June 2, 2021

Biden Administration FY2022 Budget Proposals
Related to Corporate and International Tax Matters
Released May 28, 2021

Overview

The proposals included in the Treasury's FY 2022 green book related to corporate and international tax matters are generally consistent with the proposals included in "The Made In America Tax Plan," released by Treasury April 7, 2021 in connection with the Biden Administration's "American Jobs Plan." In general, the most significant proposals would (i) raise the corporate tax rate to 28 percent; (ii) make several changes to GILTI; (iii) repeal FDII and replace with unspecified direct R&D incentives; (iv) replace the BEAT with a new provision called the "SHIELD" (Stopping Harmful Inversions and Ending Low-tax Developments); (v) make the anti-inversion rules more restrictive; (vi) provide tax incentives for locating jobs and business activity in the United States; and (vii) impose a minimum tax on large corporations based on worldwide book income.

The following are notable aspects of the green book proposals that were not described in prior documents released by the Administration:

- Effective dates. The proposals are generally effective for taxable years beginning after December 31, 2021, however –
  - *Corporate rate*: Generally, for taxable years beginning on or after January 1, 2021, but for fiscal year taxpayers, the new rate applies to the portion of the taxable year that occurs in 2022.
  - *Anti-inversion rules*: Effective for transactions completed after date of enactment.
  - *Replace BEAT with SHIELD*: Effective for taxable years beginning after December 31, **2022**.
  - *Limit foreign tax credits for sales of hybrid entities*: Effective for transactions occurring after date of enactment.
- New proposals.
  - *Disallow deductions attributable to exempt (or partially exempt) income*.
  - *Restrict deductions of excessive interest of members of financial reporting groups for disproportionate borrowing in the United States*.
  - *Limit foreign tax credits for sales of hybrid entities*.
  - *Modify foreign oil and gas extraction income (FOGEI) and foreign oil related income (FORI) rules*.
  - *Modify foreign tax credit rules for dual capacity taxpayers*.
- New features of existing proposals.
  - *US taxpayer's foreign branch income would be subject to a per-country foreign tax credit limitation*.

- *Repeal the high-tax exception for subpart F income and the cross-reference to that provision in GILTI.*
- *With respect to the new GILTI, for foreign-parented US MNC groups, take into account foreign taxes paid by foreign parent under OECD Pillar 2 qualified income inclusion rule in determining amount of CFC income subject to US minimum tax inclusion.*
- *With respect to the SHIELD, (1) limit its application to financial reporting groups (FRGs) with more than $500 million in annual revenues; (2) if a FRG has a low-taxed member, (a) disallow deductions not only for payments made directly by a domestic FRG member to low-tax FRG members but also, in part, payments made to non-low taxed FRG members, based on an aggregate ratio of the FRG's low-taxed profits to its total profits; and (b) with respect to payments by the domestic corporation or branch to FRG members for cost of goods sold (COGS), disallow other deductions (including unrelated party deductions) of the domestic corporation or branch, up to the amount of the COGS payment.*

Summary of proposals

The following is a summary of the green book's proposals related to corporate and international tax matters, including proposed effective dates and Treasury's 10-year revenue estimates.

1. **Raise the corporate income tax rate to 28 percent**.
    a. Effective date. Taxable years beginning after December 31, 2021. For taxable years beginning after January 1, 2021 and before January 1, 2022 (i.e., fiscal year taxpayers), the tax rate would be 21 percent plus 7 percent times the portion of the taxable year that occurs in 2022.
    b. Revenue estimate. $857.8B over 10.
2. **Revise global minimum tax regime (GILTI)**. Make the following changes to GILTI (referred to as "global minimum tax inclusion" or **GMTI)**: (i) increase effective tax rate to 21 percent (75 percent of corporate rate); (ii) calculate GMTI on a per-country basis; and (iii) eliminate exemption for 10 percent of QBAI.
    a. GILTI rate. Reduce section 250 deduction for GMTI to 25 percent.
    b. Per-country. Calculate GMTI and foreign tax credit limitation on a jurisdiction-by-jurisdiction basis. *A similar per-jurisdiction approach would apply with respect to a US taxpayer's foreign branch income*.
    c. Repeal the high-tax exception. The high tax exception for subpart F income would be repealed, as would the cross-reference to that provision in GILTI.
    d. Coordination with OECD Pillar 2. Residual US tax on the GMTI inclusion of a foreign-parented US multinational determined by taking into account foreign taxes imposed on the foreign parent under a Pillar 2 qualified income inclusion rule. This would also be determined on a jurisdiction-by-jurisdiction basis.

e. <u>FTC haircut</u>. No proposed change.

f. <u>Effective date</u>. Taxable years beginning after December 31, 2021.

g. <u>Revenue estimate</u>. $533.5B over 10 (estimate includes deduction disallowance and limits on expatriation – see below).

