY. Great. Thanks very much.

Thanks, Mr. Chairman.

Senator CARDIN. Senator Young?

Senator YOUNG. Well, thank you to our witnesses for being here today.

I previously shared some of my frustrations with the administration, particularly Secretary Yellen, as it pertains to the administration's handling of the OECD Pillar 2 negotiations. I highlighted my concerns specifically with the Under-Taxed Profits Rule. This rule uniquely disadvantages U.S. businesses. It allows foreign countries to tax the U.S. activity of U.S. companies. Again, for those who are watching these proceedings, this would allow foreign countries to tax the U.S. activity of U.S. companies, and these concerns are just the beginning.

I have been actively involved here on the Hill, working with my colleagues on a bipartisan basis, to ensure that we are investing in strategic sectors of our economy, so that we can lead in these sectors moving forward and outfit our warfighters with the latest, greatest technologies.

On the private side, we need to continue to encourage investments in R&D. Senator Hassan and I have introduced bipartisan legislation that would enhance R&D tax provisions in our tax code. Given this bipartisan support, I was really alarmed to see the Biden administration agree to rules at the OECD that would substantially diminish the value of our R&D tax credit.

This is at a time when if you invest $100 in R&D here in the United States, you can deduct $10. In China, invest $100, it is a super-deduction of $200. So that is who we are competing with. The OECD Pillar 2 rules confirm that nonrefundable tax credits like our R&D tax credit receive far less favorable treatment than government subsidies and refundable tax credits offered in many other countries.

This means that U.S. companies which heavily invest in domestic research, an activity with a long history of strong bipartisan support, could be subject to additional tax by foreign countries because they qualify for the R&D credit, while foreign-based companies either receiving a refundable R&D credit or direct research subsidies from their own countries for the exact same activities, are protected from a foreign revenue grab under Pillar 2.

So, Mr. Morris and Mr. Bunn, I will ask you both to respond to this question. Will Chinese companies receiving direct subsidies for research activities from the Chinese Government receive more or less favorable treatment under the OECD agreement than U.S. companies taking the U.S. R&D credit? Mr. Bunn, we will start with you, sir.

Mr. BUNN. That is correct, sir. The way these rules are structured puts subsidies in the income line, and nonrefundable credits directly reduce the effective tax rate. So, you are going to have the UTPR clawing back the tax benefits for nonrefundable credits, whereas the top-ups would not have as large of an impact on direct subsidies.

Senator YOUNG. Thank you.

Mr. Morris, I will repeat the question again. Will Chinese companies receiving direct subsidies for research activities from the Chinese Government receive more or less favorable treatment under the OECD agreement than U.S. companies taking the U.S. R&D credit?

Mr. MORRIS. Senator, thank you for that question. I am going to actually answer it more broadly, which is that all countries which give their companies grants or subsidies will come off better than countries like the United States—but probably mostly the United States—which have nonrefundable credits. And therefore, we do place our own businesses at a disadvantage under these circumstances. To the point that you made earlier about the need for economic development, it appears that this is not completely joined up.

Senator YOUNG. Thank you so much. I wanted to get each of your perspectives. I of course wanted to get your thoughtfulness on the record. I will continue to make the argument that this is highly unwise tax policy. It is inconsistent with our competitiveness as a country, and even our national security.

I do expect that once people realize the implications of this so-called Under-Taxed Profits Rule, we are going to see bipartisan animus to the ill-advised Under-Taxed Profits Rule.

If there is any hope of Congress acting on these matters, it will only be after Treasury returns to the negotiating table to work out an agreement that actually serves the interest of U.S. workers and their employers, and failing that, I fear we are headed for more tax and trade disputes that will only undermine our collective economic interests.

Thank you, Mr. Chairman.

Senator CARDIN. Thank you.

Senator Blackburn?

Senator BLACKBURN. Thank you, Mr. Chairman.

I want to stay with the Pillar 2 topic and talk with you all about that. I think one of the things that has concerned me is how this administration has entered into these negotiations. They have done it without congressional consultation, and they really have strayed from a lot of the bipartisan objective of the OECD.

I am concerned about these provisions. When you look at what is happening with OECD, a lot of these provisions are going to run into conflict with what Congress has passed, how we have acted on tax treaties, and it is also going to lead to double taxation. Now

UTPR really allows foreign entities to come in and tax us. They are not paying their share.

We did a chart breaking it out, just to have a better feel for actually what would happen to U.S. companies under this structure. American companies earn almost 39.6 percent of all the income that is targeted under the rules of Pillar 2, and it will disproportionately impact American companies and exceed our share of global GDP, which was 24 percent in 2021, according to the IMF.

When you look at other countries and how those countries are going to fare, Chinese multinationals account for 7.6 percent of the income that UTPR could target; French multinationals, 2.9 percent; German multinationals 1.6 percent. Respectively, they account for 17.9 percent, 3.1 percent, 4.5 percent of GDP. No other foreign country has a more disproportionate share of income targeted by GDP share.

The U.S. has the greatest environment for business formation in the world, and that is because we have chosen not to use the tax code to punish our businesses. The damage that this plan could have on American businesses is laid out right in front of us, and I am not sure about you all, but I do not see how anybody would think that this is a good idea for productivity and business formation and innovation in the United States.

So, Mr. Morris, I know, as the former chair of the OECD Business Tax Committee, that you have been a part of these negotiations from the beginning, and during the negotiations, was it ever mentioned that these proposals would lead to American companies receiving a disproportionate share of the tax burden?

Mr. MORRIS. Thank you, Senator, and thank you also for this very helpful chart. The answer to that is, at a number of points during these negotiations, a number of disadvantages to not just the United States but to some other countries who have a system like the United States were pointed out.

I think—to come back to one point that you made at the beginning of your remarks—one of the problems with this project is that at no point has the Congress been meaningfully involved. Therefore, the concerns that you have raised, which could have been raised during the negotiations, have not been raised. Therefore, in my testimony I suggest a way of doing that.

The point that you make here, however, is incredibly important. As you say, the amount of income that U.S. corporations have at stake is disproportionate as it relates to GDP. But this also brings us back to this important point that we have been discussing, which is that the way that the other rules operate, and in particular in relation to nonrefundable credits and the UTPR, means that that can be taxed elsewhere.

Senator BLACKBURN. Yes. Let me follow on.

Mr. Bunn, let me ask you. Have you all done any work on how this type scheme, what kind of effect it would have on incentives and subsidies to U.S. companies? And also, have you all looked at the effect of this GMT, the effect of this chart on businesses in particular States, like businesses in Tennessee, because when I am out and about in Tennessee, I hear a lot about the fears of GMT, the fears of Pillar 2, the fears of the UTPR and what that is going to do to companies.

Mr. BUNN. Thank you for the question, Senator. Our work is ongoing. We are trying to identify the U.S. tax base at risk to the UTPR. I would say another set of challenges that companies are facing right now is just that the complexity of it—the amount of data that they have to pull together that they currently do not have in the tax department to be able to comply with these rules, or to potentially report no additional tax but just to file—is immense.

That is something that I think is—you know, just the sheer complexity of it and the risk to the U.S. tax base, and we are currently working on products that will highlight those.

Senator BLACKBURN. Thank you. We would like to see those as you complete them. Thank you so much.

Senator CARDIN. Senator Warner?

Senator WARNER. Well, thank you, Mr. Chairman. And I have to say, you look really good sitting in that chair, and I do not know if I have Senator Wyden's proxy, but if we could leave you in that chair a little longer, maybe you would reconsider your tenure and service.

Senator CARDIN. We might have a deal here. [Laughter.]

Senator WARNER. I can see, if Ron is anywhere watching, his head is exploding at this moment.

You know, we are obviously deeply involved right now in trying to make sure our country does not default. I think the hypocrisy of the House proposal where they make massive cuts, and then try to ignore things like veterans or Customs and Border Patrol and others that would be cut is a little——

Senator CARDIN. I hate to interrupt, but you brought the chairman back———

Senator WARNER. Yes, I know. I thought if anything would get him rushing back, you know. Ron, I am just saying, that should be a trade. If Ben would stay, he gets to sit in your chair a little more often.

But the notion, as somebody who has been involved in these kind of deficit discussions for years, the idea we are going to fix this one side of the balance sheet only—and that being on the spending side—without looking at the revenue side, is kind of absurd.

And I have heard some of my colleagues—and listen, I am going to compliment my friend, Senator Young. I mean, I am all for the R&D tax credit and believe we need to do other investments.

But what we are faced with right now, and the reality—and I am going to come to you, Ms. Ring, because it is interesting that you seem to have been avoided by some of my colleagues' questions—is that 140 nations have been working for years on an effort to try to avoid tax avoidance by tax havens. And we have in our country a 21-percent corporate rate, and we will see how well-implemented a 15-percent minimum rate is that was put in as part of the payments for the IRA. But with these 140 countries working to make sure that we do not leave money on the table that could come to the United States Government, do you have any sense, Professor Ring, that with the UK, the EU, Japan, Korea, virtually every partner we have—whether we like it or not, is this new international tax regime, Pillar 2, going to be implemented?

Ms. RING. Yes. Every indication is it's going forward, and just this week, Australia outlined its timetable. So I think, to your really underlying point, we need to appreciate the seriousness, and quite honestly, it is the seriousness of something that we asked for. We asked the global community to join us in a minimum tax. They have done so, and now it is moving forward.

Senator WARNER. Right, and is there any indication—I know some of my colleagues are saying, "Well, why do we not just reopen this whole negotiation?" I know China's an outlier as well, but the idea that we are going to reopen this whole negotiation——

At this point in time, is there any indication that any of the countries that are in the process of implementing this are going to be saying, "Hold it"? The United States, because what we said was, we wanted this minimum tax to make sure that people were not using the Irelands or the Caymans or others—are we going to reopen a full negotiation?

Ms. RING. No. The regime, as sort of already embraced by the countries, I think is really where they are. What we are seeing at this point is implementation rules and details. I think there is space for continuing conversation, but it is at the level of regulations, not the big picture.

Senator WARNER. Right. But that implementation process—and I know, this is complicated stuff. The chairman and I and Senator Brown last year tried to put forward some framework on international taxation. If there was ever a case of the devil's in the details, it is this. And we have seen, when I really question some of the 2017 part, I think even the biggest advocates of 2017 would acknowledge they did not get it all right on GILTI.

So the thing that bothers me, Mr. Chairman, is I feel like much of our multinational business community in America is burying their head in the sand, somehow acting like this is not going to come. I would encourage them and anybody who is sitting here watching, engage with us. Engage with us on both sides of the aisle.

The idea that, if we throw a temper tantrum we are going to somehow avoid this happening—the world is moving forward on Pillar 2. There are ways that we can implement this that do not penalize American multinationals. There are ways we can implement this that make sure that we collect our fair share of revenues. The idea that we are going to simply wish this away or will this away is not rational, not thoughtful. My door is open to any international entity that wants to make sure we implement this right. The sooner we get back to the table, the sooner we can meaningfully engage on this, the better American businesses will stand, and at the end of the day, the better we will do in collecting our fair share of revenues. Because, if we do not engage, these revenues are going to—all the horror stories that we hear on the other side, they are still going to get collected, but those revenues are going to go to other nation-states.

So again, for our lobbying friends—and more importantly, for the folks who are watching—let us implement this in an appropriate way. We asked for this proposal. I think, at the end of the day, having that minimum tax will avoid the tax avoidance that too often takes place, and again I appreciate the chairman giving the extra minute.

The CHAIRMAN. I thank my colleague. I just want to say one thing, and then we will go to Senator Scott. I remember there were town hall meetings in rural Oregon, and it was early in the morning when you, Senator Warner, Senator Brown, and I were all on a call.

And we said, "We are going to advance today a centrist policy," a policy that we thought would appeal across the political spectrum. It did not have everything in it that each of us three, Senator Brown, you, and myself, would have put in. But I remember on that cold morning when I was headed to a town hall in rural Oregon, the three of us said, "This is a position that is substantively right and can help build a broad coalition."

So as soon as you said, "Hey, let us try to figure out how to bring people together," it basically picks up on what we were trying to do when we released it. So, well said. I look forward to working with you on it.

Senator Scott, please go ahead.

Senator SCOTT. Thank you, Mr. Chairman.

I remember a warm day in South Carolina after passage of the TCJA, and South Carolinians were celebrating the opportunity to see 4,000-plus dollars coming back into the average family's pocketbooks. As a result of the TCJA, we also saw now the resources coming back to households by letting people keep their own cash. We also saw a 30-percent increase to the Treasury, with lower taxes.

Mr. Bunn, we all know that the TCJA ended inversions and made the U.S. competitive as a location for investment, as well as a location for multinational groups to be headquartered. Since passage of the Republican tax bill, there has not been a single inversion, and the dominance of foreign acquirors and cross-border mergers and acquisitions transactions has ended. In effect, Republicans helped to flip the script.

A question for you is, if we moved the taxes back up to 28 percent, GILTI to 21 percent—talk to me about the impact.

Mr. BUNN. Thank you for the question sir, and I was able to be in South Carolina this past week visiting family.

Senator SCOTT. Awesome.

Mr. BUNN. It is still a great State, sir.

Senator SCOTT. Yes, sir.

Mr. BUNN. The question that you have is connected to competitiveness. What does it mean to be a U.S.-headquartered company and be able to invest and earn profits around the world, and be able to serve markets here at home, and hire and invest here as well? When the U.S. tax code is out of line with our foreign competitors, it creates a disadvantage to be a U.S.-headquartered company, and that is what we saw leading up to the Tax Cuts and Jobs Act. Since then, as you say, we have seen a reversal. We have seen U.S. acquisitions of foreign companies grow, and foreign acquisitions of U.S. companies shrink. Now there are all sorts of different reasons for cross-border mergers and acquisitions, but being able to see those trends reverse, as you say, speaks to the competitiveness of the U.S. tax code that is fundamentally different than it was before the Tax Cuts and Jobs Act.

Now, there is still room for improvement, especially in the context of the challenges of the mismatches between our rules and these global minimum tax rules. But as you say, we have become more competitive.

Senator SCOTT. Thank you, Mr. Bunn.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Scott.

A question for you, Mr. Setser. I think we have a couple of colleagues—oh, Senator Menendez is here. I am going to hold off for now, give Senator Menendez a chance to at least get his materials in front of him and take a deep breath, and then we will recognize him.

Senator MENENDEZ. Thank you, Mr. Chairman.

It is ironic to me to hear that some claim the 2017 international tax code reforms raised taxes on corporations. But since the bill passed, large multinationals across the board, including those in pharmaceuticals, but tech and other sectors, are actually paying less tax than ever before. Professor Ring, how much did TCJA cost over 10 years?

Dr. RING. So, one way to put that is TCJA, sort of the CBO score for making it permanent, was nearly $3 trillion. So I take that sort of as a big anchor. I wanted to sort of comment on your point about the rate reductions and the reality of sort of what U.S. multinationals are looking at, a 21-percent rate, and then what we have been discussing today: often zero on your foreign income is a significant benefit for them from TCJA.

Senator MENENDEZ. You know, in my mind the reality is that the 2017 Republican tax law did not supercharge economic productivity or job growth as promised; it simply lined the pockets of the largest corporations and some of the wealthiest individuals while ballooning budget deficits. It still—it has been 5 years since it passed, and I am still waiting for it to pay for itself like my colleagues claimed that it would.

Does anywhere between $1.5 trillion, if you do not make it permanent, or $3 trillion if you make it permanent, in tax cuts for large multinationals sound like a desirable outcome when we are trying to create a fair corporate tax system?

Ms. RING. No. It is certainly not fair. The U.S. has many goals as we think about our tax system, and quite honestly, the problem with the deficit, which is right in front of us, speaks directly to that problem.

Senator MENENDEZ. Now, one of the consequences when the Republicans rushed partisan tax giveaways are new provisions that have the potential to incentivize U.S. companies to offshore their manufacturing. When manufacturing gets shipped abroad, that means fewer good-paying jobs here at home and a higher likelihood of disruption to the Nation's supply chain.

Professor Ring, is it not true that the 2017 Republican tax law now gives U.S.-based companies a tax break for owning factories abroad?

Ms. RING. Yes, it does, and we have been talking at different points about offshoring income, reporting your income offshore. But TCJA also gave clear incentives to move your assets, your investments, your operations offshore. So we are not just talking about reporting the income, but actually the real activities.

Senator MENENDEZ. Now, are tech companies taking advantage of that as well?

Ms. RING. We are seeing it across the board.

Senator MENENDEZ. Yes, so there is a reason that Apple does not just happen miraculously to end up in Ireland by happenstance. Furthermore, we saw firsthand the consequences of offshore manufacturing during the COVID pandemic, where supplies faced bottlenecks, causing higher prices for consumers.

So my point is, in large part, one, we give an incentive for people to go abroad, and two, we ultimately have a tax provision that not only does the pharmaceutical industry but others take advantage of as well. Now too often my Republican friends claim that slashing corporate taxes is the silver bullet to increasing U.S. competitiveness, that somehow American businesses and entrepreneurs cannot compete with foreign companies without a tax advantage. It seems to me that in order for the United States to out-compete foreign competitors, we need to out-innovate them. With China and others investing more than ever before in research and development, it is critical that the United States continue to invest as well through the tax code.

But rather than enhance incentives for research and development, the 2017 Republican tax bill actually went in the opposite direction, and it gutted critical tax incentives like the R&D tax deduction. Professor Ring, what is more beneficial to incentivize research and development, a lower corporate rate or targeted tax incentives to increase domestic R&D investments?

Ms. RING. So, let me answer that in two parts. First, I would say that the idea that higher rates—and I am talking within the bands that we have been seeing—are bad for U.S. business, would drive it out—first, I would say we are now working with a global floor. That was the point of the minimum tax, so to get us to 15 percent globally, which then makes the sort of issue of a level playing field in competition different than it has been prior to Pillar 2.

Also, there is no evidence that higher U.S. tax rates—and again, not very high—have impaired U.S. multinationals' ability to compete, and I cite the evidence on capital markets in my written testimony. I think, to your point, U.S. markets are an attractive location for a host of businesses, for economic, legal, and educational reasons, and part of that is the functioning of government and adding to the infrastructure.

Now to R&D, certainly it is important, and it has been an ongoing focus of our attention for decades. I think part of it is the sort of hope, the prospect that innovation is going to transform our lives and also make our businesses leaders. There are a lot of options here, so I think it is kind of an issue that we want to be spending a fair bit of time on.

But as we do it, we want to be thinking about the intersection of IP law and those protections for enhancing our R&D, and then to think about the range of other benefits. We have heard earlier today discussion of U.S. direct investment in research, U.S. investment in education at higher levels to support research. And so, we can go forward thinking creatively about the various ways that we might want to do R&D. I do not see them as mutually exclusive.

Senator MENENDEZ. Thank you, Mr. Chairman. That is why I joined Senators Hassan and Young in cosponsoring the American Innovation and Jobs Act, and I look forward to working with the committee to see if we can make that happen.

Thank you.

The CHAIRMAN. Thank you, Senator Menendez. And I remember back in 2017 you talking about what a mistake it was to roll back something like this, when we are trying to increase our competitiveness with China. I mean, right at a time when member after member talks about how we have to be more competitive, you walk back a very important tool. I appreciated your leadership, and we are going to get this done. We are going to find a way to make it happen.

Senator Warren, you are next.

Senator WARREN. Thank you, Mr. Chairman. I want to follow up on the questions that Senator Menendez asked just from a little different perspective. Today's hearing is about the tricks and traps that giant drug companies use to evade taxes. That occurs against the background of a looming debt crisis.

So, Republicans in Congress are saying they are going to trigger a default if they don't get to slash vital programs that help families all across this country. For decades, Republicans in Washington have pursued a three-step plan to rig our tax system and jack up the deficit. Step 1, shovel tax cuts to the wealthiest individuals and corporations; step 2, slash funding for the IRS so that it cannot catch rich tax cheats; and step 3, whenever there is a Democrat in the White House, use the debt ceiling to hold our economy hostage.

Now Republicans pretend to care about fiscal responsibility, but the last time they were in charge, they pushed through tax cuts for the wealthy and rewarded big pharma and other multinationals for offshoring jobs and profits. Professor Ring, what impact did the 2017 Republican tax bill have on the deficit that the House Republicans now claim to care so much about?

Ms. RING. So, CBO scored the Trump, the 2017 Act, as increasing the deficit by $1.9 trillion.

Senator WARREN. $1.9 trillion. Okay. Because the Trump tax cuts allow giant corporations to pay a lower tax rate than teachers, firefighters, or nurses, our debt ballooned by nearly $2 trillion. So Democrats have fought back. The Inflation Reduction Act that Democrats passed last year imposed a new 15-percent minimum tax on billionaire corporations, and it provided the IRS with long-overdue funding to track down wealthy tax cheats and make them pay up. So of course, House Republicans are now demanding that we once again gut the IRS or they are going to trigger a catastrophic government default.

Professor Ring, how would the House Republican plan to claw back IRS funding and protect wealthy tax cheats affect the deficit?

Dr. RING. So, CBO has scored that clawback as increasing the deficit by $120 billion.

Senator WARREN. Wow. So they want to increase the deficit, and for the cherry on top here, do you know how they will pay for that $120 billion in increased tax cheating for their wealthy buddies? By kicking 21 million of the poorest Americans off Medicaid, food stamps, and other assistance.

That is not all. On the same day that House Republicans passed their disastrous debt ceiling hostage demand bill, *Roll Call* reported that they are still working to try to extend the 2017 tax giveaways, with plans to unveil a bill this month or next to extend loopholes that big corporations use to drive their tax bills down to nothing, and that would apply to big tech, to big pharma, and to big banks.

So, Professor Ring, how much would doubling down on the Trump 2017 tax giveaways to the wealthy and the largest corporations cost our Nation?

Dr. RING. So, I have not seen any of the specific tax bills that you are referencing, but CBO scored the cost of making TCJA permanent at nearly $3 trillion.

Senator WARREN. Wow. So, increasing the deficit, right, by $3 trillion?

Ms. RING. Increasing.

Senator WARREN. Yes. Even House Republicans who are now—they pretend to care about fiscal responsibility, but they are working around the clock to try to extend the tax giveaways for their wealthy pals, which is what got us into this mess in the first place. Congress needs to pass a clean bill to avoid default. The United States Government does not default on its obligations.

And as for budget proposals that would reduce the deficit? Let us start by closing loopholes for tax-dodging, offshoring corporations, and let us make billionaires pay their fair share. President Biden has proposed a budget to do just that, raising enough money to make critical investments in affordable housing and child care, while also reducing the deficit by $3 trillion. That is the kind of responsible economic policy that we need in this country.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague.

We may have one or two other members coming, so do not think I am just filibustering here to keep you in your seats.

One of the issues that has come up this morning, and also in the past, is whether perhaps—I think it was described as cherry-picking, and I made mention of the Joint Committee on Taxation which, if anything, they are not accused of cherry-picking. They do it by the book, and they focus on the facts. And we have investigated five companies—and I think I will ask this of you, Mr. Setser—all of which offshored a substantial share of the profits that they earned by charging American patients these extraordinary sums, these sums of money that people actually talk about in coffee shops that they cannot afford, when they are waiting in lines at a Fred Meyer or a Rite-Aid in Oregon or their doctor's office; this is what they talk about.

They do not know all the nuances of OECD and these exotic kinds of schemes. But they sure know when they are getting clubbed over the head by the cost of medicine. And we have heard well, maybe this is just targeting a few practices and maybe a handful of companies.

It sure looks to me like an industry-wide problem, and we asked the Joint Committee on Taxation to look at it from that standpoint.

We wanted to have a report where—on all of the particulars, especially whether this was an industry-wide matter—we had accurate facts. They came back and said 75 percent of big pharma profits were offshore, and were offshore for the purposes of tax breaks.

Mr. Setser, on this question—I am not sure if you have been asked this already—is the committee's work and the work of the Joint Committee on Taxation in some way, any way targeting just a handful of bad-acting companies, or in your view does the kind of tax avoidance that our investigative team found, is it something that permeates the entire industry? I would like your thoughts on that.

Mr. SETSER. Well, Senator, I have read your work very closely. I have read the work of the Joint Committee closely. I have looked quite extensively at the information that large U.S. pharmaceutical companies disclose to their own investors in their 10–Ks, and my conclusion is very clear. My conclusion is that this is a systemic practice, that nearly all the large pharmaceutical companies pursue these kinds of tax games, and that it is, if anything, more prevalent in the pharmaceutical sector than in other sectors, which is, I think, also a conclusion that the Joint Committee on Taxation reached.

The CHAIRMAN. All right.

So, one more question, and we wanted to make sure that our new member on the committee, Senator Tillis, would have a chance to ask questions. So we will recognize him when he arrives.

Also at home, I am constantly asked about the relationship between government subsidies and offshore profits. So we have spent the morning talking about how these prices in the United States are higher than anywhere in the world, and also when this topic comes up at home, people say, "Hey, our tax dollars are used to subsidize these profits through Medicare Part D to help seniors cover the cost of drugs, and we all know about research incentives and the like."

What is the relationship, in your view, Mr. Setser, between the money, say from the Medicare reimbursements helping big pharma's profits, and then the companies turning around and sending everything offshore to avoid paying U.S. taxes? What is that relationship between government subsidies and offshore profits?

Mr. SETSER. Look, I think any analyst who looks closely at the pharmaceutical industry will come to a couple of conclusions. One conclusion is that Americans pay, by far, the world's highest prices for a range of drugs. One would therefore reasonably expect that pharmaceutical companies would actually make most of their money in the United States. The profit margins from selling at a high price are generally higher than the profit margins from selling at a low price, yet we do not see that. It is equally a given in the pharmaceutical industry that the bulk of companies' revenue tends to come from the United States, for the very same reason. That is true for American companies.

Most European companies report that they earn more in the United States or generate more revenue in the U.S. than they generate in Europe.

And then the third point, which is universally true—and I think most pharmaceutical companies would recognize it—is that, without the funding for a lot of drugs that comes from Medicare, there is no way these kinds of high prices could be sustained. Without the support for research and basic biological processes that the National Institutes of Health provides, we would not be the center of innovation. And I think we really need to consider ways of trying to link a little more closely the research and development tax preferences to keep intellectual property here, to not shifting it abroad.

The CHAIRMAN. My constituents would probably say you are being too logical. So, heaven forbid that logic should break out over all this.

Senator Tillis is with us.

Senator TILLIS. Thank you, Mr. Chairman, and thank you all for testifying. Actually, I want to go down a logic path myself for a moment. I was pleased to hear that Ms. Yellen indicated that in order for us to move forward with this, it would be subject to congressional approval. Earlier in the process, it appeared as though they were thinking through whether or not that was the case.

You know, quite honestly this has no prayer of passing this Congress. So you think about OECD moving forward—and businesses have expressed concerns with it—coming back and saying now with the implementation, we are going to be put into a difficult position, as if asking for something that would align with OECD.

I think I will start with Mr. Morris. Welcome. What do we need to look ahead for once this gets implemented and businesses have some competitive disadvantage? What would be the easiest way to address that, and do you agree with the premise?

Mr. MORRIS. Senator, we are unfortunately where we are rather than where we would wish to be. So, the question is right. As I have said a number of times now, if this committee and the Congress had had the opportunity to interact earlier on this, things might be different. But we are where we are.

So this is going to happen. Clearly, the EU has already passed the directive. Countries are doing it—the UK, Japan, South Korea, et cetera, et cetera—and you know for U.S. businesses, that is going to be a large part of it. And then because of the way the rules are currently drafted and currently work, there will be this reach-back into the U.S. to recapture tax credits, if you will.

It is a difficult situation. There are a number of things which might be possible to do on a technical level. I have talked about potential safe harbors, safe harbors which would carve the credits back out, or safe harbors which would look at the home country jurisdiction, because that seems to be the most difficult—and to put it very politely, innovative—procedure here, to be able to reach into a home country's income and to tax that in other jurisdictions where subsidiaries are.

There are ways that safe harbors could deal with that, and whether we make other types of credits that the U.S. uses good, or whether we look at other ratios. I think there are possibilities there. But it is going to require the Treasury to go back in there and do that. It is going to require the Congress to encourage the Treasury to do that, and it is also going to require the countries to come back to the table to talk about that.

This is not a reopening of the rules. This is actually some of the guidance, which is still ongoing. I think that is the best possibility. It is not a great one, but that is the best one.

Senator TILLIS. Mr. Bunn, Mr. Setser described the Tax Cuts and Jobs Act as a Pharma Tax Cuts and Irish Jobs Act. I have spoken with the National Federation of Independent Businesses. Small businesses constitute about 80 percent of the job creation in North Carolina. They seem to be saying positive things about the Tax Cuts and Jobs Act, and how it has allowed them to invest and grow.

So how would you describe the Tax Cuts and Jobs Act? Do you think it is a Pharma Tax Cuts and Irish Jobs Act?

Mr. BUNN. I would disagree with that characterization, and thank you for the question, Senator. As I said in my testimony, the 2017 reform was not perfect, but it moved us in the right direction, particularly on the domestic side. I think with the global minimum tax rules coming, with the conversation that you just had with Mr. Morris, I think there are changes that this Congress will have to consider to make sure that there is not too much friction between our approach and these global minimum tax rules.

I will also say something a little bit about this concept of profit-shifting and what happened before the Tax Cuts and Jobs Act, versus what has happened after. You know, there was a lot of shifting of activities to avoid our 35-percent rate in our worldwide regime, to maintain competitiveness with foreign-headquartered multinationals. After the reforms, some of that has shifted. We have seen kind of a leveling off of what had been a skyrocketing in some of these metrics to capture shifting. So I think that says, well, okay now going forward, our company is going to choose to do business here, and some industries already have set up their footprint abroad and continue to invest here.

Senator TILLIS. Thank you.

In my remaining 25 seconds, Ms. Ring, you made a comment about maybe a tax regimen for, I think it was directed at pharma and biotech, based on their ability to pay. Here is my concern with that concept. They will have an ability to pay, and it will be at the expense of research and development, investigational new drugs, small molecule research.

How does a publicly traded company deal with added tax and regulatory burden? They figure out how to take the costs out. You already have said you cannot raise prices. So then you have to take cost out, and you have to look at your R&D budget. And if the R&D budget gets cut, their ability to pay that tax increment also will, their ability to investigate or build on Alzheimer's research, ALS research. All the promising drugs in the pipeline will shrink.

Thank you, Mr. Chair.

The CHAIRMAN. I thank my colleague.

Senator Whitehouse——

Senator WHITEHOUSE. Thank you very much——

The CHAIRMAN [contining]. Who I noted in the beginning has spent a lot of time looking at these kinds of tax rip-offs, and I appreciate it.

Senator WHITEHOUSE. Thank you very much, Mr. Chairman.

