HINDSIGHT IS 2020

What the TCJA and Global Developments Tell Us About the Future of Tax

FEBRUARY 13–14, 2020 | THE RITZ CALRTON, WASHINGTON, DC
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Description:
Enacting comprehensive tax reform in 2017 marked a monumental change to the U.S. tax system. Now, two years in, we can begin to understand its broad economic impact. A panel of experienced economists offered their views on how new U.S. tax rules have affected business financing, structuring investment, innovation, trade, and other aspects of the U.S. economy.

Panelists:
- Rosanne Altshuler, Professor of Economics, Rutgers University (moderator)
- Robert Carroll, Co-Director, Quantitative Economics & Statistics Group (QUEST), EY
- Kyle Pomerleau, Resident Fellow, American Enterprise Institute
- Martin A. Sullivan, Chief Economist, Tax Analysts

MS. ROSANNE ALTSHULER: My name is Rosanne Altshuler, and I want to thank TCPI for inviting me to moderate this panel. I’m honored to be here with the distinguished economists on my left.

The Tax Cuts and Jobs Act was the most comprehensive reform since 1986. The blurb for this panel states that two years later we can begin to understand its broader economic impact. Well, I’m not quite sure that’s true. It’s not clear we can begin to understand its impact just yet, but we can certainly try.

Entire careers in academia, particularly in economics and accounting, will be made studying the effects of TCJA on business decisions such as where to invest, how much to invest, what assets to invest in, how to finance those investments and the impact on financial decisions and on trade, growth, and innovation. We’ll be studying the Act well into the future and there will be some excellent studies. Just come back in 5 or 10 years. We need the data to become available before we can start the careful analyses.

Today we are going to focus on three important questions in our quest to understand the impacts of TCJA and how it may be influencing business decisions.

Marty Sullivan is going to take on the “what happened” question. Briefly, Marty is Chief Economist and Contributing Editor of Tax Analysts. I’m quite sure that everyone in the room has read his careful and clear analysis of the tax law, and if you haven’t, you should. Last year, he was the recipient of the Tax Council Policy Institute’s Pillar of Excellence Award for his contributions to the tax community and efforts to formulate tax policy. He is going to tell us what happened.

Bob Carroll will help us understand what we know now and what we can hope to know about TCJA’s impact. Bob Carroll is Co-Director of the Quantitative Economics & Statistic Group (QUEST) at EY. Before joining EY, Bob was the Deputy Assistant Secretary for Tax Analysis of the U.S. Treasury Department. He oversaw the Department’s work on developing business tax reforms to improve the global competitiveness of the United States and efforts to reform the tax system. I was lucky enough to work with him on the President’s Tax Panel for Federal Tax Reform.

Kyle Pomerleau will address the question of what should and will happen next, the where-do-we-go-from-here question. That’s a fun one. Kyle is a Resident Fellow at the American Enterprise Institute, where he studies federal tax policy. Before joining AEI, he was Chief Economist and Vice President of Economic Analysis of the Tax Foundation, where he led the macroeconomic and tax modeling team and wrote on
various tax policy topics, including corporate taxation, international tax policy, carbon taxation, and tax reform.

We are going to take two broad approaches to answering the questions on the first slide. First, we’re going to try to increase our value added to you by focusing on how economists address these questions. We are all economists.

Second, we’re going to take into account that we may never know the impact of the act on all decision margins. I participated in a conference many years ago in which the organizers invited academics to write about the impact of tax policy on a variety of different decision margins faced by businesses, individuals and governments. Each of us were tasked with addressing questions which I thought were really interesting: what do we know; what don’t we know; and what is unknowable.

Ultimately, we’re going to have to make policy decisions concerning tax reform without knowing everything we want to know. The key is to gather what we do know and to use it in our framework to evaluate tax policy. Without further ado, I’m going to move on and turn the mic over to Marty Sullivan.

MR. MARTY SULLIVAN: Thank you, Rosanne. Before I do a semester of economics in five minutes, I want to thank KPMG and the Tax Council Policy Institute for putting this all together.

Now, here is a picture you probably all are familiar with. These are the revenue estimates for the TCJA from the Joint Committee on Taxation. It adds up to $1.5 trillion, which was necessary to meet the reconciliation target. You see it tails off at the end because in 2026 the individual tax cuts are repealed. That was necessary to meet the Byrd Rule. The next slide you may not be familiar with.
This is the CBO’s estimate of the increase in GDP resulting from the TCJA. It starts off slow at $60 billion in Fiscal 2018; and it peaks in 2022 at $237 billion and then it comes down. Now, is that a big number or a small number? Let me give you some context. If the GDP is $22 trillion, then the peak in 2022 is about 1 percent of GDP. The economy is 1 percent larger than it would otherwise be because of the TCJA under the CBO estimates.

Another way of thinking about this is: how does the TCJA affect the economic growth rate? Well, economic growth in 2019 was 2.3 percent, and if we translate this chart into economic growth, it’s about .3 percent. What the CBO is saying is that without TCJA, we would have 2 percent growth instead of 2.3 percent growth.

The other thing about this number is it would have to be five times larger if the tax cuts paid for themselves.

Now, we’re economists. We like supply and demand. So, we have supply and demand mixed in here. The demand effects are up front, and the supply effects are in the back. The demand side is the short term. The supply side is the long term. In the short term, because of all of the increased cash coming into the economy, we expect investment and consumption to go way up. In fact, consumption has gone way up and investment has gone way down, but that’s the expectation of economists here up front contrary to expectation – probably because of tariffs.

On the tail end, the demand side effects wear off quickly, in a year or two, and then the supply side effects take hold, because of reduction in the effective tax rates on capital we expect more investment and because of the reduced tax rates of individuals we expect more labor supply. More capital and more labor will increase the productive capacity of the economy.

Now, let’s put the two slides together. This is Slide Number 1 and Slide Number 2 mixed on top of each other. If you take the ratio of all of the costs -- the tax cuts, the red -- and you take the ratio of the green, all the increase in GDP, to the tax cost, the revenue cost, you have what we call a multiplier. The multiplier for this bill is 1.3.
Now is that good or is that bad? Multipliers can be two or three or even four. Of course, there’s tremendous uncertainty, and it depends upon the bill. Why is this only 1.3? There’s several reasons. The high multipliers on the demand side, up front, usually apply to a fiscal stimulus that comes in the form of government spending. Government spending is usually better than tax cuts for short-term economic growth.

What’s another reason why? If you wanted to increase short-term economic growth stimulus, you would target the tax cuts to low-income folks who are going to spend more as opposed to high-income folks. That keeps this multiplier down.

What really keeps it down is that the tax cuts were enacted when we were not in a recession but when we were close to full employment. The increase in aggregate demand is sort of hemmed in by the productive capacity of the economy. In the long term, why isn’t there more economic growth? Well, one reason, of course, is that the tax cuts expire, but also the CBO estimates that the increase in capital and the increase of labor are not that large. Now, we could have a big debate, as economists always do, about the responsiveness of capital and labor to tax cuts. Ever since I took my first class in economics in the Carter Administration, it’s been the same old debate.

