

# GILTI: The Co-operative Potential of a Unilateral Minimum Tax

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## Abstract

*Prior to the Tax Cuts and Jobs Act of 2017 (TCJA), the US allowed US parented multinationals to delay indefinitely their payment of US corporate income tax on non-US income earned by non-US corporate subsidiaries (CFCs). The TCJA revoked this permission through the enactment of a unilateral, current minimum tax on the “global intangible low-taxed income” (GILTI) of CFCs. The post-TCJA US international tax law generally imposes current US tax on CFC income subject to reductions for foreign income taxes paid or accrued. This US regime supports the continued existence of a corporate income tax and presents an opportunity to co-ordinate the details of corporate income tax systems globally. Similarity among systems, for instance with respect to rate, timing and base, would further strengthen the corporate income tax and perhaps support innovations such as formulary apportionment. US tax administrators, non-US governments and taxpayers will each play a role in negotiating the details of international corporate income tax law going forward and in determining whether and on what terms these details converge.*

## Introduction

Over the past few decades, international tax competition has resulted in declining corporate tax rates and increased corporate tax base erosion.<sup>1</sup> In the case of the US, before the TCJA, competitive tax policy was expressed in an unusual way. Instead of lowering the US corporate tax rate, the US instead allowed US-parented multinationals to defer or delay indefinitely the payment of any US income tax on much of their non-US income earned through non-US controlled foreign corporations. The US, in other words, had a “maybe later” approach to taxing much non-US corporate income prior to the TCJA. Under prior law, if a US-parented multinational firm could also plan to avoid non-US income tax on non-US income—and many could—then double non-taxation resulted absent an actual or deemed repatriation.<sup>2</sup>

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<sup>1</sup> See, e.g. R. Altshuler and H. Grubert, “The Three Parties in the Race to the Bottom: Host Governments, Home Governments, and Multinational Corporations” (2005) 7 Fla. Tax Rev. 153 (noting tax competition strategies including tax rate cuts and acquiescence in multinational base erosion); K.S. Markle and D.A. Shackelford, “Cross-Country Comparisons of Corporate Income Taxes” (2012) 65 Nat’l Tax J. 493 (showing decline in corporate tax rates globally from 1988 to 2009).

<sup>2</sup> See, e.g. J. Chew, “7 Corporate Giants Accused of Evading Billions in Taxes”, *Fortune*, 11 March 2016, available at: <http://fortune.com/2016/03/11/apple-google-taxes-eu/> [Accessed 12 August 2019]; E. Kleinbard, “Stateless Income” (2011) 11 Fla. Tax Rev. 699.

It is this “maybe later” feature of prior US law that the GILTI unilateral minimum tax repeals and reverses.<sup>3</sup> The earlier US rules allowed indefinite deferral of US multinational firms’ payment of income tax on non-US income. The earlier US rules thus contributed to a “race to the bottom”, which weakened the corporate tax on international income. In contrast, the tax on GILTI revokes the US deferral permission that had made double non-taxation possible (absent repatriation) for US-parented firms. Because GILTI’s foreign tax credit provision also protects the imposition of non-US corporate income tax, the GILTI tax has a fundamentally co-operative structure.

After the TCJA, US parent corporations must generally pay current tax on the income of their CFCs, subject to reduction for foreign income taxes paid or accrued. The main way for a US-parented multinational to reduce current US income tax on the GILTI or subpart F income of its CFCs is to pay or accrue income tax to a foreign jurisdiction and claim a foreign tax credit, which reduces US tax. Thus the US rules after the TCJA generally ensure that either a corporate income tax is paid to the US on CFC income, or it is paid to another jurisdiction.<sup>4</sup>

The mechanics of the GILTI tax are roughly as follows. The description assumes a US multinational firm in which a US parent corporation wholly owns a CFC.<sup>5</sup>

First, GILTI equals much of the non-subpart F income earned by the CFC, but it excludes an exempt return equal to 10 per cent of the adjusted basis of the CFC’s tangible assets used in the production of GILTI.<sup>6</sup> Secondly, the US corporate parent includes GILTI in its gross income, even if the CFC does not repatriate any profit to the US parent.<sup>7</sup> Thirdly, the US corporate parent may take a 50 per cent deduction for GILTI, which reduces the effective US tax rate on GILTI to half of the US statutory rate, or 10.5 per cent currently.<sup>8</sup> Fourthly, the tax on GILTI is reduced (but not below zero) by 80 per cent of foreign income taxes paid or accrued on that same income.<sup>9</sup> Fifthly, under the foreign tax credit limitation, this foreign tax credit may only offset tax on foreign-source GILTI, and US rules are used to determine the amount of foreign-source GILTI.<sup>10</sup> Sixthly, there is no foreign income tax credit carry over or carry back for GILTI foreign tax credits.<sup>11</sup>

The US rules after the TCJA do not insist on a very high rate of corporate tax. Under certain assumptions including tax base conformity, the US tax on GILTI equals zero if the non-US

<sup>3</sup> S.C. Morse, “International Cooperation and the 2017 Tax Act” (2018) 128 *Yale L.J. Forum* 362.

<sup>4</sup> An insightful article about GILTI from a European perspective suggests that US trading partners could benefit from the shelter of GILTI by “implement[ing] global minimum tax rates on foreign source income that cluster around a US unilateral price”, which would “ultimately enable[e] beneficial competition with respect to productive factors”. See G. Charles Beller, “Made in America for European Tax: Unilateral Measures and Cooperative Surplus in the International Tax Competition Game” (2019) 38 *Va. Tax Rev.* 271, 309.

<sup>5</sup> Summaries of GILTI include New York State Bar Association Tax Section, *Report on the GILTI Provisions of the Code* (4 May 2018) (detailing technical problems and questions raised by GILTI rules) and D.N. Shaviro, “The New Non-Territorial US International Tax System” (2 July 2018) 160 *Tax Notes* 57.

<sup>6</sup> See IRC s.951A(b)(2) (defining “net deemed tangible income return” as the excess of 10% of a shareholder’s share of a CFC’s qualified business asset investment over net interest expense of the CFC allocated to that shareholder).

<sup>7</sup> See IRC s.951A (providing for current inclusion of GILTI); Shaviro, above fn.5, 58 (describing GILTI’s “now or never” approach).

<sup>8</sup> See IRC s.250(a) (allowing a 50% deduction for GILTI).

<sup>9</sup> See IRC s.960(d) (allowing foreign tax credit for up to 80% of foreign taxes paid or accrued).

<sup>10</sup> See IRC s.904(d) (providing separate GILTI foreign tax credit limitation basket).

<sup>11</sup> See IRC s.904(c) (last sentence).

effective corporate tax rate equals 13.125 per cent. Under similar assumptions, the US tax on subpart F income equals zero if the non-US effective corporate tax rate equals 21 per cent.<sup>12</sup>

Nevertheless the post-TCJA US rules better protect the existence of the corporate income tax globally, compared to the pre-TCJA US rules, because the incentive to avoid foreign income tax altogether is reduced compared to the pre-TCJA regime. The potential of the post-GILTI US regime to support a robust global corporate income tax will be realised if it encourages corporate income tax laws to converge globally. Tax policy makers can choose to implement GILTI in a way that encourages this convergence. This article discusses convergence with respect to three features: rate, timing and base.

A key mechanism that can encourage convergence is the foreign tax credit.<sup>13</sup> The foreign tax credit is the central linchpin and connection point between the US tax on CFCs' GILTI or subpart F income and non-US income tax systems. The terms of the US foreign tax credit, particularly the foreign tax credit limitation, may adjust to accommodate the terms of non-US income tax law. The terms of non-US income tax law may adjust to accommodate the terms of US income tax law. Also, taxpayer planning may achieve converging results, for example if taxpayers prefer tax bases that conform for purposes of calculating each of foreign income tax liability and the US foreign tax credit limitation.

On rate, the post-TCJA US rules move toward convergence. Prior to the TCJA, the US top corporate tax rate of 35 per cent materially exceeded other jurisdictions' rates. Then the TCJA followed other countries' lead by reducing corporate income tax rates. Several post-TCJA tax rates are relevant for the new US law. The US tax rate for GILTI is 10.5 per cent. The foreign income tax rate at which US tax liability on GILTI equals zero is, under certain assumptions, 13.125 per cent. The foreign effective rate that would qualify CFC income for an elective high-tax exclusion under proposed regulations is 18.9 per cent. The US tax rate for subpart F income is 21 per cent, subject to a dollar-for-dollar foreign tax credit.

The important point for convergence is that these statutory rates are close to the range of corporate tax rates in the rest of the world. Certainly they are closer than the 35 per cent US statutory rate in force prior to the TCJA. Taxpayers and foreign governments may respond to the offered menu of tax rate options by converging around one tax rate or another, depending on the context.<sup>14</sup>

On timing, GILTI's approach of current US taxation subject to a foreign tax credit works best if US and foreign law measure income at the same time. In addition, the main alternative to GILTI taxation for CFC income is subpart F taxation. Current subpart F taxation subject to a

<sup>12</sup> In addition, proposed regulations would also allow an election to exclude certain CFC income subject to a rate of at least 18.9%. See Prop. Treas. Reg. s.1.951A-2(c)(6) (proposing high-tax exclusion election on a qualified business unit basis for net income on which paid or accrued foreign income taxes exceed 90% of the top US statutory corporate rate).

<sup>13</sup> Similarly, the calculation of foreign taxes for purposes of high-foreign-tax exception income also serves a linchpin role.

<sup>14</sup> cf. K. Clausing, *Profit Shifting Before and After the Tax Cuts and Jobs Act* (2018), Table 5 (modeling the possible changes in allocations of income to different foreign jurisdictions after the TCJA and predicting some winners and losers, including the likely allocation of income away from tax havens), available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3274827](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3274827) [Accessed 12 August 2019].

foreign tax credit also works best if US and foreign law measure income at the same time. The key US timing provisions count foreign income taxes when they have been paid or accrued.

On tax base, the post-TCJA US law tends to ensure that tax is paid somewhere, but not necessarily entirely to the US. The foreign tax credit is the mechanism used to reduce the US tax on GILTI, by up to 80 per cent of foreign taxes paid; and to reduce the US tax on subpart F, by up to 100 per cent of foreign taxes paid. The mechanism works smoothly when tax bases are conformed, so that the same tax base is used to calculate both foreign taxes and the US foreign tax credit limitation. The question of tax base conformity, however, was not explicitly addressed in the US statute and now presents a series of challenging expense allocation and other issues.