Let me ask Professor Ring first if there is anything, particularly in the so-called “check-the-box” department that Treasury could be doing on its own to help remedy the unfairness that presently is created between big businesses—big corporations that have the wherewithal to go and set up tax avoidance subsidiaries overseas—and regular companies that do not engage in that behavior? What could Treasury do on its own?

Ms. RING. So, the answer is “yes,” they can do something with the check-the-box regulations. And when they came in in 1997, the focus was a domestic application of that rule, and the sort of flexibility for selecting your business form. But it was extended to cover foreign entities as well, but that really was not the focus.

And as we have seen in the intervening 25 years, that has been a foundational piece of multinationals’ planning. Clearly, one of the first things we could be doing, in addition to everything else we have discussed this morning, is address check-the-box on an international level.

Senator WHITEHOUSE. Thanks, Professor Ring.

Mr. Setser, I have a bill called the No Tax Breaks for Outsourcing Act. I do not know if you are familiar with it, but setting aside whether you are familiar with it, do you accept the proposition that when you build this kind of an escape hatch into the U.S. tax code, you give advantage to big corporations against smaller corporations and rivals that simply do not have the scale to have a department of overseas tax manipulation, and set up subsidiaries, front or otherwise, overseas?

Mr. SETSER. Well, Senator, I am actually familiar with your legislation. I think it is one of many approaches that would actually effectively address the current off-drawing of profits and offshoring of jobs. There are some small differences, perhaps, with the approach of Chairman Wyden and some of the other Senators. But fundamentally, they both achieve the core objective that we are all looking to do. Both get rid of the huge difference between the GILTI tax rate and the 21-percent headline tax rate that drives tax avoidance. By getting rid of that difference and by making it harder at the inception to shift intellectual property created in the U.S. out of the U.S., we can cut off the flow of these tax avoidance strategies, start collecting a lot more revenue in the U.S., and create a lot of incentives for American companies to produce in the U.S. to serve the U.S. market. So, I really agree with your legislation.

Senator WHITEHOUSE. So the three big losers of the status quo are the Americans whose jobs get offshored, the revenues that are lost to offshoring for the public, and the small businesses that have to compete unfairly against bigger companies that have hidden their profits—and pay lower taxes as a result.

Mr. SETSER. Absolutely. It is sort of annoying to me when I earn consulting income. I have not bothered to set up my own corporation, so I am taxed at the individual tax rate.

But I know actually, because I have been spending a lot of time looking at it, that big multinational companies, some of our most famous companies, get 10-percent tax rates on their income, and as an individual, I cannot get that. All the small businesses I know cannot get that.

Senator WHITEHOUSE. Particularly with respect to pharma, one of the things we constantly hear when we ask big pharma to explain why it is that they insist that Americans pay the highest prices for pharmaceuticals in the world, and that they offer the exact same pharmaceutical for lower prices elsewhere, is that, “Oh, but just think of all the research that we do in the United States. Just think of all the manufacturing that we do in the United States. We are United States companies.

And then you look at their financial statements, and the profits are routed or laundered or whatever word you want to use—“laundered” is perhaps too pejorative—through tax havens overseas. Is that a fair understanding of what they do?

Mr. SETSER. It is an absolutely accurate understanding of what they do. I genuinely believe that American pharmaceutical companies would continue to do research and development in the U.S. if they paid 20 cents on the dollar to the U.S. Treasury not 10.

Senator WHITEHOUSE. And the smaller ones might have a better chance to compete against the bigger ones among U.S. companies.

If I can just close by calling to mind our great friend Senator Kent Conrad, who was a predecessor of mine as chairman of the Budget Committee, and was fond of showing the picture of the building in the Cayman Islands with a name like “Ugland House.” It was a very small building, maybe four stories high, maybe 10 windows across. But tens of thousands of American companies purported to be doing business there. It was kind of a miracle, and it gives an entirely new meaning to the phrase “small business.”

Thank you.

The CHAIRMAN. I thank my colleague.

So we have been at it for 2½ hours or thereabouts, and we have heard a lot today about hugely profitable, massive U.S. pharma companies charging American patients hundreds of thousands of dollars for lifesaving drugs, while the vast majority of their profits show up offshore.

I have been trying to describe how I think this hearing has unfolded, and I think perhaps at this point I would like to say my colleagues on the Republican side of the committee seem to have attended a different hearing. It is clear they do not want to talk about what people are talking about in coffee shops all across the country, about how they are looking at this tax cut that gave so many big pharma folks breaks and cut their taxes 40 percent, and yet we are paying $175,000 for a cancer drug that we have been talking about at length.

I am just going to close with this. It is very clear that we have to work together to resolve these issues, and this committee has a long history of doing that. Chairman Orrin Hatch, for example, and I worked together on the CHRONIC Care Act, which in effect changed Medicare to update the guarantee. Nobody thought we had a prayer in the world of doing it. We said, “You know, Medicare has changed. It is not just breaking your ankle, acute care. It is chronic disease: cancer and diabetes and heart disease and strokes.”

Chairman Hatch, the late chairman, was so kind to me. He sat here and I sat there, and we wrote it. This committee is capable of doing it, and to give you another very relevant example, Chairman Grassley and I in 2019 wrote the bipartisan provision to go after big pharma price-gouging—big pharma price-gouging.

And what we said is, when you have these drugs that have been out there for such a long time, and you charge more than inflation, you have to give Medicare the difference. Just last week, what Chairman Grassley and I worked on in 2019 was paying really big dividends, lowering the co-insurance costs of drugs like Humira.

The newspapers have been listing all the drugs. So, we are capable of doing it, and I want everybody to know that I very much appreciate the four of you making very thoughtful points.

There are differences of opinion. Guess what? That is what we do in the United States. In a lot of parts of the world, you cannot have differences of opinion, or if you have a difference of opinion with the people in charge, we might not hear about you again.

So we can do this. These things are fixable. A lot of promises were made in 2017. We have been talking about a bunch of them that did not pan out, and it is not right.

And I will close with this: that these big pharmaceutical companies paid less in taxes percentage-wise than do the teachers who come to my town hall meetings. Something is really out of whack there, folks. So we can get these problems fixed. We are going to look forward to talking to all of you. You represent the cross-section of views, and that is how we do our hearings. Senator Crapo and I can have big differences of opinion, but I will tell you, we are working really hard on this PBM issue, to go after the middlemen, hold down the cost for taxpayers and for citizens. We can do it.

I just want to thank all of you and look forward to staying in touch.

Procedural matters: questions for the record for all members of the committee are due 1 week from today at 5 p.m.

With that, we thank our witnesses. We will excuse you all.

[Whereupon, at 12:27 p.m., the hearing was concluded.]

A P P E N D I X

Additional Material Submitted for the Record

Prepared Statement of Daniel Bunn, President and CEO, Tax Foundation

Chairman Wyden, Ranking Member Crapo, and distinguished members of the Senate Finance Committee, thank you for the opportunity to provide testimony on the international tax system. I am Daniel Bunn, president and CEO of Tax Foundation.

I am going to cover three topics in my testimony today. First, I'll share my views on the motivations and effects of the reforms introduced by the Tax Cuts and Jobs Act (TCJA). Second, I will discuss how current levels of tax uncertainty undermine the goals of these reforms and how that uncertainty is connected to the global minimum tax. Finally, I will talk about a strategic approach to changing U.S. cross-border tax rules.

International tax rules in the U.S. were overhauled as part of the Tax Cuts and Jobs Act in 2017. The changes shifted how U.S. companies structured their investments abroad and led to some onshoring of intellectual property (IP).

In 2021, more than 130 countries agreed to an outline for international tax reform.[1] That outline described ambitious proposals to change the taxation of large multinational corporations with a shift in their tax base toward market countries alongside a global minimum tax. The two pieces, known as Pillar 1 (the shift in the tax base) and Pillar 2 (the global minimum tax), will impact the way large businesses arrange their tax affairs and the way governments design their tax policies.

This year, more than two dozen countries are expected to put the global minimum tax rules in place, and U.S. tax rules are on a collision course with those global rules.[2] That is because U.S. tax rules adopted in both the TCJA and the Inflation Reduction Act (IRA) differ significantly from the global minimum tax rules.

Rather than supporting a true safe harbor for U.S. rules, the U.S. Treasury Department has negotiated a deal that exposes the U.S. tax base in serious ways. Congressional action is needed to limit U.S. companies' exposure to multiple layers of taxation and compliance that will hinder their ability to compete on a global scale.

EVALUATING THE TCJA INTERNATIONAL RULES

The TCJA reforms were not perfect, but they moved the U.S. in the right direction.

It is helpful to consider why a company might want to invest overseas or how it might want to engage foreign customers. A company may be able to expand its U.S. operations and reach foreign consumers either digitally or via the international trading of goods. A company may also determine that the best way to reach foreign customers is by setting up production facilities in locations closer to its customers. Overseas hiring and investment in this case would not be offshoring; it would be necessary to reach foreign consumers. Finally, a company may use a third country

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[1] OECD/G20 Base Erosion and Profit Shifting Project, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy," OECD, July 1, 2021, *https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.*

[2] Mindy Herzfeld, "A Pillar 2 Tour Around the World," *Tax Notes Today Federal,* April 17, 2023, *https://www.taxnotes.com/tax-notes-today-federal/transfer-pricing/pillar-2-tour-around-world/2023/04/17/7ggwf.*

as a base for reaching consumers in multiple jurisdictions. This could be due to local natural resources, relevant research facilities and laboratories, or other factors.

Taxes can also play a role in these decisions.

Cross-border tax policy needs to balance at least three objectives. The first should be to support domestic companies in their domestic and overseas expansions as they seek to reach customers, source materials, and expertise from around the world. The second should be to support investment from foreign companies into the domestic market. And the third objective should be to achieve the first two while also protecting the domestic corporate tax base.

The TCJA attempted to accomplish all three.

In terms of the first objective, the TCJA included three major policies to support investment by U.S. companies: reforms to headline tax rates, international rules, and the treatment of capital expenditures.

Prior to the TCJA, the U.S. operated a worldwide tax system with the option to defer taxes on foreign income until the earnings were repatriated, an approach most developed countries had abandoned in favor of a territorial tax system that largely exempts foreign earnings from domestic tax.[3] To make matters worse, when U.S. companies brought earnings back, they faced a Federal tax rate of 35 percent, which was the highest corporate tax rate in the Organisation for Co-operation and Development (OECD).

The TCJA replaced this with a more competitive 21-percent rate, which, combined with State-level corporate taxes, put the U.S. combined rate at 25.81 percent. In 2022, this was just above the average of 23.57 percent among countries in the OECD and the worldwide average of 23.37 percent.[4]

The corporate tax rate reduction was paired with the introduction of a dividends received deduction, a feature common to territorial tax systems.[5] The dividends received deductions means that foreign earnings could be brought back to U.S. shareholders without an additional layer of U.S. tax—the old repatriation tax was eliminated.

In the 5 years immediately following the passage of the TCJA (2018–2022), companies repatriated $2.1 trillion in foreign earnings. That is a dramatic increase relative to the 5 years leading up to tax reform (2013–2017), when companies repatriated just $797 billion.[6]

Looking at just 2021 and 2022 versus 2016 and 2017, repatriations are averaging 0.04 percentage points higher as a share of gross domestic product. That is nearly $43 billion in additional repatriated earnings each year available to U.S. companies that are looking to invest in production and their workforce or return cash to shareholders.

A working paper from academic accountant Brooke Beyer and his coauthors on the usage of repatriated dollars has found that U.S. multinationals with low domestic liquidity and high domestic investment opportunities responded to the TCJA changes with more domestic capital expenditures.[7] In this way, opportunities for getting goods and services to consumers have been combined with a lower U.S. tax burden to support investment in the U.S.

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[3] Tax Foundation, "What Is Worldwide Tax System?", accessed May 2, 2023, *https://taxfoundation.org/tax-basics/worldwide-taxation/*.

[4] Cristina Enache, "Corporate Tax Rates Around the World," Tax Foundation, December 13, 2022, *https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/*.

[5] Tax Foundation, "What Is Territorial Tax System?", accessed May 2, 2023, *https://taxfoundation.org/tax-basics/territorial-taxation/*.

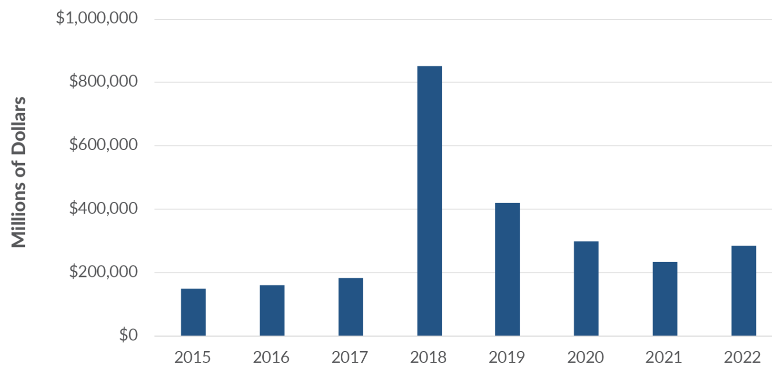
[6] Bureau of Economic Analysis, "Table 4.2. U.S. International Transactions in Primary Income on Direct Investment, Receipts, Dividends and Withdrawals," March 23, 2022.

[7] Brooke Beyer et al., "Early Evidence on the Use of Foreign Cash Following the Tax Cuts and Jobs Act of 2017," *Social Science Research Network,* April 2, 2021, *https://doi.org/10.2139/ssrn.3818149.*

FIGURE 1.

Repatriation Rose Significantly Following Tax Cuts and Jobs Act

Receipts of Cross-Border Dividends and Withdrawals



Source: U.S. Bureau of Economic Analysis, "Table 4.2 U.S. International Transactions in Primary Income on Direct Investment."

In addition to the corporate rate reduction and the dividends received deduction, the TCJA introduced the policy of immediate expensing for a large portion of capital investments (equipment and other short-lived assets) which is now expiring.[8] The changes to the corporate tax rate and the adoption of immediate expensing had the effect of lowering the marginal tax rate on domestic investment, improving incentives for business investment.[9]

These policies were also useful in terms of the second objective, becoming an attractive investment destination for foreign companies.

A working paper by economist Thornton Matheson and her coauthors finds inbound foreign direct investment financed out of retained earnings increased following the adoption of the TCJA.[10]

Looking at the third objective for cross-border tax rules brings one to the alphabet soup of the TCJA. In trying to achieve the goals of foreign success of domestic companies and domestic success of both foreign and domestic companies while protecting the U.S. tax base, the TCJA brought in two minimum taxes and one reduced tax rate.

The first global minimum tax was adopted by the U.S. as part of the TCJA. The policy, the tax on Global Intangible Low-Taxed Income (GILTI), was paired with an incentive for holding IP within the U.S. (the Foreign-Derived Intangible Income

[8] Garrett Watson et al., "Canceling the Scheduled Business Tax Increases in Tax Cuts and Jobs Act," Tax Foundation, November 1, 2022, *https://taxfoundation.org/tax-cuts-jobs-act-business-tax-increases/*.

[9] John McClelland and Jeffrey Werling, "How the 2017 Tax Act Affects CBO's Projections," Congressional Budget Office, April 20, 2018, *https://www.cbo.gov/publication/53787;* Huaqun Li and Kyle Pomerleau, "The Distributional Impact of the Tax Cuts and Jobs Act over the Next Decade," Tax Foundation, June 28, 2018, *https://taxfoundation.org/the-distributional-impact-of-the-tax-cuts-and-jobs-act-over-the-next-decade/*.

[10] Thornton Matheson et al., "The Impact of the Tax Cuts and Jobs Act on Foreign Investment in the United States," IMF Working Papers 22/79, May 2022, *https://www.imf.org/en/Publications/WP/Issues/2022/05/06/The-Impact-of-the-Tax-Cuts-and-Jobs-Act-on-Foreign-Investment-in-the-United-States-517616.*

[FDII]), and a disincentive for cross-border cost shifting (the Base Erosion and Anti-Abuse Tax [BEAT]).[11]

These reforms broadened the U.S. tax base in several ways.

GILTI expanded the scope of U.S. companies' foreign profits that face additional tax by the U.S. on an annual basis. Prior to the TCJA, companies could defer U.S. tax liability on their foreign earnings until the earnings were repatriated. Following the TCJA, foreign profits above a 10-percent return on assets face at least a 10.5-percent minimum tax rate from GILTI, and foreign earnings can be repatriated without an additional toll tax.[12]

In many cases, the tax rate companies face under GILTI is 13.125 percent or higher. The higher rate is because foreign tax credits are limited to 80 percent of their value and some domestic expenses are allocated to foreign earnings. The combined tax (foreign taxes plus U.S. taxes) on the U.S. share of foreign profits, recently estimated by Tax Foundation economist Cody Kallen, was 19.3 percent under current law for 2022.[13] Under current law in 2031, the combined tax on foreign profits of U.S. companies would rise to 20.7 percent. This is primarily because the tax rate on GILTI is scheduled to rise after 2025.

By design, GILTI has changed the incentives for investing in foreign low-tax jurisdictions because the floor for foreign tax rates is no longer zero.

A working paper by economist Matthias Dunker and his coauthors examines how GILTI impacted incentives for companies to acquire businesses in foreign low-tax jurisdictions. Compared to companies not impacted by GILTI, they find that GILTI-affected firms have been less likely to merge with or acquire foreign companies in low-tax locations. Their research also shows that acquisition targets for U.S. companies impacted by GILTI tend to be less profitable.[14] Similarly, research by academic accountants Harald Amberger and Leslie A. Robinson suggests the TCJA reforms reduced the amount of tax-motivated cross-border acquisitions by U.S. firms.[15]

Companies facing additional tax through GILTI could make foreign investments to minimize their GILTI exposure due to the exclusion of a 10-percent return on Qualified Business Asset Investment (QBAI).[16] Previously mentioned research from academic accountant Brooke Beyer and coauthors suggests that GILTI led to an increase in foreign capital expenditures.[17]

The next way TCJA broadened the tax base was via FDII, which was designed to provide a lower tax rate of 13.125 percent on profits from exports related to IP held within the U.S. The goal of the lower tax rate was to incentivize businesses to keep their software, patents, or copyrights in the U.S. rather than offshoring them to a foreign low-tax jurisdiction. In some cases, businesses have returned IP assets to the U.S. in recent years.

When IP assets are held offshore, the U.S. tax base only benefits to the extent that GILTI or other rules addressing tax avoidance apply. When IP assets are in the U.S., the IRS has the primary right to tax related earnings.

Research focused on company financial statements has identified U.S. companies that specifically benefited from FDII because they restructured their IP holdings.[18]

[11] For more information on the mechanics of these policies, *see* Kyle Pomerleau, "A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act," Tax Foundation, May 2018, *https://files.taxfoundation.org/20180502205047/Tax-Foundation-FF586.pdf.*

[12] Tax Foundation, "Global Intangible Low Tax Income (GILTI)," accessed May 2, 2023, *https://taxfoundation.org/tax-basics/global-intangible-low-tax-income-gilti/.*

[13] Cody Kallen, "How Heavily Taxed Are U.S. Multinationals?", Tax Foundation, September 29, 2021, *https://www.taxfoundation.org/us-multinational-corporations-tax/.*

[14] Mathias Dunker, Michael Overesch, and Max Pflitsch, "The Effects of the U.S. Tax Reform on Investments in Low-Tax Jurisdictions—Evidence from Cross-Border M&As," *Social Science Research Network,* September 28, 2021, *https://doi.org/10.2139/ssrn.3932459.*

[15] Harald Amberger and Leslie A. Robinson, "The Initial Effect of U.S. Tax Reform on Foreign Acquisitions," *Social Science Research Network,* February 6, 2023, *https://doi.org/10.2139/ssrn.3612783.*

[16] "What Is the Qualified Business Asset Investment (QBAI) Exemption?", Tax Foundation, accessed May 2, 2023, *https://taxfoundation.org/tax-basics/qualified-business-asset-investment-qbai-exemption/.*

[17] Beyer et al., "Early Evidence on the Use of Foreign Cash Following the Tax Cuts and Jobs Act of 2017."

[18] Martin A. Sullivan, "Latest SEC Filings Show FDII Benefits Continue to Climb," *Tax Notes Today International,* April 10, 2023, *https://www.taxnotes.com/tax-notes-today-international/corporate-taxation/latest-sec-filings-show-fdii-benefits-continue-climb/2023/04/10/7g9qj.*

Additionally, recent research by economist Javier Garcia-Bernardo and his co-authors shows the driving force behind a reduction in the share of profits that U.S. companies book abroad was repatriations of IP.[19]

One interesting indicator of this is exports of IP services to foreign jurisdictions, particularly to Ireland. For tax reasons, many U.S. companies have deployed investments in Ireland as part of their corporate structures and investment strategies in recent decades. Prior to 2020, they also regularly used entities in the Netherlands and zero-tax jurisdictions to minimize the amount of taxes paid on profits from IP.[20]

However, since 2020—the year many Irish structures became unavailable to companies—such strategies have no longer been viable.[21] Consequently, many U.S. companies brought IP back to the U.S. to serve Irish (and other) markets with IP held in the U.S. Since the start of 2020, U.S. exports of IP services to Ireland have skyrocketed.

From the start of 2020 to the end of 2022, Irish entities had imported €243.8 billion ($267.9 billion) in IP services from the U.S.—more than triple the IP services imports in the previous decade.

Much of the IP that has been shifted back to the U.S. has come from offshore financial centers such as Bermuda and the Cayman Islands.[22]

FIGURE 2.

Irish Imports of U.S. IP Services Rose Dramatically Starting in 2020

Irish Imports of IP Services from the U.S. (Royalties)

Source: Eurostat, "Balance of payments by country – quarterly data (BPM6); Services: Charges for the use of intellectual property n.i.e."

The next expansion of the U.S. tax base is the BEAT. Like the tax on GILTI, the BEAT is a minimum tax. It is meant to address tax-planning schemes where large multinationals make cross-border payments within their businesses to limit their exposure to U.S. taxes. Since outbound payments are often deductible in the U.S., and the "income" to a foreign subsidiary may be taxed more lightly, such payments have been known to "strip" otherwise taxable income out of the U.S. into low-tax

[19] Javier Garcia-Bernardo, Petr Janský, and Gabriel Zucman, "Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?", National Bureau of Economic Research, May 2022, *https://www.nber.org/papers/w30086.*

[20] Daniel Bunn, "New Research Shows Major Changes for U.S. Companies Earning Profits from Ireland," Tax Foundation, June 16, 2021, *https://taxfoundation.org/us-companies-earning-profits-ireland/.*

[21] *Ibid.*

[22] Seamus Coffey, "The changing nature of outbound royalties from Ireland and their impact on the taxation of the profits of U.S. multinationals—May 2021," Ireland Department of Finance, June 14, 2021, *https://www.gov.ie/en/publication/fbe28-the-changing-nature-of-outbound-royalties-from-ireland-and-their-impact-on-the-taxation-of-the-profits-of-us-multinationals-may-2021/.*

jurisdictions. The BEAT rate is 10 percent and applies to companies with more than $500 million in total revenues and total cross-border payments that exceed 3 percent (2 percent for some financial companies) of deductions.[23]

GILTI, FDII, and BEAT are imperfect. The burden of GILTI and its interaction with foreign tax credit rules means it operates more like a surtax than a minimum tax. The BEAT is an inelegant approach to addressing tax avoidance via cross-border shifting. Like any alternative tax measure, it can erode tax incentives. FDII also was not perfect, but its imperfections are more about the policy narrative adopted by the current administration rather than problems with the policy itself. Specifically, the Biden administration has proposed to eliminate FDII and replace it with unspecified research and development (R&D) incentives.[24]

With domestic investment, inbound investment, and shifts in IP holdings connected to the TCJA changes, it is clear that these changes were in the right direction, even with their imperfections.

Research focused on the change in business tax burdens after tax reform has found that domestic income received a significantly larger tax cut than foreign income. The finding is not surprising since the corporate tax rate was reduced so significantly, and the tax cut received by multinational companies was driven by the change in their domestic tax liability. The tax burden on foreign earnings did not change significantly. Even after accounting for the switch to the new cross-border rules, the foreign activities of U.S. multinationals face similar levels of tax compared to the previous system.[25]

One final point of evidence is how the TCJA changed the competitiveness of U.S. multinationals. Leading up to the passage of the TCJA, Bloomberg documented dozens of U.S. companies that moved their headquarters outside the U.S. between 1982 and 2017.[26] Since tax reform, this has essentially stopped.[27] It is safe to say that relative to U.S. tax rules in place before the 2017 reform, U.S.-headquartered companies are much more competitive with their global peers.

MOVING INTO THE FOG

The goals of the Tax Cuts and Jobs Act are now being undermined by a climate of uncertainty surrounding U.S. tax rules. The adoption of global minimum tax rules around the world, the administration's proposal to repeal FDII, and upcoming rate changes to GILTI and BEAT after 2025 in the context of potentially unstable political coalitions all spell a recipe for uncertainty.[28]

Certainty and stability are hard to measure, but they are strong contributors to a competitive policy environment.

Uncertainty stems first from the global minimum tax rules. These rules do not match up with U.S. tax rules or concepts, and many U.S. companies are currently preparing to comply with yet another layer of minimum taxes even though Congress has not acted.

There is also uncertainty about the legality and enforceability of the global minimum tax rules. Any policy harmonization project involving dozens of jurisdictions and their own national legal frameworks will run into challenges, and the global minimum tax is no different.

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[23] The BEAT rate is scheduled to rise to 12.5 percent beginning in 2026. The $500 million in revenues is measured as a 3-year moving average. The BEAT rate of 10 percent applies to a U.S. company's taxable income plus the value of base erosion payments minus liability for normal corporate tax. For an example of a BEAT calculation, *see* Kyle Pomerleau, "A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act."

[24] "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals," Department of the Treasury, March 9, 2023, *https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf.*

[25] Scott Dyreng et al., "The Effect of U.S. Tax Reform on the Tax Burdens of U.S. Domestic and Multinational Corporations," *Social Science Research Network,* June 5, 2020, *https://doi.org/10.2139/ssrn.3620102.*

[26] "Tracking Tax Runaways," *Bloomberg.Com,* April 13, 2023, *https://www.bloomberg.com/graphics/tax-inversion-tracker/.*

[27] Mindy Herzfeld, "Designing International Tax Reform: Lessons from TCJA," *International Tax and Public Finance* 28: 5 (2021): 1163–87, *https://doi.org/10.1007/s10797-021-09675-0.*

[28] The Biden administration has proposed to repeal FDII and replace it with unspecified research and development incentives; *see* "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals," Department of the Treasury, March 9, 2023, *https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf.*

Uncertainty also exists for congressional lawmakers trying to chart the correct policy course.

In the fall of 2021, the Build Back Better Act (BBBA) passed through the House of Representatives. The package included changes to GILTI, FDII, and BEAT. Some of the proposals would have improved the way the policies work relative to current law, primarily the GILTI provisions that would limit the amount of domestic expenses allocated to foreign profits.

A major challenge for legislators at the time was that the model rules for the global minimum tax had not yet been released. If U.S. legislators had the model rules in hand when designing the provisions of the BBBA, it is likely they would have made different choices.

The model rules for the global minimum tax were released in December 2021.[29] Further commentary and examples of how the rules might apply were released in March 2022, and administrative guidance was released in February 2023.[30]

Key differences between the model rules and the administrative guidance have increased the need for Congress to act to avoid a chaotic outcome for U.S. companies in the coming years.

But without coordination between Congress and the U.S. Treasury Department, lawmakers may continue to be uncertain about appropriate changes that can protect the U.S. tax base and maintain U.S. competitiveness.

The global minimum tax establishes a 15-percent effective tax rate based on the adjusted financial statement income of large corporate entities on a jurisdiction-by-jurisdiction basis. Under the minimum tax, a company would need to calculate the effective tax rate its operations face in each jurisdiction where it has sufficient profits. After accounting for normal corporate income taxes, a top-up may be assessed to ensure the effective tax rate in a jurisdiction is 15 percent. A substance-based income exclusion is provided both for a share of tangible assets and payroll.

The rules also use a global revenue threshold of €750 million ($790 million) in at least two of the previous four fiscal years with an optional exclusion for entities in a jurisdiction with average revenues below €10 million ($10.55 million) or income less than €1 million ($1.05 million) (the average is calculated using the current year and 2 previous years). The thresholds determine whether a company needs to comply with the rules in general or in a specific jurisdiction.[31]

The rules lay out four tools for implementing top-up taxes on low-taxed income. Generally, the first three rules apply to the same definition of taxable income, but they differ in which jurisdiction might apply the rule and where a multinational might send its tax payment for the top-up.

The three main rules of the global minimum tax are as follows:

1. Qualified Domestic Minimum Top-up Tax (QDMTT): Applies to low-tax profits within a jurisdiction's own borders.
2. Income Inclusion Rule (IIR): Applies to low-tax profits of foreign subsidiaries of a jurisdiction's own companies.
3. Under-Taxed Profits Rule (UTPR): Applies to a local subsidiary of a foreign company that has low-tax profits elsewhere in the world that are not taxed under the other top-up rules; a parent company's low-tax profit could be allocated by formula to a foreign jurisdiction for the purpose of a top-up tax on a local subsidiary.

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[29] OECD, "Tax Challenges Arising from the Digitalisation of the Economy—Global Anti-Base Erosion Model Rules (Pillar Two)," December 20, 2021, *https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm.*

[30] *See* "OECD Releases Detailed Technical Guidance on the Pillar Two Model Rules for 15% Global Minimum Tax—OECD," accessed May 2, 2023, *https://www.oecd.org/tax/beps/oecd-releases-detailed-technical-guidance-on-the-pillar-two-model-rules-for-15-percent-global-minimum-tax.htm;* "International Tax Reform: OECD Releases Technical Guidance for Implementation of the Global Minimum Tax—OECD," accessed May 2, 2023, *https://www.oecd.org/tax/international-tax-reform-oecd-releases-technical-guidance-for-implementation-of-the-global-minimum-tax.htm.*

[31] No such exclusion thresholds are available for U.S. companies under GILTI (current law or in the BBBA).

A fourth rule based on tax treaties is the Subject to Tax Rule (STTR), which a country could use to apply a 9-percent tax on payments to related parties taxed below that rate.

Also, the three main rules of the global minimum tax only roughly correspond to proposals in the BBBA passed by the House of Representatives in 2021. For example, the proposed changes to GILTI would not match the tax base of the minimum tax rules as they do not use financial accounting. The substance-based income exclusion would only apply to tangible assets rather than payroll. Additionally, the effective tax rate calculation for GILTI includes a limit on foreign taxes paid (95 percent in the BBBA; current law only provides an 80 percent credit). The per-country effective rate could be 15.8 percent or higher under the BBBA version of GILTI.

The differences, alongside the complexities of U.S. foreign tax credit rules, create significant gaps between the BBBA and the global minimum tax model rules.

