Directions for U.S. International Tax Policy, A Response to Hanna and Wilson

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Christopher Hanna and Cody Wilson argue in U.S. International Tax Policy and Corporate America *that an international tax reform proposal focusing on maintaining low financial accounting effective tax rates could win over proponents of full current rate taxation of foreign income as well as U.S. publicly traded corporate America. They propose combining full current rate taxation of foreign income with a reduced overall corporate tax rate of approximately 15%. This, they assert, could be roughly revenue neutral or raise revenue. As long-time proponents of full current taxation of foreign income subject to a credit for foreign taxes, we explain why we respectfully disagree on several grounds. A further reduction in the corporate tax rate would increase the problem of income and wealth inequality and exacerbate distortions of current law. We would not accept, as a revenue baseline, corporate tax revenue after its massive reduction by the 2017 Tax Cuts and Jobs Act. Moreover, with the adoption of the corporate alternative minimum tax by the United States in 2022 and the anticipated adoption by many countries of Pillar 2 qualified domestic minimum taxes, full current taxation of foreign income under their proposal will raise little or no additional revenue. We submit instead that the direction for international (and domestic) tax policy should lie in moving toward a comprehensive tax base that can support existing and needed future expenditures for the welfare of each country's citizens and residents, including meeting the challenges of climate change and maintaining the capacity to meet future emergencies (such as pandemics and wars). We would combine full current taxation of international income with per-country credits for foreign taxes. We support international coordination of tax rules and convergence of U.S. rules with an international consensus that is the product of a fair and inclusive international process.*

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I. INTRODUCTION

We thank the editors, Professor Christopher Hanna, and Cody Wilson for the invitation to write a response to their provocative paper, *U.S. International Tax Policy and Corporate America*.[1] Professor Hanna and Mr. Wilson's article seeks that elusive ground for U.S. international tax reform that could raise revenue and attract the support of "Corporate America," moderate Democrats, and Republicans.[2] We agree that it is a worthy objective to find a solution that attracts broad bipartisan support, including the support of Corporate America, but only if it could be practically and equitably achieved. The longstanding division between most Republican and Democratic policymakers lies in differences over the extent to which foreign business income should be subject to current and full-rate taxation. Historically, Corporate America preferred a more territorial system while many others—including congressional representatives, policymakers, and tax scholars—were unpersuaded by Corporate America's claims to need a tax boost to their

1. Christopher H. Hanna & Cody A. Wilson, *U.S. International Tax Policy and Corporate America*, 48 J. CORP. L. 261 (2023).

2. "Corporate America" refers to publicly traded C corporations. A 'C' corporation is defined for purposes of Title 26 as "with respect to any taxable year, a corporation which is not an S corporation for such year." I.R.C. § 1361(a)(2). A publicly traded corporation generally is classified as a corporation. I.R.C. § 7704(a). A publicly traded corporation does not qualify for the S corporation election. *Id.* Hanna and Wilson acknowledge that the vast preponderance of corporations by number (but not sales or profits) are not publicly traded. Hanna & Wilson, *supra* note 1, at 271 ("Of the approximately 1.6 million C corporations, only about 4,000 are publicly traded."). Section references in the text and "I.R.C." in footnotes refer to the Internal Revenue Code of 1986, as amended.

global competitiveness. Instead, this second group focused more on the distortive effects of territoriality (or its functional equivalent of deferral followed by tax forgiveness or avoidance) on domestic economic activity and favored an expanded worldwide, no-deferral system.[3]

The key to garnering Corporate America's support for a no-deferral system (i.e., current taxation of foreign business income), Hanna & Wilson argue, is found in the focus of Corporate America on financial or "book" accounting to achieve a lower book Effective Tax Rate (ETR).[4] Under their analysis, the proposals of the Biden Administration that reduced the ability of Corporate America to use permanent book-tax differences to reduce their book ETR lost the support of Corporate America, moderate Democrats, and Republicans for President Biden's Build Back Better international tax reforms.[5]

The Hanna and Wilson prescription for a substitute proposal that they believe can win the support of Corporate America would be to combine full current taxation of foreign business income with a reduced corporate tax rate (for all income, not just foreign active business income).[6] They believe that the reduced book ETR resulting from a corporate tax rate of 15% (or slightly higher but remaining in the teens)[7] would meet Corporate

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3. *See, e.g.*, J. Clifton Fleming, *Acknowledging (Celebrating? Regretting?) Sixty Years of Subpart F*, 51 INTERTAX 519 (2023) (discussing the failure of Subpart F to achieve the advantages of worldwide taxation and the uncertain progress made by the 2017 Tax Cuts and Jobs Act); James R. Repetti, *International Tax Policy's Harm to Manufacturing and National Interests*, WIS. L. REV. (forthcoming 2023) (arguing that "[t]wo tax regulations that permit U.S multinational enterprises (MNEs) to use foreign contract manufacturers and to disregard their wholly owned foreign subsidiaries have created significant tax incentives for MNEs to move manufacturing outside the" United States); J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Expanded Worldwide Versus Territorial Taxation After the TCJA*, 161 TAX NOTES 1173, 1174 (2018) (deferral was unacceptable to worldwide taxation advocates because it "effectively created a preferential tax rate for CFC income that encouraged U.S. MNEs to locate operations in and engage in income shifting to low-tax foreign countries."); Hanna & Wilson, *supra* note 1, at 265 ("Corporate America preferred a more territorial system, and many tax scholars wanted a more worldwide no-deferral system with no territorial elements.").

4. Hanna & Wilson, *supra* note 1, at 271. We will use the more colloquial term "book accounting" to refer to financial accounting.

5. *Id.* at 271, 284. These changes included Biden proposals for an increased effective tax rate on global intangible low-taxed income (GILTI) (implemented through a reduced GILTI deduction resulting in a higher tax effective tax rate (ETR)), *see* I.R.C. §§ 250(a)(1)(B), 951A (establishing the lower effective tax rate for a domestic corporation's GILTI inclusion and the U.S. GILTI regime, respectively); repeal of the partial deduction for foreign-derived intangible income (FDII), *see* I.R.C. § 250(a)(1)(A) (establishing the FDII regime); and the effective elimination of the 100% foreign dividend exemption for dividend distributions not attributable to earnings already taxed to a United States shareholder. I.R.C. § 245A. We use the phrase "the effective elimination of the foreign dividend exemption deduction" because the Biden Administration's proposals to eliminate the exclusion from GILTI for a 10% return on qualified business asset investment (QBAI) and to eliminate the high-foreign-tax exception to Subpart F income and GILTI in most cases would leave few or no future controlled foreign corporation (CFC) earnings to be eligible for the section 245A dividends-received deduction. *See* U.S. DEP'T OF THE TREAS., GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2024 REVENUE PROPOSALS 28, 30 (2023), https://home.treasury.gov/policy-issues/tax-policy/revenue-proposals [https://perma.cc/JG2T-QAJJ] (explaining U.S. tax policy relating to the dividends-received deduction, expatriating corporations, stock losses for reduced- rate foreign income, and other international tax issues).

