Reforming The Foreign Tax Credit

Abstract:

The foreign tax credit has been a cornerstone of the United States international tax system since as early as 1919. However, there have been a number of recent developments in the international tax landscape that warrant a significant revision to the foreign tax credit rules. In particular, the current global tax deal known as the OECD/G20 Inclusive Framework, Pillars One and Two, may cause the United States to lose significant tax revenue if changes are not made to its domestic tax rules, including the foreign tax credit. Thus far, the United States has shown little political will to implement either Pillars One or Two, but dozens of countries have passed legislation implementing the Pillar Two global minimum tax as early as 2024 or 2025, and many more are poised to do so. Additionally, changes to the foreign tax credit rules as part of the 2017 Tax Cuts and Jobs Act ("TCJA"), as well as new foreign tax credit Regulations (the "2022 Regulations"), have reopened a number of debates and controversies about the operation of the foreign tax credit. These pressure points indicate it may be time for more comprehensive reform of the U.S. foreign tax credit rules.

At a basic level, the current regime allows a credit, up to the U.S. income tax rate, for foreign taxes that are income taxes and that are imposed on foreign source income. One of the main issues raised in the controversy of the 2022 Regulations is the definition of an income tax. To avoid such definitional problems, as well as planning opportunities presented by the current rules, reform proponents have identified several possible options for reform. Among these options are: "grading," or allowing partial credits for different types of taxes; "leveling down", namely eliminating the foreign tax credit and permitting deductions for all foreign taxes of every type (income and non-income) as costs of doing business; "leveling up", making all foreign taxes of every type creditable, even non-income taxes; and "deconstructing," or taking apart each tax into income and non-income parts and crediting only the income tax part. Building on this prior work, this paper argues for the leveling up approach. Given that the international community as a whole is set to adopt new taxes of questionable creditability, U.S.-based MNEs would be left at a significant disadvantage were the U.S. to completely deny creditability to these new taxes. Specifically, this paper argues that the U.S. can maintain the current rate of corporate taxation at 21%, with no deferral, by allowing a deemed paid credit of 15% of worldwide income for any tax paid by a domestic corporation or CFC. The domestic corporation or CFC would not have to demonstrate that the tax was an income tax. For taxes in excess of the 15% rate, the income tax status of the tax would have to be proven. However, a broader definition of income tax would be adopted similar to the definition prior to the adoption of the recent regulations and incorporating certain new taxes under Pillars One and Two.

I. Introduction

The foreign tax credit has been a cornerstone of the United States international tax system since as early as 1919. However, global commerce and the international tax landscape have both shifted dramatically in the century since then. In particular, the last few decades have seen dramatic shifts in terms of the international economy, with the rise of electronic commerce and tech giants such as Google and Apple. At the same time, the current global tax deal known as the OECD/G20 Inclusive Framework, Pillars One and Two, represents challenges and opportunities for taxpayers and governments. Recent estimates suggest that the United States will lose significant tax revenue if changes are not made to its domestic tax rules, including the foreign tax credit rules, if other countries implement the Inclusive Framework.[1] As of this writing, the United States has shown little political will to implement either Pillars One or Two, but dozens of countries have passed legislation implementing the Pillar Two global minimum tax as early as the current year or 2025, and many more are poised to do so.[2]

In recent years, the United States has also carried out some reform of its own international tax rules, in the form of the 2017 Tax Cuts and Jobs Act (the "TCJA"). However, the TCJA did not impact the basic foreign tax credit rules significantly, beyond making conforming changes to address the new global intangible low taxed income ("GILTI") rules, adding a "foreign branch basket" to the limitation rules, and eliminating the section 902 indirect foreign tax credit to make way for its new participation exemption regime. In the wake of these legislative changes, Treasury released new foreign tax credit Regulations (the "2022 Regulations"). However, the 2022 Regulations marked a departure from long-standing practice by imposing a new attribution requirement in addition to the existing realization, gross receipts, and cost recovery requirements for foreign tax credits under sections 901 and 903. The 2022 Regulations also tightened the existing rules governing the creditability of foreign taxes. The new attribution requirement harbors significant potential for denial of creditability if a foreign tax system does not, by its terms (regardless of its substance or implementation), follow U.S. income tax treatment of transactions, including with respect to the sourcing of income, allowable deductions, and application of the arm's-length principle. The 2022 Regulations generated significant concern among business leaders and sparked sufficient controversy that Treasury has now twice issued notices postponing their application. Most recently, Treasury issued Notice 2023-80, continuing relief initially provided by Notice 2023-55, allowing taxpayers to opt to calculate their foreign tax credits under the pre-2022 rules.