Additionally, the book minimum tax adopted in the Inflation Reduction Act in 2022 introduces another definition of adjusted financial statement income that differs from the global minimum tax rules.

Table 1 provides a comparison of the different rules and how they are distinct from one another.

TABLE 1. U.S. Takes a Different Approach Than the Global Minimum Tax Model Rules

	Current Law Through 12/31/2025	Current Law After 12/31/2025	Inflation Reduction Act Book Minimum Tax	Build Back Better Act (Not Adopted)	Global Minimum Tax Model Rules
Effective Date	1/1/2018	1/1/2026	1/1/2023	Not adopted	Generally 1/1/2024 and later but it depends on the jurisdiction
Rate	10.5% (could be 13.125% or higher depending on exposure to foreign taxes)	13.125% (could be 16.4% or higher depending on exposure to foreign taxes)	15%	15% (could be 15.8% or higher depending on exposure to foreign taxes)	15%
Exclusion for a Normal Return on Tangible Assets	10% deduction for foreign tangible assets	10% deduction for foreign tangible assets	Tax accounting is used for depreciation deductions	5% deduction for foreign tangible assets	8% incrementally reduced to 5% over the first 5 years
Exclusion for a Normal Return on Payroll Costs	No	No	No	No	10% incrementally reduced to 5% over the first 5 years
Loss Carryovers	No	No	Capped at 80% of adjusted financial statement income and limited to losses accrued after 2019	No	Included in Deferred Tax Asset recast at 15% rate

TABLE 1. U.S. Takes a Different Approach Than the Global Minimum Tax Model Rules—Continued

	Current Law Through 12/31/2025	Current Law After 12/31/2025	Inflation Reduction Act Book Minimum Tax	Build Back Better Act (Not Adopted)	Global Minimum Tax Model Rules
Foreign Tax Treatment	Credit for 80% of foreign taxes paid, no carryover for excess credits	Credit for 80% of foreign taxes paid, no carryover for excess credits	Provides a credit for foreign taxes	Credit for 95% of foreign taxes paid, 5-year carryforward of excess foreign tax credits	Deferred Tax Asset recast at 15% rate
Jurisdictional Calculation	Foreign income is blended together	Foreign income is blended together	Applies to the worldwide income of U.S. companies and the U.S. income of foreign companies	Country-by-country	Country-by-country
Threshold for Application	None, 10 percent ownership threshold	None, 10 percent ownership threshold	$1 billion in financial profits	None, 10 percent ownership threshold	€750 million ($790 million) in global revenues
Income Definition	Foreign taxable income as defined in the Internal Revenue Code, no use of financial accounting methods	Foreign taxable income as defined in the Internal Revenue Code, no use of financial accounting methods	Financial profits as defined by accounting standards and adjusted to align closer to taxable profits	Foreign taxable income as defined in the Internal Revenue Code, no use of financial accounting methods	Financial profits as defined by accounting standards and adjusted to align closer to taxable profits
Under-Taxed Profits Rule (UTPR)	Base Erosion and Anti-Abuse Tax (not comparable to the OECD model rules)	Base Erosion and Anti-Abuse Tax (not comparable to the OECD model rules)	Base Erosion and Anti-Abuse Tax (not comparable to the OECD model rules)	Base Erosion and Anti-Abuse Tax (not comparable to the OECD model rules)	Yes
Qualified Domestic Minimum Top-up Tax	None	None	Applies to domestic income, but it is fundamentally different from a QDMTT	15% alternative minimum tax on worldwide financial profits (not comparable to the OECD model rules)	Yes

Source: Author's analysis of the international rules in the Tax Cuts and Jobs Act, the Inflation Reduction Act, and the global minimum tax model rules.

THE PILLAR 2 RULES AND THE U.S. TAX BASE

Under the model rules for the global minimum tax, the taxable income of a large multinational will be taxed through five layers of rules with each consecutive layer depending on how much tax is collected under the previous one:

1. Normal corporate income taxes in the jurisdiction in which income is earned.

2. Qualified Domestic Minimum Top-up Tax (QDMTT) applied by the jurisdiction in which low-tax earnings arise.
3. Controlled Foreign Corporation (CFC) rules applied by the jurisdiction of a company's headquarters or owners.
4. Income Inclusion Rule (IIR) applied by the jurisdiction of a company's ultimate parent entity on low-tax foreign earnings in each foreign jurisdiction in which the company has low-tax earnings.
5. Under-Taxed Profits Rule (UTPR) applied to entities within a jurisdiction on a country's share of low-tax profits of the corporate group that have not already been taxed by one of the previous four rules.

The U.S. currently has rules in place for numbers one and three. The U.S. corporate income tax applies at the Federal level with a 21-percent rate, though various deductions and credits can result in effective tax rates below 21 percent. The U.S. also has CFC rules that apply to the foreign income of U.S. multinationals in certain circumstances (subpart F). GILTI also roughly fits into the CFC rules category. Credits for foreign taxes paid can be applied to reduce additional U.S. tax liability, although they are limited to 80 percent of their value for GILTI, and recent regulatory changes have narrowed the scope of creditable foreign taxes.

The order of the minimum tax rules means that both the U.S. tax base through subpart F and through GILTI will be eroded when other countries adopt a QDMTT. This is because foreign tax credits for QDMTTs would offset the taxes that would otherwise be owed through subpart F and GILTI. The 80-percent foreign tax credit limit in GILTI means that after a QDMTT applies, any revenue raised through GILTI is double taxation of foreign profits.

The U.S. would be giving up the tax base it currently taxes using GILTI. In fact, the global minimum tax rules incentivize countries to adopt QDMTTs that would apply ahead of IIRs and CFC rules. Research by economists Michael Devereux, John Vella, and Heydon Wardell-Burrus suggests some jurisdictions may prefer to collect corporate taxes through the QDMTT than even the traditional corporate tax.[32]

Tax Foundation modeling from 2021 suggests that if enough foreign jurisdictions adjust their corporate income taxes to collect low-tax earnings within their jurisdictions, then aligning GILTI with the global minimum tax would result in a net loss of U.S. Federal tax revenue.[33]

Unless U.S. cross-border rules change, companies will face GILTI, BEAT, and the new book minimum tax from the Inflation Reduction Act in addition to compliance costs associated with the global minimum tax. This is a higher level of policy complexity and compliance than the foreign competition U.S. companies will face, and Congress should aim to avoid a chaotic enforcement and compliance scenario in the coming years.

The uncertainty in the current environment is driven by the minimum tax rules and their interaction with U.S. rules. In addition to interactions with GILTI and subpart F, U.S. tax incentives have critical interactions with the global minimum tax rules as well.

U.S. tax credits provided to companies for clean energy initiatives, research and development, or deductions connected to FDII can result in low effective tax rates, exposing the income of a foreign company operating in the U.S. to an IIR. The same can be true for U.S. companies that might be exposed to a UTPR on their low-tax income within the U.S.[34]

TAX INCENTIVES AND THE GLOBAL MINIMUM TAX

Many jurisdictions around the world offer tax preferences or structure their tax rules in such a way that allows companies to be taxed at rates below the 15-percent rate envisioned by the minimum tax.

[32] Michael P. Devereux, John Vella, and Heydon Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," Oxford University Centre for Business Taxation Policy Brief, January 14, 2022, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4009002*.

[33] *See* the second table in Daniel Bunn, "Adoption of Global Minimum Tax Could Raise U.S. Revenue . . . or Not," Tax Foundation, August 19, 2021, *https://www.taxfoundation.org/us-global-minimum-tax-revenue/*.

[34] Daniel Bunn, "U.S. Tax Incentives Could be Caught in the Global Minimum Tax Crossfire," Tax Foundation, January 28, 2022, *https://www.taxfoundation.org/us-global-minimum-tax-build-back-better/*.

The global minimum tax can create problems for such policies, however. For example, let's say a large multinational company headquartered in Country A makes an investment in Country B that is eligible for a 10-year corporate tax holiday. Even though the profits from the investment will not be taxed by Country B, the global minimum tax would allow Country A to apply the minimum rate of 15 percent to those profits.

Country B may choose to change its tax holiday policy to tax those profits locally rather than allowing the tax revenue to go to Country A. If Country B applies a high corporate tax rate to companies that are not eligible for a tax holiday, the additional revenue from shutting down the preferential policy could support a more general tax reform (broadening the base and lowering the rates, as the mantra goes).

Not all tax policies will follow such a straightforward analysis, however, and the model rules are only helpful in assessing policies to the extent that they result in effective tax rates below 15 percent for large multinational companies.

At the risk of oversimplifying, I have developed a rough categorization of the policies that countries will most likely need to review in the context of the minimum tax rules. This is shown in Figure 3. Policies facing a Red Light are primarily those that provide a zero effective tax rate. Yellow Light policies provide reduced effective tax rates below 15 percent but not zero. Green Light policies are those that reduce the cost of investment without triggering the minimum tax, unless the general corporate tax rate is very low.

The key items for U.S. lawmakers are in the Yellow Light category. The FDII deduction and non-refundable credits both create a risk of a top-up tax through the global minimum tax rules.

FDII is potentially vulnerable to top-up tax due to its 13.125-percent rate. Lower rates for intangible income are relatively common worldwide; an OECD survey of 49 countries finds 27 have an income-based R&D incentive similar to FDII. The FDII regime is among the larger income-based incentives as a share of its country's economy, though far short of the greatest outliers. In absolute terms, it is the largest in the world.[35] The administration's efforts to repeal FDII led the OECD to categorize it as "in the process of being eliminated."[36] However, Congress has not yet agreed on legislation to eliminate FDII, and its status both domestically and with the OECD remains in doubt.

Due to the reliance on accounting standards for the global minimum tax rules, non-refundable tax credits are treated worse than refundable credits. However, it is not a simple matter to change non-refundable credits into refundable credits. Recent analysis by PwC suggests that transforming both FDII and general business credits into refundable programs could decrease U.S. tax revenue by up to nearly $200 billion over the 2023–2032 budget window.[37] This is before accounting for behavioral changes in response to the provision of refundability.

Uncertainty surrounding the future compatibility of U.S. cross-border tax rules and tax incentives with the global minimum tax directly undermines the TCJA policies meant to support the success of multinationals connected to the U.S. market.

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[35] Silvia Appelt et al., "Cost and uptake of income-based tax incentives for R&D and innovation," OECD Science, Technology and Industry Working Papers, *https://www.oecd-ilibrary.org/docserver/4f531faf-en.pdf.*

[36] OECD, "Harmful Tax Practices—Peer Review Results," Inclusive Framework on BEPS: Action 5, January 2023, *https://www.oecd.org/tax/beps/harmful-tax-practices-consolidated-peer-review-results-on-preferential-regimes.pdf.*

[37] Peter R. Merrill et al., "Where Credit Is Due: Treatment of Tax Credits Under Pillar 2," accessed May 2, 2023, *https://www.taxnotes.com/special-reports/credits/where-credit-due-treatment-tax-credits-under-pillar-2/2023/03/17/7g743#sec-4-1-1.* If only applied to companies with gross revenues >=€750 million, the cost could be substantially lower.

FIGURE 3.

Certain Tax Policies Will Require Review in the Context of a Global Minimum Tax

RED LIGHT

Tax holidays
Zero-tax free trade zones
Zero-rate corporate tax systems

YELLOW LIGHT

Reduced-rate incentives (e.g., patent boxes or FDII)
Business tax credits (particularly non-refundable credits)
Direct funding programs
Corporate tax rates below 15 percent

GREEN LIGHT

Accelerated depreciation (full expensing)
Last-In-First-Out (LIFO) inventory treatment
Unlimited loss carryforwards
Refundable tax credits

Note: The context for review will differ by country. Red Light policies are those most likely to require re-assessment and reform. Yellow Light policies need close study with a goal of simplifying tax incentives in the context of reform. Green Light policies should not need review in light of the minimum tax rules.
Source: Author.

Designing a Strategic Approach for U.S. Reforms

Even though Treasury has not sufficiently coordinated its international negotiations with Congress, it will be Congress's responsibility to minimize the disruption caused by the implementation of the global minimum tax.

Three goals should guide lawmakers:

1. Simplify the taxation of U.S. multinationals.
2. Promote investment and innovation in the U.S. in ways that protect the U.S. tax base from foreign top-up taxes.
3. Aim for revenue neutral reforms.

First, when it comes to simplicity, the foreign tax credit is an important place to start. The foreign tax credit connections between GILTI in current law and the global minimum tax contribute significantly to additional complexity for U.S. multinationals. And recently, the U.S. Treasury has promulgated regulations that have added even more uncertainty around the foreign tax credit.[38]

The current U.S. system is a hybrid system with elements that only focus on activities directly connected to the U.S. and elements that look at a company's global footprint. Other countries that have had territorial systems for many years are now venturing out on this hybrid approach with the global minimum tax. The multinationals that face the minimum tax rules will essentially be operating under a set of rules that apply to their worldwide income.

The tensions between territorial and worldwide rules will create complexity and enforcement challenges for years to come.

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[38] Daniel Bunn, "A regulatory tax hike on U.S. multinationals," *MNE Tax,* February 28, 2022, *https://mnetax.com/a-regulatory-tax-hike-on-us-multinationals-46865.*

Returning to a set of worldwide rules for U.S. companies could be seen as a simplification relative to the complexities of administering a hybrid system and enforcing the global minimum tax rules.

Replacing our current rules with a worldwide tax system with full creditability for foreign taxes could prove simpler for compliance than a reform that tries to align GILTI, BEAT, and the book minimum tax to the global minimum tax rules. This could be done alongside permanent, growth-oriented reforms like returning to expensing for R&D and capital investments.

In 2020, I recommended that a global minimum tax should be designed with full expensing for capital expenditures.[39] The minimum tax rules generally do not stand in the way of this policy, so a worldwide tax base that includes full expensing alongside a competitive rate could be a worthwhile effort.

If policymakers choose not to go down the path of worldwide taxation and instead retain a hybrid territorial system, it will be critical to adopt rules that are at the very least compatible with the global minimum tax rules. Having companies calculate taxable income under potentially four different minimum tax regimes would be counterproductive.

Secondly, Congress should promote investment and innovation in the U.S. in ways that protect the U.S. tax base from foreign top-up taxes. To avoid U.S. companies losing tax benefits to foreign UTPRs or foreign companies operating in the U.S. to IIRs, Congress should review existing tax incentives and prioritize them for reform or elimination. Additional revenues from eliminated tax incentives could be used to extend investment-friendly policies that are more compatible with the global minimum tax, such as full expensing for capital investment.[40]

The U.S. should also maintain a relatively low corporate tax rate consistent with the international agreement.

Finally, policy reforms should aim for revenue neutrality. In the area of cross-border taxation, the structure and complexity of the rules matter greatly. But once the structure is set, policymakers should avoid creating unnecessary tax increases for businesses. The TCJA had to trade off revenue reductions in some areas with base broadening, and the same will likely be necessary in the next round of changes to cross-border tax rules.

The choice for Congress is not a simple one between adopting the global minimum tax rules or adopting the reforms to GILTI envisioned in the BBBA. Overall, taking a different approach would provide Congress a chance to simplify cross-border tax rules in a way that supports investment within the U.S. without giving up significant control of the U.S. tax base to foreign jurisdictions.

CONCLUSION

A lot has changed in international tax rules over the last decade. Congress should explore how new rules have impacted the U.S. tax base and the investment behavior of U.S. companies.

The current level of uncertainty undermines the objectives of the 2017 reforms. Policy changes that move the U.S. rules out of the fog and into longer-term stability would be welcome.

The U.S. international tax system can and should be simplified. Such an achievement would require legislators to focus their efforts on designing rules that fit within the new framework and do not unnecessarily give up control of the U.S. tax base.

Even in the face of a global minimum tax, Congress still has a chance to develop a strategic approach in support of U.S. investment and innovation. It should take that chance.

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[39] Daniel Bunn, "Designing a Global Minimum Tax with Full Expensing," Tax Foundation, September 23, 2020, *https://taxfoundation.org/designing-a-global-minimum-tax-with-full-expensing/*.

[40] For more analysis of the connection between the global minimum tax and tax incentives, *see* Table III.2 in UNCTAD, "World Investment Report 2022," June 2022, *https://unctad.org/system/files/official-document/wir2022_en.pdf*.

QUESTIONS SUBMITTED FOR THE RECORD TO DANIEL BUNN

QUESTIONS SUBMITTED BY HON. MIKE CRAPO

Question. The report issued by the Joint Committee on Taxation for this hearing (JCX–8–23) confirms that TCJA's international tax reforms expanded the U.S. tax base—especially in the pharmaceutical industry. Pursuant to that report, with respect to a sample of (i) the 21 largest U.S.-based pharmaceutical companies with global operations, and (ii) a weighted set of 21 U.S.-based non-pharmaceutical large manufacturing companies with global operations, Figure 2 on pg. 76 shows those "pharmaceutical companies had much larger GILTI inclusions on average than either all corporations or large manufacturing, averaging over $4 billion a year in 2019 and 2020." For just those 21 pharmaceutical companies, that represents income inclusions of over $80 billion annually. Similarly, Figure 3 on pg. 77 shows a dramatic increase in those pharmaceutical companies' gross income (including GILTI) for tax purposes post-TCJA.

What does this data show regarding the impact of TCJA's international tax reforms on the U.S. tax base?

Answer. The analysis shows that the adoption of the tax on Global Intangible Low-Taxed Income (GILTI) broadened the U.S. tax base. Prior to the TCJA, those profits were beyond the reach of U.S. tax rules unless they were repatriated. However, the U.S. Federal statutory corporate tax rate of 35 percent deterred many businesses from repatriating their foreign earnings. By pairing a reduction of the corporate tax rate to 21 percent with GILTI, the U.S. tax base was expanded in two ways. First, the U.S. became a more competitive location for investment and production. The additional investment and production will likely lead to taxable wages and profits within the U.S. Second, companies that earn foreign profits at relatively low rates face additional U.S. tax through GILTI. If companies choose to shift profits into the U.S. due to the lower corporate tax rate and the availability of Foreign-Derived Intangible Income (FDII), that will also represent an expansion of the U.S. tax base.

Question. Democrats have advocated for a number of reforms to GILTI in an attempt to align it with the OECD Pillar 2 global minimum tax. One of the Democrat witnesses testified that, "in combination with other GILTI regimes changes, multiple estimates project significant revenue would be raised." In support of that assertion, that testimony cites four different "independent revenue estimates" that "would raise tax revenue in the range of $442 billion to $692 billion over a 9/10-year window." However, two of those "independent" estimates are from the Biden Treasury Department Greenbook.

Based on your research, do those Treasury estimates take into account the widespread adoption of (or even a single country adopting) Pillar 2—including the adoption of QDMTTs by "investment hub" countries? If not, do you think it is accurate for the President's budget to count on that much revenue coming in to the U.S. fisc when, in reality, a substantial amount will instead go to other countries that adopt QDMTTs?

Answer. Without additional details on the modeling approaches, it is challenging to evaluate the drivers for those revenue estimates.

However, there are a few things to consider when evaluating a revenue estimate for changes to GILTI.

The first is whether the U.S. would maintain primary taxing rights over foreign low-tax profits of U.S. companies. It is likely that many foreign countries will adopt Qualified Domestic Minimum Top-up Taxes (QDMTTs). In those countries, the U.S. would not have primary taxing rights over foreign low-tax profits of U.S. companies up to the 15 percent minimum as laid out in the global minimum tax rules. This means that any residual GILTI revenue under current law or reforms would come through one of (or a combination of) three channels:

1. Double taxation due to the foreign tax credit haircut for GILTI.
2. Mismatches between the tax base for GILTI and the QDMTTs (*e.g.,* the substance carveout differences with Qualified Business Asset Investment [QBAI]).
3. A higher GILTI rate than the agreed global minimum tax rate.

A second consideration is the impact on profit shifting. In economic terms, profit shifting is driven by the difference in effective tax rates between two jurisdictions.

Practically speaking, companies make numerous investment and capital allocation decisions that impact where profits are earned. The phenomenon of profits being shifted to reduce exposure to taxes has been well-researched and documented.[1]

In Tax Foundation's work analyzing reforms to GILTI, we use a semi-elasticity of 0.8 to capture responses to effective tax rate differentials. This is based on estimates in the academic literature on profit shifting.

The 0.8 semi-elasticity means that if the difference between the U.S. effective tax rate on corporate profits and the average foreign effective tax rate increases by 1 percent, then there will be a 0.8 percent increase in shifted profits.

If changes to GILTI result in U.S. companies being subject to higher effective tax rates than they could face in foreign jurisdictions, then U.S. companies would be incentivized to shift profits outside of the U.S. or restructure their business in some way to avoid the higher GILTI burden.

In 2021, Cody Kallen estimated several scenarios for changes to GILTI.[2] He noted that under current U.S. law, if foreign countries adopted a 15 percent minimum tax, then U.S. revenues would be reduced by $20.4 billion. Adopting the corporate tax proposals in President Biden's FY 2022 budget (28-percent corporate tax rate and changes to GILTI) would increase revenues by $1.2 trillion. However, making some modifications to GILTI under the current law and adopting a Pillar 2-compliant version of GILTI both reduce U.S. tax revenues over a 10-year horizon.

Change in Federal Corporate Income Tax Liabilities of U.S. MNEs Under Different Foreign Tax Responses, Billions of Dollars

Proposal	Current Rates	15% Minimum	Difference
Current Law	0.0	−20.4	−20.4
Biden proposal	1,315.9	1,175.2	−140.7
Partial Biden	579.5	502.3	−77.2
GILTI fix	0.0	−62.5	−62.5
Pillar 2	106.0	−43.9	−150.0

Note: This table presents the 10-year change in Federal corporate income tax liabilities of U.S. multinationals in billions of dollars for each proposal. The first column uses current foreign tax rates. The second column supposes that each country-industry CFC observation faced an average tax rate of at least 15 percent. The third column presents the reduction in Federal corporate tax liabilities from this effect.

Source: Tax Foundation's Multinational Tax Model; Cody Kallen, "Options for Reforming the Taxation of U.S. Multinationals."

EFFECTS OF PROPOSALS UNDER DIFFERENT FOREIGN TAX RATE ASSUMPTIONS

In summary, the presence of the QDMTTs should significantly impact how much revenue changes to GILTI could raise, and analysis that does not clearly account for foreign QDMTTs is not capturing the entire picture.

The Treasury analysis is questionable partially because it is unclear whether there is any accounting for foreign QDMTTs. Treasury should be clear about its assumptions on this matter.

Question. TCJA enacted the Foreign-Derived Intangible Income (FDII) deduction to work in tandem with GILTI to help protect the U.S. tax base. FDII ensures companies holding their IP in the U.S. to sell around the world are taxed at the same rate of income as companies who hold their IP abroad and are subject to GILTI.

However, one of the Democrat witnesses testified that FDII provides "similar incentives to locate offshore" as GILTI does. The administration's latest budget proposes to repeal FDII, alleging it "creates undesirable incentives to locate certain economic activity abroad."

[1] Elke Asen, "What We Know: Reviewing the Academic Literature on Profit Shifting," *Tax Notes International* 102:8, May 24, 2021, *https://files.taxfoundation.org/20210621154315/What-We-Know-Reviewing-the-Academic-Literature-on-Profit-Shifting-TN-Int.pdf.*

[2] Cody Kallen, "Options for Reforming the Taxation of U.S. Multinationals," Tax Foundation, August 12, 2021, *https://taxfoundation.org/us-multinational-tax-reform-options-gilti/*.

In contrast to that academic theory, Mr. Bunn's testimony cited to a 2021 Ireland publication discussing outbound royalties from Ireland. Examining data between 2016 and 2020, the study found that outbound royalty payments from Ireland to the U.S. went from averaging €8 billion a year to €52 billion in 2020, and was expected to be even higher in 2021. Citing to TCJA's international reforms affecting U.S. multinationals—explicitly referencing FDII—the study concluded that "the annual reports for these companies show a large rise in the share of their profits being attributed to domestic, or U.S.-based operations." In the same vein, also in 2020, an analysis from another tax publication noted that "nine companies . . . estimated to have shifted a whopping $59.8 billion into the United States because of the TCJA."

What would be the impact of the administration's repeal of FDII on both the attractiveness of the U.S. as a place to develop and hold IP as well as a place for high-wage jobs in research and manufacturing? Also, as more countries adopt Pillar 2's domestic minimum taxes that will result in a reduction in U.S. GILTI revenue, does FDII become more or less important to protect the U.S. base?

Answer. Repealing FDII would create a clear incentive for U.S. companies to hold their IP offshore and to develop future IP offshore. The balance between GILTI and FDII is not perfect, but it is clear in the data that some companies have recognized that, following the passage of TCJA, holding their IP in the United States is preferable to keeping that IP offshore. This also suggests that FDII will be an important location factor for future IP development by U.S. businesses and associated high-skilled jobs.

As other countries implement domestic minimum taxes, initially the foreign burden on profits from intangible assets will rise relative to the U.S. burden. This could make the U.S. a relatively more attractive place to earn profits from IP, although that depends on whether FDII benefits will trigger a UTPR top-up for U.S. businesses.

Any additional U.S. tax on GILTI will be due to mismatches between GILTI and a domestic minimum tax as well as the foreign tax credit haircut and expense apportionment for foreign tax credit purposes.

This will continue to be the case after 2025, when the rates on GILTI and FDII increase. The problematic features of GILTI, especially when layered on top of a foreign domestic minimum tax, will make FDII even more important to attracting IP and associated activities with IP development.

It is also worth noting that the higher rate on FDII post-2025 will create less risk for U.S. taxpayers with respect to potential UTPR top-up taxes. For example, if the current UTPR risk for a U.S. taxpayer is due to a combination of FDII benefits and non-refundable credits, a higher FDII rate after 2025 will mitigate some of that UTPR risk.

In general, FDII will continue to have strategic importance for U.S. tax policy.

Questions Submitted by Hon. Todd Young

Question. During the hearing, Ranking Member Crapo noted tax receipts, when measured against the Congressional Budget Office baseline in effect prior to the Tax Cuts and Jobs Act ("TCJA"), are higher by a considerable amount. My friends on the Democratic side of the aisle and the witnesses chosen by them used revenue estimates of the legislation at the time it was passed to criticize TCJA from a fiscal standpoint.

If we are trying to get a fiscal handle on how TCJA has performed, which is the better metric: revenue estimates which are over 5 years old or actual tax receipts for the same period? Please elaborate on the comparative data in your answer.

Answer. When the facts are available, it is best to rely on those facts rather than a prediction, which, no matter how sophisticated, is always subject to error. In the case of tax revenue prediction or forecasts, despite the best efforts of revenue estimators including the Joint Committee on Taxation (JCT), errors relative to actual outcomes can be substantial due to the fundamental challenge of predicting the interactive behavior of millions of U.S. taxpayers over several years within the context of a constantly evolving and complex economy. This challenge is made more formidable when modeling the effects of complex and sometimes unprecedented tax policy changes. For instance, the JCT recently revised their revenue estimates for the green energy credits enacted as part of the Inflation Reduction (which include somewhat unprecedented features such as transferability), with the current estimates published in June of this year growing by more than 100 percent relative to the original estimates published in August of last year.[3]

Regarding revenue estimates for the TCJA, the law involved several major departures from current law at the time, including a reduction in the corporate tax rate from 35 percent to 21 percent as well as the introduction of GILTI and other international provisions, resulting in considerable uncertainty about how the law might affect tax revenue, particularly due to effects on profit shifting and economic growth. While the JCT estimated in December 2017 that TCJA would reduce tax revenue by $1.5 trillion over the period 2018 to 2027, the JCT also provided a macroeconomic analysis of the bill estimating that the TCJA would increase the average level of GDP over the budget window by 0.7 percent, resulting in an offsetting increase in revenue of $451 billion over the budget window.[4] This macroeconomic (or dynamic) effect was estimated using three different JCT models, each of which presumably produced a somewhat different result, which was then combined in some way to represent JCT's best overall estimate.

Our modeling and analysis of TCJA largely agreed with JCT's, though our estimates were somewhat different. We estimated TCJA would increase GDP by 2.9 percent over the budget window, resulting in an initial revenue loss that by 2023 would switch to a revenue gain, after accounting for economic growth effects.[5]

Our modeling has turned out to closely reflect actual outcomes in many ways, particularly in regard to our revenue estimates, despite a series of confounding and unrelated events including higher tariffs and other policy developments, a pandemic, and the return of high inflation that make any comparison to actual outcomes difficult and prone to misinterpretation. That said, at a high level, we can say with confidence that the Federal tax system under TCJA has demonstrably resulted in tax revenue collections that meet or exceed historic norms pre-TCJA. For example, average Federal tax collections in the 5 years since the TCJA's enactment (through FY 2022) are about 17.3 percent of GDP, higher than the 16.7 percent forecasted by the Congressional Budget Office (CBO) following its passage, higher than most years leading up to the TCJA, and higher than the long-run average of 17.2 percent since World War II.[6]

It remains to be seen where Federal tax collections go from here. Through the first 8 months of FY 2023, collections are down 11 percent relative to the same period last year, apparently due in part to reduced capital gains revenue as the stock and housing markets deflated in 2022.[7] However, this is relative to a record-breaking FY 2022 in which Federal tax collections reached $4.9 trillion, an all-time high, and 19.6 percent of GDP, the highest level since the dot-com bubble in FY 2000.[8] As such, depending on the path of GDP, Federal tax collections as a share of GDP could come in near the historic average in FY 2023.

As a final note, tax collections as a share of GDP reflects both changes in nominal collections and changes in nominal GDP. The TCJA boosted real and nominal GDP (according to our analysis and the JCT's, for instance), so reaching and exceeding the historic average of tax collections as a share of GDP as the TCJA has done understates the revenue performance of the law. Indeed, the available evidence over the last 5 years indicates the Federal tax system under the TCJA substantially boosted both the economy and Federal tax collections, roughly in proportion.

Question. I have joined several of my Republican colleagues in expressing deep concern for the way the Biden administration has handled the OECD Pillar 2 negotiations. However, I think there may be some confusion as to how the administra-

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[3] William McBride and Daniel Bunn, "Repealing the Inflation Reduction Act's Energy Credits Would Raise $663 Billion, JCT Projects," Tax Foundation, June 7, 2023, *https://taxfoundation.org/inflation-reduction-act-green-energy-tax-credits-analysis/*.

[4] Joint Committee on Taxation, "Macroeconomic Analysis of the Conference Agreement for H.R. 1, The Tax Cuts and Jobs Act," December 22, 2017, JCX–69–17, Joint Committee on Taxation *(jct.gov)*.

[5] Tax Foundation, "Preliminary Details and Analysis of the Tax Cuts and Jobs Act," December 18, 2017, *https://taxfoundation.org/final-tax-cuts-and-jobs-act-details-analysis/*.

[6] William McBride, "Inflation Is Surging, So Are Federal Tax Collections," Tax Foundation, October 13, 2022, *https://taxfoundation.org/federal-tax-collections-inflation-surging/*.