The author argues that tax policy makers can select responses to taxpayer planning and guidance requests that have the greatest chance of harmonising rate, timing and base across corporate tax systems worldwide. For example, taxpayers have begun to seek ways to disrupt timing co-ordination, for instance by asking for guidance that would reduce US tax now to account for foreign taxes that will not be paid or accrued until later.<sup>15</sup> Taxpayers also seek to arbitrage tax base calculations, for instance by increasing the tax base of foreign income used for calculating the US foreign tax credit limitation while decreasing the tax base used to calculate US taxes such as GILTI.<sup>16</sup> Whether GILTI will succeed as a co-operative international tax law tool depends in part on whether tax administrators allow such tactics. This in turn depends not only on willingness to resist taxpayer requests, but also on policy tradeoffs. For instance, some harmonising tactics may reduce domestic revenue.

This article proceeds as follows. Part I compares the GILTI tax to the US deferral regime that preceded it, and describes the co-operative potential of the US international corporate tax law after the TCJA. Part II explains the details of GILTI structure, which works as advertised if international tax systems conform with respect to rate, timing and base. Part III explains that taxpayers will attempt to disrupt the convergence of rate, timing and base. Tax policy makers, in turn, will face the question of whether, and how, to pursue the possibility of harmonising corporate tax systems in light of the tools offered by the US international corporate tax law after the TCJA.

## I. Co-operative potential despite competitive rhetoric

### A. *Inadvertent co-operation?*

The idea that GILTI has a fundamentally co-operative structure does not match the core “America First” message of current US foreign policy.<sup>17</sup> The rhetoric surrounding the TCJA had to do with competition, not co-operation. Most prominently, the headline reduction of the top corporate tax rate from 35 per cent to 21 per cent was a classic competitive move.<sup>18</sup> Nevertheless the unilateral

<sup>15</sup> See below Part III.C.

<sup>16</sup> See below Part III.D.

<sup>17</sup> See, e.g. G. Rose, “The Fourth Founding: The United States and the Liberal Order” (2019) 98 *Foreign Affairs* 10, 17 (“The [international] order is a positive-sum game, and [Trump] lives in a zero-sum world. It is based on sustained cooperation for mutual benefit, which is not something Trump does”).

<sup>18</sup> See, e.g. M. Keen and K.A. Konrad, “The Theory of International Tax Competition and Coordination” (2013) 5 *Handbook of Public Economics* 257, 262 (noting that leading models of tax competition consider competition over

minimum tax on GILTI takes a co-operative approach and rejects the competitive structure of the prior law's "maybe later" permission for US parent corporations to defer tax on CFC income indefinitely.

It is not entirely clear how the GILTI tax became part of the law given its tension with the competitive headline of the TCJA. Perhaps it happened in part because the Act was drafted and passed so quickly.<sup>19</sup> Perhaps despite the messy legislative process common sense seeped in, consistent with one commentator's suggestion that GILTI emerged from "Congress's disbelief that transfer pricing rules will now work for intellectual property income".<sup>20</sup> Finally, the budget reconciliation rules limited the bill's deficit financing (as measured by admittedly imperfect revenue scoring) to \$1 trillion over 10 years. The GILTI provision attracted a revenue estimate of \$112 billion over 10 years—about 9 per cent of the \$1.35 trillion estimated cost of reducing the top corporate tax rate.<sup>21</sup>

GILTI had a recent precedent in the minimum tax proposal put forward by the Obama administration<sup>22</sup> as well as in other administration studies and legislative proposals developed over the years.<sup>23</sup> The GILTI minimum tax is a close cousin to subpart F, and its structure (though not its reduced rate) resembles the original 1962 Kennedy administration proposal for the current taxation of all controlled foreign corporation income.<sup>24</sup> Finally, the tax on GILTI connects to work at the Organisation for Economic Co-operation and Development (OECD) that aims to counteract base erosion and profit shifting.<sup>25</sup>

One way or the other, the GILTI tax has become law. Its co-operative tendencies might be inadvertent, but they are there, available if tax policy makers decide to take advantage of them. Going forward, government decisions might erode the co-operative promise of the GILTI regime. Or, government choices might support that promise. This is an open question.

### *B. Why a more robust global corporate income tax is a good idea*

It is worth pausing for a moment to say why it is a good idea to have similar corporate tax systems globally. Sometimes this is called harmonisation or co-ordination.<sup>26</sup> The defence offered below

rates). See also E. Toder, "International Competitiveness: Who Competes Against Whom and For What?" (2012) 65 *Tax L. Rev.* 505.

<sup>19</sup> See G.K. Yin, "Crafting Structural Tax Legislation in a Highly Polarized Congress" (2018) 81 *Law & Contemp. Probs.* 241 (noting the "hasty and secretive manner" in which Congress considered the 2017 tax bill).

<sup>20</sup> M. Graetz, "Foreword – The 2017 Tax Cuts: How Polarized Politics Produced Precarious Policy" (2018) 128 *Yale L. J. Forum* 315 (describing the rushed legislative process).

<sup>21</sup> Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement for the "Tax Cuts and Jobs Act"* (15 December 2017).

<sup>22</sup> White House & Dep't of Treasury, *The President's Framework for Business Tax Reform* (February 2012).

<sup>23</sup> See M. Herzfeld, "The Origins of GILTI" (25 June 2018) 159 *Tax Notes* 1466 (describing academic and government antecedents for GILTI and arguing that its purpose is to address base erosion incentives that arise under a territorial system); R.S. Avi-Yonah and K.A. Clausen, "Toward a 21st-Century International Tax Regime" (26 August 2019) 95 *Tax Notes International* 48, 49 (arguing that GILTI-type taxes build on "existing principles" but "work well only if there is a consensus on profit allocation", because such taxes grant foreign tax credits to source countries).

<sup>24</sup> "Report of the Task Force on International Tax Reform" (2006) 59 *Tax Lawyer* 649 (explaining that a watered-down version of the original full-inclusion Kennedy proposal became the anti-deferral subpart F regime).

<sup>25</sup> See R. Avi-Yonah and G. Mazzoni, "BEPS, ATAP and the New Tax Dialogue: A Transatlantic Competition" (2018) 46 *Intertax* 885.

<sup>26</sup> An example is the EU effort to develop a Common Consolidated Corporate Tax Base. See J. Freedman and G. Macdonald, "The Tax Base for CCCTB: The Role of Principles" in M. Lang, P. Pistone, J. Schuch and C. Staringer

briefly considers the starting point of income taxation, as well as general goals grounded in efficiency and equity.

One important reason for the corporate income tax is that it is a proxy for taxing shareholders.<sup>27</sup> This idea rests on the commitment of the individual income tax to taxing income from capital. The commitment to taxing capital income in turn reflects a normative commitment to distributive justice, however imperfectly the commitment is practically realised.<sup>28</sup>

In other words, some income from capital—i.e. returns to shareholders—appears first as corporate profit. The failure to tax the profit of corporations globally would delay indefinitely a tax on the return from capital earned by corporations and probably shift the overall income tax burden to labour.<sup>29</sup> The domestic corporate income tax backstops the goals of the individual income tax, and the global corporate income tax backstops the goals of the domestic corporate income tax.

But the global corporate income tax is vulnerable to competition, meaning that specific jurisdictions face an incentive to lower their corporate tax burdens in a bid to attract corporate investment. Competition may be inefficient, because it produces differences among corporate income tax systems, and differences produce distortions.<sup>30</sup> The contributions of economists reveal that similar corporate income tax systems minimise cross-jurisdiction distortions, which constitutes an efficiency advantage for harmonisation.<sup>31</sup>

Another voice in favour of similar corporate tax systems comes from some global justice advocates. The idea here has to do with protecting a revenue source that could support social development goals such as the reduction of poverty globally. Scholars have proposed shifting multinational corporate tax revenue to poorer jurisdictions based on the argument that poorer

(eds), *Common Consolidated Corporate Tax Base* (Vienna: Linde, 2008) (describing effort to define “a new, unified tax base” and advocating fundamental principles including neutrality, equality, objectivity and certainty).

<sup>27</sup> See, e.g. J. Clifton Fleming, R. Peroni and S. Shay, “Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income” (2001) 5 Fla. Tax Rev. 299 (arguing that the corporate tax is necessary because of the impracticality of taxing shareholders on a pass-through basis). Regulatory motivations also have supported corporate income tax enactments. See A.K. Mehrotra, “The Public Control of Corporate Power: Revisiting the 1909 U.S. Corporate Tax from a Comparative Perspective” (2010) 11 Theoretical Inquiries L. 491, 498 (connecting business regulatory goals and corporate taxation).

<sup>28</sup> One key issue is the incidence of the corporate tax. Compare, e.g. J.G. Gravelle and K.A. Smetters, “Does the Open Economy Assumption Really Mean that Labor Bears the Burden of a Capital Income Tax” (2006) 6 Adv. Econ. Analysis & Pol’y 1 (finding that capital bears the majority of the burden of the corporate tax in a global model where investment in foreign and domestic assets are imperfect substitutes) with W.M. Gentry, “A Review of the Evidence on the Incidence of the Corporate Income Tax” (December 2007) OTA Paper 101, US Department of the Treasury 5-16 (reporting on studies that “conclude that labor bears a substantial burden of the corporate tax”).

<sup>29</sup> R.S. Avi-Yonah, “Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State” (2000) 113 *Harvard Law Review* 1573, 1624 (citing the regressive nature of a shift in the tax burden to labour as a result of tax competition).

<sup>30</sup> Some contend, however, that international tax competition has efficiency benefits. See J. Roin, “Competition and Evasion: Another Perspective on International Tax Competition” (2001) 89 Geo. L. J. 543, 561 (arguing that tax competition permits countries to offer different packages of services in exchange for different tax regimes, thus creating “locational efficiencies”).

