Made in America: International Tax Reform 2.0 – Part 2

This article, the second of two, explores the international tax reform proposed by the Biden administration and discusses the reasons for the proposed tax reform.

5. Introduction

The US Treasury released a new edition of the greenbook on 28 May 2021. This document contains technical explanations on revenue projections for the federal government in respect of the fiscal year 2022, and provides target start dates for the proposed revenue measures (FY2022 green-book).

While the FY2022 green-book mirrors all of the proposals that were previously formulated by President Joseph Biden in his Made in America Tax Plan as described in the article “Made in America: International Tax Reform 2.0 – Part 1,” it reveals other new proposals that are relevant for multinationals. That is the case with the alternative Business Interest Expense Disallowance.

There are many unknowns as to whether, when and in which form the proposed measures in the FY2022 greenbook will find a place in the bill package that, at the time of writing this article, is expected to be introduced before the US Congress in the next weeks. Determining which are the sources that US Congress should use to pay for the cost of public infrastructure modernization has given rise to a strained political negotiation between President Biden and lawmakers from the Republican Party (GOP) that have expressed a different opinion on how to fund the infrastructure bill. The Republican Party lawmakers are vehemently opposed to the idea of altering the existing international tax structure from the “Tax Cuts and Jobs Act” (TCJA).

After rounds of conversation between the Biden administration and bipartisan members of the US Senate, on 24 June 2021, the White House Briefing Room published the Fact Sheet with the announcement of an agreement that would move forward a Bipartisan Infrastructure Framework and enact the infrastructure modernization project under the American Jobs Plan. The financing sources for this agreed bipartisan package would result from strengthening the IRS enforcement on high-wealth taxpayers and large corporations, introduction of “user fees”, redirecting unused COVID-19 relief funds, and some other non-tax funding items. The agreed bipartisan law does not include any of the tax measures that were initially proposed in the Made in America Tax Plan described in Part 1 of this article.

The White House Fact Sheet confirms that President Biden will stay committed to the initial tax plan and will work with a second piece of legislation that would include the tax plan. The fact sheet states that the law would move in conjunction with this bipartisan package. Most likely, the second law will have to rely on the budget reconciliation process, the same legislative mechanism Republican lawmakers employed in 2017 when the TCJA was passed. In the reconciliation process, only the vote from all Democratic Party members of the US Congress is required. In August 2021, the US Congress enters its annual session recess. It is expected that the Made in America Tax Plan will be finalized in some form before the US Congress begins its recess.

In order to give the reader the most updated information available on this matter, this article focuses on the international tax rules in the FY2022 green-book (see sections 6. to 15).

6. Increase of the Corporate Income Tax Rate

The proposal would increase the income tax rate for C corporations from 21% to 28%. The proposal is effective for taxable years beginning after 31 December 2021. For taxable years beginning after 1 January 2021 and before

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The opinions expressed in the article are solely the author’s views and do not express the opinions of any of the author’s present or former employers.


53. C. Pérez Gautrin, Made in America: International Tax Reform 2.0 – Part 1, 75 Bull. Int'l Taxn. 6 (2021), Journal Articles & Opinion Pieces IBFD.


1 January 2022, the tax rate would equal to 21% plus 7% times the portion of the taxable year that overlaps with 2022. This results in the computation of a blended rate to apply to FY2022 only.

7. Global Intangible Low-Taxed Income

7.1. Introductory remarks

The Deemed Tangible Income Return (DTIR) exemption, which is based on the concept of Qualified Business Investment Assets, is eliminated. Accordingly, a US shareholder’s entire net controlled foreign corporation (CFC) tested income is subject to Global Intangible Low-Taxed Income (GILTI).

The section 250 deduction is reduced to 25%. This change generally increases the US effective tax rate (ETR) under GILTI to 21% based on the newly proposed 28% corporate income tax rate.

The “Global blending” method for calculating a US Shareholder GILTI is replaced with a “Jurisdiction-by-Jurisdiction” calculation. Under the new method, a US Shareholder’s GILTI inclusion and, by extension, the residual US tax on such inclusion, is determined separately for each foreign jurisdiction where there is a CFC.

