

## **U.S. International Tax Policy and Corporate America\***

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*Given the Republican-controlled House and narrow Democratic majority in the Senate, the Biden Administration has found itself in the perilous situation of needing to raise tax revenue while retaining the support of moderate Democrats. President Biden has proposed raising revenue by bringing the United States closer to a worldwide no deferral system and raising the corporate tax rate from 21 percent to 28 percent. These changes are unlikely to become law. Together, they simply do not have the support of moderate Democrats, Republicans, and, especially, Corporate America.*

*This Article aims to resolve the Biden Administration's conundrum by proposing a worldwide no deferral system with a corporate tax rate in the mid to high teens. In fact, such a proposal has already, in some sense, been made by both the Biden Administration and Congress and recently enacted into law: the 15 percent corporate alternative minimum tax. But few recognize this new tax system as a worldwide no deferral system because it is imposed on financial accounting income and applies only to the largest corporations. This Article addresses a gap in existing proposals for U.S. international tax reform by discussing Corporate America's focus on the interaction between financial accounting and tax accounting. Additionally, it proposes a U.S. international tax system that could have the support of tax scholars, policymakers, and Corporate America, all without sacrificing revenue.*

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### I. INTRODUCTION

In the Fall of 2017, representatives of one of the largest U.S. multinationals met with Republican tax staffers of the Senate Finance Committee.<sup>1</sup> The representatives wanted to discuss the corporate tax rate and the U.S. international tax system. The staffers were putting the finishing touches on a new international tax system for the United States as part of tax reform that would also lower the corporate tax rate. The existing international tax system, which traced its roots back to the 1920s, was outdated when compared to much of the developed world. It was a worldwide deferral system, meaning that the United States taxed the income of foreign subsidiaries of U.S. multinationals with a credit for foreign income taxes paid but only when the earnings were repatriated to the United States, typically by way of a dividend. Much of the developed world had shifted to a quasi-territorial international tax system in which the earnings of a foreign subsidiary were very lightly taxed or not taxed at all to the multinational parent company—a system generally referred to as dividend exemption or participation exemption.<sup>2</sup> In addition, the top U.S.

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1. The details from this non-public but non-confidential meeting come from Christopher Hanna's participation in the meeting while serving as a Senior Policy Advisor for Tax Reform to the United States Senate Committee on Finance.

2. See, e.g., Kyle Pomerleau, *Worldwide Taxation Is Very Rare*, TAX FOUND. (Feb. 5, 2015), <https://taxfoundation.org/worldwide-taxation-very-rare/> [<https://perma.cc/WDM5-WSQ2>]; see REPUBLICAN STAFF OF S. COMM. ON FIN., 113TH CONG., REP. ON COMPREHENSIVE TAX REFORM FOR 2015 AND BEYOND 238–82 (Comm. Print Dec. 2014), [https://www.finance.senate.gov/imo/media/doc/Comprehensive%20Tax%20Reform%20for%202015%20and%20Beyond%20\(C\).pdf](https://www.finance.senate.gov/imo/media/doc/Comprehensive%20Tax%20Reform%20for%202015%20and%20Beyond%20(C).pdf) [<https://perma.cc/B4MA-QAD9>] (discussing the inequities and inefficiencies in the current international tax system of the United States and offering possible avenues for reform).

corporate tax rate of 35 percent was significantly higher than much of the developed world, in which the average corporate tax rate was only about 22.5 percent.<sup>3</sup>

The tax staffers had crafted a new international tax system that was a hybrid of a territorial system and a worldwide no-deferral system. A portion of the earnings of a foreign subsidiary of a U.S. multinational, equal to the normal return on assets, would be free from U.S. tax—evidencing a territorial system.<sup>4</sup> Any excess return would be subject to U.S. tax with no deferral at a reduced rate of tax and a limitation on credits for foreign income taxes paid, evidencing primarily a worldwide no-deferral system.<sup>5</sup> In addition, earnings of a U.S. multinational attributable to goods or services in accessing foreign markets would be subject to a reduced rate of tax to complement the reduced rate of tax on the excess earnings of a foreign subsidiary.<sup>6</sup>

The meeting between the Republican tax staffers and the representatives of the U.S. multinational took place on the second floor of the Senate Dirksen Office Building in a small room adjacent to the front office of the Senate Finance Committee. The room only held about 12 people and was notable for the framed document on one of its walls of Alger Hiss’s testimony to the Senate Finance Committee. The representatives of the U.S. multinational sat on one side of the table with the Hiss framed document behind them, the Vice-President of Tax sitting in the middle, and the Republican tax staffers sitting on the other side.

The Vice-President of Tax led much of the discussion with the staffers and then made a surprising comment. “We could go for a worldwide no-deferral system if the corporate tax rate were 15 percent. Just tax it all, with no deferral of foreign income, at a flat 15 percent rate. As you know, the President wanted a 15 percent corporate tax rate.”<sup>7</sup>

One of the staffers responded, “That’s interesting that you say that. The Treasury Secretary is actually a supporter of a worldwide no deferral system. And, of course, many tax scholars believe that such a system would be more efficient and equitable than either the current system or a territorial system. Would Corporate America be on board with such a system?”

“I think so. We certainly would,” replied the Vice-President of Tax.

“What if the rate were higher than 15 percent?” asked the staffer. “Would you still support such a system at, say, 20 percent? As you may recall, Senator Wyden had a worldwide no deferral system in his tax plan, but the rate was 24 percent.”

“I don’t know if we would support such a system at 20 percent. But at 15 percent, we certainly would. If it were a little higher, I think so. I don’t know where our breakpoint would be.”

“I’m thinking – maybe the rate has to be somewhere in the teens?” inquired the staffer.

“That might be right.”

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3. See, e.g., Kari Jahnsen & Kyle Pomerleau, *Corporate Income Tax Rates Around the World, 2017*, TAX FOUND. (Sept. 7, 2017), <https://taxfoundation.org/corporate-income-tax-rates-around-the-world-2017/> [https://perma.cc/XM37-DZ32].

4. I.R.C. §§ 245A(a), 951A(b)(2).

5. I.R.C. §§ 250(a)(1)(B), 951A.

6. I.R.C. § 250(a)(1)(A).

7. Paul Hodgson, *How Sanders and Trump Aim to End Offshore Corporate Tax Havens*, FORTUNE (Mar. 11, 2016), <https://fortune.com/2016/03/11/sanders-trump-ofshore-tax-havens/> [https://perma.cc/ATQ8-2NTW].

The discussion with the representatives of the U.S. multinational did not lead to the development of a worldwide no-deferral system at a low corporate tax rate of 15 percent. One of the main reasons was that the discussion was held too late in the tax reform process. The U.S. international tax system developed by the staffers was nearing completion and was the culmination of a number of years of work. Congress had begun the process of tax reform in early 2011 when Representative Dave Camp (R-MI) became chairman of the House Ways and Means Committee.<sup>8</sup> Camp was absolutely driven to achieve tax reform, and, even though he was no longer a member of Congress when tax reform was finally accomplished in December of 2017, he could be viewed as the single most important individual behind the first successful tax reform effort in 30 years.

The tax reform process that started in 2011 did not gain any momentum for a number of years, primarily due to both the Obama Administration and Congressional leaders' lack of interest in tax reform. However, when Donald Trump was elected President in November 2016, he made it clear that tax reform was a top priority.<sup>9</sup> In meetings with Treasury Secretary Steven Mnuchin in early 2017, Mnuchin made it clear to members of the tax-writing committees and their staff that the Administration thought they had a bit of a honeymoon period in which their top legislative priorities could be achieved, and tax reform was at the top of the list. Mnuchin stressed that tax reform needed to be done by the beginning of August, which is when Congress would begin its one-month summer recess.<sup>10</sup>

As 2017 progressed, the tax staffers met with numerous representatives of U.S. multinationals to develop a new U.S. international tax system. The starting point for such a system was an uncirculated proposal of Speaker of the House Paul Ryan (R-WI) dating back to 2015,<sup>11</sup> which itself was an extension of proposals put forth by Camp in October 2011 and February 2014, and by the Obama Administration in April 2016.<sup>12</sup> In all of the proposals, a portion of the foreign income of the foreign subsidiary of the U.S.

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8. Press Release, U.S. House of Rep. Ways and Means Comm., Camp Selected as Ways and Means Chairman (Jan. 5, 2011), <https://gop-waysandmeans.house.gov/camp-selected-as-ways-and-means-chairman-2/> [<https://perma.cc/D6M3-TGMN>].

9. Heather Long, *Trump to GOP: Show Me the BIG Tax Reform*, WASH. POST (July 28, 2017), <https://www.washingtonpost.com/news/wonk/wp/2017/07/28/trump-to-gop-show-me-the-big-tax-reform/> [<https://perma.cc/5SG2-G4VF>].

10. Vicki Needham, *Mnuchin Promises Tax Reform by August*, HILL (Mar. 1, 2017), <https://thehill.com/policy/finance/321881-mnuchin-promises-tax-reform-by-august> [<https://perma.cc/AVJ6-2FL5>].

11. Kelsey Snell, *Paul Ryan's Presidential Campaign Play – Tax Reform*, WASH. POST (June 10, 2015), <https://www.washingtonpost.com/news/powerpost/wp/2015/06/04/wp/2015/06/10/paul-ryans-presidential-campaign-play-tax-reform/> [<https://perma.cc/4QSC-7QVS>] (discussing Ryan's intention to re-write the tax code).

12. Press Release, U.S. House of Rep. Ways and Means Comm., Camp Releases International Tax Reform Discussion Draft (Oct. 26, 2011), <https://gop-waysandmeans.house.gov/camp-releases-international-tax-reform-discussion-draft/> [<https://perma.cc/WP85-YVXZ>]; Press Release, U.S. House of Rep. Ways and Means Comm., Camp Formally Introduces the Tax Reform Act of 2014 (Dec. 11, 2014), <https://gop-waysandmeans.house.gov/camp-formally-introduces-the-tax-reform-act-of-2014/> [<https://perma.cc/9GFC-6EH2>]; U.S. DEP'T TREASURY & WHITE HOUSE, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM (Apr. 2016), <https://home.treasury.gov/system/files/131/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf> [<https://perma.cc/T9G9-US9B>].

multinational equal to the normal return would be exempt from U.S. tax.<sup>13</sup> Any excess return would be subject to U.S. tax at a preferential tax rate.

In early 2017, Senator Robert Portman (R-OH), a member of the Senate Finance Committee, began developing a proposal for a new international tax system using Speaker Ryan's proposal as a starting point.<sup>14</sup> At the same time, the late Senator Mike Enzi (R-WY), also a member of the Finance Committee, began developing a proposal using his own draft from five years earlier as a starting point.<sup>15</sup> In mid-to-late 2017, the Portman and Enzi proposals were melded together, resulting in the new U.S. international tax system enacted in December as part of the Tax Cuts and Jobs Act.

The new regime was a compromise between what Corporate America wanted and what many tax scholars believed to be the optimal international tax regime. As with most compromises, neither side was enthusiastic about the results, although the consensus seemed to be that the new international tax system was a definite improvement over the old system.<sup>16</sup> Corporate America preferred a more territorial system, and many tax scholars wanted a more worldwide no-deferral system with no territorial elements.<sup>17</sup> The divergent views of Corporate America and most tax scholars were why the remarks of the Vice-President of Tax of the U.S. multinational were so enlightening—Corporate America could accept a worldwide no-deferral regime as long as the corporate tax rate was around 15 percent. And many tax scholars, particularly economists, believed that the corporate tax rate should be very low because of the inefficiencies associated with it and its possible negative impact on economic growth.<sup>18</sup> A worldwide no-deferral regime with a low

13. KPMG, COMPARISON OF KEY ASPECTS OF PRESIDENT'S TAX PLAN, HOUSE GOP BLUEPRINT, CAMP TAX REFORM BILL 7 (2017), <https://home.kpmg/content/dam/kpmg/us/pdf/2017/04/tnf-trump-blueprint-camp-comparison-apr28-2017.pdf> [<https://perma.cc/RZU6-6CPN>].

14. David Rogers, *The GOP's Responsible Taxman*, POLITICO (May 10, 2017), <https://www.politico.com/story/2017/05/10/rob-portman-tax-reform-republicans-238165> [<https://perma.cc/ER5E-P2PM>]. Senator Portman also served as co-chair with Senator Charles Schumer (D-NY) on a Senate Finance Committee bipartisan working group on international taxation. The group produced a report in July 2015 that provided broad principles for international tax reform. S. COMM. ON FIN., 114TH CONG. 1ST SESS., THE INTERNATIONAL TAX BIPARTISAN TAX WORKING GROUP REPORT (July 7, 2015).

15. United States Job Creation and International Tax Reform Act of 2012, S. 2091, 112th Cong., 2d Sess. (2012).

16. The new U.S. international tax regime has become a bit of a model for the rest of the world through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. *See generally* OECD/G20 INCLUSIVE FRAMEWORK, *infra* note 22.

17. *See, e.g.*, J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Expanded Worldwide versus Territorial Taxation After the TCJA*, 161 TAX NOTES 1173, 1174 (Dec. 3, 2018) (outlining the positions of the two sides pushing for reform).

