Insight

Major Corporate Tax Changes Proposed by Ways and Means

GORDON GRAY | SEPTEMBER 15, 2021

Executive Summary

- House Committee on Ways and Means Chairman Richard Neal has proposed 25 new tax policies that would on net raise taxes on U.S. corporations by $963.6 billion over the next decade.
- Eighty-seven percent of these revenues are raised from 5 major changes to the corporate tax code, though the proposal to raise the U.S. corporate rate by 5.5 percentage points raises by far the most revenue among all of the business tax increases proposed by Ways and Means.
- While the outlook for this tax package and the reconciliation bill in general is uncertain, the direction of tax policy under this proposal is clear: It would see taxes on U.S. corporations increase by nearly $1 trillion over the next decade.

Introduction

This week, the House Committee on Ways and Means will mark-up and likely report out significant new tax changes as part of the Democrats' domestic spending agenda. Ways and Means Committee Democrats have proposed Subtitle I, a package of tax increases on individuals and businesses. Subtitle I is just one element of the larger reconciliation package that will bundle together the legislative recommendations of 12 House committees. The outlook for this tax package and the reconciliation bill in general is unclear, as there remain substantially divergent policy and political priorities among the congressional Democrats. What is clear is the direction of tax policy under this proposal, which would see taxes on U.S. corporations increase by nearly $1 trillion over the next decade.

Subtitle I – Corporate and International Tax Reforms

Ways and Means Committee Chairman Richard Neal has proposed 25 new tax policies that would on net raise taxes on U.S. corporations by $963.6 billion over the next decade. Eighty-seven percent of these revenues are raised from 5 major changes to the corporate tax code, though the proposal to raise the U.S. corporate rate by 5.5 percentage points raises by far the most revenue among all of the business tax increases proposed by Ways and Means.

Revenue Effects[1]

Tax Policy	2022-2031 Revenue ($ Billions)
Increase in corporate tax rate to 26.5 percent	540.1
Expand GILTI Inclusion	106.7
Reduce FDII and GILTI Tax Deductions	96.4
Foregin Tax Credit Changes	63.3
Interest Deduction Limitations	34.8
All Other Proposals	122.2
Total	963.6

Corporate Tax Rate

The Ways and Means Committee Subtitle I would increase the corporate tax rate from the current federal rate of 21 percent to 26.5 percent. This is 1.5 percentage points below what the Biden Administration proposed in its budget. Under current law, the United States imposes a federal rate of 21 percent, which when combined with state and local rates puts the rate at 25.75 percent, making it the 12th highest in the Organisation for Economic Co-operation and Development (OECD), and a bit above the 22.85 percent average among the 37 OECD nations. Increasing this rate by 5.5 percentage points would make the combined U.S. rate second only to Portugal's, which hardly has a growth record worthy of emulation. According to the Joint Committee on Taxation, this provision would raise $540 billion over the next decade and is the single largest revenue raiser in Subtitle I.

Expand GILTI Inclusion

Subtitle I contains a number of significant changes to the tax treatment of income earned abroad by U.S.-headquartered firms. These proposals are similar in nature to those proposed by the Biden Administration but are distinct in a number of areas. The most significant in terms of revenue collection is the proposed change to the Global Intangible Low-Taxed Income (GILTI) regime. Under current law, GILTI serves as a minimum tax on income that has similar characteristics to highly mobile intangible income. Under current law, the GILTI provision taxes income in excess of what policymakers determined to be a normal rate of return (10 percent) on tangible assets overseas. Taxpayers reporting GILTI may deduct half of the income above this threshold, for an effective rate of 10.5 percent. The GILTI provision also includes a "haircut" to appliable foreign tax credits of 20 percent, however, meaning taxpayers may only apply 80 percent of their foreign tax credits to this income, raising the effective rate under current law to 13.125 percent, and a number of firms face higher rates still. Note that a separate provision in Subtitle I would *reduce* the foreign tax credit haircut from 20 percent to 5 percent. Subtitle I would reduce the current-law threshold, known as the Qualified Business Asset Investment (QBAI) threshold, to 5 percent. Significantly, Subtitle I would also move the GILTI regime to a country-by-country test, rather than the current global blending approach, which could raise costly administrative challenges for

multinational firms.

