

**STATEMENT OF PAMELA F. OLSON
TO THE US SENATE FINANCE COMMITTEE
“HOW US INTERNATIONAL TAX POLICY
IMPACTS AMERICAN WORKERS, JOBS, AND INVESTMENT”**

March 25, 2021

Chairman Wyden, Ranking Member Crapo, and distinguished members of the Committee, I appreciate the opportunity to appear this morning as the Committee considers the impact of US international tax policy. I had the honor of serving as Treasury’s Assistant Secretary for Tax Policy from 2002 to 2004, led PwC’s Washington National Tax Services practice from 2012 until last year, and am currently a consultant to PwC. I am appearing on my own behalf and not on behalf of PwC or any client. The views I express are my own.

Introduction

The title of this hearing cuts straight to the bottom line regarding what really matters: the impact of tax policy on American workers, jobs, and investment. While international tax policy is replete with esoteric details, it must be judged by whether it delivers what Americans of all political stripes want: jobs and investment that lead to rising wages, economic security for American workers and their families, and more broadly-shared prosperity. As Yogi Berra once observed, “If you don’t know where you’re going, you might not get there.” The Committee’s focus on the bottom line results it wants should give it strategic direction.

To evaluate our international tax policy, my testimony will examine the past, present, and future: what our international tax rules were prior to 2018, how the rules changed in 2018, and how Congress might change the rules, with a particular focus on the potential effect of the OECD’s digitalization project and what other countries may do independently or in response. The latter is important because the actions of other governments affect the attractiveness of the United States as a location for jobs and investment.

As the Finance Committee charts a path for the future, it will be important to assess where we’ve been, where we are, and to make an informed judgment of where we want to go for the sake of American workers, jobs, and investment.

International tax policy before the Tax Cuts and Jobs Act (TCJA)

The unintended consequence of US international tax policy prior to the TCJA was to disadvantage US workers and US investment. Under prior law, the United States had what has been described as a nominally worldwide system and a factually territorial system. The US worldwide system subjected a US company’s profit to tax wherever earned around the globe, currently if the profit fell into categories deemed to be mobile or passive under subpart F, and upon repatriation for the remainder of its active business income. The US system was also described as a hybrid system, and to be sure, it contained the most and least attractive features of both.

What the prior system sought to achieve was a level playing field for US companies competing with foreign companies in countries with lower tax rates than the United States. The leveling of the playing field was temporary, lasting only until the profits were repatriated, but the benefit allowed US

headquartered companies to compete in foreign markets with companies subject to lower tax rates. That matters because being globally competitive increases the value of US-created assets and intellectual property that are deployed to serve markets around the globe, increasing investment in these assets and creating more and better paying jobs for American workers. It is understood by business executives and shown by academic research that US companies' foreign investments benefit American workers because they create more jobs in the United States -- a point also made by Prof. Hanlon in her testimony to the Committee last week.

The unfortunate result of the prior system is that it disincentivized the reinvestment of foreign profits in the United States to the detriment of American workers. US investments needed not only to pass an investment hurdle rate, but they also had to generate a return sufficient to cover the added tax owed on repatriation of the profit. The growing differential between the US corporate rate and that of other OECD countries made it increasingly costly to repatriate earnings to the United States, an effect evidenced by the growing amounts of foreign "permanently reinvested earnings" reported on US-headquartered companies' pre-2018 financial statements.

The "permanently reinvested earnings" were often referred to as "untaxed profits" though the reality was that most earnings had been taxed by the foreign country where the earnings originated (in some cases, the same earnings were taxed by more than one country), and the only sense in which the sums were untaxed was by the United States. By deferring the taxation of the earnings until they were repatriated, the United States eased the uncompetitive nature of its relatively high corporate rate but discouraged the reinvestment of foreign earnings in the United States. From the perspective of the American worker, the pre-TCJA playing field was not level.

The US corporate tax rate, highest among OECD countries, coupled with a worldwide system affected values in merger and acquisition transactions. Assets could fetch a higher price from foreign buyers who would not be subject to US taxes on their foreign operations and could minimize their tax burdens.¹ A benefit of a merger and acquisition transaction with a foreign headquartered company was the possibility of redomiciling the US company's headquarters outside of the United States. In effect, higher tax costs put a discount on the value of business assets in the hands of American owned companies.

The loss of a corporate headquarters can have broad consequences for both the local community and the governments where the headquarters were located. The migration of headquarters jobs overseas can lead to diminished federal, state, and local revenue and to potential follow-on job and investment losses for the shops, restaurants, businesses, and charities that depended on or benefited from the activities and employment of the corporate headquarters. The loss of corporate headquarters jobs can also reduce local civic involvement adversely affecting charitable, cultural, and educational institutions.