The controversy surrounding the 2022 Regulations, as well as the pending implementation of Pillar Two around the globe, are pressure points indicating it may be time for a more comprehensive reform of the U.S. foreign tax credit rules. This Article proposes that the United States maintain its current rate of corporate taxation at 21%, but end deferral and tax all domestic corporations and CFCs on their worldwide income. This would be mitigated by allowing a deemed paid credit of 15% of worldwide income for any foreign income tax paid by a

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[1] STAFF OF THE JOINT COMMITTEE ON TAXATION, POSSIBLE EFFECTS OF ADOPTING THE OECD'S PILLAR TWO, BOTH WORLDWIDE AND IN THE UNITED STATES (2023).

[2] *See, e.g.*, Ernst & Young LLP, *BEPS 2.0 – Pillar 2 Developments Tracker* (Jan. 3, 2024), *available at* https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/tax-pdfs/ey-beps-2-0-pillar-two-developments-tracker.pdf.

domestic corporation or CFC (excluding withholding taxes). The domestic corporation or CFC would not have to demonstrate that the tax was an income tax. For taxes in excess of the 15% rate, the income tax status of the tax would have to be demonstrated. However, a broader definition of income tax would be adopted similar to the definition prior to the adoption of the recent regulations and incorporating the new taxes under Pillars One and Two.

II. The Foreign Tax Credit: Historical Development and Modern Controversies

a. Overview of the Foreign Tax Credit

Code Section 901(b)(1) provides a credit for "the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States." This credit has been available in substantially the same form since the Revenue Act of 1918, and its acknowledged purpose has always been to prevent double taxation. However, to the extent the United States permits a credit for foreign taxes paid, it is essentially subsidizing a foreign country's or territory's tax system. To prevent abuse or excessive erosion of the U.S. tax base, section 904 limits the foreign tax credit based on a taxpayer's foreign source income, such that the maximum credit should never exceed a taxpayer's hypothetical pre-credit liability for U.S. tax on such foreign-source income. The operation of the section 904 limitation has varied over time, as Congress has implemented, revised, and at times removed certain categorical limitations, or "baskets," to limit cross-crediting of certain foreign taxes.

Since each country has its own unique tax system, questions have also arisen as to which levies constitute "income, war profits, and excess profits taxes." While economists have debated the nature and scope of an "income tax" (with the Haig-Simons definition of income used as a baseline by many tax policy experts),[3] every country's economic and political system dictates the scope of its income tax, including the definition of taxable income and the nature of any credits or deductions. Given this reality, Treasury historically approached the definition of an income tax in a flexible manner, as will be discussed in more detail below.

In addition to the credit permitted under section 901, until tax years beginning on or after December 31, 2017, an indirect or "deemed paid" tax credit was permitted under section 902 for foreign taxes paid by a 10-percent-owned foreign subsidiary of a U.S. corporation on income distributed as a dividend to the U.S. corporate shareholder by the foreign subsidiary.

Since 1942,[4] the Code has also permitted a foreign tax credit for certain taxes imposed "in lieu of" an income tax.[5] This provision expands the definition of an income tax to include commonly imposed taxes, such as withholding taxes on the gross income of foreign taxpayers, if the tax is imposed in lieu of a tax on net income where determining net income is administratively burdensome or impractical.

b. Tax Credits and the TCJA

[3] [Add citation].

[4] S*ee* S. Rep. No. 1631, 131 (1942).

[5] I.R.C. § 903.

