Statement of Peter A. Barnes

To the Tax Policy Subcommittee of the House Ways & Means Committee

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Chairman Smith, Tax Subcommittee Chairman Kelly, Ranking Member Thompson, and distinguished members of the Subcommittee, I appreciate this opportunity to speak to the Committee on the importance of the international tax proposal known as Pillar Two. As the other witnesses today have stated, this is a critically important proposal. How the United States responds will have a major impact on our multinational companies, their global competitiveness and the US fisc.

I appear today on my own behalf and not on behalf of any client. The views I express are my own, shaped by more than 40 years of teaching and practicing international tax at law firms, the US Treasury Department and for more than 22 years as Senior International Tax Counsel at a major US multinational corporation.

Introduction

The Pillar Two proposal to enact a 15 percent minimum tax on all corporate profits must be seen in the context of more than a century of international tax developments. Yes, Pillar Two represents a significant change in international tax law. But it comes as the next step in decades of efforts to align international tax rules so that corporations can and will run their businesses based on market fundamentals, including the location of customers, a talented workforce, raw materials and other inputs.

Pillar Two is an extension of the global effort by governments to limit Base Erosion and Profit Shifting ("BEPS") and thereby reduce the incentive for business decisions to be made solely because of tax considerations.

Significantly, the United States led much of this century-long effort to align tax rules. The US has been the innovator in tax treaty policy, including the rules on treaty abuse (limitation on benefits provisions) and rules for when companies are subject to tax in another jurisdiction (such as permanent establishment protections). The US successfully pushed to make bribes non-deductible for tax purposes, over the objection of major trading partners. And, importantly for Pillar Two, the United States enacted the so-called Subpart F rules in the 1960s to tax US shareholders on certain low-taxed income earned by foreign subsidiaries – exactly the mechanism that is the cornerstone of Pillar Two.

The US is the model for much of Pillar Two, with our Subpart F rules and the GILTI rules (global intangible low-taxed income) enacted in the 2017 Tax Cuts and Jobs Act. The US deserves much credit for the 2017 law change, which demonstrated the soundness of ensuring corporate income earned outside the parent company's home jurisdiction is subject to a current minimum tax. The wise next step, in my opinion, is for the United States to align our existing tax rules with the Pillar Two proposal.

Benefits of Joining the Pillar Two Exercise

The reason the United States should join this initiative is quite simple. More than 100 countries will enact Pillar Two into their domestic laws, with effect from 2024 and 2025. These countries represent 90 percent or more of global GDP (not including the US). The proposal is not going to be abandoned. So, the United States faces a choice: join this exercise or stand outside the process. I believe the merits of joining are clear.

- Participating in Pillar Two will raise significant tax revenues for the US, versus not participating.
- If the US joins the Pillar Two group, we can work with other countries to modify the rules over time, so that key US priorities (including the tax treatment of incentives and of our corporate alternative minimum tax) are better protected. If the US does not participate, our voice in negotiations will be much less influential.
- Joining Pillar Two will strongly benefit US-headquartered corporations. Compliance costs, including the cost of tax disputes, will be sharply lower. And some taxes paid by US multinationals will likely be paid to the US government instead of to other countries.

Tax Revenue

The purpose of Pillar Two is to establish a minimum 15 percent tax rate on corporate income, no matter where that income is earned. As a result, global taxes on corporations will rise. Globally, Pillar Two is estimated to raise as much as $220 billion in additional corporate tax annually (although other revenue estimates are lower.)

US multinational companies will likely pay more foreign tax to jurisdictions that adopt a 15 percent minimum tax. That is the consequence of these countries' sovereign decisions to set higher corporate tax rates. As a result of the higher taxes, US companies will pay less tax to the United States on their foreign-source income, because of foreign tax credits for the additional tax paid to other jurisdictions.

The revenue impact on the United States fisc is uncertain, as detailed in a June analysis by the Joint Committee on Taxation. But one conclusion from the JCT is clear: the US will earn more tax revenue if it adopts the Pillar Two agreement – in a range of $50 billion over 10 years – than if the US stands aside while other countries join.

In addition to the US fisc, US multinational companies will benefit financially from the adoption of Pillar Two. As just one example, temporary guidance from the OECD provides that US GILTI taxes can be used to reduce the taxes levied by other countries under Pillar Two. If the US abandons Pillar Two, there is no assurance that this temporary guidance will continue, with the consequence that US companies may pay double tax (the GILTI tax to the US and the Pillar Two taxes imposed by other countries.)