3. **Disallow deductions attributable to exempt income**. Expand application of section 265 to disallow deductions allocable to a class of foreign gross income that is exempt from tax or taxed at a preferential rate – including through the section 250 GMTI deduction and section 245A dividends received deduction. Would also repeal section 904(b)(4).

    a. <u>Effective date</u>. Taxable years beginning after December 31, 2021.

    b. <u>Revenue estimate</u>. Included in reforms to global minimum tax regime, above.

4. **Limit the ability of domestic entities to expatriate**. Would modify the anti-inversion rules of section 7874 in four ways: (i) change the 80 percent shareholder continuity test to a greater than 50 percent test for treating a cross-border business combination as an inversion transaction; (ii) treat any cross-border business combination as an inversion transaction if the fair market value of the domestic entity is greater than that of the foreign acquiring corporation, the combined entity is primarily managed and controlled in the United States, and the combined entity does not conduct substantial business activities in the foreign country in which the foreign acquiring company is created or organized; (iii) expand the scope to include a direct or indirect acquisition of substantially all of the assets of a domestic corporation or domestic partnership, or substantially all of the US trade or business assets of a foreign partnership; and (iv) treat a distribution of stock of a foreign corporation by a domestic corporation or partnership that represents either substantially all of the assets or substantially all of the assets of a trade or business of the distributing entity as a direct or indirect acquisition of substantially all of the assets or trade or business assets of the distributing entity.

    a. <u>Effective date</u>. Generally effective for transactions that are completed after date of enactment.

    b. <u>Revenue estimate</u>. Included in reforms to global minimum tax regime, above.

5. **Repeal deduction for Foreign Derived Intangible Income (FDII) and adopt new R&D incentives**.

    a. <u>Additional details</u>. Repeal deduction for FDII and use resulting revenue to encourage R&D.

    b. <u>New R&D incentives</u>. No details specified – "revenue will be used to encourage R&D."

    c. <u>Effective date</u>. Taxable years beginning after December 31, 2021.

    d. <u>Revenue estimate</u>. $0 ($123.9B over 10 for each, netting to zero).

6. **Replace BEAT with SHIELD**. Repeal the BEAT and replace it with the SHIELD (Stopping Harmful Inversions and Ending Low-Tax Developments), a rule disallowing deductions to domestic corporations or branches by reference to low-taxed income of

entities that are members of the same financial reporting group (FRG). Specifically, such deductions would be disallowed, in whole or in part, by reference to all gross payments made (or deemed made) to "low-taxed members."

a. In general. The gateway for applying the SHIELD to a domestic FRG member is the presence of one or more low-taxed members of the FRG. A "low-taxed member" is any "financial reporting group" (FRG) member whose income is subject to (or deemed subject to) an effective tax rate that is below a "designated minimum tax rate." If the FRG has a low-taxed member, then –

    i. *Application to deductible payments to FRG members*. The SHIELD will apply not only to deductions for payments made directly to FRG low-taxed members in their entirety but also, in part, to deductions for payments made to FRG members that are not low-taxed members, based on an aggregate ratio (described below).

    ii. *Application to payments for COGS to FRG members*. Furthermore, in the case of payments to FRG members that are not otherwise deductible but are for other types of costs (e.g., COGS), the SHIELD will disallow other deductions (including unrelated party deductions) from the domestic corporation or branch member, up to the amount of the payments for other types of costs (COGS). While the green book provides no rationale for including this in-lieu-of rule for COGS, it may be intended to attempt to circumvent constitutional-related issues of directly disallowing a payment for COGS for income tax purposes.

b. Applicable taxpayers. FRGs with greater than $500 million in global annual revenues (as determined based on the group's consolidated financial statement).

c. Definition of "financial reporting group". Any group of business entities that prepares consolidated financial statements (in accordance with US GAAP, IFRS, or other method authorized by Treasury) and that includes at least one domestic corporation, domestic partnership, or foreign entity with a US trade or business.

