SENATE COMMITTEE ON FINANCE

"HOW U.S. INTERNATIONAL TAX POLICY IMPACTS AMERICAN WORKERS, JOBS, AND INVESTMENT"

March 25, 2021 – 9:30 AM

OVERVIEW

On Thursday, March 25, the Senate Finance Committee held a hearing on "How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment." During the hearing, Members and witnesses discussed: the Tax Cuts and Jobs Act of 2017 (TCJA), including its global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII) provisions, bonus depreciation, and impact on corporate inversions; the corporate tax rate; tax revenues; competition; tax havens; book profits; exports; pass-through entities; an offshoring penalty surtax; the base erosion and anti-abuse tax (BEAT); domestic manufacturing of antibiotics; the hospitality industry; and tax policy guidance.

OPENING STATEMENTS

- Chairman Ron Wyden (R-OR)
- Ranking Member Mike Crapo (R-ID)

WITNESS PANEL

- Kimberly Clausing, Ph.D. – Deputy Assistant Secretary for Tax Analysis, U.S. Department of the Treasury
- Pam Olson – Former Assistant Secretary for Tax Policy, U.S. Department of the Treasury
- Chye-Ching Huang – Executive Director, The Tax Law Center, New York University School of Law
- James R. Hines Jr., Ph.D. – Richard A. Musgrave Collegiate Professor of Economics and L. Hart Wright Collegiate Professor of Law, University of Michigan

QUESTION AND ANSWER SUMMARY

Tax Cuts and Jobs Act of 2017 (TCJA)

Sen. Bob Menendez (D-NJ) asked if the Tax Cuts and Jobs Act of 2017 (TCJA) shifted tax burdens from corporations to individuals, as well as how this impacts middle class families. Ms. Clausing explained that dramatic cuts to corporate taxes require increasing the relative burden on others in the economy, like households and small businesses, while adding budget pressure on the government. She added that the TCJA's permanent provisions cut corporate taxes, made healthcare more expensive, and changed the inflation indexing of the tax code to result in a stealth tax increase on the middle class.

Global Intangible Low-Taxed Income (GILTI) and Foreign-Derived Intangible Income (FDII)

Chairman Ron Wyden (D-OR) characterized the TCJA as a "backwards system" that incentivizes offshoring. He asked if the law is negatively impacting efforts to increase domestic research and development (R&D) and manufacturing. Ms. Clausing stated the global intangible low-taxed income (GILTI) provision of the TCJA gives larger tax exemptions for offshore assets while the foreign-derived intangible income (FDII) provision provides less generous deductions for domestic assets. She explained these two provisions combined encourage offshoring, adding that recent studies find U.S. companies with the largest GILTI benefits are those with the most foreign investments.

Ranking Member Mike Crapo (R-ID) inquired about the impacts of President Biden's proposal to double the GILTI rate. Ms. Olson stated GILTI allows U.S. companies to compete, thus increasing jobs.

Sen. Pat Toomey (R-PA) asked if GILTI can be characterized as a global minimum tax. Ms. Olson confirmed it can. Sen. Toomey asked if it is true that many countries in the Organization for Economic Cooperation and Development (OECD) do not have this. Ms. Olson stated the U.S. is the only country with a minimum tax while other countries generally have territorial taxes. Sen. Toomey asked if raising this tax would eventually result in companies locating elsewhere. Ms. Olson explained a high rate puts a discount on the value of assets in the hands of a U.S. company, resulting in eventual migration through either acquisition or sales.

Sen. Sherrod Brown (R-OH) asked if a CEO would receive a better tax break from building a new factory in Mexico versus Ohio. Ms. Clausing stated the current tax code allows companies to blend income from two countries to reduce tax rates. Ms. Huang concurred, explaining there are incentives that allow a CEO with tangible assets in Mexico to exempt profits from both Mexico and Bermuda, shielding these from GILTI. She stated this averaging feature makes the U.S. one of the least attractive places for physical assets. Sen. Brown asked what this incentivizes. Ms. Clausing stated having the first 10-percent of offshore assets tax-free means moving equipment abroad qualifies a company for further favorable treatment. She added that the FDII exacerbates this through larger deductions, allowing a company to be "master distiller" of favorable outcomes when operating offshore.

