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Democrats, GOP clash during Finance Committee hearing on international tax policy

In a potential preview of legislative battles ahead, Democrats and Republicans on the Senate Finance Committee found little to agree on during a March 25 hearing focused on the US international tax regime.

Setting the stage

The hearing was held at a critical juncture in the US tax policy debate. Then-presidential candidate Joe Biden ran for office in 2020 on a tax platform advocating substantial changes to the international tax structure put in place by 2017's Tax Cuts and Jobs Act (TCJA, P.L. 115-97). Now that he is in office, President Biden and congressional Democrats, fresh off a legislative victory with the enactment of the American Rescue Plan (P.L. 117-2), are focused on a large-scale economic recovery agenda this summer and fall that could see them attempt to offset, or partially offset, spending initiatives on infrastructure, climate change mitigation, health care, and other priorities with tax code changes that would predominantly affect businesses and upper-income individuals. At the same time, members of the Organization for Economic Cooperation and Development's (OECD) so-called "Inclusive Framework" are striving to reach agreement on plans around new nexus and profit allocation rules ("Pillar One") and a global minimum tax ("Pillar Two") by this summer.

Among the major international tax reforms that Biden advocated on the campaign trail – and that are likely to appear in the administration's fiscal 2022 budget blueprint set to be released later this spring – are proposals to substantially reform the TCJA's Global Intangible Low-Taxed Income (GILTI) regime by raising its tax rate from 10.5 percent to 21 percent, changing its calculation from an aggregate to a country-by-country basis, and eliminating the exclusion from its calculation for a 10 percent return on foreign tangible investment (so-called "qualified business asset investment," or QBAI).

Biden also has proposed a 10 percent "Made in America" tax credit that generally would be applicable to incremental increases in investment in US manufacturing operations, and a corresponding 10 percent "offshoring tax penalty" that would apply to the profits of foreign production or service delivery (including call centers) intended for sale or use back into the US.

Sparring starts early

In opening the hearing, Finance Committee Chairman Ron Wyden, D-Ore., came down hard on the 2017 tax reform law, and made reference to a report released by the nonpartisan Joint Committee on Taxation (JCT) that provides an overview and analysis of the US international tax system along with certain statistics detailing how the US tax structure has changed since enactment of the TCJA.
URL: https://www.jct.gov/publications/2021/jcx-16-21/

"This hearing comes just days after the release of a jaw-dropping new report from the Joint Committee on Tax," Wyden said. "That report found that the [TCJA] slashed the average US tax rate paid by the biggest mega-corporations by more than half."

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Wyden has long been active in the international tax policy space, having introduced separate bipartisan tax reform proposals – in 2010 and 2014, respectively – with former GOP senators Judd Greg of New Hampshire and Dan Coats of Indiana that called for financing a reduction in the top corporate rate (which was then 35 percent) in part by repealing provisions that allowed for the deferral of US tax on active foreign earnings.

"…Here's my bottom line," Wyden said. "I reject the proposition that the US has to participate in the worldwide race to rock bottom on corporate taxes to compete or create good-paying jobs."

The committee's ranking Republican, Mike Crapo of Idaho, used his opening statement to counter Wyden's comments with a view broadly shared by other GOP members: namely, that the TCJA marked an improvement over the pre-2018 US tax structure.

"TCJA is a vast improvement over the prior system," Crapo said. "Since TCJA, the flood of inversions has ceased entirely, and US companies are no longer easy targets for takeovers."

"…What we should not do is hastily change the system purely for purposes of raising revenue, bringing inversions and foreign takeovers of US companies right back to the forefront," he added.

Later in the hearing, Crapo argued that much of the reduction in effective corporate tax rates post-TCJA – as referenced in the JCT report cited by Sen. Wyden – was attributable to a justified policy choice to grant firms 100 percent bonus depreciation on certain capital assets.

"Greater investment leads to greater productivity, which leads to more jobs and higher wages for workers," Crapo argued.

GILTI and FDII

Throughout the hearing, a major focus among committee Democrats revolved around a critique that the GILTI regime's exclusion of 10 percent of a firm's foreign tangible investment (QBAI) provides an incentive for companies to locate investment in foreign jurisdictions rather than in the US.

"Under the [TCJA], multinational corporations got special new breaks for shipping jobs and profits overseas," Wyden said. "There's a specific new tax break for investing in factories outside the country."

That argument was reiterated by witness Kimberly Clausing, who recently joined the Biden Treasury Department as deputy assistant secretary for tax analysis.

"The Biden administration most definitely shares your goal of ensuring that research and development and manufacturing prosper in the United States," Clausing said during an exchange with Wyden. "It most certainly works against those goals to have a tax system that directly rewards offshoring."