[7] Congressional Budget Office, "Monthly Budget Review: May 2023," June 8, 2023, *https://www.cbo.gov/publication/59134*.

[8] William McBride, "Inflation Is Surging, So Are Federal Tax Collections," Tax Foundation, October 13, 2022, *https://taxfoundation.org/federal-tax-collections-inflation-surging/*.

tion has continually hampered Congress's ability to set an appropriate path for U.S. policy on this issue.

Can you please lay out the timeline of negotiations of the Pillar 2 model rules as it relates to other Democratic policy efforts, such as the Build Back Better Act and the Inflation Reduction Act, along with the U.S. Treasury's issuance of guidance on the subject, and how those efforts have not only disadvantaged U.S. tax incentives, but also continue to undermine Congress's ability to determine U.S. tax policy?

Answer. The first substantive set of proposed rules was released by the OECD in an October 2020 report (the October 2020 Blueprint).[9] The rules revealed the design of the Income Inclusion Rule (IIR), the Undertaxed Payments Rule (UTPR), and the Subject-to-Tax Rule (STTR).

The report identified the need to ensure that GILTI could co-exist and suggested the need for GILTI to be treated as a qualified IIR.

This reflected the Trump administration's negotiation objective to avoid a result that would require congressional legislation to align with Pillar 2 rules.

The key paragraphs on this subject are as follows:

> Given the pre-existing nature of the GILTI regime and its legislative intent there are reasons for treating GILTI as a qualified income inclusion rule for purposes of the GloBE rules provided that the coexistence achieves reasonably equivalent effects. This treatment would need to be reviewed if subsequent legislation or regulations in the U.S. would have the effect of materially narrowing the GILTI tax base or reducing the legislated rate of tax. The Inclusive Framework recognizes that an agreement on the co-existence of the GILTI and the GloBE would need to be part of the political agreement on Pillar Two.
>
> At a technical level further consideration will be given to how the interactions between the GILTI and the GloBE rules would be coordinated. That includes the coordination with the application of the GILTI to U.S. intermediate parent companies of foreign groups headquartered in countries that apply an IIR. Moreover, considering the role of the undertaxed payments rule as a back-stop to the IIR, the Inclusive Framework on BEPS strongly encourages the United States to limit the operation of the Base Erosion and Anti-abuse Tax (BEAT) in respect of payments to entities that are subject to the IIR.

In the spring of 2021, the Biden administration made a clear pivot away from the Trump administration's negotiating strategy with the OECD. It released its budget for Fiscal Year 2022, proposing a country-by-country calculation for GILTI, an increase in the rate applied to GILTI, the elimination of FDII, and a minimum tax on corporate book income.[10]

The Biden administration's budget partially paved the way for agreement at the international level. In July 2021, the administration supported an OECD statement outlining high-level elements of the global minimum tax.[11]

Compared to the 2020 blueprint, the language regarding GILTI was substantively changed. There was no longer any language regarding GILTI being treated as a qualified IIR. Instead, the document had the following statement: "It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the U.S. GILTI regime will co-exist with the GloBE rules, to ensure a level playing field."

The description of the UTPR also shifted away from a tax on payments between related parties to something much broader. However, at the time, there was essentially no detail with the statement only saying the following:

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[9] OECD, "Tax Challenges Arising from Digitalisation—Report on Pillar Two Blueprint," October 14, 2020, *https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint-abb4c3d1-en.htm.*

[10] Office of Management and Budget, "Budget of the U.S. Government: Fiscal Year 2022," May 2021, *https://www.whitehouse.gov/wp-content/uploads/2021/05/budget_fy22.pdf.*

[11] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy," July 1, 2021, *https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.*

> . . . an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR. . . . The UTPR allocates top-up tax from low-tax constituent entities including those located in the UPE jurisdiction under a methodology to be agreed.

Building from the July statement, the OECD released another statement in October that provided very little additional information on the differences in details that had shifted since the 2020 blueprint for the Pillar 2 rules.[12]

The description of GILTI's coexistence remained very much the same. The UTPR description also did not change substantially apart from a new safe harbor for multinationals in their initial phase of international activity.

The Build Back Better Act was the first major piece of tax legislation to pass either chamber of Congress after the global minimum tax was agreed to.[13]

The legislation would have moved GILTI to a country-by-country calculation, shrunk the Qualified Business Asset Investment (QBAI) to 5 percent, and provided a tax rate of 15 percent (15.8 percent if the foreign tax credit haircut of 5 percent applied).

The legislation also outlined a 15-percent minimum tax on book income that clearly protected the value of general business tax credits like the research and development tax credit.

The Build Back Better Act failed to get sufficient support in the Senate and did not become law.

The first substantial update to the proposed rules outlined in the October 2020 Blueprint came in the December 2021 model rules.[14] This document showed that the Biden administration was negotiating policies at the OECD that ran contrary to the objectives of the Build Back Better Act developed by congressional Democrats.

The rules introduced several new and important concepts that created concerns for interactions with U.S. rules. First, the rules introduced the concept of a QDMTT. This would allow a country to collect top-up tax itself before a foreign jurisdiction applied an IIR. At the time, it was believed that the tax on GILTI would be treated as a tax on controlled foreign corporation (CFC) income, and the QDMTT would apply after GILTI applied.

Out of the 70-page document, just one paragraph described the situation of GILTI, suggesting that not much progress had been made on an agreement for GILTI's treatment:

> The GloBE Rules apply a minimum rate on a jurisdictional basis. In that context, the OECD/G20 Inclusive Framework on BEPS agreed, in its 8 October 2021 statement, that consideration will be given to the conditions under which the U.S. Global Intangible Low-Taxed Income (GILTI) regime will co-exist with the GloBE Rules, to ensure a level playing field.

Another interaction with U.S. law that came out of the model rules was the treatment of tax credits. Policymakers had decided to rely on accounting rules to determine how different types of tax credits would be treated in the minimum tax calculations. The model rules showed that nonrefundable general business credits like those in the U.S. would be at a relatively high risk of triggering a top-up tax while refundable tax credits would face a lower risk. This is due to the standard treatment of the different tax credits for accounting purposes, but it does not seem there were efforts to rationalize the treatment of the credits.

Qualified Refundable Tax Credits would be treated as income, and nonqualified credits would directly reduce taxes paid.

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[12] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy," October 8, 2021, *https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.*

[13] The Build Back Better Act, which later was signed into law as the Inflation Reduction Act (with significant changes) was engrossed in the House of Representatives as H.R. 5376 on November 19, 2021, *https://www.congress.gov/bill/117th-congress/house-bill/5376/text/eh.*

[14] OECD, "Tax Challenges Arising from Digitalisation of the Economy—Global Anti-Base Erosion Model Rules (Pillar Two)," December 20, 2021, *https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en.*

This outcome is opposed to what congressional Democrats were attempting to accomplish by protecting general business credits from the impact of the 15-percent minimum tax on book income that was included in the House-passed Build Back Better Act (also known as the Book Minimum Tax, or BMT).

The model rules also dramatically changed the scope and structure of the UTPR. Rather than applying to payments between related parties, the UTPR could apply to low-tax profits in a corporate structure even if a taxable entity had no direct economic relationship with the entities (or jurisdictions) where the low-tax profits were generated.

The UTPR changes alongside the approach to tax credits created significant challenges for U.S. tax rules.

Several of the provisions of the Build Back Better Act, including the 15-percent minimum tax on book income, became law as part of the Inflation Reduction Act in the summer of 2022.[15]

That law continued to show congressional intent to protect nonrefundable tax credits in the context of a minimum tax, despite the negotiated outcome in the global minimum tax model rules published in the prior years.

Significant refundable and transferable tax credits were also introduced into U.S. law as part of that legislation.

Further guidance on the OECD rules was released in February 2023.[16] This guidance document changed the approach from the model rules with respect to GILTI. First, CFC tax regimes were given lower priority than the QDMTTs. This is a change from the approach in the model rules released in December 2021. Second, the administrative guidance names GILTI as a Blended CFC Tax Regime and provides for a simplified allocation for those regimes for a limited time period (essentially through the end of 2025).

In total, the negotiated outcome at the OECD contradicts and undermines approaches taken by both parties in recent years (GILTI and BMT) and many longstanding tax credits. This puts Congress in the position of having to change U.S. law to preserve U.S. control over the tax rules impacting U.S. taxpayers.

Question. The U.S. Treasury and the OECD recently released expected revenue estimates for Pillar 2.

Could you please comment on the methodology and accuracy of these revenue estimates issued by the U.S. Treasury relating, respectively, to the U.S. and globally?

Answer. Without details on the modeling approaches, it is challenging to evaluate the drivers for those revenue estimates.

The Treasury analysis is questionable partially because it is unclear whether there is any accounting for foreign Qualified Domestic Minimum Top-up Taxes.

The OECD analysis is also questionable because it does not seem to account for the impact of significant policy changes and relies on very little information that is post-TCJA. I have critiqued that approach in commentary from January 2023.[17]

Tax Foundation has been tracking individual country estimates for the revenue impacts of Pillar 2 and many major countries expect a small increase in corporate tax revenues.

Modeling these reforms is incredibly difficult. However, the use of available data and the caveats associated with incomplete data should be front and center with these estimates. Additionally, it is necessary to be clear about the policy baseline the reform is being measured against.

We have been tracking individual country estimates, and a summary of those is included below for the record.

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[15] Public Law 117–169, Inflation Reduction Act of 2022, August 16, 2022, *https://www.congress.gov/bill/117th-congress/house-bill/5376/text.*

[16] OECD, "Tax Challenges Arising from the Digitalisation of the Economy—Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)," February 1, 2023, *https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf.*

[17] Daniel Bunn, "What the OECD's Pillar Two Impact Assessment Misses," Tax Foundation, January 23, 2023, *https://taxfoundation.org/global-minimum-tax-revenue-impact-assessment/*.

Select Country-Level Revenue Estimates for Pillar Two [18]

By Daniel Bunn and Cecilia Perez Weigel

Following international agreement on Pillar Two, the European Union unanimously adopted a directive implementing the global minimum tax in December 2022. The following month, the Organisation for Economic Co-operation and Development (OECD) released revenue estimates to assess the real impact of the tax on public finances.

The global rules are designed to raise revenue, but the question remains: how much? (This is particularly important because the new tax comes at the cost of international competitiveness and investment.) The OECD estimates these rules will raise corporate tax revenue by 9 percent, generating around USD 220 billion in additional global tax revenue annually. The International Monetary Fund (IMF) disagrees, pegging the rise in global corporate income tax revenue at 5.7 percent, more than one-third smaller than the OECD estimate.

Estimating revenue from new taxes can be complex—and sometimes policymakers only know *after* a new proposal is implemented. Nonetheless, nine countries have produced individual estimates of corporate tax revenue increases, ranging from 0.8 percent in Australia to 11 percent in Switzerland.

Australia

In May 2023, Australia formally unveiled its Federal budget, which included revenue estimates of its implementation of Pillar Two. Australia estimates that Pillar Two would raise AUD 370 million (USD 250 million) over the next 5 years in corporate tax revenue.

Between 2016 and 2020, Australia averaged USD 66.9 billion in annual corporate tax revenue. Full implementation of Pillar Two would therefore translate to a 0.8 percent annual increase in average corporate tax revenue.

Belgium

In early 2023, the Belgian government formally presented a proposal for the first phase of its "broad tax reform." In its latest budget agreement, Prime Minister De Croo announced that the implementation of Pillar Two would raise EUR 330 million (USD 360 million) in annual corporate tax revenue.

Between 2016 and 2020, Belgium averaged USD 19.4 billion in annual corporate tax revenue. Full implementation of Pillar Two would therefore translate to a 1.8-percent increase in average corporate tax revenue.

Canada

In its 2023 "Made-in-Canada Plan," the Canadian Federal Government released revenue estimates of its implementation of Pillar Two. In its estimation, national implementation would raise CAD 5.1 billion (USD 3.8 billion) in corporate tax revenue in the first 2 years. The Department of Finance will collect CAD 2.8 billion (USD 2 billion) in fiscal year 2027 and CAD 2.4 billion (USD 1.8 billion) in fiscal year 2028.

Between 2016 and 2020, Canada averaged USD 63.6 billion in annual corporate tax revenue. Full implementation of Pillar Two would therefore translate to a 3-percent increase in average corporate tax revenue.

Denmark

The Danish government is in the process of drafting Pillar Two implementing legislation. The Danish Ministry of Taxation estimates that this additional annual revenue will be between DKK 2 billion and DKK 3 billion (around USD 0.3–0.4 billion).

Between 2016 and 2020, Denmark averaged USD 10.1 billion in annual corporate tax revenue. The implementation of Pillar Two would then translate to a 3- to 4-percent increase in average corporate tax revenue (depending on the range of revenue).

France

France, one of the initial supporters of the Pillar One and Pillar Two proposals, is currently drafting a legislative proposal to transpose the EU directive into French

[18] Daniel Bunn and Cecilia Perez Weigel, "Select Country-Level Revenue Estimates for Pillar Two," Tax Foundation, April 4, 2023, *https://taxfoundation.org/pillar-two-corporate-tax-revenue-estimate-by-country/*.

law. The French Government estimates that Pillar Two implementation will raise at least EUR 1 billion (USD 1.1 billion) annually.

Between 2016 and 2020, France averaged USD 58.4 billion in annual corporate tax revenue. Implementation at the national level would then translate to a 1.8-percent increase in average corporate tax revenue in the short term and a 3-percent increase in the long term.

Germany

The German government is also drafting Pillar Two implementing legislation that will likely include an official estimate of revenue raised. A 2022 report from the IFO Institute in Munich estimates this annual additional revenue will be between EUR 5.1 billion and EUR 6.7 billion (USD 5.8 to 7.6 billion).

Between 2016 and 2020, Germany averaged USD 74.1 billion in annual corporate tax revenue. The implementation of Pillar Two would constitute an 8- to 10-percent increase in average corporate tax revenue (depending on the range of revenue).

The Netherlands

The Netherlands held a public consultation on the implementation of Pillar Two in the fall of 2022. The consultation contained an evaluation of the transposition and implementation of the EU's directive and annual estimated expected revenue to be about EUR 0.4 to 0.5 billion (USD 0.5 billion). A final estimate will be made once the Netherlands submits the transposition of the directive, and it will be certified by the Central Planning Bureau.

From 2016 to 2020, the Netherlands averaged USD 29.6 billion in corporate tax revenue. Consequently, the implementation of Pillar Two would imply a 2-percent increase in average corporate tax revenue.

Switzerland

The Swiss Federal Council has proposed a supplementary tax to implement Pillar Two. In Switzerland, the expected revenue is meant to be distributed on a consolidated basis: between the cantons, communes, and the Federal Government. While overall fiscal estimates cannot be reliably estimated, the proposal suggests the measure would increase revenue in the short term. The proposal reports a range of CHF 1 billion to 2.5 billion per year (USD 1 to 2.6 billion) in additional revenue.

From 2016 to 2020, Switzerland averaged USD 22.7 billion in annual corporate tax revenue. Consequently, the implementation of Pillar Two would mean a 4- to 11-percent increase in average corporate tax revenue.

United Kingdom

The United Kingdom estimated in its 2022 Autumn Statement that the implementation of Pillar Two would raise GBP 2.3 billion a year by 2027–28 (USD 2.7 billion). This estimate comes with the publication of the on or after 31 December 2023.

From 2016 to 2020, the UK averaged USD 68 billion in annual corporate tax revenue. National implementation of Pillar Two would equal a 4-percent increase in average corporate tax revenue.

Conclusion

Pillar Two implementation is underway in many jurisdictions, and many governments are aiming to get their proposals approved before the end of 2023. However, estimating Pillar Two's impact on government revenue is proving difficult. As a result, only a few countries have publicly presented their findings.

The Pillar Two revenue estimates of these nine countries (Australia, Belgium, Canada, Denmark, France, Germany, the Netherlands, Switzerland, and the UK) represent USD 17.6 billion dollars of the total annual USD 220 billion OECD estimate for additional tax revenue—or 8 percent.

Given the uncertainty of these estimates, policymakers should be cautious about sacrificing their country's competitiveness and ability to attract investment by implementing Pillar Two rules to chase revenue. An accurate revenue analysis on the effectiveness and magnitude of these new rules may only be possible years after their implementation.

In the meantime, countries should continue to evaluate the revenue impact of the rules and weigh pro-growth options for reforming their tax systems overall to support investment and growth.

PREPARED STATEMENT OF HON. MIKE CRAPO,
A U.S. SENATOR FROM IDAHO

Almost 8 years ago—before the Republican-enacted Tax Cuts and Jobs Act—this committee's bipartisan working group concluded our international tax system was "clearly broken." Inversions were on the rise, used as a defensive strategy by U.S. companies to fend off foreign takeovers. Mr. Chairman, you rightly observed this "inversion virus" was "multiplying every few days."

Ironically, the bipartisan report cited the pharmaceutical industry to illustrate how the pre-TCJA tax code made "U.S. companies more valuable in the hands of foreign acquirers." In seeking to put TCJA on trial, today's hearing ignores facts that have flipped the competitive edge in our favor.

Fact: TCJA completely cured the inversion virus. By enacting competitive tax rates and reforming how we tax foreign income, U.S. companies and their workers can now win in the global marketplace.

Prior to the pandemic, TCJA's reforms led to one of the strongest economies in generations: unemployment dropped to a 50-year low, economic gains flowed to all demographic groups and income levels, and American businesses reported record R&D investment.

But TCJA was far from a corporate giveaway: it significantly broadened the tax base, including introducing the first global minimum tax of its kind. The result of that prescription? Record-high corporate tax receipts. In short, TCJA is a vast improvement over the prior system.

Of course, we should not rest on our laurels. In the changing global landscape, we should consider refinements that would allow U.S. companies to further invest and expand domestically without harming their ability to compete globally.

Cherry-picking data from an industry to defame TCJA ignores how the threshold question has dramatically changed since 2017. No longer is the question whether our tax code drives our companies overseas, costing American taxpayers billions. Rather, critics' chief complaint now appears to be the U.S. fisc deserves a bigger slice of the success that our companies are now able to achieve, in large part due to TCJA.

I agree that we should examine how international tax policy impacts our tax base, while ensuring we remain an attractive place for investment to boost our workers' job opportunities and wages. In that context, Congress must seriously examine the commitments this administration has made in OECD international tax negotiations.

The last 2-plus years, this administration has used those negotiations in an attempt to compel domestic law changes, disregarding the effect on U.S. revenue, companies, and workers. Without consulting Congress, much less obtaining its consent, it collaborated with the OECD on a cartel-like global tax code with a trilogy of new taxes, which appear to put America last.

The first piece mandates a global minimum level of tax on large companies. The U.S. already has one, thanks to TCJA. But, at our own administration's urging, it was not deemed good enough for the new world tax order.

The second is the enforcement mechanism, the UTPR: this extraterritorial tax greases the skids for a foreign revenue grab and blatantly undermines important job-creating tax policies passed by Congress on a bipartisan basis.

And the final one drains the U.S. fisc. The global tax code sanctions a pathway for a domestic minimum tax, and Treasury agreed to give priority to those taxes over the TCJA minimum tax, essentially handing each foreign country a model vacuum to suck away tens of billions from our tax base.

But the most indefensible position agreed to by Treasury? The disparate treatment of investment incentives for each tax in the trilogy, tilting the scale in favor of our competitors.

Investment incentives historically enacted by Congress—nonrefundable tax credits such as the R&D credit—are treated punitively by the UTPR, compared to refundable credits and government subsidies more commonly used in other countries. In other words, the OECD high priests have condemned tax competition, but blessed government subsidies.

That is why the administration's narrative of the global tax code halting the so-called "race to the bottom" rings quite hollow. In reality, if one adopts that rhetoric, the global tax code creates a more supercharged “race to the bottom”—a race for increased subsidies in government-favored industries. Even Biden’s former lead OECD negotiator recently acknowledged this.

Maybe most concerning is which country may benefit the most from this failed game of Whack-A-Mole. China bestows hundreds of billions of dollars in subsidies every year upon its favored domestic companies, and they do it far better than any other developed country.

Given the administration’s failure to subject this deal to careful public scrutiny and analysis, this global tax code could result in an “America Last” policy that cedes ground to China. Congress should seriously probe whether the administration agreed to a global tax code that materially harms our businesses, workers, and the fisc.

In the interim, Mr. Chairman, I look forward to hearing from today’s witnesses on their perspectives on the international tax challenges we face in today’s global economy.

PREPARED STATEMENT OF WILLIAM H. MORRIS,
DEPUTY GLOBAL TAX POLICY LEADER, PwC

Chairman Wyden, Ranking Member Crapo, and distinguished members of the committee. I appreciate the opportunity to appear this morning as the committee considers important questions of International Tax. My testimony will focus on what is currently one of the most significant areas of interest in this area: the Organisation for Economic Co-operation and Development (OECD) two-pillar project. I had the privilege of working as Associate International Tax Counsel in the Office of Tax Policy at the U.S. Treasury from 1997–2000. For the past 6 years, I have worked at PwC, in both London and Washington, on international tax policy. Additionally, from 2012–2022 I was chair of the Tax Committee of Business at OECD (also known as BIAC) in Paris, which allowed me to see firsthand the development of the Base Erosion and Profit Shifting (BEPS) project from 2012–15 and the two-pillar project since 2017.

I am appearing today on my own behalf and not on behalf of PwC, Business at OECD, or any client. The views I express are my own.

INTRODUCTION

The significance of the OECD two-pillar project cannot be overstated. It represents a true sea change in international taxation. Pillar 1 would allocate more taxing rights (*i.e.,* tax base) to countries where sales take place. Pillar 2 would institute a global minimum tax of 15 percent, implemented on a harmonized basis. (See Appendix 1 for more detailed explanations of both pillars.)

The Project arose out of concern that the international consensus on allocation of taxing rights was dissolving as several governments began enacting unilateral measures, which caused concern for the United States, including for members of this committee. In order to restore stability to the international tax system, the OECD, as the global standard setter for international tax matters for decades, was a logical convener of the discussion. By broadening the participants to include countries that were not members of the OECD, first the G20, and then smaller developing countries, the OECD sought to create an inclusive framework (the “Inclusive Framework”) where the interests of developing countries could be explored together with the interests of the developed countries that represent the membership of the OECD.

At its inception in 2017, the OECD’s “Project on the Tax Challenges Arising from the Digitalization of the Economy,” which became Pillar 1, set out to answer the question: “how can the international tax system be amended/augmented to allow market countries to tax the increased ability of companies through digitization to access markets without a physical presence?” This question remains outstanding, however, because Pillar 1 has not been completed, and the viability of Pillar 1 is an open question.

As regards Pillar 2, after the United States enacted a minimum tax in 2017, other governments wanted to follow suit. While that could have represented a welcome leveling of the playing field for U.S.-headquartered companies, to date that is not the way things have turned out because of choices made in the drafting process. As OECD administrative guidance stands today, the Pillar 2 Minimum Tax could work to the disadvantage of the U.S. fisc and U.S.-headquartered companies. First, the U.S. fisc could lose Global Intangible Low-Taxed Income (GILTI) tax revenue because the rules give Qualified Domestic Minimum Top-up Taxes (QDMTTs) of other countries primacy over GILTI. Secondly, in its effort to ensure a level playing field, the Undertaxed Profits Rule (UTPR) was drafted so that it effectively would give countries that have adopted Pillar 2 rules the right to tax the nonrefundable credits and incentives granted by other countries, including the United States. What that means is that U.S.-headquartered businesses would lose the benefit of those U.S. credits and incentives. The UTPR taxes imposed by other countries would not be creditable in the United States.

Let me emphasize two things before continuing. First, an answer to the original question that led to Pillar 1 is important to restore greater stability and certainty to international tax relations among countries. The world and business models are changing rapidly. An agreement that satisfies a wide range of countries would allow those business models to flourish, which will in turn create jobs and foster global economic growth. Second, Pillar 2 is in the process of happening. While there may be adjustments to the workings of Pillar 2, there's no turning back the clock as other countries begin to legislate. The question for this committee, therefore, is how the United States should respond to these global developments. Can the OECD, the United States, and other countries continue to work together to ensure Pillar 2 achieves its objective without disadvantaging the United States or impeding key legislative objectives? Doing so has the greatest likelihood of stabilizing the international tax regime for the long term, which would benefit the United States as well as other countries.

THE CHALLENGE AHEAD

Congress has several options to consider on both pillars. It should be said at the outset that the acceptance and durability of an international negotiation that would redraw taxing rights among countries will be greater if the decisions of one country can coexist with the decisions of other countries regarding their own tax systems, which may differ. Put slightly differently, if the negotiations aim for "interoperability"—a level of coexistence—between tax systems, that allows different tax systems to operate alongside each other with a mutual understanding of and respect for the choices that legislatures in different countries may make based on each country's unique circumstances, the result is more likely to be stable over the long term. The Pillar 2 model rules' effort to level the playing field heads more in the direction of tax "harmonization." Multilateral cooperation to achieve interoperability is important, but so is the ability of countries to address the needs of their citizenry and achieve their sovereign goals.

The work on the OECD two-pillar project should be continued in order to allow the United States—and all other governments as well—to enact the laws Congress determines to be appropriate, including to incentivize certain types of activity through the tax system, and to protect the U.S. tax base. Congress's goal should be to ensure that the United States remains an attractive and vibrant location for creating jobs, starting a business, and making investments, and to have the ability to address the country's economic, national security, and public health needs. The ongoing international tax negotiations must allow other countries to carry out their own tax policy choices as well while preventing, to the greatest extent possible, value-destroying friction at the international/multilateral level (*i.e.,* finding the appropriate interoperability). While there has been progress towards interoperability through the OECD's administrative guidance, it is important for that effort to continue to produce a result that is sustainable.

Particularly in relation to Pillar 2, the model rules limit governments' ability to use incentives delivered through the tax system. The model rules include criteria on what constitutes "qualified" tax base elements, including for credits and incentives. Two examples of what this means practically for the United States are:

- GILTI, the minimum tax that gave rise to Pillar 2, does not satisfy the OECD requirements for a qualifying minimum tax, and the corporate alternative minimum tax (CAMT), enacted by Congress last year, does not satisfy the OECD requirements for a qualifying domestic minimum top-up tax.
- The OECD model rules permit favorable treatment for government grants and for tax incentives such as R&D credits, but only if they are structured as "qualified" refundable tax credits. The U.S. R&D and many other credits are not refundable, and thus not qualified under Pillar 2. Furthermore, other longstanding provisions of the Internal Revenue Code, such as the exemption

for municipal bond interest, would not be recognized. The practical effect of this is that these U.S.-granted incentives would be brought into the tax base of other countries, thus undoing the policy Congress intended.

BACKGROUND: DISSATISFACTION WITH THE INTERNATIONAL TAX RULES

In the aftermath of the global financial crisis starting in 2007–8 (although with many roots predating that) there was widespread dissatisfaction in many countries, including the United States, with the international tax rules.

- The United States had concerns that U.S. law created a disincentive for U.S. companies to reinvest foreign profits in the United States, allowed profit shifting to low-tax jurisdictions, funded other countries' taxes through the U.S. foreign tax credits ("FTCs"), encouraged acquisitions of U.S. companies by foreign companies, and created incentives to redomicile.
- Some countries, including other G7 "residence" countries, believed they were not getting their "fair share" of taxes from large U.S. technology companies, in particular.
- Many developing countries, large and small, believed that the 100-year-old tax framework that allocated much of the tax base (and thus tax revenue) to the providers of capital rather than to countries where goods or services are used or consumed, resources extracted, etc., needed overhauling to allocate more tax rights (tax base) to countries where sales took place ("market-based taxation").

The international response to these concerns initially resulted in the Base Erosion and Profit Shifting (BEPS) project of 2013–15, which resulted in agreement on significant coordinated measures on restrictions on interest deductibility, anti-hybrid measures, strengthening transfer pricing, preventing the abuse of treaties and "country by country" reporting among tax jurisdictions. In many areas BEPS has achieved the objectives set for it. But many countries (and regions) decided that they also needed to take individual action to address the issues outlined above. I describe those briefly below, and then move to the follow-on OECD project launched in 2017.

U.S.: Tax Cuts and Jobs Act

The United States' answer to its concerns was included in the Tax Cuts and Jobs Act (TCJA)—with a minimum tax on overseas income (GILTI) and a minimum tax aimed at preventing erosion of the U.S.'s domestic tax base (the Base Erosion and Anti-Avoidance Tax or "BEAT").[1] The TCJA significantly changed the taxation in respect of earnings of non-U.S. corporations owned directly or indirectly by U.S. persons. The GILTI tax is an annual tax on low-taxed income earned by a controlled foreign corporation ("CFC"). The BEAT requires certain U.S. corporations to pay a minimum tax associated, broadly speaking, with deductible payments to non-U.S. related parties.

EU: Digital Services Taxes

The European Union's answer was the 2018 proposal for an EU-wide digital services tax ("DST") that was temporarily rejected, followed by the adoption of DSTs by some EU member states (including France, Spain, Austria, Poland, and Italy, as well as then-EU member, the United Kingdom). The EU has put its DST proposal on hold pending the outcome of the OECD's Two Pillar Project. Other non-EU countries have enacted or proposed DSTs as well.

OECD: The Two Pillar Project

In 2019, the OECD's project on the taxation of the digitalizing economy identified two policy options (organized into two separate "pillars"). Pillar 1 addressed taxing rights and nexus rules, while Pillar 2 outlined a global minimum tax and a tax on base-eroding payments.

Pillar 1 was originally aimed at technology companies but was broadened in response to U.S. objections to a narrow scope that appeared focused on U.S. companies. At the U.S. Treasury's urging, the qualitative scope of Pillar 1—which was originally focused on automated digital services (*e.g.,* online search engines, intermediation platforms, gaming, and advertising) and consumer-facing businesses—was narrowed in July 2021 and replaced with a quantitative scope targeted at com-

[1] The TCJA also includes other base protection measures (anti-hybrid rules, tightened transfer pricing rules, and interest deduction limitations) and a one-time tax on prior unrepatriated foreign earnings of U.S. corporations.

panies with more than €20 billion in revenue and more than 10 percent in profit. This shifted the focus of Pillar 1 away from digital businesses. It also significantly reduced the number of companies likely to be in scope (approximately 100 companies, about half of which are expected to be U.S. companies—see below). The Inclusive Framework aims to finalize a multilateral convention implementing Pillar 1 by this summer.

Pillar 2 proposes that countries enact a global minimum tax that resembles GILTI and an undertaxed profits rule that originally resembled BEAT. The goal of Pillar 2 is to require companies to pay a minimum rate of tax in each jurisdiction where they have a taxable presence. U.S. implementation of GILTI and BEAT regimes encouraged several EU countries to advance this initiative within the OECD's Inclusive Framework as a forerunner to EU action on a directive (see below). When the Pillar 2 rules were being designed, it was acknowledged by the OECD that GILTI was more stringent overall in its application than the Pillar 2 design.

