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Chairman Wyden, Ranking Member Hatch, and distinguished members of the Committee, I appreciate the opportunity to appear today to discuss some key international tax issues, including the G-20's Base Erosion and Profit Shifting (BEPS) project. We appreciate the Committee's interest in these issues and the great amount of attention and effort the Committee has devoted toward reforming the international tax system in a way that would improve its sustainability and improve the U.S. system of taxation

I would like to begin by describing the work we are doing in the BEPS project and then link that discussion to a consideration of the need for general corporate and international tax reform, as well as measures to address U.S. base stripping and inversion transactions that are outlined in the Administration's FY2015 budget proposals.

In June 2012, at the G-20 Summit in Los Cabos, Mexico, the leaders of the world's largest economies identified the ability of multinational companies to reduce their tax bills in high-tax countries by shifting income into low- and no-tax jurisdictions as a significant concern. They instructed their governments to develop an action plan to address these issues, which was developed over the course of 2012-2013 and endorsed by G-20 leaders last September at the G-20 Summit in St. Petersburg. The Organization for Economic Cooperation and Development (OECD) has hosted this process, but G-20 governments, some of whom are not members of the OECD, are driving the process.

The BEPS Action Plan adopted last year outlines 15 specific areas where governments need to work to change the rules of the road that encourage companies to shift their income at the expense of the global tax base. The action items are generally aimed at developing recommendations to help countries combat BEPS. Ultimately, these recommendations will require changes to countries' domestic laws and changes to the OECD model income tax convention, and there is even discussion of a multilateral treaty to address BEPS. The BEPS project is expected to release its first set of recommendations on policies related to transfer pricing documentation and country-by-country reporting, transfer pricing with respect to intangibles, treaty abuse, hybrid mismatch arrangements, harmful tax practices, and the digital economy this fall. The BEPS project is set to conclude at the end of 2015 with final recommendations under all of the action items.

To provide some context for the BEPS project, I would like to discuss a number of factors that gave rise to the need for the BEPS project. First, the interaction of various countries' rules for taxing cross-border income creates incentives for companies to let tax decisions drive corporate policy in order to pay very low rates of tax or even to entirely avoid paying tax anywhere on large portions of their income. Public frustration arises when companies that do business in one country pay low or no tax there or anywhere else. While it is national governments that write the tax laws, and companies should not be expected to pay more tax than they owe, much of the global interest nonetheless centers around the activities of U.S.-based multinational companies because, as global household names, their activities have received the most publicity perhaps and also because various government inquiries here and abroad have focused on them. This frustration on the part of the public and also national governments, in turn, is not surprisingly reflected in the political arena such that, as noted above, the G-20 leaders came together in an effort to rein in this activity through the G-20/OECD BEPS Project.

The United States has a great deal at stake in the BEPS project and a strong interest in its success. Our active participation is crucial to protecting our own tax base from stripping by multinational companies, much of which occurs as a result of exploiting differences in national regimes. A key goal of BEPS is to seek to identify those differences and write rules that plug the holes. Because the United States provides a foreign tax credit to companies for taxes they pay overseas, the United States also has a direct financial stake in rules that enjoy broad international consensus. In addition, as the home of some of the world's most successful and vibrant multinationals, we have a stake in ensuring that companies and countries play by tax rules that are clear and administrable and that companies can avoid unrelieved double taxation, as well as time-consuming, expensive tax disputes. Both the United States and our companies also have a strong interest in access to robust dispute resolution mechanisms around the world. In contrast, failure in the BEPS project could well result in countries taking unilateral, inconsistent actions thereby increasing double taxation, the cost to the U.S. Treasury, and the number of tax disputes.

