

US International Tax Reform and Pillar Two

Interconnected Destinies

GUESTS

Michael Lebovitz
John Rienstra

Mayer Brown LLP
IBFD North America

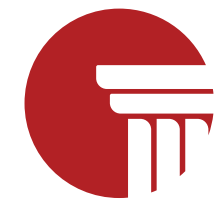


10 February 2022



IBFD, Your Portal to Cross-Border Tax Expertise

Agenda



IF Agreement On the Two Pillars



The BBBA and Pillar Two



Other Important BBBA Changes

Agenda



IF Agreement On the Two Pillars



The BBBA and Pillar Two



Other Important BBBA Changes

The IF Agreement – How we got here

- 20-plus-year attempt to tax the digital economy
- No movement on BEPS Action 1
- OECD Two-Pillar Initiative – recognition that some profit needs to be allocated to a market jurisdiction
- Definitional challenges and delays spur rise of DSTs and trade disputes
- Biden administration suggests change of focus from “digital” to size and profitability
- Change of US administration renews optimism that global deal could be reached – retraction of safe-harbour concept

The IF Agreement – How we got here

- 13 October, 2021 – G20 endorses IF agreement
- 20 December, 2021 – OECD releases model Pillar Two rules
- 22 December, 2021 – European Union proposes Pillar Two implementation Directive
- Entry into force targeted for 2023

Pillar One

- New taxing right enabling market countries to tax a portion of premium profits earned by largest and most profitable MNEs
- Scope:
 - Annual average revenue > €20 billion
 - Profit margin > 10%
 - Expected that 100 MNEs fit this profit
- Nexus – MNE generates at least €1 million sales (special rules for LDCs)
- Quantum – allocable portion of 25% of residual profit above 10% base
- DSTs and equivalent taxes (DPT?) are eliminated

Pillar Two

- The IF adopted Pillar Two in essentially the same form as the October 2020 Blueprint
 - Income inclusion rule
 - Undertaxed payment rule
- Agreed 15% global minimum tax rate
 - Subject-to-tax rule set at 9%

Implementation Outlook in the United States

- Pillar 1 requires statutory and treaty changes to implement
- Pillar 2 requires statutory changes
- Treaty changes require two thirds of the vote in the Senate
- Statutory changes require Congress to agree
- Bipartisan consensus to remove DSTs, but this consensus is hampered by legislative gridlock

GILTI Coexistence and BEAT Changes

- The IF agreed that consideration will be given to whether GILTI will “coexist” with Pillar Two
- GILTI already functions as an IIR but does not fit squarely within Pillar Two model rules
 - Effective tax rate
 - Jurisdictional blending

Poll Question 1

Question

Do you expect that Pillar Two rules will be in force in 2023?

A Yes

B Yes, if the United States can get its act together

C No - European Union implementation will be delayed

D No - Developing country concerns will derail Pillar Two

Agenda



IF Agreement On the Two Pillars



The BBBA and Pillar Two



Other Important BBBA Changes

The Build Back Better Act – Lessons of Icarus

- May 2021 – Initial ambition – Green Book – \$3.5 trillion in spending
 - Increase in corporate rate to 26%
 - Increase individual rate
 - Wealth tax
- October 2021 – Reality sets in – \$1.75 trillion in revised BBBA
 - Book income AMT
 - High income surtax
- November 2021 – House passes BBBA, bill moves to Senate
- December 2021 – Senator Manchin announces he will not support BBBA
- January 2022 – Biden regroups, will split up BBBA into Build Back “Something”
- April 2022 – Easter Recess
- May 2022 – Memorial Day Recess
- November 2022 – Midterm elections

GILTI Conformity

- GILTI changes included in BBBA to conform to Pillar Two
- Effective tax rate on GILTI is below 15% agreed minimum rate
 - Current rate is 10.5% (net GILTI inclusion reduced by 50% deduction for corporate taxpayers)
 - Rate increases to 13.125% in 2026
 - 80% credit for foreign taxes paid on GILTI inclusion with no C/F or C/B
 - 13.125% cross-over rate
- BBBA would increase GILTI rate to 15.015% by reducing GILTI deduction to 28.5%
 - FTC increased to 95% with C/F depending on year
 - Cross-over rate would increase to 15.805%

GILTI Conformity

- Jurisdictional blending
 - Currently, GILTI is calculated at the US shareholder level so that the GILTI inclusions of all CFCs are aggregated
 - This allows GILTI losses to offset GILTI income to determine a net GILTI inclusion
- BBBA would calculate GILTI on a country-by-country basis with no offsetting of profits and losses
 - GILTI losses at country level carried over by country
- Foreign tax credits on GILTI would also be calculated on a per-country basis
- Changes effective for tax years beginning after 31 December 2022