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Clausing further noted her view that the GILTI regime as currently structured, along with a separate deduction created in the TCJA that US firms may be eligible to claim on their foreign-derived intangible income (FDII), are working in concert to encourage investment offshore.

"…[T]he GILTI gives you a larger tax-free exemption the more tangible assets you have offshore," Clausing said, while "the FDII gives you a less generous deduction the more US assets you have, all things equal. …These are two powerful incentives that directly encourage offshoring."

Sen. Mark Warner, D-Va., touched on a similar theme later in the hearing.

"I think some of our friends who thought with the GILTI system and FDII they would balance it right," Warner said. "In actuality, by doing some of these blending rates…they actually got it flat wrong and incented, particularly, R&D and intangible assets to go offshore."

Sen. Sherrod Brown, D-Ohio, similarly argued that the QBAI provision creates an incentive for businesses to locate incremental investment in other countries rather than in the US.

For their part, the committee's Republicans generally defended the GILTI regime's current structure as being an effective component of a broader international tax system that fosters US competitiveness.

"We were…the first country to enact a global minimum tax and were very deliberate about the burden imposed on US company's global activities," ranking member Crapo said. "While we wanted to protect the US tax base and prevent tax base erosion, we did not want to accomplish those goals at the expense of our companies' ability to compete."

Sen. Pat Toomey, R-Pa., commented that "[w]e do actually put our multinationals based in the US at a competitive disadvantage with respect to the tax code," noting that the US is the only developed country with a foreign minimum tax regime. "But it's not so onerous that we drive everyone out of the country," he said.

Sen. Rob Portman, R-Ohio, by contrast, argued that QBAI exclusion is rooted in sound policy since, as a general matter, many multinational firms may be required to maintain physical assets in countries where they have customers and derive income.

"QBAI is not a loophole," Portman said. "It's a recognition that earnings attributable to tangible property are not susceptible to profit shifting."

Portman also argued in favor of the FDII regime, noting that it works "in tandem" with GILTI and provides "a disincentive to move intellectual property offshore."

Aggregate versus country-by-country: During an exchange with Ohio Democrat Sherrod Brown, Clausing also spoke in favor of the Biden proposal to require that GILTI be calculated on a country-by-country, rather than aggregate, basis.

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"If you have some income in Mexico and some income in an offshore haven, you can blend those streams of income and together get that 50 percent [GILTI] deduction relative to doing business in Ohio," Clausing said, noting that she "sometimes refer[s] to this as an 'America last' policy."

BEAT

The TCJA's base-erosion and anti-abuse tax (BEAT) – which in general seeks to prevent a stripping of the US tax base by imposing an additional tax on certain firms with respect to deductible payments made by US entities to foreign affiliates – also was discussed, though at a fairly high level.

"[T]here were many problems with both the final legislation and also with implementing regulations that made it such that the BEAT's revenues have been very disappointing," Clausing said. "So it hasn't really stemmed the income stripping of foreign companies offshore as much as it was intended."

Clausing also agreed with a comment by Sen. Tom Carper, D-Del., that the manner in which the BEAT is calculated may inadvertently disincentivize investments in US renewable energy projects.

"We don't want to be mistakenly harming companies that are investing in clean energy rather than targeting this foreign profit shifting," Clausing said.

"The Biden administration has not yet taken a position on [BEAT] reforms, but we're actively studying that problem and we're aware of all of these issues," she added.

For her part, witness Pam Olson, who served as Treasury assistant secretary for tax policy during the George W. Bush administration, agreed that the BEAT can have some "odd effects" – both due to the possibility of unintended consequences related to renewable energy investments, and the fact that the regime does not take into account whether payments out of the US are subject to tax in a foreign jurisdiction.

US corporate rate in the international context

Another major theme of the hearing revolved around the relative merits and demerits of the TCJA's reduction in the top corporate rate from 35 percent to 21 percent and what that has meant for corporate tax revenues received by the government.

Many of the committee's Democrats expressed a view that the corporate rate cut was too steep and that the US has room to raise corporate tax revenues without endangering the competitiveness of US firms. (President Biden campaigned on and continues to support raising the corporate rate to 28 percent.)

In an exchange with Treasury's Clausing, Sen. Bob Menendez, D-N.J., pointed to an assertion in her opening statement that "in 2018 and 2019…the United States raised only 1 percent of [gross domestic product] from the corporate tax. He noted that is "half the level we collected prior to the GOP corporate tax bill and one-third of the [OECD] average."

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Clausing responded that the corporate tax reduction has shifted tax burdens toward individuals and could pose a danger to the government's fiscal position.