d. Determination of "designated minimum tax rate". Determined by reference to the rate agreed to under Pillar Two. If SHIELD is in effect before a Pillar Two agreement, the designated minimum tax rate trigger will be the US global minimum tax rate (e.g., 21 percent under green book proposal).

e. Determination of effective tax rate. Based on income earned (aggregate both related and unrelated party income) and taxes paid or accrued with respect to the income earned in that jurisdiction by FRG members.

    i. *Use of financial statements*. Income and taxes are determined based on the members' separate financial statements or the FRG's consolidated financial statements, as disaggregated on a jurisdiction-by-jurisdiction basis.

    ii. *US tax under subpart F and GILTI*. Taxes paid or accrued under subpart F and GILTI would appear to be included in the effective tax rate calculation, assuming they can be identified on a per-jurisdiction basis. Note in the "reasons for change," Treasury implies the SHIELD would not

apply to payments to CFCs ("A comparable rule [to GILTI] that applies to entities that are not CFCs is necessary to ensure that companies cannot avoid a minimum rate of taxation by, for example, inverting to a foreign jurisdiction").

iii. *Treasury authority.* Treasury has authority to provide special rules to (1) address differences (both permanent and temporary) between the relevant income tax base and the base as determined under financial accounting; and (2) account for net operating losses in a jurisdiction.

f. Covered deductions/Amount of deduction denied.

i. *Payments made directly to FRG low-taxed member*. Would be subject to the SHIELD in their entirety.

1. If payment is otherwise deductible, SHIELD applies in its entirety to disallow that payment.
2. If payment is for other types of costs (e.g., COGS), SHIELD applies in its entirety to disallow other deductions (including unrelated party deductions) of the domestic corporation or branch member, up to the amount of the payment for other types of costs (COGS).

ii. *Payments made to other FRG members*. Would be partially subject to the SHIELD. A portion of such payments would effectively be treated as having been made to the low-taxed members of the FRG based on the aggregate ratio of the FRG's low-taxed profits to its total profits, as reflected on the FRG's group consolidated financial statements.

1. If payment is otherwise deductible, SHIELD will apply to the extent of the aggregate ratio to disallow a portion of payment.
2. If payment is for other types of costs (e.g., COGS), SHIELD will apply to the extent of the aggregate ratio to disallow other deductions (including unrelated party deductions).

g. Insurance-related payments. Corresponding provisions would take into account (1) reductions in the gross amount of premiums and other consideration on insurance and annuity contracts arising out of indemnity provisions; (2) deductions from the amount of gross premiums written on insurance contracts during the tax years for premiums paid for reinsurance; and (3) insurance policy claims and benefits accrued and losses paid during a tax year (which would be deductible payments that are within scope of the SHIELD).

h. Additional Treasury authority. Treasury has authority to (1) exempt from SHIELD payments in respect of FRGs that meet, on a jurisdiction-by-jurisdiction basis, a minimum effective level of tax as determined to the satisfaction of Treasury; and (2) 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.

i. Effective date. Taxable years beginning after December 31, 2022.

j. Revenue estimate. $390B over 10.

7. **Provide tax incentives for locating jobs and business activity in the United States and remove tax deductions for shipping jobs overseas**. Would create a new general business tax credit equal to 10 percent of eligible expenses connected to onshoring a US trade or business and disallow deductions for expenses connected with offshoring a US trade or business.

    a. Onshoring. Reducing or eliminating a trade or business outside the US and starting up, expanding, or moving the same trade or business to a location within the US, to the extent it results in an increase in US jobs. Eligible expenses may be incurred by a foreign affiliate, but the credit would be claimed by the US taxpayer.

        i. US territories (Puerto Rico and American Samoa). If they implement this proposal, US will reimburse them for the credits they provide pursuant to a plan.

        ii. Mirror-code territories (Guam, Northern Mariana Islands, USVI). US will reimburse them for credits provided by reason of enactment.

    b. Offshoring. Reducing or eliminating a trade or business conducted inside the US and starting up, expanding, or moving the same trade or business to a location outside the US, to the extent it results in a loss of US jobs. Deduction denial also applies to costs incurred by a CFC in calculating its subpart F income or GMTI inclusion.

    c. Expenses. Applicable expenses limited solely to expenses associated with the trade or business relocation; do not include capital expenditures, severance pay, or other assistance to displaced workers.

    d. Effective date. Expenses paid or incurred after date of enactment.

    e. Revenue estimate. $0 ($112M over 10 for each, netting to zero)