Sen. Mark Warner (D-VA) stated blending rates in GILTI and FDII was "flat wrong." He asked how to incentivize investments in human capital, expressing concern that there are no relevant benefits in tax, accounting or reporting systems. Ms. Huang condemned the TCJA for incentivizing the movement of capital and investment offshore, stating FDII in particular contributes to this result. She advocated for carefully targeted provisions to invest in workers.

Sen. Rob Portman (R-OH) argued GILTI does not incentivize offshoring, and its allowances for Qualified Business Asset Investment (QBAI) recognize that earnings attributed to tangible property are not susceptible to profit shifting. He stated companies headquartered in the U.S. also need locations near their consumers, explaining that 90-percent of sales by U.S. companies' foreign operations are to foreign customers. He asked if the treatment of assets under GILTI is appropriate. Ms. Olson agreed GILTI provisions do not incentivize offshoring and QBAI measures a return on tangible assets abroad. She argued companies do not move overseas due to GILTI but rather try to escape it by either bringing assets to the U.S. or subjecting themselves to Subpart F.

Sen. Portman stated FDII works with GILTI to provide a deduction for domestic intellectual property (IP) used abroad. He asked if repealing FDII would undermine the attractiveness of the U.S. for locating intangible property, jobs and research. Dr. Hines agreed, contending the repeal of FDII would be a mistake because it encourages companies to locate IP and high-tech assets in the U.S. as well as offers a more competitive tax rate for internationally mobile companies. Ms. Olson stated FDII is an important provision that should be retained. She added that R&D credits also impact where research is done, advocating for the Committee to change the TCJA provision requiring R&D expenditures to be capitalized in 2022.

Bonus Depreciation

Ranking Member Crapo inquired about the impacts of the TCJA's bonus depreciation provisions, highlighting his legislation to make these permanent. Dr. Hines stated bonus depreciation encourages greater investment while benefitting the economy. He acknowledged corporate tax revenues are smaller upon the initial introduction of this measure because deductions are frontloaded, but added this does not mean it is a bad policy.

Corporate Inversions

Sen. Toomey stated corporate inversions stopped almost immediately after the enactment of the TCJA, asking if this was a coincidence. Ms. Olson agreed the two were related. She stated the anti-base erosion rules are more onerous than other witnesses suggested, contending this and amendments to section 163(j) eliminated the movement of headquarters offshore.

Sen. Ben Sasse (R-NE) asked if witnesses agreed that corporate inversions stopped after 2017. Ms. Clausing stated there is evidence that Obama-era regulations contributed to a decline in sizable inversions. Dr. Hine stated the TCJA put a clear end to inversions. He also highlighted "invisible inversions," which take place when U.S. companies lose out on foreign business activity in a way that is difficult to measure.

Corporate Tax Rate

Ranking Member Crapo stated lowering the combined statutory tax rate brought the U.S. more in line with the rest of the world, adding that this is still two points higher than the average rate among OECD countries. He inquired about the impacts of President Biden's proposal to increase the combined statutory rate to nearly 33-percent. Ms. Olson stated this increase would rank the U.S. first among OECD countries, contending this would not be advantageous.

Ranking Member Crapo asked who bears the overall burden of an increased corporate tax rate. Dr. Hine stated economists have not reached a consensus on this, though economic theory insists workers are most impacted. Ms. Olson agreed there is not consensus among economists. Ms. Clausing disagreed, stating most models agree that corporate tax rates impact capital and excess profits instead of workers. She argued many countries with low tax rates have not seen evidence of higher wages for workers. Ms. Huang agreed with Ms. Clausing, adding that any flow through to workers is skewed to higher wage workers such as executives.

