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Key International Tax Proposals in the Biden Administration’s Green Book and Their Potential Impact on Businesses

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OVERVIEW

On May 28, 2021, the US Department of the Treasury (Treasury) released the Fiscal Year (FY) 2022 budget and Green Book, which provides detailed insights into the proposals of US President Joe Biden’s recently released American Jobs Plan and American Families Plan. This article summarizes the key proposals affecting businesses and provides further insight on planning considerations.

IN DEPTH

COUNTRY-BY-COUNTRY REGIME TO APPLY TO GILTI AND FOREIGN BRANCH INCOME

The current global intangible low-taxed income (GILTI) regime operates on a global blended basis such that excess taxes paid in high-tax jurisdictions may be used to offset residual US taxes on income earned in low-tax jurisdictions. The Green Book raises a concern that global blending incentivizes US companies that have operations in high-tax jurisdictions to invest in low-tax jurisdictions, and US companies that have operations in low-tax jurisdictions to invest in high-tax jurisdictions. In either case, per the Treasury, US companies are encouraged to invest outside the United States whether the foreign tax rate is higher or lower than the US tax rate. Thus, the Green Book proposes to create a new standard under which a US taxpayer’s GILTI inclusion and foreign tax credit limitation would be determined on a country-by-country (CBC) basis. If enacted, this proposal would constitute both a significant tax increase and a major compliance and tax administration burden for taxpayers and the Internal Revenue Service (IRS).

Similar to computing a US shareholder’s GILTI inclusion and foreign tax credit limitation on a CBC basis, the Green Book would expand the CBC regime to foreign branch income, citing the same global blending concerns that exist in the GILTI context. The Treasury was, presumably, concerned that taxpayers might shift from GILTI structures into branch structures if the CBC approach were to

extend only to GILTI. However, taking a CBC approach to foreign branch income will introduce additional complexity to foreign tax credit limitation determinations, particularly where there is a foreign branch loss in a particular country.

REPEAL OF SUBPART F AND GILTI HIGH-TAX EXCEPTIONS

The Green Book proposes to repeal the Subpart F and GILTI high-tax exceptions. This proposal goes significantly further than simply revising the high-tax threshold upward along with the proposed increase in US corporate tax rates. Many may criticize the Green Book proposal as overly burdensome on companies with overseas operations driven by business necessities as opposed to tax benefits. The proposal to repeal the high-tax exceptions would be especially impactful to companies that use these exceptions to mitigate residual US taxation on GILTI or Subpart F income where the application of the expense allocation and apportionment provisions results in a foreign tax credit limitation under section 904 principles or where the utilization of losses adversely impacts the section 250 taxable income limitation.

REPLACING BEAT WITH SHIELD

Additionally, the Green Book proposes to replace the existing Base Erosion and Anti-Abuse Tax (BEAT) with a new tax regime, Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD) According to the Green Book, the current BEAT regime does not adequately address the concern of erosion of the US corporate tax base by inefficiently favoring certain activities over others. Instead of imposing a minimum tax, SHIELD would disallow deductions to domestic corporations or branches with respect to gross payments made to “low-taxed members” of the same “Financial Reporting Group.” As in the case of the proposed excess indebtedness interest disallowance rule, a Financial Reporting Group is any group of business entities that prepares consolidated financial statements, as determined in accordance with US generally accepted accounting principles (GAAP), international financial reporting standards (IFRS) or other method authorized by the US Secretary of the Treasury (Secretary), and includes at least one domestic corporation, domestic partnership or foreign entity with a US trade or business. Accordingly, the majority of multinational enterprises with US presence would be treated as one or more Financial Reporting Groups for this purpose.

“Low-taxed members” generally means any members of a Financial Reporting Group whose income is subject to an effective tax rate that is below a “designated minimum tax rate.” The “designated minimum tax rate” is either the rate agreed to under Pillar Two of the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on base erosion and profit shifting (BEPS) project (Pillar Two Agreement) or before a Pillar Two Agreement is reached. (The US global minimum tax would be 21% under the Green Book proposal.) This means US-parented multinational groups would not be subject to SHIELD (as GILTI prevents any relevant payments from being “low-taxed”). Thus, this element of President Biden’s plan would be a rare win for US-based multinationals in that BEAT concerns would be eliminated without any need to contend with the BEAT replacement regime.