The GILTI regime is significant to the multilateral tax negotiation convened by the OECD, known as the Inclusive Framework. As part of this initiative, over 130 nations have agreed to enact a new global minimum tax, known as Pillar 2, of at least 15 percent. The agreement also provides for a substantive carveout of at least 5 percent (and at least 7.5 percent for the first 5 years) of the value of tangible investment and payroll. The effect of this proposal is to exclude the normal returns to overseas tangible investment and labor, a similar concept to that of QBAI. Subtitle I would therefore expose a greater share of overseas income to taxation than the OECD Pillar 2 policy.

Combined, these modifications to GILTI would raise $106.7 billion over the next decade.

Reduce FDII and GILTI Deductions

The foreign-derived intangible income (FDII) provision of the Tax Cuts and Jobs Act (TCJA) provides a new tax preference for locating mobile intellectual property income in the United States. FDII relies on similar concepts and definitions as other policies established under the TCJA, such as GILTI, and is designed to act in concert with those policies to preserve the U.S. tax base while improving the investment climate in the United States. The FDII provision – a 37.5 percent deduction against income earned abroad that exceeds a deemed return on tangible assets (QBAI) – provides a reduced effective tax rate on high-return income, consistent with intellectual property income, and is similar in inspiration to “patent boxes” in other nations.

Under this provision in Subtitle I, both deductions for FDII and GILTI would be reduced to 21.875 percent and 37.5 percent, respectively. Given the proposed 26.5 percent corporate rate, these reduced deductions yield a 20.7 percent FDII rate and a 16.5625 GILTI rate. A separate provision in Subtitle I would reduce the foreign tax credit haircut from 20 percent to 5 percent, such that 95 percent of the foreign tax credit could be claimed instead of 80 percent. This effect would combine with the other modifications to GILTI in Subtitle I to yield an effective GILTI rate of about 17.4 percent. Again, the Ways and Means legislation would tax U.S. firms operating abroad above the rate agreed to under Pillar 2.

Combined, these modifications to FDII and GILTI would raise $96.4 billion over the next decade.

Foreign Tax Credit Changes

Under current law, U.S. firms can aggregate foreign taxes paid for the purposes of claiming foreign tax credits subject to certain limitations. Credits for foreign taxes are limited in their application to taxes paid on different types of income or “baskets.” Under Subtitle I, among other changes, firms would be required to claim foreign tax credits on a per-country basis, precluding the blending and averaging that somewhat simplifies the administrative burden of the current foreign tax credit calculation. Subtitle I would also limit the degree to which excess credits can be used to offset tax liabilities in the present and future. This policy would repeal the current law one-year carryback allowance and reduce the ability of firms to carry excess credits forward from 10 to 5 years.

Combined, these changes to the foreign tax credit would raise $63.3 billion over the next decade.

Interest Deduction Limitations

In general, U.S. firms can deduct a portion of interest on indebtedness from taxable income. Under current law, this deduction is generally limited to 30 percent of income. Under Subtitle I, U.S. firms that are part of multinational groups would be further limited from claiming interest deductions. The underlying rationale is to mitigate income shifting from U.S. corporations to related parties abroad. The provision would limit the interest such a corporation can deduct to a percentage of 110 percent of the overall multinational corporation's interest expense. The percentage is the domestic corporation's percentage of the overall multinational's earnings.

Combined, this proposal would raise $34.8 billion in revenue over the next decade.

Additional Proposals

Subtitle I contains 19 additional provisions that would raise taxes on U.S. corporations. The revenue estimated to be raised from two of these provisions are included in the revenue estimates for the proposed changes to the foreign tax credit limitations and to the GILTI regime. Additional changes include increases in the Base Erosion and Anti-Abuse Tax (BEAT), as well as higher taxes related to corporate reorganizations and certain other transactions, among other provisions. One provision that loses revenue, referenced above, would make the treatment of foreign tax credits under GILTI more generous, among other changes.

Combined, these additional measures would raise a net $122.2 billion in revenue over the next decade.

Conclusion

House Democrats enacted a budget resolution that instructs the Ways and Means Committee to report legislation by September 15 that reduces the deficit by $1 billion over the next decade. The Ways and Means Committee has the tax code in its jurisdiction and, given the substantial spending the House Democrats intend to pursue through the tax code, must offset that spending with other changes to programs within its jurisdiction. While those offsets could be spending reductions, House Democrats have instead proposed substantial tax increases to pay for the new spending. The proposed $963 billion in tax increases on U.S. firms is part of this agenda.

[1] https://www.jct.gov/publications/2021/jcx-42-21/