<sup>31</sup> See M. Keen and K.A. Konrad, “The Theory of International Tax Competition and Coordination” in A.J. Auerbach, R. Chetty, M. Feldstein and E. Saez (eds), *Handbook of Public Economics* (Elsevier, 2013), Vol.5, 257, 269 (noting that an equilibrium tax rate among similar countries has “production efficiency” as “all countries charge the same tax rate, so the allocation of capital is first best”, even if a small uniform increase in tax rate would increase welfare further).

jurisdictions support corporate profits by suffering environmental and labour force exploitation,<sup>32</sup> or based on the goal of maximising the welfare resulting from provision of public goods.<sup>33</sup> Some analyses suggest that the corporate tax is a particularly important revenue source for developing nations and that formulary apportionment would increase the tax base for emerging and developing nations, especially if employment-based factors were used.<sup>34</sup>

This promise of global corporate taxation to support social development goals is contested, in part because it may depend on the assumption that richer nations would agree to transfer corporate tax revenue to poorer nations.<sup>35</sup> But if such transfers were possible from a political economy viewpoint, similar corporate systems might make the transfer easier, for instance by facilitating formula allocation based on factors favorable to developing countries.<sup>36</sup> Formulary apportionment works if systems are similar as to rate, timing and base, because in that case firms have less incentive to manipulate factors to cause income to be allocated to particular jurisdictions.

### *C. Why the GILTI minimum tax is classically co-operative*

The GILTI minimum tax executes a vintage co-operative move. This move involves a residence tax country giving up its claim to taxing jurisdiction in favour of a source country—provided that the source country in fact imposes tax. In the GILTI setup, the US is the residence country for a US-parented multinational. Other jurisdictions where the multinational operates are source jurisdictions. Some say this is a customary international law norm for the allocation of tax jurisdiction.<sup>37</sup> Others label the arrangement an example of the single tax principle.<sup>38</sup>

<sup>32</sup> See A. Christians and L. van Apeldoorn, “Taxing Income Where Value is Created” (2019) 22 Fla. Tax Rev. 1, 35–39 (giving example of revised transfer pricing results after considering labour exploitation).

<sup>33</sup> See A. Rosenzweig, “Defining a Country’s ‘Fair Share’ of Taxes” (2015) 42 Fl. St. L. Rev. 373, 400–401 (advocating for allocation to countries with fewer public goods based on the declining marginal utility of public goods).

<sup>34</sup> See, e.g. IMF, *Corporate Taxation in the Global Economy* (IMF Policy Paper, March 2019), 33.

<sup>35</sup> See, e.g. T. Dagan, “The Costs of International Tax Cooperation” in E. Benevisti and G. Nolte (eds.), *The Welfare State, Globalization and International Law* (Berlin; New York: Springer, 2004) (arguing that developed countries are likely to come out ahead in multilateral negotiations over tax revenue division, so that “host countries will end up effectively paying for the redistributive function of home country taxes” and also explaining that revenues directed to host countries might not in fact go to address development goals); T. Diniz Magalhães, “What is Really Wrong With Global Tax Governance and How to Fix It” (2018) 10 *World Tax Journal* 4 (arguing that the “technical discourses” that dominate international tax policy discussion have not furthered the interests of developing countries in part because these discourses conceal “normative assumptions about what is right and wrong, what is fair and unfair, while denying the presence of ideologies and entrenched power relations”).

<sup>36</sup> See T. Faccio and V. Fitzgerald, “Sharing the Corporate Tax Base: Equitable Taxing of Multinationals and the Choice of Formulary Apportionment” (2018) 25 *Transnat. Corps.* 67 (demonstrating that the impact of formulary apportionment adoption on developing country revenues depends on the factors adopted); J. Martens-Weiner, *Company Tax Reform in the European Union: Guidance from the United States and Canada on Implementing Formulary Apportionment in the EU* (New York: Springer, 2001). cf. I. Benshalom, “The New Poor At Our Gates: Global Justice Implications for International Trade and Tax Law” (2010) 85 *N.Y.U. L. Rev.* 1 (arguing that the existing international tax framework evaluates focuses on existing commercial relationships as revealed by transactions, and lacks a theory of distributive justice).

<sup>37</sup> See, e.g. J. Clifton Fleming Jr, “To What Degree Does Customary International Law Require Accommodation of a Source Country’s Right to Tax High, Tax Low or Not Tax At All” in A. Zimmerman (ed.), *A Commitment to Excellence: Essays in Honour of Emeritus Professor Gabriël Moens* (Redland Bay: Connor Court, 2018), 312.

<sup>38</sup> R.S. Avi-Yonah, “Who Invented the Single Tax Principle: An Essay on the History of US Treaty Policy” (2014) 59 *N.Y. L. Sch. L. Rev.* 305.

Under this norm, the source country jurisdiction is primary and the residence country jurisdiction is secondary. The source country's jurisdiction does not include the right to insist that there be no tax at all on the relevant activity. It is more like a right of first refusal. Under the co-operative norm, the source country holds the first right to tax. The taxpayer should receive a reduction of residence country income tax otherwise due to account for the payment of income tax to the source jurisdiction.

This co-operative approach under which a residence jurisdiction cedes the primary right to tax to the source jurisdiction dates at least to the decision of the United States to unilaterally enact a foreign tax credit.<sup>39</sup> As in 1918, the 2017 framework involves the US as a residence jurisdiction, with a US parent exporting capital to a non-US subsidiary. As in 1918, the foreign tax credit does most of the work of ceding the jurisdiction of the US to tax controlled foreign corporation income to the non-US jurisdiction that seeks to tax the controlled foreign corporation's income. One difference is that the GILTI regime only allows 80 per cent (not 100 per cent) of foreign income taxes to reduce GILTI tax liability.

Still, the GILTI tax is fundamentally co-operative. When the GILTI foreign tax credit reduces current US tax liability to account for taxes imposed by non-US source jurisdiction, the US rules support *other countries'* corporate tax systems. This foreign tax credit link can also incentivise non-US corporate income tax systems that are similar to the system in the US. The mechanism for this incentive is that more similar tax systems produce more usable foreign tax credits.

#### *D. A key assumption: US-parented multinationals will remain important*

The claim that GILTI offers a robust co-operative framework requires a caveat, which is that GILTI only applies to US-parented multinationals. The GILTI tax is imposed on certain US shareholders of CFCs, including the US parents of multinational firms.<sup>40</sup> The GILTI tax does not apply to a multinational whose parent firm is incorporated outside the US. This presents the risk that multinationals will reject US-parented structures in favour of non-US parented structures not burdened by a minimum tax regime.

But various frictions discourage firms from discarding the US parent structure. These include business considerations, which historically have made it prohibitively expensive for a US-based startup to begin as a non-US company.<sup>41</sup> They also include anti-base erosion provisions like the new US base erosion and anti-abuse tax (BEAT), which limits a firm's ability to erode the base of US subsidiaries when the firm causes these subsidiaries to make deductible payment to non-US parent firms.<sup>42</sup> Also, US rules make it difficult and expensive to "invert" and abandon US-parented status.<sup>43</sup> The number of inversions is not large—even including strategic mergers apparently

<sup>39</sup> See M.J. Graetz and M.M. O'Hear, "The 'Original Intent' of U.S. International Taxation" (2007) 46 Duke L. J. 1021, 1043–1054 (describing the introduction of the foreign tax credit in 1918 and its enactment in 1919 and noting that it attracted little notice in the legislative process).

<sup>40</sup> See IRC s.951A(a) (requiring GILTI inclusion for domestic corporations who are US shareholders, that is, who own 10% or more of a controlled foreign corporation by vote or value).

<sup>41</sup> See, e.g. S.C. Morse, "Startup Ltd.: Tax Planning and Initial Incorporation" (2013) 14 Fla. Tax Rev. 319; E.J. Allen and S.C. Morse, "Tax Haven Incorporation for U.S. Firms: No Exodus Yet" (2013) 66 Nat'l Tax J. 395.

<sup>42</sup> IRC s.59A. The BEAT penalises excessive deductible payments made by certain US firms to related non-US affiliates.

<sup>43</sup> IRC s.7874.



motivated only partly by tax and designed to avoid the prohibitively expensive features of the anti-inversion rules.<sup>44</sup> Finally, other jurisdictions may themselves adopt minimum taxes and anti-base erosion provisions, reducing the incentive to reject US parented status.<sup>45</sup>

For these reasons, it is entirely possible that US-parented multinational structures will continue to thrive despite the new US minimum tax. It is this situation that this article considers. It assumes, in other words, that powerful and wealthy corporations will continue to organise in US-parented multinational structures. In this context, this article asks whether post-TCJA developments, including but not limited to the administration of the GILTI regime, could meaningfully reduce international tax competition and give strong protection to a robust global corporate income tax.

## II. The details of GILTI co-operation: rate, timing and base

### A. Rate

The first feature of the post-TCJA regime that might support similar corporate tax systems globally is the tax rate. Or, stated more carefully, the tax rates, plural, under the new US law. Each of the several US tax rates is within the lower end of the range of tax rates imposed by US trading partners (i.e. other members of the OECD). This contrasts to the high 35 per cent US statutory rate in place before the TCJA. The new US law, in other words, accepts a lower consensus global tax rate range for corporate income, which other countries had already been moving toward. But it also provides more vigorous and improved support for that lower global tax rate range, by imposing current tax on CFC income subject to foreign tax credit reduction.<sup>46</sup>

Table 1 lists corporate tax rates provided and suggested by US law after the TCJA. It assumes a US-parented multinational in which a US parent wholly owns one or more controlled foreign corporations, or CFCs. It also assumes that US income is earned directly by the US parent while non-US income is earned by the CFCs.

Table 1 first lists post-TCJA tax rates on different types of non-US, or foreign, income earned by CFCs in US-parented multinational groups. These rates imposed on non-US income are the focus of the analysis in this article. The point of the table, as further described below, is to show that there are several rates, ranging from 21 per cent to 0 per cent.

The last two rows in the table describe US corporate income tax rates for US corporate income earned directly by US corporations. These rates are 13.125 per cent (until 2026) for

<sup>44</sup> See, e.g. N. Rao, “Corporate Inversions and Economic Performance” (2015) 68 Nat’l Tax J. 1048 (identifying 48 inversions over about 10 years), see also R. Rubin and J. Hopkins, “Going Out of Style: Tax-Driven Deals to Move Corporate HQs Outside US”, *Wall Street Journal*, 1 August 2019, available at: <https://www.wsj.com/articles/inversion-reversions-arrive-as-companies-get-smaller-tax-edge-from-foreign-addresses-11564662353> [Accessed 18 September 2019].

<sup>45</sup> See OECD/G20 Inclusive Framework on BEPS, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD Publishing, 2019), 26 (outlining an idea for a GILTI-like “income inclusion rule that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate”); see generally J. Englisch and J. Becker, *International Effective Minimum Taxation—The GLOBE Proposal* (Working Paper, 2019), available at <https://ssrn.com/abstract=3370532> [Accessed 12 August 2019].