Apart from the additional tax burden, US companies will face excruciatingly difficult compliance burdens if the US does not conform to Pillar Two. All of the complex US tax rules on foreign income will apply to these companies, plus all the rules under Pillar

Two. Aligning the US rules on GILTI and the corporate AMT with Pillar Two will make the compliance tasks of US multinationals more manageable.

There is an urgency for action by the US to join Pillar Two. During the fourth quarter of 2023, US multinationals must prepare and publish financial forecasts for 2024, including the effects of Pillar Two on 2024 financial earnings.   Companies need certainty; the issue of whether the US will adopt Pillar Two injects significant uncertainty into corporate planning.

The tax law changes required are modest

As noted above, the US rules under GILTI and Subpart F are the model for Pillar Two. So, the legislative changes required for conformity with Pillar Two are modest. In simple terms, the US rate on income earned by foreign affiliates of US companies would rise from 10.5 percent to 15 percent, and the calculation would be made on a country-by-country basis, rather than on a blended global basis.

The Build Back Better legislation approved by this Committee and the House of Representatives in the last Congress included the changes to US tax law that would be required to align the US with Pillar Two. So, the path forward is well marked.

In making changes the necessary changes to align with Pillar Two, Congress could sensibly amend other related rules, especially relating to the corporate AMT. The result

would be a simpler, more easily administered set of tax rules for US multinational corporations.

Under-taxed profits rule

Much of the criticism of Pillar Two has centered on the under-taxed profits rule (UTPR). This rule – which is complex in its administration – would allow a third country to impose additional tax if the source country did not impose a 15 percent tax on income <u>and</u> the home country of the shareholders did not impose a "top-up tax" to 15 percent on the shareholders.

Criticism has centered on two features of the UTPR. First, the UTPR (and, indeed, all of Pillar Two) is viewed as a violation of tax sovereignty, since the tax rules are developed by the OECD and a third country might step in to impose tax. This argument misunderstands the concept of sovereignty. If a country (the US, or any country) adopts tax rules, then that is the quintessential exercise of tax sovereignty. Aligning the US tax rules with Pillar Two would be an act of sovereignty by our government and the results of those rules would not diminish our sovereignty.

Indeed, that is the argument the US Treasury has made for more than three decades when countries object to the use of arbitration as a tool for dispute resolution in tax cases under the mutual agreement procedure in tax treaties. Many countries historically complained that allowing arbitrators to decide a tax dispute was a denial of sovereignty. No, the US repeatedly argued. When a sovereign adopts a rule, such as the use of tax arbitration,

there is no loss of sovereignty because it is the decision of the sovereign to allow a third party to participate. The argument that Pillar Two undermines US tax sovereignty is not persuasive.

Second, and more importantly, the UTPR is a small and rapidly diminishing feature of Pillar Two. If a country adopts the key elements of Pillar Two, including the Income Inclusion Rule and its "top-up tax," then there will be no under-taxed income earned by that country's multinational corporations that could be subject to the UTPR. The US can self-help itself and its corporations out of the UTPR simply by adopting Pillar Two. If, as expected, a major share of the world's trade is conducted by companies subject to Pillar Two in their home countries, then the UTPR will apply to a tiny fraction of global business.

Seat at the table

The Pillar Two proposal is the result of many compromises. Any informed critic can find elements of the proposal that are not satisfying or need additional scrutiny. The tax press is filled weekly, even daily, with criticisms of Pillar Two.

Fortunately, discussions about the technical issues under Pillar Two are still under debate at the OECD and within individual countries. So far, the United States has had a full voice in those discussions. In some cases, as with the treatment of GILTI taxes as qualifying taxes for certain calculations, the US interests have been given strong weight. There are still pending difficult discussions regarding the treatment of credits and tax

incentives in the Pillar Two calculation, and the US may or may not prevail in those discussions.

The US benefits from its full participation in these on-going negotiations, and the rest of the world benefits as well. But there is likely a limit to what weight the US interests will be given if the US chooses to stand outside Pillar Two. It is essential that the US join the Pillar Two initiative so that the US voice will continue to be strong and effective in negotiating the terms of these rules.

Summary

Some critics of Pillar Two act as if the proposal can still be derailed. The OECD, of course, cannot dictate to countries that they must adopt Pillar Two. But at last count 138 countries indicated their intention to do so. While some countries – including, possibly, the United States – will not adopt the proposal, a critical mass of major trading countries will do so.

The choice facing the US, both the government and its corporate taxpayers, is binary: adopt the proposal (with the financial and administrative benefits, plus the opportunity to continue to influence the direction of the legislation), or step away from the table, with the attendant consequences.

I urge this committee and Congress to enact legislation to align the US tax rules with Pillar Two. That will continue our country's leadership in developing sound international tax practices that benefit our companies and their ability to drive economic growth.

Thank you.