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President Biden's "Made in America Tax Plan" and proposed changes to US tax law for multinationals

On 7 April 2021, the Biden administration published the Made in America Tax Plan ("**MAT Plan**"), part of the newly announced American Jobs Plan, the goal of which is "*to make American companies and workers more competitive by eliminating incentives to offshore investment, substantially reducing profit shifting, countering tax competition on corporate rates, and providing tax preferences for clean energy production*".

This newsflash provides a high level overview of the proposed changes to US tax law for multinationals and the US' shift in stance on the efforts of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (hereafter, for ease of reference, the "**OECD**") to overhaul international corporate taxation. The overview is predominantly tailored to non-US tax professionals with an interest in, but a basic understanding of, the US corporate tax system.

Whilst the MAT Plan is very much a work in progress and the proposals are likely to be subject to further modification, tax managers and advisers of US multinationals and non-US multinationals operating in the US, are well advised to consider the potential impact of the proposed changes. Significant reforms are on the horizon.

EXECUTIVE SUMMARY

- The MAT Plan lays the foundation for an ambitious overhaul of the US tax code. The most important takeaways from the MAT Plan are the following:
  - An increase of the US corporate income tax rate from 21% to 28%.
  - Bolstering the US CFC regime (GILTI) by (i) increasing minimum tax rate on foreign income to 21%, (ii) ending the exemption from CFC pickup for the deemed return of 10% on foreign tangible assets and (iii) calculating the CFC pickup on a per-country basis rather than the current global basis (allowing blending of high and low tax countries).
  - Replacing the BEAT regime by SHIELD, which aims to deny tax deductions in the US on payments made to related parties that are subject to a low effective tax rate. This rate is proposed to be set at 21%, unless consensus is reached on a global minimum rate (OECD's Pillar Two) prior to SHIELD becoming effective.
  - Revoking the FDII regime in full, which regime essentially provided a beneficial US effective rate on income derived by US companies from the selling goods and services abroad.
  - The introduction of minimum tax of 15% on book income (likely US GAAP) for the for highly profitable US companies that report a net income of USD 2 billion or more, which would function as a "top-up tax".
- At the same time, the US has dropped the reluctant position on the BEPS 2.0 project as taken by the Trump administration. Instead, it is assuming an active role and has sent a position paper to the Steering Group of the OECD in which a heavily modified Pillar One proposal is put forward. This position paper has clear links to the MAT Plan and states that Pillar Two cannot be successful absent Pillar One. Since the US intends to apply its own global minimum tax rate of 21% in case no consensus is reached on a different global minimum rate, the US is effectively pushing the OECD to reach consensus swiftly.
- Interesting times are ahead for the international tax landscape and much is still in flux. It is however clear that much more can be expected in the coming months, where both the Pillar One and Pillar Two proposals will receive the active weigh in from the US. The US will likely attempt to align those proposals as much as possible to the current US policy intent and the US tax code that comes to be. Looking at the MAT Plan, which for instance does not contain meaningful exceptions for "active income" in its revised GILTI CFC proposal and aims to apply its regime on a per-country instead of global blended basis, this may result in certain countries (offering special tax regimes) and industries (e.g. IT and MedTech/Pharma) being heavily impacted.

INTRODUCTION

On 31 March 2021, the Biden Administration released an outline on the "American Jobs Plan", a USD 2 trillion proposal for a broad range of infrastructure spending, production of clean energy, the care economy and various matters. To finance the significant investments described in the American Jobs Plan, the White House is again proposing significant changes to the US tax code through the MAT Plan, further details on which were published on 7 April 2021.

It is estimated that the MAT Plan will fully pay for the investments in the American Jobs Plan in the next 15 years.

According to House Speaker Nancy Pelosi, the target date for passing the plans is 4 July 2021.

SUMMARY OF PROPOSED CHANGES IN THE MAT PLAN

The Tax Cuts and Jobs Act ("**TCJA**") introduced by the Trump administration in 2017 brought sweeping changes to the US tax code. Generally, the TCJA significantly lowered the effective corporate income tax rate in the US, with the aim to have US multinationals invest more in the US and to discourage them moving profitability and jobs overseas. However, at least to a certain extent, the measures introduced by the TCJA did not result in the desired effect, and tax bills of many US multinationals ended up even smaller than anticipated.

According to the Biden administration, the TCJA made an already unfair tax system worse. The average effective tax rate for the largest US multinationals was slashed in half and a number of new provisions functioned contrary to their policy intent and created incentives to shift profits and jobs overseas. The MAT Plan aims to reverse this damage and fundamentally reform the way the US tax code treats US companies and large US multinationals.

Federal corporate tax rate increase

» An increase of the Federal corporate tax rate from 21% to 28%.

