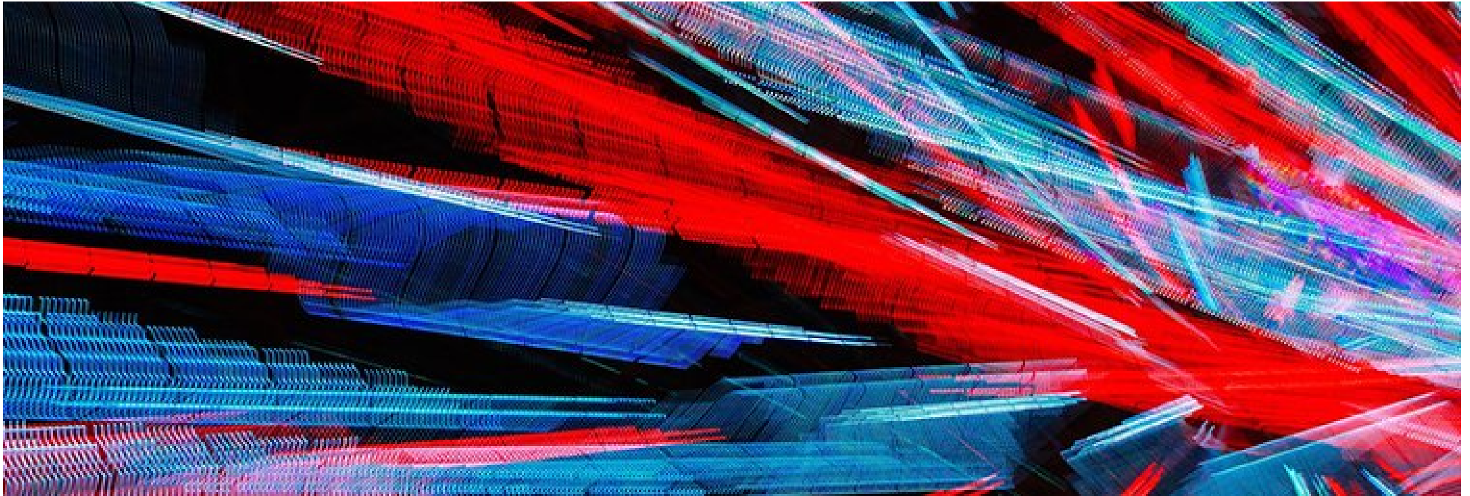

Senators Wyden, Brown and Warner release draft legislative language on international tax proposals

Global Tax Reform Alert

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On August 24, 2021, Senate Finance Committee members Ron Wyden (D-OR), Sherrod Brown (D-MA) and Mark R. Warner (D-VA) released a discussion draft (the Discussion Draft) providing additional details on their international tax reform proposal (the Framework, released on April 5, 2021).

The Discussion Draft constitutes the first round of draft legislative language released in connection with international tax proposals currently being considered by Congress and the Biden Administration. As described in the Senate Finance Committee press release, the Discussion Draft seeks to "overhaul international taxation and invest in America by ensuring mega-corporations pay their fair share."

1. **GILTI no more**

The Discussion Draft would modify the name of the regime to "Net CFC Tested Income," presumably as a result of the proposed elimination of the QBAI exclusion (ie, absent adjustments for QBAI, the GILTI calculation arrives to the inclusion amount – its final step – once Net Tested Income is determined).

Country-by-country determination of low-tax and high-tax income

Under the Discussion Draft, Net CFC Tested Income would be calculated by excluding "High-Tax Tested Income" (HTTI).

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HTTI would generally be tested income subject to a foreign effective tax rate greater than the maximum US corporate tax rate adjusted by the Section 250 deduction (eg, if the Section 250 deduction is 25 percent for a taxable year and the US corporate tax rate is 28 percent, then the tested income would be HTTI if subject to a foreign effective tax rate in excess of 21 percent).

The foreign effective tax rate is determined on a "tested unit" basis, defined in a similar manner as tested units within the GILTI high-tax exclusion regulations, and only considering foreign taxes attributable to amounts taken into account in determining tested income or loss. Further, for these purposes, the foreign taxes may be subject to a haircut ranging from 0 percent to 20 percent.