Sen. John Thune (R-SD) asked if keeping the U.S. corporate tax rate competitive relative to the rest of the world is an important anti-base erosion measure. Ms. Olson agreed it is important to keep this rate in the ballpark of other countries to encourage domestic investment.

Sen. Steve Daines (R-MT) highlighted Treasury Secretary Janet Yellen's past statements that any increase in the corporate tax rate must be done in the context of a global agreement. He asked if Ms. Clausing agreed. Ms. Clausing stated Secretary Yellen's comments indicate that she is committed to working with other countries, who have a joint interest in addressing low rates. She added that the U.S. also has many advantages that mean the country does not have to match what every country is doing.

Sen. Sasse expressed doubt that the U.S. can achieve a treaty with enough countries to avoid inversions after increasing its corporate tax rate. Ms. Clausing stated there are many strong tools that can be used to encourage cooperation.

Sen. Todd Young (R-IN) asked if a dramatic increase in the corporate tax rate would hurt workers and families, particularly those earning less than $400,000 per year. Dr. Hines agreed, stating higher taxes reduce business activity and the demand for labor. Ms. Olson stated having the top corporate tax rate in the world would be disadvantageous for job creation, adding that there is no indication that other countries would engage in setting a minimum rate anywhere near what has been proposed.

Tax Revenues

Chairman Wyden asked how the U.S. can invest in government priorities such as infrastructure while tax revenues are falling. Ms. Huang stated multinational corporations would benefit from investments in infrastructure, innovation and a skilled workforce, contending that reducing tax subsidies for foreign profits would be a "sound revenue source" for this activity.

Sen. Warner asked how the U.S. can compete with China with such low revenue levels. Ms. Clausing advocated for increasing tax revenue for public investments in infrastructure, stating there is room to increase corporate tax revenues without creating concerns about competitiveness.

Competition

Chairman Wyden asked which tax policies would allow the U.S. to remain competitive on the global stage. Ms. Clausing stated investments in infrastructure, human capital, and crisis response contribute the larger business climate in the U.S. and add to competitiveness.

Sen. Bob Menendez (D-NJ) asked if targeted tax incentives to increase R&D investments are more beneficial to the economy and U.S. competitiveness than a lower corporate tax rate. Ms. Clausing stated it is more important to focus on investing in R&D and infrastructure than to further reduce corporate taxes. Sen. Menendez asked if R&D investments create high-paying jobs and help the U.S. compete with China. Ms. Clausing agreed, stating investments in R&D and education are essential. She added that opening the economy to the talents of the world through immigration and foreign students also contributes to a competitive advantage.

Tax Havens

Chairman Wyden expressed concern about tax havens, asking for an overview of the challenges they pose and what can be done. Ms. Clausing explained U.S. multinationals often invest in high-tax countries due to their strong institutions and workforce, while profits are offshored to low-tax countries. She stated 47-percent of all after-tax profits were in just seven havens in 2017, rising to 51-percent in eight havens in 2018. She added that non-haven countries have a shared interest in tackling this problem and the U.S. can work with them.

Book Profits

Sen. Elizabeth Warren (D-MA) asked what tax rate Amazon paid between 2018 and 2020, when the corporate rate was 21-percent. Ms. Clausing stated the company paid around 4.5-percent. Sen. Warren asked how this is possible. Ms. Clausing explained there are many reasons why companies end up with low tax burdens, including profit shifting, tax credits, reduced liability through past losses, and more. Sen. Warren suggested these activities are better characterized as "loopholes and tax shelters" and asked if this activity is unusual. Ms. Clausing stated this is very common. Sen. Warren suggested applying a flat, 7-percent tax on the profits that companies report to investors. She asked if applying this to corporations that report more than $100 million in profits would help end loopholes. Ms. Huang stated this idea "makes it clear how easy it is for companies to control what they report on paper" whether for tax or financial reporting purposes. She stated the government can either try to make these better reflect reality or target the gap between these reports. Sen. Warren announced she will introduce legislation in coming weeks to create a small tax on book profits.