<sup>46</sup> See Morse, above fn.3.

foreign-derived intangible income (roughly, related to exports)<sup>47</sup> and 21 per cent for other income.<sup>48</sup> They are included for purposes of comparison, even though this article is mainly concerned with the rates of tax shown in the first portion of Table 1.

**Table 1: US corporate tax rates under TCJA**

<i>Non-US income: Tax rates for income earned by controlled foreign corporations (CFCs)</i>		
Subpart F	21% =	US tax rate imposed on US parent Subject to dollar-for-dollar credit for foreign taxes
GILTI	10.5% =	US tax rate imposed on US parent Subject to credit for up to 80% foreign taxes
	13.125% =	Foreign tax rate at which no US tax imposed
Excluded high-taxed income	18.9% =	Foreign tax rate at which no US tax imposed
Excluded 10% QBAI return	0% =	US tax rate; no US tax imposed
<i>US income: Tax rates for income earned directly by US parent</i>		
US statutory rate	21%	
Foreign-derived intangible income (FDII)	13.125%	

With respect to these rates applied to non-US income earned through CFCs, Table 1 first notes that the top US corporate rate of 21 per cent applies to subpart F income. Subpart F income means, roughly, passive or mobile income earned under the legacy antideferral subpart F rules in existence since the 1960s. Key categories of subpart F income include foreign personal holding company income such as interest, dividends, rents, royalties and capital gain<sup>49</sup>; foreign base company sales income, for instance income from structures that seek to allocate sales profit to a low-taxed intermediate affiliate<sup>50</sup>; and foreign base company services income, for instance earned with the substantial assistance of a US affiliate.<sup>51</sup>

The TCJA did not materially change the Code's subpart F provisions. In particular, the TCJA did not change taxpayers' ability to choose whether to categorise CFC income as either subpart F or not subpart F. Both prior to and after the TCJA, tax planning offers taxpayers the option of either achieving or avoiding subpart F income status for CFC income.<sup>52</sup>

Prior to the TCJA, US multinationals typically used this optionality to avoid subpart F status for CFC income. Prior to the TCJA, there was no tax on GILTI. If a CFC avoided subpart F

<sup>47</sup> "Foreign derived intangible income", roughly, means a US corporation's income from export-related income less an imputed 10% return on tangible assets deemed to support that income from exports. See IRC s.250(b) (defining FDII). The 13.125% effective rate is achieved via a deduction equal to 37.5% of FDII. This deduction is scheduled to reduce to 21.875% in 2026, causing a 16.4% effective rate: IRC s.250(a).

<sup>48</sup> IRC s.11(b).

<sup>49</sup> IRC s.954(c).

<sup>50</sup> IRC s.954(d).

<sup>51</sup> IRC s.954(e); see Notice 2007-13, 2007-13 I.R.B. 410 (Jan. 29, 2007) (providing substantial assistance safe harbours).

<sup>52</sup> Several developments made subpart F treatment elective as a practical matter. Likely the most important was the check-the-box regulations that made it possible for U.S. parent corporations to disregard many transactions between foreign affiliates for U.S. tax purposes. See L. Lokken, "Whatever Happened to Subpart F" (2005) 7 Fla. Tax Rev. 186.

income, avoided non-US income taxes, and avoided actual or deemed repatriation, the US multinational that owned the CFC could achieve double non-taxation for the CFC's income. Subpart F optionality was part of the way in which the US system prior to the TCJA competed, and facilitated lower corporate income tax payments by US-parented firms.

But the TCJA changed the stakes of avoiding subpart F.<sup>53</sup> After the TCJA, the main alternative to subpart F for CFC income is treatment as GILTI. GILTI treatment generally means that the US parent must pay current tax and cannot achieve double non-taxation.<sup>54</sup> (An exception is the 10 per cent return on QBAI, which, as explained below, generally is set aside for purposes of this article.<sup>55</sup>)

A lower rate of tax applies for GILTI compared to subpart F income, since subpart F income fully included in corporate income and attracts a top statutory rate of 21 per cent. In comparison, lower effective rates of tax on GILTI are accomplished through deductions. The 50 per cent GILTI deduction in effect through 2025 produces a 10.5 per cent effective US rate for GILTI, which is the rate listed in Table 1. In 2026, the GILTI deduction is scheduled to decrease to 37.5 per cent. This level of deduction produces a 13.125 per cent effective US rate.<sup>56</sup>

The TCJA also means that different foreign tax credit rules apply to subpart F income compared to GILTI. The tax on subpart F income is reduced dollar-for-dollar by a credit for foreign income taxes paid on the same income.<sup>57</sup> The subpart F income foreign tax credit also carries back one year and forward 10 years.<sup>58</sup> The foreign tax credit limitation, which prevents the foreign tax credit from exceeding the US tax that would otherwise be due on foreign source income, is calculated separately for passive income (such as subpart F foreign personal holding company income) and active income (such as subpart F foreign base company sales and services income).<sup>59</sup> This means that cross-crediting—the mixing of high-taxed and low-taxed foreign income so that the credits from the high-tax income reduce US tax on the low-tax income—is

<sup>53</sup> See, e.g. J. Cummings, “2017 Act Effects on Cross-Border Transactions” (28 January 2019) 162 *Tax Notes* 377 (noting that multinationals are considering planning into subpart F).

<sup>54</sup> IRC s.951A(c)(2)(A) defines “tested income” from which GILTI derives by exclusion, or in other words by including all of a CFC's income except listed carveouts. The carveouts include US-source effectively connected income (as described in s.952(b)), subpart F income, gross income excluded from subpart F income by reason of a high-tax exclusion; related-party dividends; and foreign oil and gas extraction income. In text, this article generally presents CFC income as including four main categories: subpart F, GILTI, 10% QBAI return, and high-tax exception income. Other carveouts also generally should produce current taxation. For instance, US-source effectively connected income is subject to current US tax: s.882. Foreign oil and gas extraction income tends to attract high taxes and therefore presents particularly attractive cross-credit opportunities. See B.I. Bittker and L. Lokken, *Fundamentals of International Taxation* (New York: Thomson Reuters, 2011), para.72.11.2 (explaining purposes of preventing “high foreign taxes on FOGEI from offsetting US tax on less heavily taxed [foreign] income”).

<sup>55</sup> The exemption for a 10% return on the net basis of tangible assets used to produce GILTI, or QBAI, is a companion provision to other measures that allow immediate or rapid expensing when capital equipment is purchased. It is thought of as a tax base measurement provision rather than a provision that co-ordinates the imposition of US versus foreign income tax. See below fnn.66–68 and accompanying text.

<sup>56</sup> IRC s.250(a).

<sup>57</sup> IRC ss.951, 960.

<sup>58</sup> IRC s.904(c).

<sup>59</sup> IRC s.904(d). The subpart F foreign tax credit is more generous in other respects as well, since it may allow cross-crediting with other general basket or passive basket income, and also allows a one-year carry back and 10-year carry over of foreign tax credits. See, e.g. L. Zhang, “To the Frying Pan: New Virtues of Subpart F Over GILTI” (2 July 2018) 160 *Tax Notes* 73.

available for subpart F income within the general basket and within the passive basket, but not across the two baskets.

The foreign tax credit for GILTI is less generous. It is allowed up to 80 per cent of foreign income taxes paid on the same income,<sup>60</sup> and there is no carry back or carry over.<sup>61</sup> Non-passive GILTI income goes into a single basket for foreign tax credit limitation purposes.<sup>62</sup> As with the baskets that apply for passive and active income, there is no per-country limitation, so cross-crediting is available for GILTI from any CFC affiliate within a multinational group.

It is the 80 per cent foreign tax credit for GILTI which supports Table 1's statement that 13.125 per cent is the foreign tax rate at which no US tax is imposed on GILTI. Importantly, this calculation is subject to a counterfactual assumption of equivalent tax bases. Nevertheless it suggests the interaction between GILTI and foreign tax systems. Through 2025, when the US effective rate is 10.5 per cent, the 80 per cent foreign tax credit suggests that 13.125 per cent is the foreign tax rate at which the US tax on GILTI would equal zero under the same-tax-base assumption.<sup>63</sup> Starting in 2026, when the US effective rate is 13.125 per cent, 16.4 per cent is the approximate foreign tax rate at which the US tax on GILTI would equal zero.<sup>64</sup>

Two further details can explain the last two rows of Table 1 in the non-US income section. These table rows show a rate of 18.9 per cent for excluded high-taxed foreign income and a rate of 0 per cent for a 10 per cent exempt return on QBAI, which stands for "qualified business asset investment". Both these details relate to the definition of GILTI.

The definition of GILTI excludes high-taxed foreign income, defined by cross-reference to a subpart F subsection, which in turn describes net income items subject to tax at a rate that at least equals 90 per cent of the maximum US statutory rate. Since the current maximum rate is 21 per cent, the threshold for the elective high-taxed income exclusion equals 18.9 per cent. The statute only refers to high-tax exception items that are part of the definition of subpart F income, but proposed regulations would allow taxpayers to elect into the high-taxed exception even for items of income that did not qualify as subpart F income. At the moment it is not clear whether high-tax exception items will form their own category or a subset of the subpart F income category.<sup>65</sup>

<sup>60</sup> IRC s.960(d).

<sup>61</sup> IRC s.904(c) (last sentence).

<sup>62</sup> IRC s.904(d)(1)(A).

<sup>63</sup> In other words,  $80\% \times 13.125\% = 10.5\%$ .

<sup>64</sup> In other words,  $80\% \times 16.40625\% = 13.125\%$ .