7.2. End of GILTI (and Subpart F) high-tax exclusion

The proposal announced in FY2022 green-book repeals the high-tax exemption for GILTI and Subpart F. This amendment would terminate the applicability of the existing Treasury and the Internal Revenue Service (IRS) final guidance under sections 951A and 954 of the Internal Revenue Code (IRC) regarding income subject to a High Rate of Foreign Tax.

7.3. Deemed-paid foreign tax credits

The FY2022 green-book proposal would take into account any foreign taxes paid by the foreign parent, under an Income Inclusion Rule that is consistent with the OECD Inclusive Framework’s Pillar Two project regarding a global minimum tax, GloBE. This proposal would become effective for taxable years beginning after 31 December 2021.

7.4. GILTI exclusion of Foreign Oil and Gas Extraction Income

The FY2022 green-book proposals would repeal the exemption from GILTI for Foreign Oil and Gas Extraction Income (FOGEI). The definition of FOGEI is amended to include income derived from shale oil and tar sands activities. This proposal is effective for taxable years beginning after 31 December 2021.

7.5. Treaty carve-outs

The Treasury recognizes that there are aspects from its FY2022 green-book proposal that could affect the amount of a foreign levy paid by a dual-capacity taxpayer, which qualifies as a creditable tax. That could implicate US treaty obligations that explicitly allow a credit for taxes paid or accrued on certain oil and gas income. Consequently, the Treasury has said that the treaty provisions have priority over domestic rules.

7.6. Deduction disallowances

The green-book proposals expand the application of section 265 of the IRC to disallow deductions allocable to a class of foreign gross income that is exempt from tax or taxed at effective rates after applying certain deductions, GILTI inclusions subject to section 250 super deduction and section 245A Dividends Received Deduction. This proposal is effective for taxable years beginning after 31 December 2021.

8. Corporate Inversions

The FY2022 green-book proposal would broaden the application of section 265 of the IRC to disallow deductions allocable to a class of foreign gross income that is exempt from tax or taxed at effective rates after applying certain deductions, GILTI inclusions subject to section 250 super deduction and section 245A Dividends Received Deduction. This proposal is effective for taxable years beginning after 31 December 2021.

9. Foreign-Derived Intangible Income

The FY2022 green-book proposal repeals the provisions on Foreign-Derived Intangible Income (FDII) effective for taxable years beginning after 31 December 2021.

10. The Base Erosion and Anti-Abuse Tax

The FY2022 green-book proposal repeals the Base Erosion and Anti-Abuse Tax (BEAT). A new regime comes into place – SHIELD, an acronym for “Stopping Harmful Inversions and Ending Low-tax Developments” (see section 11.).

11. SHIELD

11.1. Introductory remarks

SHIELD would disallow a domestic corporation or branch deduction, in whole or in part, by reference to all gross payments, whether related or unrelated party deductions, that are made or deemed made to “low-taxed members”. This is a defined term, which consists of Financial Reporting Group members whose income is subject to or deemed subject to an ETR below a designated minimum tax rate. Before the OECD Inclusive Framework’s Pillar Two project is concluded to determine the global minimum rate, the SHIELD rate has been set up at 21%. In the OECD/ G20 Statement of 1 July 2021 regarding the Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalization of the Economy, it was publicly announced
that the Inclusive Framework on Base Erosion and Profit Shifting has agreed to conclude a two-pillar solution to address the tax challenges arising from the digitalization of the economy. The agreement contains the implementation of a global minimum tax rate of at least 15%. It is unknown whether the United States will first have to pass the hurdles of US Congress ratification to implement the two-pillar solution at the national level in order to start applying this 15% global minimum tax rate as the SHIELD rate. This requires further clarification.

11.2. SHIELD is not for everyone

SHIELD applies exclusively to Financial Reporting Groups reporting greater than USD 500 million in global annual revenues based on the group’s consolidated financial statements determined in accordance with US Generally Accepted Accounting Principles (US GAAP), International Financial Reporting Standards (IFRS) or other methods authorized by the Treasury.

A Financial Reporting Group is any group of business entities that prepares consolidated financial statements and includes at least one domestic corporation, domestic partnership, or foreign entity carrying a trade or business in the United States. This term should not be confused with “Includible Corporations” for the purposes of the Consolidated Returns regime under section 1503 of the IRC. This other regime follows a different methodology subject to a separate tax computation based on corporate income tax reporting.