But two things have changed. We have a more globalized economy, so we do expect capital to respond more to tax cuts because there will be inflows and outflows from an internationally integrated economy. Also, there’s a new class of economic models -- dynamic, general, equilibrium models -- that stress only-term supply-side effects. If you believe in those models, you’ll see more economic growth.

Now, what about those deficits? I’m going to make five points about deficits, and my fellow panelists will tell you if I’m wrong. I don’t think we have any sovereign debt crisis to worry about. There’s not going to be any magical financial collapse in the next few years. The debt capacity of the U.S. economy is very large. We’re not Greece. We’re not Argentina. If these countries aren’t collapsing, we’re nowhere near that, so I think financial collapse due to too much U.S. debt is a false concern.

I think the real problem is that we’re borrowing from foreigners and we got to pay them back. We’re increasing our productive capacity by borrowing from foreigners as reflected in our GDP numbers, but when we have to pay back the foreigners, our income is not going up as reflected in our GNP numbers. I think that’s what we have to be concerned about. It’s a slow drip. There’s going to be no catastrophic
failure to the economy.

The other problem with the deficit is that even though we have lots of what’s called “fiscal space,” the fiscal space perceived by our lawmakers will seem small. Now we have $1 trillion deficits, and I think it’s very easily possible that we’re going to have $2 trillion deficits within the next 10 years. Our legislators might get cold feet if we have a recession and fail to enact sufficiently having stimulative fiscal policy.

That’s really important now, and it’s unprecedented because our interest rates are so low that when the next recession hits, we cannot depend on monetary policy to bail us out. Our 10-year Treasury rate is about 1.6 percent. We usually need about 500 basis points of interest rate reductions to get us out of a recession. Since we can’t have significantly negative interest rates, the Fed cannot do the job for us this time. Congress will have to act if we want to get out of a recession. If we have $2 trillion deficits, do you think the legislators we just saw on the screen are going to be as willing to double those, which might be required?

The other thing to be concerned about is what is called the theory of secular stagnation. This theory is put forward by former Treasury Secretary Larry Summers. In fact it is the case that our economy suffers from all of the symptoms of secular stagnation. We have low interest rates; we have low inflation; we have low long-term economic growth; we have low population growth. When you’re in this type of situation a continuous, not a cyclical, injection of debt may be needed to keep the economy from stagnating.

What I’m saying, something I wouldn’t have said two years ago, is that maybe deficits aren’t all as bad as we think they are. Obviously, this is a controversial issue, and I hate to mention it to any member of Congress to give them an excuse for increasing the deficit. But it’s something to consider, and if you think this is just a theory, consider the third largest economy in the world, which used to be the second largest economy in the world, Japan, which is suffering through this right now.

Finally, let me just mention quickly five things that we economists like and that are guiding principles for this bill. We like taxation on an accrual basis. We really like the dividend received deduction for foreign profits. We got rid of that lockout effect. That’s really good. By the same logic, we would also like to see more capital gains taxation on accrual.

We like neutrality. We also like lowering the corporate tax rate because that eliminates the bias against corporate capital, but we like the limitation on interest deductions because that helps eliminate the bias against equity in favor of debt.

We don’t like Section 199A because of the cherry-picking of certain professions and certain situations where the benefits are granted, and opportunity zones are not especially neutral.

We like subsidizing positive externalities, so we like the R&D tax credit. We’d like to keep R&D expensed, but we have amortization coming in in 2022, which nobody likes.

Economists, like everybody, we like simplification. Everybody promises simplification; we never get it. No surprise there.

Finally, we like certainty. This bill has built uncertainty into it because of the expiring provisions. The Big Kahuna here is the individual tax cuts which are going to expire in 2026, but probably more familiar to everybody else in this room are the expiring of the business tax provisions that are coming down the pike. Obviously, Congress would like to change these, but inertia always seem to get in the way.

Finally, the other source of uncertainty is that the bill was passed on the partisan basis, as you see from the previous film. I didn’t see many Democrats in there. Of course, that’s the way it had to be done, but obviously that makes the bill more uncertain because if the Democrats do get back into power, they are going to be gunning for increasing the corporate tax rate and increasing the tax on multinationals.
I hope this background helps set the table for the rest of the panel.

**MS. ALTSHULER:** Great. You have set the table and I think there is a lot for us to react to. I’m going to first let Bob and Kyle provide their reactions to Marty’s presentation.

**MR. ROBERT CARROLL:** I’ll just say a couple things. The way, Marty, you framed it in the beginning with the slide looking at the revenues and the GDP effects I thought was just marvelous in making the distinction between the aspects of the 2017 act that provide the stimulus to the economy up front versus the provisions that were more focused on increasing potential GDP. Also, these provisions having longer term effects through increasing labor supply by increasing the after-tax reward to work or increasing the capital stock and the productive capacity of the economy through capital deepening via the expensing and lower corporate rate and so on.

I think that’s a great way to frame it, and a great way to think about the effects near term versus longer term and reflects the way a lot of people think about this inside and outside the government.

One thing to keep in mind is the act was enacted at a time when the economy was ostensibly at full employment, so the stimulative effects would naturally have been limited. The Fed would have tried to address any possibility that they were going to result in inflation or overheat the economy by having an offsetting change in monetary policy, not so much that they would raise interest rates. But they would have a change in monetary policy relative to what they would have done otherwise.

Then on the ability of the U.S. to carry a higher debt load, I’ve been on a number of panels with Marty over the years, and we tend to agree on a lot of things, and a point that’s not often made in these sorts of panels is that the United States has the ability because we have such a large, diversified economy to carry a really large debt load. We’re not Greece. Japan has a debt-to-GDP ratio approaching 200 percent, and so we have a tremendous capacity.

That doesn’t mean it’s a good idea, right? Not to say that. It just means that a grave economic crisis is not around the corner, but the point that you made about payments going to foreigners if foreigners hold the debt, that is a drain on the economy. That is a difference between us and Japan. In Japan, a lot of the holders of the debt are Japanese, and it’s kind of self-financing, so they’re making payments to themselves. They have stagnation, but Japan is kind of a unique, different case, certainly different than us.

In terms of accrual, I think you represented that we like accrual, so I would have some caveats around that. I think you have to weigh accrual. It depends on the provision where simplification is really important, low compliance costs are really important; a realization basis to accrual in the context of, let’s say, capital gains can be a very complex system and would not be simple. It could impose significant compliance burdens. It doesn’t mean we shouldn’t go there; it just means that has to be carefully thought through. I’ll just leave it there.

**MR. KYLE POMERLEAU:** Just working backwards quickly. Another point on accrual. One of the reasons you hear that the income tax is very close to a consumption tax already and is because individuals can defer taxation on capital gains, which reduces the effective tax rate. Another tradeoff here is that going to an accrual system, especially in the individual side, would lower the returns to saving and have an impact at that margin that needs to be considered.