<sup>65</sup> The high-tax exclusion is under consideration. Under the statute, GILTI excludes "any gross income excluded from the foreign base company income (as defined in section 954)...by reason of section 954(b)(4)". IRC s.951A(c)(2)(A)(i)(III). Section 954(b)(4), in turn, allows an election for the high-tax exclusion from subpart F income treatment. Treasury initially released proposed regulations that described high-tax exclusion income as a subcategory within subpart F. Treasury, *Notice of Proposed Rulemaking, Guidance Related to Section 951A*, 83 Fed. Reg. 51072, 51075 (10 October 2018) (clarifying that the high-tax exclusion applies to an item of income "solely by reason of an election made to exclude the income under...section 954(b)(4). Accordingly, the exclusion does not apply to income that would not otherwise be subpart F income"). But some taxpayers objected. See A. Velarde, "IRS Silent Amid Claims That GILTI Regs Skirt Legislative Intent" (18 February 2019) 93 *Tax Notes International* 774 (noting comments of National Foreign Trade Council representative). A second set of proposed regulations includes a provision that would allow election of the high-tax exclusion even if CFC income did not qualify as subpart F. See Prop. Treas. Reg. s.1.951A-2(c)(6) (proposing high-tax exclusion election on a qualified business unit basis for net income on which paid or accrued foreign income taxes exceed 90% of the top US statutory corporate rate); see also Treasury, *Notice of Proposed Rulemaking, Guidance Under Section 958 and Section 951A*, 84 Fed. Reg. 29114, 29120 (21 June

The definition of GILTI also exempts an amount equal to 10 per cent multiplied by the adjusted basis of tangible assets used to produce GILTI.<sup>66</sup> Related foreign taxes may not be claimed as foreign tax credits. Although the 0 per cent tax rate for the 10 per cent QBAI return might encourage US multinationals to reduce US taxes by making real capital investments abroad,<sup>67</sup> it probably will not dominate pure tax planning efforts. Tangible investments involve real-world frictions<sup>68</sup> and a 10 per cent exempt return on tangible investments does not encompass digital economy and other high-profit returns that taxpayers seek. As discussed further below in Part III.B, the other US tax rates, ranging from 10.5 per cent to 21 per cent, will likely have the most relevance. It is these rates that offer pure tax planning opportunities to multinational taxpayer groups and present policy choices to non-US governments who might be encouraged to administer their corporate income tax systems in a way that maximises taxpayers' ability to claim US foreign tax credits.

### *B. Timing*

The second feature of the post-TCJA US regime that supports similar corporate tax systems is timing. "Timing" here means that applicable law requires CFCs to pay US tax currently, subject to reduction for current foreign tax liabilities only (in the case of GILTI) and subject to reduction for current and carryover or carryback liabilities (in the case of subpart F). The most striking timing change produced by the TCJA is the tax on GILTI. The US tax on GILTI is due in the year the related income accrues, subject to reduction through the foreign tax credit for foreign taxes paid or accrued in the same year.

Prior to the TCJA, the US system generally did not impose current tax on CFC income unless it was subpart F income,<sup>69</sup> and as described above in Part II.A, it had become straightforward for many multinationals to avoid categorising CFC income as subpart F. Before the TCJA, if CFC income was not taxed as subpart F income, the US deferred taxation and did not tax that CFC income until repatriation, for instance as a dividend.

Even though the pre-TCJA US system promised to tax eventually non-subpart F income, companies controlled the timing of dividend repatriation and therefore the timing of the maybe-later tax. Financial accounting rules that allowed US-parented firms to avoid accruing income tax expense on "indefinitely reinvested" CFC profit increased the incentive to delay repatriation indefinitely. Thus it developed that many firms planned to wait to repatriate, at least until a moment when the US tax rate was much lower than 35 per cent.<sup>70</sup> The 2004 repatriation

2019) (asserting that the independent election is consistent with legislative intent to exclude high-taxed income from GILTI).

<sup>66</sup> IRC s.951A(b)(2) (defining "net deemed tangible income return"). The exemption for a 10% return on tangible assets resembles the treatment of certain tangible assets used in a US business under the TCJA. These receive an immediate expensing allowance for several years after the passage of TCJA. IRC s.168(k). Presumably because of this benefit, a 10% return on tangible assets that produce FDII earned by US corporations is not allowed the usual advantageous FDII tax rate. IRC s.250(b).

<sup>67</sup> See, e.g. D. Kamin, et al., "The Games They Will Play: Tax Games, Roadblocks and Glitches Under the 2017 Tax Legislation" (2018) 103 *Minn. L. Rev.* 1439, 1493–94 (identifying the possible offshoring incentive as a result of the exempt QBAI return).

<sup>68</sup> See M. Sullivan, "GILTI and That Disappointing Deemed Tangible Return" (7 May 2018) 159 *Tax Notes* 773.

<sup>69</sup> IRC s.951.

<sup>70</sup> See Morse, above fn.3.

holiday, which imposed tax on repatriations at a rate of only 5.25 per cent,<sup>71</sup> fueled confidence in this deferral planning. The idea that US tax eventually would apply to CFC income at a top statutory rate because firms eventually would repatriate became a remote and feeble threat.

After the TCJA, in contrast, a CFC's income generally fits into one of four categories, as suggested above in Table 1. The four categories are: subpart F income, GILTI, 10 per cent exempt QBAI return and high-taxed foreign income subject to an elective exclusion. In all of the categories except for the exempt QBAI return, income tax must be paid or accrued currently. In the case of subpart F and GILTI,<sup>72</sup> the inclusion in a US shareholder's (such as a US corporate parent's) income happens when the income accrues. This "now or never" approach<sup>73</sup> departs dramatically from the previous "maybe later" system that applied under earlier law.<sup>74</sup>

The linchpin that can encourage similar corporate tax systems under the TCJA is the foreign tax credit. The timing of foreign tax credits for subpart F income and GILTI, as well as the determination of sufficient foreign taxes to exclude high-taxed income, depends on whether the foreign taxes have been paid or accrued. Assuming that the obligation to pay tax arises simultaneously with or shortly after the tax accrues, the timing of foreign tax payments for foreign tax credit purposes and the payment of US tax should be more or less co-ordinated. But as explained in Part III.C, taxpayers might try to disrupt this simultaneity between US and foreign tax liability, for instance by attempting to claim foreign tax credits immediately for foreign income taxes that will not be paid until later.

### *C. Base*

The third feature of the post-TCJA US tax regime that might support similar corporate tax systems globally is the tax base. Of the three similarity features—rate, timing and base—tax base is the item least developed in the US statute. Yet tax base is key to the prospect that GILTI and other post-TCJA US rules might help harmonise corporate tax systems worldwide. The foreign tax credit that links US and non-US corporate income tax systems could encourage uniform bases for three purposes: the calculation of taxable income for US purposes (for instance, the calculation of subpart F income or GILTI); the calculation of taxable income for foreign tax purposes; and the calculation of foreign source income for purposes of the US foreign tax credit limitation.

The US statute does not take on the project of harmonising tax bases, even though the legislative history sometimes seems to assume that they are the same. For instance, the Act's legislative history includes language that implicitly raises, but ultimately dodges, the question of a uniform tax base. The conference report appears to assume that no expenses require allocation

<sup>71</sup> See T.J. Brennan, "What Happens After a Holiday? Long-Term Effects of the Repatriation Provision of the AJCA" (2010) 5 N.W. J. L. & Soc. Pol'y 1.

<sup>72</sup> IRC s.951A (providing that US shareholder "shall include in gross income such shareholder's global intangible low-taxed income for such taxable year"). See also IRC s.951A(c)(1) (determining shareholder GILTI by reference to the income of a CFC in the CFC's taxable year "which ends in or with such taxable year of such United States shareholder"). This is the same language used to ensure that a partner will account currently for the income earned by a partnership. See IRC s.706(a) ("[T]he inclusions required... shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner").

<sup>73</sup> Shaviro, above fn.5, 58.

<sup>74</sup> See Morse, above fn.3.

for US (but not non-US) purposes, and that therefore the same tax base would be used to calculate foreign income for purposes of determining foreign income tax liability and for purposes of determining the foreign tax credit limitation. It states:

“Since only a portion (80 percent) of foreign tax credits are allowed to offset US tax on GILTI, the minimum foreign tax rate, with respect to GILTI, at which no US residual tax is owed by a domestic corporation is 13.125 percent. ... Therefore, as foreign tax rates on GILTI range between zero percent and 13.125 percent, the total combined foreign and US tax rate on GILTI ranges between 10.5 percent and 13.125 percent.”<sup>75</sup>

As Mindy Herzfeld points out, this statement in the Joint Committee report avoids the issue of expense allocation. The “examples... all assume the shareholder has no expenses that could be related to CFC income”.<sup>76</sup> Or, equivalently, they assume that the expenses allocated to an item CFC income purposes of calculating the foreign tax credit limitation are the same as expenses allocated to an item of income for purposes of calculating foreign tax liability.

As the law currently stands, there are numerous differences in the calculation of tax base for foreign income tax purposes as compared to US foreign tax credit limitation purposes. This is an area of developing guidance. Taxpayers will presumably argue for rules that produce a tax base that is larger for US foreign tax credit limitation purposes than for other purposes. Administrators must decide how to respond. Part III.D further discusses this dynamic.

### III. Now what?

#### *A. Dynamic analysis: taxpayers v governments*

As described above, the TCJA, through the GILTI tax, revoked US-parented multinationals’ ability to defer indefinitely US tax on US multinationals’ non-US income. Instead, the post-TCJA system generally imposes a current tax on US multinationals’ non-US income unless a foreign tax credit is granted for foreign income taxes paid or accrued with respect to the same income.<sup>77</sup> The foreign tax credit is the linchpin that ties the systems together. It can help harmonise income tax systems globally, for instance with respect to rate, timing and base.

But taxpayers often will resist similar corporate income tax systems. Their ability to arbitrage systems is supported by differences between the systems. Thus we should expect them to invent tax planning strategies and to request government guidance to support arbitrage planning. Tax policy makers can resist arbitrage and instead promote co-ordination. Sometimes this goal may be advanced by administrative guidance or other law changes, either within or outside the US.<sup>78</sup>

<sup>75</sup> *Tax Cuts and Jobs Acts Conference Report to Accompany H.R. 1* (115th Conf., 1st Sess.) 15 Dec. 2017, 626–627.

<sup>76</sup> M. Herzfeld, “Three Attempts to Fix GILTI” (21 January 2019) 158 *Tax Notes* 266.

<sup>77</sup> Or, if proposed regulations are finalised, see above fn.65, an election is made to exclude high-taxed income, but note that this election also requires current paid or accrued foreign income tax.

<sup>78</sup> In the US, the IRS or Treasury will likely provide much of the legal guidance that administers the post-TCJA tax law. Government tax administrators have substantial discretion to promulgate regulations and provide other guidance in the US. Although this article generally leaves aside the question of whether proposed actions would be outside Treasury and IRS discretion, there are constraints that properly limit US tax administrators’ ability to pursue harmonisation goals. Administrative discretion is limited by the statute. See, e.g. *Chevron U.S.A., Inc. v Natural*

Sometimes it will be advanced best if the government refrains from offering guidance, and instead leaves the market to respond to an incentive in existing law for taxpayers to plan into convergence.