The OECD released Pillar 2 model rules in December 2021 and commentary in March 2022. The model rules provide details on two interlocking measures, the Income Inclusion Rule (IIR) and the UTPR,[2] whereby income taxed at less than 15 percent under the Pillar 2 financial accounting base would be subject to additional taxation. The rules also enabled countries to adopt their own domestic minimum top-up tax that applies to low-tax profits within a country's own borders (referred to as a QDMTT).

In December 2022, the EU adopted a directive to implement Pillar 2, requiring EU members to transpose the global minimum tax rules into their national legislation by December 31, 2023, and a number of those EU members have already started that legislative process. Outside of the EU, an increasing number of countries are also moving forward with Pillar 2 implementation in the form of proposed legislation, public consultations, and announced target dates (including Australia, Canada, Colombia, Guernsey, Hong Kong, Japan, Jersey, Malaysia, Mauritius, New Zealand, Norway, Panama, Singapore, South Korea, Switzerland, the United Arab Emirates, and the United Kingdom).

ISSUES WITH CURRENT PILLAR 1 AND 2 THAT AFFECT THE UNITED STATES

My testimony covers three issues concerning Pillar 2 and one with Pillar 1.

Pillar 2

1. Treatment of Tax Credits and Incentives

The first issue is the treatment of credits for the purposes of calculating the tax base. Whether credits are refundable or non-refundable determines how they are treated under Pillar 2. Given the United States' traditional reliance on non-refundable credits to achieve congressional policy objectives, this distinction has an adverse impact on the United States.

Briefly, non-refundable credits are treated as a reduction in income tax paid, which has the effect of making it more likely that the company will be subject to another country's UTPR. Refundable credits, in contrast, are treated as income to the company, rather than a reduction in tax paid. While the increased income will also affect whether a company is subject to another country's UTPR, the effect is much smaller. This is explained through an example in accompanying footnote 3.[3]

[2] Prior to December 2021, as explained in more detail under subhead "2," this was known as the Undertaxed Payment Rule, and required an actual deductible payment to trigger the provision.

[3] For purposes of calculating the Pillar 2 effective tax rate (referred to as the "GloBE ETR") in a jurisdiction, the total amount of the adjusted covered taxes of all group entities domiciled in that jurisdiction is divided by the net GloBE income of these entities. The Pillar 2 model rules distinguish between Qualified Refundable Tax Credits ("QRTCs") and other credits. This distinction has a significant impact on the ETR because QRTCs increase the denominator of the ETR (that is, GloBE income) and other income tax credits decrease the numerator (that is, adjusted covered taxes). In effect, QRTCs are treated as items of income rather than reductions of taxes. The following simplified example illustrates the different treatment of QRTCs and other tax credits: a constituent entity has GloBE income of 1,000 (without consideration of any impacts of refundable credits) and pre-credit tax expense of 200, and qualifies for a tax credit of 100. If the credit is a QRTC, the ETR (under the Pillar 2 model rules) is 18.2 percent (200/(1,000 + 100)); however, if the credit is not a QRTC, the ETR is 10 percent ((200 − 100)/1,000). As a result, treatment of an income tax credit as a QRTC may result in less top-up tax for a company in the scope of Pillar 2, even if the effect on the non-GloBE tax liability of the company is the same as a non-QRTC.

The financial accounting for tax credits generally depends upon how the tax credit will be monetized. Non-refundable credits are generally accounted for as part of income tax expense. Other credits may be accounted for as part of pre-tax income. This will generally be the case when the credit can be monetized without regard to the existence of an income tax liability. For example, a refundable credit is typically accounted for as part of pre-tax income. In other cases, the financial statement accounting may be based on accounting policy choices an entity has made.

The impact of the treatment of non-refundable credits was raised in March 2022 by the business group BIAC in a letter (*https://25159535.fs1.hubspotusercontent-eu1.net/hubfs/25159535/website/documents/pdf/Tax/20220311%20Business%20at%20OECD%2011%20Mar%2022%20UTPR%20Tax%20Credit%20letter.pdf*) to the members of the Inclusive Framework (*i.e.,* the 140+ participating governments) addressing the disparate treatment of qualified versus non-qualified tax credits under the Pillar 2 rules. The letter highlights three cases where the treatment of non-qualified credits can have undesirable societal effects: in the case of R&D incentives that are not Qualified Refundable Tax Credits ("QRTC"); "social" incentives (*e.g.,* Low-Income Housing Tax Credit); and credits for renewable energy in relation to "green transition." The letter requested governments to consider the impact of this issue on their home country incentive regimes. In relation to the United States, had there been a process for Treasury and Congress to exchange views before other countries began to legislate, the problem might have been more easily addressed—as it was when the same issue was identified and solved in the design of CAMT.[4]

Examples of other congressionally enacted incentives the benefits of which would be affected by the UTPR are included in Appendix 2.

In sum, features of the U.S. tax system through which Congress has historically delivered job-creating incentives and fiscal support for the economy, etc., will be limited by Pillar 2 absent continuing negotiations, for example, to create a safe harbor. It is critical that the ongoing work on Pillar 2 give further consideration to ensure an appropriately balanced coordination that preserves the flexibility of the United States and other countries with respect to the treatment of credits and incentives.

2. UTPR Changed From an Undertaxed "Payment" to "Profits" Rule

The scope of the UTPR was significantly broadened in December 2021 in the model rules to allow a country to impose the UTPR both through denials of deductions as well as through a collection of top-up tax on a group company in its jurisdiction. This ability to collect tax, not just deny deductions, effectively changed the UTPR from an "undertaxed *payments*" rule to an "undertaxed *profits*" rule. Following the December 2021 change, all jurisdictions in which a group operated were subject to the UTPR rules on low-taxed income, not just those jurisdictions between which deductible payments had occurred. This now meant that any country in which a member of the group operated could collect UTPR tax from that member, including in respect of "low taxed" income in the home country of its parent calculated under Pillar 2 tax base rules.

This change came as a surprise to those who had understood, based on earlier OECD explanations including the 2020 "blueprint,"[5] that this was an extension of BEPS principles where there had to be a deductible payment into a low tax jurisdiction to trigger application of the rule. The commentary on the model rules, released in March 2022, reinforced the position that there need not be a connection and/or transaction between the group member that a country collects UTPR top-up tax from, and other members of the group in a low-tax country, including the home country (the formula for allocating UTPR top-up tax among implementing jurisdictions is not tied to a group's economic activity in a country but based on a formula).[6] This means that all tax credits in the "home country"[7] are now covered by Pillar 2.

In addition to being a significant change in relation to the ability of the home country to determine and order its own tax affairs, there are tax treaty implications.

[4] *See,* proposal on page 8.

[5] *See* Chapter 7 of OECD (2020), Tax Challenges Arising from Digitalisation—Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, *https://doi.org/10.1787/abb4c3d1-en.*

[6] The UK's initial January 2022 public consultation on implementing the Pillar 2 model rules redefines "UTPR" as the "Undertaxed Profits Rule" (replacing "payments" for "profits").

[7] The "home country" is the country where the "Ultimate Parent Entity" (UPE) is located. The OECD Pillar 2 model rules generally define UPE as the main entity of a group (which is not owned, with a controlling interest, directly or indirectly by another entity).

Contrary to longstanding international tax treaty practice, it also gives countries the right to tax income not earned in their jurisdiction based on calculations not necessarily agreed to by the home country. The compatibility of the UTPR with tax treaties seems likely to be litigated.

It is worth noting that, originally, the UTPR had been envisaged as a backup to the IIR, where a home country did not itself enact an IIR. Governments and businesses (including in the United States) were concerned that some large economies might not enact an IIR, and thus that the businesses in such countries might be advantaged against businesses in those countries that had enacted IIRs. However, the change in the UTPR in 2021, which opened up the possibility of much greater taxation by other countries of home country income, is an example of where this project has expanded beyond the stated original intent.

3. Introduction of the QDMTT

The introduction of a new top-up tax—the QDMTT—in the final Pillar 2 model rules, although connected to the other two issues, above, is a separate issue. The QDMTT arose out of the desire of some countries to raise their own tax rates to capture tax revenue in respect of earnings arising in those countries rather than have any amount below 15 percent taxed in the home country of the parent entity. An additional factor for the United States is the subsequent February 2023 clarification on the ordering rules, which means that GILTI revenues will be reduced perhaps substantially, because other countries that enact a QDMTT will have primary taxing jurisdiction over that income.

The Pillar 2 ordering rules mean that in practice, QDMTTs will apply before any GILTI allocations and the IIR and UTPR. For countries that adopt a QDMTT, any allocation of taxes paid under GILTI will not be taken into account when determining the local QDMTT liability. The QDMTT, thus, has the effect of locking in a primary taxing right for these countries, as opposed to residence countries, and/or countries in which value creating activity occurred.

Pillar 1 Issue

Pillar 1 was originally aimed at preventing the "ring-fencing of the digital economy" under income tax rules, and subsequently aimed at preventing the gross basis taxes known as DSTs. As the Pillar 1 rules have become increasingly complex, however, countries (especially developing countries both large and small) have become concerned about administrability as well as results.

This has led to difficulties in getting countries to agree on several critical provisions of Pillar 1. Treasury officials have recently confirmed that significant political and technical issues remain for which consensus must be reached before there is a final Pillar 1 agreement, including the treatment of withholding taxes, dispute resolution provisions (including a form of binding arbitration), and the scope of "unilateral" measures (including DSTs) that are subject to standstill and withdrawal. Because of the complex structure of Pillar 1, and the potential falling short in the resolution of the outstanding issues, it may not be possible for the United States to sign the agreement—expected to be produced in July—despite the leading role Treasury has played in its design. Alternatively, even if the administration does sign, prospects for Senate ratification would seem uncertain given the well-known procedural challenges of treaty consideration in the Senate even when there is broad, bipartisan support for an agreement.

What that means—either way—is that in January 2024, when Treasury's October 2021 standstill agreement on DSTs expires, then if Pillar 1 has not entered into force, Congress should anticipate the introduction and implementation of new DSTs falling primarily on U.S. businesses.[8] This will likely be of bipartisan concern to Senators on this committee.

In short, Pillar 1 still faces challenges and has not yet delivered stability to the system. This is not an outcome that will promote growth and jobs, and it will be necessary to continue to work on it.

[8] As the November 2022 UK National Audit Office (NAO) report (which examines the UK implementation of their DST) has shown, these DSTs will be paid almost exclusively by very large companies (many of which are likely to be U.S. companies).

What can be done, including possible congressional action?

The UTPR/Home Country Issue

The home country issue needs to be solved by the beginning of 2025 when UTPRs will generally come into effect. However, there are significant challenges in the legislative options that have been proposed for the U.S. Congress to resolve these issues:

- *Moving to country-by-country effective tax rate (ETR) calculations under GILTI.* While this would likely make GILTI a "qualified IIR," it would not address the UTPR/home country issue. If under the Pillar 2 tax base rules the U.S. income of a business is calculated to have been taxed below 15 percent (*e.g.,* because of the R&D credit or some of the new Inflation Reduction Act credits), then the qualified status of GILTI will not help.
- *Making all U.S. credits refundable within 4 years.* Refundability would solve the UTPR/home country problem, but it would also upend longstanding U.S. tax policy and could carry a significant revenue cost.[9]
- *Enact a QDMTT.* While this would protect the U.S. fisc, it would not allow Congress to grant effective credits and incentives to the extent those reduce the tax below a rate of 15 percent for Pillar 2 purposes, because they would simply be taxed under the QDMTT.
- *By otherwise conforming all aspects of the U.S. tax base to Pillar Two rules.* While conformity would solve the UTPR/home country problem, it would also be a significant, time-consuming undertaking, and would be disruptive to both the U.S. Government and taxpayers' longstanding tax expectations. In addition to the credits and incentives issue above, many aspects of the U.S. tax code that give rise to timing differences would need to be identified and amended. Furthermore, beyond tax, Pillar Two is closely based on IFRS, so where U.S. GAAP diverges, with that result leading to a different characterization under Pillar Two, also would need to be addressed. It also would require revisiting the recently enacted CAMT's treatment of nonrefundable credits.

Another route for resolving the issues, noted above, would be through the ongoing OECD work—perhaps through safe harbors—which could address the issue and provide further flexibility for governments to provide qualified tax credits and incentives. This could be achieved most likely in one of two ways:

- *By focusing on problem areas*—expanding the rules for tax credits and timing items, for example, to treat certain societally and/or economically beneficial credits in the same way as refundable credits. While this raises definitional issues, based on long-standing parameters established in U.S. and other countries' laws for different types of credits, that issue is soluble from a technical point of view.
- *By focusing more generally on taxation elements in the home country* (*e.g.,* a safe harbor based on a mix of local country statutory rate, an absence of "harmful" regimes, etc.). An exemption or safe harbor test could be applied that looks at a combination of a country's statutory tax rate, an absence of "harmful" regimes, any home country domestic minimum tax, the proportion of domestically generated income, a business's overall global rate (including the home country), and other similar tests. Viewing these facts in their totality should give interested parties confidence that certain home country jurisdictions (including the U.S.) are not in fact "low tax jurisdictions."

Moving forward in this manner will require full engagement by Treasury to convince other countries in the Inclusive Framework to come around to changing what will be fully enacted statutes in some jurisdictions. That will not be easy, but it would be beneficial to other countries as well as the United States to have greater flexibility to use the tax system when they deem it appropriate to address the needs of their citizenry. It certainly seems preferable to the tensions that might otherwise result.

Dissatisfaction of Countries With the Current International Tax Regime

In the medium/longer term some of the outstanding issues (*e.g.,* the demands of market jurisdictions for a greater allocation of taxing rights) along with revealed

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[9] Peter R. Merrill, Karl Russo, Aaron Junge, Damien Boudreau and Florian Holle, "Where Credit Is Due," *Tax Notes International,* March 20, 2023, P. 1627

shortcomings in the process of international tax rule making (*e.g.,* how smaller developing countries are included) will need to be thoughtfully studied and addressed.

What did not happen in the early stages of Pillar 1 (but can still happen now) was the establishment of the tax policy process needed to achieve a coherent and broadly accepted understanding of the issue which underlies this dissatisfaction—namely, what gives rise to the right to tax? Is it the market (*i.e.,* sales)? Is it the provision of capital? Is it where innovative activity occurs and/or where IP is owned? Is it where certain key functions [10] are performed? Or is it some combination of all of those and more? And, if so, in what proportions? And how do we balance all of that with creating the conditions that lead to economic growth, jobs, and investment? Only with broadly agreed answers to these questions can a stable agreement be reached.

Pillar 1 has let the genie of market-based taxation out of the bottle (with a little help from BEAT), and there will be no getting it back in. It should be noted that the United States, with one of the biggest and most developed markets in the world, should not automatically be at a disadvantage. The process has not yet restored the promised stability and certainty to international tax affairs, but there is no going back. A renewed process for reaching agreement on these and other issues is needed both among countries and within them to achieve stability and certainty. Within the United States, the process should include the close involvement of the Congress. A continuation of the process could lead to a broad and sustainable agreement.

Preventing This Problem From Arising in the Future

Finally, from a U.S. systemic/institutional standpoint, no one wants to have this happen again. There must be a way for the Congress to provide direction for Treasury's position in international tax negotiations, at least when the negotiations would significantly affect the United States' jurisdiction to tax or would require statutory changes. One model that might be considered is Trade Promotion Authority, which requires active consultation and oversight by the appropriate committees of Congress when an agreement is being negotiated.[11] That could strengthen Treasury's hand in negotiations by telegraphing to negotiating partners what is politically realistic for the United States.

Above and beyond helping to keep other countries informed of Congress's views, this process would also strengthen the validity and legitimacy of the entire international tax rulemaking process from the beginning to the end in the United States. It should be noted that this is an issue which at its inception touches upon the powers granted by the Constitution under article 1, sections 7 and 8 relating to revenue bills (origination and amendment), and the power to lay and collect taxes.[12] For that reason, it is important to have a process whereby both the House and Senate have the ability to exchange views with the Treasury on international negotiations affecting tax in which the administration is, or intends to become, involved. In this way, the Treasury will understand the parameters within which it can operate with some level of assurance of congressional support—and so will foreign countries. At the same time, Congress will be made aware of challenges that the positions of other countries may present to the United States, and congressional input can strengthen the hand of the Treasury in such circumstances.

CONCLUSION

As noted, the OECD two-pillar project is the most significant overhaul of international tax rules in many decades and will bring about a sea change in tax relations between countries. As it now stands, its outcomes may be sub-optimal both for the stability of the international tax system more generally, and, specifically, for the interests of the country whose members this distinguished committee represent—the United States.

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[10] The so-called DEMPE approach (development, enhancement, maintenance, protection and exploitation). This was developed at OECD level within Actions 8–10 of the BEPS Project, which had the aim to align transfer pricing outcomes with value creation between associated enterprises in order to ensure that transfer prices reflect the economic circumstances of a transaction. "DEMPE" stands for Development, Enhancement, Maintenance, Protection and Exploitation.

[11] Mindy Herzfeld, "Can Congress Fix Treasury's GLOBE Mistakes?", 110 *Tax Notes International,* 7 (April 3, 2023).

[12] *See,* Kysar, Rebecca M., "On the Constitutionality of Tax Treaties" (May 3, 2013), *Yale Journal of International Law,* Vol. 38, 2013, Brooklyn Law School, Legal Studies Paper No. 274, available at SSRN: *https://ssrn.com/abstract=2034904.*

It is not too late to address the elements causing concern. Moreover, doing so is likely to provide greater long-term stability. Furthermore, there are ways to ensure that Congress provides direction to Treasury *before* international tax negotiations begin in the future.

Given the importance of tax to funding the activities of the state and achieving a range of economic and social goals, a necessary level of international coordination to allow for interoperability, coupled with the flexibility that allows each country to achieve their legislative objectives, is key to a stable global tax regime. Conflict and discord in the international tax system will discourage cross-border trade and investment (which the economic evidence shows creates more and better jobs). Continuing the work of the OECD, with the support of the Congress, is the best means of achieving a positive outcome for the United States and other countries as well.

Thank you again for inviting me to testify. I would be pleased to answer any questions you may have or otherwise to assist the committee in its important work.

Appendix 1: Common Acronyms/Explanations

OECD: Organisation for Economic Co-operation and Development Inclusive Framework: OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting BIAC: Business at OECD BEPS: Base Erosion and Profit Shifting MNE: Multinational enterprise GAAP: General accepted accounting principles IFRS: International Financial Reporting Standards
Pillar 1
Amount A: Under "Amount A" of Pillar 1, a formulaic share of a portion of the consolidated profit of MNEs will be allocated to markets (*i.e.,* where sales arise). Amount A applies to MNEs with revenues exceeding EUR 20 billion and a profitability greater than 10 percent. It reallocates 25 percent of the MNE's profit in excess of 10 percent of its revenues to "market jurisdictions" (jurisdictions where goods or services are used or consumed) in which the MNE satisfies the "quantitative nexus" test, subject to adjustments under the marketing and distribution profits safe harbor (MDSH). The Amount A tax base will be quantified using an adjusted profit before tax measure, derived from the consolidated financial accounts of in-scope groups, rather than on a separate entity basis. Two sectors remain carved out from Amount A: extractive industries and regulated financial services. Amount A is expected to affect approximately 100 of the world's largest companies; it is estimated that approximately 50 percent of those are U.S. MNEs. The intention is for the rules under Amount A to be included in a multilateral convention, which the OECD has indicated should be available for signature in the summer of 2023. For Amount A to enter into force, a "critical mass" of countries, including particularly the United States, but also Japan, Germany, the UK and France—which possess a substantial majority of parent companies for in-scope groups—must ratify the convention. **Amount B:** "Amount B" forms part of the Inclusive Framework's Pillar 1 proposal and is focused on simplifying and streamlining the remuneration of baseline marketing and distribution activities in-market. The aim is that this would enhance tax certainty around marketing and distribution returns, while reducing disputes between taxpayers and tax authorities in this area. Amount B potentially has relevance to MNEs far beyond Amount A, both due to the lack of a specific size threshold for Amount B to apply, and since the possibility of including the Amount B rules in the OECD Transfer Pricing Guidelines is being contemplated.

Appendix 1: Common Acronyms/Explanations—Continued

Pillar 1
Digital Service Taxes (DSTs): Tax on gross revenue modeled on the original "digital services tax" proposed by the EU Commission in March 2018. The particular services and revenue in scope vary by country. In general, these taxes apply to gross revenue from the provision of goods and services via digital platforms and must be paid by the company earning such revenue, regardless of whether the company has a permanent establishment in the country. The key impetus of the global negotiations on the OECD's digital tax project was to preclude unilateral measures (*e.g.,* DSTs) from being imposed by different jurisdictions. The October 8, 2021, Inclusive Framework agreement formalized this resolution. The agreement noted that the Pillar 1 multilateral convention would remove existing DSTs and "relevant similar measures" for all companies, presumably including those that are not in the scope of Pillar 1. It also commits parties not to introduce any new DSTs or other relevant similar measures. Specifically, the agreement requires the parties not to impose any newly enacted DSTs (or other such measures) from October 8, 2021, until the earlier of December 31, 2023, or the coming into force of the multilateral convention. **Marketing and Distribution Profits Safe Harbor (MDSH):** Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbor will cap the residual profits allocated to the market jurisdiction through Amount A. The MDSH is primarily designed to address issues related to "double counting" that may occur, for example, if a market jurisdiction already has the ability to tax residual profits of an MNE in two ways: (i) once under existing profit allocation rules (typically transfer pricing); and (ii) again through Amount A allocations. Further work on the design of the safe harbor is ongoing.
Pillar 2
Global anti-Base Erosion (GloBE) Rules: The global minimum tax rules under Pillar 2, referred to as the GloBE Rules, will apply to MNEs with annual global consolidated revenues above EUR 750 million and consist of (1) the income inclusion rule (IIR), which will impose a top-up tax for the difference between the jurisdictional Pillar 2 effective tax rate (ETR) and the 15-percent minimum rate; and (2) the UTPR (formerly known as the "Undertaxed Payments Rule"), which is intended to apply as a backstop if low-taxed income is not fully collected under the IIR. In addition to the IIR and the UTPR, the respective country with the top-up tax may collect the amount via a Qualified Domestic Minimum Top-up Tax (QDMTT). The IIR and QDMTT could be implemented by countries as early as December 31, 2023. Countries implementing a UTPR are expected to do so as early as December 31, 2024. **Income Inclusion Rule (IIR):** The IIR is applied before the UTPR. The IIR imposes a top-up tax on a parent entity with respect to the low-taxed income of a member of the group (*i.e.,* income that has not been subject to an effective minimum tax of at least 15 percent). Generally, the IIR is applied at the top, at the level of the ultimate parent entity, and works its way down the ownership chain.

Appendix 1: Common Acronyms/Explanations—Continued

Pillar 2
Undertaxed Profits Rule (UTPR): Where there is remaining top-up tax after the IIR has been applied, such that the UTPR backstop kicks in, the adjustment or additional cash tax expense can be achieved in the manner each jurisdiction decides, *e.g.,* denial of a deduction, an additional tax, a reduction in any allowance for equity, or deemed income (reversing a related party expense). The total UTPR amount is allocated among implementing jurisdictions under a formula that is based on the relative proportion of employees and tangible assets in each jurisdiction. Importantly, under this formula, there is no requirement that an entity in a UTPR jurisdiction actually makes deductible payments to a low-taxed affiliate.
Qualified Domestic Minimum Top-up Tax (QDMTT): A QDMTT allows countries to impose top-up tax on the exclusively domestic income of companies in the scope of Pillar 2. The application of a QDMTT can prevent the levying of a top-up tax on these domestic profits in other countries through either their IIR or UTPR. Many countries are considering implementing a QDMTT. For a domestic minimum top-up tax to be considered "qualified," it must (1) be consistent with the design of the GloBE Rules; and (2) provide for outcomes that are consistent with the GloBE Rules.

Appendix 2: Examples of Congressionally Enacted Incentives Potentially Negated by the UTPR *

Incentives to Promote Economic Growth, Investment, and Jobs	Incentives to Help Economic Recovery	Incentives to Promote Social and Environmental Goals
• Research credit	• Carryback of net operating losses	• State and local tax-exempt bonds
• Investment tax credits	• Modification of limitation on business interest deduction	• Energy investment credit
• Incentives for the development and retention in the U.S. of intellectual property	• Liberty Zone investment and employment credits	• Energy production credit
• Targeted employment incentives such as the work opportunity credit	• Hurricane and other disaster relief incentives	• Empowerment Zone incentives
		• Opportunity Zone incentives
		• Rehabilitation credit

* Narrow exceptions are provided under the Pillar 2 rules for tax credits that are (i) refundable or (ii) received through investments in certain tax equity structures. These narrow exceptions will not—on their face—protect transferable tax credits.

QUESTIONS SUBMITTED FOR THE RECORD TO WILLIAM H. MORRIS

QUESTIONS SUBMITTED BY HON. RON WYDEN

Question. Can you explain the rationale behind the substance-based exclusions (QBAI and SBIE) as part of the design of a minimum tax to target profit shifting? Would the SBIE under the OECD Pillar 2 proposal carve out more income than QBAI? What are the implications for U.S. companies if the U.S. did not include a substance-based exclusion in GILTI while other countries provide the SBIE under Pillar 2?

Answer. The regime for taxing global intangible low-taxed income (GILTI) provides an exclusion for a 10-percent return on Qualified Business Asset Investment (QBAI), which is defined as the taxpayer's basis in depreciable property such as buildings and equipment. The Pillar 2 rules provide a substance-based income exclusion (SBIE), which after a transition period will phase down to 5 percent of payroll costs and tangible assets (from an initial 10 percent and 8 percent, respectively). Tangible assets included in the SBIE include some assets that are not depreciable, hence a wider range of assets is included in SBIE relative to QBAI, but the SBIE exclusion is limited to 5 percent after the transition period relative to the 10 percent exclusion in QBAI. The SBIE exclusion for a return on payroll costs is an exclusion not available under QBAI.

The rationale for these exclusions is to exempt from the respective minimum taxes a portion of income based on a company's physical operations in a country. Income that is most mobile globally is income associated with intangible assets rather than tangible assets that may also require a significant employee presence. The idea is that if a company's income in any country exceeds the deemed return on QBAI or the SBIE, it may be indicative of income related to intangibles.

QBAI only considers the return on depreciable property in defining the return not associated with intangible property, while the SBIE considers a return on tangible property *and* income associated with a portion of payroll costs. Because the SBIE allows only a 5-percent return while the QBAI exemption allows a 10-percent return, whether the SBIE is larger or smaller than the QBAI exemption will depend on the particular mix of assets and payroll costs of any taxpayer. A company for which payroll exceeds depreciable property, *i.e.,* a company that is relatively labor-intensive, would receive a larger deduction under the SBIE than under QBAI. It is clear, however, that if GILTI did not allow any exemption such as QBAI, it would result in a larger amount of income of a U.S. multinational company being subject to tax than that of a foreign multinational company under the Pillar 2 rules.

Question. Please describe some previous congressional responses (or potential future responses) to recessions, disasters, and/or national security threats that would have been (or could be) undermined by the Pillar 2 UTPR.

Answer. Following the 9/11 terrorist attacks, Congress provided for bonus depreciation, an expanded carryback of net operating losses (NOLs), and targeted benefits for New York City, including expanded eligibility for the Work Opportunity Credit and increased authority to issue tax-exempt bonds. Following the start of the 2008–2009 recession, Congress enhanced bonus depreciation and increased authority for tax-exempt bond issuances. To address the pandemic-induced recession, Congress provided retention tax credits for employers, and expanded carryback of NOLs, among other things. The benefit of all these tax incentives potentially could have been reduced or eliminated for in-scope companies if Pillar 2 had been in effect at that time. As a result, the ability of Congress to mitigate the impact of severe economic downturns on American workers could have been diminished had Pillar 2 been in effect. There are many cases outside of the context of recessions, disasters, and/or national security threats where Congress's policy objectives would be impeded by Pillar 2. For instance, in 2001, Congress included an incentive for worksite employer-provided child-care facilities in the form of a tax credit.

Question. What would be the impact of the administration's repeal of FDII on both the attractiveness of the U.S. as a place to develop and hold IP as well as a place for high-wage jobs in research and manufacturing? Also, as more countries adopt Pillar 2's domestic minimum taxes that will result in a reduction in U.S. GILTI revenue, does FDII become more or less important to protect the U.S. base?

Answer. Repeal of the deduction for Foreign-Derived Intangible Income (FDII) would increase the rate of tax on income associated with intangible property (IP) held in the United States. Approximately half of OECD countries (including France, Italy, Spain, and the United Kingdom), China, and numerous other countries have preferential tax rates for IP income ranging from the single digits to as high as 15 percent. Combined with the administration's proposed increase in the corporate income tax rate and average State income tax rates, the U.S. tax rate on IP income would be 32.4 percent, higher than in 36 of the other 37 OECD countries.

Under the OECD Pillar 2 administrative guidance, Qualified Domestic Minimum Top-up Taxes (QDMTTs) come before tax regimes like GILTI in the ordering rules for determining taxing rights. As a result, adoption of QDMTTs abroad will reduce the ability of the United States to tax foreign income under the GILTI regime. A regime like FDII becomes even more important to protect the U.S. fisc because the deduction for FDII incentivizes companies to own IP in the United States, preserving U.S. primary taxing jurisdiction on IP income. The deduction for FDII is thus a U.S. tax base protection measure.

Question. Could you please comment on the methodology and accuracy of these revenue estimates issued by the OECD relating, respectively, to the U.S. and globally?

Answer. While there seems no doubt that enactment by a significant number of countries of Pillar 2 will raise additional revenue, commentators have noted four potential issues with the revised Pillar 2 OECD revenue estimates published in January 2023. Three of these issues may cause the overall amount of extra tax revenue generated by Pillar 2 to be overstated in the estimates. The fourth, while not necessarily impacting the overall amount, may nevertheless affect the geographic dispersion of these additional Pillar 2-generated revenues. In brief the potential issues that have been noted are as follows.

ISSUES AFFECTING OVERALL AMOUNT:

1. The revenue estimates are believed to be based on 2018 Country by Country Reporting (CbCR) data. In that year CbCR data still included dividends received from associated (related) enterprises, despite the fact that such dividends would not be included for Pillar 2 purposes. This double counting of income could lead to an overestimate of Pillar 2 tax owed.
2. The Pillar 2 revenue estimates do not take into account deferred taxes, unlike the actual Pillar 2 tax calculations, which is again likely to lead to an overestimate of Pillar 2 taxes owed.
3. The Pillar 2 estimates, being based on 2018 data, do not (cannot) take account of a number of important law changes since that time. These changes in law have already driven significant behavioral shifts that have reduced the amount of low taxed income in many jurisdictions. Very important among these are the changes of the Tax Cuts and Jobs Act (TCJA), including the U.S.'s own global minimum tax, GILTI, as well as anti-hybrid rules and other measures. Furthermore, in addition to the changes in the United States resulting from TCJA, other countries adopted many of the OECD's BEPS action items, most notably the EU in its Anti-Tax Avoidance Directives (ATAD), as well as the UK and others. Therefore, it is likely that much of the increased revenue estimated to be raised by Pillar 2 using 2018 data is, in fact, already being raised by TCJA and other law changes in the past few years, leading to a much lower amount of new tax revenue.