I’m just going to emphasize the point about GNP versus GDP. Senator Grassley talked about what’s the point of increasing economic growth. It’s to increase living standards, but ultimately our living standards are based on the amount of income we actually get at the end of the day, not necessarily what we can produce here. Keeping an eye on GNP matters a great deal as we go into a period where debt is going to climb pretty significantly. It may not impact our production, but it will still impact our living standards.

Then just adding a little bit more detail on sort of the growth implications of the law, I think Marty did set
this out very nicely, but looking at just the supply side stuff, the impact that these provisions have on effective tax rates, the return to certain activities, whether it’s investing in intellectual property or equipment and machinery, is somewhat complex in the Tax Cuts and Jobs Act. There are some offsetting features, so the lower statutory tax rate that obviously reduces marginal effective tax rates, expensing for short-lived assets, that reduces effective tax rates.

There are other aspects that work against it such as amortization of R&D. In fact, you look at CBO’s projections of effective marginal tax rates over the next decade, the effective tax rate on R&D is going to be higher than it otherwise would have been if nothing happened; if we didn’t pass Tax Cuts and Job Act. That’s due primarily to the amortization. There’s a lot going on under the hood, even though on net we’ll see additional output over the next decade.

MS. ALTSHULER: This has been a great start. I’m going to move on to Bob who will help us understand what we know at this point about the consequences of the Tax Cuts and Jobs Act.

MR. CARROLL: So, what do we know? That’s my task, is to give some sense for what we know and perhaps what we don’t know. I do really like the phrase a lot was going on under the hood, so I just wanted to make that point. Looking at the data over the past several years, there is certainly a case that the 2017 Act had discernible effects on the economy. It’s not a shut-and-closed case, but I think when you look at the data, you do see impacts. Were they as large as people had forecast, had projected? That’s a question.

As Phil Swagel said earlier and Marty has on the table here, the effects that CBO and the Joint Committee projected and others, some were perhaps larger, are pretty significant for this type of bill. The over-the-budget window, the effects were an increase in GDP on average of about a higher level of GDP by about seven-tenths of a percentage point; for employment effects, about six-tenths of a percentage point; and capital stock, about nine-tenths of a percentage point that the capital stock would be higher by that amount.

When you look at the data, let’s say if we started with just GDP growth in 2018, it was at 2.9 percent. When you look at GDP growth in 2017, it was 2.4 percent. In 2016, it was 1.6 percent, so it looks like in 2018 we had a higher level of GDP growth. We had the tax act occurring, enacted in December of 2017. So that would seem that’s probably related to the 2017 Act.

If you compare trend growth since the end of the Great Recession, it was around 2.2- 2.3 percent. When you look at that difference, it’s pretty significant. It’s generally consistent with some of the projections. But if you go back and when you look at business investment, it’s probably a stronger case. Business investment in 2018 was 6.4 percent. In 2017, it was 4.4 percent. A lot of that was stacked in the last half of the year, in the fourth quarter and the third quarter. If you go back to 2016, it was .7; and 2015, it was 1.8 in terms of business investment.

Then in 2019, you see the numbers coming down for both GDP at 2.3 to 2.4 percent; for business investment, 2.1 percent overall, but negative in a couple of quarters. It looks like there’s a bounce in 2018. But, there’s a lot of other things going on in the economy. I think it’s not a shut-and-closed case. When you go back a little bit further and you look at the business investment numbers, we had business investment numbers that were much higher than the 6.4 in 2011, 2012, 2013. They were 8 or 9 percent. So, the 6.4 percent doesn’t look quite as large. But, again, it does depend on what you think the trend growth would have been in business investment.

What you’re really trying to sort out is what do you think the counterfactual would have been absent the tax act. That’s a really, really difficult thing to know. There are lots of other things that are going on in the economy at exactly the same time. Of course, we had the trade war or trade tensions, that’s a significant factor. We had changes in oil prices going up and down, and so that makes it very difficult.

There’s a Wharton study that suggests that the uptick in business investment in 2018 was due to the
changes in oil prices, not so much related to the 2017 act. The other thing to focus on is the extent to which there’s a stimulative effect versus longer term effects. Marty’s chart suggests that there are longer term effects from the increase in the after-tax reward to work and an increase in the return to savings and investment associated with the act.

When you look at the numbers on the act of what it actually did in terms of those two metrics, the average marginal tax rate on wages fell from about 24 to 21 percent, about a 10 percent reduction in the tax on wages, which is a pretty significant change. It’s a combination of the lower rates, as well as the changes in the rate brackets. When you look at the change in the marginal effective tax rate on new investment in the business sector, it’s roughly the same in the passthrough sector versus the corporate sector. The marginal effective tax rate fell by about 6 or 7 percentage points, and which is a fairly large reduction in the METR, in the marginal effective tax rate. Both of those are going to drive labor supply.

In some of the economic models when you have an economy of full employment, the labor market effects of that lower tax rate on labor income is going to show up as wages more so than employment effects because the economy is already at full employment. Then you would expect a lot of increase in investment associated with a METR reduction of 6 percent.

One of the things that’s kind of interesting is when you look at the business investment data, the METRs really fell for investment and equipment, not for structures. When you look at what’s under the hood, on the business investment numbers, a lot of the increase in business investment didn’t occur in equipment; it was more in structures. That’s kind of a puzzle. So, it is a little hard to piece this together.

I mentioned that we had the trade tensions. We also had Brexit. We had large increases in government spending. Phil Swagel’s talk was very interesting earlier this morning. One of the things to focus on is in the CBO estimates which they mention quite a lot in their budget and economic outlook is when talking about the 2017 tax act, they seem to think that there was an increase in GDP related to the act, an increase in consumer spending due to the stimulative effects, and an increase in business investment. They were fairly short-lived. Changes in monetary policy and other things going on in the economy, probably a damp into the longer-term effect as one went into 2019 and 2020.

Then thinking about underneath the hood, economists, those are the high-level aggregates. There are a whole host of other things that economists are really interested in that the TCJA affected. It affected the incentive to borrow on the part of companies that changed the relationship between debt and equity finance, and with the lower corporate rate, you would expect there to be less reliance on debt finances that was equalized.

There were significant changes. Depending on the type of passthrough business, there were changes in the relationship between a return to investment in the corporate sector versus the noncorporate sector. That’s much more in play when the Section 199A sunsets in 2026.

I think it’s really a mixed bag. When I started grad school in 1986, it was in September. That October, it was a great time to start grad school, and the ’86 act was passed in October, I believe, and we had tons of issues to focus on in the classroom setting when thinking about a thesis topic, going to conferences. Everyone, as Rosanne said, everyone was writing papers on what are the effects of the act. Everyone was writing papers on what are the effects of the act.

On the individual side, the research didn’t really start showing up until, I would say, the early ’90s. I started at Treasury in 1990 and had mountains of tax data to work with. There were papers showing up in journals, in conferences, and papers being generated at Treasury and JCT and CBO on different aspects of the ’86 act.