For over a decade prior to the enactment of the TCJA, pressure had been mounting for international tax reform, and numerous studies and proposals had called for reform to bring the U.S. international tax regime closer in line with those of major U.S. trading partners.[6] Among other things, these reports and proposals, informed by input from taxpayers and expert commentators, noted that the U.S. corporate tax rate, 35% for most large corporations, was among the highest of OECD member states. Further, the United States had long imposed a system of worldwide taxation on its residents, including corporations, in contrast to the territorial system of taxation used by most European countries, as well as major Asian trading partners, which provided a so-called participation exemption to foreign-source dividends paid by certain related parties.[7] Much of this earlier work was incorporated into what became the TCJA, although the exact parameters of the international tax provisions in the TCJA contained some surprises.[8]

Predictably, the TCJA lowered the corporate tax rate, and implemented a new participation exemption regime.[9] In adding a dividends received deduction ("DRD") in section 245A, Congress moved the United States closer towards the territorial tax system in place in many trading partner jurisdictions. Because the DRD allows U.S. corporations to deduct foreign-source dividends received from certain 10%-owned foreign corporations, Congress removed section 902, the former indirect foreign tax credit provision. It was generally thought that section 902 was no longer needed, since taxpayers would be able to deduct from their income the pro rata share of dividends which previously would have included (as a result of section 78 gross-up) foreign taxes paid with respect to that income. However, while the deemed paid credit under section 960 still permits a credit for a pro rata portion of foreign taxes deemed paid with respect to GILTI and Subpart F income, dividends received from foreign subsidiaries that are not CFCs (i.e., which are not owned 50% or more by U.S. shareholders) may still reflect foreign taxes for which no deemed paid credit is allowed.[10]

Additionally, the TCJA enacted a number of other international tax provisions relevant here. First, it implemented the GILTI regime, which imposes a U.S. tax on CFC profits in excess of a 10% return on depreciable assets. GILTI essentially subjects all CFC earnings other than effectively connected income and Subpart F income to current U.S. tax, although the amount is allowed to be reduced by 50% under section 250 for corporations (resulting in an effective rate of 10.5%).[11] 80% of the related foreign income taxes are allowed to reduce the net tax on GILTI, but may not be cross-credited because a separate GILTI basket limits the foreign tax credits to the net GILTI foreign source income.

To further limit cross-crediting, the TCJA, in addition to the GILTI basket, also created the branch basket. Thus, instead of branches being included in the general basket, their income and taxes are now separated, limiting foreign tax credit planning.

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[6] *See, e.g.*, Cong. Rsch. Serv., RL34115, Reform of U.S. International Taxation: Alternatives 1 (2017) (citing several studies and proposals calling for reduction in the corporate tax rate and shift from a hybrid system of worldwide taxation to a territorial system in line with those of major U.S. trading partners, among other changes).

[7] *Id.* at note 2.

[8] [Add citation - there are many - and some explanation].

[9] *See* I.R.C. § 245A. [Add cite to TCJA]

[10] Rebecca Rosenberg, *Partial Repeal of Foreign Tax Credits By the Tax Cuts and Jobs Act: Resulting Behavioral Incentives, Self-Help, and New Mechanics for Some Remaining Portions of the Credit*, 38 Va. Tax Rev. 63, 66 (2018).

[11] I.R.C. § 250(a)(1)(B). The effective tax rate for GILTI is expected to increase in 2026. *See* I.R.C. § 250(a)(3)(B) (reducing the deductible amount from 50% to 37.5% for corporations).

c. GloBE and the Foreign Tax Credit

Even as the United States moved forward with implementing the new international tax rules enacted by the TCJA, it was participating actively in the OECD base erosion and profit shifting (BEPS) project, an effort to address perceived problems with the international tax regime, including common tax planning strategies used by multinational enterprises to exploit gaps and mismatches in tax rules.[12] The first stage of BEPS culminated in 2015 with the release of a final report on 15 agreed-upon actions to address tax avoidance and provide greater coherence and harmonization of tax rules globally. However, in order to further address certain BEPS actions, particularly the challenges raised by the digitalization of the global economy, and to bring more non-OECD-member countries into the discussions, in 2019 the G20 and the OECD launched the Inclusive Framework, which in 2019 launched a two-pillar initiative: the first pillar focused specifically on allocation of taxing rights with respect to digital business, seeking to provide a multilateral approach to supplant the self-help of unilateral digital services taxes being implemented by numerous countries and leading to diplomatic disputes. The second pillar focused on developing a global minimum tax.[13]

While progress has been made on both pillars, agreement on Pillar One in its current form appears unlikely. Both the United States and some developing countries oppose it, and this situation does not appear likely to change.[14] Nonetheless, numerous countries have enacted unilateral digital services taxes (DSTs), which impose tax on certain revenue of large firms that earn income from digital products and services, such as Google and Amazon. DSTs levy a tax on revenue, rather than income, and are thus not traditional income taxes. [Add citation/discussion of nature of DSTs, possibly cite Kim & Shanske.]