Similar to BEAT, SHIELD provides a *de minimis* exception under which SHIELD does not apply to Financial Reporting Groups with global annual revenues that do not exceed $500 million. Notably, while BEAT does not treat cost of goods sold (COGS) as base eroding payments, the Green Book specifically indicates that under SHIELD, other types of costs (such as COGS) would be disallowed up to the amount of the payment made to low-taxed members, which would be an extremely harsh outcome for those subject to the new regime

In addition, SHIELD includes rules that apply to disallow deductions of domestic corporations on an aggregate basis with respect to the entire Financial Reporting Group. These rules would treat a portion of payments made to members that are not low-taxed as payments made based on the aggregate ratio of the Financial Reporting Group's low-taxed profits to its total profits. In other words, if the Financial Reporting Group as a whole is subject to an effective tax rate lower than the designated minimum tax rate, all deductible payments made to other members of the Financial Reporting Group would be subject to SHIELD.

Finally, SHIELD provides the Secretary with authority to exempt from SHIELD payments that meet a minimum effective level of taxation on a jurisdiction-by-jurisdiction basis.

EXPANSION OF SECTION 265 TO DISALLOW PARTIAL DEDUCTIONS UNDER SECTIONS 245A AND 250

Section 265(a)(1) generally disallows a deduction for any amount that is allocable to certain classes of income that is wholly exempt from US taxation. This rule does not apply to the 100% dividend-received-deduction for the foreign-sourced portion of certain dividends under section 245A or the 50% deduction of foreign-derived intangible income (FDII) under section 250 because those provisions constitute deductions as opposed to rendering any income "wholly exempt" from US taxation. The existence of section 904(b)(4), which the Green Book would repeal as no longer relevant, demonstrates that Congress understood that present-law section 265 does not apply to deny these deductions. The Green Book includes an interesting footnote that implies present-law section 265 could be interpreted as already applying to disallow these deductions, but there appears to be no basis for that statement under the current Code and regulations.

The Green Book describes the current rules as effectively providing a tax subsidy for multinationals' foreign investments by allowing a domestic corporation (or a foreign corporation with US corporate subsidiaries) to receive a deduction against US taxation with respect to certain income derived outside the United States. Thus, the Green Book proposes to reduce the 50% deduction under section 250 to 25%. Further, the proposal would expand the application of section 265 to disallow deductions allocable to income taxed at a preferential rate through a deduction in addition to deductions allocable to wholly exempt income. With respect to such partially exempt income, the new section 265 under the proposal would disallow a portion of the deductions under sections 245A and 250 and provide rules for determining the amount disallowed.

As noted above, the Green Book would also repeal section 904(b)(4), which applies to disregard deductions allocable to income from foreign stock other than GILTI or Subpart F income inclusions for determining a taxpayer's section 904 foreign tax credit limitation.

EXCESS INDEBTEDNESS INTEREST DISALLOWANCE RULE

Originally proposed – but not enacted – as part of the Tax Cuts and Jobs Act (TCJA) legislative process, section 163(n) would limit interest deductions of multinational corporations, specifically members of multinational groups that prepare consolidated financial statements (Financial Reporting Groups). The Green Book revisits this concept and proposes a limitation on a Financial Reporting Group member's deduction for interest expense. Generally, the limitation would apply where the member's net interest expense for financial reporting purposes exceeds the member's proportionate share of the Financial Reporting Group's net interest expense reported on the group's consolidated financial statements. Recognizing some groups may have an administrative burden in calculating

and/or substantiating their relative US and international interest expense, the proposal provides an alternative calculation. Under this alternative, the member's interest deduction would be limited to the member's interest income plus 10% of their adjusted taxable income. Either limitation would apply in addition to a taxpayer's limitation under section 163(j), which was introduced by the TCJA. Section 163(j) generally limits a taxpayer's business interest expense deduction to business interest income, 30% of their adjusted taxable income and floor plan financing interest.

The Green Book describes this change as a way to prevent multinationals from reducing their US tax on income earned from US operations by incurring a disproportionate amount of their debt financing in the United States. Multinationals may respond by asserting numerous non-tax motivated reasons for why their US operations and non-US operations might require differing amounts of leverage. More importantly, unlike earlier versions of the proposal, the Green Book version would not apply to US-based multinationals.