18. *See, e.g.*, Åsa Johansson et al., *Taxation and Economic Growth 2* (Org. for Econ. Coop. & Dev., Working Paper No. 620, 2008) ("Corporate taxes are found to be the most harmful for growth."); *Does the Tax System Support Economic Efficiency, Job Creation and Broad-Based Economic Growth?: Hearing on Tax Reform Before the S. Comm. on Fin.*, 112th Cong. 104 (statement of Dr. R. Glenn Hubbard, Dean and Professor, Columbia University Graduate School of Business) ("Economists have long recognized that the corporate income tax reduces economic efficiency more than alternative tax instruments. The corporate income tax hinders capital accumulation and interferes with production efficiency . . . It is important to reduce the corporate tax rate."); *Id.* at 46 (statement of Dr. Alan J. Auerbach, Professor of Economics and Law, University of California Berkeley) ("If we focus just on domestic activities, the corporate tax imposes important distortions that impede economic

corporate tax rate could address and resolve a number of issues, such as U.S. multinationals shifting income to a low-tax jurisdiction, U.S. corporations inverting to a low-tax foreign jurisdiction, and transfer pricing and earnings stripping between related entities.

It has been more than five years since the Tax Cuts and Jobs Act was enacted. President Joseph Biden has proposed some significant changes to the U.S. international tax system—changes that would bring it closer to a worldwide no-deferral system but with a much higher corporate tax rate.<sup>19</sup> The Organisation for Economic Co-operation and Development (OECD) is working on a project that would change how multinationals are taxed on their foreign income.<sup>20</sup> One pillar of the project would be a dramatic change in the world of international tax. It would require a portion of the residual profits of a multinational to be allocated to a market country even though the multinational had minimal or no physical presence in that country.<sup>21</sup> A second pillar of the OECD project would adopt an international tax regime similar to what the United States enacted as a part of the Tax Cuts and Jobs Act (TCJA)—a hybrid of a territorial and worldwide no-deferral regime—achieved by taxing the foreign income of a multinational annually (i.e., no deferral) at a preferential or minimum tax rate.<sup>22</sup>

With the corporate tax rate at 21 percent and the elimination of deferral on most foreign income, maybe now is the time for the United States to adopt a worldwide no-deferral system at a low corporate tax rate. The TCJA enacted the two most critical parts of such a regime: a low corporate tax rate and the elimination of deferral. The next steps would be to reduce the corporate tax rate from 21 percent to a rate in the mid- to high- teens

activity.”); *Id.* at 82 (statement of Michael J. Graetz, Professor of Law, Columbia Law School) (“Corporate income taxes are popular with the public, despite the virtually unanimous view among economists and other tax policy analysts—for many of the reasons I have discussed here—that the corporate tax is a bad tax, if the goal is to enhance our nation’s economic wellbeing.”).

19. U.S. DEP’T OF TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2022 REVENUE PROPOSALS 1 (May 2021), <https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf> [<https://perma.cc/7YJ3-88D7>] (summarizing Biden administration revenue proposals); Gordon B. Mermin et al., *An Updated Analysis of Former Vice President Biden’s Tax Proposals*, TAX POL’Y CTR. (Nov. 6, 2020), [https://www.taxpolicycenter.org/sites/default/files/publication/160472/an\\_updated\\_analysis\\_of\\_former\\_vice\\_president\\_bidens\\_tax\\_proposals\\_11-6-20\\_correction\\_1.pdf](https://www.taxpolicycenter.org/sites/default/files/publication/160472/an_updated_analysis_of_former_vice_president_bidens_tax_proposals_11-6-20_correction_1.pdf) [<https://perma.cc/C8NL-S2VU>] (“This brief updates estimates of the revenue and distributional effects of former vice president Joe Biden’s 2020 campaign tax proposals.”); Garrett Watson et al., *Details and Analysis of Joe Biden’s Tax Plan*, TAX FOUND. (Oct. 22, 2020), <https://taxfoundation.org/joe-biden-tax-plan-2020/> [<https://perma.cc/MWA7-KARV>] (citing the key premises of Biden’s tax plan).

20. *See generally* Statement from the Org. for Econ. Coop. & Dev., Statement on a Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Oct. 8, 2021), [www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm](http://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm) [<https://perma.cc/88E2-6QD7>] (describing components of the two-pillar plan).

21. *See* OECD/G20 INCLUSIVE FRAMEWORK ON BASE EROSION AND PROFIT SHIFTING, TAX CHALLENGES ARISING FROM DIGITALISATION – REPORT ON PILLAR ONE BLUEPRINT 19 (Oct. 2020), <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm> [<https://perma.cc/CEF4-ZEPY>] (“[A] location of taxing rights . . . can no longer be exclusively circumscribed by reference to physical presence.”).

22. *See generally* OECD/G20 INCLUSIVE FRAMEWORK ON BASE EROSION AND PROFIT SHIFTING, TAX CHALLENGES ARISING FROM DIGITALISATION – REPORT ON PILLAR TWO BLUEPRINT (Oct. 14, 2020) (explaining the second pillar’s approach to ensuring that all internationally operating businesses pay a minimum level of tax).

and, in conjunction, tax all foreign income of a controlled foreign corporation (CFC) annually (i.e., no deferral) with no preferential tax rate. A variation of such a system was proposed in 2021 by the Biden Administration<sup>23</sup> and Congress as part of the Build Back Better Act<sup>24</sup> and was enacted into law as part of the Inflation Reduction Act of 2022, which President Biden signed on August 16, 2022.<sup>25</sup> Few have recognized this new tax system as a low-tax rate, worldwide no-deferral system because it is a corporate alternative minimum tax (AMT) with a tax base of financial accounting income and very limited applicability to only the largest corporations.<sup>26</sup> A low-tax rate, no-deferral corporate tax regime could be accomplished in a revenue-neutral manner or even with a revenue increase and could achieve greater efficiency, equity, and possibly greater simplicity in the U.S. international tax regime.<sup>27</sup> And, importantly, Corporate America could support such a regime.

## II. CURRENT U.S. INTERNATIONAL TAX SYSTEM

As part of the TCJA, Congress substantially changed the U.S. international tax system.<sup>28</sup> Before it was enacted, the United States had a worldwide deferral system with a credit for income taxes paid to a foreign country. More specifically, the United States taxed the income of foreign subsidiaries of U.S. multinationals with a credit for foreign income taxes paid, but only when the earnings were repatriated to the United States, typically by way of a dividend. As part of the TCJA, Congress shifted the U.S. international tax system, eliminating much of the deferral of U.S. tax but also providing an exemption from U.S. tax for a portion of the foreign subsidiary's earnings.<sup>29</sup>

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23. See U.S. DEP'T TREASURY, *supra* note 19, at 21.

24. Build Back Better Act, H.R. 5376, 117th Cong. § 138101 (1st Sess. 2021).

25. Inflation Reduction Act of 2022, Pub. L. No. 117-169, § 10101, 136 Stat. 1818, 1818–29 (2022).

26. See, e.g., Memorandum from Thomas A. Barthold, Proposed Book Minimum Tax Analysis by Industry (July 28, 2022), [https://www.finance.senate.gov/imo/media/doc/jct\\_analysis\\_book\\_minimum.pdf](https://www.finance.senate.gov/imo/media/doc/jct_analysis_book_minimum.pdf) [<https://perma.cc/DN97-7GCA>] (noting that the staff of the Joint Committee on Taxation estimates that approximately 150 companies annually will be subject to the new corporate AMT); Martin A. Sullivan, *Tax Credits and Depreciation Relief Slash Burden of New Corporate AMT*, 176 TAX NOTES FED. 1185 (Aug. 22, 2022). In addition, any tax paid under the new corporate AMT can be credited against the corporate tax in a year in which the corporation's regular tax liability (and BEAT liability) is greater than the corporate AMT liability. I.R.C. § 53. As a result of the corporate AMT credit, the new corporate AMT will not impact a corporation's effective tax rate unless a valuation allowance is placed against the deferred tax asset recorded for the corporate AMT credit. See CHRISTOPHER H. HANNA, PAUL H. YONG & MARK P. THOMAS, *CORPORATE INCOME TAX ACCOUNTING* § 2.22[1] (2022).

27. See Christina A. Davis, *Is the Tax Cuts and Jobs Act GILTI of Anti-Simplification?*, 38 VA. TAX REV. 315, 327–50 (2019) (exploring possible benefits to a low-tax rate, no deferral corporate tax regime). The new corporate AMT enacted in the Inflation Reduction Act of 2022 may impact the revenue generated by a low-tax worldwide no deferral system. Such revenue impact is not considered in this Article. The new corporate AMT is scheduled to be effective for taxable years beginning after December 31, 2022.

28. Compare I.R.C. §§ 951, 951A (subjecting U.S. shareholders of a controlled foreign corporation to immediate taxation on income earned by a controlled foreign corporation), with J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, *Worse than Exemption*, 59 EMORY L.J. 79, 87–89 (2009) (explaining the deferral system in which U.S. multinationals generally did not owe U.S. tax on income earned by a controlled foreign corporation until the corporation repatriated the income to the United States).

29. I.R.C. §§ 951, 951A; see also Michael P. Donohoe, Gary A. McGill & Edmund Outslay, *The Geometry of International Tax Planning After the Tax Cuts and Jobs Act: A Riff on Circles, Squares, and Triangles*, 72 NAT'L TAX J. 647, 652 (2019) (providing an overview of the act's implications).

Generally, the earnings of a CFC of a U.S. multinational can be placed into one of three categories. The first category is Subpart F income, which is generally mobile or passive income.<sup>30</sup> Mobile income is referred to as foreign base company sales income and foreign base company services income.<sup>31</sup> Foreign base company sales income is generally income derived by a CFC from the purchase or sale of personal property involving a related party in which the goods are manufactured and sold for use or consumption outside the CFC's country of incorporation.<sup>32</sup> Foreign base company services income is income derived by a CFC in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services for or on behalf of any related person outside the CFC's country of organization.<sup>33</sup> Passive income, referred to as foreign personal holding company income, generally includes income of a CFC such as dividends, interest, royalties, rents, annuities, and net gains on dispositions of property producing any of the foregoing types of income.<sup>34</sup> Subpart F income is taxed annually (i.e., no deferral) to the U.S. parent corporation at the U.S. corporate tax rate, which is currently 21 percent.<sup>35</sup> A credit is provided for foreign income taxes paid on Subpart F income, with any unused credits carried back one year and forward for up to 10 years.<sup>36</sup>

The second category of income of a CFC is tested income/global intangible low-taxed income (GILTI).<sup>37</sup> Income in this second category is generally income that is not Subpart F income, and which exceeds 10 percent of the adjusted basis of depreciable tangible property of the foreign subsidiary (referred to as a "qualified business asset investment" or QBAI).<sup>38</sup> Income in this category is taxed annually (i.e., no deferral) to the U.S. parent corporation at effectively half of the U.S. corporate tax rate, which is achieved through a 50 percent deduction of GILTI.<sup>39</sup> A credit is provided for foreign income taxes paid on tested income.<sup>40</sup> The credit is reduced by 20 percent, and any unused credits may not be carried back or forward and are therefore either utilized in the current year or lost.<sup>41</sup>

The third category of income is a residual category—income that is not Subpart F income or GILTI. It is generally composed of income equal to 10 percent of the adjusted basis of the depreciable tangible property of the foreign subsidiary, known as a CFC's net deemed tangible income return.<sup>42</sup> But it also includes high-taxed Subpart F income and

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30. I.R.C. § 951(a).

31. I.R.C. §§ 954(d)(1)(A)–(B), 954(e)(1)(A)–(B).

32. I.R.C. § 954(d)(1)(A)–(B).

33. I.R.C. § 954(e)(1)(A)–(B).

34. I.R.C. § 954(a)(1), (c)(1).

35. I.R.C. §§ 11, 951.

36. I.R.C. §§ 904(c), 960(a).

37. I.R.C. §§ 957(a), 958(b).

38. I.R.C. § 951A(c)(2)(A); Treasury Reg. § 1.951A-2(b)(1), (c).

39. I.R.C. § 250(a)(1)(B), (a)(2). The 50 percent deduction declines to 37.5 percent beginning in 2026. I.R.C. § 250(a)(3)(B).

40. I.R.C. § 960(d).

41. I.R.C. §§ 904(c)–(d)(1)(A), 960(d).

42. I.R.C. § 951A(b).



high-taxed GILTI if elected pursuant to the high-tax exception.<sup>43</sup> The residual category income is deferred from U.S. taxation until repatriated to the U.S. multinational by way of dividends. Upon repatriation, it is taxed by the United States, but the U.S. multinational is entitled to a 245A 100 percent dividends-received deduction, with the result of an effective U.S. tax of zero on income in the third category.<sup>44</sup> No foreign tax credits are permitted for income in the residual category.<sup>45</sup>

The current U.S. international tax system can be viewed in at least one of four ways. These views are organized in Table 1 below. First, it is a hybrid territorial/worldwide tax system.<sup>46</sup> The first category of income of a CFC—Subpart F income—represents the worldwide nature of the current system. It is taxed in full by the United States. The third category of income—the residual category—is not taxed at all by the United States, representing the territorial nature of the current system. The second category—GILTI—partially represents a worldwide system and partially represents a territorial system. It is taxed by the United States, reflecting its worldwide nature. But it is effectively only partially taxed by the United States through a 50 percent deduction, reflecting its territorial nature.

A second view is that the current system is a hybrid no-deferral/deferral system. Both Subpart F income and GILTI are taxed annually to the U.S. parent of the CFC. There is no deferral of the taxes owed on the income. With respect to the third category of income—the residual category—the taxing event does not occur until the income is repatriated by way of dividends to the U.S. parent. And, in almost all cases, the U.S. parent qualifies for a 245A 100 percent dividends-received deduction. As a result, the residual category of income is deferred from U.S. taxation but ultimately not taxed by the United States.