Whether income is HTTI is determined on a country-by-country basis. All separate tested units within the same CFC and in the same country would be aggregated into a single tested unit. Additionally, all tested units in the same country that are members of the same expanded affiliated group would be aggregated into a single tested unit. This aggregation should generally lead to all the operations in a country treated as a tested unit, creating a country-level determination for HTTI. The same aggregation approach also applies for losses. Income that is treated as HTTI is excluded from GILTI and may be repatriated tax free if the requirements of section 245A are met.

Foreign tax credit modifications

The status of the GILTI foreign tax credit haircut remains under consideration, with the Discussion Draft emphasizing that the haircut could be anywhere from 0 percent to 20 percent. Consistent with the country-by-country limitation discussed above, only taxes paid in countries that are neither high-tax nor in a loss position are creditable.

Adjustments for timing differences

The Discussion Draft included a placeholder to address timing differences. Presumably, this placeholder is in response to taxpayers' commentaries that adjustments for timing differences are necessary to lessen the impact of the proposed country-by-country determination.

2. Subpart F

The Discussion Draft would generally conform the treatment of high-tax subpart F income with the proposed treatment of high-tax tested income, including the country-by-country tested unit determination, aggregation rules and loss treatment. Income in the general basket and passive basket would be determined separately. The maximum US corporate rate would be used to determine the newly proposed high-tax exclusion.

Foreign tax credit modifications

The Discussion Draft would extend the foreign tax credit haircut to taxes attributable to subpart F income. The proposed foreign tax credit haircut would also extend to foreign taxes attributable to previously taxed earnings and profits. As with the GILTI haircut discussed above, the extent of the haircut is still to be determined but could be anywhere from 0 percent to 20 percent.

3. Foreign branch taxation

The Discussion Draft extends the high-tax exclusion rule discussed above to foreign branches by enacting new section 139J. Income is treated as high-tax foreign branch income if it is subject to a tax rate greater than the US corporate rate or greater than the highest US individual rate for non-corporate taxpayers. Due to the rate current rate disparity between corporations (ie, 21 percent) and individuals (ie, 37 percent), this bifurcated treatment would result in certain items of branch income being excluded for corporate taxpayers, but subject to tax for individual taxpayers. It is unclear whether making a section 962 election could eliminate this disparity.

The high-tax foreign branch exclusion would also be tested at the country level, with branches in the same country being aggregated and foreign tax credits potentially subject to a haircut. Where the high-tax foreign branch exclusion differs from the GILTI and subpart F is the treatment of branch losses. Branches that have losses would not be treated as creating high-tax foreign branch income. However, no foreign tax credits would be allowed for foreign branches with losses.

Further, the definition of "foreign branch" would be broadened by removing the requirement to be treated as a "qualified business unit" (as defined in section 989).

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4. **R&E and stewardship expense allocation**

Stewardship and R&E expenses conducted in the United States would be allocated entirely to U.S. source income where those activities are conducted in the United States. This is a taxpayer-favorable provision as it would generally increase the taxpayer's capacity to benefit from foreign tax credits.

5. **FDII**

The Discussion Draft proposes to replace the FDII regime with a deduction for "Foreign-Derived Innovation Income" based on a percentage of certain expenses rather than income. The relevant expenses are qualified research and development expenses (as defined in section 904(b)(5)) and qualified worker training expenses. Applicable percentages are still to be determined. The Section 250 deduction for Net CFC Tested Income and FDII is expected to be equalized, the applicable deduction is yet to be determined.

6. **BEAT**

The Discussion Draft proposes to add a second, higher rate of taxable income to BEAT in determining base erosion tax liability. The higher bracket would apply to "base erosion income," which is an amount of income considered in determining modified taxable income. The applicable percentage for base erosion income has yet to be determined.

Regular taxable income, excluding base erosion income, would remain subject to the 10 percent rate in the BEAT calculation. Section 38 domestic credits would be allowed under the proposal. Further, the Discussion Draft anticipates the intention to incorporate SHIELD principles into the BEAT.

7. **Effective date**

The proposal would be effective prospectively from the date of its enactment.

Learn more about this evolving discussion by contacting either of the authors or your DLA Piper attorney.

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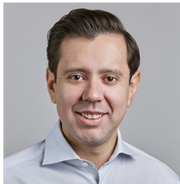

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