Ways and Means GOP proposal takes aim at Pillar Two's 'undertaxed profits rule'

Ahead of a planned visit with tax officials in Europe to express in person their opposition to international tax law changes, House Republican taxwriters this week introduced legislation that would impose retaliatory taxes on the US income of certain foreign entities and individuals based in countries that implement an undertaxed profits rule (UTPR) or similar measures to ensure large multinational groups pay a minimum level of tax.

The GOP has long criticized the OECD-driven global tax agreement that the Biden administration signed on to in 2021, and House Ways and Means Committee Chairman Jason Smith, R-Mo., has ratcheted up the condemnation since becoming the chamber's top taxwriter earlier this year. Smith has been especially critical of the UTPR, which was crafted as part of the OECD agreement's Pillar Two and serves as backstop to the primary rule through the imposition of a "top-up" tax—either by denying a deduction for payments or by making an equivalent adjustment—on the operations of large multinational companies that are otherwise not subject to a minimum level of tax in each jurisdiction in which they operate.

A UTPR will generally impact only those in-scope multinational groups whose parent is based in a jurisdiction that does not have an income inclusion rule (IIR) or if the otherwise low-tax jurisdiction has not adopted a qualified domestic minimum top-up tax (QDMTT), each of which is intended to ensure a 15 percent minimum tax is paid on income within each jurisdiction. The US does not have either a QDMTT or an IIR and does not seem poised to advance legislation this year that would bring US tax law in line with those rules, leaving US-based groups open to having UTPRs imposed on their US income by other countries.

Defending American Jobs and Investment Act

Under the Defending American Jobs and Investment Act (H.R. 3665) unveiled by Smith on May 25 and co-sponsored by all of the committee's other 24 Republican members, the tax rate on US income of wealthy investors and corporations in countries identified as having "extraterritorial taxes or discriminatory taxes" such as UTPRs would increase by 5 percentage points each year for four years, to a maximum of 20 percentage points above the base, and would remain at that level as long as the UTPR or similar discriminatory taxes are in effect.
URL: https://gop-waysandmeans.house.gov/wp-content/uploads/2023/05/Defending-American-Jobs-and-Investment.pdf

"This bill sends a clear warning to any nation tempted to exploit the success of our workers and businesses for its own gain," Smith said in a statement accompanying the introduction. "Republicans are taking action where the Biden administration has failed—in standing up for the interests of American workers and families. We will not allow a bad deal negotiated by the Biden White House to enable foreign governments to steal away Americans' jobs and opportunity, and we will not stand idly by while other countries use the OECD global tax deal to extract over $120 billion in US tax revenue over the next decade."

A number of the nearly 140 countries that signed onto the OECD agreement have announced plans to implement aspects of Pillar Two over the next couple of years, with UTPRs largely set to take effect in 2025 in jurisdictions including Canada, the EU, Japan, and the UK.

In a February 10 letter to OECD Secretary General Mathias Cormann, Smith wrote, "This UTPR surtax is fundamentally flawed—and it will never be effective against companies backed by the Chinese Communist Party. 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."
URL: https://waysandmeans.house.gov/wp-content/uploads/2023/02/Letter-to-Secretary-General-Cormann.pdf

A key aspect of the Pillar Two rules that has raised concerns among lawmakers in both parties is their more favorable treatment of refundable tax credits, which are more common in jurisdictions outside of the US, 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 R&D credit in the US is treated as a reduction in tax payments that can drop a company's effective tax rate in the US below 15 percent under the Pillar Two rules, 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, but there is not a simple solution to this challenge, as Congress is unlikely to change the format of such US credits and negotiators around the OECD table have said they are not willing to reopen the topic.

Face-to-face diplomacy

Smith and other members of the taxwriting committee, including GOP Reps. Kevin Hern of Oklahoma, Ron Estes of Kansas, and Lloyd Smucker of Pennsylvania, are scheduled to visit tax officials in Paris and Berlin the week of May 29, during the House's planned Memorial Day recess; however, the trip could be postponed if members need to return to Washington early and vote on legislation to avert a breach of the federal debt limit. (Negotiations over the debt limit are ongoing and fluid, but House Speaker Kevin McCarthy, R-Calif., has said he hopes to have an agreement ready for a vote ahead of the June 1 deadline that Treasury Secretary Janet Yellen has cited as the likely date for default on the US's credit obligations if Congress does not act to increase or suspend the nation's borrowing cap. See separate coverage in this issue for details on those developments.)

Hern told *Tax Notes* on May 24 that the goal of the trip to Europe is to speak to representatives from the OECD to express the House GOP's disapproval of the UTPR "and discuss with them some alternative measures we can take."

"The problem with the UTPR process is that it's a tax grab against the US businesses for their operations in the United States that have no bearing on operations in other countries," Estes said. "So hopefully they'll see that that doesn't make sense."

The Defending American Jobs and Investment Act is not expected to become law in the current Congress; however it is likely to serve as a marker for the direction in which Republicans intend to take tax policy should they win control of the House and Senate in the 2024 elections.

A June tax bill in the works?

In other Ways and Means Committee developments, various Republican members of the panel told press outlets this week that Chairman Smith hopes to mark up a tax package focused on economic growth sometime in June.

Discussions of just what will go in that legislation are not yet complete but there currently appears to be consensus around provisions to mitigate or repeal certain business-focused tax code changes that were mandated under the Tax Cuts and Jobs Act (TCJA, P.L. 115-97) and have recently taken effect, such as the phase-down of the bonus depreciation percentage, mandatory amortization of research expenditures under section 174, and stricter rules for applying the limitation on deductions of net business interest expense under section 163(j).
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Many lawmakers in both parties had hoped to address these TCJA changes during last year's post-election lame duck legislative session but they were unable to reach an agreement that included these or other tax provisions—aside from a package of retirement security reforms—that had bipartisan support.

It is currently unclear whether House taxwriters will include relief from the more stringent Form 1099-K reporting thresholds imposed on third-party settlement organizations under the American Rescue Plan Act of 2021 (P.L. 117-2). That legislation reduced the dollar threshold for the reporting requirement from $20,000 to $600 and eliminated the 200-transaction threshold, with the changes effective for calendar years after 2021; however, the Treasury Department late last year issued Notice 2023-10, in which it delayed enforcement of the new rules until after 2023.
URL: https://www.congress.gov/117/plaws/publ2/PLAW-117publ2.pdf
URL: https://www.irs.gov/pub/irs-drop/n-2023-10.pdf

Also unclear is whether the Ways and Means package will include legislation (H.R. 976) introduced earlier this year by Ways and Means Committee Vice Chairman Vern Buchanan, R-Fla., that would permanently extend the TCJA's tax relief provisions for individuals and passthrough entities that are scheduled to expire after 2025.
URL: https://www.congress.gov/bill/118th-congress/house-bill/976/text

— Storme Sixeas and Michael DeHoff
Tax Policy Group
Deloitte Tax LLP