As much as it was then, I think it still is much easier to kind of decipher what happened on the individual side, where the data is very good on both sides if you’re in government. The ability to tease out the effects and identify the responses is easier because of the way the tax system is structured on the individual side than on the business side. Nevertheless, I would expect over the next three or four years,
as people gain access to the data, whether they're doing it internally or have access from the outside that will learn more, but we probably are not able to say very much at the moment.

**MS. ALTSHULER:** I think the conclusion up to now is that we really don’t know much about what the impact has been of TCJA. It is too early. Next lets move on to Kyle who will address the question of what should come next. This is a fun question!

**MR. POMERLEAU:** I guess my presentation could be somewhat fun, but, admittedly, we don’t really know exactly what the effects are yet. I think we can say something about the structure, the impact on deficit, the impact on certainty going forward, and we can also say something about -- at least from an economist’s perspective -- whether the outcome of the law was aligned with the goals that we heard in the video.

The one thing we heard over and over again was economic growth. Well, are there places going forward where there could be improvements made to the law to encourage more economic growth while also paying attention to the sustainability of the law, which has a lot to do with debt and deficit.

First and foremost, and Marty hit on this nicely, is that I think, if I were a lawmaker, the first thing I would address here is permanency. Whatever you think of the law’s particulars, one of the biggest weaknesses is the fact that a lot of the Tax Cuts and Jobs Act is just not going to stick around. So, policy today is not going to be the same as policy five years from now.

On the business side, we’ve already gone through this. R&D amortization, 100 percent bonus is going to phase down; net interest expenses treatment is going to change. The tax burden on foreign profits is scheduled to go up.

On the individual side, that’s going to go away, but that also has an impact on business because a great deal of the capital stock in the United States is held by noncorporate or non-C-corporate business. This means the effect of the individual provision or the change in the individual provisions can have an impact on investment incentives because of that.

Why does the issue of permanency matter? Well, I think it undermines growth, so we looked at CBO’s numbers. The effect on growth, so the delta there, tapers off and then starts going down. Economic growth starts slowing relative to previous years assuming CBO’s right, and a big reason for it are all of those scheduled changes that affects the effective tax rate.

The law not being permanent or staying still undermines taxpayer certainty. It creates uncertainty. The example I like to use, maybe not a small goal, but one of the goals of the Tax Cuts and Jobs Act specific to FDII was encouraging companies to bring intellectual property back to the United States by providing a lower effective tax rate. However, if I’m a company and I’m thinking about the prospects of moving IP back to the United States and in the long term whether I’m going to have a lower effective tax rate, it’s going to matter a great deal whether I think FDII is going to stay at a 37.5 percent deduction or drop to the 21.875 percent. That sort of certainty undermines some of the goals that the law has.

After permanency, I think lawmakers should also start thinking about the sustainability of the tax system. If we think that the Tax Cuts and Jobs Act is good, it’s going to produce economic growth, you’re going to want it to stay still because it’s going to produce that growth, and reversing that is a bad thing. A big part of the reason why right now it’s not sustainable is that debt and deficits are going to climb, and I won’t belabor this because Phil Swagel was already telling you all the details. If lawmakers want to keep fundamental parts of the Tax Cuts and Jobs Act around, they’re going to have to address this. Otherwise, portions of the TCJA will have to be reversed, things like the corporate rate reduction or other aspects that lawmakers liked. Some potential ideas here on broadening the current tax base, and we’re thinking about how to make it sustainable: further limiting itemized deductions to broaden the base; rethinking Section 199A. Again, it was part of the Tax Cuts and Jobs Act, but when I hear Kevin Brady talk about benefits for small business, I know he’s talking about 199A, but thinking about that law’s structure, I
question whether that’s where the benefit is really going.

The benefit is actually for individuals who earn business income, regardless of entity size. It’s based on how much income they earn, not how large the company is that they work at. I know that that’s somewhat correlated, but 199A, the way it works is not perfectly structured. Rethinking that, whether that’s repealing that and thinking of something else or ways to hone that revenue loss towards that. Then also limiting other exclusions in the tax system; employer-sponsored health insurance, a large exclusion in the tax code, could be pared back. You could go after that for very high-income individuals rather than just an across-the-board change which would be very politically difficult.

Thinking more long-term and also thinking about things that may be just not politically feasible right now or in a decade is alternate sources of revenue, whether that’s a value-added tax or a carbon tax. Both of those taxes could raise significant amount of revenue and have limited impact on incentive effects, especially on the investment side in the United States. Sense of scale here, a very broad-based, value-added tax at 10 percent could raise about a $1 trillion every single year. It’s a very significant potential source of revenue, at the same time, not raising marginal tax rates all that much.

Lastly, going forward, building on the Tax Cuts and Jobs Act, there are lots of positive aspects, lower corporate rate, expensing that contributed towards growth, but there’s more that you could do there to accomplish that goal if that’s what you want to do.

The thing I like to point to is moving more towards a cash flow tax. This was actually something debated in 2016. The House GOP blueprint -- leave aside the border adjustment for a second, which was controversial -- just looking at the domestic side of things, expanding expensing to all assets, not just short-lived assets, this actually could have a large effect given that structures are the majority of the U.S. capital stock and they’re currently left out of expensing.

Jason Furman just put out an estimate of what he thinks the growth would be under a cash flow tax. He thinks that it could increase long-run output by 5.8 percent, which is more than five times what the long-run effect of the Tax Cuts and Jobs Act is projected to be under CBO’s assumptions. That’s a big difference that expanding this idea of a cash flow tax to everything could have.

Then on the individual income tax side, you could make the individual provisions permanent. That would reduce in the long run marginal tax rates on work. There are places you could fix up 199A. There’s also an aspect of individual income taxation that wasn’t touched whatsoever, and that’s the treatment of saving by individuals.

I can’t remember which lawmaker it was that talked about the Tax Cuts and Jobs Act. They wanted to encourage saving, but I don’t think there’s anything in the law that actually work towards that goal. I don’t think that the incentive to save was changed all that much in the TCJA, so it was left out. That’s one way you could build off the TCJA by looking at how you could simplify savings for individuals and expand those savings accounts.

I also promised that I would at least briefly touch on the OECD’s work as something looking forward. Now, as I haven’t looked at this very carefully or as much as I should, but I get the sense, at least at this point, that it’s going to be tradeoffs in terms of working towards broadening or changing the corporate tax base in ways that may increase taxation of corporations. It may have effects on incentives for corporations to invest, whether it’s increasing the amount of investment they do in a jurisdiction or moving investments from one jurisdiction to another. I’m actually very curious to see what they come up with.

To put that more concretely, one way in which this matters is in the discussion on GILTI. GILTI may be part of this discussion, and the structure of GILTI matters with respect to how it affects investment. I think there’s a big difference between, say, a worldwide minimum tax that taxes all returns of corporations on a minimum rate and what the United States did, which was a worldwide minimum tax that has an exemption for a deemed return or an ordinary return. The idea of the latter is to exempt the ordinary return to
investment so it doesn’t distort investment decisions as much as, say, a worldwide minimum tax that taxes the total return to investment. Structure will matter. With that, I will conclude.

