Mind the Gap: Observations on the Differences Between the Minimum Tax Under GILTI and the OECD Framework

By Caroline H. Ngo

I am honored to serve as the new Editor-in-Chief of the INTERNATIONAL TAX JOURNAL. The ITJ has long served as a platform for relevant, thoughtful, and insightful articles on international tax and been one of the very best international tax journals. I look forward to working with the Advisory Board and authors to continue the ITJ's commitment to excellence.

This column makes some observations on the differences or the "gap" between the proposed revised GILTI[1] regime as described in the Green Book[2] and the income inclusion rule of Pillar Two[3] described in the OECD/G20 Blueprint.[4]

As background, at the end of May, the Administration released the Green Book, which provided more detail on the Administration's revenue proposals, including estimated revenue impacts on each of the proposals. The Green Book's international tax proposals were mainly expected based on prior announcements from the Biden Administration but there were a few new proposed changes. The Green Book's proposals include:

Proposed changes to GILTI:

- Lower the Code Sec. 250 deduction for GILTI to 25 percent, resulting in a tax rate on GILTI of 21 percent under the proposed corporate income tax rate of 28 percent (expected);
- Apply GILTI on a country by country basis (expected) (and similarly, apply foreign branch rules on a country by country basis (*new*));
- Repeal subpart F and GILTI high-tax exemptions (*new*);
- Eliminate exemption for qualified business asset investment (expected); and
- Expand Code Sec. 265 to disallow deductions allocable to foreign gross income that is exempt from tax or taxed at a preferential rate through a

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TABLE 1.

		Proposed Revised GILTI	OECD Income Inclusion Rule
1.	Tax rate	21 percent	Potentially 15 percent[1]
2.	Timing differences—Carry over losses and excess taxes	No—Use losses and taxes in a current year or lose forever	Yes—Pillar Two "should not impose tax where the low ETR is simply a result of timing differences"
3.	Substance carve out	No—QBAI exemption would be repealed	Yes
4.	Application of expense allocation and apportionment rules	Yes, which can result in effective rates of taxation above the minimum rate	No
5.	Disallow deductions allocable to GILTI inclusion (because income is partially exempt through Code Sec. 250 deduction)	Yes, new proposal in Green Book	No
6.	Haircut of foreign taxes paid	Yes, 20 percent of foreign taxes paid not creditable under GILTI rules	No

[1] *See* below discussion.

deduction (*e.g.*, income eligible for a Code Sec. 245A or 250 deduction) (*new*).

In summary, given that one of the oft-repeated messages is that the proposed changes to the international tax rules would not make the U.S. anti-competitive compared to the rest of the world, the United States should be mindful that the proposed revised GILTI regime is significantly harsher than the proposed minimum tax being negotiated with the United States and the international tax community.

Other international tax proposals:

- Restrict deductions of interest for disproportionate borrowing in the United States, similar to Code Sec. 163(n), which was proposed in, but ultimately left out of, the TCJA (*new*);
- Replace the foreign-derived intangible income regime with research and development incentives (expected, but no details provided);
- Replace the base erosion anti-abuse tax (BEAT) with the stopping harmful inversions and ending low-tax developments (SHIELD) rule (expected);
- Impose a 15 percent minimum tax on book earnings of large corporations (expected); and
- Further tighten anti-inversion rules (expected).

The proposed revised GILTI regime and the proposed income inclusion rule under the OECD/G20 Blueprint have significant differences. The GILTI regime as described in the Green Book is significantly harsher than the minimum tax described in the OECD/G20 Blueprint. The basic differences raise the question as to which, if any, of the differences will ultimately be reconciled through the legislative process. Reconciling differences seems to be a particularly worthy goal given that one of the oft-repeated defenses of the Biden Administration's proposed international tax changes is that the proposed changes would not make the U.S. anti-competitive compared to the rest of the world because the United States and the OECD/G20 are negotiating a comprehensive agreement on minimum taxation. Resolving the differences by adopting the Green Book version in preference to the OECD/G20 version would not achieve this goal.

Below is Table 1 that summarizes a few key differences.