[Describe Pillar Two initiatives and taxes.] In spite of some political support in the United States, Congress has so far failed to adopt the global minimum tax provisions. However, over thirty other countries, including major U.S. trading partners, have implemented one or more of the Pillar Two taxes effective in 2024, with many more going into effect in 2025.[15]

d. Challenges to Creditability for Pillar One and Two Taxes

III. Definition of an Income Tax

a. Definition of an Income Tax Under Pre-2022 Rules

The 1983 regulations broadly stated that "a foreign levy is an income tax if and only if—(i) it is a tax; and (ii) its predominant character is that of an income tax in the U.S. sense."[16] The most significant case interpreting the 1983 regulations was the Supreme Court's decision in *PPL*

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[12] *See, e.g.*, OECD, *What is BEPS?*, last accessed May 19, 2024, https://www.oecd.org/tax/beps/about/.

[13] OECD/G20 Inclusive Framework on BEPS, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* (May 31, 2019), https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm.

[14] *See, e.g.*, https://www.ft.com/content/cd88500d-a063-4f15-b6ad-e453a1d8b16d.

[15] [Cite EY or PWC Pillar 2 Tracker?].

[16] Prior Reg. § 1.901-2(a)(1).

Corp. v. Commissioner.[17] At issue in this case was the creditability of a one-time "windfall tax" imposed by the United Kingdom (U.K.) on companies that were privatized by the government between 1984 and 1996. PPL Corp., a U.S. corporation that partly owned a privatized U.K. corporation, sought a foreign tax credit for its share of this tax. The tax used a complicated formula to impute gains embedded in the value of privatized companies, which arguably failed the realization and gross receipts tests of the regulations. However, the Supreme Court focused on the economic substance of the arrangement and held that the tax was creditable, noting that the 1983 regulations codified the holding in *Biddle v. Commissioner*[18] that a "foreign levy is an income tax if and only if…[t]he predominant character of that tax is that of an income tax in the U.S. sense."[19] The Court noted that the 1983 regulations defined "predominant character" of a tax as the normal manner in which a tax applies.[20] Although the windfall tax used a complicated formula, the Court agreed with PPL Corp. that it determined net income, or profit, in the same manner that a U.S. excess profits tax would.[21]

b. Definition of an Income Tax Under 2022 Regulations

IV. The FTC Reform Debate

a. Situate amid other recent proposals

i. General Options: Barry and Kleiman

In a recent article, Barry and Kleiman provide an important overview of the various possible approaches to reforming to the U.S. foreign tax credit regime.[22] One is to broaden the definition of income tax. Another is to employ a technique that the authors call grading, allowing partial credits for specific classes of taxes. A third alternative is leveling, crediting all kinds of taxes, not just income taxes. A final approach is deconstructing, allowing taxpayers to deconstruct taxes into their component parts and then evaluate whether each part is an income tax. The choice of approach will be based on policy preferences of the person choosing. For example, leveling up, allowing creditability for a wider variety of taxes, might appeal to those that want to stress competitiveness of U.S. businesses abroad. Leveling down, only allowing a deduction for every kind of tax, might be preferred by those that want to raise revenue.

The proposal offered by this Article suggests a modified leveling-up approach, allowing a simplified credit for a wider variety of taxes, but also preserving the U.S. tax revenue base by limiting the credit to 15%.

ii. Considerations Related to Book-Tax Differences: Hanna and Wilson

Our proposal also draws on suggestions made by Hanna and Wilson in their 2023 article arguing for a worldwide no-deferral system with a corporate tax rate in the mid- to high-teens, on

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[17] 569 U.S. 329 (2013).

[18] 302 U.S. 573 (1938).

[19] 569 U.S. at 334.

[20] *Id.* at 334-35.

[21] *Id.* at 337-38.