The OECD observed the United States' tax system pre-2017 was out of sync with the rest of the world, which had reduced corporate tax rates, adopted territorial tax systems, and enacted laws to safeguard their domestic tax bases. Other governments also relied increasingly on consumption taxes like the value-added tax (VAT) as a mechanism to meet their revenue needs. The premise underlying the OECD's Base Erosion and Profit Shifting (BEPS) project, commenced in 2013, was the instability of the international tax regime. The distortion of investment decisions caused by United States' policy pre-TCJA contributed to

¹ Andrew Lyon, "Insights on Trends in U.S. Cross-Border M&A Transactions after the Tax Cuts and Jobs Act," Tax Notes International, October 26, 2020, pp. 497-507.

the instability. The increasing amounts of “permanently reinvested earnings,” attributable to the United States’ high rate and worldwide system, became an attractive target for other governments as a perceived unclaimed pot of earnings.² The United States failed to stake its claim or counter the stateless income assertion until the “untaxed,” “nowhere,” and “stateless” income labels had stuck. The labels skewed the global political debate because they created the appearance that the earnings belonged nowhere and consequently were up for grabs. Although the perception should have been changed by the TCJA’s enactment, with its tax on accumulated unrepatriated foreign earnings and its new global minimum tax on foreign income referred to as GILTI, that has not been the case. While that was a failing more of messaging than of substance, it was not without consequence. To wit, foreign government complaints of unfair competition based on companies not being taxed shifted quickly to complaints, not about *whether* the companies were being taxed, but to *where* the companies were being taxed. Foreign governments, it turned out, cared not so much about perceptions of unfair competition as they cared about asserting jurisdiction to tax a share of US companies’ global profits.

Policy coalescence around the need for and shape of change

US international tax policy before 2017 was an inherently unsustainable system, a fact that was broadly recognized on a bipartisan basis before 2017. Chairman Wyden, you were a leader in this area with your bipartisan comprehensive tax reform bill in 2010 lowering the corporate rate to 24 percent and significantly broadening the base. Other Democrats, including President Obama and then-Vice President Biden, and Republicans, beginning with then House Ways & Means Committee Chairman Dave Camp, put forward proposals to lower the corporate rate, broaden the corporate base, and transition to an international system that ended the disincentive to repatriate foreign earnings. Then Finance Committee Chairman Max Baucus likewise put forward proposals to reform the international tax rules. This Committee’s working group on international tax reform, chaired by Senators Portman and (now Majority Leader) Schumer, called for a dividend exemption system with “robust and appropriate base erosion rules” that would end the disincentive to repatriate foreign earnings. The international tax reform working group also examined the need to make the United States a more hospitable environment for headquartering companies and to reduce the corporate rate. In 2014, Senator Cardin introduced legislation that coupled a 10 percent VAT with a reduction in the corporate tax rate to 17 percent.

To be sure, there were differences among the many proposals put forward, but the differences were of degree, not direction.

The OECD’s BEPS project, which was explicitly about closing loopholes and gaps in the tax systems between countries and not about reallocating jurisdiction to tax global profits, included a number of “best practices” to prevent base erosion and profit shifting. Some of the OECD’s recommendations reflected concepts originated in and advocated for by the United States. Whether the BEPS recommendations motivated TCJA provisions, many of the recommendations were enacted in TCJA.

International tax policy after the TCJA

² Companies headquartered in countries with territorial tax systems received a comparable but permanent benefit, meaning that unlike US companies, there was no similar residual tax claim to report on their financial statements.

As an observer of the legislative process, the TCJA's corporate reforms reflect a remarkable triumph of bipartisan policy development, despite the ultimate absence of Democratic votes for the final legislation. It lowered the corporate rate, taxed offshore earnings, ended the disincentive to reinvest foreign earnings in the United States, and adopted a number of provisions intended to protect the US fisc from base erosion and profit shifting, many of which were also among the OECD's BEPS recommendations. These include anti-hybrid rules, tightened transfer pricing rules, and interest deduction limitations. TCJA included not just one minimum tax but two aimed at cross-border transactions and foreign earnings (i.e., GILTI and BEAT), thus far surpassing the OECD's recommendations. In addition to the overall corporate rate reduction -- possibly the greatest base protection measure any country can enact -- TCJA also included an incentive for the use of intangibles in the United States that aimed to level the playing field for American jobs and investments and correct the imbalances of the prior system.

The TCJA and its base broadening provisions, in particular, have generated criticism as too generous and too onerous. The mutual dissatisfaction may suggest an appropriate balance was struck. Tax return data for the period since the TCJA was enacted is not yet available but initial data on the activities of US multinational companies collected by the Bureau of Economic Analysis are quite favorable. According to the BEA, US multinational companies grew faster in 2018 in their US employment, US value added, and US investment in plant, equipment, and research and development than in their corresponding foreign activities. In fact, growth at home by these US companies in terms of their employment, value added, and investment was above their average growth rate of the past 20 years.³ In addition, the BEA has reported that US companies have repatriated \$1.5 trillion in foreign earnings to the United States since the enactment of TCJA through the third quarter of 2020 -- this is more than three times greater than the amount repatriated over a similar time period prior to the enactment of TCJA.