6. Hanna & Wilson, *supra* note 1, at 271.

7. Hanna and Wilson do not pin down a specific rate. So, for purposes of our discussion, we will assume that the proposal is for a 15% rate. Our observations would be the same if the rate were slightly higher but remained in the teens.

America's objective of a sufficiently low book ETR to garner enough support for passage of their proposal.[8]

Hanna and Wilson provide a useful review of the current and immediately preceding international tax rules applicable to U.S. multinational corporations and different ways to view the rules in relation to whether they rely on deferral and whether they tax normal or residual returns.[9] Important to their premise regarding the significance of financial reporting, Hanna and Wilson also show how those international tax rules interact with financial reporting, including particularly reporting of book income tax expense.[10] This builds on prior work of each author and, we agree, is an important contribution to the literature on international tax reform.[11]

We do not share Hanna and Wilson's optimism that a structural shift to full current taxation of foreign income (with a per-country foreign tax credit), combined with a further rate reduction on all corporate income, would win over tax scholars or most of Corporate America for that matter. We respectfully disagree with the Hanna and Wilson prescription.

Raising revenue to support public goods and enhancing the equity of the federal tax system matters. The Staff of the Joint Committee on Taxation estimated the revenue loss from the 2017 Tax Cuts and Jobs Act (TCJA) would be $1.46 trillion over the 10-year period 2018 to 2027.[12] The reduction in the corporate tax rate from 35% to 21% was estimated to lose $1.35 trillion over this period.[13] Hanna and Wilson's comforting assertion that their proposal would be revenue neutral (or even raise revenue) fails to take into account that revenue neutrality using a baseline that was lowered by $1.46 trillion in the

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8. Hanna & Wilson, *supra* note 1, at 271. This 15% supposition is supported by one of the author's anecdotes regarding a 2017 conversation between a congressional staff member and the Vice President of Tax for a U.S. multinational company. The Vice President of Tax said he thought the business community could support full current taxation of active foreign business income at a rate of 15% or close to that. *Id.* at 263. Compounding support for this supposition, one of the authors of this article was an invited witness in a closed-door meeting of a House Ways and Means Committee Subcommittee in 2011 and witnessed the Vice President for Tax of a U.S. tech multinational company identify a 15% rate on currently taxed foreign income as something multinational business could manage. One of us who has twice served in the Treasury would observe that such off-the-record statements of corporate representatives are rarely repeated publicly and even more rarely put forward or supported by business lobbying organizations such as the U.S. Chamber of Commerce, Business Roundtable, and National Foreign Trade Council. Perhaps more importantly, one looks in vain for public Corporate America support for legislation with a net tax increase in over three decades. This is one reason why repeated (and bipartisan) tax cuts have eroded U.S. fiscal flexibility to deal with crises. *See* Bobby Kogan, *Tax Cuts Are Primarily Responsible for the Increasing Debt Ratio*, CTR. FOR AM. PROGRESS (Mar. 27, 2023), https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio [https://perma.cc/KJ2Q-P23P].

9. Hanna & Wilson, *supra* note 1, at 271–77.

10. *Id.* at 277–84.

11. *See, e.g.*, Christopher H. Hanna, *Corporate Tax Integration: Past, Present, and Future*, 75 TAX LAW. 307 (2022); Cody Wilson, *International Tax Planning for Domestic Multinational Corporations: Optimizing Effective Tax Rates By Turning Sticks into Snakes and Implementing Other Strategies*, 15 VA. L. & BUS. REV. 45 (2020); Christopher H. Hanna, *Corporate Tax Reform: Listening to Corporate America*, 35 J. CORP. L. 283 (2009).

12. *See* STAFF OF THE JOINT COMM. ON TAX'N, 115TH CONG., GENERAL EXPLANATION OF PUBLIC LAW 115–97, at 441 (Comm. Print 2018) (estimating revenue effects of the Tax Cuts and Jobs Act of 2017 (TCJA) for fiscal years 2018–2027). The TCJA included numerous budget gimmicks including phase-ins and sunsets of provisions, designed to keep the revenue loss within the instructions for the budget reconciliation legislation of which the tax provisions were a key part.

13. *Id.* at 436.

TCJA would accept a one-way downward ratchet in revenue. It is unjustifiable when $1.35 trillion of that lowered baseline is itself attributable to recent corporate rate reductions, and it is even more difficult to justify in light of subsequent events, including needed spending for COVID pandemic relief and supporting Ukraine's defense against unjustified and illegal Russian military aggression. In our view, revenue needs to be increased, not maintained at TCJA-depressed levels.

As discussed in Part II.A.5, the United States has a substantial need for revenue to pay for the costs of climate change responses, an adequate social safety net, investments in human and physical infrastructure, and security both domestically and internationally. Today, the failure to maintain a strong sustainable tax base, including on corporations, has led to under-investment in public resources that diminishes U.S. capabilities. Equally important to the need for revenue, expanding the TCJA corporate tax reduction, as the Hanna and Wilson proposal would do, does not address the growing structural income and wealth inequalities that threaten our social fabric and are reflected in growing populist disdain for democracy.

Part II examines the structural implications of Hanna's and Wilson's prescription of a lower corporate rate and full taxation of foreign income, including their expectations of a resulting revenue increase. In Part III, we describe the directions that we think international tax reform in the current global context should take. Part IV concludes that we respectfully dissent from Hanna and Wilson's argument to expand the TCJA corporate tax reduction and offer a different approach.

II. STRUCTURAL AND REVENUE CAPACITY ISSUES

A. Structural and Revenue Issues

1. Corporate Rate Reduction

There has been a long history of siloing policy discussions of the outbound international tax rules from discussions of the overall U.S. federal income tax. Such an approach also has long been outdated. Thus, including an overall corporate rate reduction in a standalone international tax proposal exacerbates the silo problem because the reduction has multiple collateral structural consequences in both the domestic and international tax contexts.