FDII REPEAL AND INTRODUCTION OF R&D REGIME

The Green Book proposes to repeal the FDII deduction and use the resulting revenue to expand on more effective research and development (R&D) incentives but provides no details on what those incentives might be.

15% BOOK TENTATIVE MINIMUM TAX ON LARGE CORPORATIONS

As part of his campaign, President Biden proposed a 15% alternative minimum tax on book earnings of large corporations. The Green Book proposes to impose a "book tentative minimum tax" (BTMT) on corporations with an income over $2 billion. A corporation's BTMT equals (1) 15% of the corporation's worldwide pre-tax book income minus (2) certain business credits such as R&D, clean energy and housing tax credits. It remains to be seen whether there will be any appetite in Congress for allowing such an unprecedented encroachment of financial accounting principles to override provisions of the tax code and adopting a new regime that would be tremendously complex and controversial internationally.

NEW TAX INCENTIVES TO CREATE JOB OPPORTUNITIES IN THE UNITED STATES

According to the Green Book, the current tax regime encourages offshoring US jobs while providing limited tax incentive to onshore foreign job opportunities.

To provide a tax incentive for relocating foreign jobs to the United States, the Green Book proposes to create a new general business credit equal to 10% of the eligible expenses incurred in connection with onshoring a US trade or business. Onshoring a US trade or business means reducing or eliminating a trade or business currently conducted outside the United States and moving the same trade or business within the United Sates to the extent that this action results in an increase in US jobs. In the event the eligible expenses are incurred by a foreign affiliate of a US taxpayer, the business credit can be claimed by the US taxpayer for the expenses.

Additionally, to address offshoring concerns, the Green Book proposes to disallow deductions for expenses incurred in connection with offshoring a US trade or business. For this purpose, offshoring a US trade or business means reducing or eliminating a trade or business currently conducted inside the United States and moving the same trade or business outside the United States to the extent that

this action results in a loss of US jobs.

For example, in determining a US shareholder's Subpart F inclusion or GILTI, no deduction would be allowed for expenses a controlled foreign corporation (CFC) incurred in moving a US trade or business outside the United States to the extent offshoring results in a loss of US jobs.

SIGNIFICANT EXPANSION OF ANTI-INVERSION RULES

The Green Book proposes to modify the anti-inversion rules in several ways. First, the current inversion rules would be modified to treat a foreign corporation as a domestic corporation based upon a 50% continuity ownership threshold as opposed to the existing 80% threshold. Second, the Green Book proposes that, regardless of the level of shareholder continuity, an inversion transaction would occur if (1) immediately prior to the acquisition, the fair market value of the domestic entity is greater than the fair market value of the foreign acquiring corporation, (2) after the acquisition the expanded affiliated group (EAG) is primarily managed and controlled in the United States and (3) the EAG does not conduct substantial business activities in the country in which the foreign acquiring corporation is created or organized.

The Green Book would expand the scope of an acquisition to also include a direct or indirect acquisition of substantially all of the US trade or business assets of a foreign partnership. Furthermore, the Green Book also proposes to cause a distribution of stock of a foreign corporation by a domestic corporation or a partnership that represents either substantially all of the assets or substantially all of the assets constituting a trade or business of the distributing corporation or partnership to be treated as a direct or indirect acquisition of substantially all of such assets.

EFFECTIVE DATES

In general, most of the proposals of the American Jobs Plan and American Families Plan take effect for taxable years beginning after December 31, 2021, but there are a few notable exceptions. The BEAT repeal and SHIELD enactment would take effect for taxable years beginning after December 31, 2022.

For calendar year taxpayers, the US corporate tax rate would increase to 28% beginning after December 31, 2021. However, for fiscal taxable years beginning after January 1, 2021, and before January 1, 2022, the current rate would apply to that portion of the taxable year occurring in calendar 2021, and the new rate would apply to that portion occurring in calendar 2022.

The capital gains tax rate would be effective for capital gains required to be recognized after the date in which the increase was announced, which is presumably April 28, 2021(the date in which the American Families Plan was released). It remains to be seen whether such a broadly applicable retroactive tax increase will be viable in a closely divided Congress.

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