This Part III considers three illustrations of the likely back-and-forth between US-parented MNC taxpayers and government tax administrators under post-TCJA law. On rate, the author proposes that US multinationals will be incentivised to shift their foreign tax liabilities among foreign jurisdictions through base erosion and profit shifting to hit the rate mostly or entirely sheltered by the US. For instance, that rate could be 13.125 per cent (for GILTI under current law) or 21 per cent (for subpart F income). On timing, the author suggests that taxpayers may attempt to claim that foreign taxes accrue for US foreign tax credit purposes before the foreign taxes are paid. On base, the author considers taxpayers' efforts to persuade tax administrators to allow the allocation of deductions against US, not foreign, income, so as to increase allowable foreign tax credits by maximising the foreign tax credit limitation.

Each of these illustrations shows that tax policy makers have choices about how to pursue their interpretation of the law and their enforcement of the law. Their choices are technical and interstitial. Yet many decisions could be informed by the broad and overarching goal of using the GILTI minimum tax to harmonise corporate tax systems globally, specifically with respect to rate, timing and base. Tax administrators could craft their technical guidance and enforcement strategies under post-TCJA law to support a more robust and uniform global corporate tax system. It is an open question as to whether they will in fact do so, in part because of the policy tradeoffs involved.

*B. On rate: incentive for taxpayers to profit shift among non-US jurisdictions*

Before the TCJA, it was possible for US multinationals to avoid current US tax on CFC income. The strategy was to categorise such income as non-subpart F income, thus achieving deferral of US tax. The ability to defer US tax meant that US multinationals preferred to minimise current taxes paid to foreign governments also. Before the TCJA, US multinationals had an incentive to reduce foreign taxes to zero.

In contrast, under the post-TCJA US regime, US multinationals no longer face a strong incentive to drive foreign taxes to zero. Instead, they are relatively indifferent to foreign taxes that will mostly or completely reduce US tax liability. Foreign tax rates may begin to converge at the levels that happen to be paid for (or mostly paid for) by offsetting reductions in US liability, such as 13.125 per cent (if GILTI) or 21 per cent (if subpart F income).

The reason that there is an incentive to converge around a 13.125 per cent for a foreign tax rate applicable to GILTI is that there is a kink in the tax rate schedule at that point.<sup>79</sup> Through 2025, 13.125 per cent is the foreign tax rate at which GILTI liability equals zero, under certain assumptions including the same tax base for foreign income tax base and US foreign tax credit

*Resources Defense Council*, 467 U.S. 837 (1984). Discretion is also limited by administrative law requirements. See, e.g. 5 U.S.C. § 706(2)(A) (authorising the invalidation of guidance that is "arbitrary and capricious").

<sup>79</sup> Kinks in tax rate schedules have been shown to encourage convergence. See J. Slemrod, "Buenas Notches: Lines and Notches in Tax System Design" (2013) 11 *eJournal Tax Research* 259, 273 (arguing that behavior may converge around notches or kinks).



limitation purposes.<sup>80</sup> Above 13.125 per cent (or 16.4 per cent starting in 2026) the US foreign tax credit no longer applies, and so additional foreign tax will cost taxpayers a full extra dollar for every dollar of foreign tax raised. In contrast, increasing foreign tax liability to an amount at or below 13.125 per cent is not nearly as costly. Every dollar of foreign tax raised when the rate is at or below 13.125 per cent only costs taxpayers 20 cents. This is because the US foreign tax credit will increase by 80 cents for every such dollar of foreign tax raised below the kink point.

A similar analysis applies for the 21 per cent rate for subpart F income (as well as for the rate of 18.9 per cent for high-tax exclusion income now provided by proposed regulations). For instance, under certain assumptions including conforming tax bases, 21 per cent is the rate at which the US tax on subpart F income equals zero. Above 21 per cent, the US foreign tax credit no longer applies, so additional foreign tax costs taxpayers a full extra dollar for every dollar of foreign tax raised.<sup>81</sup> In contrast, increasing foreign tax liability to an amount at or below 21 per cent for subpart F income does not cause taxpayers to experience any additional tax liability. This is because the US foreign tax credit will increase by one dollar for every dollar of foreign income tax raised at or below 21 per cent. The discontinuity in the rate schedule at 21 per cent encourages foreign tax rates applicable to subpart F to converge around that point.

To predict how tax rates might converge in response to the new complex menu of US tax rates, we should look to and anticipate actions from at least two groups. One group is foreign governments, who might change their stated tax rates or other provisions to adjust to the US law. The second group is multinational firms, who might change their tax planning to adjust to the US law.

One possibility is that foreign governments could adjust their tax rates, either up or down, to cause the effective tax rates on income within their jurisdictions to equal the US rates at the foreign tax credit discontinuities. Yet this is not a straightforward exercise, in part because there are so many possible tax rate targets. If the income is GILTI, the convergence rate is 13.125 per cent through 2025 and then 16.4 per cent. If the income is high-tax exclusion income (under the assumption that the applicable proposed regulation becomes effective), the convergence rate is 18.9 per cent. If the income is subpart F, the convergence rate is 21 per cent. Plus, all of these rates are subject to statutory amendment. For example, if Congress were to increase the US corporate tax rate, all of these rates would increase, but each in slightly different ways.

A more promising route for foreign governments might involve facilitating or simply allowing multinational planning. Assume, for instance, that a US multinational's CFCs have GILTI income as to which the preferred tax rate is 13.125 per cent. The multinational does not require a foreign statutory rate of 13.125 per cent to achieve this preferred rate objective. Instead, it can achieve the rate via base erosion, for instance via deductible payments to a tax haven affiliate. If the foreign jurisdiction's rate is 26.5 per cent, the multinational might prefer to erode half the base in that jurisdiction through deductible payments to a zero-tax affiliate. Or, if the foreign jurisdiction has an alternative tax regime, such as a patent box, the multinational might tax plan to allocate enough CFC income to the patent box regime to hit the rate of 13.125 per cent. If the foreign tax rate at which US tax on GILTI equals zero rate goes up as planned to 16.4 per cent

<sup>80</sup> See below Part III.D.

<sup>81</sup> Subject in the case of subpart F to carry-over and carry-back provisions, see s.904(c).

in 2026, the CFC will face a slightly different incentive, and may base erode less and/or be less aggressive in allocating income to its patent box. Taxpayers will be more nimble than foreign governments in changing effective rates to optimise foreign tax credit results under the law.

In this scenario, the role of foreign governments is to decide how much taxpayer planning to tolerate. In other words, as to rate, governments may not be the first movers as the law develops to converge around advantageous foreign tax rates. Rather, taxpayers may be the first movers, and foreign governments' question will be whether to allow their planning to reduce foreign taxes.

For foreign tax administrators, the question has a tax competition element to it. It has to do with dividing the right to tax among relevant foreign jurisdictions. For instance, if the GILTI regime is the relevant regime, then a foreign jurisdiction may face an incentive to allow a CFC to reduce its effective tax rate to less than 13.125 per cent, assuming that other countries charge more than 13.125 per cent. This is classic tax competition. But the tax competition space is more limited than it was before the TCJA. Before the TCJA, the US law that permitted indefinite deferral often made it advantageous for US multinationals to reduce non-US tax as close to zero as possible. After the TCJA, tax competition will be more limited than it was before the TCJA, because firms face a reduced incentive to tax plan below the level at which foreign taxes are completely or mostly credited by the US. For instance, firms may experience an incentive to plan down to an overall rate of 13.125 per cent (or 18.9 per cent, or 21 per cent) but not further.

*C. On timing: could deferred foreign income taxes “accrue” now?*

Before the TCJA, the US often imposed tax on CFC income later than foreign jurisdictions imposed direct corporate tax on the same income. This is because the US refrained from taxing corporate income until repatriation, for instance through a dividend from a CFC to its US parent. Indeed, under the pre-TCJA maybe-later law, repatriation might never come, and the US might never impose corporate income tax on CFC income. But a foreign tax system might impose corporate income tax prior to repatriation, in the ordinary course of taxing a corporation's income connected with a certain jurisdiction. The foreign jurisdiction's tax would not wait for repatriation, except in the case of dividend withholding taxes, which treaties often reduced to 0 per cent or 5 per cent. Therefore one pre-TCJA pattern involved the imposition of foreign income taxes in, say, Year 1 and then maybe later, upon repatriation, in, say, Year X, the imposition of US income tax subject to a foreign tax credit.<sup>82</sup>

The passage of the TCJA might encourage a reversal of this timing pattern. That is, taxpayers might see an opportunity to delay the payment of *foreign* taxes. Meanwhile, taxpayers might accrue the foreign tax liability and seek a credit for it currently.

Assume that CFC income, such as subpart F or GILTI, accrues in Year 1. In Year 1, US taxes are due. Foreign income taxes on the same income might be paid or accrued in Year 1, or might be paid or accrued in a different year. The taxpayer comes out ahead if foreign income taxes are *accrued* in Year 1, but *payable* later, in, say, Year X. The incentive of the US tax administrator

<sup>82</sup> IRC s.902, now repealed, provided for an indirect foreign tax credit upon dividend repatriation to certain US shareholders.

should be to ensure that credited foreign taxes will be paid promptly. Otherwise, taxpayers can exploit a timing arbitrage opportunity.

The TCJA conditions relief from current US taxation of GILTI (whether through foreign tax credit or high-tax exception) on current foreign taxation.<sup>83</sup> Under existing rules, not changed by the TCJA, a foreign tax is current, for this purpose, if it has been “paid or accrued” under the so-called “all events test”.<sup>84</sup> This bare “all events test” rule for foreign taxes is more generous to taxpayers than the usual US tax accounting rule for the accrual of most taxes. The special, taxpayer-favourable suspension of the economic performance rule for foreign taxes means that taxpayers might accrue foreign taxes before they have paid these foreign taxes. The usual rule requires economic performance in addition to the satisfaction of the all events test, which has the effect of pushing the accrual of some tax expenses to a later moment in time, when they are actually paid.<sup>85</sup>

A famous US case, *Ford Motor Co v Commissioner (Ford Motor)*, illustrates the timing problem.<sup>86</sup> In *Ford Motor*, the taxpayer car company settled a tort claim relating to exploding fuel tanks by agreeing to pay plaintiffs settlement amounts in years to come. The company attempted to deduct currently the full future value of the settlements, i.e. the amounts that would be paid in the future. But the present value of the damage amounts, or the amount that the company had to invest in order to fund the settlements, was far smaller. The court disallowed the larger, future value-based deduction, and Congress amended the tax statute to add the economic performance rule, which now limits such deductions to amounts actually paid. But as noted above, the economic performance rule does not apply to foreign taxes.