Ranking Member Crapo asked why looking at financial statements is not a good way to understand what a company pays, asking if R&D tax credits would also be described as a tax loophole. Ms. Olson stated there are many ways to reduce corporate tax receipts, including through various investment credits for R&D or clean energy. She explained financial statements and tax returns are prepared for different purposes.

Exports

Sen. Maria Cantwell (D-WA) asked which tax policies would encourage more U.S. exports. Ms. Clausing advocated for avoiding unnecessary distortions around the location of economic activity, stating the current tax code incentivizes operations offshore.

Pass-Through Entities

Sen. Thune explained pass-through entities are larger players in the U.S. than other OECD countries, asking if comparing the OECD to the U.S. is an "apples and oranges exercise." Ms. Olson agreed, stating the pass-through sector has grown in the U.S. while in other countries it has shrunk. She advocated for taking this into account when analyzing data, stating there are a lot of "apples and oranges" in data on corporate tax receipts.

Offshoring Penalty Surtax

Sen. Thune highlighted candidate-Biden's proposal to add a 10-percent offshoring penalty surtax when U.S. companies buy from an affiliate abroad. He characterized this as a broad tariff that ignores the reality of global supply chains, asking if this kind of surtax would penalize domestically-headquartered companies. Dr. Hines confirmed it would.

Base Erosion and Anti-Abuse Tax (BEAT)

Sen. Menendez stated the base erosion and anti-abuse tax (BEAT) is poorly constructed, expressing concern that it penalizes many businesses for playing by the rules and creating domestic jobs while turning a blind eye to some of the worst base eroders.

Sen. Tom Carper (D-DE) expressed concern that the basic design of the BEAT disincentivizes investments in clean energy projects. He asked why a gap exists between projected and collected revenues from the BEAT, as well as if this should be repealed and re-written from scratch. Ms. Clausing explained the BEAT was intended to target profit shifting and income stripping for foreign direct investment, adding that there were many problems with both the legislation and its implementation. She stated there is ample room for improvement, adding that the Biden Administration has not yet taken a position on reform but is actively studying relevant issues. Ms. Olson stated the BEAT has "odd" effects and could be improved, noting it was the hardest provision to estimate because it was completely novel. She expressed concern that the negative impacts will be exacerbated in future years when it goes from 5 to 10-percent. Ms. Huang described the BEAT as "bizarre," stating it has many holes that result in reduced liability. Dr. Hines indicated the BEAT should not go on.

Domestic Manufacturing of Antibiotics

Sen. Bill Cassidy (R-LA) expressed concern that beta lactam drugs like penicillins and cephalosporins are made entirely in China and do not have a long shelf life. He asked which tax policies would incentivize companies to manufacture medicines domestically. Ms. Olson emphasized the overall corporate tax rate is important, as well as tax credits for R&D. She stated the combined statutory tax rate is still higher than the OECD average, while R&D tax incentives are lower.

Hospitality Industry

Sen. Catherine Cortez Masto (D-NV) asked how Congress can ensure high-paying domestic jobs through the tax code, particularly in the hospitality industry. Ms. Huang advocated for investments that directly support workers and hard-hit industries instead of tax subsidies for offshore investments. She highlighted the boost in the Earned Income Tax Credit through the American Rescue Plan Act of 2021 as a measure that heavily benefits workers, tourism and hospitality.

Guidance

Sen. Cortez Masto asked how Congress can provide better guidance on international tax policy. Ms. Olson advocated for clear instructions for negotiators through a formal mechanism similar to Trade Promotion Authority. She added that any agreement reached at OECD will return to the Senate Committees on Finance and Foreign Relations, encouraging Members to engage in this process.

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Please click here for the archived hearing.