We turn first to the domestic context. A reduction in the general corporate rate to 15% would create a substantial disparity from the top 37% rate applicable to individuals. This disparity would be further exacerbated in tax years starting after 2025 when the top marginal rate on individual taxpayers will return to 39.6% unless the TCJA individual tax rate cuts are extended by Congress. Moreover, even application of the complex 20% section 199A deduction for qualified business income of qualifying individuals would still yield a 29.6% effective rate (for tax years starting before 2026)—almost double the proposed corporate rate.[14] This degree of individual-versus-corporate rate disparity would

14. Tony Nitti, *Understanding the New Sec. 199A Business Income Deduction*, TAX ADVISER (Apr. 1, 2018), https://www.thetaxadviser.com/issues/2018/apr/understanding-sec-199A-business-income-deduction.html#fn_4 [https://perma.cc/86QE-Q3NM]. Furthermore, section 199A will expire for tax years starting after 2025 unless Congress extends section 199's sunset. *Id.*

increase the incentive for U.S. individual tax residents to use and retain income in, C corporations.[15] We question whether such a rate disparity would be tenable or sustainable as a political matter.[16] If the response were a direct reduction in individual rates, an increase in the section 199A qualified business income deduction, or a further reduction in the section 1(h) tax rate on qualified dividend income, Hanna and Wilson's expected revenue neutral outcome would not be met.

We next consider how the TCJA benefited Corporate America's international business (at the "cost" of losing deferral taxation of earnings retained offshore) while largely disregarding international businesses owned by individuals. The section 250(a)(1)(B) deduction for global intangible low-taxed income (GILTI) of a controlled foreign corporation (CFC) only applies to domestic corporate shareholders, and the section 250(a)(1)(A) FDII deduction for exports is only available for domestic corporations.[17] In both cases, individual taxpayers were not accorded the same tax subsidy for foreign income allowed to Corporate America. Individual shareholders are taxed on GILTI at their full individual rates without a credit for the CFC's corporate-level tax (unless they make a section 962 election, which has other negative tax consequences for the electing shareholders) and they are not allowed a FDII deduction in relation to export income (even if they make a section 962 election).

To set a baseline for the discussion, the following Example shows (with simplified facts) how a domestic corporation and a U.S. individual shareholder would be taxed under current law's GILTI rules.

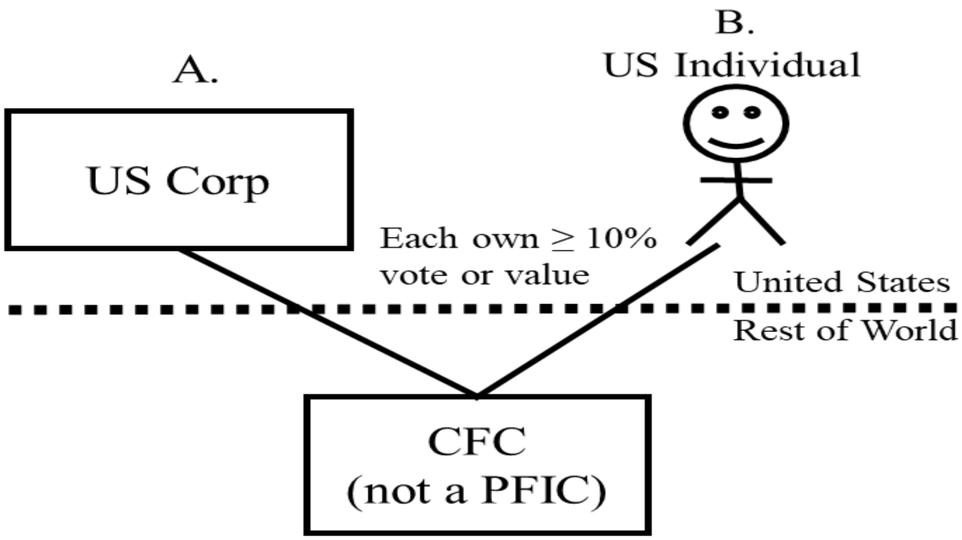
> **Example 1.** Assume that a foreign corporation, CFC, has two shareholders—a U.S. corporation (U.S. Corp) and a U.S. individual (U.S. Individual). U.S. Corp and U.S. Individual each own 10% or more of CFC by vote or value. For simplicity, assume that CFC has no Subpart F income and no "net deemed tangible income return" (NDTIR), so all of CFC's income is GILTI. Additionally, assume that no U.S. expenses are allocated to the GILTI income for purposes of the foreign tax credit limitation. CFC pays foreign tax at an effective rate of 10% and there are no withholding taxes. The U.S. corporate tax rate is 21% and U.S. Individual's tax rate is 37%, the GILTI deduction is at 50% of GILTI, and there is a 20% haircut on the GILTI foreign tax credit by reason

15. *See generally* U.S. DEP'T OF THE TREAS., REPORT OF THE DEPARTMENT OF THE TREASURY ON THE INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS: TAXING BUSINESS INCOME ONCE (1992) ("This Report examines in detail several different [individual and corporate tax] integration prototypes, although it does not attempt an exhaustive discussion of all possible integration systems or of all the technical issues raised by the alternative prototypes."); Alvin C. Warren, Jr., INTEGRATION OF THE INDIVIDUAL AND CORPORATE INCOME TAXES 28–39 (AM. L. INST. 1993). Among other things, this rate disparity would encourage shareholders of closely held corporations to disguise corporate profits distributions as excludable fringe benefits.

16. The burden of the corporate tax is estimated to fall significantly on those with high incomes. *See* TAX POL'Y CTR., T17-0179 - SHARE OF CHANGE IN CORPORATE INCOME TAX BURDEN; BY EXPANDED CASH INCOME LEVEL, 2017 (June 6, 2017), https://www.taxpolicycenter.org/model-estimates/distribution-change-corporate-tax-burden-june-2017/t17-0179-share-change-corporate [https://perma.cc/R68Z-ZN2Z].

17. I.R.C. §§ 250(a)(1)(A), (a)(1)(B). The failure to allow the FDII deduction to a U.S. branch of a foreign corporation is clearly discriminatory under U.S. tax treaties. *See, e.g.*, Double Taxation Convention, U.S.-U.K., art. 25, July 24, 2001, T.I.A.S. No. 13161 ("The taxation on a permanent establishment [of a U.K. enterprise in the United States] shall not be less favourably levied . . . than the taxation levied on [U.S.] enterprises . . . carrying on the same activities.").

of section 960(d). Assume that U.S. Corp and U.S. Individual each have $1000 of GILTI and that U.S. Individual does not make a section 962 election.