ISSUES AFFECTING GEOGRAPHIC DISPERSION OF NEW PILLAR 2 TAX REVENUE:

4. The revenue estimates do not take into account the QDMTT. The original Pillar 2 proposal was for the IIR to be paramount, resulting in parent jurisdictions (*i.e.,* jurisdictions where the "Ultimate Parent Entity" is located) collecting revenue on low-taxed income of MNCs headquartered in that jurisdiction. However, the QDMTT ordering rules now mean that the QDMTT takes precedence, with the result that tax revenue will arise not in the parent jurisdictions from application of the IIR, but in the countries where the income arises (and this is supported by the June 2023 revenue estimates released by the Joint Committee on Taxation in "Possible Effects of Adopting the OECD's Pillar Two, Both Worldwide and in the United States").

PREPARED STATEMENT OF DIANE M. RING, PROFESSOR OF LAW, BOSTON COLLEGE LAW SCHOOL

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 percent–11.2 percent on book income from 2018–20, far lower than the new low statutory corporate rate of 21 percent. 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 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 2. 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 2 guidance released in February 2023 has furthered key U.S. objectives in the design of Pillar 2 rules.[3]

At this point the United States has the opportunity to advance its 2017 embrace of a minimum tax that will meaningfully counter longstanding 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 2 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 2 implementation time-

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[1] For further analysis of continued profit shifting post-TCJA, *see* Javier Garcia-Bernado, Petr Jansky, and 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) *National Tax Journal* 1233–1266 (2020), *https://ssrn.com/abstract=3274827.*

[2] At the release of the OECD/G20 Inclusive Framework Guidance on Pillar 2, 142 jurisdictions agreed to the guidance. *See* Treasury Department, "Treasury Welcomes Clear Guidance on Pillar Two Global Minimum Tax, Tax Credit Protections" (February 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)" (February 2, 2023), *https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf.*

tables[4] of the European Union, South Korea, and a host of other jurisdictions 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 2, 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 2. 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 2 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

[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/*.

[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 and Harry Grubert, "The Three Parties in the Race to the Bottom: Host Countries, Home Countries, and the Multinational Corporations," 7 *Florida Tax Review* 137 (2005): Harry Grubert, "Foreign Taxes and the Growing Share of U.S. Multinational Company Income Abroad: Profits not Sales Are Being Globalized," 65 *National Tax Journal* 241 (2012); Edward Kleinbard, "Stateless Income," 11 *Florida Tax Review* 699 (2011). A series of studies

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 percent to 21 percent 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 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-percent 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.

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was recently reviewed in Congressional Research Service, "Tax Havens: International Tax Avoidance and Evasion," R40623 (January 6, 2022).

[7] *See* Martin A. Sullivan, "Pharma Profits Are Mostly Overseas, But Only Amgen is in Tax Court," *Tax Notes International* (March 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%200 3220221%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-%20Senate%20Budget%20Committee.pdf;* and James Repetti, "International Tax Policy's Harm to Manufacturing and National Interests," 2023(4) *Wisconsin Law Review* (forthcoming), *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4368322.*

[10] This is accomplished through the GILTI exemption for 10 percent of QBAI (Qualified Business Asset Investment)—essentially this can be understood as an exemption for an amount of income equal to a 10-percent 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.

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 percent of 2020 net revenues were based in the U.S., 76 percent in 2021, and 78 percent in 2022.[13] Given this mix of earnings and sales data, the reported low book ETRs of 11.1 percent in 2021 and 12.1 percent 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 percent in 2021 and 45 percent in 2022.[16] At the same time Merk reported the percentage of its book income that was U.S. as 13 percent for 2021 and 6 percent for 2022.[17] With such reported numbers, the resulting reported book ETRs are not surprising: 11.7 percent for 2022, 11 percent 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 percent in 2018, 14.2 percent in 2019, 10.7 percent in 2020, and 12.1 percent in 2021), despite having most of its customer base in the United States.[20] For example, during 2021, 70 percent of Amgen book sales revenue derived from the U.S.,[21] while the corporation reported only 28 percent of its pre-tax book income in the United States.[22] As the Senate Finance Committee letter to Amgen observed, by placing 70 percent 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 percent and face only GILTI regime 10.5 percent 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 3-year period ending in the current tax year and is anticipated to affect fewer than 150 corporations.[24] Under CAMT, a 15-percent tax on the corporation's adjusted book income applies when that tax exceeds the regular corporate tax liability plus any tax due under BEAT (Base Erosion and Anti-Abuse Tax). Importantly, though, for comparing CAMT to Pillar 2 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,

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[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.*

[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 Street Journal* (October 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 and CEO, Amgen (December 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 Committee on Taxation "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 Federal* 1185 (August 22, 2022).

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 2 FOR THE UNITED STATES

Pillar 2, 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 2 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 2. The objections generally reflect a misunderstanding of Pillar 2, 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 2 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 percent and thereby block other Pillar 2 taxes (IIR or UTPR) from being imposed by other countries.

To the extent Pillar 2 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 2 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 2, 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-percent rate. In this case, other Pillar 2 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, 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-percent 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 2 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 2 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 2. 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 2

Working through Pillar 2 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

[25] Allison Christians and Stephen E. Shay, "The Consistency of Pillar 2 UTPR with U.S. Bilateral Tax Treaties," *Tax Notes* (January 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 International* 1257 (December 5, 2022); Reuven Avi Yonah, "UTPR's Dynamic Connection to Customary International Law," 108 *Tax Notes International* 951 (November 21, 2022); Allison Christians and Tarcisio Diniz Magalhaes, "Undertaxed Profits and the Use-It-Or-Lose-It Principle," 108 *Tax Notes International* 705 (November 7, 2022); Heydon Wardell-Burrus, "Four Questions for UTPR Skeptics," 108 *Tax Notes International* 699 (November 7, 2022).

[27] Allison Christians and Stephen E. Shay, "The Consistency of Pillar 2 UTPR with U.S. Bilateral Tax Treaties," *Tax Notes* (January 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 and 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.*

number of options for 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 percent.[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 percent. 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 reevaluated in 2027.[32] This window for the simplified allocation also provides a window for the U.S. to consider aligning GILTI with Pillar 2.

Without doubt, Pillar 2 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 2 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 2, 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.

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 2:

   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]

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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 (February 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 2 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 percent; rather such taxes would be directed to its low-tax jurisdictions. *Id.* at 69, Ex. 4.3.2–1.

[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 9–10-year window, according to four independent revenue estimates reported by 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 2, 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 percent) that permits global averaging. Moreover, converging with Pillar 2 on country-by-country reduces some administrative burden on U.S. multinationals and foreign multinationals operating in the U.S.

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 percent dividends received deduction in section 245A should be eliminated.

c. The GILTI rate should be increased to above 15 percent 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 percent as the U.S. statutory rate moves to 28 percent.

(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 2.[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 percent 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).

The obvious challenge to a corporate tax increase—even one that returns the U.S. to its previous 28-percent 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.

PREPARED STATEMENT OF BRAD W. SETSER, WHITNEY SHEPHERDSON SENIOR FELLOW, COUNCIL ON FOREIGN RELATIONS

I want to thank Chairman Wyden, Ranking Member Crapo, and the distinguished members of this committee for the opportunity to testify today.

Tax avoidance by American pharmaceutical companies is a very real problem.

It is also a very solvable problem. Straightforward changes to the U.S. tax code would encourage American and global pharmaceutical companies to produce more patent-protected pharmaceuticals in the United States, and to onshore rather than offshore their global profit.

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[34] Key examples include ongoing efforts to secure agreement that tradable credits (such as U.S. renewable energy credits) will be treated as QRTC under Pillar 2. Other steps are domestic including reviewing credits that don't secure favorable status and determining the creditability in the U.S. of Pillar 2 taxes paid abroad such as a QDMTT, both currently under consideration at Treasury and IRS.

[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 (September 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*.

America's pharmaceutical companies clearly have a critical role to play in creating a more resilient American and world economy. They have been at the forefront of many of the world's most important medical innovations—helped, in many cases, by research funded by the National Institute of Health and other government agencies. To cite the most prominent recent example, mRNA vaccines helped dramatically limit the loss of life associated with the COVID–19 pandemic.[1]

Unfortunately, most of America's leading pharmaceutical companies currently have structured their businesses to shift the profit from their U.S. sales to their offshore subsidiaries. As a part of these tax strategies, American pharmaceutical companies also have shifted production and jobs to other jurisdictions.

My testimony will be divided into three parts.

The first part will examine the incentives in the tax code that favor offshoring profits and production, to the detriment of the U.S. Treasury and the strength and resilience of the U.S. biopharmaceutical industrial base.

The second will review the empirical evidence of profit shifting in the pharmaceutical sector, drawing on both the data disclosed by the large listed pharmaceutical companies in their own annual reports and on the trade data.

The third will identify the reforms that I believe would substantially reduce the current incentive to offshore profits and jobs.

1. THE U.S. TAX CODE

For many years, the U.S. tax code combined a relatively high (35 percent) corporate tax rate with the ability to indefinitely defer profits that were technically the payment of tax on income earned outside the United States. Technical tax rules evolved over time so that it became relatively easy for a U.S. firm to transfer its intellectual property rights to one of its offshore subsidiaries without incurring a U.S. tax penalty, and then to shuffle those rights among its offshore subsidiaries to gain additional tax advantages.

The results of the incentives created by this tax structure were quite apparent. Several prominent U.S. firms—particularly firms in the technology and pharmaceutical sectors—paid relatively low effective tax rates and accumulated large offshore profits.[2] Firms learned how to borrow onshore against their offshore profits to pay dividends and conduct buybacks onshore, but there was widespread agreement that the combination of global taxation and indefinite deferral generated perverse incentives that only advantaged offshore financial centers.[3] By the end of 2016, analysts calculated that the deferred profits of U.S. firms had reached close to $2 trillion. That included at least $150 billion in accumulated offshore profits by the 8 largest U.S. pharmaceutical firms.[4]

The 2017 Tax Cuts and Jobs Act changed the structure of the U.S. tax code without, unfortunately, changing the underlying incentive to move profits and jobs offshore to obtain a lower tax rate.

The Trump corporate tax cuts reduced the headline corporate tax rate from 35 percent to 21 percent. This new tax system was generally designed so that income earned in the United States would be taxed at the U.S. rate, and income earned abroad typically would not be subject to U.S. tax. In an inadequate attempt to put in place guard rails against abuse intrinsic to such an international tax system, the U.S. Congress created two special tax regimes—a 10.5-percent tax on some of the global profits of U.S. companies (the Global Intangible Low-Tax Income or GILTI) and a special U.S. tax preference for export earnings above a 10-percent return on

[1] Tenforde, Mark W. et al. "Effectiveness of mRNA Vaccination in Preventing COVID–19—Associated Invasive Mechanical Ventilation and Death—United States, March 2021—January 2022." *MMWR Morbidity and Mortality Weekly Report* 71, no. 12 (March 2022): 459–465.

[2] Brad Setser, "Tax Games: Big Pharma Versus Big Tech." *Follow the Money,* Council on Foreign Relations, February 12, 2020, *https://www.cfr.org/blog/tax-games-big-pharma-versus-big-tech.*

[3] Alexandra Scaggs, "B.R.E.A.M. (Bonds Rule Everything Around Me)." *Financial Times,* February 1, 2018, *https://www.ft.com/content/930dbb73-8032-3ba8-9c23-00be0280ec49;* Clausing, Kimberly A. "Profit Shifting Before and After the Tax Cuts and Jobs Act." *National Tax Journal* 73, no. 4 (December 2020): 1233–1266; Yardeni, Edward et al. "Corporate Finance Briefing: S&P 500 Buybacks & Dividends." Yardeni Research Inc., April 2023, *https://www.yardeni.com/pub/buybackdiv.pdf.*

[4] Bob Herman, "The U.S. Companies With the Most Cash Parked Overseas." *Axios,* December 4, 2017, *https://www.axios.com/2017/12/16/the-us-companies-with-the-most-cash-parked-overseas-1513388347.*

U.S. tangible assets. In technical terms, the result was a hybrid tax system—territorial in its concept, but with a low worldwide tax on foreign income that was taxed abroad at an exceptionally low rate.

By institutionalizing a large gap between the U.S. headline corporate tax rate and the low GILTI tax on U.S. firms' global income, the new tax code generated strong incentives to continue to transfer profits and production abroad. The exemption of a deemed return on tangible assets located abroad from even the special 10.5-percent GILTI rate further encouraged firms to produce abroad, as increasing a firms' foreign assets works to reduce its GILTI income and thus lower its global tax.[5] Tangible assets located in the United States received no such special treatment. Dr. Kimberly Clausing has rightly called this an "America last" tax policy, as the reform structurally favored foreign income over domestic income.[6] The last place an internationally mobile firm would want to book the global profit on its tangible assets is in the United States.

Five years have now passed since these reforms were enacted and the results are clear. A minority of firms, primarily technology firms that generate most of their revenues from the sale of advertising, repatriated the global right to make use of their intellectual property and simplified their tax structure. But the bulk of U.S. multinational firms have opted to maintain global businesses models designed to shift mobile income out of the United States into low tax jurisdictions.[7]

The U.S. balance of payments data provides clear evidence of the aggregate impact of these practices. U.S. multinational companies report earning $325 billion in seven low tax jurisdictions (Bermuda, the Caymans, Ireland, Luxembourg, the Netherlands, Singapore, and Switzerland) and only $50 billion in seven of the world's largest economies (China, France, Germany, India, Italy, Japan, and Spain). The IRS data on firms' country-by-country profits tells the same story—in 2019, the last available data point, American firms report earning far more profits in the Caymans than Canada and China combined.

2. THE PHARMACEUTICAL SECTOR IN THE TAX AND TRADE DATA

After the enactment of the Trump corporate tax cuts, American pharmaceutical companies in particular have doubled down on business models based on offshore production to shift profits on drugs sold in the U.S. market to their offshore subsidiaries. There are two independent sources of data that illuminate the extent of profit shifting in the pharmaceutical sector: the data that publicly listed U.S. firms disclose to their own investors as part of their SEC reporting requirements and the U.S. trade data.

SEC Disclosure

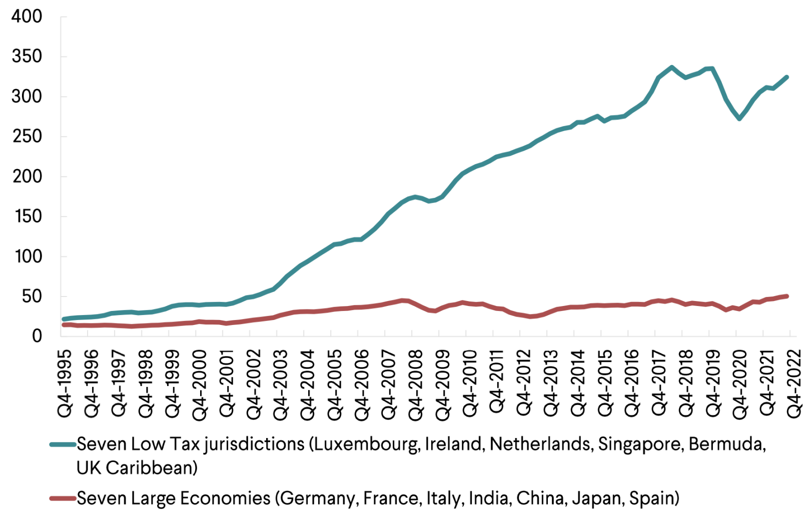
America's pharmaceutical companies are known the world over for their innovativeness, but they increasingly do not produce their most significant products in the United States. Rather, they produce many of their most lucrative patent protected drugs outside the United States in order to facilitate the transfer of the profits generated from U.S. sales outside of the United States and to avoid reporting a U.S. profit on their global sales.

[5] U.S. Congress, Senate, Committee on the Budget, "A Rigged System: The Cost of Tax Dodging by the Wealthy and Big Corporations," 118th Congress, 1st Session, 2023 (testimony of Kimberly A. Clausing); U.S. Department of the Treasury, "General Explanations of the Administration's FY 2024 Revenue Proposals," March 9, 2023, *https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf.*

[6] Kimberly Clausing, "Fixing our 'America Last' Tax Policy." *The Hill,* April 11, 2019, *https://thehill.com/opinion/finance/438274-fixing-our-america-last-tax-policy/.*

[7] Kamin, David et al., "The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax," *Minnesota Law Review* 103 (2019), *https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2025&context=faculty_scholarship;* Ludvig Wier and Gabriel Zucman, "New Global Estimates on Profits in Tax Havens Suggest the Tax Loss Continues to Rise," *CEPR,* December 4, 2022, *https://cepr.org/voxeu/columns/new-global-estimates-profits-tax-havens-suggest-tax-loss-continues-rise.*

U.S. Offshore Corporate Profits in Select Jurisdictions (USD Billion)



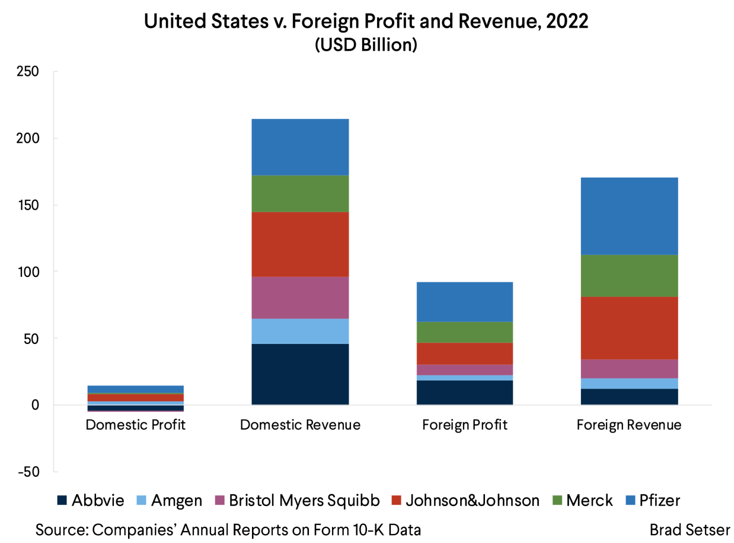
Source: U.S. Census Bureau/Haver Analytics — Brad Setser

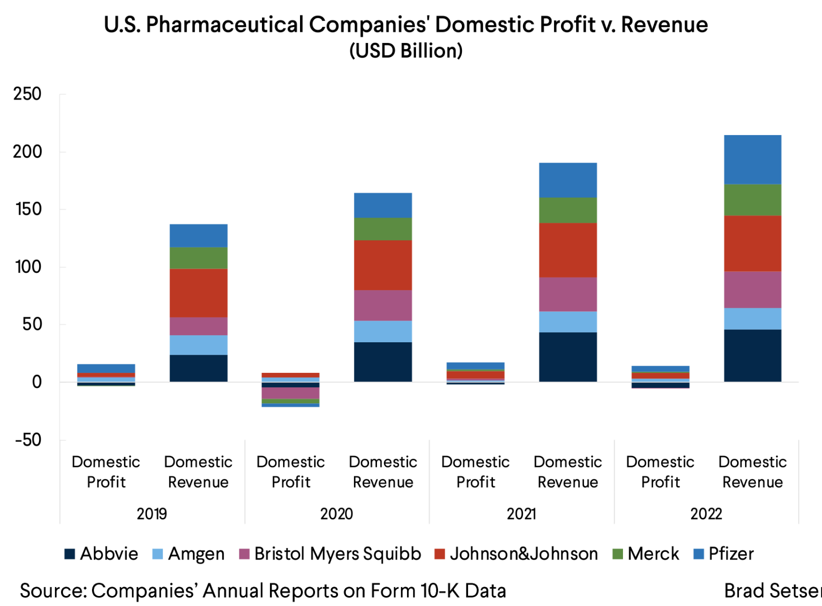
This is the clear pattern that emerges from a systemic examination of the 10–K annual financial reports of the main U.S. listed pharmaceutical companies. In these reports, companies generally detail the reasons why their actual tax rate differs from the 21-percent headline rate as well as disclose key risks, including risks to their current tax treatment.

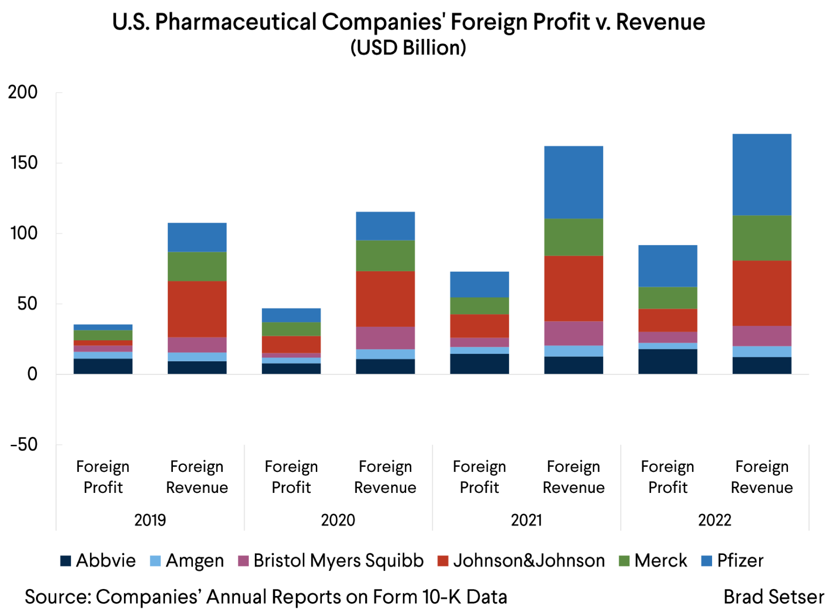
Excluding Gilead, whose reported data is incomplete but suggests that it now books the bulk of its global income in the United States, and Eli Lilly, whose data is also incomplete but unfortunately suggests it engages in significant profit shifting, the major U.S. listed pharmaceutical companies reported earning around $10 billion in U.S. profits on $214 billion of U.S. revenue in 2022. These firms also reported earning over $90 billion abroad—a quite significant fraction of their almost $171 billion in reported foreign revenue. Actual tax paid follows the reported profits: these U.S. firms reporting paying a bit over $2 billion in U.S. tax and close to $11 billion in tax abroad.

Twenty twenty-two was a particularly profitable year for many pharmaceutical companies. But the pattern of small U.S. profits relative to U.S. revenues—and a small U.S. share of global profits—has been consistent over time.

Over the same time frame, many large U.S. pharmaceutical companies have consistently reported sizable foreign profits relative to their foreign revenues.


United States v. Foreign Profit and Revenue, 2022
(USD Billion)
250
200
150
100
50
0
-50
Domestic Profit
Domestic Revenue
Foreign Profit
Foreign Revenue
Abbvie
Amgen
Bristol Myers Squibb
Johnson&Johnson
Merck
Pfizer
Source: Companies' Annual Reports on Form 10-K Data
Brad Setser


U.S. Pharmaceutical Companies' Domestic Profit v. Revenue
(USD Billion)
250
200
150
100
50
0
-50
Domestic Profit
Domestic Revenue
2019
2020
2021
2022
Abbvie
Amgen
Bristol Myers Squibb
Johnson&Johnson
Merck
Pfizer
Source: Companies' Annual Reports on Form 10-K Data
Brad Setser



Such a pattern is all the more striking because the United States is well known to have the highest pharmaceutical prices in the world.[8] The cost of pharmaceutical production does not vary significantly from jurisdiction to jurisdiction, so the profit margin on high priced U.S. sales would normally be expected to be much higher than the margin on foreign sales. It consequently is particularly noticeable that the bulk of the American pharmaceutical industry appears to barely make any money on their U.S. operations, while reporting large profits in countries that more intensively regulate pharmaceutical pricing.

I want to highlight three companies in particular, based on their SEC disclosed tax structures over the last 5 years.

As Senator Wyden and his team have highlighted, AbbVie systematically transfers nearly all the profits on its patent-protected medicines out of the United States. In fact, AbbVie reported a $4.6-billion loss in the United States in 2022—and a near $20-billion offshore profit. The reported U.S. loss is not an aberration—AbbVie has reported a U.S. loss every year between 2013 and 2022. These domestic losses occur even though AbbVie reports that it generates 75 percent of its revenue in the United States, and its blockbuster drug Humira sells at a substantially higher price in the United States than in Europe.[9]

Bristol Myers Squibb now displays the same pattern as AbbVie—it reported a U.S. loss of $0.14 billion while reporting nearly $8 billion in offshore earnings. It also reports that the United States generates nearly two-thirds of its revenues.

Pfizer also historically reported losses on its U.S. operations and large profits abroad. That pattern was attenuated by the success of its COVID–19 vaccine, which Pfizer produced in the United States for the United States and many other global markets. Nonetheless, there are indications that Pfizer continues to be among the

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[8] "Prescription Drug Prices in the United States Are 2.56 Times Those in Other Countries," RAND Corporation, January 28, 2021, *https://www.rand.org/news/press/2021/01/28.html#:~:text=Levels%20of%20Sleep-,Prescription%20Drug%20Prices%20in%20the%20United%20States,Times%20Those%20in%20Other%20Countries&text=Prescription%20drug%20prices%20in%20the%20United%20States%20are%20significantly%20higher,a%20new%20RAND%20Corporation%20report.*

[9] Eric Saganowsky, "AbbVie Offers Up 80% Humira Discount in EU Tender Market to Hold Off Biosimilars: Report," *Fierce Pharma,* October 31, 2018, *https://www.fiercepharma.com/pharma/abbvie-offers-up-80-humira-discount-eu-tender-market-to-hold-off-biosims-report.*

firms that aggressively shift profits out of the United States. In 2022, Pfizer reported that it only generated $5 billion of its $35 billion global profit in the United States. That is a change from its $2.9-billion loss on its U.S. operations in 2020, its $4-billion loss in 2018, and its $6.9-billion loss in 2017—but it is still a remarkably small profit on $42 billion in U.S. sales in 2022.[10]

Such profit-shifting strategies explain why many major listed U.S. pharmaceutical companies report effective tax rates close to 10 percent. Merck's 2022 10–K notes that tax differentials tied to foreign earnings lowered its effective tax rate by about 10 percentage points. To quote its annual report: "the foreign earnings tax rate differentials in the tax rate reconciliation above primarily reflect the impacts of operations in jurisdictions with different tax rates than the U.S., particularly Ireland and Switzerland, as well as Singapore and Puerto Rico."[11] Pfizer reports that lower taxation on its operations abroad lower its tax rate by about 5 percentage points; it observes "the reduction in our effective tax rate is a result of the jurisdictional location of earnings and is largely due to lower tax rates in certain jurisdictions, as well as manufacturing and other incentives for our subsidiaries in Singapore and, to a lesser extent, in Puerto Rico."[12] Reporting from the Irish journalist Thomas Hubert indicates that Pfizer should also have highlighted its Irish operations; Hubert's investigation concluded: "what will not appear in the group's consolidated accounts is the central role Ireland plays in the development, manufacture and distribution of its ground-breaking medicines around the world—as well as its finances and tax affairs."[13]

U.S. Trade Data

The story that emerges from a close reading of the SEC filings of American pharmaceutical companies is supported by the U.S. trade data.

The United States now imports around $200 billion of pharmaceutical products (NAICS 3254) while exporting about $101 billion. If imports from Puerto Rico are included, imports would increase to over $230 billion (Puerto Rico, a U.S. territory, is inside the U.S. customs border but outside the United States for corporate income tax purposes).[14]

U.S. biopharmaceutical exports increased during the pandemic as a result of U.S. production of the COVID–19 vaccines, which were produced in the United States for the global market and have raised U.S. exports of "biologics (NAICS 325414)."

However, excluding the special case of vaccines, which were produced under U.S. government contracts that often required U.S. production, the U.S. trade deficit in pharmaceuticals has increased steadily after the passage of the Tax Cuts and Jobs Act. The United States now imports a bit over $150 billion of pharmaceutical products other than biologics, while exporting a bit under $60 billion—with imports almost doubling since the passage of the Trump corporate tax cuts.