A third view is that the system is an overall system, as opposed to a country-by-country one. The second category of income—GILTI—is thought to be the largest category of income of most CFCs. It is applied as an aggregate of income and not on a country-by-

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43. Treasury Reg. §§ 1.951A-2(c), 1.954-1(d)(1). The Subpart F high-tax exception is provided in the tax code. I.R.C. § 954(b)(4). A very limited GILTI high-tax exception is provided in the tax code. *See* I.R.C. § 951A(c)(2)(A)(i)(III). The Treasury, through regulations, expanded the GILTI high-tax exception, although some members of Congress objected, feeling that Treasury had exceeded its authority in doing so. *See* Treasury Reg. § 1.951A-2; Press Release, U.S. Senate Comm. on Fin., Wyden Statement on GILTI High-Tax Exception Regulations (July 20, 2020), <https://www.finance.senate.gov/ranking-members-news/wyden-statement-on-gilti-high-tax-exception-regulations> [<https://perma.cc/J9NW-9TXZ>]; Press Release, U.S. Senate Comm. on Fin., Wyden, Brown Introduce Bill to Block Latest Trump Administration Corporate Giveaway (Feb. 12, 2020), <https://www.finance.senate.gov/ranking-members-news/-wyden-brown-introduce-bill-to-block-latest-trump-administration-corporate-giveaway> [<https://perma.cc/FL47-BFED>].

44. I.R.C. §§ 245A(a), 951A(b)(1).

45. I.R.C. § 245A(d)(1).

46. The hybrid modifier is necessary because the goal of a territorial tax system is to tax income only in its source jurisdiction. *See* Kyle Pomerleau & Kari Jahnsen, *Designing a Territorial Tax System: A Review of OECD Systems*, TAX FOUND. (July 2017), <https://files.taxfoundation.org/20170822101918/Tax-Foundation-FF554-8-22.pdf> [<https://perma.cc/93QG-HNY6>] (providing an overview of taxing foreign profits).

country basis.<sup>47</sup> More specifically, each CFC computes its tested income or tested loss.<sup>48</sup> These amounts are aggregated for all CFCs of the U.S. parent and result in net tested income.<sup>49</sup> In addition, QBAI is aggregated for all CFCs.<sup>50</sup> GILTI is the excess (if any) of net tested income over ten percent of QBAI.<sup>51</sup> GILTI is not determined on a CFC-by-CFC basis or a country-by-country basis.<sup>52</sup>

Finally, and probably most importantly, the current U.S. international tax system is a tax on supernormal or excess returns earned by a CFC, which are generally returns associated with an intangible asset.<sup>53</sup> An excess or supernormal return is a return that cannot be duplicated and is thought in most, if not all, cases to arise from skill or luck and not simply from a capital investment.<sup>54</sup> Supernormal returns can be taxed at high rates

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47. The Treasury Department has issued regulations permitting an expanded high-tax exception for GILTI, similar to the high-tax exception for Subpart F income. Treas. Reg. § 1.951A-2(c) (as amended in 2020). In calculating the effective foreign tax rate to apply the exception, in essence, a country-by-country determination is made. Treasury has also issued proposed regulations conforming the high-tax exception for Subpart F income with the expanded high-tax exception for GILTI. Guidance under Section 954(b)(4) Regarding Income Subject to a High Rate Foreign Tax, 85 Fed. Reg. 44650 (July 23, 2020) (codified at 26 C.F.R. pt. 1). President Biden and Congress have proposed applying GILTI on a country-by-country basis. See U.S. DEP'T. OF TREASURY, *supra* note 19, at 4–8; Build Back Better Act, H.R. 5376, 117th Cong. § 138126 (1st Sess. 2021).

48. See I.R.C. § 951A(c)(2).

49. See I.R.C. § 951A(c)(1).

50. I.R.C. § 951A(b)(2). If a CFC has a tested loss, its QBAI is not included in the calculation of 10 percent of QBAI in determining GILTI. I.R.C. § 951A(b)(2)(A).

51. See I.R.C. § 951A(b)(1).

52. In July 2020, the Treasury released the final GILTI high-tax exception regulations. The final regulations adopt a tested unit approach in calculating the foreign effective tax rate as opposed to the qualified business unit approach of the proposed regulations. Under the final regulations, there are three tested units: (1) a CFC; (2) an interest in a pass-through entity held, directly or indirectly, by a CFC, provided either the pass-through entity is a tax resident of a foreign country, or the pass-through entity is not subject to tax as a resident but is treated as a corporation (or another entity that is not fiscally transparent) for purposes of the CFC's tax law; and (3) a branch or portion of a branch, the activities of which are carried on, directly or indirectly, by a CFC, provided either the branch gives rise to a taxable presence in the country in which it is located, or the branch gives rise to a taxable presence under the owner's tax law, and this law provides an exclusion, exemption, or other similar relief (such as a preferential rate) for income attributable to the branch. Treas. Reg. § 1.951A-2(c)(7)(iv)(A) (as amended in 2020). Under a tested unit combination rule, all tested units of a U.S. shareholder that are tax residents or located in the same foreign country are treated as a single tested unit. Treas. Reg. § 1.951A-2(c)(7)(iv)(C) (as amended in 2020). The result of the tested unit combination rule in the final regulations is that the foreign effective tax rate for purposes of applying the GILTI high-tax exclusion is determined on a country-by-country basis. This means that, in one aspect, GILTI is applied on a country-by-country basis.

53. The focus and discussion of supernormal returns did not enter the tax law literature until the mid-1990s, so it is a relatively recent development in tax policy. See, e.g., William M. Gentry & R. Glenn Hubbard, *Distributional Implications of Introducing a Broad-Based Consumption Tax*, 11 TAX POL'Y & ECON. 1 (1997); Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax is Exempt Under a Cash Flow Tax?*, 52 TAXL. REV. 1 (1996); Richard A. Musgrave, *Clarifying Tax Reform*, 70 TAX NOTES 731 (1996); Noël B. Cunningham, *The Taxation of Capital Income and the Choice of Tax Base*, 52 TAXL. REV. 17 (1996). And even more recent is the association of supernormal returns and intangible assets. Former House Ways and Means Chairman Dave Camp noted the linkage in his discussion draft of international taxation in October 2011. See Press Release, Camp Releases International Tax Reform Discussion Draft, *supra* note 12.

54. See, e.g., Warren, *supra* note 53; Cunningham, *supra* note 53; David Elkins & Christopher H. Hanna, *Taxation of Supernormal Returns*, 62 TAX LAW. 93 (2008) (“[S]upernormal return should not be considered an

because they cannot be duplicated; therefore, the investment will continue.<sup>55</sup> However, because such returns are generally associated with intangible assets, which are highly mobile, it is thought that taxing such returns at a high rate will cause the intangible to migrate to a low-tax jurisdiction. GILTI, which is the excess of tested income of a CFC over 10 percent of its QBAI, represents the excess or supernormal return. The 10 percent of QBAI represents the normal return, which is exempt from U.S. tax by falling into the third category of income—the residual category.<sup>56</sup>

*Table 1: Summary of Ways to View the Current U.S. International Tax System*

<b>Income Category</b>	<b>Territorial/ Worldwide</b>	<b>No Deferral/ Deferral</b>	<b>Overall/Country-by-Country</b>	<b>Supernormal Returns</b>
<b>Subpart F Income</b>	Worldwide	No Deferral	CFC-by-CFC	N/A
<b>GILTI</b>	Part Worldwide/Part Territorial	No Deferral	Overall	Taxed
<b>Residual</b>	Territorial	Deferral	Overall	N/A

### III. BACKGROUND ON FINANCIAL ACCOUNTING

With the context of the current U.S. international tax system in mind, one must now appreciate the relationship between financial accounting (also known as book accounting) and tax accounting to understand why Corporate America would support a worldwide no-deferral system at a low corporate tax rate. To use the words of an investment banker, “saving taxes is all very nice, but earnings per share make the world go round.”<sup>57</sup> Put another way, Corporate America cares deeply about tax savings that impact the income tax expense as measured by financial accounting, and not all tax savings do.<sup>58</sup>

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element of the return on capital but rather a return on skill or labor or, in some cases, simply a windfall.”); CHRISTOPHER H. HANNA, *TAX POLICY IN A NUTSHELL* ch. 6 (2d ed. 2022) (“[S]upernormal return . . . is the return due to a unique idea, entrepreneurial skill, or simply luck.”).

55. See generally Reuven S. Avi-Yonah, *A New Corporate Tax*, 168 *TAX NOTES FED.* 653, 657–58 (July 27, 2020) (describing how these types of returns can be taxed at rates up to eighty percent at a very high income threshold).

56. I.R.C. §§ 245A(a), 951A(b)(2).

57. Daniel N. Shaviro, *The Optimal Relationship Between Taxable Income and Financial Accounting Income: Analysis and a Proposal*, 97 *GEO. L.J.* 423, 449 (2009).

58. In its Enron report, the staff of the Joint Committee on Taxation reproduced a memo from Bankers Trust to a prominent tax lawyer describing three similar transactions that could be sold to companies such as Enron. See Letter from William B. Boyle to William McKee (June 2, 1997), in *JCS-3-03 STAFF OF THE JOINT COMM. ON TAX’N, REPORT OF INVESTIGATION OF ENRON CORPORATION AND RELATED ENTITIES REGARDING FEDERAL TAX AND COMPENSATION ISSUES, AND POLICY RECOMMENDATIONS*, Vol. II, JCS-3-03 (Feb. 2003) at B-181. Each of the three transactions would result in identical cash tax savings of \$80 million over a 20-year time period. The first transaction, however, would result in no financial accounting benefit. The second transaction would result in a moderate financial accounting benefit—\$80 million of net income over 20 years. The third transaction would result in a significant financial accounting benefit—\$80 million of net income over five years. Bankers Trust concluded their memo “that a business entity would be willing to pay (1) little, if any, fee for the first transaction, (2) a moderate fee for the second transaction, and a substantial fee for the third transaction.”

Most U.S. corporations, in fact, almost all, are not concerned about the financial accounting effects of tax reform because they are not required to prepare and publicly disclose financial accounting statements.<sup>59</sup> Of the approximately 1.6 million C corporations, only about 4,000 are publicly traded.<sup>60</sup> It is these publicly traded corporations, referred to herein as “Corporate America,” that are extremely focused on the financial accounting effects of corporate tax policy.<sup>61</sup> And almost all of the corporate tax revenues are from publicly traded corporations.<sup>62</sup> In 2019, for example, the S&P 500 accounted for only 0.02 percent of corporate tax returns, but 59.4 percent of corporate tax revenue.<sup>63</sup>

This Part proceeds in two subparts. Part III. A begins by providing evidence of the importance of financial accounting to Corporate America. It then explains the types of differences that exist between financial and tax accounting and how those differences are accounted for on a company’s financial statements. From this, it should be clear that Corporate America cares deeply about tax policy that creates permanent differences but, at times, is almost indifferent to that which creates temporary differences. Part III. B describes the landscape of widely available mechanisms by which a U.S. multinational could generate favorable permanent differences both before and after the TCJA.

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59. U.S. companies that issue securities on a national securities exchange are required to file financial reports with the SEC. *See* 15 U.S.C. §§ 78m, 78n(a)–(c) (2015); *see generally* MORRISON FOERSTER, FREQUENTLY ASKED QUESTIONS ABOUT PERIODIC REPORTING REQUIREMENTS FOR U.S. ISSUERS – OVERVIEW 1, <https://media2.mofo.com/documents/faq-periodic-reporting-requirements-for-us-issuers-overview.pdf> [<https://perma.cc/Z2V6-PNAE>] (providing a full discussion of a public corporation’s various filing requirements with the SEC).

60. *See, e.g.*, Vartika Gupta, Tim Koller & Peter Stumpner, *Reports of Corporates’ Demise Have Been Greatly Exaggerated*, MCKINSEY & CO. (Oct. 21, 2021), <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/reports-of-corporates-demise-have-been-greatly-exaggerated> [<https://perma.cc/5NVL-QKHX>] (“According to our analysis, the number of public companies listed in the United States dropped from about 5,500 in 2000 to about 4,000 in 2020.”); Matt Krantz, *Chasing Right Stocks to Buy Is Critical with Fewer Choices but Big Winners*, INV.’S BUS. DAILY (Nov. 27, 2020), <https://www.investors.com/news/publicly-traded-companies-fewer-winners-huge-despite-stock-market-trend/> [<https://perma.cc/DP5Q-YU4W>] (3530 public companies in 2020); Kathleen M. Kahle & René M. Stulz, *Is the US Public Corporation in Trouble?*, 31 J. ECON. PERSPS. 67, 69 (2017) (3766 public corporations in 2015); Jason M. Thomas, *Where Have All the Public Companies Gone?*, WALL ST. J. (Nov. 16, 2017), <https://www.wsj.com/articles/where-have-all-the-public-companies-gone-1510869125> [<https://perma.cc/2FMZ-62FS>] (3671 public companies in 2017); *cf.* Anne VanderMey, *IPOs Are Dwindling, So Is the Number of Public Companies*, FORTUNE (Jan. 20, 2017) <http://fortune.com/2017/01/20/public-companies-ipo-financial-markets/> [<https://perma.cc/9S7N-RAEU>] (5734 public companies in 2017).

61. Christopher H. Hanna, *Corporate Tax Reform: Listening to Corporate America*, 35 J. CORP. L. 283, 286 (2009).

62. *See* Amber Keefer, *The Differences in Tax Reporting Between Publicly Traded Corporations & Privately Held*, CHRON, <https://smallbusiness.chron.com/differences-tax-reporting-between-publicly-traded-corporations-privately-held-36563.html> [<https://perma.cc/EX3J-738F>] (discussing how tax reporting methods can impact overall taxes paid by companies).