[22] Jordan M. Barry & Ariel Jurow Kleiman, *Rationalizing the Arbitrary Foreign Tax Credit*, 75 TAX LAW REV.1 (2021).

the basis of the new 15% corporate alternative minimum tax on the financial accounting income of the largest corporations.[23] The article stresses that the effect of taxes on financial accounting is a primary driver of U.S. corporations' preferences with respect to tax rates and the structure of taxes.

iii. Flow-Through Income: Peroni, Fleming, and Shay

We also draw on critiques put forth by Peroni, Fleming, and Shay, noting the complexity introduced into the U.S. tax system by efforts to curb deferral.[24] Their article notes that the tension between allowing some deferral but curbing other deferral perceived as inappropriate makes the U.S. international tax system generally, and Subpart F specifically, very complicated. The authors propose a solution of treating each U.S. person (natural or corporate) that owns stock of a foreign corporation as if earned pro rata share of foreign corporation's income and expenses. This proposal would apply Subchapter K in modified form to income from foreign corporations. To determine ownership interest, a formula would have to be developed to account for voting rights, rights to current earnings and accumulated surplus, and the right to share in net assets in liquidation. There are a number of benefits to this approach including simplification of the U.S. international tax regime, elimination of the CFC rules and the rules in Code Sections 902, 956, 960, and 1248, elimination of the PFIC, FPHC, and FIC regimes, decreasing transfer pricing disputes, decreasing stress on Code Section 367 and the inversion rules, decrease stress on choice of entity, and permit fungibility of interest.

b. Policy Considerations

i. Revenue

The Joint Committee on Taxation recently estimated that the implementation of Pillar 2 without adoption by the US would reduce US tax revenue by approximately $122 billion over the next 10 years. https://www.finance.senate.gov/ranking-members-news/jct-us-stands-to-lose-revenue-under-oecd-tax-deal. The proposal in this paper would significantly limit this revenue loss and was determined as follows:

We examined the 2018, 2019 and 2020 Statistics of Income (SOI) corporate foreign tax credit information published by the IRS (Form 1118 data) that allows us to estimate net US tax derived from CFCs.[1] This data includes Subpart F income and GILTI income. Unfortunately, this data also includes deferred Section 965 income from the deemed repatriation provisions of the TCJA introducing potential error in our estimates. We removed the deferred 965 tax from each year based on SOI data found at: https://www.irs.gov/statistics/soi-tax-stats-soi-bulletin-fall-2021. After making the required adjustments for the deferred section 965 income, the residual tax paid on deemed income other than GILTI in 2019 and 2020 was a net refund, possibly because firms are converting high-tax income into Subpart F income to reduce their residual tax on the deemed repatriation tax. Because the deferred section 965 tax potentially altered multinationals' tax planning, we believe that we should ignore Subpart F income in the General basket. We also

[23] Hanna, C. H., & Wilson, C. A., *U.S. International Tax Policy and Corporate America,* 48 J. CORP. L. 261 (2023).

[24] R.J. Peroni, J. Fleming, and S.E. Shay, *Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income*, 52 SMU L. REV. 455 (1999).

ignore Subpart F in the Passive basket because, between 2019 and 2020, the estimated average revenue is less than $1.5 billion.

We are finally left with GILTI which we can accurately estimate at an average of approximately $19 billion over the 3 year period. To calculate this amount, we found the following website https://www.irs.gov/statistics/soi-tax-stats-corporate-foreign-tax-credit-statistics#:~:text=What%20is%20the%20Corporate%20Foreign,source%20income%20of%20U.S.%20corporations. And downloaded table 3. Using 2020 as the example, we located the GILTI row number 16, we started with column D, Inclusions under Sections 951(a)(1) and 951A, and added column F, Foreign dividend income from foreign taxes deemed paid (gross-up) and subtracted column O, Section 250 deductions to arrive at taxable income from GILTI of $240,285,598. We then multiplied that by the corporate tax rate of 21% and subtracted the GILTI FTC, already adjusted by the required 20% reduction (50,459,976 – 32,704,567) for a net GILTI tax of $17,755,408. The potential GILTI FTC of $38,872,515 was larger than the actual FTC claimed meaning the FTC was limited and the excess FTC is lost as it cannot be carried forward or back.

The following table summarizes the increase in US tax revenue. From 2018 – 2020, the US collected average GILTI revenue of $18.804 billion from GILTI. Our proposal would increase the net tax to $27.723 billion following this methodology, and increase of nearly $9 billion annually, largely offsetting the loss in revenue from other countries implementing Pillar 2.