**MS. ALTSHULER:** Thank you panelists for your excellent presentations. I have a bunch of questions for everyone. All three of you have talked about growth, but we haven’t talked about competitiveness and what the Act did for competitiveness. Did the Act make U.S. firms more competitive? What happened to effective tax rates on foreign investment? Has the reduction in the corporate rate, combined with GILTI, decreased or increased the incentive to shift profits abroad? If you don’t think we’ve become competitive, what would you change?

**MR. SULLIVAN:** Well, I think undoubtedly the reduction in the corporate rate from 35 to 21 percent, that’s a 40 percent reduction, was absolutely excellent tax policy. I call it chicken soup for the tax code because it makes everything better. It makes domestic investment more attractive; it makes profit shifting less attractive; it makes debt less attractive. As the OECD and everybody else says, it’s our most economically destructive tax, so it’s good that we reduced it significantly.

**MR. POMERLEAU:** The way I think about competitiveness, at least in terms of international tax policy, say there is some hypothetical investment and a U.S. firm could do it but also a foreign firm could do this investment or own this investment. How does the tax system affect that? From my perspective, this may be one of the areas where we don’t really know, and it might be very firm-specific. Thinking about the effects of GILTI specifically, (and I don’t want to give away the poll question) the statutory rate on foreign profits is lower but the tax is accelerated, meaning that you pay it earlier, whereas under the previous system the rate was higher but you could defer. Maybe it’s going to matter based on the firm specifics and how they are paying back profit. I’m not entirely certain.

**MR. CARROLL:** Yeah, the way I would think about it is from a couple different perspectives. One perspective would be how does the incentive to invest in the United States versus other countries, how has that changed with the TCJA? Certainly, in the beginning, over 2018 through just before the expensing starts to get phased out and then sunset, the marginal effective tax rate for new investment in the U.S. declined by six or seven percentage points, which is a very large reduction. The U.S. should be a more favorable place to invest, so we should be more attractive for domestic investment and inbound investment from foreign companies. But, as we’ve all discussed, you do the reconciliation, there’s the important provisions sunset: expensing, 199A.

Then we also have a couple of provisions that increase the marginal effective tax rate on new investment, principally the first one on this slide, the interest limitation, not terribly binding now, but as will become much more binding in 2022. All else equal, that will lift the marginal effective tax rate, and amortization of R&D, the same thing. When you look at the METRs, the METRs don’t really change that much when you’re all in, looking at everything under the hood when you get into 2027 and beyond. That’s one way to look at it.

With respect to GILTI, it’s really quite complicated. It would be very idiosyncratic depending on the firm you’re looking at. Kyle made the point that the way some of the provisions are structured, you’re trying to remove the tax on the expected normal return to some extent, so that plays into the incentive effects. It is really, really complicated.

**MS. ALTSHULER:** Let’s look at the polling question, which I believe is the next slide. Based on your experience, what percentage of taxpayers would you say cannot use all their foreign tax credits in the GILTI basket because of the foreign tax credit limitation? In other words, what percent are in an excess credit position? In other words, what percent are really facing a territorial tax system?
Polling Question: Based on your experience what percentage of taxpayers would you say cannot use all their foreign tax credits in the GILTI basket because of the foreign tax credit limitation (that is, they are in an excess credit position)?

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MS. ALTSHULER: And as you’re voting, I will ask what the panelists think.

MR. SULLIVAN: Well, I think just the thing to point out is that there’s a debate in the OECD now about whether we should have a per-country or an overall calculation for any minimum tax.

The United States strongly favors overall, and all practitioners favor overall because nobody can imagine doing a per-country calculation.

MS. ALTSHULER: I do have a paper with Harry Grubert that if you read it carefully at the end says we do favor an overall limitation which is where we ended up. Many academics believe GILTI should be on a per-country basis.

MR. SULLIVAN: Right, and that was the position of the Obama Administration, and academics who don’t practice in the real world.

If you’re in excess credit position, which I’m guessing most firms are, your incentive on the margin to shift profit and invest in low-tax countries is very large.

MS. ALTSHULER: But we do have that lower rate.

MR. SULLIVAN: The way one practitioner said it to me was this: “before TCJA, it was 35 versus 0. And now it’s 21 versus 10 and a half. But if you’re in excess credit, it’s really 21 versus 0 still.”

The compression of the rate differential reduces profit shifting and the incentive to shift abroad.

MS. ALTSHULER: Wow, just as Marty said. Okay, so the results say greater than 50 percent.
MR. SULLIVAN: I think the variation is what’s interesting.

MS. ALTSHULER: I’m going to direct a question to Bob. How has tax planning changed? I assume you’re involved somewhat in that in your job with QUEST. Not much?

MR. CARROLL: Not so much.

MS. ALTSHULER: How has tax planning changed, and I’m really talking about for multinational corporations, since the act? And maybe I’ll just get back to income shifting. Do you think we’ve seen a change in income shifting?

MR. SULLIVAN: Well, the incentives are less, obviously.

MS. ALTSHULER: Do you think we’ve seen less?

MR. CARROLL: But we had trade tensions. We had shifts in oil prices. You know, we had other things going on. I think the disruption associated with the trade tensions was really quite significant. It kicked in at about the same time. As Phil Swagel indicated, it’s very, very hard to disentangle that.

When you look at the aggregate numbers, you’re simply not going to be able to decipher that. I mean, I think to Marty’s point, with a lower corporate rate, you should see less, less shifting. It doesn’t mean there’s less planning. I think the firms are still very, very busy.

MS. ALTSHULER: There are some people that really believe that if there’s just a one percentage point difference…

MR. CARROLL: Yeah, that’s one economist but clearly, we have new provisions. They’re complex. There’s a lot of activity helping firms understand those provisions.

MS. ALTSHULER: Well, I hope we’ve helped you understand the provisions and what’s going on in the economy because I see we’re now down to 15 seconds. Thank you very much. Thank you to all the panelists.
Mini-Session:
Corporate Rate Point/Counterpoint

Description:
One of the most significant provisions of the TCJA is the cutting of the U.S. corporate income tax rate. It is also one of the most intensely debated. Is 21% the right rate for a healthy business environment? What were the intended goals of the rate cut and are those goals being achieved? The session provided a brief point-counterpoint on this “tent-pole” aspect of the TCJA.

Participants:
Aparna Mathur, Resident Scholar, American Enterprise Institute
Steven M. Rosenthal, Senior Fellow, Urban-Brookings Tax Policy Center

MS. APARNA MATHUR: Thank you so much for having us here. I think instead of talking about is the 21 percent the right rate or should we move up or down, I wanted to put a little bit of thought and a little bit of background to why we’re talking about a corporate rate cut in the first place, why was the Tax Cuts and Jobs Act really about the corporate side, the business side, and cutting rates. I’m an economist by training, looking at why we keep talking about competitiveness. You heard a lot of videos all throughout the morning on why the corporate rate cut mattered.