63. Jeff Ferry & Bill Parks, *Public Company Corporate Tax Under the TCJA and Sales Factor Apportionment*, 168 TAX NOTES FED. 2229, 2230 (2020).

*A. Importance of Book-Tax Differences to Corporate America*

Generally speaking, Corporate America is more concerned with the way financial accounting treats income taxes than the amount of income taxes actually paid in a given period (i.e., cash taxes paid). This makes sense when considering that the reports that U.S. publicly traded companies must regularly file with the Securities and Exchange Commission (SEC) are publicly available and prepared using financial accounting.<sup>64</sup> Foreign companies traded on U.S. stock markets have similar filing requirements.<sup>65</sup> Tax returns, on the other hand, are not accessible by the public,<sup>66</sup> leaving the SEC filings, particularly the income statement, as the main information source to be scrutinized by the capital markets.<sup>67</sup>

Looking at the income statement, three items are of particular importance to Corporate America.<sup>68</sup> First, many stakeholders view net income as the key indicator of the performance of corporate management. Net income differs from pretax book income by accounting for the income tax expense.<sup>69</sup> Second, investors focus heavily on a figure distilled from net income, earnings per share (EPS).<sup>70</sup> EPS is commonly expressed as net income or operating income minus preferred dividends, divided by the weighted average of common shares outstanding.<sup>71</sup> Diluted EPS is computed as if all convertible securities (e.g., outstanding convertible preferred shares, convertible debentures, stock options, and warrants) were exercised.<sup>72</sup> Naturally, EPS increases as net income increases. A third indicator that is particularly important to corporate management is the effective tax rate (ETR).<sup>73</sup> The ETR equals the total income tax expense for financial accounting purposes divided by income from continuing operations.<sup>74</sup>

The importance of net income, EPS, and the ETR to Corporate America is well

64. 15 U.S.C. §§ 78m, 78n(a)–(c) (2015).

65. See 17 C.F.R. § 249.220f (2005) (describing the similar SEC filing requirements that foreign registrants have compared to U.S.-based companies).

66. See generally I.R.C. § 6103 (stating that, in general, tax returns and return information should be confidential unless otherwise authorized).

67. A corporation must disclose its basic and diluted EPS for income from continuing operations and net income on the face of its income statement with equal prominence. See FIN. ACCT. STANDARDS BD., ACCOUNTING STANDARDS CODIFICATION 260-10-45-2 [hereinafter FASB ASC].

68. See HANNA ET AL., *supra* note 26, § 4.02[2].

69. GUY WANJIALIN, AN INTERNATIONAL DICTIONARY OF ACCOUNTING & TAXATION 302 (2004).

70. DONALD E. KIESO ET AL., INTERMEDIATE ACCOUNTING 167 (16th ed. 2016) (“[T]he financial world has widely accepted an even more distilled and compact figure [than net income] as the most significant business indicator—earnings per share.”).

71. FASB ASC 260-10-45-10 (detailing how to calculate basic earnings per share).

72. FASB ASC 260-10-45-16 (detailing how to calculate diluted earnings per share).

73. See Tom Neubig, *Where’s the Applause? Why Most Corporations Prefer a Lower Rate*, 111 TAX NOTES 483 (Apr. 24, 2006) (describing why the effective tax rate is particularly important to corporate management); see also 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, 54 (2020) (explaining how a reduced effective tax rate increases net income and EPS).

74. FASB ASC 740-10-50-12.

documented.<sup>75</sup> Interestingly, one study revealed that some companies will actually trade off tax savings to increase net income.<sup>76</sup> It further revealed that some companies who had fraudulently overstated their net income in filings with the SEC also fraudulently overstated their taxable income in tax returns filed with the Internal Revenue Service.<sup>77</sup> This is in line with the results of a survey that showed most Chief Financial Officers rank net income as being the most important metric to investors, not free cash flows or cash flows from operations.<sup>78</sup> It is not surprising, then, that net income and a figure distilled from it, EPS, are frequently used as benchmarks in the short-term bonus plans of corporate management.<sup>79</sup> Of course, net income and EPS are functions of the income tax expense that, in many cases, decreases as the ETR decreases. Therefore, it is also not surprising that another survey revealed that 84 percent of tax executives in publicly traded companies believe that the ETR is at least as important or more important to top management than cash taxes paid.<sup>80</sup>

Book-tax differences arise because of the different objectives of financial accounting and tax accounting. The SEC has the authority to prescribe accounting and other standards for the reports but has generally granted such authority to the Financial Accounting Standards Board (FASB).<sup>81</sup> FASB, in turn, has promulgated generally accepted accounting principles (GAAP) “to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity.”<sup>82</sup> GAAP aims to protect the stakeholders from being misled through the overstatement of income. In contrast, companies must use tax accounting to prepare tax returns that they file with the various jurisdictions in which they operate.<sup>83</sup> Tax accounting is generally concerned with the understatement of income; however, the general rule often bends to promote social or economic policies. These exceptions to the general rule—known as tax expenditures or tax preferences—are accompanied by other exceptions aimed at promoting the equitable collection of revenue and the efficient determination of tax liabilities.<sup>84</sup>

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75. See e.g., Wilson, *supra* note 73, at 47 (explaining that optimizing ETR maximizes two indicators investors use to determine profitability: net income and EPS); Hanna, *supra* note 61.

76. Merle Erickson, Michelle Hanlon & Edward L. Maydew, *How Much Will Firms Pay for Earnings That Do Not Exist? Evidence of Taxes Paid on Allegedly Fraudulent Earnings*, 79 ACCT. REV. 387, 406 (2004).

77. *Id.* at 400 (estimating that the median firm in the sample sacrificed eight cents in additional income taxes for an additional dollar of inflated pretax earnings).

78. John R. Graham, Campbell R. Harvey & Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3, 5 (2005).

79. Benjamin Bennett et al., *Compensation Goals and Firm Performance*, 124 J. FIN. ECON. 307, 308 (2017) (finding in a study of the 750 largest firms that “EPS is the most popular [metric] with around 46% of the [bonuses] linked to an EPS goal”).

80. John R. Graham et al., *Incentives for Tax Planning and Avoidance: Evidence from the Field*, 89 ACCT. REV. 991, 994 (2014).

81. *About the FASB*, FASB, <https://www.fasb.org/info/facts> [<https://perma.cc/7SHH-35LY>].

82. FASB, STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS NO. 8 1 (as amended Aug. 2018).

83. See HANNA ET AL., *supra* note 26, § 4.02[1].

84. See *Thor Power Tool Co. v. Comm’r*, 439 U.S. 522, 542 (1979) (“The primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and others properly interested; the major responsibility of the accountant is to protect these parties from being misled. The primary

In the instances where financial accounting and tax accounting are incompatible, differences arise that are either temporary or permanent in nature. Temporary differences arise when an item enters pretax book income earlier than it enters taxable income or vice versa.<sup>85</sup> For example, a temporary difference arises when the Internal Revenue Code (IRC) includes an item of income in gross income during an earlier or later year relative to inclusion in revenue for financial accounting purposes; when a deduction is accelerated or deferred relative to being treated as an expense for financial accounting purposes; or when the amount of a deduction is limited during a particular year, with any excess being carried forward.<sup>86</sup> Each category of temporary difference may eventually reverse in a later period (hence them being temporary). Permanent differences, in contrast, never reverse. They arise when an item enters pretax book income and never enters taxable income, or vice versa.<sup>87</sup> For example, a permanent difference arises when the tax laws treat revenue as tax exempt or an expense as nondeductible.<sup>88</sup>

Financial accounting requires companies to account for temporary differences when computing the income tax expense. The income tax expense computed for purposes of financial accounting is accrual-based, meaning it does not necessarily reflect the actual taxes paid by the company.<sup>89</sup> In other words, the income tax expense associated with a company's earnings for a particular period is accrued regardless of when the income tax expense is paid.

The ability of a company to recover the cost of an asset more quickly under tax accounting than financial accounting offers a helpful example of a temporary difference. The IRC provides for the cost recovery of tangible depreciable personal property in the form of accelerated depreciation,<sup>90</sup> section 179 expensing,<sup>91</sup> and the expensing of tangible

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goal of the income tax system, in contrast, is the equitable collection of revenue; the major responsibility of the Internal Revenue Service is to protect the public fisc. Consistently with its goals and responsibilities, financial accounting has as its foundation the principle of conservatism, with its corollary that 'possible errors in measurement [should] be in the direction of understatement, rather than overstatement, of net income and net assets.' In view of the Treasury's markedly different goals and responsibilities, understatement of income is not destined to be its guiding light. Given this diversity, even contrariety, of objectives, any presumptive equivalency between tax and financial accounting would be unacceptable."); *see also* Cody Wilson, *Taxing Trades: Proposals to Keep Moneyball Out of Tax Law*, 72 SMUL. REV. 953, 964–67 (2019) (providing examples of how the Internal Revenue Code deviates from a measure of economic income known as the Haig-Simons definition of income).

85. *See* FASB ASC 740-10-20 (defining "temporary difference" as the difference between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the asset or liability is recovered or settled); *see also* HANNA ET AL., *supra* note 26, § 2.07.

86. *See* HANNA ET AL., *supra* note 26, § 2.07.

87. FASB has not defined permanent difference but has written: "Some events do not have tax consequences. Certain revenues are exempt from taxation and certain expenses are not deductible. In some tax jurisdictions, for example, interest earned on certain municipal obligations is not taxable, and fines are not deductible." FASB ASC 740-10-10-1. *See* HANNA ET AL., *supra* note 26, § 4.03.

88. FASB ASC 740-10-10-1.

89. *See* FASB ASC 740-10-30-3 (describing how a "deferred tax liability asset" is measured).

90. *See* I.R.C. § 168 (discussing methods and forms of determining depreciation, including the recovery period); *see also* HANNA ET AL., *supra* note 26, § 4.04[2][b] (explaining how depreciation under tax accounting differs from depreciation under financial accounting).

91. *See* I.R.C. § 179 (describing expensing for certain depreciable business assets).

depreciable property with a recovery period of 20 years or less.<sup>92</sup> Financial accounting, in contrast, requires that companies recover the cost of an asset over the period the asset will perform its expected function.<sup>93</sup> Accordingly, in the early years of a depreciable asset's life, tax depreciation is often greater than book depreciation. In later years, however, this difference reverses such that the same total amount of depreciation is taken for both tax and book purposes over the asset's recovery period. Stated another way, the tax depreciation for an asset may exceed the book depreciation initially, but at some point, book depreciation will exceed tax depreciation. The future tax associated with the excess taxable income in later periods is accrued in the current period for financial accounting purposes.<sup>94</sup> Thus, accelerated tax depreciation does not reduce a company's income tax expense as reported on its income statement, despite reducing the actual amount of taxes paid in the current period.<sup>95</sup>

The accrued income tax expense in the depreciation example, without a corresponding tax payment, creates a deferred tax liability. A deferred tax liability represents the tax effects of a future reversal of a temporary difference that causes future taxable income to increase relative to pretax book income or, alternatively, future pretax book income to decrease relative to taxable income.<sup>96</sup> The reversal of a temporary difference can have an opposite effect. When the reversal causes future taxable income to be reduced relative to pretax book income or future pretax book income to increase relative to taxable income, a deferred tax asset results.<sup>97</sup>

The amount of deferred tax liabilities and deferred tax assets depends on the expected tax rate at the time the temporary difference will reverse. Each amount is computed by multiplying the expected tax rate at the time of reversal by the temporary difference.<sup>98</sup> The amount of deferred tax liabilities increases when the corporate tax rate increases, which, when holding everything else constant, causes an increase to the income tax expense. An increased corporate tax rate, however, also causes the amount recorded for a deferred tax asset to increase, which reduces the income tax expense if everything else holds constant. In contrast, a reduction in the corporate tax rate decreases deferred tax liabilities and assets.<sup>99</sup> Thus, a corporate tax rate cut positively impacts the financial statements of companies with net deferred tax liabilities by reducing income tax expense and thereby increasing earnings, but companies with net deferred tax assets take a one-time "hit" to earnings in the form of increased income tax expense as measured by financial

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92. See I.R.C. § 168(k) (describing expensing for certain qualified property).

93. FASB ASC 360-10-35-3.

94. FASB ASC 740-10-30-3.

95. See Wilson, *supra* note 73 (describing a mathematical example of how accelerated tax depreciation does not affect the income tax expense as measured by financial accounting).

96. FASB ASC 740-10-20 Glossary (stating that deferred tax liability is the "deferred tax consequences attributable to taxable temporary differences"); see HANNA ET AL., *supra* note 26, § 2.08 (discussing generally deferred tax liabilities and assets).

97. FASB ASC 740-10-20 Glossary (stating deferred tax asset is the "deferred tax consequences attributable to deductible temporary differences"); see HANNA ET AL., *supra* note 26, § 2.08.

98. See HANNA ET AL., *supra* note 26, § 2.08[3] (describing the annual computation of deferred tax liabilities and deferred assets).