"That's definitely true [that] the relative amount of taxes paid by households and small businesses is higher relative to that paid by corporations," she said. "But we also put a lot of budget pressure on the government. We raise only about 16 percent of GDP in federal revenues right now. The last time we balanced the budget it was 20 percent of GDP."

For their part, the committee's GOP members argued that the US corporate rate is not too low, but rather is in the middle of the pack among developed countries and that raising it could stymie the US's competitive position.

"Under President Biden's proposed corporate rate increase, which would result in a combined US [and state] rate of nearly 33 percent, we again would have one of the highest combined statutory rates among developed countries," Sen. Crapo said.

Other Republicans argued that a lower corporate rate also serves to protect the US tax base by reducing incentives for firms to shift profits out of the US and into lower-tax jurisdictions and that a look at corporate receipts alone is misleading given the amount of passthrough business income reported on individual income tax returns.

"Isn't keeping the US rate competitive with the rest of the world an important anti-base erosion measure?" asked Sen. John Thune, R-S.D., during an exchange with witness Pam Olson.

For his part, Ohio Republican Rob Portman, recalling a 2015 bipartisan task force on international tax that he led with then-Finance Committee member – now Senate Majority Leader – Chuck Schumer, D-N.Y., said there was "a lot of consensus" at the time that the corporate rate was too high and that the international tax structure was encouraging an outflow of jobs and investment.

"The TCJA reflected that consensus," Portman said. "There were lots of parts of that bill that were relatively controversial, [but the] international parts actually reflected that consensus. Lower the rate, territorial system."

Portman also argued that a "competitive effective rate is needed to prevent the GILTI provision from harming the competitiveness of US companies relative to their foreign competitors."

Supply chains and the Biden offshoring penalty

Notwithstanding the broadly held Democratic view that certain perceived flaws in the GILTI regime are serving to encourage the offshoring of jobs and investment, there was also – not surprisingly – bipartisan agreement that US supply chains need to be strengthened, particularly with regard to personal protective equipment,

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certain pharmaceuticals, and advanced technology products that have faced supply chain issues since the onset of the coronavirus pandemic.

But views diverged on how exactly lawmakers should go about that task.

One particular supply chain proposal put forward by the Biden campaign – a 10 percent surtax (that is, an additional 2.8 percent on top of Biden's proposed 28 percent general corporate rate) on the profits of foreign production of goods and services (including call centers) intended for sale or use in the US – came under fire from Sen. John Thune, R-S.D.

"The Biden proposal ignores the reality of global supply chains," Thune said. "There are certain products and components that simply cannot be manufactured or created here in the United States, especially when they're to be sold abroad."

OECD digital tax negotiations

Members also discussed the ongoing talks at the OECD with respect to the taxation of the digital economy.

"I have said directly to [Treasury] Secretary Yellen…that I appreciate how the Treasury Department and bipartisan tax leaders in Congress have consistently spoken with one voice when it comes to pursuing an agreement at the OECD that is fair to the United States," Sen. Crapo said during an exchange with Clausing, who pledged that Treasury would continue to keep the taxwriting committees apprised of the negotiations and would welcome bipartisan feedback on the positions members believe Treasury should take in the United States' negotiations with other members of the "Inclusive Framework."

Former Treasury Assistant Secretary Olson later suggested that as lawmakers pursue digital tax talks with the OECD they should consider leveraging a form of authority that Congress often utilizes in the trade context (so-called "Trade Promotion Authority") to lay out negotiating objectives and procedures for considering implementing legislation.

"If an agreement is reached at the OECD, …it's going to come back and land in this committee and in the Foreign Relations Committee to write legislation and ratify treaties that might have to be changed as a consequence," Olson said. "So it's really important that you get engaged in that process and something formal along the lines of the Trade Promotion Authority process would be a good thing to think about."

Next up: Wyden white paper

In what is sure to be a significant development in the tax policy debate going forward, Chairman Wyden noted that he, along with a pair of other Finance Committee Democrats, will soon be releasing a long-anticipated white paper outlining their vision for changes to the international tax system.

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“In the coming days, joined by Sen. Brown and Sen. Warner, I’ll be releasing a new framework for international taxation that reverses the Trump-era handouts to multinationals,” Wyden said.

“Our new framework is based on a few simple propositions,” Wyden said. “First, multinationals must pay a fair share, just like Americans who work for a living. …Second, the tax code must reward companies that invest and create good-paying jobs in the US, and stop rewarding companies that ship jobs and factories overseas.”

“We’re going to focus on policies that actually make us more competitive, attract US investment – high-skill, high-wage jobs – and do it in a way without blowing up the budget.”

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