The ETR of a member of a Financial Reporting Group is determined based on the income earned in the aggregate, taking into account both related and unrelated party income and taxes paid or accrued in respect of the income earned in that jurisdiction by Financial Reporting Group members, computed on the basis of the members’ separate financial statements or the Financial Reporting Group’s consolidated financial statements, as disaggregated on a Jurisdiction-by-Jurisdiction basis, a minimum effective level of taxation as determined to the satisfaction of the Treasury Secretary to exempt payments.

The FY2022 green-book proposal provides authority for the Treasury Secretary to exempt from SHIELD payments in respect of Financial Reporting Groups that meet, on a Jurisdiction-by-Jurisdiction basis, a minimum effective level of taxation as determined to the satisfaction of Treasury Regulations. The proposal provides additional authority for the Treasury Secretary to exempt payments to domestic and foreign members that are investment funds, pension funds, international organizations or non-profit entities, and to take into account payments by partnerships. This type of carve-out requires additional details, as it could open the gates to special interests and tax planning aimed at circumventing SHIELD exposure. The proposal to repeal the BEAT and replace it with SHIELD is effective for taxable years beginning after 31 December 2022.

11.3. Extensive application of SHIELD

SHIELD is partially applicable to the extent that other Financial Reporting Group members are subject to an ETR of less than the minimum tax rate. In such a case, the domestic corporation or branch would effectively become treated as having paid a portion of its related party amounts to the low-taxed members, if any, of the Financial Reporting Group based on the aggregate ratio of the group’s low-taxed profits to its total profits, as reflected on the group’s consolidated financial statements.

11.4. SHIELD exemptions

In contrast to the BEAT, SHIELD may include specific rules that will account for net operating losses (NOLs). These rules are summarized in Table 1.

<table>
<thead>
<tr>
<th>Specific Types of Payments</th>
<th>SHIELD Consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments made by a domestic corporation or branch directly to low-tax members that are otherwise deductible costs.</td>
<td>SHIELD disallowance in its entirety.</td>
</tr>
<tr>
<td>Payments for other types of costs, such as cost of goods sold (COGS) and other deductions, including unrelated party deductions.</td>
<td>SHIELD disallowance up to the amount of the payment.</td>
</tr>
<tr>
<td>Payments made to Financial Reporting Group members that are not low-tax members.</td>
<td>SHIELD is subject to profitability proportionate to the entire financial group.</td>
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</tbody>
</table>

## 12. Foreign Tax Credits and Disposals of Hybrid Entities: Section 338 Elections

Section 338(h)(16) of the IRC provides that, subject to certain exceptions, the deemed asset sale resulting from a section 338 election is generally ignored in determining the source or character of any item for purposes of applying the foreign tax credit (FTC) rules to the seller. Instead, for these purposes, any gain recognized by the seller is treated as gain from the sale of the stock of the target corporation. Accordingly, in the case of a foreign target corporation, section 338(h)(16) of the IRC prevents the earnings and profits (E&P) generated from the deemed asset sale from changing the gain characterization from capital to ordinary, thereby permitting the use of FTCs to reduce or eliminate residual US tax on the stock gain.
The FY2022 green-book proposal would rely on section 338(h)(16) principles to determine the source and characterization of any item recognized in connection with a direct or indirect disposition of an interest in a specified hybrid entity and to a change in the classification of an entity that is not recognized for foreign tax purposes. For FTC purposes, the source and characterization of any item resulting from the disposition of the interest in the specified hybrid entity, or check-the-box entities would be determined based on the source and characterization of an item of gain or loss the seller would take into account upon the sale or exchange of “stock”. This treatment would apply even if a section 338(h)(16) election was made. This proposal is effective for transactions occurring after the date of enactment.

13. Business Interest Expense Disallowance

13.1. Introductory remarks

The FY2022 green-book raises the Treasury’s reproaches about the effectiveness of section 163(j) of the IRC as revised by the TCJA. According to the Treasury, section 163(j) of the IRC does not consider the leverage of a multinational’s US operations relative to the leverage of the group’s worldwide operations. Multinationals would reduce US tax on income earned from US operations by over-leveraging their US operations relative to those in lower-tax jurisdictions. That situation results in allocating high amounts of debt to low-tax subsidiaries.