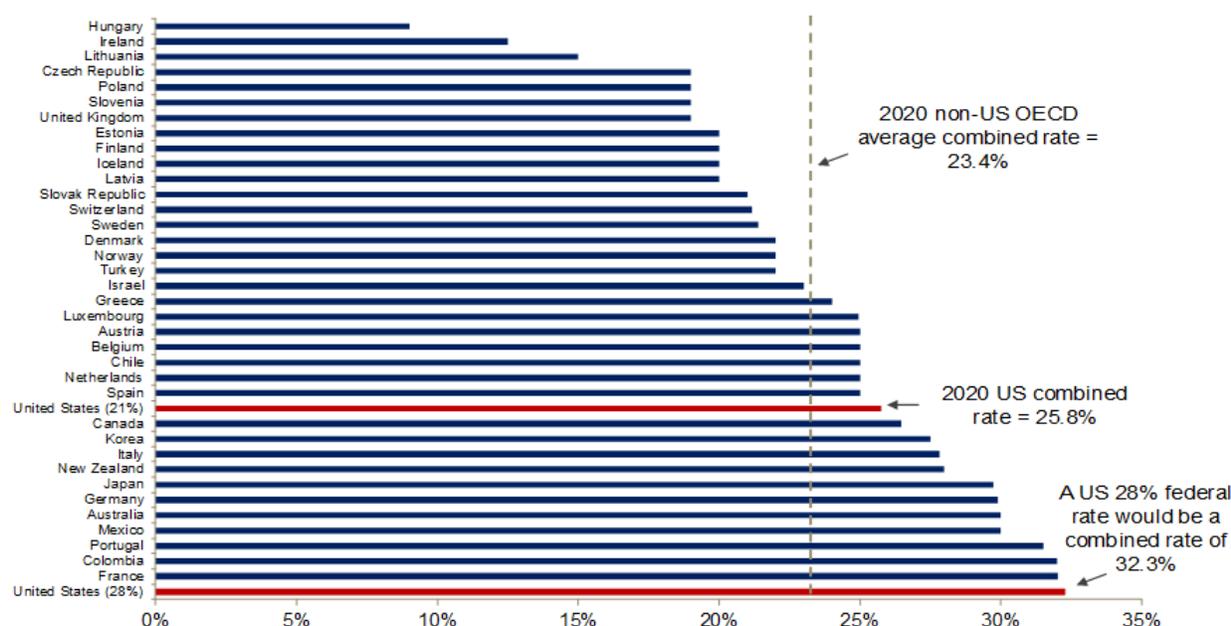
What follows are further observations regarding the TCJA's provisions that are most significant and that have garnered the most attention, positive or negative.

Corporate rate. Reducing the corporate tax rate was the single most significant change Congress could have made to address base erosion and increase the attractiveness of the United States as a location for investment and job creation. The lower rate reduces the incentives for, and rewards from, efforts to avoid taxes. The flip side is it increases the rewards from hiring and investing in the United States. The 21-percent corporate rate, after taking into account state and local taxes, dropped the United States from its highest ranking among OECD countries, a position we occupied for a number of years, to the middle of the pack.⁴

³ Bureau of Economic Analysis, "Activities of US Multinational Enterprises, 2018," News Release BEA 20-40, August 21, 2020, available at: <https://www.bea.gov/news/2020/activities-us-multinational-enterprises-2018>

⁴ In 2020, the United States had the 12th highest combined federal and state statutory corporate rate in the 37-country OECD, and the US rate was 2.3 percentage points higher than the average rate of the other 36 countries. On a GDP-weighted basis, the United States was less than one percentage point below the average of the other OECD countries.

Figure 1. US corporate rate relative to other OECD countries



Note: France has enacted a 25% rate effective in 2022. Colombia enacted a phased reduction to 30% in 2022. The UK has announced a 25% rate effective in 2023. Source: OECD and PwC calculations.

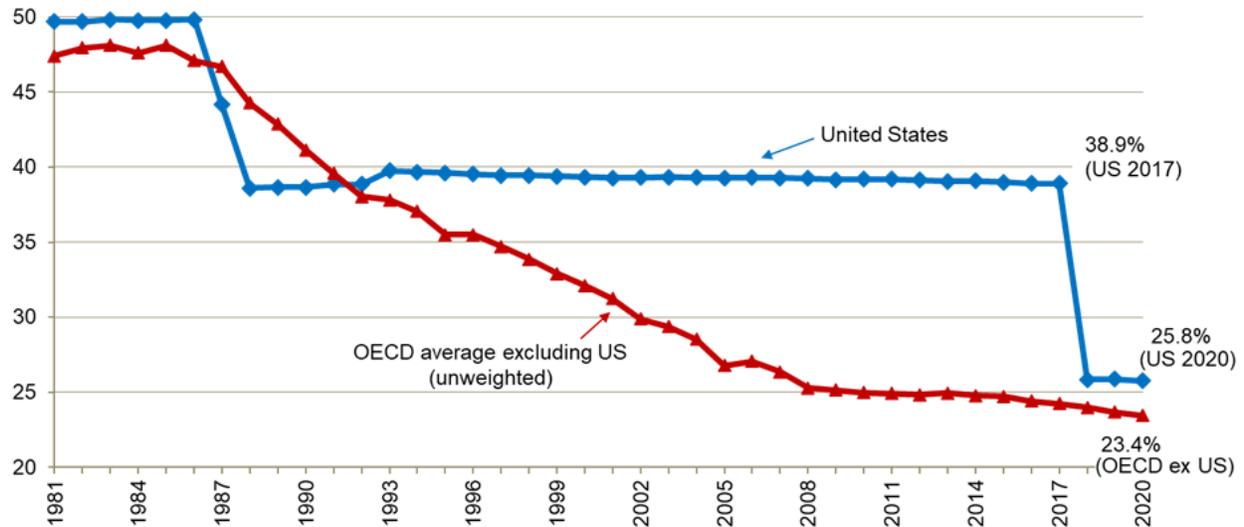
The notes to the chart above indicate there are two scheduled rate reductions yet to take effect - France and Colombia - and one rate increase - the United Kingdom. The chart also indicates where the United States would stand if it were to increase its federal rate to 28 percent: including state and local taxes, the United States would again be number one, and not in a good way, undoing the benefits of the TCJA that incentivize investing and job creation here. With scheduled rate reductions in France and Colombia, even a 25 percent rate would put the United States effectively in a tie for second place, behind only Portugal. That is a contest we do not want to win.