The principal target of the BEPS project is so-called "stateless income," basically very low- or non-taxed income within a multinational group. Low and non-taxed income located in various jurisdictions around the world is an inviting fiscal target for other countries. The existence of large amounts of stateless income in a time of global austerity has put pressure on the longstanding, widely accepted international tax rules. This pressure is increased in a global economic environment in which superior returns can accrue to intangibles that can be easily located anywhere in the world and that are often the result, for example, of intensive research and development activities that a single multinational may conduct in many countries, or marketing intangibles can be exploited in one country but owned and financed from another, often low-tax, country. Some countries with large markets believe that some of these premium profits enjoyed by multinationals should be taxed in those market countries, whereas current international norms attribute those profits to the places where the functions, assets, and risks of the multinational firm are located – which are often not in the market countries.

The G-20/OECD BEPS project is made even more challenging by the reality that some of the gaps in the international tax rules are created by countries intentionally seeking to attract mobile income through various special tax regimes. Left unchecked, these regimes could result in an unproductive race-to-the-bottom in tax competition. When otherwise legitimate practices, such as the desire to subsidize research and development, drop any pretense linking the tax break to activity in the country itself, these regimes become no more than open invitation to strip more highly taxed income from countries like the United States.

I am happy to report that the OECD BEPS project has had a promising beginning and there are areas where commendable work is being done to resolve gaps in existing international rules and where broad consensus should be possible. These areas include minimizing potential for hybrid mismatches (situations in which a multinational issues an instrument that gives rise to a tax deduction in one country without a corresponding inclusion in another); helping countries minimize abuse of their bilateral income tax treaties, including through so-called "treaty shopping"; requiring country-by-country reporting of profits and taxes by multinationals so that they can be made available to tax administrators for purposes of risk assessment; designing interest limitation rules that can be applied across borders; updating the transfer pricing rules on the application of the "arm's length" standard to intangibles and endorsing "special measures" when those rules produce stateless income; and updating the rules on permanent establishment to minimize the artificial avoidance of those rules.

As the work moves into 2015, there is more that can be achieved, and also several areas where we must guard against bad outcomes. One of the key 2015 action items will focus on making dispute resolution more efficient, which we hope will include a significant broadening of the use of mandatory arbitration to resolve tax disputes between the tax authorities of the two countries. When countries know that tax disputes will be settled by a neutral arbitrator, it improves the dispute resolution process from beginning to end. In 2015, we will also work closely with other countries to limit the base stripping that results from excessive interest deductions, a topic of strong interest to the United States and that, as discussed below, is also the subject of one of the President's FY2015 budget proposals.

We must also work hard in several areas to preserve our national interest in rules based on principles and not merely individual country revenue interests. Let me highlight just a few. In the area of transfer pricing, we must ensure that the currently-used arm's length standard is clearly articulated and that profits are attributable to the place of economic activity – that is, where the assets, functions, and risks of the multinational are located. We must further ensure that any "special measures" agreed at the OECD are firmly anchored in these principles, and that legal and contractual relationships are ignored in determining intercompany prices only in unusual circumstances. The arm's length standard has been a bedrock of international taxation for over 50 years, and while it is not perfect, it is the best tool available to deal with the difficult issue of pricing among affiliates of a multinational group. We must steadfastly avoid turning longstanding transfer pricing principles into a series of vague concepts easily manipulated by countries to serve their revenue needs at the expense of the U.S. tax base and our multinationals.

With respect to country-by-country reporting by multinationals of income and tax information, we must strongly support measures that ensure that the information is used by countries' tax administrators solely as a risk assessment tool. Country-by-country data is useful to tax administrators because it will permit them to identify companies that have shifted income into low- or no-tax jurisdictions. In those cases, countries may appropriately feel that such a company deserves a closer look on audit to determine whether income has been shifted out of their jurisdiction through non-arm's length pricing. Given the potentially sensitive nature of this information, we must ensure that information of U.S.-based multinationals is made available only through our treaty and information exchange networks so as to ensure its confidentiality and appropriate use by our treaty or information exchange partners. Finally, this work should contain a remedy in the event countries misuse the information to make tax adjustments that do not conform to agreed international standards.