It’s also surprising, and I think it doesn’t come out as much in the debate today, that there was a lot of consensus before the Tax Cuts and Jobs Act even passed on the corporate rate cuts. President Obama, in his 2016 budget, talked about cutting the corporate rate from the 35 percent headline rate to 28 percent and a specific rate of 25 percent for manufacturing. And, of course, a lot of Republicans also had talked about the rate cut, and there was speculation that Speaker Ryan and President Obama were going to try to cut the headline rate as well.

Why the focus on the rate cut? I think it’s pretty obvious now to anybody who looks at the issue that corporate rates matter for competitiveness. Corporate rates matter when companies are deciding where to locate investment. If you look at the history of U.S. corporate tax reform, and this again came up in one of the sessions earlier, we had not had a corporate rate cut in the headline rate since 1986. We were decades behind other countries where every other country around the globe -- and if you look at the average for the rest of the OECD, it was around 24, 25 percent when we were still at the 35 percent rate.

It was becoming increasingly clear that that was affecting us globally, where when investors look at which countries matter for investment, they look at the headline rate, and that decides the location of investment. There’s a ton of research in economics that is able to correlate or actually show a causal link between rates and investment. And so, in that sense, competitiveness in the U.S. was being hurt.

Now, this is not just about the headline rate. A lot of times when you hear people say, oh, the headline rate was 35 percent, the pushback is, no, it wasn’t, it was actually way lower because we have a ton of deductions and credit. But the CBO did a study, again just before the Tax Cuts and Jobs Act, and found that even if you look at effective average of marginal rates, we were in the top of the OECD countries. We were in the top three or four countries in terms of our headline rates.

Now, that meant that we’re getting lower investment. Companies were being competed out and our investment was being competed out by other countries, and in research that I did with Kevin Hassett, we also show that that mattered for workers as well. There’s a wage impact of having lower investment in your country, which is that lower investment leads to lower capital labor ratios, leads to lower productivity,
and leads to lower wages.

So, that’s the context in which the Tax Cuts and Jobs Act came in. It wasn’t as if we had really high revenues coming in with those high rates of 35 percent. It wasn’t as if cutting the rate to 21 percent suddenly caused this big decline in revenues. In fact, even before the Tax Cuts and Jobs Act, we were saying, well, corporate tax revenues in the U.S. compare very poorly to corporate tax revenue, to GDP ratios in other OECD countries that have far lower rates.

So, the question is what did the Tax Cuts and Jobs Act do? Where are we now? Are we getting more revenues? We’ve, again, seen a lot of discussion about where we are, but that’s the context in which the TCJA was passed. That’s the reason why the rate became the centerpiece of the Tax Cuts and Jobs Act.

I would say we’re still in the phase where we’re discovering what is the TCJA actually achieving. The first thing that I look for when I look at the impact of the rate cut is on investment. As Phil Swagel pointed out this morning, the CBO says, well, in 2018, the TCJA did lead to higher investment. In 2019, it did so as well, and it’s projected to do that in 2020.

When you look at things like wages, it’s hard to see a break in trend from the Tax Cuts and Jobs Act. It is true that wages were on the path to recovery before the Tax Cuts and Jobs Act, and they’re still trending up. We’re still at 3 percent nominal wage growth. And Phil again showed a bunch of charts showing how well the economy is doing. I think as an economist, I would say, well, let’s wait a few years. It’s hard to tease out currently the impact of the Tax Cuts and Jobs Act, and more specifically just the rate cut on investment, on wages, on productivity growth, and on GDP. We will have a lot more data going forward.

And, finally, before I end, again, the TCJA was not just about the corporate rate cut. There were a million other things, as policymakers, as people who’ve looked into the bill, there are many things that raise rates on companies that broaden the tax base. Just looking at the rate impact and assigning everything to the cut in the rate is a little bit unfair, and we need to give it time. We need to figure out what did the TCJA actually do. Thanks.

MR. STEVEN ROENTHAL: Thank you, Aparna. You anticipated some of my pushback. When Obama suggested lowering the 35 percent rate to 28 percent, he also noted the effective tax rates were 23 percent; the marginal tax rates were 19 percent, maybe a little higher than other OECD countries, but not a catastrophe. On the other hand, I’d agree with Aparna and with Obama, our old system was broken. We had elective taxation. Multinationals could shift profits overseas and choose to defer their U.S. taxes. Everybody agreed it was a mistake and had to be fixed.

Now, slashing the rate from 35 percent to 21 percent was sold on the notion that workers were going to benefit. Remember the fatter paychecks that all the workers in America should look for? $4,000? Kevin Hassett said maybe as large as $9,000? Those fatter paychecks, well, we haven’t seen signs of that yet.

Now, not surprising, because ask yourself: What would be the mechanism for workers to have higher wages? I think we might all agree on the mechanism that the theory is U.S. corporate tax rates are cut; that allows corporations to retain more of their after-tax profits; maybe attract capital from foreigners. They can use that extra capital to invest in plants and equipment. The new plants and equipment will increase worker productivity. And the increased productivity might yet translate into higher wages, the last step.

Now, two things to observe. That’s a lot of steps and a lot of time. When the White House was selling “look for that extra $4,000 in your pay envelopes,” even Kevin Hassett was backing away. Well, perhaps three to five years. Maybe twice as long. That’s what Kevin Hassett said.

By contrast, Paul Krugman was saying, we should be thinking in terms of decades. The ability for workers to benefit, that’s in the long run, the long-run equilibrium. That could take decades, not a matter of a few years.
We’re now a little over two years after the passage of TCJA. What do we know? We know some. I’m not saying we know a lot, but the best argument for the economics of TCJA now is, gosh, we don’t know much; we can’t tell what’s really happening; give us time. Well, let’s think about whether we’re seeing any of the steps that are supposed to occur on the way to higher taxes. Are we seeing corporations retain their after-tax profits? No. A whole bunch of stock buybacks.

Are we seeing corporations attract foreign capital in a substantially greater fashion? No, we’re not seeing much of that.

Finally, are we even seeing any signs of increased capital investment, CapEx? No. I think we heard earlier there was a good 2018, and I think the expression was a couple of bad 2019 quarters on business investment. It wasn’t just a couple. It was three in a row, three straight negative capital investments.

It’s not as if any of these steps are showing any signs of happening. We saw a bunch of bonuses right after the tax bill was enacted, and the President was out there saying, look at all these bonuses being declared. But Joint Tax wrote a report this week explaining. Rich Rubin from the Wall Street Journal flagged it: That’s tax arbitrage.

I’m a tax lawyer. I know how to arbitrage. You accelerate your deductions into a 35 percent deduction year, and you defer your associated income to a 21 percent year. That’s expensive. That’s what we saw. That wasn’t worker compensation being increased. So, again, we’ve got a long-run story we’re waiting to see play out, but we haven’t seen it play out.

Let me just finish with one thought that I’ve put a lot of time into research. Who wins in the short run? Well, economists all believe shareholders win in the short run. You cut tax rates, after-tax profits go up. It’s capitalized into the stock price. Stock prices go up. That’s what happens in the short run. The short run could be decades. Who’s benefitted? Shareholders. One percent of our country owns more than 50 percent of the equity. The bottom 50 percent own about 1 percent.