Recently, concern about a “race to the bottom” has garnered significant attention. The facts suggest the race to the bottom, if there was one, has evolved to a race to the middle. As can be seen in the chart below, the United States had first-mover advantage when it enacted the Tax Reform Act of 1986, moving from a rate above the OECD average to a rate below it. But that is where the United States remained, except for a one percentage point increase in 1993. Other countries initiated their own rate reductions in the 1980s and 1990s, and soon left the United States behind. Indeed, in 2016, President Clinton, who signed the legislation raising the corporate rate to 35%, noted “I was the president who urged it to be raised to 35 percent, but when I did it, it was precisely in the middle of OECD countries. It isn’t anymore.”⁵ Based on PwC’s calculations from OECD data, approximately 90 percent of the global corporate tax rate reductions between 1981 and 2020 had occurred by 2007. The two countries with upcoming reductions scheduled are currently the first and second highest on the previous chart. The reductions will leave them at or above the OECD average. As the notes indicate, the United Kingdom has proposed an increase in

⁵<https://www.cnbc.com/2016/09/21/bill-clinton-supports-lower-corporate-tax-rate-says-reasoning-for-tpp-clear.html>

its corporate tax rate to 25 percent, which would put it in the middle of the OECD pack, but still below the current US all-in rate.

Figure 2. Statutory (Federal and State) Corporate Income Tax Rates, OECD, 1981-2020



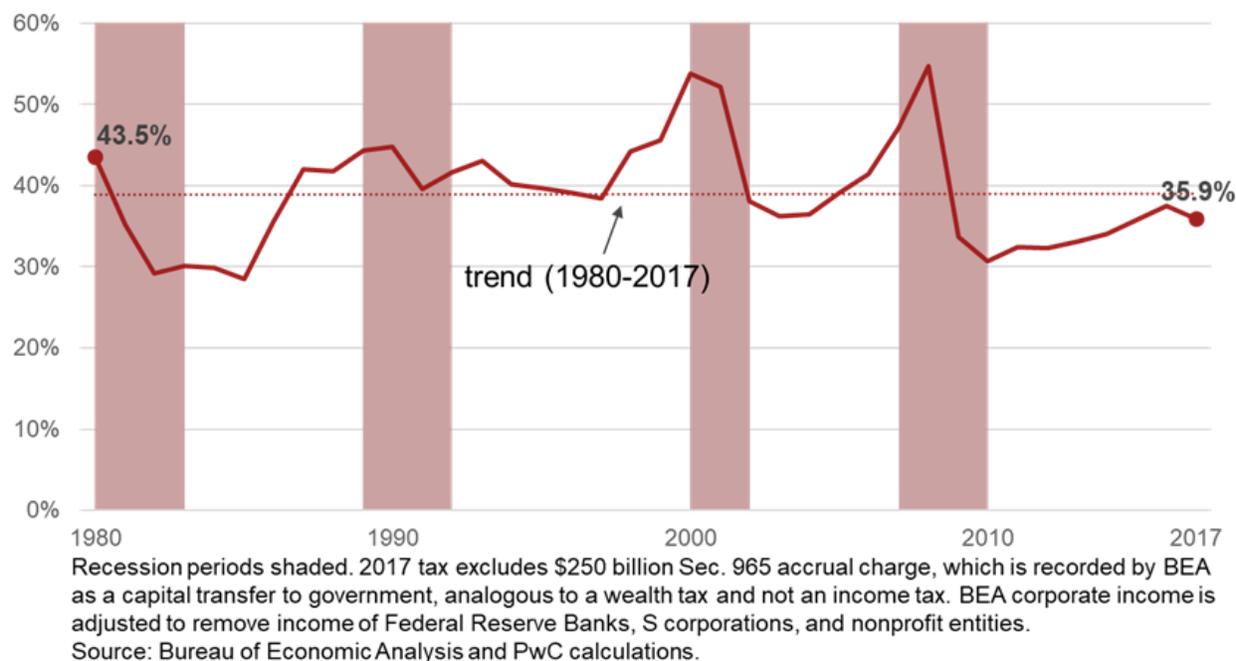
Source: OECD and PwC calculations.