It is therefore possible that the existing rules could support a taxpayer-favourable timing difference in the reverse direction compared to pre-TCJA planning. In other words, perhaps foreign tax credits could reduce cash taxes due to the US Government before any corresponding cash taxes were paid to a foreign government. From the US Government’s perspective, one way to resist this kind of taxpayer planning would be to subject foreign taxes to the economic performance rule, just like other taxes.<sup>87</sup>

Not surprisingly, taxpayers are pushing in the other direction and lobbying Treasury to, in effect, allow them to use future foreign taxes to offset current US tax liability. To take just one

<sup>83</sup> See IRC s.960(d)(3) (providing that no deemed-paid foreign tax credit is available unless the foreign taxes are paid or accrued).

<sup>84</sup> A special rule in the s.461(h) regulations applies to foreign taxes. It provides that the classic “all events” test applies, without regard to economic performance. See Treas. Reg. s.1.461-4(g)(6)(iii)(B) (crossreferencing 1.446-1(c)(1)(ii)). See, e.g. *Albemarle Corp v US* 797 F.3d 1011 (Fed. Cir. 2015).

<sup>85</sup> Usually, the economic performance rule of IRC s.461(h) means that taxes are accrued when paid, subject to the application of a rule relating to recurring items. See Treas. Reg. s.1.461-4(g)(6); 4(g)(8) Example 8 (giving default rule and referring to recurring item rule).

<sup>86</sup> See *Ford Motor Co v Commissioner* 71 F.3d 209 (6th Cir. 1995).

<sup>87</sup> That change would support timing conformity. Such a change would be particularly important if taxpayers successfully lobbied a foreign government to adopt a rule permitting the firm to defer the payment of foreign taxes to some date in the future, under a structure that would allow the firm to claim that the US “all events test” for accrual was met currently. Since this hypothetical describes an accelerated accrual made possible by the action of a non-US (and therefore non-federal) government, it also appears to fall under s.461(d). See L.J. Lisses and R.C. Nissen, “Section 461(d): A Code Section Whose Time Has Gone” (1994) 46 *Tax Executive* 30. Invoking s.461(d) would allow the government to mount an audit and litigation challenge against the accelerated accrual, which might provide an avenue for challenge that would not require Treasury guidance and would apply retroactively.

example, the New York State Bar Association (NYSBA) gives a scenario in which a US parent has a calendar year end for US tax purposes but a 30 June year end for foreign tax purposes. It is possible that even if there were profit in the first calendar year, no foreign tax would accrue in that year, points out the NYSBA, because the foreign tax system would be waiting to find out what the overall results were for the 1 July–30 June period that has not yet closed by 31 December, and so the taxes would not accrue until the second calendar year. The NYSBA notes that GILTI tax liability is only reduced if foreign taxes have accrued, and also that there is no carry-forward or carry-back provision for foreign income tax related to GILTI to reduce US tax in a different year. They write: “A mismatch in US and foreign taxable years may thus irreversibly result in a mismatch of foreign taxes and related foreign income for a CFC.”<sup>88</sup>

To solve this problem the NYSBA proposes that, if tax years do not correspond, the Treasury should allow taxes attributable to any portion of a first calendar year to accrue in that first year, even if the foreign tax year has not closed and the all events test has not been met by the end of the first calendar year.<sup>89</sup> If Treasury agrees, it will enable taxpayer arbitrage with respect to timing, since a taxpayer might claim the US benefit of a tax reduction under the foreign tax credit in year one with respect to foreign taxes that it will not accrue (let alone pay) until year two. It might be better for Treasury to do nothing. If Treasury acts, it will endorse a timing discrepancy (claim foreign tax credit now, pay foreign taxes later) that undercuts the co-ordination and harmonisation potential of the post-TCJA regime. The timing discrepancy will extend an interest-free loan to taxpayers as a result of allowing Year 2, or Year X, foreign tax liability to reduce Year 1 US tax on GILTI.

Meanwhile, a solution to this problem does not require Treasury action. At worst, the taxpayer can tax plan into subpart F instead of accepting GILTI treatment. Subpart F treatment offers foreign tax credit one-year carry-back and 10-year carry-over provisions.

The problem of mismatched tax years is a well-worn fact pattern. For instance, in the partnership tax context, the applicable rule requires a partner to recognise income for the taxable year of the partnership that ends within or with the taxable year of the partner.<sup>90</sup> There is an incentive for a profitable partnership to adopt a year end that falls early in the calendar year of individual partners, because this approach will defer the partners’ inclusion of income.<sup>91</sup> To address this incentive, the divergence between partnership and partner tax years is limited by the statute.<sup>92</sup>

Rather than preferring to defer the recognition of income, as in the profitable partnership case, the US parent of a CFC prefers to accelerate the accrual of foreign tax credits. Taxpayers request guidance to help accomplish this result. If Treasury declines the request, most taxpayers will still have a tool to match foreign tax credit timing (leaving aside withholding taxes) and US tax liability timing. This is because taxpayers generally can change tax years so that CFC and

<sup>88</sup> New York State Bar Association, *Report on the Proposed Foreign Tax Credit Regulations* (5 February 2019), 44–45.

<sup>89</sup> See New York State Bar Association, above fn.88, 46 (requesting “an approach that attributes foreign income taxes for a foreign taxable year that does not match the US taxable year to both US taxable years to which the foreign income taxes actually relate”).

<sup>90</sup> IRC s.706(a).

<sup>91</sup> W. McKee, W. Nelson and R. Whitmire, *Federal Taxation of Partnerships and Partners*, 4th edn (New York: Warren, Gorham & Lamont, 2007), para.9.04 (giving example with 31 January partnership year end).

<sup>92</sup> IRC s.706(b).

US parent tax years conform, or they can opt into subpart F treatment to take advantage of carry-back and carry-over provisions.

Yet even if the government decides not to respond to all taxpayer guidance requests related to timing, administrators should still monitor the issue. For instance, they should be alert to *Ford Motor*-inspired taxpayer planning that would accelerate the accrual of foreign taxes for foreign tax credit purposes to a time well before the payment of those taxes.

*D. On base: renewed incentive to maximise foreign tax credit limitation*

Before the TCJA, many US-parented multinationals had an incentive to minimise foreign taxes and get these foreign taxes as close to zero as possible. After the TCJA, the incentive to minimise foreign taxes is not as strong. Instead, US-parented multinationals have an incentive to maximise foreign tax credits.

US-parented multinationals care less about minimising foreign taxes after the TCJA because minimising foreign taxes will not pave the way to double non-taxation, even on a current basis. After the TCJA, if a US-parented multinational successfully eliminates all foreign tax liability, it must pay or accrue taxes currently on CFC income under either the subpart F rules or the GILTI rules. Thus there is less pressure to reduce foreign taxes.

Instead, the new priority for US parented multinationals is to ensure that any foreign taxes paid or accrued can be used to reduce US taxes. Foreign taxes can reduce US taxes on CFC income through the foreign tax credit, which reduces taxes otherwise due on subpart F income and on GILTI. Also, under proposed regulations, foreign taxes would reduce US taxes by making items of CFC income eligible for a high-tax exclusion election.

In other words, the TCJA brings foreign tax credits back into vogue, and with them, the exercise of maximising foreign tax credit limitations. Instead of incentivising the reduction of foreign income tax liability to zero, the TCJA places a premium on the capacity to fully credit foreign income taxes that are paid. Some practitioners even recommend (in some circumstances) planning into subpart F income treatment intentionally, because a full foreign income tax credit is available there together with carry-over and carry-back provisions.<sup>93</sup>

The questions of tax base and source of income arise in the foreign tax credit limitation. A US taxpayer may only credit foreign income taxes up to an amount of US tax that otherwise would be paid on the relevant foreign source income. Thus, for foreign tax credit limitation purposes, taxpayers' incentive is to maximise foreign source income items and minimise foreign source deduction items. The limitation is calculated separately for each of non-passive GILTI, passive basket income (such as foreign personal holding company subpart F income) and general basket income (such as foreign base company sales and services income).<sup>94</sup>

Soon after the passage of the TCJA, taxpayers began to raise issues about the calculation of the GILTI tax base that revealed the issue of tax base nonconformity.<sup>95</sup> Taxpayers worry about a situation where the tax base for purposes of calculating foreign income tax paid or accrued exceeds the tax base for purposes of calculating the US foreign tax credit limitation. For instance,

<sup>93</sup> See, e.g. Cummings, above fn.53, 378 fn.11 (noting that multinationals are considering planning into subpart F).

<sup>94</sup> See IRC s.904(d).

<sup>95</sup> See, e.g. A. Lewis, "Taxpayers Nervously Await GILTI Expense Allocation Regs" (20 August 2018) 91 *Tax Notes International* 851 (noting comments from MasterCard, the Semiconductor Industry Association, and others).

US tax rules require a taxpayer to allocate some US deductions, like an interest or research expense directly incurred by US parent corporations or other US affiliates, to a CFC's foreign income for FTC limitation purposes even if the expense is not deductible from the foreign income tax base.

For example, US interest expense allocation regulations require the allocation of certain US interest expense to foreign income of CFCs above the interest that the CFC itself is obligated to pay or accrue.<sup>96</sup> These regulations aim to properly measure income. They have a coherent and clever foundation, which is that interest expense should be allocated to the assets or income that support the firm's ability to borrow. The regulations do not accept the affiliate named as the borrower (such as the US parent) as the taxpayer who will deduct the interest expense. Instead, the regulations often cause a reallocation of interest deductions from the named borrower (such as the US parent) to other affiliates, such as controlled foreign corporations, whose assets or income are also assumed to contribute to support the firm's debt.

Interest expense allocated away from a US parent and to a CFC, for instance to a CFC's subpart F or GILTI income, reduces the US foreign tax credit limitation. But it might not be deducted under foreign income tax law (e.g. because no foreign affiliate is listed as a borrower for a particular liability). Thus, an interest expense reallocated under the US regulations might reduce the FTC limitation but not the foreign tax due.