In this simplified Example 1, under current law, U.S. Corp would pay U.S. tax of $25 and total taxes of $125 (a 12.5% effective rate because of the 20% haircut on the credit for GILTI foreign taxes). U.S. Individual would pay U.S. tax of $333.00 and total taxes of $433.00 (a 43.3% overall effective rate).[18]

We are not suggesting that individuals who forgo a section 962 election should receive a credit for corporate-level foreign taxes. We simply make the point that the international

18. The calculation is below as prescribed by I.R.C. sections 951A(c)(2)(A), 960(d), 78, and 250(a)(1)(B):

Example 1	A. U.S. Corp.	B. U.S. Individual
U.S. income	$900.00	$900.00
Section 78 gross-up	$100.00	$0.00
U.S. "tested" income	$1,000.00	$900.00
GILTI deduction @ 50%	$500.00	$0.00
U.S. taxable income	$500.00	$900.00
Tentative U.S. tax	$105.00	$333.00
Section 960 foreign tax credit	$80.00	$0.00
Final U.S. tax	$25.00	$333.00
Total taxes	$125.00	$433.00

Again, for simplicity, we forgo a section 962 election calculation.

provisions of the TCJA that Congress and the Trump Administration threw together principally benefit Corporate America.[19]

Before turning to the effects of the Hanna and Wilson proposal, we observe that the context of a rapidly changing domestic and international tax environment differs from 2017 when the United States was a first mover in relation to the GILTI reduced-rate minimum tax on foreign income. This is highlighted by the intervening adoption of the new corporate alternative minimum tax in the United States in 2022 and the coming adoption of Pillar 2 minimum taxes by most U.S. trading partners.[20]

2. *The U.S. Corporate Alternative Minimum Tax*

We next consider the impact of the 2022 Inflation Reduction Act. This legislation added a new 15% corporate alternative minimum tax (CAMT).[21] The CAMT applies to corporate adjusted financial statement (book) income—other than book income of an S corporation, a regulated investment company, or a real estate investment trust—if the corporation has average annual adjusted financial statement net income of more than one billion dollars for the three-tax-year period ending with the tax year in question.[22] The CAMT applies when 15% of adjusted financial statement income exceeds a corporation's regular tax liability plus its liability for the base erosion and anti-abuse tax (BEAT). If such excess is paid as CAMT, it will be allowed as a credit in years in which the CAMT does not apply.

The CAMT is estimated to affect fewer than 150 corporations.[23] Accordingly, CAMT's use of a 15% rate on a financial statement income tax base is not a convincing path toward a 15% general corporate tax rate.[24] More importantly, the CAMT as adopted is a floor, not a ceiling, for a corporate tax. By comparison, Hanna's and Wilson's proposed reduced corporate rate could be viewed as more an entry in a race to the bottom than an entry to the floor on a race to the top.

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19. And the benefits of the lack of detailed consideration of the rules keep flowing to Corporate America as evidenced by the windfall recently accorded Federal Express in a district court decision allowing it to claim foreign tax credits for foreign taxes on earnings never taxed by the United States. FedEx Corp. v. United States, No. 20-cv-02794, 2023 WL 2755311 (W.D. Tenn. Mar. 31, 2023). We believe that this decision is wrongly decided and expect that it will not be sustained on appeal.

20. *See* Mindy Herzfeld, *A Pillar 2 Tour Around the World*, 179 TAX NOTES FED. 383 (2023) (detailing GloBE Pillar 2 implementation by region); J. Clifton Fleming Jr., Robert J. Peroni & Stephen E. Shay, *Viewing the GILTI Tax Rates Through a Tax Expenditure Lens*, 108 TAX NOTES INT'L 1399, 1408–09 (2022) (describing global movement toward adoption of Pillar 2 minimum tax).

21. I.R.C § 55(b)(2).

22. I.R.C. §§ 55(b)(2), 59(k).

23. *See* Memorandum from Thomas A. Barthold, Chief of Staff of the Joint Comm. on Proposed Book Minimum Tax Analysis by Industry (July 28, 2022), https://www.finance.senate.gov/imo/media/doc/jct_analysis_book_minimum.pdf [https://perma.cc/XFL3-VHLF] ("[W]e project that only 150 taxpayers annually will be subject to the proposed book minimum tax . . . ."); Martin A. Sullivan, *Tax Credits and Depreciation Relief Slash Burden of New Corporate AMT*, 176 TAX NOTES FED. 1185, 1185 (2022) ("[W]e identify 90 corporations that are likely to be subject to [the] corporate alternative minimum tax (CAMT) in calendar year 2023.").

24. *See generally* Christopher H. Hanna, Michelle Hanlon, Norman Richter & Michael Schler, *The Rise of the Minimum Tax*, 100 TAXES 55, 80–81 (2022) ("Therefore, all of the authors of this article prefer an AMT based on earnings and profits to an AMT based on book income, and three of the four authors prefer no AMT to an AMT based on book income.").

3. *The G20/OECD Inclusive Framework's Pillar 2*

The G20/OECD Inclusive Framework's Pillar 2 is another important contextual development affecting the consideration of Hanna's and Wilson's proposal. Under the framework of Pillar 2, implementing countries will impose a global minimum tax rate of 15% on income earned by large multinational groups (generally, with consolidated revenue of €750 million or more).[25] Pillar 2 is based on adjusted financial income (GloBE income) determined on a source jurisdiction-by-source jurisdiction basis with a top-up tax imposed if the ETR on GloBE income for a source jurisdiction is less than 15%. It is expected that most source countries will adopt a qualified domestic top-up tax (QDMTT) to retain revenue that, under Pillar 2, would otherwise be paid to others as a "top-up" tax to reach the 15% minimum rate on GloBE income.[26] This is important as we return to Hanna and Wilson's proposal and consider its application if the effective foreign tax rate is 15%.

As we will see in Example 2 below, under Hanna's and Wilson's proposal, as affected by Pillar 2, the disparity in treatment of corporations and individuals remains, but the hoped-for U.S. revenue from taxation of foreign income to "pay for" the overall corporate rate reduction is unlikely to materialize. The corporate rate reduction will yield a revenue loss that could only be avoided by the most fanciful dynamic scoring.

Can increased U.S. taxation of foreign income pay for a low corporate rate? After the adoption of the CAMT and anticipating the passage of Pillar 2 legislation by most important U.S. trading partners, there will be little net revenue from expanded U.S. taxation of foreign income at a reduced overall corporate tax rate.

> **Example 2.** Assume the same facts as in Example 1—except that the U.S. corporate tax rate is 15%, the effective foreign tax rate is 15%, there is no deduction for GILTI, and there is no haircut on GILTI foreign tax credits. Under this understanding of Hanna's and Wilson's proposal, U.S. Corp's U.S. tax would be eliminated by the foreign tax credit for the 15% foreign tax. U.S. Corp would pay total taxes of $150 (a 15% effective rate), all to foreign countries.[27] Consequently, in the corporate scenario, the entire U.S. tax is offset by taxes paid to foreign governments and is unavailable to mitigate the U.S. revenue loss from the reduced tax on domestic corporate income. U.S. Individual would pay U.S.

