Ways and Means chairman continues criticism of global tax pact

With questions remaining over the path forward for US implementation of a 2021 global tax reform agreement being advanced by the OECD/G20 Inclusive Framework on BEPS, the House's top taxwriter has kept up a running critique of both the Biden administration and the OECD in recent weeks, calling the agreement "a bad deal for American workers and families" and an "attack" on the US that puts China at a competitive advantage.

Following the OECD's most recent release of guidance on February 2, House Ways and Means Committee Chairman Jason Smith, R-Mo., declared that implementation of the agreement has "no path forward in Congress" and said the House GOP will hold the administration to account for what Republicans see as failure in the global negotiations. (A discussion of the OECD guidance is available from Deloitte Tax LLP.)
URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/dttl-tax-alert-us-07-february-2023.pdf

Focus on Pillar Two

With the current focus primarily on Pillar Two of the agreement, which addresses base erosion by ensuring large multinational groups pay a minimum 15 percent tax to each country in which they operate, there are legislative changes viewed as necessary in the US for the current global intangible low-taxed income (GILTI) regime to comply and for the US to maximize its ability to tax multinationals. Chief among these changes, compliance with Pillar Two would require that the tax rate on GILTI be raised to 15 percent (from 10.5 percent through 2025 and 13.125 percent thereafter) and calculated on a country-by-country basis. Democratic taxwriters sought to include these changes in early versions of the expansive budget reconciliation legislation that moved through Congress during 2021 and 2022, but those provisions lacked sufficient support in the Senate and were left out of the measure that was ultimately enacted into law—the Inflation Reduction Act of 2022—last August.

One argument against such changes last year was that other countries had not yet moved to comply with Pillar Two, and that if the US, which already had a minimum tax regime in place, was first out of the gate to implement it, then US-based multinationals would be put at a further competitive disadvantage. Since then, however, the EU has achieved unanimity among its member states to implement Pillar Two beginning in 2024, and countries including the UK, South Korea, and Switzerland have announced the same timeline. Singapore announced this week that it will implement one aspect of the rules—a domestic minimum tax—in 2025.

Beyond the timing, however, many Republicans have also criticized the agreement more broadly, charging that the Biden administration made commitments that only Congress can authorize, conceded far too much in the multi-year negotiations (begun under President Trump), and allowed US-specific tax incentives to be diluted by the new rules.

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Smith's latest concerns

In a statement responding to the February 2 guidance, Smith argued that "[t]he OECD guidance revokes important job-creating tax incentives passed by Congress and threatens to authorize foreign countries to pocket US tax revenues."
URL: https://waysandmeans.house.gov/chairman-smith-biden-administration-cannot-override-congresss-constitutional-tax-writing-authority/

Soon after, in a February 10 letter to OECD Secretary-General Mathias Cormann, Smith blasted the "technocrats negotiating this backroom deal in Paris" and said the OECD tax agreement "reflects a tenuous political negotiation that relies heavily on US concessions and allows China to gain a competitive edge in the global economy."
URL: https://waysandmeans.house.gov/wp-content/uploads/2023/02/Letter-to-Secretary-General-Cormann.pdf

"Despite numerous reformulations, the OECD global tax deal fails to deliver on its most important objectives: eliminating discriminatory digital services taxes, strengthening the principles of cross-border taxation for a digitalizing economy, and ensuring fair treatment across countries," the letter said.

In particular, the Ways and Means chair criticized the undertaxed profits rule (UTPR) crafted as part of Pillar Two, which is a so-called backstop to the primary and secondary rules, either by denying a deduction for payments or by making an equivalent adjustment.

"This UTPR surtax is fundamentally flawed—and it will never be effective against companies backed by the Chinese Communist Party," Smith's letter said. "Instead, the UTPR surtax will target important US tax incentives—including the research and development tax credit—as well as the operations of American companies in third-party jurisdictions."

A key aspect of the Pillar Two rules that has been a source of concern for lawmakers in both parties is its more favorable treatment of refundable tax credits over nonrefundable credits, which are more prevalent in the US. For example, the UK's R&D tax credit, which is refundable, is treated as income, while the nonrefundable version in the US is treated as a reduction in tax payments that can drop a company's effective tax rate below 15 percent and thus subject the company to a top-up tax. Treasury officials have acknowledged these concerns and said last year that they would work with the OECD to address them; however, there does not appear to be a simple solution to this challenge, as Congress is unlikely to change the format of such US credits and negotiators around the OECD table are not willing to reopen discussions on the topic.

In his letter to the OECD's leader, Smith raised the threat of retaliatory action, saying House Republicans, who control the chamber in the 118th Congress, will "aggressively pursue tax and trade countermeasures to protect American jobs, sovereignty, and tax revenue." However, such moves would also require the support of the Senate, where Democrats hold the majority and are generally more supportive of the OECD deal, as well as the White House.

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OECD announces public consultation meeting

In other Pillar Two developments, the OECD announced this week that it will hold a virtual public consultation meeting on March 16 on the tax certainty aspects of the Pillar Two global minimum tax proposals.

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