Tax rate changes are easier to understand than changes to the tax base to which the tax rate is applied. That may explain why tax base changes are generally overlooked, even though the tax base change may be more significant or even offset the effect of the rate change. Both the US tax rate changes in the Tax Reform Act of 1986 and in the TCJA were accompanied by significant broadening of the corporate tax base. Applying a lower rate to a broader base means that many companies did not see a change in their tax liabilities despite the significant drop in the rate. Some industries calculated that the base broadening provisions in the TCJA completely offset the rate reduction. A rate increase with the same TCJA base for these industries will increase the cost of doing business in the United States above the cost before enactment of the TCJA.

Base broadening has often accompanied rate reduction in other countries as well. Going the other direction, the United Kingdom's corporate tax rate increase is to be preceded by significant base-narrowing investment incentives that will offset the impact of the rate increase. The coupling of rate and tax base changes likely accounts for the fact that corporate receipts as a share of corporate income have stayed relatively unchanged despite the general trend of rate reduction. The chart below illustrates the constancy of US corporate tax receipts over time, taking into consideration only the domestic income of corporations that are taxed under the corporate income tax and excluding the income of S corporations, whose owners are taxed directly on all income under the individual income tax.⁶

⁶ It is important to account for the increased share of business income earned by passthroughs, such as S corporations, when evaluating tax revenues collected on business income. For example, IRS data indicate that in 1980, S corporations earned only 1 percent of the income earned by C corporations, but by 2016 they earned nearly 50 percent of the income of C corporations.

Figure 3: Corporate Income Tax Payments as a Percentage of BEA Corporate Domestic Income (adjusted for C corporations only)



Mandatory deemed repatriation of foreign profits. Because of the high rate differential between the United States and other countries, US-headquartered companies had accumulated significant profits outside the United States. The mandatory deemed repatriation of all of those profits wiped the slate clean, subjecting all of the foreign earnings to tax and allowing companies to repatriate the earnings for reinvestment in the United States. The tax cost of the deemed repatriation, even paid over a period of eight years, was significant for many companies, especially those whose foreign investments were treated as cash and subject to tax at the higher rate. Going forward, however, it reduced borrowing needs, simplified Treasury functions, and facilitated investing and job creation in the United States.

Minimum taxes. TCJA included two minimum taxes: the tax on global intangible low-taxed income (GILTI), which was drawn from the proposals put forward by President Obama, former Chairman Camp, former Chairman Baucus, and other members of Congress; and the base erosion and anti-abuse tax (BEAT), a new starter that denies a deduction, generating an additional tax liability, if the US taxpayer's payments to foreign affiliates exceed a percentage threshold. Relative to the norms of international taxation, both GILTI and BEAT have quirks. GILTI, for example, limits foreign tax credits to 80 percent and permits no carryover of unused credits. BEAT applies without regard to whether the deductible payments are subject to tax in the jurisdiction to which they are paid, which is the jurisdiction with primary taxing rights. BEAT was designed and intended to create a level playing field and operates as such. It applies equally to payments to foreign-headquartered companies and foreign affiliates of US-headquartered companies providing cross-border services to their US affiliates.

There are other features that produce unintended results. Under the GILTI rules, for example, expense allocation against foreign income can push the tax rate above the foreign country's rate, even when that rate exceeds the US statutory rate. The mechanics of BEAT make it a procyclical tax. Despite steps being taken to reduce the difficulty of compliance, such as computing GILTI on a global rather than country-by-country basis, both taxes add considerable complexity to the tax code.

GILTI, like other minimum tax proposals, is designed to reduce opportunities for base erosion and ensure all income from intangible assets is subject to a minimum level of tax. It has been asserted that TCJA created incentives to shift income offshore, but that is simply untrue. GILTI applies to profits that under prior law would not have been subject to US tax unless and until they were repatriated to the United States. The 13.125-percent tax (that GILTI generally equates to after factoring in the foreign tax credit haircut), applied currently, clearly reduces the pre-TCJA incentives to create and hold assets outside the United States, deferring tax indefinitely. If the GILTI rate were increased, for example, by reducing the 50-percent exclusion, then US-headquartered companies would be subject to significant additional tax on much of their foreign income that foreign-headquartered companies are not.

While the connection of foreign operations to American workers, jobs, and investments is not always obvious, burdening US companies with an expense not borne by their foreign competitors will cost them opportunities. As mentioned at the outset of my testimony and as Prof. Hanlon noted in her testimony at last week's hearing, a US company's foreign operations create jobs here in America. This is an important point to consider in the design of US international tax policy: growth abroad creates jobs at home. Conversely, lost opportunities abroad are likely to translate to fewer jobs and reduced investments in the United States.

