# The New Non-Territorial U.S. International Tax System

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# Overview

2 linked international tax papers in one: broad conceptual overview; BEAT, GILTI, & FDII in 2017 U.S. tax act.

No time here for both! So I'll mainly discuss the latter.

The US didn't "go territorial," but "WW vs. territorial" is a bad frame. (E.g., if everyone's a "hybrid," it doesn't tell us anything.)

Rather, the US repealed & replaced deferral, i.e., "tax now or (maybe) later."

Post-act, it's "now or never" – but with an expanded "now" (so "later" was split in both directions).

# Goodbye to the "WW vs. territorial" frame

These concepts differ at 2 margins, not one: tax rate for FSI, marginal reimbursement rate (MRR) for foreign taxes.

Why conflate, why the arbitrary packages & polar options.

"WW vs. territorial" also fails to illuminate the main choices that countries actually appear to care about these days.

These include (1) ETRs for MNCs (vs. other businesses), (2) resident vs. foreign MNCs, (3) issues re. resident MNCs' "bad" FSI, & (4) MRRs for foreign taxes.

Each lacks consensus & poses "Goldilocks problems."

# (1) The BEAT: Rationales

MNC base erosion tools include deductible payments to affiliates.

Can involve transfer pricing &/or concentrating deductions in high-tax jurisdictions.

Best combated (insofar as one wants to) comprehensively & without undue reliance on labels.

There's also a U.S. rationale for shifting anti-base erosion efforts to bear more than previously on non-U.S. MNCs.
(Prior *balance* was wrong, whether the overall *level* was too high or too low.)

# The BEAT: Basic mechanics

Minimum tax structure: “broader” base, lower rate, pay to the extent in excess of regular tax.

Add “base erosion tax benefits” (**BETBs**) to convert regular into “modified” taxable income; 10% BEAT rate.

Say $10X regular taxable income, $30X BETB. Pay $2.1X regular tax + an additional $1.9X of BETB.

MRR for BETBs = 21% until one hits the BEAT, then zero.

Could think of this as a BETB excise tax of 0% then 21% (reversing the deduction).

# Why the min tax/dual rate excise tax?

No clear substantive rationale (leaving aside optics, treaties, etc.).

If modified taxable income = economic income, might rationalize min tax as target tax rate for MNCs.

But this would require that "correct" transfer prices = zero.

If dual-rate excise tax, reason for the jump is unclear.

Worse still, the BEAT combines harshness with avoidability, due to various escape routes.

# Avoiding/revising the BEAT

--Doesn't apply to cost of goods sold (COGS). (Has rationale, but what about everything else; tax planning responses.)

Doesn't apply if <3% of deductions are BETBs. (Rationale??; cliff problem; tax planning responses.)

Doesn't apply if 3-year average gross receipts <$500M. (Too high? Cliff problem.)

A modest proposal: (1) extend to COGS, (2) eliminate 3% rule, (3) lower the gross receipts floor, (4) offset extra burden by commensurately lowering rate (or via excise tax?).

Separate (Goldilocks) question whether should have any such rule; also myriad other legal/technical issues.

# (2) GILTI: Rationales

CFC rules tax "bad" FSI – generally deemed to be that arising in tax havens (and often with a very high ROR).

Significant consensus about what it is; far less about how harshly vs. leniently to tax it.

**Pro:** address "excessive" base erosion & perhaps rents.

**Con:** can't reach it when earned by non-resident MNCs; reducing low foreign taxes not itself domestically undesirable.

# GILTI: Basic mechanics

Reduce relevant FSI (e.g., stripped of subpart F income) by 10% deemed return on QBAI (adj. basis, tangible assets used in CFC businesses).

This is half-taxable (i.e., half is deducted), subject to FTC for 80% of relevant foreign taxes.

Say Acme-US has $100X of relevant FSI, $200X of QBAI, paid $10X foreign taxes.

GILTI = $100X – .1($200X) = $80X, reduced by 50% deduction to $40X.

GILTI liability @ 21% = $8.4X – $8X FTCs = $.4X.

# GILTI tricks and traps

Lots of little tricks & traps can harshen GILTI's effects. E.g.:

--May get perverse results if loss as well as gain CFCs.

--The 50% deduction can't create or increase NOLs.

--GILTI FTC basket has internal cross-crediting, but not vs. other baskets, & no FTC carryovers if excess-credit.

Global minimum tax of 13.125? (From 10.5% rate, foreign tax rate needed to eliminate all U.S. liability.)

Not if one gets trapped by other features! (E.g., pay foreign taxes in the wrong year.)

# Assessing GILTI

Its tricks & traps (but also perhaps its allowing internal cross-crediting) seem foolish.

Can make offsetting changes (e.g., to deduction %) to keep net revenue or net burden constant.

Can defend 80% FTC both substantively & on treaty grounds.

The 10% QBAI rule may have perverse effects. *Expected* return (given market rates) needed to avoid odd incentives.

Opinions may reasonably differ on GILTI's core purpose & effects.

# (3) FDII: Rationales

U.S. policymakers wanted a "carrot," alongside GILTI's "stick," to encourage keeping intangible-type income in the U.S.

Patent / innovation box would have been the obvious thing.

But instead Congress enacted FDII, differing in 2 key ways:

1) Intangible income inferred via QBAI structure, rather than being directly observed.

2) Special tax rate only for exports – so an (almost surely WTO-violating) export subsidy.

# FDII: Basic Mechanics

Deduct 37.5% of "foreign-derived intangible income," lowering its effective tax rate to 13.125%.

FDII is basically U.S.-source income from exports. But such income is reduced by the ratable portion of a 10% deemed return on U.S. QBAI.

Say Acme-US has $100X of relevant US source income, $40X of it from exports. Say also $200X of US QBAI.

40% of the 10% deemed return ($8X) reduces FDII to $32X.

Acme deducts 37.5%X of this amount ($12X), reducing its U.S. tax liability by $2.52X.

# Policing the border

FDII's being an export subsidy is not only WTO-violating & bad policy, but yields tax planning/compliance headaches.

Destination-based taxes (such as VATs) treat exports & imports symmetrically, so "round-tripping" is not generally a problem.

But FDII makes it both fundamental & imperfectly definable.

Just a question of how closely & detectably the export & re-import are linked.

Legislative history suggests that one need only avoid making the foreign re-importer too much of a pure conduit.

# Summing up

Good riddance to “WW vs. territorial”! – focus instead on margins countries care about. Answers often unclear.

U.S. isn’t going back to pre-2017 act international tax law, & why should it.

The BEAT & GILTI are in the ballpark of addressing reasonable concerns, although serious flaws as implemented.

FDII is fatally flawed by its being an export subsidy. Could replace w/ a more conventional patent box, or w/ nothing.