25. *See* Org. for Econ. Coop. & Dev. [OECD], *Tax Challenges Arising from the Digitalisation of the Economy—Global Anti-Base Erosion Model Rules (Pillar Two)*, at 7–8 (Dec. 14, 2021), https://www.oecd-ilibrary.org/docserver/782bac33-en.pdf?expires=1687208187&id=id&accname=guest&checksum=1527C54DBE61483CF1494346DCBA3979 [https://perma.cc/JX3B-J9AQ] (providing the Executive Summary and Scope of the GloBE Rules).

26. *See* Herzfeld, *supra* note 20, at 388 ("What's notable about those countries that have announced plans to enact [Pillar 2] is how virtually all of them have made adoption of the QDMTT the priority. . . ."). The top-up tax would be paid either by an ultimate or intermediate parent entity in an implementing country under an income inclusion rule (IIR) or, if there is no such parent entity, to a group affiliate under an undertaxed profits rule (UTPR). OECD., *supra* note 25, at 11–14. For possible responses by developing countries, see ALLISON CHRISTIANS ET AL., A GUIDE FOR DEVELOPING COUNTRIES ON HOW TO UNDERSTAND AND ADAPT TO THE GLOBAL MINIMUM TAX (2023).

27. This would be the generally expected result assuming Pillar 2 adoption. As under today's law, with proper allocation of expenses to foreign income, some U.S. tax likely would be paid as a result of the operation of the U.S. foreign tax credit limitation.

tax of $314.50 and total taxes of $464.50 (a 46.5% overall effective rate).[28] Thus, the outcome disparity between the corporate U.S. tax and the individual U.S. tax is preserved, but this is not a feature of the Hanna and Wilson proposal.

The disparity between corporate and individual tax outcomes in the context of GILTI continues under the Hanna and Wilson proposal. While individual planning (e.g., the section 962 election) could reduce this differential in some cases, it essentially tracks the domestic corporate-individual tax rate disparity.

A more important point is that this outcome—increased taxes paid to foreign countries in the corporate scenario—is in the United States' national interest when those taxes fund public goods, including health, education, investments in human capital, investments in infrastructure, and investments in public security. The United States benefits directly and importantly when these investments by other countries improve the lives of their citizens, reduce the pressure for economic migration, create trading partners, and share the burden of international security. The limited international tax coordination of Pillar 2 will increase global growth and security in a win-win scenario for almost all participating countries.

B. The U.S. Need for Tax Capacity

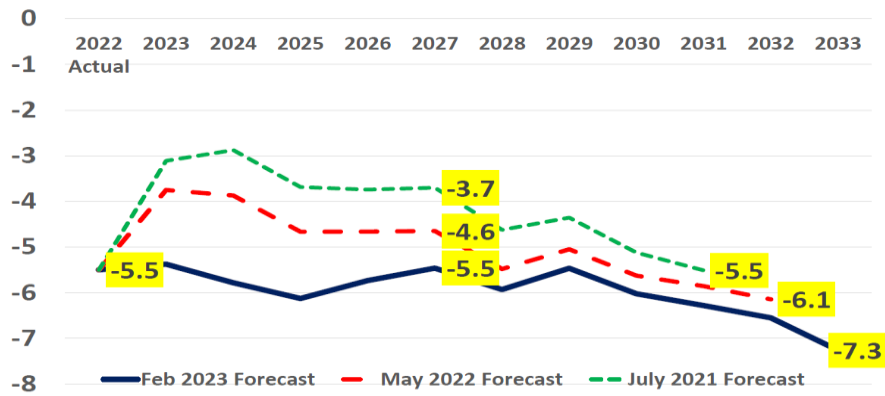
The United States has its own need for material additional revenues. The most recent Congressional Budget Office projections paint a bleak, deteriorating budget picture.[29] This

28. The calculation is below:

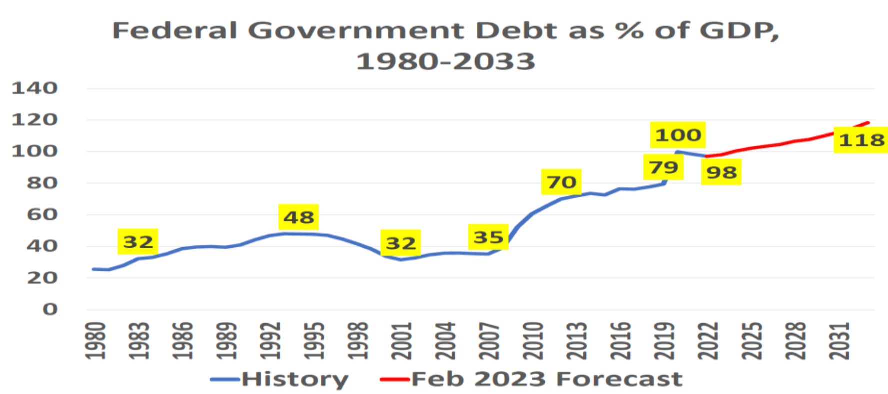
Example 2	A. U.S. Corp.	B. U.S. Individual
U.S. income	$850	$850
Section 78 gross-up	$150.00	$0
U.S. taxable income	$1,000	$850
Tentative U.S. tax	$150.00	$314.50
Section 960 foreign tax credit	($150.00)	$0
Final U.S. tax	$0.00	$314.50
Total taxes	$150.00	$464.50

29. *See generally* CONG. BUDGET OFF., THE BUDGET AND ECONOMIC OUTLOOK: 2023 TO 2033 (2023), https://www.cbo.gov/system/files/2023-02/58848-Outlook.pdf [https://perma.cc/9XFX-4YZ4] (providing information about budget and economic outlook by fiscal year).

is illustrated in the following chart of succeeding CBO projections of the federal budget deficits as a percentage of GDP:[30]



The failure of presidential and congressional leadership on taxes dates to the 1980s. For most of the intervening decades, Presidents have feared to push, and Congress has failed to pass, increases in revenue. Instead, politicians prefer politically safe tax reductions. This failure to match revenue mobilization with spending extends to financing wars, corporate subsidies, and benefits for the rich as well as the middle class. The following chart illustrates where the United States stands in terms of the federal debt held by the public in relation to GDP and CBO estimates of where the United States is going.[31]



This fiscal picture is perpetuated by the one-way ratchet of accepting current revenue levels as a baseline for a "revenue neutral" proposal, as Hanna and Wilson would do, as well as for measuring politically unpalatable tax increases. This "revenue neutral" perspective has, for decades, resulted in the failure to pass legislation with net tax increases while ignoring the decades-long evident situation in which Democrats consistently hope to