99. *Id.*



accounting.<sup>100</sup>

The complexity of accounting for temporary differences is offset by the relatively simple nature of permanent differences. Permanent differences occur because certain provisions of the tax code cause taxable income to be permanently lower or higher than pretax book income. For example, the tax-exempt nature of interest received on state and local bonds causes a permanent difference.<sup>101</sup> Such interest is never included in taxable income but is included in pretax book income. Since this difference will never reverse, there is no need to record a deferred tax liability or deferred tax asset. This means that permanent differences, unlike temporary differences, impact the effective tax rate that a company reports on its form 10-K.<sup>102</sup>

#### *B. Permanent Book-Tax Differences Before and After the TCJA*

Beyond reducing the top corporate income tax rate from 35 percent to 21 percent, the TCJA drastically changed the widely available permanent differences that could be used to reduce a U.S. corporation's ETR. These changes were a net benefit to Corporate America. The overall ETR for the S&P 500 was 17.56 percent in 2021, 18.02 percent in 2020, 17.50 percent in 2019, and 17.72 percent in 2018.<sup>103</sup> This was down from 24.37 percent in 2017, 26.44 percent in 2016, and 27.46 percent in 2015.<sup>104</sup>

Corporate America had three widely available mechanisms to reduce the ETR before the enactment of the TCJA. By designating the earnings of CFCs as indefinitely reinvested, a multinational corporation could, in certain cases, reduce its ETR by 10 percentage points or more from the top corporate tax rate of 35 percent.<sup>105</sup> Additionally, the research and development tax credit provided, in many cases, a one to one and one-half percentage point reduction, and the deduction for qualified production activities, known as the manufacturing deduction, provided, in a number of cases, a two to three percentage point

100. *Id.* An adjustment to net deferred tax liabilities and net deferred tax assets due to a change in the corporate tax rate took place upon enactment of the Tax Cuts and Jobs Act. Those companies in a net deferred tax liability position received a one-time bump in earnings as a result of the 14-percentage point reduction in the top corporate tax rate.

101. I.R.C. § 103(a).

102. FASB ASC 740-10-50-12 (2022). The effective tax rate reconciliation may be accomplished utilizing percentages or dollar amounts. The estimated amount and nature of each significant reconciling item should be disclosed. *Id.* Rule 4-08(h) of SEC Regulation S-X requires disclosure of reconciling items that are five percent (or more) of the amount computed by multiplying the pretax income by the statutory tax rate (i.e., any item that increases or decreases the tax rate by 1.05 percent or more). 17 C.F.R. § 210.4-08 (outlining general notes to financial statements). For a mathematical example of how a permanent difference created by the research and development tax credit reduces the income tax expense as measured by financial accounting, see Wilson, *supra* note 73.

103. This data was compiled from ETRs reported in the Forms 10-K filed by the companies that make up the S&P 500. Howard Silverblatt, *S&P 500 Earnings and Estimate Report*, S&P GLOBAL (Sept. 10, 2022), [https://www.spglobal.com/spdji/en/documents/additional-material/sp-500-eps-est.xlsx?force\\_download=true](https://www.spglobal.com/spdji/en/documents/additional-material/sp-500-eps-est.xlsx?force_download=true) [https://perma.cc/Z7ND-AMDZ] [hereinafter S&P GLOBAL DATA].

104. *Id.*

105. Christopher Hanna & Josh Odintz, *Tax Cuts and Jobs Act and Permanent Differences (or How I Learned to Stop Worrying and Love FDII)*, BAKER MCKENZIE (Dec. 2019), <https://bakerxchange.com/rv/ff005745840033c25c8499e45b43ad33725bd2b4/p=4596788> [https://perma.cc/CHX8-TJ65].

reduction.<sup>106</sup>

Designating earnings of foreign subsidiaries as being indefinitely reinvested typically provided a multinational corporation with the greatest reduction in its ETR. This was possible before the TCJA because the foreign income that a U.S. multinational corporation earned through a foreign subsidiary was generally not included in U.S. taxable income until repatriated.<sup>107</sup> A few features of the U.S. tax system combined to allow deferral of a foreign subsidiary's income in this way. First, since 1913, the United States has taxed its citizens, residents, and corporations on their worldwide income.<sup>108</sup> Foreign persons and foreign corporations, however, are generally taxed by the United States only on U.S. source income, either as non-business investment income or income that is effectively connected with the conduct of a trade or business in the United States. Second, since 1913, U.S. tax law has consisted of separate taxing regimes for individuals and corporations.<sup>109</sup> Tax law treats corporations as being legally distinct from their shareholders.<sup>110</sup> A corporation's earnings are taxed once at the corporate level and a second time at the level of the shareholders but not until distributed. In addition, a third feature, the treatment of a corporation as being either domestic or foreign under U.S. tax law based on its place of incorporation, combined with the other two features, created the opportunity for deferral.<sup>111</sup> Congress curbed this deferral opportunity slightly in 1962 when it added Subpart F to the IRC.<sup>112</sup> Nonetheless, by earning foreign income through a foreign subsidiary and avoiding Subpart F through tax planning, a U.S. multinational corporation could avoid being subject to U.S. tax on the foreign income until the foreign subsidiary distributed its income to its U.S. multinational parent.

The ability to defer U.S. tax on foreign income earned through a foreign subsidiary raised the issue of how the deferred tax liability should be recorded for purposes of financial accounting.<sup>113</sup> U.S. multinational corporations include income from their CFCs in book income for the year such income is earned.<sup>114</sup> As discussed above, however, income earned by a CFC is generally not included in the U.S. multinational parent's taxable income until such income is repatriated, typically by way of a dividend. This gives rise to a book-tax difference that was addressed by the Committee on Accounting Procedure—a precursor to FASB—in 1959, when it issued its accounting pronouncement concerning the reporting of a company's U.S. and international operations in a consolidated financial

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106. *Id.*

107. OFF. TAX POLICY, DEP'T OF TREASURY, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY 1–4 (Dec. 2000) [hereinafter TREASURY CFC STUDY].

108. *Id.*

109. *Id.*

110. *See Moline Props., Inc. v. Comm'r*, 319 U.S. 436, 438–39 (1943) (holding that a corporation constitutes a separate taxable entity for U.S. tax purposes when formed for a valid business purpose).

111. TREASURY CFC STUDY, *supra* note 107, at 3.

112. I.R.C. § 951(a); *see also* Fleming, Peroni & Shay, *supra* note 28, at 89 (explaining the mechanics and development of the Subpart F anti-deferral regime).

113. Michael P. Donohoe et al., *Through a Glass Darkly: What Can We Learn About a U.S. Multinational Corporation's International Operations from Its Financial Statement Disclosures*, 65 NAT'L TAX. J. 961, 968 (2012).

114. FASB ASC 810 (Consolidation); FASB ASC 323 (Equity Method).

statement.<sup>115</sup> The Committee stated that a company should record U.S. taxes associated with foreign earnings “on an estimated basis” when accrued except where the “income has been, or there is evidence that it will be permanently invested by the subsidiaries.”<sup>116</sup> The successor to the Committee on Accounting Procedure and immediate predecessor to FASB, the Accounting Principles Board (APB), revisited the issue in 1967 but deferred any accounting modification pending further study.<sup>117</sup> Then, in 1973, the APB revisited the recording of income taxes on unrepatriated foreign earnings for financial accounting purposes in Accounting Principles Board Opinion No. 23. The APB stated:

[I]t should be presumed that all undistributed earnings of a subsidiary will be transferred to the parent company. Accordingly, the undistributed earnings of a subsidiary included in consolidated income should be accounted for as a temporary difference unless the tax law provides a means by which the investment in a domestic subsidiary can be recovered tax free.<sup>118</sup>

In other words, when income earned from international operations is included in a U.S. multinational corporation’s net income but not taxable income, a presumption arises that the book-tax difference is temporary; thus, a deferred tax liability must be recorded. The APB, however, also provided criteria for rebutting the presumption. The “indefinite reinvestment criteria” provided that the book-tax difference could be treated as permanent and no taxes needed to be accrued if “sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation.”<sup>119</sup> Accordingly, designating foreign earnings as “indefinitely reinvested” became known as making an APB 23 representation. FASB later adopted the APB’s position on accounting for income taxes associated with unrepatriated foreign earnings in 1992<sup>120</sup> and maintains that position today in Accounting Standards Codification 740.<sup>121</sup>

The worldwide deferral system, coupled with the indefinitely reinvested assertion, created two strong incentives for U.S. multinational corporations to leave foreign earnings offshore. One incentive that naturally flowed from the tax laws was that U.S. corporations could defer U.S. taxation on earnings from foreign subsidiaries. Tim Cook, the CEO of Apple Inc., commented on this cash flow incentive in a 2016 interview with the *Washington Post*.<sup>122</sup> At the time, Apple had more than \$230 billion of earnings overseas. Mr. Cook explained:

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115. *No. 51 Consolidated Financial Statements*, ACCT. RSCH. BULL. (Comm. on Acct. Proc./Am. Inst. of Certified Pub. Acct., New York, N.Y.) Aug. 1959.

116. *Id.* at 46.

117. Donohoe et al., *supra* note 113, at 968–69.

118. Accounting Principles Board Opinion No. 23, *Accounting for Income Taxes—Special Areas* at 446 (1973).

119. *Id.* at 447.

120. Donohoe et al., *supra* note 113, at 970 (citing Financial Accounting Standards No. 109, *Accounting for Income Taxes* (Feb. 1992)).

121. FASB ASC 740-10-25-3; 740-30-25-18; 740-30-25-19.

122. Jena McGregor, *Tim Cook, The Interview: Running Apple ‘Is Sort of a Lonely Job’*, WASH. POST (Aug. 13, 2016), <https://www.washingtonpost.com/sf/business/2016/08/13/tim-cook-the-interview-running-apple-is-sort-of-a-lonely-job/> [<https://perma.cc/EQ4J-KDVF>].

The tax law right now says we can keep that in Ireland or we can bring it back. And when we bring it back, we will pay 35 percent federal tax and then a weighted average across the states that we're in, which is about 5 percent, so think of it as 40 percent. We've said at 40 percent, we're not going to bring it back until there's a fair rate. There's no debate about it. Is that legal to do or not legal to do? It is legal to do. It is the current tax law. It's not a matter of being patriotic or not patriotic. It doesn't go that the more you pay, the more patriotic you are.<sup>123</sup>

Another incentive to leave foreign earnings offshore had its roots in financial accounting. A survey of nearly 600 tax executives found that the financial accounting incentive to leave foreign earnings offshore through the APB 23 representation had statistically equal importance to the cash flow incentive.<sup>124</sup> This makes sense considering that designating foreign earnings as indefinitely reinvested allowed Corporate America to boost net income and EPS by reducing the income tax expense, but that benefit was lost if such earnings were ever repatriated or even considered of being repatriated. James Tisch, the CEO of Loews Corp., acknowledged this "accounting penalty" in a 2008 letter to the editor of the *Wall Street Journal*.<sup>125</sup> He said:

Unbeknownst to many (including legislators and Joint Committee on Taxation estimators), Generally Accepted Accounting Principles allow corporations to avoid the accrual of taxes on foreign earnings . . . . The result of the interaction of our repatriation tax laws and the GAAP accounting rules is that very little in the way of foreign earnings are repatriated . . . . The accounting penalty for repatriating even a penny of foreign profits is so great that those foreign funds will not come back to the U.S. . . . .<sup>126</sup>

Mr. Tisch's letter reinforces the notion that tax savings are nice, but EPS is Corporate America's true focus.

Table 2, below, is an excerpt from the tax footnote of an S&P 500 company showing its effective tax rate and the impact of the APB 23 representation ("country mix impacts of foreign operations"). The result is a reduction in the ETR by 6.8 percentage points, 9.1 percentage points and 14.0 percentage points for the years 2017, 2016 and 2015, respectively.<sup>127</sup>

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123. *Id.*; John W. Schoen, *Confused by the EU Apple Ruling: Read This*, CNBC (Aug. 30, 2016), <https://www.cnbc.com/2016/08/30/confused-by-the-eu-apple-ruling-read-this.html> [https://perma.cc/8HCD-5WEK]; Sean Farrell & Henry McDonald, *Apple Ordered to Pay €13bn after EU Rules Ireland Broke State Aid Laws*, GUARDIAN (Aug. 30, 2016), <https://www.theguardian.com/business/2016/aug/30/apple-pay-back-taxes-eu-ruling-ireland-state-aid> [https://perma.cc/Y6UJ-54FM].

124. Graham et al., *supra* note 78.

125. James Tisch, Letter to the Editor, *The Taxation of Overseas Earnings Creates Incentives*, WALL ST. J. (July 5, 2008), [wsj.com/news/articles/SB121522053376129815](http://wsj.com/news/articles/SB121522053376129815) [https://perma.cc/JL4P-2PVA].

126. *Id.*

127. See *infra* note 128.

Table 2: ETR Reconciliation Reported in Procter & Gamble's Form-10K for FY 2017<sup>128</sup>

<b>Years ended June 30</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
U.S. federal statutory income tax rate	<b>35.0 %</b>	35.0 %	35.0 %
Country mix impacts of foreign operations	<b>(6.8)%</b>	(9.1)%	(14.0)%
Changes in uncertain tax positions	<b>(2.0)%</b>	(0.5)%	(0.9)%
Excess tax benefits from the exercise of stock options	<b>(1.3)%</b>	— %	— %
Venezuela deconsolidation charge	— %	— %	6.6 %
Other	<b>(1.8)%</b>	(0.4)%	(2.0)%
<b>EFFECTIVE INCOME TAX RATE</b>	<b>23.1 %</b>	<b>25.0 %</b>	<b>24.7 %</b>

As previously mentioned, other widely applicable ways to reduce the ETR before the TCJA included utilizing the research and development tax credit and the qualified production activities deduction.<sup>129</sup> The research and development tax credit equals, and continues to equal, up to 10 percent of a company's "qualified research expenses."<sup>130</sup> The qualified production activities deduction provided up to a nine percent deduction on U.S. income derived from qualified production activities.<sup>131</sup> Congress, as part of the TCJA, repealed the qualified production activities deduction,<sup>132</sup> but retained the research and development tax credit.<sup>133</sup>

The TCJA overhauled the way U.S. multinational corporations reduce their ETR

128. Procter & Gamble Co., Annual Report (Form 10-K), at 49 (Aug. 7, 2017).

129. Hanna & Odintz, *supra* note 105.

130. I.R.C. § 41.

131. I.R.C. § 199 (effective Jan. 1, 2005), *repealed by* Pub. L. No. 115-97, § 13305, 131 Stat. 2054, 2126 (2017).

132. Pub. L. No. 115-97, § 13305, 131 Stat. 2054, 2126 (2017). In a report from the Committee on Ways and Means, the Committee explained that there is "no longer a need for such deduction" in light of "the reduction in corporate rate and creation of a maximum rate on business income of individuals." H.R. REP. NO. 115-409, at 260 (2017). Furthermore, the Committee cited a belief that repealing the deduction "furthers the Committee's general goal of simplification of the tax code." *Id.*

133. See I.R.C. § 41 (defining qualified research expenses and allowed credits).

below the statutory corporate tax rate.<sup>134</sup> An overall ETR of 17.56 percent for the S&P 500 in 2021 is largely attributable to the top corporate income tax rate being reduced from 35 percent to 21 percent, the retention of the research and development tax credit, and the creation of three new mechanisms to create favorable permanent differences. In place of the financial accounting benefit associated with the indefinitely reinvested assertion, two of the categories of income earned by CFCs—GILTI and the residual category—create an opportunity to reduce the ETR below the statutory rate of 21 percent. Additionally, the deduction for foreign-derived intangible income (FDII) serves as a replacement for the permanent difference mechanism that was lost with the repeal of the qualified production activities deduction.