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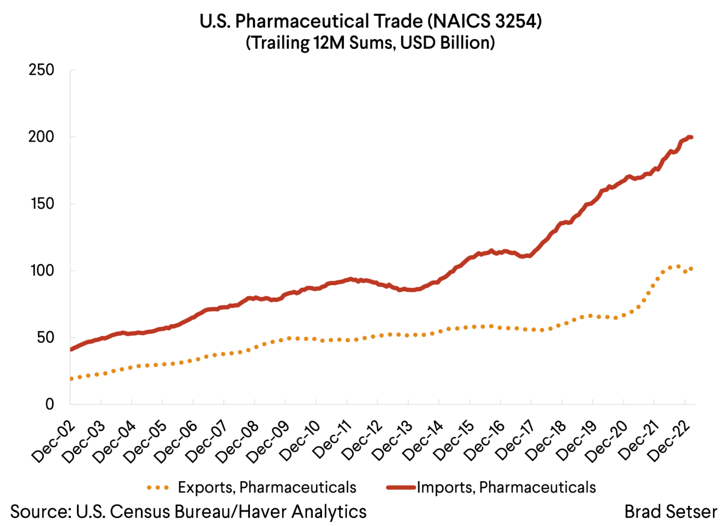
[10] Pfizer reported a significant 2019 profit, but that profit was clearly an outlier; Pfizer's 10–K for 2019 indicates its large U.S. income was the result of "the completion of the Consumer Healthcare joint venture transaction with GSK". *See* Pfizer's 2019 10–K, p.89: *https://d18rn0p25nwr6d.cloudfront.net/CIK-0000078003/dee171a3-b766-46e8-a807-dab4c7fb1895.pdf.*

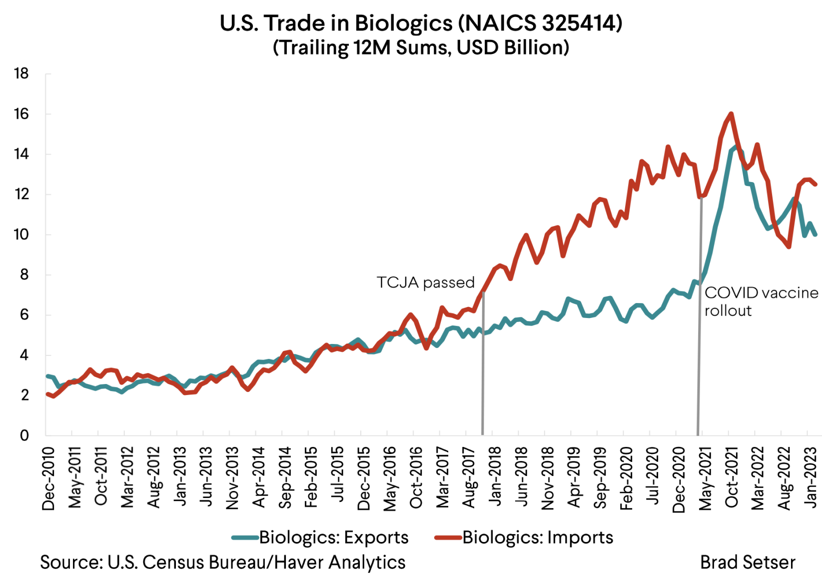
[11] *See* Merck's 2022 10–K, p. 191–121, *https://s21.q4cdn.com/488056881/files/doc_financials/2022/ar/b390be48-92bf-4595-96da-ac5cd7c3d92e-(1).pdf.*

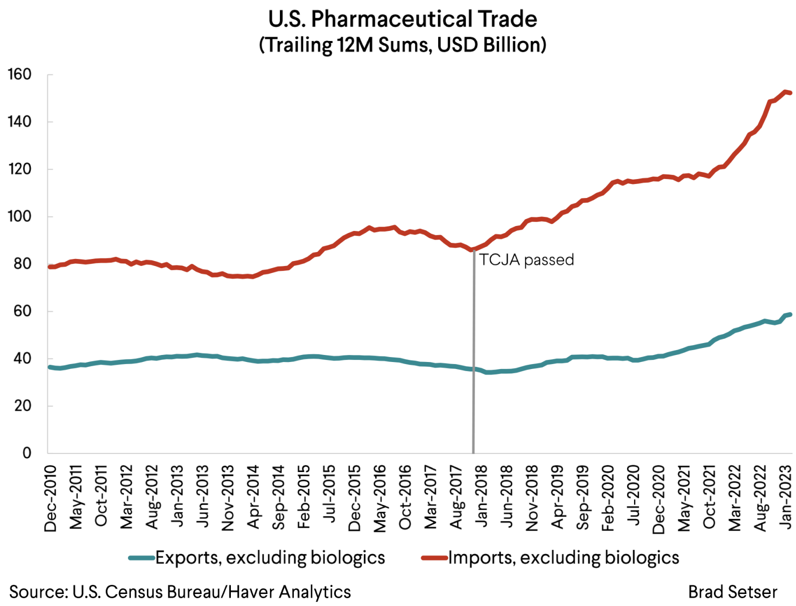
[12] *See* Pfizer's 2022 10–K, p. 69, *https://d18rn0p25nwr6d.cloudfront.net/CIK-0000078003/de8a877e-8aa4-4fb9-a84a-7ff78e3e0dbf.pdf.*

[13] Thomas Hubert, "Patents, Profits and Inter-company Debt: How Pfizer Built a $100bn Irish Empire," *The Currency,* February 2, 2021, *https://thecurrency.news/articles/34624/inside-pfizers-corporate-maze-the-vaccine-makers-100bn-irish-business-is-as-big-as-googles-or-microsofts/.*

[14] Planning Board of the Government of Puerto Rico, "External Trade Statistics 2022," *https://jp.pr.gov/wp-content/uploads/2023/02/ETS-2022.pdf.*


U.S. Pharmaceutical Trade (NAICS 3254)
(Trailing 12M Sums, USD Billion)
250
200
150
100
50
0
Dec-02
Dec-03
Dec-04
Dec-05
Dec-06
Dec-07
Dec-08
Dec-09
Dec-10
Dec-11
Dec-12
Dec-13
Dec-14
Dec-15
Dec-16
Dec-17
Dec-18
Dec-19
Dec-20
Dec-21
Dec-22
Exports, Pharmaceuticals
Imports, Pharmaceuticals
Source: U.S. Census Bureau/Haver Analytics
Brad Setser


U.S. Trade in Biologics (NAICS 325414)
(Trailing 12M Sums, USD Billion)
18
16
14
12
10
8
6
4
2
0
TCJA passed
COVID vaccine rollout
Dec-2010
May-2011
Oct-2011
Mar-2012
Aug-2012
Jan-2013
Jun-2013
Nov-2013
Apr-2014
Sep-2014
Feb-2015
Jul-2015
Dec-2015
May-2016
Oct-2016
Mar-2017
Aug-2017
Jan-2018
Jun-2018
Nov-2018
Apr-2019
Sep-2019
Feb-2020
Jul-2020
Dec-2020
May-2021
Oct-2021
Mar-2022
Aug-2022
Jan-2023
Biologics: Exports
Biologics: Imports
Source: U.S. Census Bureau/Haver Analytics
Brad Setser



The trade deficit in pharmaceuticals is not primarily with low-wage and low-cost jurisdictions, as one might expect. Rather, the largest sources of imports are Ireland, Switzerland, and Singapore, with increasing imports from countries like Belgium—all of which offer special tax regimes for pharmaceutical companies.[15]

The trade data maps to ongoing reports of U.S. firms increasing their offshore production. Merck has expanded its Irish production of Keytruda (Pembrolizumab), an important immunological treatment. Janssen Biotechnologies, a major subsidiary of Johnson & Johnson, is investing in Irish production capacity for Stelara (Ustekinumab), another blockbuster drug.[16] Eli Lilly has announced a $1-billion new investment in its Irish production facility, reportedly to produce a new Alzheimer's drug, among others.[17] Pfizer has also reported a $1.3 billion investment in biologic production capacity in Ireland.[18]

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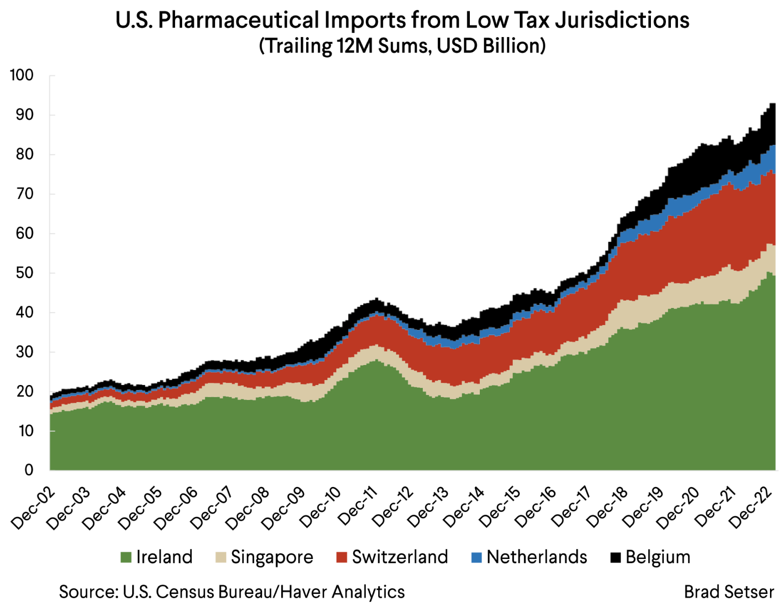
[15] "Ireland as a Tax Haven" Wikipedia, *https://en.wikipedia.org/wiki/Ireland_as_a_tax_haven;* Jessica Davis Plüs, "Switzerland's Tax Haven Reputation Runs Deep Even With Reforms," SwissInfo, *https://www.swissinfo.ch/eng/business/switzerland-s-tax-haven-reputation-runs-deep-even-with-reforms/48430002;* "Singapore as a Tax Haven," Offshore Protection, January 23, 2023, *https://www.offshore-protection.com/singapore-offshore-tax-haven.*

[16] Central Bank of Ireland, Quarterly Bulletin 01, February 2020, *https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/qb-archive/2020/quarterly-bulletin---q1-2020.pdf?sfvrsn=b811861d_9.*

[17] David Raleigh, "Eli Lilly to Invest $1bn in Limerick Drug-manufacturing Site," *Irish Times,* March 27, 2023, *https://www.irishtimes.com/business/2023/03/27/eli-lilly-to-invest-1-billion-in-limerick-site/;* Ken Dunleavy, "Eli Lilly Pours $500M More Into API Manufacturing Site Under Construction in Ireland." *Fierce Pharma,* March 28, 2023, *https://www.fiercepharma.com/manufacturing/500m-added-investment-lilly-api-facility-ireland-twice-nice.*

[18] Fraiser Kansteiner, "Pfizer plots €1.2B investment—and up to 500 new jobs—at Irish manufacturing plant." *Fierce Pharma,* December 1, 2022, *https://www.fiercepharma.com/manufacturing/pfizer-plots-eu12b-investment-and-500-new-jobs-irish-manufacturing-plant.*



In my judgment, there is no plausible explanation for the current scale of U.S. imports of pharmaceuticals from Belgium, Ireland, Switzerland, and Singapore that isn't tied to tax avoidance. The net result is a loss of tax revenue for the U.S. Treasury and a smaller biopharmaceutical industrial base. This clearly leads to a less resilient U.S. economy. The pandemic showed that a diverse advanced manufacturing base and a technically skilled workforce can be vital assets in rapidly scaling up production of innovative medicines in the face of an unexpected shock.

3. NECESSARY REFORMS

Significant changes to the current U.S. tax code are needed to remove the current incentive for pharmaceutical firms, and other high margin manufacturing firms, to shift jobs and profits out of the United States.

The starting point for any reform is straightforward: the U.S. Congress should increase the tax rate that U.S. firms now face on their global intangible income, and thus assure that firms that engage in tax games to shift profit outside the United States nonetheless pay a U.S. tax rate of at least 15 percent. In addition to raising the baseline GILTI rate to at least 15 percent, Congress should assess this tax on a country-by-country basis. Right now, firms that pay zero tax on their profits in say, Bermuda, or perhaps 5 percent in Ireland, can actually lower their overall tax rate by blending those profits with profits in high tax jurisdictions like Germany (a perverse outcome). Such changes on their own would clearly raise a meaningful amount of revenue, given the low effective tax rates that firms report in their SEC disclosures and the large reductions in tax that firms disclose as a result of "the jurisdictional mix earnings." In addition, careful consideration should be given to deeming patent boxes to be in a separate foreign tax bracket for the purpose of calculating a firms GILTI income and tax liability. Such patent boxes currently create strong incentives to shift profits into what would otherwise be relatively high tax jurisdictions, such as Belgium.

There is little downside to an increase in the U.S. global minimum tax. Thanks to the leadership of Secretary Yellen and others, America's main trading partners have already committed to a 15-percent global minimum tax. Consequently, the United States should immediately enact the changes in U.S. tax law required to implement—or at least converge with—the second pillar of the OECD-G20 Inclusive Framework. Without U.S. action, other countries will rightly be able to collect top-up taxes on under-taxed U.S. firms that operate in their jurisdictions and continue to systematically shift profits to low-tax jurisdictions. U.S. firms that have retained their intellectual property in the United States and pay U.S. tax on the associated royalty income by contrast will face much less of a risk of being subject to a top-up tax.

Moreover, the United States should increase its tax collection from the pharmaceutical industry by enacting the first pillar of the OECD-G20 Inclusive Framework. Pillar 1 shifts a portion of the tax a firm owes on its global income to the "market" jurisdiction—essentially the jurisdiction of sales. Foreign pharmaceutical firms that generate large profits on their U.S. sales would thus be required to make a payment to the U.S. Treasury. Pillar 1 would also raise U.S. tax revenues from U.S. pharmaceutical and medical technology firms that "inverted" and became Irish-headquartered companies, even though the bulk of the firms' operations and sales are in the United States. Even U.S. headquartered pharmaceutical firms could, absent changes in their tax structure, potentially be required to make additional payments to the United States, as many currently generate the majority of their sales inside the United States while booking the majority of their profits abroad. Aligning a portion of the taxing rights to these firms' global income to the jurisdiction of sales thus would imply greater, not smaller, payments to the U.S. Treasury.

In addition to these reforms, most of which have been proposed by the U.S. Treasury, I would recommend a set of additional hard-hitting reforms to discourage firms from shifting profits earned in the United States outside of the United States. A higher minimum U.S. tax on the offshore income of U.S. firms reduces, but does not fully eliminate, the incentive to offshore future profits.

Specifically, the U.S. Congress should consider a set of reforms to reinvigorate subpart F of the corporate tax code. Subpart F dates back to the 1960s. It was originally introduced to the tax code to discourage U.S. firms from locating the passive profits and income from certain related party transactions, including sales and services income, abroad. Today many firms locate production as well as their intellectual property rights abroad, but the basic principle that firms should not gain a tax advantage by shifting profits outside of the United States remains important. Over time, though, subpart F has been effectively gutted, and it is relatively easy to find ways around its basic requirement that passive income and income from certain related party transactions be taxed in the United States at the headline U.S. corporate income tax.

No doubt there are many specific changes that would strengthen subpart F. I will highlight three. One, foreign royalty income should be denied any exemption from subpart F, and thus taxed at the U.S. rate. To be concrete, this would raise the tax rate on the intellectual property that pharmaceutical firms, like AbbVie, have located in Bermuda and other no- or low-tax jurisdictions. Two, legacy "cost-shares" that allow firms to shift profits out of the United States by splitting the cost of research and development between the U.S. headquarters and a foreign subsidiary of the same firm located in a low-cost jurisdiction should lose their current special tax status. Three, transactions between foreign subsidiaries of the same firm that generate a substantial increase in the valuation of offshored intellectual property for the purpose of generating larger depreciation allowances in jurisdictions like Ireland could be subject to U.S. tax at the headline rate. To give a concrete example here, it has been widely reported that Apple's subsidiary in the isle of Jersey was bought by Apple's Irish subsidiary.[19] This transaction was designed to generate large depreciation allowances for Apple's Irish subsidiary and thus to substantially lower Apple's effective Irish tax rate without incurring any U.S. tax liability.[20] Under this proposal, the paper profits that Apple's Jersey subsidiary earned from the sale of the global rights to Apple's intellectual property to Apple Ireland would be taxed at the headline U.S. rate.

The intent of all these proposals is to discourage U.S. firms from transferring the right to profit from the intellectual property that they generate in the United States to low-tax jurisdictions, and thus to create strong incentives for U.S. firms to retain their intellectual property onshore. It would have the byproduct of substantially reducing tax incentives to offshore production and jobs, as the bulk of the profit on

[19] "After a Tax Crackdown, Apple Found a New Shelter for Its Profits," *New York Times,* Jesse Drucker and Simon Bowers, November 6, 2017, *https://www.nytimes.com/2017/11/06/world/apple-taxes-jersey.html;* Colm Keena, "Apple Made Key Subsidiary Irish-Resident for Tax Reasons in 2014," *Irish Times,* November 7, 2017, *https://www.irishtimes.com/business/apple-made-key-subsidiary-irish-resident-for-tax-reasons-in-2014-1.3282037.*

[20] Emma Clancy, "Apple, Ireland and the New Green Jersey Tax Avoidance Technique." *Social Europe,* July 4, 2018, *https://www.socialeurope.eu/apple-ireland-and-the-new-green-jersey-tax-avoidance-technique.*

offshore production accrues to the intellectual property and the goal of many offshoring strategies used in the pharmaceutical sector appears to be to create the legal basis for moving the profit on U.S. sales out of the United States. As I noted earlier, in 2022, the large American pharmaceutical firms reported earning remarkably little—$10 billion—on their $200 billion in U.S. sales. Their reported earning on their foreign operations were equally remarkable: $90 billion on $170 billion in sales, an implied margin of over 50 percent. These firms appear to have paid about $2 billion in tax to the U.S. Treasury on global earnings of over $100 billion, a remarkably small sum.

Such reforms would both raise the overall amount paid to the U.S. Treasury and increase the effective tax rate paid by U.S. pharmaceuticals. Many foreign pharmaceutical firms already pay effective tax rates of around 20 percent, or close to the headline rate in their country of origin. Denmark's Novo Nordisk is currently taxed at Denmark's headline tax rate and pays the bulk of its income tax in Denmark.[21] France's Sanofi also pays and effective rate of close to twenty percent.[22] Even the Swiss firm Novartis pays an effective tax of close to 15 percent.[23] These firms also tend to pay the bulk of their corporate income tax in their "home" country. The United States now stands out by allowing many of its major companies to achieve effective tax rates of 10 percent by moving both production and profits out of the United States—a giveaway to the shareholders of the pharmaceutical companies that comes at substantial cost to both the U.S. Treasury and the U.S. economy.

In the context of a significant tightening of subpart F, I would also support reinstating full expensing for Research and Development expenditures, structured to be effective in the context of Pillar 2 of the OECD's global tax reform. Generous tax treatment for genuine innovation though should be combined with new rules that would claw back expensing for research and development if a firm moves its intellectual property to one of its foreign subsidiaries. Such a rule would be technically challenging, but I am confident that it is feasible.

CONCLUSION

The United States generates the bulk of the revenue for American pharmaceutical companies, largely because Americans pay the world's highest prices for essential medicines. Yet American companies typically report that they earn, at least for tax purposes, almost all of their profits abroad.

The information that American pharmaceutical companies report to their own investors provides strong evidence of systemic tax avoidance. In 2022, the United Stated accounted for 55 percent of the sales of a select group of large pharmaceutical companies, but only 10 percent of their profits. The most recent round of U.S. corporate investment in Irish pharmaceutical production highlights how the Tax Cuts and Jobs Act only reinforced prior incentives to offshore both production and profits. I unfortunately do not think it is unfair to call the Tax Cuts and Jobs Act the Pharmaceutical Tax Cuts and Irish Jobs Act.

There consequently is an urgent need to reform the U.S. corporate tax code to both to assure that some of America's most profitable companies pay their fair share to the U.S. Treasury and to strengthen the U.S. biopharmaceutical industrial base. The incentives to offshore the production of some of the world's most important medicines in the current U.S. tax code are in my view an issue of supply chain security and thus ultimately of national security.

I applaud the Finance Committee for calling this hearing and encourage the Senate to move quickly to make necessary changes in the U.S. tax code.

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[21] Denmark's corporate tax rate is 22 percent; Novo Nordisk's effective tax rate in 2022 was 20 percent. Almost two-thirds of its total income taxes paid in 2022 were paid in Denmark. *See* Novo Nordisk's 2022 Annual Report, *https://www.novonordisk.com/content/dam/nncorp/global/en/investors/irmaterial/annual_report/2023/novo-nordisk-annual-report-2022.pdf.*

[22] *See* Sanofi's 2022 Annual Report on Form 20–F, p. 77, *https://www.sanofi.com/dam/jcr:b93f9582-863c-4e3b-a9d1-30c90b98d118/SAN_2022_20-F_Sanofi%20-%20accessible.pdf.*

[23] *See* Novarti's 2022 Annual Report on Form 20–F, p. 27, *https://www.novartis.com/sites/novartis_com/files/novartis-annual-report-2022.pdf.*

Appendix

2022 Pharmaceutical Company 10–K Data

Company	Abbvie	Amgen	Bristol Myers Squibb	Eli Lilly	Gilead	Johnson & Johnson	Merck	Pfizer	Select Total (ex. Eli Lilly and Gilead)
Domestic Profit	−5.0	3.0	0.0	n/a	4.0	5.0	1.0	5.0	9.7
Foreign Profit	18.0	4.0	8.0	n/a	1.0	16.0	15.0	30.0	91.7
Total Profit	13.5	7.3	7.7	6.8	5.8	21.7	16.4	34.7	101.4
Domestic Revenue	45.7	18.6	31.8	18.2	n/a	48.6	27.2	42.5	214.4
Foreign Revenue	12.3	7.7	14.3	10.4	n/a	46.4	32.1	57.9	170.7
Total Revenue	58.1	26.3	46.2	28.5	27.3	94.9	59.3	100.3	385.1
Total U.S. Tax	1.1	0.5	0.1	0.2	1.0	0.3	0.8	−0.5	2.0
Total Foreign Tax	0.5	0.2	1.2	0.5	0.3	3.5	1.2	4.2	11.0
Total Tax Paid	1.6	0.8	1.4	0.6	1.4	3.8	2.0	3.7	13.0
Effective Tax Rate (%)	12.1	10.8	17.7	8.3	21.5	17.4	11.7	9.6	13.0

2021 Pharmaceutical Company 10–K Data

	Abbvie	Amgen	Bristol Myers Squibb	Eli Lilly	Gilead	Johnson & Johnson	Merck	Pfizer	Select Total (ex. Eli Lilly and Gilead)
Domestic Profit	−1.6	1.9	1.6	n/a	8.6	6.1	1.9	6.1	15.8
Foreign Profit	14.6	4.9	6.5	n/a	−0.3	16.7	12.0	18.2	72.9
Total Profit	13.0	6.7	8.1	6.2	8.3	22.8	13.9	24.3	88.8
Domestic Revenue	43.5	18.2	29.2	16.8	n/a	47.2	22.4	29.7	190.2
Foreign Revenue	12.7	7.8	17.2	11.5	n/a	46.6	26.3	51.5	162.1
Total Revenue	56.2	26.0	46.4	28.3	27.3	93.8	48.7	81.3	352.3
Total U.S. Tax	1.1	0.6	0.6	0.0	1.5	2.1	0.3	−0.5	4.2
Total Foreign Tax	0.3	0.2	0.5	0.6	0.1	−0.2	1.2	2.8	4.8
Total Tax Paid	1.4	0.8	1.1	0.6	1.7	1.9	1.5	2.3	9.0
Effective Tax Rate (%)	11.1	12.1	13.4	9.3	25.1	8.3	11.0	7.6	10.0

PREPARED STATEMENT OF HON. RON WYDEN,
A U.S. SENATOR FROM OREGON

The Finance Committee meets this morning to discuss the highly intricate tax schemes of some of the largest U.S. pharmaceutical companies, and the immense handouts those companies got from the 2017 Republican tax law.

In short, it goes like this. When most Americans travel to some faraway land, they get a sun tan. When big pharma's profits travel overseas, they get a tax break. That tax break got a whole lot bigger as a result of the Republican reforms.

Two years ago the Finance Committee Democratic staff began investigating these issues. We asked five big pharma companies for answers to questions that really aren't all that complicated. Where do you make your sales? Where do you report your profits? Where do you stick intellectual property?

The reality is, these are not nuclear secrets. But big pharma worked hard to keep the details of their tax schemes hidden in the shadows. Nonetheless, the committee is updating the public on its ongoing investigation today.

Here is what big pharma does not want you to know.

Our investigation obtained data from the Joint Committee on Taxation, the non-partisan experts, on the effective tax rates the largest pharmaceutical companies paid before and after the Republican tax law went into effect.

The numbers are astonishing. Republicans delivered big pharma a tax cut of more than 40 percent. From 2014 to 2016, the industry paid 19.6 percent on average. In 2019 and 2020, it paid 11.6 percent.

Pharma got a substantially lower tax rate than most other industries specifically because the 2017 Republican law essentially gave a green light for the kind of tax gaming that the biggest drug companies engage in so relentlessly. They stash intellectual property in other countries. They stick manufacturing offshore. They use accounting tricks to shift money to foreign subsidiaries.

Republicans could have put a stop to these tax games. They did not.

Here's what makes this especially appalling: the U.S. is by far the biggest market for these drug companies. For some companies, this is where they do the vast majority of their sales. For Amgen, it's 74 percent. For AbbVie, it's 72. These are American companies selling to American patients, but their profits show up somewhere else. Amgen reported 60 percent of its profits offshore in 2019. AbbVie reported 100 percent of its profits offshore—100 percent!

In many cases these companies charge American patients and taxpayers staggering amounts for prescription drugs—sometimes double, triple, quadruple what they charge in other countries—and then report the profits on those U.S. sales elsewhere.

For example, the list price for Keytruda, a cancer drug produced by Merck, is $175,000 per year. Merck sold more than $37 billion of the drug in the U.S. between 2019 and 2022. According to our investigation, Merck reported virtually all of the profits on those sales overseas.

The level of profit-shifting industry-wide is enough to leave you slack-jawed. According to JCT, big pharma reports 75 percent of its income offshore.

The update to our ongoing investigation, which the Finance Committee made available this morning, goes deeper into specific cases of big pharma's tax games. It's available to read on our website right now, and without objection, I'll enter a copy of our report and the accompanying JCT analysis into the hearing record.

There is big interest among Democrats in fixing this broken system, cracking down on the tax gaming, and ensuring that corporations pay a fair share. In 2021, Senator Brown, Senator Warner, and I introduced a proposal that addresses all the issues the committee will discuss today. Senator Whitehouse is also a leader on this topic. Obviously, Treasury Secretary Yellen has led a major effort to crack down on tax schemes all over the world. So there's a lot for us to discuss. I look forward to hearing from our witnesses.

Congress of the United States

JOINT COMMITTEE ON TAXATION
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May 4, 2023

MEMORANDUM

TO: Sarah Schaefer, Jon Goldman, Ursula Clausing, and Grace Enda

FROM: Thomas A. Barthold

SUBJECT: Analysis of Large Pharmaceutical Corporation Tax Data

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This memorandum is a response to your request of April 27, 2023, for analyses of tax data for large pharmaceutical corporations. There are two tables below summarizing different sets of information related to these companies.

Table 1 reports the worldwide and U.S. average effective tax rates using generally accepted accounting principles ("GAAP") for three different groups of large corporations: non-manufacturing, manufacturing (excluding pharmaceutical corporations), and pharmaceutical (four-digit NAICS code of 3254). The data underlying the tax rate calculation are drawn from the Compustat database, which is populated from financial statements (*e.g.,* Form 10–K) filed with the Securities and Exchange Commission ("SEC"). The sample is limited to U.S. headquartered companies that appeared in the Compustat database in each year from 2014 to 2020 (*i.e.,* a balanced panel), had positive pre-tax income from foreign operations in at least one of those years, and had at least $100 million in assets in 2016. The effective tax rates presented here are weighted by income and calculated using observations with positive pre-tax income. The worldwide effective tax rate is calculated as worldwide taxes paid divided by worldwide pre-tax income as reported on Form 10–K. The domestic effective tax rate is calculated as federal taxes paid divided by domestic pre-tax income. The years 2017 and 2018 are excluded from the table as the payment of section 965 repatriation taxes create anomalous results.[1]

Table 1.—Worldwide and U.S. GAAP ETRs for Large Corporations

	Worldwide Effective Tax Rates		Domestic Effective Tax Rates	
	2014–2016	2019–2020	2014–2016	2019–2020
Non-Manufacturing	27.9	16.7	25.7	11.3
Manufacturing	24.1	17.4	25.7	15.4
Pharmaceutical	19.6	11.6	27.0	15.7

Source: Compustat and JCT Staff calculations.

Table 2 reports information on the share of activity these corporations report occurring outside of the United States, constructed from fields on Form 1120, *U.S. Corporation Income Tax Return,* and Form 8992, *U.S. Shareholder Calculation of Global Intangible Low-Taxed Income.* The numerator is the sum of subpart F income, global intangible low-taxed income, and section 78 gross up deemed dividend amounts reported on Form 1120, as well as the net deemed tangible income return from Form 8992. The denominator is the sum of taxable income, section 250 deductions, and net operating loss deductions from Form 1120, as well as the net deemed tangible income return from Form 8992. Here, the numerator provides an estimate of the total foreign income subject to U.S. tax, and the denominator provides a rough estimate of the worldwide taxable income of the U.S. taxpayer. There are several components of a corporation's foreign income that would not be captured by this measure (*e.g.,* particularly branch income for foreign sales and differences in consolidation between tax measures and financial accounting measures). Mimicking the presentation of the first table, each ratio is reported separately for non-manufacturing, manufacturing (excluding pharmaceutical corporations), and pharmaceutical corporations. Firms included in this analysis had at least $100 million in assets in 2016, were in the sample each year from 2014 to 2020, were not majority foreign owned, and had multinational operations. Ratios are reported as the average for years 2019 and 2020.

Table 2.—Foreign Share of Taxable Income

Non-Manufacturing	0.22
Manufacturing	0.45
Pharmaceutical	0.75

Source: SOI and JCT Staff calculations.

American Patients, *American* Companies, *Offshore* Profits

Senate Finance Committee Democratic Staff Memorandum, May 11, 2023

The 2017 Republican tax law was a massive giveaway to megacorporations and the wealthy. In particular, its international tax provisions favored billion-dollar multinationals over American workers and families, with a huge reduction in the U.S. tax rate on foreign earnings and new incentives to offshore jobs and stash profits in tax havens.

[1] Section 965 imposed a one-time transition tax on a U.S. shareholder's pro-rata share of certain of undistributed and previously untaxed post-1986 foreign earnings and profits earned by a specified foreign corporation at the end of such specified foreign corporation's last taxable year beginning before January 1, 2018. The transition tax constituted an additional tax expense for financial reporting that increased effective tax rates reported on Form 10–K in 2017 and 2018 (in some cases by more than 50 percent).

Few industries benefited more than Big Pharma.

The pharmaceutical industry reaps huge shares of its revenue from U.S. patients by charging sky-high prices for essential prescription drugs—prices often far higher than it charges foreign patients for the same products. A significant share of these pharmaceutical sales are made to American taxpayers through bedrock federal health programs including Medicare and Medicaid. Billions of taxpayer dollars also go to support pharmaceutical research. Yet the pharmaceutical industry pays tax rates that barely exceed single-digits, and the lion's share of Big Pharma profits show up offshore, yielding massive tax savings.

The American public deserves to know how Big Pharma does it.

The ongoing Senate Finance Committee Democratic staff investigation of Big Pharma's tax practices pulls the curtain back on an industry that excels at shifting profits offshore to avoid tax. Through offshoring intellectual property (IP), aggressive transfer pricing, foreign manufacturing, and other techniques, Big Pharma is able to put most of its income—and sometimes every single dollar of profit—into offshore subsidiaries.

Under the Global Intangible Low-Taxed Income (GILTI) regime Republicans created in 2017, these offshore profits can access a special low tax rate and take advantage of "global blending" of foreign income to minimize any additional tax. These provisions significantly cut pharmaceutical companies' tax rate, sometimes into just single-digits, creating a huge incentive to put profit, investments, and jobs offshore. The industry's average effective tax rate is an astonishingly low 11.6 percent—a *40-percent decrease* from years prior to the 2017 Republican tax law.

This system needs significant reform to ensure big corporations pay their fair share, while helping to spur investment in the U.S., not in foreign countries. Until that happens, Big Pharma's tax games will continue.

The following memorandum provides a sampling of the findings of the Finance Committee Democratic staff investigation. A final report detailing the full extent of the Committee's findings is expected to be released later this year.