Examples are often given of facilities built abroad that, it is asserted, could have been built in the United States, but many industries serve markets around the globe and can only do so if they have facilities from which to serve those markets. Hotels, restaurants, and stores are obvious examples, but so are plants that manufacture products for which shipping costs from the United States to the foreign market would be excessive relative to the value of the product or to satisfy local content requirements. The foreign operations of those US companies require supporting headquarters jobs for American workers and mean a stronger and healthier employer. Setting a tax rate on those foreign operations that exceeds the tax borne by their competitors in the local market could cost American workers their jobs.

There are proposals to eliminate the exception from GILTI of a 10-percent return on qualified business asset investment (QBAI), which are the tangible assets a company uses in its foreign operations. When first devised in the minimum tax context, the 10-percent return on tangible assets served as a rough proxy for intangible income. If the return exceeded 10 percent, it was deemed to be intangible income. Concern about the mobility of intangibles is what generated the minimum tax proposals and what motivated the OECD's BEPS project. Thus, the exception for a return on QBAI is a means of measuring the intangible income - the excess of the 10 percent return on QBAI - that should be captured by a minimum tax. In effect, it recognizes the primary taxing right that the country in which the operations are located has to income from the tangible assets there. Including that income in GILTI would increase opportunities for double taxation and disputes. The QBAI exception allows US companies to compete on a level playing field with foreign companies with respect to investments in tangible assets that yield normal rates of return, by subjecting them to only the foreign tax rate in the country in which the tangible assets are located. A-10 percent return on fixed assets is not what minimum taxes were intended to capture.

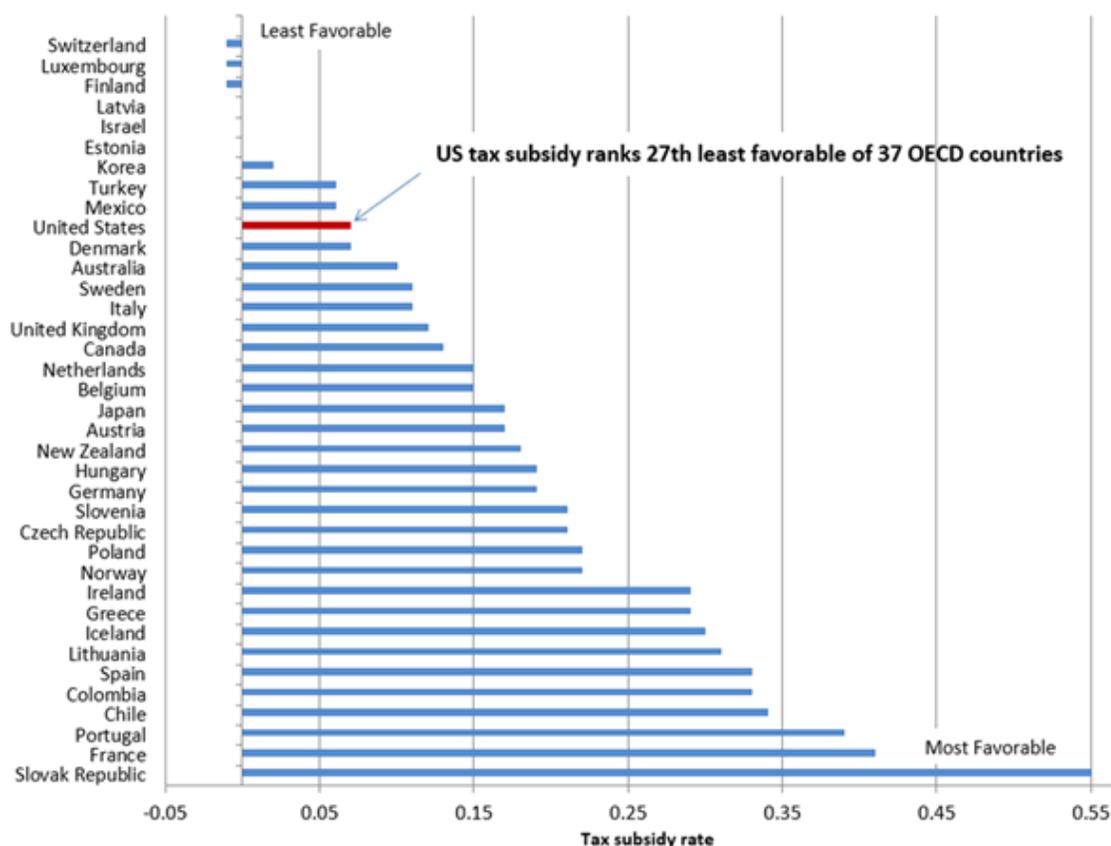
Concerns have been expressed that QBAI and other features of GILTI may encourage companies to invest outside of the United States. The BEA data described above is compelling evidence that should lay the concern to rest. It indicates that US-headquartered companies' investment in property, plant, and equipment in the United States increased faster than in their foreign affiliates. The BEA data also put the US growth rate above its 20-year average. Anecdotally, I am unaware of any company being induced by the design of GILTI to invest outside the United States. Indeed, articles have been written on the benefits of electing into subpart F, full current taxation of foreign income, as preferable to GILTI.⁷

The deduction for foreign-derived intangible income (FDII) was designed and intended to create a level playing field in the tax rate applied to US income derived in foreign markets from products and services. It uses the same rough proxy as GILTI for computing income from intangible assets - the excess over a 10-percent return on fixed assets - and the 37.5-percent deduction against a 21-percent corporate rate yields a 13.125-percent rate for FDII. The goal of the deduction is to equate the tax rate applicable to intangible income whether generated in the United States or abroad. The GILTI tax rate is scheduled to increase after 2025, with a matching adjustment to FDII, keeping the tax rates equal.