8. **Restrict deductions of excessive interest of members of financial reporting groups for disproportionate borrowing in the United States**. (Similar to a proposal in Obama Administration FY 2017 green book). Would limit the interest expense deduction of member of a "financial reporting group" if the member has net interest expense (for US tax purposes) and the member's financial reporting net interest expense (on a separate company basis) exceeds its proportionate share of the group's net interest expense reported on the group's consolidated financial statements ("excess financial statement net interest expense"). Proportionate share determined based on financial statement EBITDA.

    a. Deduction disallowance. The group member's excess net interest expense is a disallowed deduction. Excess net interest expense is the member's net interest expense for US tax purposes multiplied by the ratio of its excess financial statement net interest expense to its net interest expense for financial reporting purposes.

    b. Excess limitation. If a member's financial reporting net interest expense is less than its proportionate share of the group's financial reporting net interest expense,

a proportionate amount is converted to an excess limitation carryforward for US tax purposes.

c. Alternatively. If the group member fails to substantiate its proportionate share of net interest expense, or makes an election, the member's interest deduction is limited to interest income plus 10-percent of its adjusted taxable income (as defined under section 163(j).

d. Carryforward. Amount of disallowed interest expense can be carried forward indefinitely.

e. Coordination with section 163(j). Whichever allows the lower interest expense deduction applies.

f. US subgroup treated as single member. A US subgroup of a FRG would be treated as a single member. A US subgroup is a US entity not owned directly or indirectly by another US entity, and all members (domestic or foreign) owned directly or indirectly by such entity. Thus, the proposal would generally apply only to foreign-parented FRGs.

g. Coordination with section 265. Where a US subgroup member owns stock in one or more foreign corporations, this proposal would apply before application of section 265.

h. Exception for financial services entities. Proposal would not apply to financial services entities; they would be excluded from the financial reporting group.

i. De minimis exception. Proposal would not apply to financial reporting groups with less than $5 million of net interest expense, in the aggregate, on one or more US tax returns for a taxable year.

j. Effective date. Taxable years beginning after December 31, 2021.

k. Revenue estimate. $18.6B over 10.

9. **Limit foreign tax credits for sales of hybrid entities**. Would apply principles of section 338(h)(16) to determine the source and character of items recognized in connection with a disposition of an interest in a specified hybrid entity and to a check the box election or other change in the classification of an entity not recognized for foreign tax purposes. Thus, source and character determined for foreign tax credit purposes based on what they would be upon the sale or exchange of stock (without regard to section 1248).

   a. Effective date. Transactions occurring after date of enactment.

   b. Revenue estimate. $436M over 10.

10. **Modify foreign oil and gas extraction income (FOGEI) and foreign oil related income (FORI) rules**. Would (i) repeal the exemption from GILTI for FOGEI, (ii) amend the definition of FOGEI and FORI to include income derived from shale oil and tar sands activity.

    a. Effective date. Taxable years beginning after December 31, 2021.

    b. Revenue estimate. $84.8B over 10.

11. **Modify foreign tax credit rules for dual capacity taxpayers**. Would limit the amount of a foreign levy paid by a dual capacity taxpayer that is treated as a creditable foreign tax to the amount that does not exceed the foreign levy that the taxpayer would pay if it were not a dual capacity taxpayer (codifying the safe harbor included in current regulations and making it the sole method for determining the creditable portion of the levy). The proposal would yield to treaty obligations to the extent that they allow a credit for taxes on certain oil or gas income.
    a. Effective date. Unless otherwise specified, taxable years beginning after December 31, 2021.
    b. Revenue estimate. $1.4B over 10.
12. **Book minimum tax**. Impose 15 percent minimum tax on large corporations' worldwide book income, allowing credits for (i) general business credits (including R&D, clean energy and housing tax credits); and (ii) foreign tax credits. Applies to companies with book income of $2 billion or greater.
    a. Book tentative minimum tax. Taxpayers would calculate book tentative minimum tax equal to 15 percent of worldwide pre-tax book income (calculated after subtracting book net operating loss deductions), before application of credits.
    b. Book tax credit. A credit for the amount of positive book tax liability (i.e., book tentative minimum tax in excess of regular tax liability) can be claimed as a credit against regular tax in future years, limited by book tentative tax liability in that year.
    c. Effective date. Taxable years beginning after December 31, 2021.
    d. Revenue estimate. $148.3B over 10.