The deduction for GILTI can reduce the ETR when the income is subject to low foreign tax rates. As discussed above, U.S. multinational corporations are taxed annually on the GILTI attributable to CFCs with a foreign tax credit equal to 80 percent of foreign income taxes paid.<sup>135</sup> The current tax rate imposed on GILTI can be as low as 10.5 percent, achieved through a 50 percent deduction of GILTI.<sup>136</sup> Like the deduction for FDII, there is no analogous economic outlay for the GILTI deduction that would reduce book income.

The exact financial accounting treatment of taxes on GILTI is beyond the scope of this Article, but a brief overview illustrates its impact on the ETR. FASB has taken the position that GILTI can be accounted for by recognizing it as a period cost (i.e., a permanent difference) or, alternatively, by recognizing deferred tax assets and liabilities when basis differences exist that are expected to reverse as GILTI in future years (i.e., temporary differences).<sup>137</sup> An overwhelming majority of U.S. public corporations choose to treat the tax on GILTI as a period cost.<sup>138</sup> For those that elect to account for GILTI in their deferred taxes, however, such deferred taxes should be measured by reducing the 21 percent U.S. corporate tax rate by the deduction for GILTI expected to be realized when the temporary differences are expected to reverse.<sup>139</sup>

The residual category of income earned by CFCs also reduces the ETR when earned in low-taxed foreign jurisdictions.<sup>140</sup> This category of income is not taxed by the United States when earned by a CFC.<sup>141</sup> Also, as a result of the 245A 100 percent dividends-received deduction, it is not subject to U.S. tax when repatriated to a U.S. parent corporation.<sup>142</sup> The income, however, enters book income when it is earned. Therefore, if

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134. See generally Wilson, *supra* note 73.

135. I.R.C. §§ 951A(a), 960(d).

136. I.R.C. § 250(a)(1)(B). The deduction is currently slated to decline to 37.5 percent beginning in 2026. I.R.C. § 250(a)(3)(B).

137. FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income (Jan. 2018).

138. JAMES J. NEWHARD ET AL., STRAFFORD, FINANCIAL REPORTING CHANGES POST-TAX REFORM: GAAP ENTRIES FOR REPATRIATION TAX, GILTI AND BEAT 54 (Aug. 22, 2019), <https://s3.us-east-1.amazonaws.com/media.straffordpub.com/products/financial-reporting-changes-post-tax-reform-gaap-entries-for-repatriation-tax-gilti-and-beat-2019-08-22/presentation.pdf> [<https://perma.cc/WM7N-8YQ5>].

139. KPMG, ACCOUNTING FOR INCOME TAXES HANDBOOK 112, 397 (Apr. 2022), <https://frv.kpmg.us/reference-library/2022/accounting-for-income-taxes.html> [<https://perma.cc/B3LC-5ACV>].

140. For a mathematical example of how GILTI and the residual category of CFC income can reduce the income tax expense and the ETR as measured by financial accounting when subject to low foreign tax rates, see Wilson, *supra* note 73.

141. I.R.C. § 951A(b)(2).

142. I.R.C. § 250(b)(2)(B).

the income is subject to a foreign tax rate of less than 21 percent, earning the residual category of income can reduce a U.S. corporation's ETR below the current U.S. corporate tax rate.

With the deduction for FDII, Congress leveled the playing field when a U.S. multinational corporation accesses a foreign market directly (and generates FDII) or indirectly through a CFC (and generates GILTI).<sup>143</sup> Intangible property need not be exploited to qualify for the deduction. Rather, any U.S. corporation that earns a high return from accessing foreign markets (i.e., greater than 10 percent of QBAI) can qualify for the FDII deduction. The current FDII deduction is 37.5 percent but is slated to decline to 21.875 percent in 2026. This deduction (along with the GILTI deduction) is limited to the corporation's taxable income.<sup>144</sup> The deduction results in the United States generally taxing FDII at a preferential rate of 13.125 percent, which is scheduled to become 16.40625 percent in 2026.

The deduction for FDII reduces the ETR for the same reason that the qualified production activities deduction did before the TCJA.<sup>145</sup> It creates a permanent difference by reducing the amount of taxable income with no analogous expense that would reduce book income. Since the difference will never reverse, there is no need to record a deferred tax liability. This, in turn, decreases the income tax expense as measured by financial accounting.

Table 3 below is an excerpt from the tax footnote of an S&P 500 company showing its effective tax rate and the impact of GILTI and the residual category of income ("country mix impacts of foreign operations") and FDII. The result is a reduction in the ETR each year, with a 17.2 percent ETR in 2020.

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143. I.R.C. § 250(a)(1)(A).

144. I.R.C. §§ 250(a)(2); 250(a)(3)(A).

145. For a mathematical example of how FDII reduces the income tax expense and the ETR as measured by financial accounting, see Wilson, *supra* note 73, at 71–72.

Table 3: ETR Reconciliation Reported in P&G's Form-10K for FY 2020.<sup>146</sup>

Years ended June 30	2020	2019	2018
U.S. federal statutory income tax rate	21.0 %	21.0 %	28.1 %
Country mix impacts of foreign operations	(0.1)%	(0.5)%	(4.7)%
State income taxes, net of federal benefit	1.4 %	2.6 %	1.4 %
Excess tax benefits from the exercise of stock options	(1.6)%	(3.8)%	(0.4)%
Tax benefit from simplification of legal entity structure	(1.4)%	— %	— %
Foreign derived intangible income deduction (FDII)	(1.0)%	(2.2)%	— %
Changes in uncertain tax positions	0.1 %	(0.3)%	(0.3)%
Goodwill impairment	— %	22.8 %	— %
Net transitional impact of U.S. Tax Act	— %	— %	4.5 %
Other	(1.2)%	(4.9)%	(2.6)%
<b>EFFECTIVE INCOME TAX RATE</b>	<b>17.2 %</b>	<b>34.7 %</b>	<b>26.0 %</b>

Notably, all of the widely available, post-TCJA mechanisms for reducing the ETR below the statutory rate—with the exception of the research and development tax credit—may be reduced or eliminated under the Biden Administration. The Biden Administration has proposed to reduce the GILTI deduction from 50 percent to 25 percent; eliminate the exclusion of the 10 percent return on QBAI (which is part of the residual category of a CFC's income); and repeal the FDII deduction.<sup>147</sup> Eliminating these mechanisms is especially noteworthy given that President Biden also proposes raising the corporate tax rate to 28 percent.<sup>148</sup> If enacted, these proposed changes may return Corporate America's overall ETR close to the levels experienced before the TCJA.

#### IV. PROPOSED WORLDWIDE NO DEFERRAL SYSTEM WITH LOW TAX RATE

The international tax system crafted as part of the TCJA can be viewed as a steppingstone to a worldwide no deferral system. Congress repealed deferral for, in many cases, almost all the income of a CFC through enactment of the GILTI regime and the retention of Subpart F. The only element of deferral that remains after the TCJA is the residual category of income, which is not taxed by the United States because of the 245A 100 percent dividends-received deduction on repatriation by way of dividend.

In addition, Congress significantly reduced the corporate tax rate, creating an

146. Procter & Gamble Co., Annual Report (Form 10-K), at 49 (Aug. 7, 2020).

147. U.S. DEP'T TREASURY, *supra* note 19, at 1.

148. *Id.* at 3.



opportunity to tax the worldwide income of a U.S. multinational at a low corporate tax rate. This is notable because a worldwide no-deferral system has the support of tax scholars and policymakers. With a low enough corporate tax rate, Corporate America may support such a system, too. Even more notable is the fact that such a system could be enacted in either a revenue neutral or revenue-positive manner.

Finally, in 2021, the Biden Administration and Congress proposed a worldwide no-deferral tax system at a 15 percent corporate tax rate in the form of the corporate AMT.<sup>149</sup> The proposed corporate AMT was enacted into law as part of the Inflation Reduction Act of 2022 with a tax base of adjusted financial statement income. If the base of the corporate AMT is modified to taxable income (or possibly even earnings and profits), such a proposal is a path to implementing a worldwide no-deferral system at a 15 percent corporate tax rate.<sup>150</sup>

#### A. *Support from Scholars and Policymakers*

For many years, tax scholars have proposed a worldwide no-deferral tax system for the United States.<sup>151</sup> An underlying theme of many of the proposals is to achieve the concept of capital export neutrality (CEN). The term CEN was coined by Richard Musgrave in 1959 and generally requires a U.S. tax policy that eliminates tax considerations for investors choosing between U.S. and foreign investment opportunities.<sup>152</sup> It is achieved by imposing U.S. tax on foreign source income and allowing a tax credit for foreign income taxes paid against U.S. tax liability. For example, a U.S. multinational considering investing or doing business in the United States, France, India, or China should select the location that brings the highest pre-tax rate of return. Imposing the same tax rate (the U.S. corporate tax rate) can ensure that result. Fully comporting with CEN would require the United States to provide a refund if the foreign income tax exceeds the U.S. tax on the same income. The thinking of tax scholars is that CEN maximizes global economic welfare or output by having prospective domestic or foreign investments not distorted by taxes.<sup>153</sup>

In late 2015, a number of the most prominent U.S. international tax scholars wrote an open letter to Congress advocating a worldwide no-deferral system and rejecting a

149. *See id.* at 21 (describing the proposed tax policy).

150. *See, e.g.*, Christopher H. Hanna, Michelle Hanlon, Norman Richter & Michael Schler, *The Rise of the Minimum Tax*, 100 TAXES 55 (March 2022) (suggesting earnings and profits as a possible tax base for a corporate minimum tax).

151. *See, e.g.*, Robert J. Peroni, J. Clifton Fleming Jr. & Stephen E. Shay, *Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income*, 52 SMU L. REV. 455 (1999); J. Clifton Fleming, Jr., Robert J. Peroni and Stephen E. Shay, *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299 (2001); Edward D. Kleinbard, *Throw Territorial Taxation from the Train*, 114 TAX NOTES 547 (Feb. 5, 2007); Samuel C. Thompson, Jr., *An Imputation System for Taxing Foreign-Source Income*, 130 TAX NOTES 567 (Jan. 31, 2011).

152. *See* Richard A. Musgrave, *Criteria for Foreign Tax Credit*, in TAXATION AND OPERATIONS ABROAD 83 (1959).

153. *See* Jane G. Gravelle, CONG. RSCH. SERV., RL34115, REFORM OF U.S. INTERNATIONAL TAXATION: ALTERNATIVES 7-5700 (Aug. 1, 2017) (asserting that CEN maximizes global economic welfare); *see also* Peggy B. Musgrave, *Sovereignty, Entitlement and Cooperation in International Taxation*, 26 BROOK. J. INT'L L. 1335, 1346-47 (2001) (asserting the same).

territorial system.<sup>154</sup> The scholars noted that such a system would eliminate the incentive of U.S. multinationals “to shift production and jobs, as well as profits, offshore, especially to tax havens.”<sup>155</sup> In addition, a worldwide no-deferral system “would end many of the competitive disadvantages that American domestic firms experience with U.S. multinational corporations.”<sup>156</sup>

Policymakers have also proposed a worldwide no-deferral system. Such a system was considered in the early 1960s during the John F. Kennedy Administration.<sup>157</sup> In 1961, Harvard law professor Stanley Surrey was serving as the first Assistant Secretary of the Treasury for Tax Policy and favored a worldwide no-deferral system.<sup>158</sup> But Corporate America strongly opposed such a proposal, arguing that it would harm their competitiveness as other countries had adopted a territorial system.<sup>159</sup> In June 1961, Surrey drafted a memo to Treasury Secretary C. Douglas Dillon, providing recommendations for retreating from the worldwide no-deferral position. Surrey proposed to: (1) limit the proposal’s scope as applied to non-tax-haven corporations; (2) limit the proposal’s application to tax haven corporations; and (3) limit the proposal’s scope for tax haven corporations so that it reaches only income diverted from the United States to the tax haven.<sup>160</sup> The result, in 1962, was a compromise—the Subpart F regime—in which a CFC’s mobile or passive income would be taxed at the full corporate tax rate with no deferral.