In the area of digital businesses, we must guard against the desire of some countries to use new business models as a pretext for taxing income beyond that which arises from the functions, assets, and risks located in those countries. We continue to believe that long standing, widely accepted rules that require a physical presence in another country before that country receives the right to impose an income tax is the most administrable and appropriate rule even in a digital age, and we are very encouraged by the work at the OECD to further adapt the rules concerning value added taxes to the digital age – so that countries with a VAT can have a revenue source from the digital economy without resorting to new, exceedingly complex and difficult to administer income tax solutions. Finally, as a matter of U.S. tax treaty policy, the United States took the international lead in limiting treaty abuse by adopting "limitation of benefits" provisions in our treaties. We believe that they have worked fairly and effectively to limit treaty shopping. In the G-20/OECD BEPS project we will continue to propose the limitation on benefits provision as a solution to protect against treaty shopping and will oppose proposals to include a main purpose test (or principal purpose test) in our own treaties as this test is too vague and subjective and creates unacceptable uncertainty about how such rules will be administered. In short, the remainder of 2014 and 2015 will be a very challenging time in the G-20/OECD BEPS Project. The United States needs to remain deeply engaged in moving the project to a successful conclusion.

While the international negotiations over BEPS progress, it is worth acknowledging steps the United States could take today to reform our own tax system to improve competitiveness, secure our tax base, and reduce incentives for profit shifting by U.S. firms.

As the President has proposed, we should reform our business tax system by reducing the rate and broadening the base. It is frequently noted that the United States has a high statutory corporate rate, but much lower effective tax rates. High statutory rates encourage multinationals to find ways to shift profits, especially on intangible income, to other jurisdictions. So lowering our statutory rate while broadening the base could be a start toward reducing stripping of the U.S. base.

But it would only be a start, because even with lower rates U.S. multinationals would continue to aggressively seek ways to lower their tax bills by shifting income out of the United States. So what other tools do we have at our disposal? We can examine the ways multinationals lower their U.S. effective rates and take sensible protective measures.

First, in the international arena specifically, the President's framework for business tax reform proposes a minimum tax on foreign earnings. Other recent tax reform plans have included similar proposals, which would improve on the current complex and porous international tax rules by requiring that companies pay tax on all foreign earnings, but at a somewhat reduced rate.

Whether as part of tax reform or in the context of our current tax system, we should also take a close look at interest deductibility, noting that in this area our thin capitalization rules are inadequate and that our system actually gives an overall advantage to foreign-owned multinationals in this regard. Foreign-owned multinationals typically lend funds into the United States to benefit from interest deductions against income that would otherwise be subject to a 35 percent tax rate, while the related interest income is subject to significantly lower tax rates in the lending jurisdiction. It is especially disconcerting to observe that among the foreign multinationals that can most aggressively take advantage of the deficiencies in our thin capitalization rules are so-called "inverted" companies – that is, foreign-parented companies that were previously U.S.-parented. The Administration's FY 2015 budget contains a proposal that would strengthen our interest-stripping rules and level the playing field by limiting the ability of U.S. subsidiaries of a foreign multinational to deduct a disproportionate amount of the group's global interest expense in the United States. Specifically, this proposal would limit the U.S. group's share of global interest expense deductions by reference to the U.S. group's proportionate share of the multinational's worldwide consolidated earnings, as computed under Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS).

Another Administration FY 2015 budget proposal would limit the deduction of interest expense of U.S. multinationals related to deferred foreign subsidiary income. Our own multinationals typically do all of their borrowing in the United States to benefit from interest deductions against income that would otherwise be subject to a 35 percent tax rate, but they then use borrowed cash throughout the multinational group, financing operations generating income that may not be subject to current U.S. tax. Indeed, we have recently seen examples of U.S. multinationals borrowing in the United States – rather than bringing back cash from offshore – to pay dividends to their shareholders. By aligning the timing of interest expense deductions with the timing of the recognition of the income supported by the proceeds of borrowing, the Administration's proposal would address the mismatch under current law that allows companies to take current deductions for interest related to income that is not subject to current U.S. tax.