The Treasury adds that the BEAT is not providing either a sufficient earning stripping shield because of the exceptions to certain deductible payments. The current 10% BEAT rate is less than half of the 21% corporate income tax rate.

It is for the reasons advanced by the Treasury in the preceding paragraphs that the FY2022 green-book introduces a new limitation rule that could place a deduction disallowance on business interest payments from entities that are members of a multinational, which consolidates financials in the same manner as described for SHIELD (see section 11.). In case a group does not prepare financial statements under US GAAP or IFRS, it is expected that Treasury Regulations would allow the use of any type of financial statements, as long as they are prepared in accordance with the jurisdiction’s generally accepted accounting principles in appropriate circumstances. The new rules could have the effect of over expanding the scope of Action 4 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) on limitation on interest deductions.

13.2. Do the existing section 163(j) rules still apply?

A member of a Financial Reporting Group that is subject to the proposed business interest deduction rules would continue to apply section 163(j) of the IRC as is. Accordingly, the amount of interest expense disallowance is subject to both interest expense disallowance provisions determined based on whichever of the two provisions, section 163(j) of the IRC and the proposed provision, imposes the lower limitation.

Following this part of the proposal, a multinational would have to run two sets of business interest limitation calculations, the first one is subject to section 163(j) of the IRC and another is subject to the newly proposed rules. Then, it would have to compare the two results, and pick the one that leads to the lowest amount of Business Interest Expense Disallowance. This situation could increase the taxpayer compliance process by having to create a separate set of IRS forms that counterbalance Form 8990. The IRS enforcement would also have another task to add to its auditing process by reviewing the new rules.

13.3. How the alternative limitation to business interest expense deduction would work?

The deduction for interest expense is limited if: (i) the Financial Reporting Group member has net interest expense for US tax purposes, i.e. interest expense is higher than interest income; and (ii) the member’s net interest expense for financial reporting purposes as computed on a separate company basis exceeds the member’s proportionate share of the group’s net interest expense reported on the group’s consolidated financial statements, i.e. the excess financial statement net interest expense. Accordingly, a multinational would now have to deal with three sets of computations. This position is summarized in Table 2.

| Table 2 – Amounts A, B and C: Three sets of computations for multinationals |
|-----------------|--------------------------------------------------|
| **Amount A**    | Net interest expense reportable for purposes of Form 1120. |
| **Amount B**    | Corporation portion of net interest expense based on entity financials. |
| **Amount C**    | Pro rata share of net interest expense that belongs to the member corporation and based on the proportionate share of the Financial Reporting Group’s earnings after adding back net interest expense, tax expense, depreciation, depletion and amortization as reflected in consolidated financials. |

If Amount A and/or Amount B is greater than Amount C, when a Financial Reporting Group member has excess financial statement net interest expense, a deduction is disallowed for the member’s excess net interest expense for US tax purposes. It is only the excess amount that falls subject to the disallowance and not the totality of the net interest expense.

In computing the interest disallowance formula, rather than summing up Amount A and Amount B, it appears that this rule would require either Amount A or Amount B to exceed Amount C for the limitation to operate. This situation is the most likely case, as there is a specific rule in FY2022 green-book that applies to Amount A and another rule for Amount B. As the Treasury states:

For the purpose, the member’s excess net interest expense equals the member’s net interest expense for U.S. tax purposes (Amount A) multiplied by the ratio of the member’s excess financial statement net interest expense to the member’s net inter-
13.4. Other method: Interest income plus 10% Adjusted Taxable Income

If a Financial Reporting Group member fails to substantiate its proportionate share of the group's net interest expense for financial purposes, or a member has elected to do so, the member's interest deduction would get limited to the member's interest income plus 10% of the member's Adjusted Taxable Income (ATI) as defined under section 163(j) of the IRC. As this other method is based on the ATI threshold, it is subject to the temporary rule of section 163(j)(8)(A)(v) that will change at the beginning of FY2022, in case the ATI temporary rule remains intact. The FY2022 green-book does not express its position on whether the existing ATI rule of section 163(j)(8)(A)(v) will become permanent. Following the same mechanics of section 163(j), any interest disallowance under the new rules is subject to indefinite carry-forward.