BEAT Changes

- BEAT currently functions as a minimum tax
- 10% tax on taxable income adjusted by removing deductible payments to related parties
 - 10% rate currently scheduled to increase to 12.5% in 2026
- Applicable to taxpayers with:
 - Average gross receipts of at least \$500 million, and
 - Base-eroding payment of at least 3% of total deductible payments
- BBBA changes to BEAT:
 - Rate increased to 12.5% in 2023, 15% in 2024 and 18% in 2025
 - Elimination of 3% floor
 - 10 year taint if considered an applicable taxpayer
 - Expanded definitions of base-eroding payments

BEAT Changes

- Converting BEAT to a STTR
 - Currently a payment is not a BEAT payment if it is subject to full 30% withholding tax
- BBBA expands this significantly by providing that a payment is not a base-eroding payment if it is subject to tax in the hands of the payor or payee at the applicable BEAT rate:
 - If the payment is subject to tax in the hands of the recipient equal to the lesser of 15% or the applicable BEAT rate
 - If the payment is included in GILTI income (without regard to GILTI deduction)
- BBBA changes will essentially eliminate application of BEAT on payments to US CFCs

Foreign Tax Credit Changes – Back to 1976

- General concept – FTC limited to equivalent amount of US tax on foreign source income
- The application of the FTC limit has changed over the years
 - Overall limitation
 - Per-country limitation
 - Baskets based on type of income
 - Every change in law creates substantial complexities
- BBBA would revert to a per-country limitation
 - FTC limit tested at the taxable unit level
 - General basket and passive basket retained
 - Branch basket eliminated
- Effective for taxes paid after 31 December 2022.
- Consider application of attribution concept in recently finalized FTC regulations

Impact on Pillar Two

- BBBA changes would generally conform GILTI to Pillar Two
- Changes would also make BEAT function more like an STTR
- Changes timed to coincide with Pillar Two effectiveness
- Practical deadline of April or May 2022 to pass BB
“Something”
- All relevant parties “cautiously optimistic”
 - United States was impetus behind Pillar One agreement
 - Impact on implementation of EU Directive
 - Impact on UK consultation
 - Does failure to pass BBBA stall further work on Pillar One?
 - If Pillar One work is delayed, what is the impact on DST repeal/proliferation
 - Developing country concerns

Poll Question 2

Question

What happens if major countries do not implement Pillar Two?

- A** DSTs will proliferate
- B** Pressure will mount for global formulary apportionment
- C** Developing countries will suffer
- D** All of the above
- E** None of the above

Agenda



IF Agreement On the Two Pillars



The BBBA and Pillar Two



Other Important BBBA Changes

Other Notable Changes in BBBA

- Corporate Alternative Minimum Tax
- Foreign-Derived Intangible Income
- Interest Deduction Limitation
- Foreign Dividend Deduction
- Portfolio Interest Exemption

Corporate Alternative Minimum Tax

- New 15% AMT imposed on financial income
- Applies if exceeds regular tax + BEAT
- Computed based on adjusted financial statement income (AFSI)
- Applies to US corporate groups with AFSI > \$1 billion (3-year average)
- Applies to foreign-parented groups with:
 - Global AFSI > \$1 billion; and
 - US AFSI > \$100 million

Foreign-Derived Intangible Income (FDII)

- Current law permits FDII deduction of 37.5% (21.875% after 2025)
- Applies to income received by US corporations from sale or licence of intangible property to foreign persons and income from the performance of services to foreign persons, or with respect to property, not located in United States
- BBBA proposal to reduce FDII deduction to 24.8%
- Results in tax rate increase on FDII from 13.125% to 15.8%
- BBBA also proposes to modify categories of eligible income

New Interest Deduction Limitation

- Interest deduction cap for members of international financial reporting groups
- Deduction limited to 110% of allocable share of worldwide interest
- Allocable share based on proportionate share of EBIDTA (United States vs. Worldwide)
- Applies if net interest expense is > \$12 million (3-year average)
- Current limitation of 30% of adjusted taxable income (EBIT) continues to apply
- Lower of two limitations will apply
- Disallowed interest expense can be carried forward

Foreign Dividend Deduction

- Current law permits 100% deduction for foreign-source dividends
- Applies to dividends received by 10% US shareholders of specified foreign corporations
- BBBA proposal to limit deduction to dividends paid to US shareholders of CFCs

Portfolio Interest Exemption

- Current law provides US tax exemption for portfolio interest
- Applies to creditors who own $< 10\%$ of the paying corporation's voting shares
- BBBA proposal to disallow exemption if creditor holds $\geq 10\%$ of shares by either vote or value

Poll Question 3

Question

Which of the following proposals discussed in today's presentation is projected to raise the most tax revenue for the US Treasury:

- A** GILTI Revisions
- B** BEAT Revisions
- C** Corporate Minimum Tax
- D** FDII Revisions
- E** Interest Deduction Limitation

Thank **you** for your attention!