United States

Global Minimum Tax Re-Emerges in U.S. Tax Reform Debate

BY ALEX M. PARKER

Members of Congress seeking a new glue to hold hopes of tax reform together are toying with one of the few bipartisan ideas left in Washington—a minimum tax on U.S. corporations to ensure that their earnings anywhere on the globe are taxed.

Variations on the idea are in both the tax reform draft offered in 2014 by former Rep. Dave Camp (R-Mich.)—which Senate staffers picked up and explored through June and the first part of July—and in alternative proposals now circulating on Capitol Hill.

A global minimum tax is conceptually simple and intuitive compared with the House Republican proposal for border-adjusted tax reform. The idea is that no matter where income is earned or stashed, U.S. companies must pay some level of tax on it.

A shift to a territorial tax system, which exempts overseas income, could encourage profit-shifting from the U.S.; a global minimum tax would avoid that rush and make the policy more feasible. It would also avoid the perception that a deemed repatriation of currently deferred income, another key goal of the tax reform push, would be a repeat of the 2004 tax holiday, which the Joint Committee on Taxation said ultimately reduced revenue and may have encouraged companies to defer more income.

To critics and opponents, the relative ease and simplicity of the minimum-tax approach is a mirage, masking an important flaw—it is a residency-based approach, which puts tremendous pressure on the location of a U.S. company’s headquarters and inevitably leads to inversions and takeovers.

“The residency solution in a global economy is not going to be effective,” Bret Wells, a professor at the University of Houston Law Center, told Bloomberg BNA July 3. “In a free society, where we have free import and export of capital, it is difficult to create a wall high enough that prevents a company from being able to combine with a foreign-based company to achieve a corporate inversion.”

Option C The “Option C” in Camp’s initial 2011 draft, which became the main base erosion measure in the 2014 version of the proposal, would create a new Sub-part F income category, “foreign intangibles income,” aiming to eliminate or discourage some of the most well-known forms of profit-shifting. While not technically a minimum tax, the proposal would achieve a similar result by applying only when the income is taxed at less than 15 percent by the local jurisdiction. The income would be taxed at 15 percent if it is ultimately derived from consumption outside the U.S., and at 25 percent—the full tax rate in the Camp plan—if it is derived from the U.S.

The draft defined intangibles income as gross income beyond 10 percent of depreciable assets—a formulaic approach that acknowledged the difficulty of defining intangible assets in the modern global economy.

Declared dead on arrival when it was released in February 2014, the Camp draft as recently as late June was exhumed by Senate staffers looking for ideas to push along a stalled tax reform effort. The re-emergence of Option C has prompted the technology and pharmaceutical fields to gird for opposition to rules they see as unfairly targeting their businesses, which rely heavily on intellectual property.

One source familiar with the discussions, who requested anonymity to discuss private conversations, said June 28 that Senate staffers are looking into tweaks to the Camp Option C that were negotiated between House Speaker Paul D. Ryan (R-Wis.) and Sen. Charles E. Schumer (D-N.Y.) in 2015 as part of a failed deal to pay for the highway spending bill. Those changes include provisions that would moderate when the 15 percent threshold of foreign taxation kicks in, possibly using a weighted average rather than looking at taxation in an individual jurisdiction. The tweak would bring the concept even closer to a global minimum tax.

But defining that threshold of taxation is one of the many administrative difficulties that critics of the Camp draft imagine.

“What tax do you get to put into that 15 percent? What if there’s business licensing? Maybe they have a different way of structuring their tax,” Gavin Ekins, an economist with the Tax Foundation, a conservative-leaning Washington think tank, told Bloomberg BNA June 30. “You can imagine that these other countries could say, ‘Well, if 15 percent is the minimum, we’ll just charge them 15 percent and then cut other taxes that we’d charge them.’ ”

Other Ideas While the Camp draft is re-examined, other variations on the concept of a minimum tax have also circulated.

In June, FedEx Corp. founder and Chief Executive Officer Frederick W. Smith floated a proposal—titled GROW—that includes a 10 percent minimum tax on passive income not already taxed locally at the same rate. The plan itself notes interest, rents, royalties, and
dividends as examples of passive income, closely tracking the definition already used by Subpart F.

The discussion is veering toward the proposal in President Donald Trump’s campaign plan, which didn’t include a minimum tax but would have achieved a result much like one. The plan would have ended deferral and taxed worldwide corporate income immediately—but also would have lowered the overall corporate rate to 15 percent. By leaving foreign tax credits in place, Trump’s plan would have exempted most global income from U.S. taxation, kicking in only when income is taxed at below 15 percent. Trump’s later plans discarded the concept.

President Barack Obama’s 2016 budget request, released in February 2015, also called for an immediate 19 percent tax on global earnings, regardless of how or where they arise. That proposal, much broader than the Camp plan, was seen as part of a growing consensus among Washington policy makers for a minimum tax as a backstop to increasingly complicated and difficult-to-enforce transfer pricing rules.

Hurting U.S. Using a minimum tax to fix the international tax system relies on the inherently arbitrary concept of corporate residence. Rather than focusing on defining economic activity in a way that is harder to game—the aim of the border-adjustment proposal, which targets consumption in the U.S.—this would be a special new regime applying only to U.S. companies, belying the administration’s goals of making the country’s economy more competitive with the world.

“We should design rules based upon the world that we have, and the world that we have is that most of our other trading partners are not using a residency-based solution,” said Wells, who advocated stronger rules against earnings stripping and other payments that erode the U.S. tax base.

Ekins said a tax system that tries to determine where income originates across business operations, in multiple jurisdictions—rather than at the point of destination, where consumption occurs—is the ultimate problem, and any solution that leaves the existing transfer pricing system in place won’t solve it.

“I think it’s just going to exacerbate it,” he said. “We’re using these tools as a Band-Aid for a problem of, really, we shouldn’t be taxing income at the origin level. It’s just too difficult—the supply chains are too complicated, and they’re only going to get more complex.”

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