More specifically, first, the proposed tax rate under the GILTI regime is higher than a likely proposed tax rate under the OECD/G20 income inclusion rule. As noted above, the Administration has proposed a tax rate for GILTI of 21 percent.[5] As of July 10, 2021, 131 nations agreed to a global minimum tax of at least 15 percent on a country by country basis, which is a step towards consensus, but does not mean that (as of July 10, 2021) consensus has been reached, on a 15 percent minimum tax. The minimum tax rate previously mentioned in OECD discussions was 12.5 percent.

Second, under current U.S. rules, tested losses and excess taxes do not carry over and thus are lost forever if they are not used in the current year. In contrast, the OECD/G20 Blueprint intentionally addresses timing differences. The OECD/G20 Blueprint states: "The mechanism to address volatility is based on the principle that Pillar Two should not impose tax where the low ETR is simply a result of timing differences in the recognition of income or the imposition of taxes. The [Pillar Two] rules therefore allow an MNE to carry-over losses incurred or excess taxes paid in prior periods into a subsequent period in order to smooth-out any potential volatility arising from such timing differences."

Third, the proposed GILTI rules would eliminate the exemption for qualified business asset investment (often referred to as "QBAI"). In contrast, the OECD/G20 Blueprint has a formulaic substance carve-out, which excludes a fixed return for substantive activities within a jurisdiction from the scope of the Pillar 2 rules. Excluding a fixed return from substantive activities focuses on "excess income," such as intangible-related income, which is most susceptible to BEPS challenges.

Fourth, GILTI applies without threshold limitations and incorporates expense allocation rules in the calculation of foreign tax credits, which can result in effective rates of taxation above the minimum rate. In contrast, under the OECD/G20 Blueprint, expense allocation rules would not apply.

Fifth, the Green Book introduced a new proposal that would disallow deductions allocable to foreign gross income that is taxed at a preferential rate through a deduction (*e.g.*, income eligible for a Code Sec. 250 deduction), which is potentially another tax cost (through the disallowance of deductions) in earning GILTI.

Sixth, the current GILTI rules provide that 20 percent of foreign taxes paid are automatically not eligible for a foreign tax credit. The Green Book does not propose any modification of this rule. Thus, if the proposed GILTI rules were enacted, with respect to GILTI derived in a country with a 15 percent rate of tax, the overall rate of U.S. and foreign tax would increase to 24 percent (15 percent source country tax plus (21 percent U.S. tax rate minus foreign tax credit of 12, after applying the 20 percent haircut)).

In summary, given that one of the oft-repeated messages is that the proposed changes to the international tax rules would not make the U.S. anti-competitive compared to the rest of the world, the United States should be mindful that the proposed revised GILTI regime is significantly harsher than the proposed minimum tax being negotiated with the United States and the international tax community. This effect is certainly well understood by the Treasury negotiators and policy architects.

ENDNOTES

1. GILTI is the acronym for global intangible low taxed income under Code Sec. 951A.
2. General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals (the "Green Book").
3. Pillar One focuses on nexus and profit allocation, in particular, in the context of digital income. Pillar Two focuses on a global minimum tax intended to address remaining BEPS issues. The principal mechanism to achieve this outcome is the income inclusion rule ("IIR") together with the undertaxed payments rule ("UTPR") acting as a backstop. The IIR triggers an inclusion at the level of the shareholder where the income of a controlled foreign entity is taxed below an agreed minimum tax rate.
4. The OECD/G20 Blueprint refers to the OECD/G20 Inclusive Framework on the BEPS project as described in the Blueprint released October 2020.
5. The GILTI rate of 21 percent is based on a 25 percent deduction, keyed off a proposed corporate tax rate of 28 percent. The more likely corporate tax rate may be around 25 percent, given the close margins in Congress and that key Democrats have publicly expressed support for increasing the rate to 25 percent. If the corporate tax rate lands at 25 percent, and assuming arguendo that the proposed Code Sec. 250 deduction stays at 25 percent, the tax rate on GILTI could potentially be 18.75 percent, which is still higher than a likely proposed tax rate under the income inclusion rule.