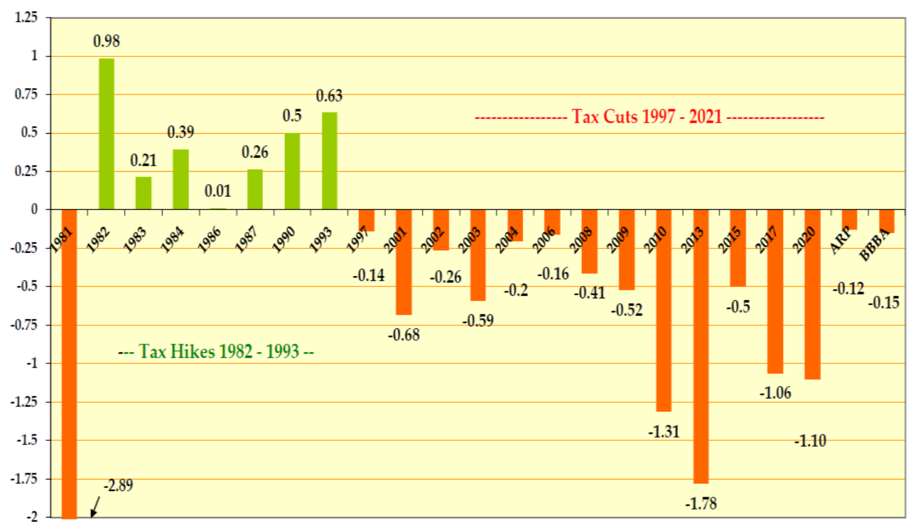
30. Martin A. Sullivan based on CBO Forecasts–UVA Presentation, Slide 20, Mar. 31, 2023 (on file with authors).

31. *Id.* at Slide 18.

maintain or increase spending on public goods while Republicans are unable to reduce federal spending as they purportedly desire. The TCJA, passed with only Republican support, *initially* aimed to lower revenue by (only) $1.5 trillion over ten years with no meaningful net spending reductions.[32] And that was before the pandemic was even in sight. Moreover, the purported $1.5 trillion revenue loss relied on a sleight of hand, including using 2025 sunsets of benefits that are highly likely to be "extended."[33] The real revenue loss from the TCJA far exceeds the $1.5 trillion of the original budget estimates.[34]

While Republicans have been the most vehement opponents of raising sufficient revenue through federal taxes to pay for the U.S. government's direct expenditure programs, the following table illustrates that failure of leadership on taxes is bipartisan.[35]

Estimated Revenue Effects of Major Revenue Legislation, First Four Years, As % of GDP, 1981-2021



We support increased government spending, particularly to address the needs of disadvantaged populations and to provide a social safety net. We additionally do not believe that deficits are always bad. Nevertheless, it is irresponsible for policymakers and

32. *See* STAFF OF JOINT COMM. ON TAX'N, JCX-67-17, ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT" (2017) (initially estimating the TCJA would result in a revenue decrease of about $1.6 trillion over the 2018–2027 period).

33. *How Did the TCJA Affect the Federal Budget Outlook?*, TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/how-did-tcja-affect-federal-budget-outlook [https://perma.cc/84JU-D97H] (2020).

34. *See* Letter from the Cong. Budget Off. to Mike Braun, U.S. Senator (Oct. 28, 2019), https://www.cbo.gov/system/files/2019-10/55743-CBO-effects-of-public-law-115-97-on-revenues.pdf [https://perma.cc/4E9Z-WHC4] (noting initial estimates of the cost of the TCJA were underestimates).

35. Sullivan, *supra* note 30, at Slide 35. Estimates for 1981 through 2013 can be found in Jerry Tempalski. Revenue Effects of Major Tax Bills (U.S. Dep't of the Treas., OTA Working Paper No. 81, 2006). Subsequent calculations are Sullivan's using revenue estimates from the Joint Committee on Taxation and GDP projections from the Congressional Budget Office. *Id.*

public representatives to fail to maintain a capacity to use taxes to pay for public goods, wars, national emergencies, and business subsidies.[36] In our view, a tax system with public support to raise revenues reasonably close to current expenditures and with the capacity to raise substantial additional revenue in the case of emergency is an important national security asset.

The corporate tax is not a large contributor to federal revenues, varying annually between 8 to 12 percent of total federal receipts.[37] Nevertheless, it is disproportionately important in two respects. First, the corporate tax is the principal tax on U.S. tax-exempt entities (directly and indirectly through their holdings of investments) and on many foreign-owned corporations. Second, the corporate tax also is effectively a strongly progressive tax: U.S. owners of shares skew heavily toward the financially well-off. It should not be a candidate for rate reduction post-TCJA and under current domestic and international circumstances as described above.

III. DIRECTIONS FOR REFORM.

A. Principles

International tax rules, for corporations and for individuals, are an integral part of an overall income tax system. They should not be siloed, and they should not be the source of privilege to taxpayers who happen to engage in cross-border transactions. We have long argued for comparable treatment of foreign and U.S. income when determining the income tax base and in setting rates.[38]

However, there are two respects in which the international rules must differ from domestic rules. The first is to take account of the limits on U.S. jurisdiction to prescribe and enforce taxes.[39] The second is to honor the right of other countries to tax income in ways that satisfy international standards for inter-nation division of income and to mitigate international double taxation of income by allowing a foreign tax credit.[40] We have explained why taxation of foreign business income of a U.S. person to the extent not taxed by another country with a right to tax remains superior to a territorial system.[41]

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36. We take no position here on the lively debate among economists concerning the level at which deficits pose an existential economic threat. We apparently have not hit that point.

37. *Federal Revenue: Where Does the Money Come From*, NAT'L PRIORITIES PROJECT, https://www.nationalpriorities.org/budget-basics/federal-budget-101/revenues/ [https://perma.cc/DBF7-T6JX] (graphing the percentage of the total federal revenue that comes from corporate income taxes between 1934 and 2021).

38. *See, e.g.*, Fleming, Peroni & Shay, *supra* note 3 (discussing why the current "U.S. outbound international tax system remains defective").

39. *See* Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *The David R. Tillinghast Lecture: "What's Source Got to Do with It?" Source Rules and U.S. International Taxation*, 56 TAX L. REV. 81, 106–36 (2002) (discussing the criteria, including the relevant limitations on taxing jurisdiction, that help determine how the United States structures its international tax policy).

40. *See* J. Clifton Fleming Jr., Robert J. Peroni & Stephen E. Shay, *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 328–33 (2001) (analyzing the relationship of the ability-to-pay principle to the foreign tax credit and the foreign tax credit limitation).