Further, if interest deductions are allocated to a CFC for foreign tax credit limitation purpose, but not for purposes of calculating the foreign income tax base, then it is possible for a taxpayer's foreign income tax paid to exceed the taxpayer's foreign tax credit limitation. For example, the taxpayer may find that it must pay tax on GILTI even if its foreign income tax rate exceeds 13.125 per cent; or that it must pay tax on subpart F income even if its foreign income tax rate exceeds 21 per cent. This is simply because of base differences. If the FTC limitation base is smaller than the tax base for purposes of foreign law, then it is possible for the FTC limitation to be smaller than the foreign income tax due. The tax paid or accrued can exceed the limitation even if the foreign income tax rate is no higher than the rate which should, assuming equal tax bases, result in no US tax.

Taxpayers requested that Treasury release guidance stating that taxpayers would not be required to allocate interest expense to GILTI at all for purposes of calculating the GILTI foreign tax credit limitation. Taxpayers argued that the legislative history quoted above revealed a "flat-rate" theory of GILTI. Taxpayers' "flat-rate" theory would require the government to ensure that no GILTI tax applied if the foreign tax rate equaled or exceeded 13.125 per cent.<sup>97</sup>

<sup>96</sup> See Treas. Regs. § 1.861-9T (requiring interest expense allocation and apportionment and stating the rationale that "money is fungible" and "interest expense is attributable to all activities and property"). See also J. Kuntz and R. Peroni, *U.S. International Taxation* (New York: Thomson Reuters, 2018), para.A2.05[5][d][iv] (describing the "CFC netting rule" that applies when a US shareholder has relatively more debt than its CFCs and explaining that the purpose of the rule was to discourage "substantially more favorable allocation and apportionment of interest expense for foreign tax credit limit purposes than would have been achieved if the foreign corporations had directly borrowed the funds").

<sup>97</sup> See New York State Bar Association, *Report on the GILTI Provisions of the Code* (4 May 2018), 15–16 (advocating flat-rate theory); see also J.P. Fuller and L. Neumann, "U.S. Tax Review" (4 June 2018) 90 *Tax Notes International* 1143, 1149 (arguing that Congressional intent was to "ring-fence" GILTI and allocate "no expenses" "to the GILTI Section 904 basket").

But the “flat-rate” theory sidesteps the real issue. The problem is that the foreign tax credit works when the foreign tax credit limitation base equals the foreign income tax base. Yet the law does not produce equal tax bases. Thus the law contains a tension.

Treasury’s solution to the problem of interest allocation for foreign tax credit limitation purposes did not fully adopt the “flat rate” theory. Treasury reasoned that the Act left intact, and indeed reinforced, the statutory section 904 requirement that certain shareholder expenses should be allocated and apportioned to CFC gross income. Instead, the regulations treat a portion of GILTI income as exempt income that will not attract any interest expense allocation. For instance, when a 50 per cent deduction may be claimed for GILTI income, half of that income is treated as exempt and will not attract an allocation of interest expense from the US shareholder to the foreign source income of the CFC.<sup>98</sup>

Table 2, below, shows different interest allocation results. In particular, it shows results under: 1. a US rule that allocates interest deductions according to gross income; 2. the US compromise regulation that excludes from consideration the amount of GILTI deductible under section 250; and 3. a non-US rule that allocates interest deductions to the US parent because the US parent is the borrower of record.

Table 2 assumes that the US parent and its CFC earn equal amounts of income and that all of the CFC’s income is GILTI. In particular, it assumes a US corporate parent with a single wholly-owned foreign corporate subsidiary, which is a CFC. The US parent borrows 1,000 from a lender and pays 100 in interest annually. For US purposes, the US parent allocates interest expense based on the gross income of its affiliates. The US parent and its CFC each have equal amounts of gross income. All of the CFC’s income is GILTI.

**Table 2: comparison of interest deduction allocation methods<sup>99</sup>**

	US rule that allocates deductions in accordance with income	Compromise US regulations that do not allocate interest deductions to CFC assets that produce GILTI subject to deduction <sup>100</sup>	Non-US rule that allocates interest deductions to borrower of record
Allocation of interest expense to US parent	50	67	100
Allocation of interest expense to CFC	50	33	0

The compromise US regulations establish a position that lies between the view of the US and the view of some non-US countries on interest allocation. Thus the regulations may step toward some other countries’ approach to interest expense allocation, and so this change might be said to advance the co-operation goal advanced in this article. But there are tradeoffs.

<sup>98</sup> See Prop. Treas. Reg. 1.861-8(d)(2)(ii)(C)(1) (treating amount of s.250 GILTI deduction as exempt income).

<sup>99</sup> Hypothetical facts: US parent borrows \$1,000; interest deductions equal \$100; US parent has 800 of gross income; CFC has 800 of gross income, all of which is GILTI; s.250 GILTI deduction equals 50%.

<sup>100</sup> CFC income subject to the GILTI deduction are disregarded. Assuming a 50% deduction, half the CFC’s income is disregarded, or 400 out of 800 total. This leaves a denominator for purposes of allocating the interest deduction of 1200 (800 in US parent assets plus 400 in CFC). The interest deduction of 100 is allocated 800/1200, or 2/3 to the US parent and 1/3 to the CFC. This results in an allocation of 67 to the US parent and 33 to the CFC in this example.

The first tradeoff is that shifting of deductions away from the CFC and to the US parent will cost the US fisc; it will result in less tax revenue collected. The second tradeoff is that the compromise US regulations do not advance the goal of accurate income measurement. The idea is that a US borrower should not reduce US source income for deductions that are really supported by the assets or income of its foreign affiliates. From the perspective of a lender, the assets or income of a foreign affiliate still support the borrowing at least to the same extent if the foreign affiliate's income is exempt from US tax. Thus the failure to allocate interest expense fully to GILTI, without regard to the 50 per cent deduction, is not consistent with the US policy underlying interest expense allocation.

Treasury's approach does not take on the full responsibility for achieving conformed tax bases. It does not, in other words, fully sacrifice the US regulations' idea of how income should be measured and instead follow another jurisdiction's approach of allocating deductions only to a named borrower. Its halfway or compromise action raises the question of whether other developments might also help achieve conformity.

There are at least three paths to increasing tax base conformity. The first two approaches involve government action. One way is to for the US law to decrease the deductions allocated to foreign income under US rules for FTC limitation purposes. Taxpayers requested this result, and the US compromise regulation partly grants their request, as described above.

A second way is for non-US law to increase the deductions allocated to foreign income for purposes of calculating foreign income tax liability.<sup>101</sup> But this is unlikely—after all, it would reduce tax revenue for non-US jurisdictions. For instance, Item 4 of the BEPS Project takes on a different question when it proposes limiting interest deductions for any particular multinational affiliate to a percentage of that affiliate's EBITDA.<sup>102</sup>

The third approach does not involve government action, but rather only requires taxpayer planning. Taxpayers can change their planning in order to conform the deductions allocated to foreign income under foreign tax law and under US foreign income tax limitation rules.<sup>103</sup> A US parented multinational could, for instance, cause its CFC to be listed as a co-borrower with respect to an obligation in order to allow deductions in the non-US jurisdiction. Of course, the flexibility of interest expense deductibility depends to some extent on circumstances and local

<sup>101</sup> See M. Graetz, "A Multilateral Solution for the Tax Treatment of Interest Expenses" (2008) 62 Bull. Int'l Tax'n 486.

<sup>102</sup> See OECD/G20 Base Erosion and Profit Shifting Project, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4—2016 Update* (Paris: OECD Publishing, 2016), 51–58 (describing "fixed ratio" proposals).

<sup>103</sup> The illustration in the text relates to interest expense, but a similar approach could be taken when choosing a government response to taxpayer requests to only allocate research and development expense against GILTI if related intellectual property were owned by the CFC. In other words, if the group could rearrange its planning so as to also allocate the research and development expense against GILTI for foreign tax credit limitations purposes, the best course for the US Government might be to postpone or decline to issue the requested regulations, and instead observe whether taxpayers were able to use planning to conform tax bases. See, e.g. Letter from U.S. Chamber of Commerce, *Commenting on REG- 105600-18: Guidance Related to the Foreign Tax Credit, Including Guidance Implementing Changes Made by the Tax Cuts and Jobs Act* (1 February 2019) (commenting on Prop. Regs. ss.1.861–17 and arguing that "guidance should be issued providing that allocation and apportionment of US-level 'R&E' expenses to the GILTI basket is not required unless the controlled foreign corporations (CFC) has an ownership interest in the intellectual property (IP) resulting from the R&E").



law. But some adjustments should be possible. Taxpayer planning, as well as government action, might sometimes produce a co-operative global corporate income tax outcome.

## Conclusion

The TCJA aimed the GILTI regime at US-parented multinational firms that reportedly paid very little tax anywhere on non-US source income prior to the passage of the TCJA. Prior to the TCJA, US law permitted such firms to delay indefinitely the payment of US tax on such income, under a “maybe later” deferral system. The GILTI tax revoked this deferral permission. After the TCJA, the US law generally ensures that current tax will apply to a controlled foreign corporation’s income, for instance as subpart F income or GILTI. In each of these categories, the US imposes current tax unless foreign income tax is paid or accrued with respect to the relevant income. The design of these provisions sustains the corporate tax rather than undermining it.

The reduction of US tax liability to account for foreign income taxes, such as through the foreign tax credit, is the linchpin that connects US corporate tax rules and foreign corporate tax rules under the post-TCJA US rules. This connection can encourage convergence of different jurisdictions’ corporate tax rules with respect to rate, timing and base. If corporate tax systems globally become more similar with respect to each of these features, the corporate income tax will become less vulnerable to competition and arbitrage. It is even possible that more similar and robust corporate income tax rules globally could support additional innovations such as an administrable formulary apportionment system.

The dynamic question going forward has to do with the responses of government tax policy makers to the anticipated efforts of taxpayers to reduce their tax liabilities under the new system. Tax planning efforts will be technical and interstitial. And optimal government responses can consist of decisions to enforce, to issue guidance, or to allow taxpayer planning to adjust to the new system. Through a series of incremental decisions, government administrators and other policy makers will have the opportunity to treat the post-TCJA law as a co-operative project. Whether they will convert this opportunity into a more robust global corporate income tax is an open question. <sup>13</sup>

<sup>13</sup> Controlled foreign companies; Foreign income; Global minimum tax; Intangible assets; International taxation; Multinational companies; Tax rates; Tax reform; United States