Residual US Tax SOI Form 1118 Data Tax Years 2018 - 2020					
	2018	**2019**	**2020**	**Total**	**Average**
General	76,715,424	679,483	546,350	77,941,258	
Remove 965 Residual	(10,822,221)	(18,265,789)	(18,265,789)	(47,353,798)	
General wo 965 not neg	65,893,204	-	-	65,893,204	21,964,401
Passive	4,774,044	1,523,073	1,072,411	7,369,528	2,456,509
GILTI	15,645,594	23,013,244	17,755,408	56,414,247	18,804,749
Residual US Tax Excl 965	152,208,064	6,952,031	1,110,401	160,264,439	53,421,480
Conclusion, GILTI appears to be the only reliable revenue generator for taxing CFC income as currently designed.					
The general basket appears to be a one off in 2018					
If credit is limited to 15% of gross inclusion, and no GILTI deduction or FTC limit on GILTI with no effect on the substance based exclusion.					
GILTI	374,817,200	535,977,054	475,375,335		
Tax Rate	21%	21%	21%		
US Tax before FTC	78,711,612	112,555,181	99,828,820		
GILTI FTC @100%	(46,989,557)	55,891,478	48,572,211		
	31,722,055	168,446,659	148,401,031		
	374,817,200	535,977,054	475,375,335		
	15%	15%	15%		
GILTI FTC @ 15%	56,222,580	80,396,558	71,306,300		
Net GILTI Tax	22,489,032	32,158,623	28,522,520		
GILTI @ 6%	22,489,032	32,158,623	28,522,520	83,170,175	27,723,392
Additional Estimated GILTI Revenue					8,918,643

Our proposal of allowing for a deemed paid credit up to 15%, with no Section 250 deduction, no reduction for 20% of FTCs and no expense apportionment would significantly change the result. As shown above, our proposal would increase the average annual GILTI tax revenue from just under $19 billion to just under $28 billion, an increase of approximately $9 billion annually or $90 billion over the ten-year period assuming no changes, largely offsetting the expected reduction of $122 billion to US tax revenues as estimated by JCT.

[1] Table 3 found at: https://www.irs.gov/statistics/soi-tax-stats-corporate-foreign-tax-credit-statistics.

ii. Neutrality(ies)

[Weisbach, D.A. (2015). The use of neutralities in international tax policy. *National Tax Journal*, 68(3), 635-652. Weisbach challenges the use of all neutralities, such as capital export neutrality, capital import neutrality, and capital ownership neutrality, in international tax policy.]

iii. Double Taxation and Double Non-Taxation
iv. Compliance, Simplicity, and Administrability

V. Example/Case Study to Illustrate Proposal

In a simple example of how the current rules would operate if other countries adopt Pillar 2 while the US does not; USP directly owns CFC B which in turn directly owns CFC A and CFC Z, all in different countries. CFC A makes $100 and pays $10 of tax to the country where A does business. Because B is organized in a country that has adopted Pillar 2 and B is the direct parent of CFC A, country B imposes a $5 IIR to bring the tax rate on A's earnings up to 15%. This creates several problems for FTC purposes as things stand now. First, while $15 of total tax was levied on the income of A, the United States would only allow a $10 FTC because that was the only tax imposed on CFC A, effectively disallowing the IIR tax of $5. This is obviously a bad answer for international operations and results in double tax. Our solution, of allowing a 15% FTC for foreign taxes regardless of the method of imposition or its current qualification under FTC rules provides a better answer for the US.

The below example shows how three CFCs of US multinationals would be tax under different hypothetical tax rates with the left columns illustrating current tax laws and the right side showing how our proposal would change the taxation showing how the taxation would work under both a foreign tax credit with no cap and also with a foreign tax credit cap at 15%. In all cases, the three CFCs earn $175 of pretax income and pay local taxes of 10%, 15% and 20% respectively. In the current case, foreign tax expense is $22.50 for an effective tax rate of 12.9% and the US GILTI tax is $0.30. The Pillar 2 tax (IIR), is $4.70, taxing CFC A's income up to 15% when combined with the US GILTI tax resulting in total tax of $27.50 on CFC earnings, an effective tax rate of 15.7%.