The 2017 Republican Tax Law Was a Huge Tax Cut for Giant Pharmaceutical Corporations

The 2017 Republican tax law was a massive tax cut for giant pharmaceutical corporations. These companies now commonly pay lower tax rates than small business owners, school teachers, and firefighters. The Joint Committee on Taxation (JCT) provided the Committee data analyzing the average effective tax rates of large multinational pharmaceutical corporations for years prior to the 2017 tax law and years after the 2017 tax law. The tax cut for Big Pharma is *astonishing.*

The 2017 Republican tax law cut Big Pharma's tax rate *by more than 40 percent,* and these companies now pay tax rates that are barely above single-digits on average. While the 2017 Republican tax law provided a massive tax break to mega-corporations in every business sector, the magnitude of the cut for Big Pharma makes it one the biggest beneficiaries. This has resulted in billions of dollars in tax savings for pharmaceutical corporations.

Table #1: Average Effective Tax Rate, U.S. Pharmaceutical Corporations

Year	Pharmaceutical industry average effective tax rate[1]
2014–2016	**19.6%**
2019–2020	**11.6%**

The data across all pharmaceutical companies from JCT aligns with the public data the Committee analyzed. In 2021, the effective tax rate of every single one of the seven largest pharmaceutical corporations in the United States was lower than 15 percent, and substantially lower than the statutory corporate tax rate of 21 percent. The Committee believes these rates are in large part a result of the flawed design of the international provisions of the 2017 Republican tax law.

Table #2: Effective Tax Rate of Seven Largest U.S. Pharmaceutical Corporations (2021)[2]

Company	Abbott	AbbVie	Amgen	BMS	Johnson & Johnson	Merck	Pfizer
ETR	13.9%	12.5%	12.1%	13.4%	8.3%	11%	7.6%
Income (billions)	$8.2B	$12.9B	$6.7B	$8.1B	$22.7B	$13.9B	$24.3B

U.S. Pharmaceutical Corporations Book Most of Their Profits Offshore for Tax Purposes

Over several years, the Democratic staff of the Senate Finance Committee obtained tax information from several large U.S. pharmaceutical corporations related to the use of offshore subsidiaries. In particular, the Committee focused on determining the percentage of the companies' income for tax purposes that was reported by foreign subsidiaries, or "controlled foreign corporations" (CFCs).[3] The income reported by CFCs generally reflects income that is offshore.

As part of this effort, the Committee published an interim report in 2022 detailing the extent to which pharmaceutical giant AbbVie used offshore subsidiaries to avoid paying billions of dollars in taxes on prescription drug sales.[4] That report highlighted how in 2020, 99 percent of AbbVie's taxable income was reported by offshore subsidiaries. This means that despite being headquartered in the U.S. and generating 75 percent of its sales from U.S. patients, only one percent of AbbVie's taxable income was subject to the U.S. corporate income tax rate of 21 percent. The 99 percent of AbbVie's income in 2020 that was reported by offshore subsidiaries was likely able to access the substantially lower GILTI rate of 10.5 percent.

Since the publication of the AbbVie report, the Committee obtained similar information from four other large U.S. pharmaceutical corporations: Abbott Laboratories (Abbott), Amgen, Bristol Myers Squibb (BMS), and Merck. While the Committee will make more of this information public in a comprehensive final report expected later this year, the Committee is including data obtained for 2019 in this hearing memo-

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[1] The data underlying the tax rate calculation are drawn from the Compustat database, which is populated from financial statements (*e.g.,* Form 10–K) filed with the Securities and Exchange Commission ("SEC"). The sample is limited to U.S. headquartered companies that appeared in the Compustat database in each year from 2014 to 2020 (*i.e.,* a balanced panel), had positive pre-tax income from foreign operations in at least one of those years, and had at least $100 million in assets in 2016. The effective tax rates presented here are weighted by income and calculated using observations with positive pre-tax income. The effective tax rate is calculated as worldwide taxes paid divided by worldwide pre-tax income as reported on Form 10–K.

[2] Largest firms was determined by total revenue. Data are from each company's 2021 annual report.

[3] A CFC is a foreign corporation that is majority owned by U.S. shareholders that own at least 10 percent of a foreign corporation. While not all CFCs would be a foreign subsidiary as commonly understood, it is generally thought that the vast majority of CFC income is through traditional, wholly-owned, foreign subsidiaries.

[4] *https://www.finance.senate.gov/chairmans-news/wyden-releases-interim-report-in-big-pharma-tax-investigation.*

randum. This information confirms the finding that major U.S. pharmaceutical corporations book most—and sometimes nearly all—of their profits offshore for tax purposes. By minimizing the amount of profits subject to the 21-percent U.S. corporate income tax, these companies are able to save billions of dollars in taxes on sales of high-cost prescription drugs.

The substantial majority of profits being booked offshore stands in stark contrast to who is paying for the drugs these companies make: American patients. The U.S. is typically the largest customer for major pharmaceutical corporations, and in the case of some pharma companies, makes up more than two-thirds of total revenue. This creates a structure sometimes described as "round-tripping." The sale is made to an American patient by an American-headquartered company, but the profit from that sale is shifted offshore.[5]

The data presented in the table below makes clear that the 2017 Republican tax law's flawed international provisions enabled Big Pharma's continued shifting of profits overseas.

Table #3: Percentage of Sales to U.S. Patients, and Percentage of Income in the U.S. and Offshore for Tax Purposes (2019) [6]

Company	Sales to U.S. patients [7]	Income reported in U.S.	Income reported offshore
AbbVie	**72%**	**0%**	**100%**
Abbott [8]	**36%**	**13%**	**87%**
Merck	**43%**	**16%**	**84%**
BMS	**60%**	**17%**	**83%**
Amgen	**74%**	**40%**	**60%**

All of these Big Pharma companies are American. One-third to over two-thirds of their revenue comes from American patients. Yet, in most cases, over 80 percent of their profits are showing up offshore.

According to new data provided to the Committee by JCT, these companies do not appear to be outliers among Big Pharma companies. In fact, according to JCT, **75 percent of all Big Pharma income is reported offshore for tax purposes.**

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[5] As an example of how this may work, the U.S. customer buys the pharmaceutical product from a U.S. sales arm of the U.S. pharmaceutical company. That U.S. sales arm purchased the product from the offshore CFC of that same pharmaceutical company. Little if any profit from the sale is left in the U.S. sales entity, and most of the profit is reported by the CFC, which gets the benefit of the lower GILTI tax rate. The CFC then is able to distribute that profit, generally tax free, to its U.S. parent company. The profit makes a round trip—from the U.S. sales arm, to the offshore CFC, and then back to the U.S. parent.

[6] The income considered reported offshore by the Committee was calculated in two ways, based on what was received from the company. One method was the sum of subpart F income, GILTI, and the section 78 gross up, as determined on the relevant tax return forms. This includes income that would not be included in taxable income due to the section 250 deduction from GILTI. For other companies, this was calculated as the difference between taxable income minus taxable income excluding income from CFCs, plus the 250 deduction from GILTI. Both methods should equal roughly the same result for a company. Total income was calculated as taxable income plus the total 250 deduction, including from GILTI and FDII. The income exempt from tax under the net deemed tangible income return provisions should also be treated as income of a CFC for tax purposes, but this data point was not received from all companies. As such, it was excluded for consistency purposes. Had it been included for the companies that we received it from, the share of income from CFCs only would have increased marginally. AbbVie's data did not include the additional section 250 deductions, but given AbbVie was technically in excess of 100 percent offshore, the percentage would have been unlikely to change.

[7] Sales to U.S. patients refers to U.S. sales as a percentage of worldwide revenue for each company. So if the number is 75 percent, that means that 75 percent of the company's worldwide sales that year were made to U.S. customers. This information is readily available in each company's annual report (10–K filing with SEC).

[8] Abbott, the manufacturer of baby formula brand Similac, refused to respond to a follow-up request for additional information regarding the amount of its 250 deduction, and that data is not included in this calculation. As such, it is likely that the percentage of income booked offshore is higher than the amount currently listed.

Even compared to other multinationals, Big Pharma's profit shifting is extreme.[9] Averaging across many multinational corporations, Big Pharma's share of offshore income far surpassed both non-manufacturing companies and manufacturers outside of the pharmaceutical industry.

Table #4: Percentage of Income Offshore for Tax Purposes (average for 2019–2020) [10]

Industry	Income reported offshore
Non-manufacturing	**22%**
Manufacturing, excluding pharma	**45%**
Pharmaceutical	**75%**

Billions of Dollars in American Sales of Blockbuster Prescription Drugs Like Keytruda are Taxed as Offshore Income

As a result of the giveaways of the international provisions of the 2017 Republican tax law, profits from U.S. sales of certain blockbuster drugs are being taxed almost exclusively at low offshore rates. A good example of this is Merck's Keytruda, a cancer fighting drug that is so lucrative it would be a Fortune 200 company on its own. Merck charges an annual list price of *$175,000 per year, per patient* for Keytruda, making it extraordinarily expensive for patients and taxpayers. Over the four years 2018–2021, the U.S. government has spent an astounding $12 billion under Medicare to help patients cover the cost of Keytruda, effectively subsidizing a major portion of Merck's profits for the drug.[11]

Between 2019 and 2022 Merck sold $37.1 billion worth of Keytruda in the United States, yet little if any of the profits generated by those sales were taxed in the U.S.[12] Rather, the profits from Keytruda sales to U.S. patients are taxed offshore, likely benefiting from the lower GILTI rate of 10.5 percent, just half of the statutory corporate income tax rate of 21 percent. Merck provided information indicating that this is because the IP rights for Keytruda are exclusively located in the Netherlands and the drug is manufactured in Ireland.

In a response to the Committee, Merck stated that with respect to Keytruda, ". . . because its patents have always been owned outside the United States, Merck's operating profit attributable to Keytruda IP rights is taxed in jurisdictions outside the United States." Merck also added that as Keytruda sales increased by 55 percent from 2019 to 2021, Keytruda "became an even larger portion of Merck's overall profits and [Keytruda's] expansion increased the portion of Merck's overall income subject to tax outside the United States."

This is also the case for AbbVie's blockbuster rheumatoid arthritis drug Humira. As pointed out in the interim report last year, AbbVie owns the IP rights in a subsidiary located in Bermuda and manufactures the product in Puerto Rico. Since income from entities based in Puerto Rico is treated as foreign for tax purposes, income from Humira is taxed not at the U.S. corporate rate of 21 percent, but the much lower GILTI rate of 10.5 percent.

The IRS Is Challenging Certain Profit Shifting Structures by Big Pharma, Including Amgen

Pharma giant Amgen is currently in litigation with the Internal Revenue Service (IRS) that may result in the company owing billions in additional taxes. As part of that dispute, the IRS is claiming that Amgen inappropriately shifted $24 billion in

[9] Firms included in this analysis had at least $100 million in assets in 2016, were in the sample each year from 2014 to 2020, were not majority foreign-owned, and had multinational operations. Ratios are reported as the average for years 2019 and 2020.

[10] The methodology for determining offshore income was similar to that used by the Finance Committee. The differences were that the net deemed tangible income return was added into the numerator and denominator, and any net operating loss that reduced total income was added back to the denominator.

[11] The Centers for Medicare and Medicaid Services (CMS) Medicare spending by drug database tracks federal spending for major prescription drugs through Medicare Part B and D.

[12] Merck sales of Keytruda in the U.S. according to 10–K filings with the SEC: $6.3 billion in 2019, $8.4 billion in 2020, $9.8 billion in 2021 and $12.7 billion in 2022.

income to subsidiaries in Puerto Rico, which is treated as foreign for tax purposes. Unlike some other pharma companies, Amgen retains IP rights in the U.S., but still manages to offshore a significant share of its profits. Rather than transfer the IP, Amgen licenses to Puerto Rico-based CFCs the rights to manufacture and sell its products in the U.S. and globally. This distinct structure still allowed Amgen to have 60 percent of its profit show up in CFCs treated as foreign for tax purposes, even as 74 percent of its sales were to U.S. patients. The IRS is seeking $10.7 billion in back taxes and penalties.

Responses provided by Amgen to the Committee suggest that the structure being challenged by the IRS, which enables Amgen to generate a lion's share of its profits in foreign tax jurisdictions, remains in place today. In a letter to the Committee, attorneys for Amgen stated that, "While the litigation currently involves Amgen's 2010–2015 tax years, many of the same core issues remain in the post-TCJA years (2018 and beyond)."

While Amgen is disputing the tax bill with the IRS, the company's profits have simultaneously been heavily subsidized through significant federal spending in the form of Medicare Part B and D reimbursements. According to public data compiled by the Committee, the United States government has spent an astounding $27.3 billion between 2018–2021 through Medicare part B and D to help patients cover the cost of prescription drugs manufactured by Amgen through Medicare part B and D to help patients cover the cost of prescription drugs manufactured by Amgen.[13] These drugs include blockbuster arthritis treatment Enbrel, for which Amgen charges over $8,000 per month—equating to over *$100,000 a year per patient*—showcasing how prescription drug sales to U.S. patients are the company's biggest profit driver.

In 2021, Amgen generated 38 times more Enbrel sales revenue in the United States than the entire rest of the world combined. That year, Amgen sold more than $4 billion worth of Enbrel in the U.S. compared to just $113 million in the rest of the world. Since acquiring the rights to Enbrel in 2002, Amgen has raised its price 27 times and made more than $70 billion from sales of Enbrel. The Committee has confirmed that, while over 95 percent of the sales of Enbrel are in the U.S., 40 percent of the profits are reported in jurisdictions considered foreign for tax purposes, likely allowing the company to avoid hundreds of millions in corporate income taxes. Without reforms to our international tax system, this is likely to grow into billions of dollars in tax avoidance.

[13] The Committee reached the $27.3-billion figure by aggregating data from the public Medicare Part B and D spending databases at the Center for Medicare and Medicaid Services (CMS). For this calculation, the Committee added up all Medicare Part B and D spending from 2018–2021 for the following drugs manufactured and sold by Amgen: Enbrel, Prolia, Otezla, Xgeva, Neulasta, Aranesp, Repatha and Kyprolis.

COMMUNICATION

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Statement of Michael Bindner

Chairman Wyden and Ranking Member Crapo, thank you for the opportunity to address this issue.

Regardless of where drugs are developed or manufactured, their costs do not vary by where they are sold. Indeed, if a drug is manufactured in the United States, it may have a lower price in other markets—although usually manufacture has shifted to Asia. Prices are another matter. They are dictated by what the market will bear, given the regulatory environment of each market. As long as price is less than the cost, the drug will be sold. Sadly, this puts prices out of reach in the developing world.

PhARMA relies, in part, on claims that negotiation will lead to cost shifting. The dirty little secret in this debate is that single-payer solutions in the rest of the OECD have already resulted in price (not cost) shifting, where the rest of the world shifts its cost to the United States to the greatest extent possible (although they might anyway).

Most people with insurance don't notice this. Single-payer health care, either through a public option or Medicare for All, will further bury this. For now, allowing drug price negotiation will give drug companies leverage to renegotiate their deals with the rest of the world. As a side note, how Medicare for All or a Public Option might work is explained in an attachment.

PhARMA also relies on the claims that new cures for pandemics and subsidizing the development of orphan drugs and new therapies requires the right to charge the most the market can bear. This ignores the fact that most basic research comes through government grants and contracts, not drug company profits. The latter fund commercial, not scientific, development.

An important part of decreasing cost to consumers is to expand funding, such as the President's ARPA–H proposal. Part of ARPA–H is the funding for research on orphan drugs and the lingering problem of their cost once research leads to product development. In comments to Senate Finance on March 16th of this year, we repeated our proposal in this area for NIH to retain ownership in any such drug and contract out its further development and manufacture. Keeping ownership in public hands ends the need for drug companies to charge extreme prices or increase prices for its existing formulary to fund development.

PhARMA would still make reasonable profit, but the government would eat the risk and sometimes reap the rewards. NIH/FDA might even break even in the long term, especially if large volume drugs which were developed with government grants must pay back a share of basic research costs and the attached profits, as well as regulatory cost.

International tax policy is broken. The United States leaves potential revenue on the table by not enacting consumption taxes. This hurts American manufacturers, whose sales must include the cost of government in the United States, which may be an unconstitutional export tax if looked at from a product cost perspective. A second attachment gives background to our consumption tax proposals as context for the third, which discusses how these will impact trade.

We propose repealing corporate profits taxes as part of the creation of subtraction value-added taxes and repeal of capital gains taxes in the United States will lead to their repeal worldwide. If Asset Value-Added Taxes are adopted, as described in the fourth attachment, the rate should be negotiated so that investors who are able do not market shop for the lowest rate. The recent OECD compact on minimum rates is an example of how tax cooperation on capital can work for other types of asset taxation.

Thank you again for the opportunity to add our comments to the debate. Please contact us if we can be of any assistance or contribute direct testimony.

Attachment One—Hearing on Pathways to Universal Health Coverage, June 12, 2019

There are three methods to get to single-payer: a public option, Medicare for All and single-payer with an option for cooperative employers.

The first to set up a **public option** and end protections for pre-existing conditions and mandates. The public option would then cover all families who are rejected for either pre-existing conditions or the inability to pay. In essence, this is an expansion of Medicaid to everyone with a pre-existing condition. As such, it would be funded through increased taxation, which will be addressed below. A variation is the expansion of the Uniformed Public Health Service to treat such individuals and their families.

The public option is inherently unstable over the long term. The profit motive will ultimately make the exclusion pool grow until private insurance would no longer be justified, leading again to single payer if the race to cut customers leads to no one left in private insurance who is actually sick. This eventually becomes Medicare for All, but with easier passage and sudden adoption as private health plans are either banned or become bankrupt. Single-payer would then be what occurs when

The second option is Medicare for All, which I described in an attachment to June 18th and 19th's comments and previously in hearings held May 8, 2019 (Finance) and May 8, 2018 (Ways and Means). Medicare for All is essentially Medicaid for All without the smell of welfare and with providers reimbursed at Medicare levels, with the difference funded by tax revenue.

Medicare for All is a really good slogan, at least to mobilize the base. One would think it would attract the support of even the Tea Partiers who held up signs saying, "don't let the government touch my Medicare!" Alas, it has not. This has been a conversation on the left and it has not gotten beyond shouting slogans either. We need to decide what we want and whether it really is Medicare for All. If we want to go to any doctor we wish, pay nothing and have no premiums, then that is not Medicare.

There are essentially two Medicares, a high option and a low one. One option has Part A at no cost (funded by the Hospital Insurance Payroll Tax and part of Obamacare's high unearned income tax as well as the general fund), Medicare Part B, with a 20% copay and a $135 per month premium and Medicare Part D, which has both premiums and copays and is run through private providers. Parts A and B also are contracted out to insurance companies for case management. Much of this is now managed care, as is Medicare Advantage (Part C).

Medicaid lingers in the background and the foreground. It covers the disabled in their first two years (and probably while they are seeking disability and unable to work). It covers non-workers and the working poor (who are too poor for Obamacare) and it covers seniors and the disabled who are confined to a long-term care facility and who have run out their assets. It also has the long-term portion which should be federalized, but for the poor, it takes the form of an HMO, but with no premiums and zero copays.

Obamacare has premiums with income-based supports (one of those facts the Republicans hate) and copays. It may have a high option, like the Federal Employee Health Benefits Program (which also covers Congress) on which it is modeled, a standard option that puts you into an HMO. The HMO drug copays for Obamacare are higher than for Medicare Part C, but the office visit prices are exactly the same.

What does it mean, then, to want Medicare for All? If it means we want everyone who can afford it to get Medicare Advantage Coverage, we already have that. It is Obamacare. The reality is that Senator Sanders wants to reduce Medicare copays and premiums to Medicaid levels and then slowly reduce eligibility levels until everyone is covered. Of course, this will still likely give us HMO coverage for everyone except the very rich, unless he adds a high-option PPO or reimbursable plan.

Either Medicare for All or a real single-payer would require a very large payroll tax (and would eliminate the HI tax) or an employer paid subtraction value-added tax (so it would not appear on receipts nor would it be zero rated at the border, since there would be no evading it), which we discuss below, because the Health Care Reform debate is ultimately a tax reform debate. Too much money is at stake for it to be otherwise, although we may do just as well to call Obamacare Medicare for All and leave it alone.

The third option is an **exclusion for employers,** especially employee-owned and cooperative firms, who provide medical care directly to their employees without third party insurance, with the employer making HMO-like arrangements with local hospitals and medical practices for inpatient and specialist care.

Employer-based taxes, such as a subtraction VAT or payroll tax, will provide an incentive to avoid these taxes by providing such care. Employers who fund catastrophic care or operate nursing care facilities would get an even higher benefit, with the proviso that any care so provided be superior to the care available through Medicaid or Medicare for All. Making employers responsible for most costs and for all cost savings allows them to use some market power to get lower rates.

This proposal is probably the most promising way to arrest health-care costs from their current upward spiral—as employers who would be financially responsible for this care through taxes would have a real incentive to limit spending in a way that individual taxpayers simply do not have the means or incentive to exercise. The employee ownership must ultimately expand to most of the economy as an alternative to capitalism, which is also unstable as income concentration becomes obvious to all.

Attachment Two—Tax Reform, Center for Fiscal Equity, March 24, 2023

Consumption Taxes

Subtraction Value-Added Tax (S–VAT). Corporate income taxes and collection of business and farm income taxes will be replaced by this tax, which is an employer paid Net Business Receipts Tax. S–VAT is a vehicle for tax benefits, including

- Health insurance or direct care, including veterans' health care for non-battlefield injuries and long-term care.
- Employer paid educational costs in lieu of taxes are provided as either employee-directed contributions to the public or private unionized school of their choice or direct tuition payments for employee children or for workers (including ESL and remedial skills). Wages will be paid to students to meet opportunity costs.
- Most importantly, a refundable child tax credit at median income levels (with inflation adjustments) distributed with pay.

Subsistence-level benefits force the poor into servile labor. Wages and benefits must be high enough to provide justice and human dignity. This allows the ending of state administered subsidy programs and discourages abortions, and as such enactment must be scored as a must pass in voting rankings by pro-life organizations (and feminist organizations as well). To assure child subsidies are distributed, S–VAT will not be border adjustable.

Invoice Value-Added Tax (I–VAT). Border-adjustable taxes will appear on purchase invoices. The rate varies according to what is being financed. If Medicare for All does not contain offsets for employers who fund their own medical personnel or for personal retirement accounts, both of which would otherwise be funded by an S–VAT, then they would be funded by the I–VAT to take advantage of border adjustability.

I–VAT forces everyone, from the working poor to the beneficiaries of inherited wealth, to pay taxes and share in the cost of government. As part of enactment, gross wages will be reduced to take into account the shift to S–VAT and I–VAT, however net income will be increased by the same percentage as the I–VAT. Inherited assets will be taxed under A–VAT when sold. Any inherited cash, or funds borrowed against the value of shares, will face the I–VAT when sold or the A–VAT if invested.

I–VAT will fund domestic discretionary spending, equal dollar employer OASI contributions, and non-nuclear, non-deployed military spending, possibly on a regional basis. Regional I–VAT would both require a constitutional amendment to change the requirement that all excises be national and to discourage unnecessary spending, especially when allocated for electoral reasons rather than program needs. The latter could also be funded by the asset VAT (decreasing the rate by from 19.25% to 13%).

Carbon Added Tax (C–AT). A Carbon tax with receipt visibility, which allows comparison shopping based on carbon content, even if it means a more expensive item with lower carbon is purchased. C–AT would also replace fuel taxes. It will fund transportation costs, including mass transit, and research into alternative fuels. This tax would not be border adjustable unless it is in other nations, however in this case the imposition of this tax at the border will be noted, with the U.S. tax applied to the overseas base.

Attachment Three—Trade Policy

Consumption taxes could have a big impact on workers, industry and consumers. Enacting an I–VAT is far superior to a tariff. The more government costs are loaded onto an I–VAT the better.

If the employer portion of Old-Age and Survivors Insurance, as well as all of disability and hospital insurance are decoupled from income and credited equally and personal retirement accounts are not used, there is no reason not to load them onto an I–VAT. This tax is zero rated at export and fully burdens imports.

Seen another way, to not put as much taxation into VAT as possible is to enact an unconstitutional export tax. Adopting an I–VAT is superior to its weak sister, the Destination Based Cash Flow Tax that was contemplated for inclusion in the TCJA. It would have run afoul of WTO rules on taxing corporate income. I–VAT, which taxes both labor and profit, does not.

The second tax applicable to trade is a Subtraction VAT or S–VAT. This tax is designed to benefit the families of workers through direct subsidies, such as an enlarged child tax credit, or indirect subsidies used by employers to provide health insurance or tuition reimbursement, even including direct medical care and elementary school tuition. As such, S–VAT cannot be border adjustable. Doing so would take away needed family benefits. As such, it is really part of compensation. While we could run all compensation through the public sector.

The S–VAT could have a huge impact on long term trade policy, probably much more than trade treaties, if one of the deductions from the tax is purchase of employer voting stock (in equal dollar amounts for each worker). Over a fairly short period of time, much of American industry, if not employee-owned outright (and there are other policies to accelerate this, like ESOP conversion) will give workers enough of a share to greatly impact wages, management hiring and compensation and dealing with overseas subsidiaries and the supply chain—as well as impacting certain legal provisions that limit the fiduciary impact of management decision to improving short-term profitability (at least that is the excuse managers give for not privileging job retention).

Employee owners will find it in their own interest to give their overseas subsidiaries and their supply chain's employees the same deal that they get as far as employee ownership plus an equivalent standard of living. The same pay is not necessary, currency markets will adjust once worker standards of living rise. Attachment Four further discusses employee ownership.

Over time, ownership will change the economies of the nations we trade with, as working in employee-owned companies will become the market preference and force other firms to adopt similar policies (in much the same way that, even without a tax benefit for purchasing stock, employee-owned companies that become more democratic or even more socialistic, will force all other employers to adopt similar measures to compete for the best workers and professionals).

In the long run, trade will no longer be an issue. Internal company dynamics will replace the need for trade agreements as capitalists lose the ability to pit the interest of one nation's workers against the others. This approach is also the most effective way to deal with the advance of robotics. If the workers own the robots, wages are swapped for profits with the profits going where they will enhance consumption without such devices as a guaranteed income.

Attachment Four—Asset VAT, The President's Fiscal Year 2023 Budget, June 7, 2022

There are two debates in tax policy: how we tax salaries and how we tax assets (returns, gains and inheritances). Shoving too much into the Personal Income Tax mainly benefits the wealthy because it subsidizes losses by allowing investors to not pay tax on higher salaries with malice aforethought.

Asset Value-Added Tax (A–VAT) is a replacement for capital gains taxes and the estate tax. It will apply to asset sales, exercised options, inherited and gifted assets and the profits from short sales. Tax payments for option exercises, IPOs, inherited, gifted and donated assets will be marked to market, with prior tax payments for that asset eliminated so that the seller gets no benefit from them. In this perspective, it is the owner's increase in value that is taxed.

As with any sale of liquid or real assets, sales to a qualified broad-based Employee Stock Ownership Plan will be tax-free. This change would be counted as a tax cut, giving investors in public stock who make such sales the same tax benefit as those who sell private stock.

The repeal of corporate profits taxes as part of the creation of subtraction value-added taxes and repeal of capital gains taxes in the United States will lead to their repeal worldwide. If Asset Value-Added Taxes are adopted, the rate should be negotiated so that investors who are able do not market shop for the lowest rate. The recent OECD compact on minimum rates is an example of how tax cooperation on capital can work for other types of asset taxation.

This tax will end Tax Gap issues owed by high income individuals. The base 20% capital gains tax has been in place for decades. The current 23.8% rate includes the ACA–SM surtax), while the Biden proposal accepted by Senator Sinema is 28.8%. Our proposed Subtraction VAT would eliminate the 3.8% surtax. This would leave a 25% rate in place.

Settling on a bipartisan 22.5% rate (give or take 0.5%) should be bipartisan and carried over from the capital gains tax to the asset VAT.A single rate also stops gaming forms of ownership. Lower rates are not as regressive as they seem. Only the wealthy have capital gains in any significant amount. The de facto rate for everyone else is zero.

With tax subsidies for families shifted to an employer-based subtraction VAT, and creation of an asset VAT, taxes on salaries could be filed by employers without most employees having to file an individual return. It is time to TAX TRANSACTIONS, NOT PEOPLE!

The tax rate on capital gains is seen as unfair because it is lower than the rate for labor. This is technically true, however it is only the richest taxpayers who face a marginal rate problem. For most households, the marginal rate for wages is less than that for capital gains. Higher-income workers are, as the saying goes, crying all the way to the bank.

In late 2017, tax rates for corporations and pass-through income were reduced, generally, to capital gains and capital income levels. This is only fair and may or may not be just. The field of battle has narrowed between the parties. The current marginal and capital rates are seeking a center point. It is almost as if the recent tax law was based on negotiations, even as arguments flared publicly. Of course, that would never happen in Washington. Never, ever.

Compromise on rates makes compromise on form possible. If the Affordable Care Act non-wage tax provisions are repealed, a rate of 26% is a good stopping point for pass-through, corporate, capital gains and capital income.

A single rate also makes conversion from self-reporting to automatic collection through an asset value added tax levied at point of sale or distribution possible. This would be both just and fair, although absolute fairness is absolute unfairness to tax lawyers because there would be little room to argue about what is due and when.

Ending the machinery of self-reporting also puts an end to the Quixotic campaign to enact a wealth tax. To replace revenue loss due to the ending of the personal income tax (for all but the wealthiest workers and celebrities), enact a Goods and Services Tax. A GST is inescapable. Those escapees who are of most concern are not waiters or those who receive refundable tax subsidies. It is those who use tax loopholes and borrowing against their paper wealth to avoid paying taxes.

For example, if an unnamed billionaire or billionaires borrow against their wealth to go into space, creating such assets would be taxable under a GST or an asset VAT. When the Masters of the Universe on Wall Street borrow against their assets to avoid taxation, having to pay a consumption tax on their spending ends the tax advantage of gaming the system.

This also applies to inheritors. No "Death Tax" is necessary beyond marking the sale of inherited assets to market value (with sales to qualified ESOPs tax free). Those who inherit large cash fortunes will pay the GST when they spend the money or Asset VAT when they invest it. No special estate tax is required and no life insurance policy or retirement account inheritance rules will be of any use in tax avoidance.

Tax avoidance is a myth sold by insurance and investment brokers. In reality, explicit and implicit value-added taxes are already in force. Individuals and firms that collect retail sales taxes receive a rebate for taxes paid in their federal income taxes. This is an intergovernmental VAT. Tax withheld by employers for the income and payroll taxes of their labor force is an implicit VAT. A goods and services tax simply makes these taxes visible.

Should the tax reform proposed here pass, there is no need for an IRS to exist, save to do data-matching integrity. States and the Customs Service would collect credit invoice taxes, states would collect subtraction VAT, the SEC would collect the asset VAT and the Bureau of the Public Debt would collect income taxes or sell tax-prepayment bonds.

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