More recently, Senator Ron Wyden (D-OR), who is the current chair of the Senate Finance Committee, proposed a worldwide no-deferral system in 2010<sup>161</sup> and again in 2011<sup>162</sup> as part of bipartisan tax reform bills with Senators Judd Gregg (R-NH) and Dan Coates (R-IN), respectively. Former President Donald Trump also proposed a worldwide no-deferral system when campaigning in 2016, as did Senator Bernie Sanders (I-VT).<sup>163</sup>

One of the main stumbling blocks in enacting a worldwide no-deferral system is the opposition of Corporate America—opposition that dates back to at least 1961. Once one understands the nature of Corporate America’s opposition, however, it becomes possible to craft a worldwide no-deferral tax system that satisfies tax scholars, policymakers, and Corporate America. The nature of Corporate America’s opposition has changed over the years, with the more recent emphasis focusing overwhelmingly on financial accounting rather than cash taxes paid.

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154. Edward D. Kleinbard et al., *Scholars Criticize International Tax Reform Proposals*, 149 TAX NOTES 149, 149 (Oct. 5, 2015).

155. *Id.*

156. *Id.*

157. TREASURY CFC STUDY, *supra* note 107, at 10.

158. See Reuven S. Avi-Yonah, *Territoriality and the Original Intent of Subpart F*, 155 TAX NOTES 1581 (June 12, 2017).

159. *Id.*

160. Memorandum from Stanley Surrey on a Worldwide No Deferral Position to Secretary Dillon (June 22, 1961), *reprinted in* Avi-Yonah, *supra* note 158, at 3–4.

161. The Bipartisan Tax Fairness and Simplification Act of 2010, S.3018, 111th Cong., 2d Sess. (2010).

162. The Bipartisan Tax Fairness and Simplification Act of 2010, S.727, 112th Cong., 1st Sess. (2011).

163. See Paul Hodgson, *How Sanders and Trump Aim to End Offshore Corporate Tax Havens*, FORTUNE: LEADERSHIP (Mar. 11, 2016), <https://fortune.com/2016/03/11/sanders-trump-offshore-tax-havens/> [https://perma.cc/MC4E-AB58].

*B. Key to Corporate America's Support is Financial Accounting*

If policymakers were to consider enacting a worldwide no-deferral system, it would have the support of many tax scholars. In addition, and more importantly, such a system could have the support of Corporate America if the corporate tax rate is set sufficiently low and with an eye towards the effective tax rate as measured by financial accounting.

Corporate America focuses on net income, EPS, and the ETR as measured by financial accounting, rather than tax accounting. This has important implications for the making of good tax policy. In very simple terms, tax policymakers typically have two goals when taxing Corporate America. There is a desire to enhance the competitiveness of U.S. multinational corporations, compared to those located abroad, and a desire to protect the corporate tax base as a source of revenue.<sup>164</sup> Increasing competitiveness requires that Corporate America actually value the corporate tax preferences that become law.

Since Corporate America is concerned with financial accounting, so must policymakers. Corporate America prefers corporate tax preferences that create permanent differences over those that merely provide a temporary or timing benefit. Further, Corporate America generally prefers a low corporate tax rate over any tax preferences because of its simplicity, low compliance costs, and favorable effect on financial accounting numbers.<sup>165</sup>

There are many different ways of computing a corporation's effective tax rate, as illustrated by the many different reports on corporate effective tax rates. For example, in May 2013, the U.S. Government Accountability Office (GAO) issued a well-publicized report on corporate effective tax rates.<sup>166</sup> The GAO computed worldwide ETRs for corporations that filed a schedule M-3 (corporations with gross assets of \$10 million or more) in three different ways, with the denominator remaining the same in each way—pretax worldwide net book income. The numerator, however, was: (1) current and deferred tax expense (i.e., total book tax); (2) current tax expense (i.e., current book tax); or (3) cash taxes paid (primarily actual tax paid). Figure 1 below, reproduced from the GAO report, shows the three different worldwide effective tax rate calculations for the years 2008 to 2010, which includes only profitable corporations, and the years 2006 to 2010, which includes all corporations.

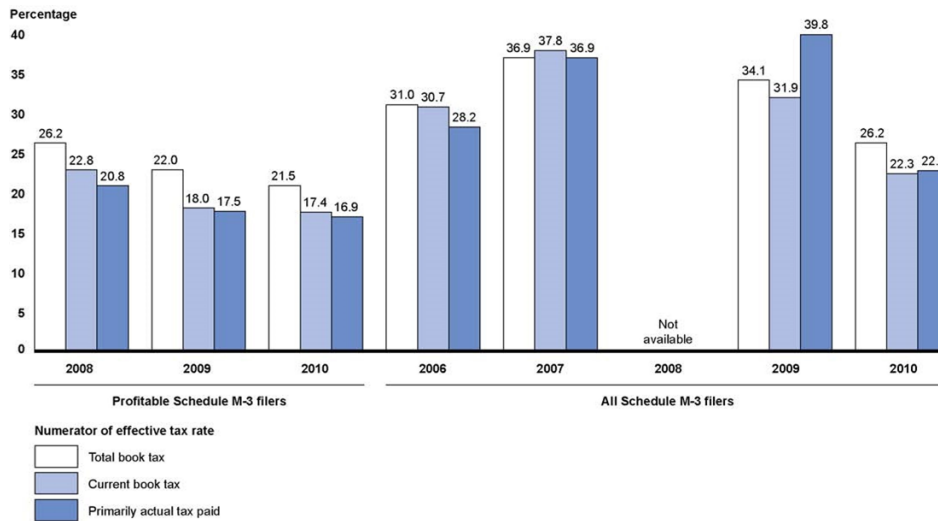
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164. See Kimberly Clausing, *Taxing Multinational Companies in the 21st Century*, in TACKLING THE TAX CODE: EFFICIENT AND EQUITABLE WAYS TO RAISE REVENUE 240 (Jay Shambaugh & Ryan Nunn eds., 2020).

165. See generally Hanna, *Corporate Tax Reform*, *supra* note 61 (elaborating on the needs and desires of Corporate America ultimately leading to simplicity, low compliance costs, and favorable effect on accounting).

166. See generally U.S. GOV'T ACCOUNTABILITY OFF., GAO-13-520, CORPORATE INCOME TAX: EFFECTIVE TAX RATES CAN DIFFER SIGNIFICANTLY FROM THE STATUTORY RATE (May 2013).

Figure 1: Data from the U.S. Government Accountability Office's 2013 Report



Source: GAO analysis of IRS data.

At about the same time, the Congressional Research Service (CRS) also prepared a report on corporate effective tax rates.<sup>167</sup> Jane Gravelle, a tax economist who prepared the report, focused on average effective tax rates and marginal effective tax rates for corporations. In her discussion of average effective tax rates, Gravelle defined it as simply “taxes paid divided by profits.” She noted that the average effective tax rate captures some of the tax benefits and subsidies, thereby showing the comparability of a country with a high statutory tax rate and narrow tax base with a country with a low statutory tax rate and broad tax base. In discussing marginal effective tax rates, Gravelle noted that it was the proper measure, in theory, for determining the tax rate effects on investments. The drawback, however, was that marginal effective tax rates often would not include all aspects of an investment—generally, it included only fixed assets or fixed assets and inventory.

The Congressional Budget Office (CBO) issued a report on corporate effective tax rates in March 2017.<sup>168</sup> The CBO used slightly different terminology than the CRS, referring to “effective tax rates” as “average tax rates,” and “marginal effective tax rates” as “effective tax rates.”<sup>169</sup> The report, written by economists, stated that U.S. multinationals consider the “average corporate tax rate” (i.e., effective tax rate) when deciding whether to undertake a large or long-term investment in a particular country. If the U.S. multinational was deciding whether to expand its investment in a country in which it already operates, the economists determined that the “effective tax rate” (i.e., marginal effective tax rate) is more informative.

167. JANE G. GRAVELLE, CONG. RSCH. SERV., R41743, INTERNATIONAL CORPORATE TAX RATE COMPARISONS AND POLICY IMPLICATIONS 1 (2014).

168. CONG. BUDGET OFF., INTERNATIONAL COMPARISONS OF CORPORATE INCOME TAX RATES (2017).

169. *Id.*

Although there are many ways to calculate a company's effective tax rate, either on an average or marginal basis, Corporate America focuses on one measure of effective tax rate—that determined under financial accounting and reported on the form 10-K (and 10-Q) and referred to herein as the ETR. The ETR is equal to the sum of the current and deferred tax expense (i.e., book tax) divided by income from continuing operations (generally, operating income). It is an average rate and based on financial accounting (i.e., book) and not tax accounting. The ETR impacts a corporation's net income and EPS. Temporary differences, such as expensing and accelerated depreciation, have no impact on the corporation's ETR as measured by financial accounting. In contrast, a change in the corporate tax rate has a direct effect on a corporation's ETR, as do permanent differences, such as the FDII deduction and the research and development tax credit.

As mentioned above, the overall ETR for the S&P 500 was 17.56 percent in 2021, 18.02 percent in 2020, 17.5 percent in 2019, and 17.72 percent in 2018.<sup>170</sup> This was down from 24.37 percent in 2017, 26.44 percent in 2016, and 27.46 percent in 2015.<sup>171</sup> With the ETR currently around 17.5 percent for the S&P 500, making changes to the tax laws that keep that ETR in the same range should be acceptable to Corporate America, even if it impacts their cash taxes paid. More specifically, shifting from the current hybrid territorial/worldwide international tax system to a worldwide no-deferral system could receive the support of Corporate America if doing so kept the ETR around 17.5 percent.

Shifting to a worldwide no deferral system could be accomplished. All that is needed is the repeal of the deductions for both FDII and GILTI as well as the repeal of the exclusion from U.S. tax for the residual category of CFC income.<sup>172</sup> By doing this, all of the income from a CFC could be treated as either Subpart F income or GILTI, with the result that the U.S. taxes the income annually at the U.S. corporate tax rate with a credit for foreign income taxes paid.<sup>173</sup>

Where to set the corporate tax rate becomes an exercise in modeling if the goal is a lower corporate tax rate but also to raise revenue. If the corporate tax rate is lowered slightly from the current 21 percent to the high teens, it should result in keeping the corporate ETR for the S&P 500 at around 17.5 percent and additionally may raise revenue for the U.S. government. The lowering of the corporate tax rate may also result in economic growth, which is in line with the view of many economists that the corporate tax is the

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170. See S&P GLOBAL DATA, *supra* note 103.

171. *Id.*

172. The OECD, as part of Pillar 2, has adopted a substance-based carve-out that excludes from the tax base a certain amount of income calculated by reference to a fixed return on assets and payroll expenses in each jurisdiction. See *supra* note 22. This is similar to the ten percent of QBAI that is currently excluded from the U.S. tax base under the GILTI regime. If other countries adopt a substance-based carve-out as proposed by the OECD, it may make sense for the United States to retain the exclusion from its tax base of ten percent of QBAI or modify it to make it similar to the OECD substance-based carve-out.

173. Foreign tax credits are treated differently depending on whether they are associated with Subpart F income or GILTI. Foreign tax credits related to Subpart F income can reduce the U.S. tax liability on such income with any excess credits carried back one year and forward up to 10 years. I.R.C. § 904(c) (2018). Foreign tax credits related to GILTI are reduced by 20 percent and any excess credits may not be carried back or forward. I.R.C. §§ 904(c), 960(d). As a result, treating all the income of a CFC as either Subpart F income or GILTI would require determining how to handle the foreign tax credits, such as reduction of the credits and whether a carryforward or carryback period for excess credits would be permitted.

most inefficient of all taxes.<sup>174</sup>

Senator Bernie Sanders released the Joint Committee on Taxation's revenue estimate of Title VIII ("Corporate Tax Dodging Prevention") of his Corporate Fair Share Act.<sup>175</sup> It contemplated that: taxing at the current corporate tax rate of 21 percent the worldwide foreign earnings of CFCs currently by including all foreign-source income in Subpart F income of their U.S. shareholders; imposing a country-by-country limitation on the use of foreign tax credits; repealing the CFC look-through rule; and treating foreign business entities as corporations would raise \$692.1 billion over a 10-year period.<sup>176</sup> Repealing the deduction for FDII was estimated to raise \$224.2 billion over the same 10-year period.<sup>177</sup> As part of the Biden Administration's revenue proposals, Treasury estimated that repeal of the FDII deduction would raise \$123.9 billion over a 10-year period.<sup>178</sup> The Joint Committee and Treasury estimates clearly show that a worldwide no-deferral system (and repeal of the FDII deduction) could raise a significant amount of revenue.

The corporate tax rate could be reduced significantly in conjunction with a worldwide no-deferral system under a proposal that overall is revenue neutral. According to a 2020 report by the CBO, changing the corporate income tax rate by one percentage point results in a \$99.3 billion change in revenue over a 10-year period.<sup>179</sup> The revenue lost from decreasing the corporate tax rate could be offset by the revenue gained from a worldwide no-deferral system.

Enacting a worldwide, no-deferral tax system with a low corporate tax rate may be accomplished in a revenue neutral or revenue positive manner. This claim is supported by an analysis of the tax consequences to a "typical" U.S. multinational corporation. In a recent article, Martin Sullivan—a former Joint Committee on Taxation economist—analyzed the effects of current tax law and alternative proposals of a worldwide no-deferral system to multinational corporations.<sup>180</sup> He did so by modeling a U.S. multinational corporation with \$2,000 of before-tax financial statement income divided equally between domestic and foreign sources, 40 percent of domestic income being FDII, and a realistic amount of investment, depreciation, and research credit.<sup>181</sup> Using Sullivan's "typical" multinational corporation, Table 4 compares the tax consequences under current law and under a hypothetical worldwide no-deferral system with varying corporate tax rates of 28 percent, 21 percent, 17.5 percent, and 14.685 percent.<sup>182</sup>

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174. See *supra* note 18 and accompanying text.