Our proposal with no cap of the FTC would increase the US tax from $0.30 to $9.25 and would eliminate the IIR of $4.70 resulting in a net tax increase $4.25 ($31.75 – $27.50), an increase of 2.4% ($4.25 / $175). While this may seem like a large increase, there are several benefits. Absent limits, the U.S. collects 6% (21 - 15), resulting in increased US tax revenue while also simplifying the FTC calculations. This achieves three policy goals: 1) The United States collects adequate revenue; 2) The taxpayer is not subject to double taxation; and 3) The system is much simpler than the current system from the standpoint of tax compliance and administration.

This proposal also addresses several issues in current law:

1. Determining what foreign taxes are creditable is no longer required
2. This solves the debate over taxes imposed under Pillars One and Two, which, under current rules may not be income taxes under current U.S. law. [Explain this with a high-level overview of the Pillars, no more than one paragraph each.]
3. Expense allocations are eliminated.
4. Basketing income is eliminated.
5. Calculating asset basis for GILTI is eliminated and
6. Applying Subpart F rules is eliminated

Also, by eliminating deferral, several complicating aspects of the current system may be mitigated. By permitting credits beyond 15%, the proposal is not worse than current law. The proposal would also retain the high-tax exemption.

Current Tax law - Pillar 2 applies				
GILTI Tax Calculation				
	A	B	C	Total
Income	100	50	25	175
Tax Rate	10%	15%	20%	
Tax	10.00	7.50	5.00	22.50
Tested Income	90.00	42.50	20.00	152.50
10% QBAI	15.00	10.00	5.00	30.00
GILTI				122.50
Inclusion %				80%
Sec 78				18.07
GILTI + Sec 78				140.57
250 Deduction				70.29
Taxable GILTI				70.29
Tax Rate				21%
GILTI before FTC				14.76
FTC @ inclusion % @80%				14.46 *
Net GILTI Tax				0.30
* 1.960-2(c)(7)(i)				

GILTI Tax Allocation for Pillar 2				
	A	B	C	Total
Income	100	50	25	175
Tax Rate	10%	15%	20%	
Tax	10.00	7.50	5.00	23
Key GILTI Rate	13.125%	13.125%	13.125%	
Allocation Key	3.13			3.13
GILTI	0.30	-	-	0.30
Total Tax for IIR	10.30	7.50	5.00	22.80
Globe ETR	10.30%	15.00%	20.00%	

IIR Calculation				
Income	100	50	25	175
Required Rate	15.00%	15.00%	15.00%	
IIR Rate	10.30%	15.00%	20.00%	
Additional Tax Rate	4.70%	0.00%		
IIR Tax	4.70	-		4.70
Total Tax	15.00	7.50	5.00	27.50
Total Tax Rate	15%	15%	20%	15.7%

Our Proposal - no cap on FTC				
Income	100	50	25	175
Tax Rate	10%	15%	20%	
Tax	10.00	7.50	5.00	22.50
US Income	100.00	50.00	25.00	175.00
US Tax Rate	21%	21%	21%	
US Tax	21.00	10.50	5.25	
FTC	15.00	7.50	5.00	27.50
US Tax	6.00	3.00	0.25	9.25
IIR	-	-	-	
Worldwide Tax	16.00	10.50	5.25	31.75
Tax Rate	16%	21%	21%	18.1%
US Add'l Tax				8.95

Our Proposal - with cap on FTC				
Income	100	50	25	175
Tax Rate	10%	15%	20%	
Tax	10.00	7.50	5.00	22.50
US Income	100.00	50.00	25.00	175.00
US Tax Rate	21%	21%	21%	
US Tax	21.00	10.50	5.25	
FTC	15.00	7.50	3.75	26.25
US Tax	6.00	3.00	1.50	10.50
IIR	-	-	-	
Worldwide Tax	16.00	10.50	6.50	33.00
Total Tax Rate	16%	21%	26%	18.9%
US Add'l Tax				10.20

VI. Conclusion

The changing global tax landscape calls for a change to the US international tax regime in order to both protect the US tax base and mitigate double taxation on US multinationals. From a tax policy perspective, this improves simplicity, eases compliance burdens and makes for a more administrable tax system. Our proposal achieves these goals by replacing GILTI and Subpart F into one system, eliminating complicated expense apportionments and removes doubt surrounding the creditability of certain foreign taxes.