Other TCJA base broadening provisions. In addition to the lower rate, the tax on unrepatriated foreign profits, two minimum taxes, and other international changes that fell into the OECD's "best practices" category, the TCJA included a switch from expensing to capitalization and amortization of R&D expenses. Since R&D received significant attention from the Committee at last week's hearing, I will only observe that there is tremendous global competition for R&D jobs. Why? Because companies' R&D investments create jobs and have knock-on effects that positively affect investment and the economy. Every decision to conduct R&D elsewhere makes it more logical to make the next investment elsewhere. Some countries, including China, recognize the knock-on effects and are willing to offer subsidies and deductions equal to multiples of the R&D expense in order to attract R&D investment. Others offer favorable treatment of income generated by R&D through intellectual property incentives (so called "IP box regimes") to which FDII is a partial response. The United States already ranks 27th least favorable out of 37 OECD countries in R&D tax incentives, before capitalization and amortization of R&D becomes effective, weakening our position further. For the benefit of American jobs and investments, the United States should give careful consideration to the comparability of its R&D tax incentives to those of other countries to maintain its leading position in the global economy.

⁷ Libin Zhang, "To the Frying Pan: New Virtues of Subpart F Income Over GILTI," Tax Notes [TA], July 2, 2018, pp. 73-81.

Figure 4: Tax Subsidy Rates on R&D Expenditures of Large Profitable Firms, 2020



Source: OECD, R&D Tax Incentive Database, December 2020.

Where should international tax policy go from here?

The OECD’s project on taxation of the digitalizing economy is not on the list of topics for this hearing, but it is the elephant in the room. As was the case with the BEPS project that preceded the digitalizing economy project, the US Treasury has been a very active participant in the discussions. As was also the case with the BEPS project, the work began and proceeded without the direction of Congress that ought to precede a discussion in which the allocation of US taxing jurisdiction is at stake. Members of Congress, including in particular the leaders of this Committee, have been vocal in stating their opposition to digital services taxes, ring-fencing the digital economy for tax purposes, and changes in international tax agreements that target US companies, and they have stated their desire for resolution through multilateral discussions at the OECD rather than unilateral measures. No Congressional guidance has been provided, however, regarding the content of the agreement even though the proposals on the table would require legislation and, in addition, amendments to treaties or the entry into a multilateral instrument, both of which would require Senate ratification. Waiting for the Treasury Department negotiators to return with a deal is too late to begin consideration of what the Senate would like to see in it.

One part of the digitalizing economy project - “Pillar 2” - matches up relatively well with the two minimum taxes enacted in the TCJA. Pillar 2 proposes that countries enact a global minimum tax that resembles GILTI and an undertaxed payments rule that resembles BEAT. The Pillar 2 version of BEAT may be

better designed than BEAT, but avoiding multiple levels of taxation will require careful coordination with the global minimum taxes, and logically the minimum tax should have priority in determining whether a deductible payment is undertaxed. Only time will tell whether other countries' implementation of Pillar 2 follows this construct, or whether they use the template of Pillar 2 as an opportunity to enact an undertaxed payment rule, denying deductions for or imposing withholding taxes on payments to US companies.

Secretary Yellen has voiced support for the OECD project, noting that a global minimum tax would put a floor under corporate tax rates and end the "race to the bottom". As previously noted, the facts suggest a race to the bottom in headline corporate tax rates may be a thing of the past, but that said, broadly subjecting foreign-headquartered companies to the same kind of a minimum tax as US-headquartered companies may help level the playing field. The problem with a minimum tax - unless other countries follow suit - is that it can disadvantage a country's own headquartered global companies relative to foreign companies. GILTI, for example, raises the tax paid by US-headquartered companies on their foreign operations, but it cannot raise the tax paid by foreign companies on their foreign operations. A robust OECD agreement pursuant to which all or most other countries with major corporate headquarters enacted similar minimum taxes could be beneficial to US companies.

There are three concerns with this rosy scenario.

The first is that there are questions whether GILTI would be considered a compliant minimum tax under Pillar 2. It is passing strange for countries, none of which have enacted minimum taxes, to pass judgment on whether GILTI is sufficiently stringent, but setting that aside, the OECD has acknowledged that GILTI is more stringent overall in its application than the Pillar 2 design. GILTI could be amended to bring it into greater conformity with the details of the Pillar 2 design, but note that that would require Congress to enact legislation the terms of which would be dictated by the OECD.