Strengthening US CFC-regime (GILTI)

» The global intangible low-taxed income ("**GILTI**") regime is intended to approximate the income from intangible assets held abroad and to tax that income in the US. The current GILTI regime can roughly be explained as follows:
  - A US company must include GILTI in its gross taxable income annually;
  - GILTI is calculated as the total "active" income earned by a US company's foreign affiliates that exceeds 10% of their "foreign depreciable tangible property" ("**QBAI**"). In other words, there is an exemption in an amount of 10% of QBAI;
  - A US corporation can deduct 50% of the GILTI and claim a foreign tax credit for 80% of foreign taxes paid or accrued on GILTI;
  - Therefore, if the foreign tax rate is zero, the effective US tax rate on GILTI is 10.5% (50% of the regular 21% tax rate);
  - If the foreign taxes are equal to or higher than 13.125%, no additional US tax should in principle be due after the 80% foreign tax credit.

» The GILTI regime arguably incentivizes offshoring activities and the shifting of profits abroad:
  - GILTI is taxed at approximately half of the ordinary corporate tax rate;
  - Depreciable tangible property was moved or built up abroad, as this increases the tax exemption on the first 10% return on these assets;
  - GILTI is calculated on a global basis (blending GILTI of all foreign affiliates) as opposed to jurisdictional, allowing optimized blending of high and low-tax income to avoid the GILTI pick-up or keep it at a minimum.

» The MAT Plan aims to discourage offshoring through fundamental changes to the GILTI regime, by:
  - increasing the GILTI minimum tax from 10.5% to 21%;
  - ending the exemption for the first 10% return on QBAI; and
  - applying the GILTI minimum tax on a per-country basis instead of a global blended basis.

Repealing tax preferences on income derived from export (FDII)

» The foreign-derived intangible income ("**FDII**") rules operate in tandem with the GILTI rules. Where GILTI was originally intended as the stick, FDII's could be characterized as the carrot.

» The FDII regime is intended to approximate income from the sale of goods and services abroad attributable to intangible assets held in the US and to subject that income to a lower effective tax rate. As such, a US company's export income categorized as FDII is subject to a reduced effective rate of 13.125% rather than the regular 21%, in order to stimulate US companies to export goods and services whilst keeping IP within the US. However, especially combined with GILTI, FDII did not turn out to be an effective way to incentivize new domestic investment in R&D, since:
  - the reduced FDII rate only applied to export income that exceeds a 10% return domestic tangible assets (QBAI) held by the US company (i.e. an incentive to reduce the tangible US assets); and
  - it provides large tax breaks to companies with excess profits derived from already existing IP.

» The MAT Plan repeals FDII in full, where the freed-up funds may be used to expand targeted R&D investment incentives.

Stricter rules on base eroding payments (replace BEAT by SHIELD) and inversions

- The Base Erosion and Anti-Abuse Tax ("**BEAT**") attempts to reduce the shifting of profits to low-tax jurisdictions and can roughly be explained as follows:
  - In scope of BEAT are large multinational companies with average gross receipts of more than USD 500 million, that make base eroding payments to related companies, which payments exceed 3% of the overall deductions. Base eroding payments are, for instance, interest and royalty payments, but – importantly – COGS are not in scope.
  - If in scope, the company must first calculate its regular US tax due at the ordinary 21% rate.
  - The amount due under the ordinary rules must then be compared with the amount due under BEAT, which in essence implies that the company should add back to its ordinary taxable basis its base eroding payments and multiply this broadened basis with the BEAT rate of 10%.
  - If the regular tax amount is lower than the BEAT amount, then the company must pay the regular tax plus the amount by which the BEAT exceeds the regular tax (essentially a top-up tax).

- The BEAT has been relatively ineffective and remained well behind its forecasted revenue projections, largely caused by the COGS exception and the 3% threshold.

- The MAT Plan aims to replace the BEAT with new rules under the title SHIELD (Stopping Harmful Inversions and Ending Low-tax Developments).
  - SHIELD denies multinational companies US tax deductions on payments made to related parties that are subject to a low effective rate of tax.
  - The low effective rate of tax would be defined by reference to the rate agreed upon in a multilateral agreement with the OECD (i.e. OECD's Pillar Two proposal, the rate of which has not been determined yet);
  - SHIELD resembles the OECD Pillar Two undertaxed payments rule ("UTPR"), which is a deduction limitation on all types of outbound payments to low-taxed foreign group companies;
  - However, if SHIELD becomes effective before an agreement has been reached with the OECD, the increased GILTI minimum rate would apply, which is currently proposed at 21%. This rate is significantly higher than the rates that are anticipated under the OECD's Pillar Two.