41. *See, e.g.*, J. Clifton Fleming Jr., Robert J. Peroni & Stephen E. Shay, *Two Cheers for the Foreign Tax Credit, Even in the BEPS Era*, 91 TUL. L. REV. 1 (2016) ("For reasons summarized in this Article, we favor

We support international coordination of tax rules that govern cross-border activity. This approach has decades of precedent evidenced by the adoption of bilateral treaties, multilateral treaties, and common standards. These agreements and standards were achieved through consensus-based soft law multilateral engagement at the OECD and the United Nations. These efforts—including the most recent work on Pillar 2—though far-reaching, nonetheless allow for national sovereignty and autonomy. Pillar 2 will benefit populations of almost all countries, albeit to differing degrees. While there are improvements to be made in governance and genuine inclusiveness, we expect these to occur as part of an evolving process.

B. Corporate America Is Not the Only Stakeholder

In our experience, the objective of Corporate America is to pay the least amount of tax that can be sustained on examination. While we agree that book ETRs carry greater weight in many cases than cash taxes and that there is a premium on permanent differences, there is a limit to that exchange. After all, deferred tax payments are accounted for in book ETRs.[42]

Business community support for international tax changes is desirable; however, in recent years, their Washington representatives have been caught up in the same polarization that has bedeviled legislative compromise generally. Each side believes that they can win the next election. This politically competitive environment restricts the ability to reach compromise on issues when there are genuine and material differences.

Even absent political polarization, assuming a budget constraint, Corporate America is far from the only stakeholder in international tax issues. The current insistence by some in Congress to maintain the very favorable tax treatment of research and development costs while refusing to extend the expanded child tax credit because of revenue constraints illustrates the recognition that a revenue-losing tax expenditure for one group means there will be less for others. With a budget constraint, it is necessary to look at the interests of the whole and not just by reference to the interests of a subset such as Corporate America.

Moreover, Corporate America ultimately does not speak with one voice. Even a rate reduction will cause some corporations to be winners (those with greater deferred tax liabilities) and others, at least in relative terms, losers (those with greater deferred tax assets). Additionally, stakeholders who do not participate in gains are, for the fiscal reasons outlined above, losers because of the failure to fund needed programs. To achieve compromise in this environment, there must be tough negotiations.

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worldwide taxation if it is real worldwide taxation."); Fleming, Peroni & Shay, *supra* note 3 (explaining why worldwide taxation is favorable by comparing the two systems). While we do not favor the limited exclusion of an individual's foreign earned income, see I.R.C. § 911, and would favor repeal of this provision, it is sufficiently constrained in scope that it does not pose a fundamental risk to the U.S. individual income tax base.

42. INCOME STATEMENT RELATED DISCLOSURES, Accounting Standards Codification § 740-10-50-9 (FIN. ACCT. STANDARDS BD. 2019) (discussing the relevant components to disclose regarding income items, including deferred tax expenses and benefits).

C. Directions for International Tax Reform

1. Inter-Nation Division of Income

The adjustment to global international tax rules represented by Pillars 1 and 2 are stop-gap measures that only partially address longstanding inequities in the division of income between capital exporting and manufacturing dominant countries, and capital importing and consumption dominant countries (the United States is fortunate to be both in roughly comparable degrees). Amount A[43] of Pillar 1 and the QDMTT rules of Pillar 2 are initial steps that redress the over-allocation of taxing rights to residence countries and under-allocation to source countries. Pillar 1 and Pillar 2 should create space and an incentive for a more considered basis for inter-nation division of income.

Before the advent of low-cost global transportation, the communications revolution, and the development of digital business, historic proxies of place of manufacture and performances of services—combined with arm's-length transfer pricing—adequately created reasoned (if not always reasonable) divisions of income between countries. It has long been understood that these are merely proxies and that there is little economic substance to the concept of a source of income.[44] It is time for countries to redevelop principles and rules to govern inter-nation divisions of income.

2. Distributive Goals

We have long advocated for taking account of distributive considerations in international taxation.[45] In our prior work, we focused on the application of an ability-to-pay baseline to residents of the taxing country. Others have expanded their scope to take account of global distributive considerations.[46] The interconnectedness of challenges facing countries strongly supports acknowledging that broader distributive principles should be incorporated into a reasoned debate regarding international tax policy reform.

Whether the issue is climate change, global health and exposure to pandemics, or economic migration, it is necessary to recognize the need to improve lives globally rather than only in one's immediate neighborhood or only in one's own nation. Nevertheless, just

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43. Org. for Econ. Coop. & Dev. [OECD], Public Consultation Document: Pillar One—Amount A: Draft Model Rules for Tax Base Determinations (2022), https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-tax-base-determinations.pdf [https://perma.cc/E565-YDC8] (discussing Amount A).

44. *See* Shay, Fleming & Peroni, *supra* note 39, at 83 ("[W]e find that source rules that serve as instruments for implementing source taxing jurisdiction and effecting residence country accommodation of source country taxation are surprisingly lacking in normative content. Thus, if timing of income and expense recognition is the Achilles heel of a purely domestic income tax system, the source of income and expense is an equally weak link in the international tax rules.").

45. *See, e.g.*, Fleming, Peroni & Shay, *supra* note 40, at 302 (citing how distributive concepts have operated within the U.S. tax system and how new theories need to take this operation into account).

46. *See, e.g.*, Miranda Stewart, *Redistribution Between Rich and Poor Countries*, 72 BULL. FOR INT'L TAX'N 297 (2018); TSILLY DAGAN, INTERNATIONAL TAX POLICY: BETWEEN COMPETITION AND COOPERATION 189-93 (Cambridge U. Press 2018) (summarizing the dispute among philosophers regarding whether distributive concerns should be taken into account at the national or international level); Ilan Benshalom, *How to Redistribute? A Critical Examination of Mechanisms to Promote Global Wealth Distribution*, 64 U. TORONTO L.J. 317, 351–58 (2014) (discussing different structures international taxation may take before concluding that "[i]t offers a concrete and relatively straight-forward" model of international redistribution).

as we properly weigh family concerns above considerations for strangers and national needs over those of other countries, it is critical to address the needs and concerns of other populations and countries in some reasonable balance.

3. Tax Administration and Enforcement

Perhaps the greatest accomplishments to date in adapting to a 21st century tax world have been made in the area of international cooperation in tax information exchange—largely through the G20/OECD Global Forum for Transparency and Exchange of Tax Information. Information is at the heart of tax administration and enforcement, so these are welcome developments. The Global Forum also has been attentive to the misuse of taxpayer information, a critical component to retaining broad support for tax cooperation. Work should continue to facilitate information exchange while reducing the burden on taxpayers through improved coordination of forms and processes.