175. Letter from Thomas A. Barthold, Chief Staff, Joint Comm. on Tax'n, to Senator Bernie Sanders (Mar. 2, 2021), <https://www.sanders.senate.gov/wp-content/uploads/Corporate-Tax-Dodging-Prevention-Act-Score-of-offshore-portion.pdf> [<https://perma.cc/8YT2-YJZU>].

176. *Id.* at 4.

177. *Id.*

178. U.S. DEP'T TREASURY, *supra* note 19, at 104.

179. CONG. BUDGET OFF., *OPTIONS FOR REDUCING THE DEFICIT: 2021 TO 2030* at 77 (2020). More recently, CBO has estimated that increasing the corporate tax rate by one percentage point would increase revenue by \$129.3 over a 10-year period. CONG. BUDGET OFF., *OPTIONS FOR REDUCING THE DEFICIT: 2023 TO 2032, VOL. II SMALLER REDUCTIONS* at 58 (2022).

180. Martin A. Sullivan, *Biden's Incoherent Corporate Tax Policy*, 170 TAX NOTES FED. 9, 9 (Jan. 4, 2021).

181. *Id.* The estimates for investment, depreciation, and research were derived from data provided by the IRS Statistics of Income Division and the Bureau of Economic Analysis. *Id.* at 14.

182. The model does not consider provisions, such as the new corporate AMT, recently enacted as part of the Inflation Reduction Act of 2022.

Table 4: Example of Impact of Current Law and Worldwide No Deferral at Various Rates

Policy	Current law	Worldwide w/ 28% rate	Worldwide w/ 21% rate	Worldwide w/ 17.5% rate	Worldwide w/ 14.685% rate
<b>U.S. taxation of U.S. income</b>					
U.S. book income	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00
Excess of tax over book depreciation	\$310.00	\$310.00	\$310.00	\$310.00	\$310.00
U.S. taxable income before FDII	\$690.00	\$690.00	\$690.00	\$690.00	\$690.00
FDII percentage of domestic income	40%	0%	0%	0%	0%
FDII deduction (37.5%)	\$103.50	\$0.00	\$0.00	\$0.00	\$0.00
Taxable income after FDII deduction	\$586.50	\$690.00	\$690.00	\$690.00	\$690.00
U.S. tax rate	21%	28%	21%	17.5%	14.685%
U.S. tax on U.S. income before credits	\$123.17	\$193.20	\$144.90	\$120.75	\$101.33
Research and other general business credits	\$20.00	\$20.00	\$20.00	\$20.00	\$20.00
U.S. tax on U.S. income after credits	\$103.17	\$173.20	\$124.90	\$100.75	\$81.33
<b>Foreign and U.S. taxation of foreign income</b>					
Foreign book income	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00
Foreign tax rate	10%	10%	10%	10%	10%
Foreign tax	\$100.00	\$100.00	\$100.00	\$100.00	\$100.00
GILTI tax rate	10.5%	28%	21%	17.5%	14.685%
GILTI tax before credits	\$105.00	\$280.00	\$210.00	\$175.00	\$146.85
GILTI tax credits	\$80.00	\$100.00	\$100.00	\$100.00	\$100.00
Net U.S. tax on GILTI after FTC	\$25.00	\$180.00	\$110.00	\$75.00	\$46.85
Total tax on U.S. income	\$103.17	\$173.20	\$124.90	\$100.75	\$81.33
Total tax on foreign income	\$125.00	\$280.00	\$210.00	\$175.00	\$146.85
Total tax on all income	\$228.17	\$453.20	\$334.90	\$275.75	\$228.18
<b>Total U.S. tax revenue</b>	<b>\$128.17</b>	<b>\$353.20</b>	<b>\$234.90</b>	<b>\$175.75</b>	<b>\$128.18</b>

Column 1 provides an example of current law.<sup>183</sup> Assuming the corporation has \$1,000 of U.S. book income and \$690 of U.S. taxable income after tax depreciation, 40 percent of which is FDII, the corporation will have \$586.50 of U.S. taxable income after

183. Martin A. Sullivan, *Biden's Incoherent Corporate Tax Policy*, 170 TAX NOTES FED. 9, 14 (Jan. 4, 2021).

the 37.5 percent deduction for FDII. This results in \$123.17 of U.S. tax, which is reduced to \$103.17 after the research and development tax credit. On the foreign front, foreign profit is taxed at 10 percent by the foreign jurisdiction resulting in \$100 of foreign tax. Assuming QBAI is equal to zero and the corporation benefits from the full GILTI deduction, the net U.S. tax on GILTI is \$25 after \$80 of FTCs. Thus, the total U.S. tax revenue is the sum of \$103.17 and \$25, which equals \$128.17.

Columns two through five show an example of a worldwide no-deferral system with varying corporate tax rates. The worldwide no-deferral system is modelled by setting the GILTI tax rate equal to the statutory corporate tax rate, allowing 100 percent creditability of foreign taxes, and assuming that QBAI is zero. There is also no deduction for FDII, achieved by setting the percentage of income that is FDII to zero. The research and development tax credit, however, is retained. A corporate tax rate of 14.685 percent in conjunction with the worldwide no-deferral system is revenue neutral with respect to Corporate America. A corporate tax rate of 17.5 percent with the worldwide no-deferral system results in a 37 percent increase in revenue from a typical U.S. multinational corporation compared to current law. Of course, the model is static in that it does not consider behavioral responses to expanding the tax base and decreasing the corporate tax rate. But it does give a sense that a revenue neutral or revenue positive worldwide no-deferral system with a low corporate tax rate may be possible.

### *C. Remaining Concern of Corporate America*

Although Corporate America could support a worldwide no-deferral system with a low corporate tax rate, their concern would be that Congress would either not agree to a low corporate tax rate or would raise the rate shortly after enactment of a worldwide no-deferral system. Their concern is probably well founded. An increase in the corporate tax rate is viewed politically as low-hanging fruit. It currently raises about \$100 billion per percentage point over 10 years with the CBO recently estimating the revenue raise could be as much as \$130 billion per percentage point increase. There are many policymakers who believe that Congress reduced the corporate tax rate too much as part of the TCJA. They believe that the rate should have been reduced to 25 percent or 28 percent, and some, like Senator Bernie Sanders, believe that it should not have been reduced at all.

There are strong policy arguments against raising the corporate tax rate from its current 21 percent. The corporate tax is noted as one of the most harmful taxes for economic growth.<sup>184</sup> Increasing it could negatively impact capital investment by raising the cost of capital. A higher corporate tax rate would also exacerbate the two levels of tax on corporate earnings. In addition, raising the corporate tax rate to 28 percent would give the United States a combined federal–state rate of 32.34 percent, which would be the highest in the OECD.<sup>185</sup> Even at the current federal–state rate of 25.8 percent, the United States has the 11th highest corporate tax rate of the 38 OECD countries (not including

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184. See *supra* note 18 and accompanying text.

185. See GARRETT WATSON & WILLIAM MCBRIDE, TAX FOUND., FISCAL FACT NO. 751, EVALUATING PROPOSALS TO INCREASE THE CORPORATE TAX RATE AND LEVY A MINIMUM TAX ON CORPORATE BOOK INCOME 1 (2021) (“An increase in the federal corporate tax rate to 28 percent would raise the U.S. federal-state combined tax rate to 32.34 percent, highest in the OECD . . .”).



Colombia, which became an OECD member in 2020, or Costa Rica, which became an OECD member in 2021).<sup>186</sup>

A worldwide no-deferral system, coupled with an increase in the corporate tax rate, could certainly lead many U.S. multinationals to consider inverting to a foreign jurisdiction. Doing so would allow the U.S. multinational to avoid the increased U.S. corporate tax rate on all of its worldwide income aside from its U.S. earnings. Inversions of U.S. multinationals were a serious concern of policymakers, and, to some extent, it led to the enactment of the significantly lower corporate tax rate in the TCJA. But since enactment of the TCJA, there have been no major corporate inversions involving U.S. multinationals.<sup>187</sup> In fact, some U.S. companies that inverted prior to the enactment of the TCJA have returned to the United States.<sup>188</sup>

If Congress enacted a worldwide no-deferral system with a corporate tax rate around 15 to 18 percent *on a bipartisan basis*, there would be less concern that the rate would be raised in the very near future. As part of the Tax Reform Act of 1986, which was enacted on a bipartisan basis, Congress decreased the top corporate tax rate from 46 percent to 34 percent. It remained at 34 percent until 1993, when it was increased by one percentage point. And then it remained at 35 percent for 25 years until the enactment of the TCJA.

186. *OECD Corporate Tax Rate FF*, TAX POL'Y CTR.: FISCAL FACTS (Jan. 4, 2021), <https://www.taxpolicycenter.org/fiscal-fact/occd-corporate-tax-rate-ff-01042021> [<https://perma.cc/SLH6-FJ8R>].

187. See, e.g., DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RSCH. SERV., R43568, CORPORATE EXPATRIATION, INVERSIONS, AND MERGERS: TAX ISSUES (June 17, 2021) (explaining that the TCJA was aimed at discouraging inversions and slowed foreign acquisitions of U.S. firms in the following years); Michael Rapoport & Isabel Gottlieb, *Biden Tax Plan Targets Inversions to Keep Them From Coming Back*, BLOOMBERG TAX (Apr. 8, 2021), <https://news.bloombergtax.com/daily-tax-report-international/biden-tax-plan-targets-inversions-to-keep-them-from-coming-back> [<https://perma.cc/88V3-K9E8>] (“President Biden’s global tax plan takes aim at corporate tax inversions—merger transactions that U.S. companies use to shift their headquarters out of the U.S. to a low-tax country—even though the practice has largely disappeared.”); Gordon Gray, *Recalling Inversions*, AM. ACTION F. (July 27, 2021), <https://www.americanactionforum.org/insight/recalling-inversions/> [<https://perma.cc/N4DU-F9SM>] (“[S]ince the TCJA’s passage, not a single major inversion has been reported.”); Christopher Hanna & Joshua Odintz, *United States: The Return of Corporate Inversions?*, GLOBAL COMPLIANCE NEWS (Nov. 11, 2020), <https://www.globalcompliancencews.com/2020/11/11/united-states-the-return-of-corporate-inversions-01102020/> [<https://perma.cc/WK7V-Q8DU>] (“Many analysts have credited the enactment of the Tax Cuts and Jobs Act (TCJA) for removing many of the incentives and benefits of a US multinational inverting or redomesticating to a foreign jurisdiction, such as Ireland or the UK, as part of a merger or acquisition of a foreign company.”).

188. U.S.-based AbbVie’s acquisition of Irish-based Allergan in 2020 provides strong evidence of the lack of interest in inverting because a similar acquisition that AbbVie was attempting in 2014 for Irish-based Shire would have resulted in AbbVie inverting to the United Kingdom. Selina McKee, *AbbVie Completes Acquisition of Allergan*, PHARMATIMES (May 11, 2020), [https://www.pharmatimes.com/news/abbvie-completes-acquisition\\_of\\_allergan\\_1340086](https://www.pharmatimes.com/news/abbvie-completes-acquisition_of_allergan_1340086) [<https://perma.cc/2ZET-EV4Q>]; Sean Farrell, *AbbVie Withdraws Bid for Shire After US Gets Tough on Tax*, GUARDIAN (Oct. 16, 2014), <https://www.theguardian.com/business/2014/oct/16/abbvie-shire-tax-us> [<https://perma.cc/K7S9-66GC>]. Also, the merger of U.S.-based Upjohn—Pfizer’s off-patent drug unit—and the Dutch-based Mylan N.V., which inverted to the Netherlands in 2015, with the resulting company, Viatrix, being domiciled in the United States, brought Mylan back into the U.S. tax base. Angus Liu, *Mylan, Pfizer’s \$12B Viatrix Merger Clears FTC with a Deal for Product Selloffs*, FIERCE PHARMA (Nov. 2, 2020), <https://www.fiercepharma.com/pharma/mylan-pfizer-s-12b-viatrix-merger-clears-ftc-deal-for-product-selloffs> [<https://perma.cc/G5XY-7A3S>].

## V. CONCLUSION

For many years, policymakers and tax scholars have pushed for the United States to adopt a worldwide no-deferral international tax system. And for many years, Corporate America has pushed back on adoption of such a system. But with the changes made to the tax system as part of the Tax Cuts and Jobs Act, such as the elimination of deferral for much of the foreign income of a CFC and the significant reduction in the corporate tax rate, not only is it possible, but it is likely that Corporate America would support a worldwide no-deferral regime. And recently, as part of the Inflation Reduction Act of 2022, the Biden Administration and Congress have enacted such a regime—the 15 percent corporate AMT—although few have recognized it as such because of the financial accounting tax base and its limited applicability to only large corporations.

The key element in obtaining that support is the setting of the corporate tax rate. In determining where to set the corporate tax rate in a worldwide no-deferral regime so as to get the support of Corporate America, knowing and acknowledging the importance of financial accounting to Corporate America can unlock the mystery. If the rate were set in the 15 to 18 percent range, a worldwide no-deferral regime could be enacted and address and resolve issues such as U.S. multinationals shifting income to a low-tax jurisdiction; U.S. corporations inverting to a low-tax foreign jurisdiction; and transfer pricing and earnings stripping between related entities. In addition, the lower corporate tax rate would benefit all U.S. corporations by decreasing the inefficiencies and possible hindrance of economic growth associated with the corporate tax. Finally, and perhaps most importantly, in the current legislative environment, such a regime may raise revenue relative to current law.