In addressing stripping of the U.S. base, it is also important to consider so-called "hybrid arrangements," which may allow taxpayers to claim U.S. deductions with respect to payments that do not result in a corresponding income item in the foreign jurisdiction. These arrangements serve little function other than to produce stateless income and could easily be reined in. To neutralize these arrangements, the Administration's FY 2015 budget proposal would deny deductions for interest and royalty payments made to related parties under certain circumstances involving hybrid arrangements. For example, the proposal would deny a U.S. deduction where a taxpayer makes an interest or royalty payment to a related person and there is no corresponding inclusion in the payee's jurisdiction, or where the taxpayer is able to claim a deduction with respect to the same payment in another jurisdiction.

Additionally, it has been well documented that shifting intangibles outside the United States is a key avenue through which U.S. base erosion occurs. The principal means of shifting intangible income is to undervalue intangible property transferred offshore or to take advantage of perceived loopholes in our definition of intangibles. Once this intellectual property is offshore, the income that it produces can accrue in low- or no-tax jurisdictions, outside the scope of U.S. taxation. The Administration's FY 2015 Budget contains a number of proposals that would discourage the corporate tax base erosion that occurs via intangibles transfers. One of those proposals would clarify the definition of intangible property to address taxpayer arguments that certain value does not fall within the current definition and therefore may be transferred offshore without any U.S. tax charge. Another proposal would modify our subpart F rules to tax currently certain excess returns of a controlled foreign corporation from intangibles transferred to it by a U.S. person, while yet another proposal would update subpart F to currently tax certain highly mobile income from digital goods and services where the controlled foreign corporation earning the income did not itself make a substantial contribution to the development of the relevant intangible property.

Finally, and as underscored by Secretary Lew's July 15th letter to Congress, I want to emphasize the serious need for the United States to once again directly address the potential loss of federal tax revenues from corporate inversion transactions. Letting our corporate tax base erode through inversions will worsen our fiscal challenges over the coming years. Once companies invert, there is a permanent loss to the U.S. income tax base since it is safe to assume these companies are not coming back to the United States.

An anti-inversion provision has been part of the Internal Revenue Code since 2004, but experience has shown that this provision insufficiently deters inversion given the large tax rate and other tax disparities between United States and the countries to which formerly U.S.-based multinationals have relocated. According to a recent Congressional Research Service report, forty-seven U.S. corporations have reincorporated overseas through corporate inversions in the last 10 years. This is an increase from only 29 inversions in the prior 20 years. And proposed inversions are being reported in the media on a much more frequent basis.

To reinforce the existing anti-inversion statute, the Administration, in the FY 2015 Budget, has proposed to broaden the scope of inversion transactions subject to the statute. As amended, where shareholder continuity in the inverted company after a transaction is more than 50 percent, or where the inverted company meets certain criteria demonstrating that it retains a close connection to the United States and does not have a close connection to the country to which it relocates, the statute would provide that the inverted company would continue to be treated as a domestic corporation for U.S. federal income tax purposes. Regardless of any other base stripping or tax reform legislation adopted, such strengthened anti-inversion legislation is necessary to prevent a permanent reduction in federal corporate income tax revenues. As the Secretary indicated in his June 15 letter, Congress should pass legislation immediately with an effective date of May 2014 to prevent companies from effectively renouncing their citizenship to get out of paying taxes.

In closing, I would like to acknowledge the tireless work and dedication of the office of the International Tax Counsel at the Treasury Department, which has been a leader in providing technical guidance on these issues in the G-20 and at the OECD.

Thank you for the opportunity to speak to you today. I look forward to answering your questions.