If you look to domestic U.S. equity, you know who owns the biggest chunk as a class? Foreign investors, 35 percent of the U.S. equity is held by foreign investors. A windfall for foreigners. So, should corporate taxes have been cut? Yes, but it should have been cut in combination with a wider package of reforms, and it’s not clear that the large cuts that occurred has helped much of anybody except for the rich investors. That’s my take.

MS. MATHUR: Yes, so, Steve, I do agree with you. I think the rate cut happened in a broader package of reforms that I think people are still figuring out, which I think explains a little bit of the investment, the lack of investment response that we’re seeing right now. We’ve discussed a lot about the international tax proposal that I think companies are still figuring, well, what does that mean for me. This was something that’s been debated over the last two years since the TCJA was passed. So, yeah, I agree with you. There will be a longer-term effect.

Now, going back to the wage question, this was a centerpiece of the tax reform, and I remember Kevin going on TV and saying, we’ll get the rate cut and this is the wage impact we’ll see. I think that the problem is going and taking the academic literature on the issue, which is robust and which does show an effect, and trying to translate that to what does this mean for the U.S., and I think that’s always been a challenge. And it’s tough to do research and corporate tax reform in the U.S. because we haven’t had any major changes to the corporate tax code since 1986.

So, I know exactly where those numbers are coming from. The question always becomes, well, what happens with the rate cut, and now we’ve heard the story, it goes from investment to productivity to wages, and in economics, we call this what is the incidence of corporate tax changes. Who bears the burden of higher corporate taxes? There is now a bunch of literature that says, well, the incidence -- a big chunk of any higher rate is going to be paid by workers in the form of lower wages.

Now, it’s hard to predict, you know, is that going to be $2,000 for the U.S.? Is that going to be $1,000? Is
that going to be $4,000? I have no idea where those numbers come from, except to say, well, there is some basis in the research to suggest --

MR. ROSENTHAL: But when? When will this happen?

MS. MATHUR: And that is the better question. The better question is how long will it take for companies to get that initial investment response. I have always said it’s going to be longer term, and longer term doesn’t mean 10 years. I think it does mean four to five years. I think it’s still too early, given that Treasury is still writing guidance, is still explaining to companies what do the international reforms mean for your specific company, what does that mean for your tax bill, what does it mean for profits.

Given all the other uncertainty that has come with this tax package over the last two years, the trade war, Brexit, the global uncertainty, I think it’s unfair to say all of the stuff we’re seeing right now is because the tax cut failed. I think it’s too early to say it failed. I also think it’s too early to say it’s a success. But I think we’re at that middle ground where we know that, again, at some point, we will try to tease out the impact of all that happened in 2017 on the economy, but it’s too early to say that now.

In terms of the bonuses, you’re exactly right. I don’t think of that as being a response to the Tax Cuts and Jobs Act. I think it was something that companies did to show support for the Tax Cuts and Jobs Act, but that’s not how the economics of the tax cut is supposed to work. That is a longer-term phenomenon. That does take into account what happened --

MR. ROSENTHAL: But are you seeing any green shoots yet? I mean, we’re over two years out, and you’re saying four years you expect to start seeing the indicators of higher wages. What green shoots do we see? Do we see corporates keeping more of their after-tax profits and investing them? Do we see any signs of investment? When might we see those?

MS. MATHUR: So, that’s interesting. When you look at the expensing provision, I think there is some evidence to suggest that you did see equipment expensing go up in 2018 and in 2019, and I think some of that can be traced to the TCJA. The longer-term investment, again, was on an upward trajectory before the TCJA. We continue to see that, so it’s hard to say, well, this is the incremental response to the Tax Cuts and Jobs Act.

I think give it time. I think it will be a few years before companies figure it out, and then we’re going to see --

MR. ROSENTHAL: I’m not quite as patient with giving the TCJA a pass. I think Marty made the point in the last panel that TCJA was enacted in a strictly partisan way, in 50 days raced through Congress. That leads to instability. That leads to question marks as to whether the Democrats will repeal those tax rate cuts as soon as they get elected. As a consequence, in my view, the TCJA planted the seeds of its own destruction. This was not a way to write a tax reform bill.

So, where do we end up? We may yet end up back closer to where Obama was at a 28, maybe a 25 percent rate, with a broader base in some fashion than we had in the past. We’ve got to work on per-country, per-world, what the minimum tax rate ought to be. Those are difficult questions, but I think we’re going to have a restructuring but it won’t be 21 percent. That’s not where we’re going to land, at least in my view.

MS. MATHUR: I agree with you. I think that there will be an attempt to raise the rate up, probably to 25 to 28 percent, and I think that is adding to the uncertainty that companies are facing because if you anticipate within the next year or so that there will be a push to raise the rate up, back to something higher, I think that does add to uncertainty for companies.

I think there’s also uncertainty in other provisions. With the FDII provision as Kyle mentioned, companies have an incentive to get intellectual property back to the U.S., but then there’s all this question about, well, is this going to be WTO-compatible and is this actually a provision that will stay. The more we keep
debating, well, is this something -- yes, TCJA was passed with just Republican support and as soon as Democrats come into the White House, a lot of this will be reversed, I think that adds to the uncertainty. I don’t disagree with you there. You know, that’s the political process.

MR. ROSENTHAL: Well, I think we’re on the same page as to how the process itself led to uncertainty, but the conference motto, I was looking at my name tag here, Hindsight is 20/20. Well, maybe now we know that those great economic windfalls will take a while to occur. But the President was predicting fatter paychecks, with GDP growth of 3 percent a year. I think that was 30 percent over 10 years, whatever the number was in the President’s mind, but every responsible estimator who looked at these questions said, look, it’s going to be hard to tease out any GDP effect. Yeah, there could be some wage increase in the long run and Joint Tax, CBO scored a little of the distribution towards workers, but I think that our experience so far in the two-plus years since the TCJA aligns pretty well with where the estimators were predicting. We’re going to see maybe a little improvement to workers’ wages in the long run.

We haven’t seen much of it yet, but I want to make sure I leave you with one thought. Taxes are the price we pay for civilization. We use taxes to fund the services that we all depend upon. TCJA added $2 trillion to the nation’s debt. The corporate rate cuts amounted to over a trillion of that extra debt. I think the rule of thumb on rate cuts is a $100 billion for every percentage point.

We’re now looking at $1 trillion a year deficits for as far as the eye can see. I understand Marty’s sympathy for large deficits. They haven’t seemed to have had any effect, and I think he could be right until he’s wrong, and then bad things can happen. But I do believe when you borrow money you need to repay it, and we repay that money either with higher taxes and new taxes in the future or cutting spending that we all depend upon. The U.S. now has a tax problem.