If GILTI does not qualify - and other countries' treatment of US companies under their anti-hybrid rules demonstrates their willingness to not treat GILTI as a compliant minimum tax - then US-headquartered companies may be subject to the implementation of the undertaxed payment rule in any country that adopts that part of Pillar 2, resulting in double tax on US companies and/or revenue loss to the US fisc.

The second concern is whether other countries would enact the agreed upon minimum taxes. The concept of a foreign minimum tax has been around at least since the late 1990s when the OECD launched work on "harmful tax competition." Interest in the concept returned when President Obama proposed a foreign minimum tax, Chairman Camp included it in his draft international legislation, and the Obama Treasury pushed for inclusion of foreign minimum taxes as an action item in the OECD's BEPS project. Despite more than 20 years of international attention to the concept, no country other than the United States has chosen to enact one or, to my knowledge, entertained the possibility of doing so.

Countries may sign on to a Pillar 2 agreement but fail to enact an effective foreign minimum tax on their multinational companies, giving them a competitive advantage while denying deductions or imposing withholding taxes on payments made by US multinationals to both their foreign affiliates and to the US parent. The complexity of the OECD's proposed approach alone will discourage many countries from proceeding. It will be difficult to prevent countries from simply selecting those aspects of the Pillar 2 framework that appeal to them or can easily be implemented (like denying deductions or imposing withholding taxes) while failing to implement the meaningful minimum tax that should be the foundation of

Pillar 2.

A crucial unknown is at what level the Pillar 2 minimum tax rate will be set. Most discussions assume a rate comparable to Ireland's 12.5 percent. At 13.125 percent, the US GILTI rate is already higher and will be several points higher when the scheduled change to GILTI takes effect in 2026. Pillar 2 will not provide a floor that protects US-headquartered companies, particularly if President Biden's proposed increase in the GILTI rate is enacted.

The third concern is that some countries that have displayed little interest in Pillar 2 refuse to agree to Pillar 2 without the reallocation of taxing jurisdiction that is Pillar 1, and Pillar 1 is a whole different kettle of fish.

The BEPS project was *technically* difficult. It required the identification of loopholes in and between national taxing regimes that allowed income to fall into gaps and one country's tax system to be used to erode the tax base of another. It also required determining and agreeing on the best method of closing those loopholes and gaps. Although BEPS has had limited time to work, the anecdotal evidence suggests it has had (and continues to have) a significant effect on business operations that have been adjusted to satisfy BEPS' substantive requirements.

Although technically difficult, BEPS was *politically* easy because it did not seek to reallocate companies' global profits among countries, but rather to align corporate taxation with economic activity and ensure all profit was booked *and taxed* in the location of the economic activity. BEPS brought countries an expectation of increased tax revenue, not that they would be asked to reallocate global profits within their taxing jurisdiction to another country. This politically fraught question is exactly what Pillar 1 puts on the table.

Pillar 1 diverges from longstanding international tax rules and no discernible economic (or other) principle underlies it. It is true that technological advances permit a company to operate in a country without a physical presence, but borders open to trade have allowed market access for sales of products for decades, if not centuries. That has not led to countries in which sales are made requiring payment of income tax on a share of the product manufacturer's global profits.

The Pillar 1 discussion would have an effect on US taxing rights that differs from any other country. Based on information PwC has gathered, over half of the global profits taxable by market countries under the Pillar 1 proposal are profits of US companies. It should not be a surprise then that the United States Treasury has been reticent about agreeing to Pillar 1. Rather than acknowledging the surrender of taxing jurisdiction the proposal asks of the United States, however, the OECD discussion has largely revolved around not whether, but how much of global profits to reallocate.

In exchange for agreeing to Pillar 1, the United States received two commitments: (1) agreement that other countries will repeal or refrain from implementing "unilateral" measures such as digital services taxes that target US companies, and (2) agreement to mandatory binding dispute resolution procedures to resolve intergovernmental disputes over taxing jurisdiction. The first is hard to square with continuing proposals for or adoption of digital services taxes without plans to roll them back once OECD agreement has been reached. To the credit of Secretary Yellen's negotiating team, however, defining a "unilateral measure" has been added as an OECD workstream. Reports indicate the second has encountered unyielding resistance from governments unwilling to surrender control over tax disputes.

To borrow Hegelian dialectics - we have thesis, we have antithesis, but we are nowhere near synthesis. There are many other significant issues to be resolved under Pillars 1 and 2. The details of these are matters with which this Committee should be familiar because they will land in your lap: the expectation is that an agreement reached at the OECD will be implemented by the United States Congress. These details may affect the latitude the Committee has to design and enact policies you believe are in the best interest of American workers, jobs, and investments.

Perhaps most important, whatever the outcome of the OECD negotiations, other governments are going to act, and they will act in a manner they believe will foster the interest of workers, jobs, and investments in their countries, not in the United States.

Conclusion

The Committee's focus on international tax policy's effect on American workers, jobs, and investments is timely and proper. As the Committee considers tax policy changes, whether directly to the international provisions or to the provisions that determine the attractiveness of the United States as a place to invest and create jobs, it will be important to apply lessons from the past and understand how the actions of other governments will affect American workers, jobs, and investment. US policymakers do not operate in a political or economic vacuum.

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.