13.5. US subgroups

The US subgroups of a Financial Reporting Group are treated as a single member of the group for the purposes of applying the proposal. For this purpose, a US subgroup is composed of any US entity that is not owned directly or indirectly by another US entity, and all of the members, domestic or foreign, that are owned directly or indirectly by such entity. If a member of a US subgroup owns stock in one or more foreign corporations, this proposal would apply before the application of section 265 of the IRC, which generally disallows a deduction for amounts allocable to tax-exempt income.

13.6. Scope of application

The proposal would not apply to financial services entities, and these entities are being excluded from the Financial Reporting Group for the purposes of applying the proposal. The interest expense disallowance would not apply to groups that otherwise report less than USD 5 million of net interest expense, in aggregate, on one or more US income tax returns for a taxable year. Further Treasury Regulations would elaborate more on the definition of financial services entities. The interest expense disallowance proposal is effective for taxable years beginning after 31 December 2021.

14. Book Tentative Minimum Tax

The FY2022 green-book proposes to impose a 15% minimum tax on worldwide book income for corporations with income in excess of USD 2 billion. In particular, taxpayers would have to calculate the Book Tentative Minimum Tax (BTMT) equal to 15% of worldwide pre-tax book income calculated after subtracting book NOL deductions from book income, less General Business Credits, including section 41 Research and Experimentation (R&E) credits, Clean Energy and Housing Tax Credits and FTCSs. The BTMT equals the excess of tentative minimum tax over regular tax.

Taxpayers are allowed to claim a credit generated by a positive book tax liability against regular tax in future years. However, the credit is capped to the BTMT for the same tax year. The BTMT is effective for FY2022.

15. New General Business Credit for Onshoring of US Trade or Business

15.1. What qualifies for this new credit?

The onshoring of a US trade or business means reducing or eliminating a trade or business or line of business currently conducted outside the United States or starting up, expanding, or otherwise moving the same trade or business to a location in the United States, provided that this action results in US jobs. A US taxpayer could qualify for the tax credit even if the eligible expenses are incurred through its foreign affiliates.

This proposal brings another disallowance rule on deductions for expenses. In this case, expenses that are paid or incurred in connection with onshoring of a US trade or business would fall subject to disallowance. This rule is separate and distinct to section 163(j) of the IRC and the new alternative interest disallowance rule that was discussed earlier.

15.2. In what circumstances could offshoring of expenses be disallowed?

Expenses related to offshoring of a US trade or business by reducing or eliminating a trade or business or line of business currently conducted inside the United States or the starting up, expanding, or otherwise moving the same trade or business to a location outside the United States. For the disallowance rule to apply, however, there is an important condition that must occur, i.e. the offshoring action must result in a loss of US jobs. Consequently, not every situation in which there is a deployment of business activities would necessarily result in the offshoring of US trade or business, but only those cases in which there is evidence of reduction of US employment resulting from the offshoring process. The disallowance rule is extensively applied to the computation of GILTI and Subpart F.

15.3. What types of expenses are subject to the new tax credit?

Expenses paid or incurred in connection with the US trade or business relocation are subject to the new tax
credit. The tax credit regime, however, will not apply to capital expenditures or severance payments and other assistance to displaced workers. This carve-out aspect of the tax credit could mean that cash that is effectively used for the purchase of US-based plant and equipment that is required for the repatriation of foreign trade or business activities will not qualify for the General Business Credit. This part requires further explanation from the Treasury. A literal reading of “capital expenditures” could place an important limitation to the true value of the new incentive. The proposal becomes effective for expenses paid or incurred after the date of enactment.

16. Conclusion

In the Greek mythology narrated in Hesiod’s Works and Days, Pandora had a box containing every imaginable tribulation, misery and evil. Pandora opened the box, and the evil rapidly escaped, scattering throughout the Earth; however, there was one thing left inside Pandora’s box, and that was hope.

Hesiod’s story brings to mind the harsh times the world economy is now facing in the aftermath of the COVID-19 pandemic, a health crisis that has pushed the public finances of most countries to the brink of cataclysm. The United States is no exception. Whether the Made in America Tax Plan will be passed into law, or whether the proposed tax plan would spark the type of US economic bonanza that the Biden administration expects is uncertain. As with Pandora’s box, there is one thing left for President Biden’s tax plan, and that is hope.