Strengthen anti-inversion regime

- As an additional backstop to SHIELD, the MAT Plan aims to strengthen provisions aimed at preventing US companies from inverting.
- Under the proposal, a foreign acquiring company would continue to be treated as a US company if either (i) 50% or more of the existing US shareholders continue to own the post-inversion non-US company (as opposed to the current 80%), or (ii) if the post-inversion non-US company is managed and controlled in the US. Since the US has always determined a company's residence based on its place of incorporation, this would constitute a significant departure from its existing tax residency principles.

Minimum Book Tax

- The Biden administration proposes to introduce a new domestic "Minimum Book Tax" for highly profitable US companies that report net income of USD 2 billion or more.
- Under this proposal, these companies would pay a minimum tax of 15% on their book income (likely US GAAP), which is the profit such companies generally report to their investors. The tax would effectively function as a "top-up tax" where the difference between 15% of the net book income less the regular tax liability would due. Based on historic figures, it is estimated that about 45 US companies would have paid a minimum book tax liability under the MAT Plan.

Other reforms

- The MAP Plan also proposes to eliminate subsidies, loopholes, and special foreign tax credits available to the fossil fuel industry and to replace them with targeted incentives for clean energy production and to strengthen the enforcement against companies to address corporate tax avoidance, by increasing the IRS' funding and resources.[1]

[1] These proposals are not further addressed here

FORWARD LOOKING REMARKS – THE US TAKES THE REINS INTERNATIONALLY

The TCJA that was adopted in 2017 resulted in a significant decrease of the effective US tax rate of large US multinationals, and moved the US away from its former worldwide tax system to a territorial one.

On the other side, the global tendency of multinational companies making excessive profits and not paying their "fair share" of taxes was growing. The OECD's Inclusive Framework, which currently brings together 139 jurisdictions to collaborate on the implementation of the BEPS Package, made significant progress on their proposals on addressing the tax challenges arising from the digitalization of the economy ("**BEPS 2.0**"), with the aim to increase corporate taxes globally.

The BEPS 2.0 project, which began early 2019, consists of Pillar One and Pillar Two. The Pillar One proposal focuses on new nexus and profit allocation rules for highly digitized business models generating excess profits, whereas the Pillar Two proposal aims to establish a set of rules that ensure that profits of multinationals are subject to a global minimum rate of tax ("**GloBE**"), to reduce tax competition between jurisdictions and address any remaining BEPS opportunities.

The Trump administration took a reluctant position on the BEPS 2.0 project. Pillar One should not be mandatory, but multinational companies should rather have the choice to have Pillar One apply to them (the so called "safe harbor" approach). On Pillar Two, the position was taken that there should be grandfathering rule ensuring that the US GILTI regime is considered acceptable under the proposed GloBE minimum tax rules. Since the OECD is a consensus based organization, these positions from the US significantly complicated the process and the chance of reaching a meaningful consensus. This in turn increased the risk of more countries taking unilateral measures, and for other economic blocks such as the EU to adopt measures of their own.

In the past months, the Biden administration has taken a surprise move by shifting the US' stance on these topics. Instead of resisting the global trend and complicating a path to global consensus, it is rather reengaging with the OECD. As the biggest economy in the world, the US will be better positioned to model global consensus in a way that is ultimately beneficial to the US by having an active seat at the table.

On 26 February 2021, US Treasury Secretary Janet Yellen notified the OECD that the US dropped aforementioned safe harbor approach and affirmed that the Biden administration is committed to reaching global consensus on Pillar One.

However, as could be expected, the US is not sitting idly by and is assuming an active leadership role.

On 8 April 2021, the US sent a presentation to the Steering Group of the OECD, which has clear links to the MAT Plan, in which they propose a heavily modified approach to Pillar One. The amendments are aimed at these rules becoming simpler and applicable to all types of businesses, rather than businesses that sell automated digital services or consumer facing businesses. In effect, less than 100 multinationals would be targeted under the US' Pillar One proposal, as the US allegedly targets a minimum in-scope revenue threshold of USD 20 billion[2]. The presentation also notes that a binding non-optional dispute prevention and resolution process is a key aspect of Pillar One (which is a difficult pill to swallow for many OECD/Inclusive Framework jurisdictions) and made it quite clear that the US cannot accept any result that is discriminatory towards US companies, which is a much heard concern of the OECD Framework Pillar One proposal. The US also emphasizes the importance of a "rollback" of all relevant unilateral measures, which need to be specifically identified as part of any agreement. Finally, the presentation made clear that Pillar Two cannot be fully successful absent Pillar One. Since the US has included in its SHIELD proposal that the applicable minimum US tax rate will be 21% in case no consensus on Pillar Two is reached, the US is effectively pushing the OECD to reach consensus before SHIELD becomes law.

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[2] Raffaele Russo, "*60 Years Later: Wishes Coming True*", 21 April 2021.