D. Directions for U.S. International Tax Reforms

1. Tax Base Reforms

The re-appearance of a corporate minimum tax (in the United States, the CAMT) is directly related to the shrinkage of the U.S. tax base, including the corporate tax base, graphically reflected above in the repeated tax legislation adopting various tax benefits between 1997 and 2021. Whether these benefits are formally included in the category of tax expenditures or simply treated as tax reductions, it is important to rebuild the income tax base and restore the capacity to increase taxes as necessary to meet national needs. In almost every case, we would favor shifting toward a more comprehensive (rather than a narrower) base. Doing so obviates the need for a minimum tax to constrain tax expenditures and permits Congress to adjust revenue upward or downward through transparent changes to tax rates. Even the most appealing tax expenditures tend to miss their target, grow out of hand, or both.[47]

What about other tax instruments, such as the value-added tax (VAT)? The VAT is a tax that looks far more appealing in an economist's model than it does in practice. The exceptions or lower rates routinely adopted to address distributive concerns, such as for food items and certain services, effectively erase the efficiency benefits claimed for the VAT. Moreover, avoidance of VAT through carousel fraud, missing trader fraud, and more recently digital hacks, rival IRS estimates for corporate income tax. avoidance[48] Finally, a

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47. *See, e.g.*, Stephen E. Shay, J. Clifton Fleming, Jr. & Robert J. Peroni, *R&D Tax Incentives: Growth Panacea or Budget Trojan Horse?*, 69 TAX L. REV. 419, 419–22 (2016) (noting how U.S. tax policy concerning research and development, while politically popular, requires reform to achieve the intended welfare spillovers); *see also* J. Clifton Fleming, Jr. & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and Its International Dimension*, 27 VA. TAX REV. 437, 441–45 (2008) (discussing how the comparatively politically unpopular tool of tax expenditure analysis is important for scrutinizing the efficacy of hidden government spending programs through the tax system).

48. *Compare* IRS, TAX GAP ESTIMATES 2014–2016 (AND PROJECTIONS FOR 2017–2019) 4 (2022), https://www.irs.gov/pub/irs-pdf/p5364.pdf [https://perma.cc/LPE8-PEDH] (projecting the corporate income tax gap from 2014–2016 to be $37 billion, or 7% of the share of the gross tax gap), *with* Eur. Comm'n, *VAT Gap in the EU: Report 2022*, at 40 (2022), https://data.europa.eu/doi/10.2778/109823 [https://perma.cc/YDZ9-98Y2] (in 2020, the VAT Gap in the EU27 was €93 billion, or 9.1% of the total expected VAT revenues).

U.S. federal-level VAT is effectively dead politically in both major parties. It is unlikely to be resurrected until there is no alternative, which means that efforts to reform the income tax should take precedence.

What about the promise of optimal income taxation and the advantages of limiting the tax base to "excess profits?" As one of us has written, that appeal is largely in the mirage of a theory that has not been pressure-tested in practice and is based on heroic assumptions that cannot be operationalized.[49] Ramsay-like taxation concepts[50] ask too much of a system with hundreds of millions of taxpayers and a need to raise trillions of dollars every single year.

2. Source Taxation

Other than the BEAT adopted in the TCJA, U.S. source taxation rules have not been fundamentally reexamined since 1966.[51] Such a reexamination is long overdue and should be one major focus of future international tax reform efforts.

The accessibility of information to source countries from the taxpayer or by exchange has undermined the rationale for imposing source tax on gross income. One approach would be to reduce or eliminate exceptions from gross withholding taxes while allowing a nonresident taxpayer the option of taxation of its income on a net income basis. Consideration should be given to expanding source taxation of offshore asset sales, as outlined by the Platform for Collaboration in Tax, in coordination with treaty and trading partners.[52]

3. Residence Taxation

Consistent with our prior work, we support full current taxation of GILTI without an NDTIR exclusion at the generally applicable corporate rate.[53] This would be a substantial simplification of current law. We would allow a credit for all foreign taxes, without a haircut, subject to a robust per-country foreign tax credit limitation that accounts for expenses properly allocable to the income taxed by another country in accordance with international standards.

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49. *See* Stephen E. Shay, *The Deceptive Allure of Taxing "Residual Profits,"* 75 BULL. FOR INT'L TAX'N 527, 527 (2021) (arguing that "practical limitations" to proposed models of optimal income taxation create inconsistencies "with the assumptions used in [the] models").

50. *See generally* Frank P. Ramsey, *A Contribution to the Theory of Taxation*, 37 ECON. J. 47 (1927) (proposing a concept for taxation that optimizes tax rates to maximize social welfare).

51. *See* Shay, Fleming & Peroni, *supra* note 39, at 85 (discussing the Foreign Investors Tax Act of 1966 and noting it as the last time U.S. source taxation of foreign persons had been reexamined).

52. *See generally* PLATFORM FOR COLLABORATION ON TAX, THE TAXATION OF OFFSHORE INDIRECT TRANSFERS—A TOOLKIT (June 4, 2020), https://www.tax-platform.org/sites/pct/files/publications/PCT_Toolkit_The_Taxation_of_Offshore_Indirect_Transfers.pdf [https://perma.cc/7P7H-86MF] (discussing possible approaches to expand source taxation of offshore assets sales).

53. *See, e.g.*, Fleming, Peroni & Shay, *supra* note 20, at 1407.

4. *Transfer Pricing and Transparency*

Country-by-country reporting should be made more useful for transfer pricing enforcement and should be publicly disclosed by taxpayers, with limited exceptions, as should redacted unilateral, bilateral, and multilateral advance pricing agreements.

5. *Coordinated International Income Division*

We support efforts to redress inter-nation divisions of income to authorize greater source taxation of business income from sales to consumers in that country. In this respect, we think the Pillar 2 incentive for source countries to tax at least a minimum rate is a positive development.

IV. CONCLUSION

International tax reform is inseparable from income tax reform generally. We support moving to a comprehensive income tax base both domestically and in cross-border taxation subject to allowance of a foreign tax credit. Other directions lead to complexity and administrative burdens for taxpayers and the government. If there is hope for reducing the burden of taxation in everyday life and the cost of compliance, it lies in the fewest of exceptions and elections, and a preference for rough justice over theoretical perfection.

We welcome authors Hanna and Wilson's initiating a public dialogue on what would comprise a durable international tax reform. We respectfully disagree with their prescription and favor instead meeting current U.S. social, economic, and strategic realities by building greater revenue capacity and continuing to engage in international coordination of cross-border tax rules that advance U.S. interests. We agree with Hanna and Wilson that this is the time to begin that important discussion and we contribute our competing perspective regarding the ends to be sought and how to accomplish those ends.