I know there’s a great mantra on the right, there’s a spending problem. But when you look at all the industrial countries in the world, our tax per GDP is near the bottom. Our deficit per GDP is near the top. Our spending for an industrial country is about average. Why can’t we tax to pay for the services we all expect to afford? We’ve now shifted from tax and spend to borrow and spend. I don’t think that’s good for the future, but that’s, I think, where we are.

MS. MATHUR: I’m going to agree with you there. I think the fact that the TCJA was passed with a massive addition to the deficit and debt picture going forward is a concern, and I think we need to figure out definitely ways to get those revenues back. As Kyle mentioned and as my work on carbon taxes shows, there are good ways to broaden the tax base, to fix certain loopholes and to try to get those revenues back.

So, again, a dampener on growth has been the fact that the rate cut happened in a tax package that did add significantly to the deficit. I think all of us, at least reasonable people who were looking at the bill, said this is going to affect the impact of the rate cut on companies and on the economy going forward. So, I absolutely agree with you there. We need to figure out ways to raise revenues going forward. We need to address deficits in that, and then maybe try to figure out, well, what’s the best way to make the U.S. economy competitive again. Thank you.

MR. ROSENTHAL: I’m glad we agree.

MS. MATHUR: Thank you, Steve.
The TCJA in Action: Tax Reform in the Real World

Description:
Part of the promise of the TCJA, as set forth in the *Unified Framework* on tax reform, was “to make America the jobs magnet of the world by leveling the playing field for American businesses.” Two years on from enactment, can we begin to evaluate to what extent and how the new law achieves these goals? This panel of senior tax executives discussed the real-world effects of the most fundamental aspects of U.S. tax reform on American businesses and workers, including the lower corporate tax rate, the participation exemption system, GILTI, and more.

Panelists:
- Ronald Dabrowski, Principal and Technical Deputy, Washington National Tax, KPMG (moderator)
- Kevin Conway, Senior Vice President, Tax, AmerisourceBergen
- Jacqueline Crouse, Vice President, Tax, Amgen, Inc.
- Heather Crowder, Vice President & General Tax Officer, Phillips 66

MR. RON DABROWSKI: We started this morning with the policy, the politics, and the economists’ view of the TCJA. We’re going to transition now and get a little more practical -- the impact on the tax function, the impact on the business, the perspectives from the tax function on the business effects of the TCJA.

Our panel is The TCJA in Action. I’m Ron Dabrowski. I’m a Principal in KPMG’s Washington National Tax Office. I’m lucky today to have a great panel of CTOs from some of the biggest companies in the United States. I’m going to ask them to introduce themselves, to tell us a little bit about your companies and your role, and then we’ll kick it off from there.

Jackie?

MS. JACKIE CROUSE: Hello. I’m Jackie Crouse. I head the tax function at Amgen. We are a biotechnology company located in Southern California. We’re a much larger company now but still small compared to some of the very large multinationals. Biotechnology companies started in the late ’70s, early ’80s with innovation in DNA technology. We make protein medicines that are injected into seriously ill patients. The company started in 1980 with eight employees, really smart scientists, and now we have over 20,000 employees.

We’re primarily U.S.-based. We have about 80 percent of our sales in the U.S. When I started with the company, we had operations mainly in the U.S. and Western Europe, and now we’re in over 75 countries.

MR. KEVIN CONWAY: I’m Kevin Conway. I’m the Head of Tax at AmerisourceBergen. We are a pharmaceutical wholesale distribution services company so we are a major supply chain company in the healthcare system. We provide services to pharmaceutical manufacturers, healthcare providers, pharmacies, and our tax footprint is mainly in the U.S.

MS. HEATHER CROWDER: I’m Heather Crowder. I manage the Tax Function at Phillips 66. We are a diversified energy, manufacturing and logistics company. Basically, that means we refine, transport and market energy products. We are mainly domestic, about 80 to 85 percent domestic. We are also in the chemical business through our partnership with Chevron.
MR. DABROWSKI: Okay, let me set out our agenda. Basically, we’re taking some of the big-picture themes we’ve heard this morning. We’re going to address them, but, again, if this morning was more macro, we’re going to be a little bit more micro and get it from the perspective of the companies themselves. But let’s start with reactions to what we heard this morning. Anything jump out to you from the economists, the politicians, the policy discussion?

Jackie?

MS. CROUSE: I wouldn’t disagree with them on the macro level, but it may be too early to tell the overall effects. On the level of our particular company, I think the TCJA was very beneficial, particularly the lower rate. We’ve made investments -- I’ll talk about those during our panel -- but I think there’s still some instability because of some of the rate increases that will occur, unless that’s changed, but overall I think I agree with their sense that it’s a little bit too early to tell broadly.

MR. CONWAY: Yeah, I think in terms of the rate, everyone talks about 21 percent, but in fact, the rate’s really more like 25 or 26 percent. You have to take into account state taxes. We now have GILTI, right? That adds to the rate. For those of us who elected the installment treatment for the transition tax, we’re now in the installment period.

When people are talking about 21 percent, that’s a theoretical number. That’s not the number in the real world. It’s more like 25, 26 percent-plus. So, when you compare the U.S. to other countries, we’re not really at the low end, not an outlier.

MS. CROWDER: Like I said, we’re heavily domestic, so there’s just no doubt that the rate was a big benefit for us. We are in a taxable position, and just looking at the difference in cash taxes paid we see the benefit. Of course, it took quite some time to file that 2018 return. It was well into 2019… and I know other companies know what I am talking about with respect to the filing delays.

MR. DABROWSKI: We’ll touch on that, too.

MS. CROWDER: But it’s just a tremendous advantage to have the domestic rate lowered as much as it was, even with the state tax burden and GILTI.

MR. DABROWSKI: Okay, we’re going to dive in. Let me just note, we have four polling questions, so we’re going to get your views on some of these things, get a little more data for the economists to work with perhaps, so make sure you have your apps up and ready. It’s the polling section in the menu.

All right, first topic. What benefit -- is it the rate and it’s all about the rate? But, TCJA had more elements to it -- bonus, a FDII export incentive, the end of deferral, the end of the lockout effect. What won? I guess what’s the benefit that sort of jumps out to you today?

Jackie, you want to start?

MS. CROUSE: I’d say for us the largest benefit is the reduced corporate tax rate, primarily because we still have a lot of income in the U.S. We also benefitted from the deferral, but I’d say for us the tax rate was the largest. Ending deferral increased our rate but was offset by the lower corporate rate.

Second would be the ability to use our foreign cash where the business would want to use it and not be limited by prior tax law rules.

MR. CONWAY: I would say the rate obviously. The lockout effect was huge on the ability to access foreign cash, I’ve spent my career trying to develop plans for tax-efficient repatriation of foreign earnings, so that’s a major simplification. There was some short-term complexity, transition tax, GILTI, but long term, from a structural standpoint, elimination of the lockout effect is huge.
MS. CROWDER: Well, going back to the rate issue, and it being too early to tell in terms of the impact on the economy, overall, there’s no doubt that having more cash has increased our investments. There was some criticism around stock buybacks by companies, after tax reform, which is part of managing shareholder return. However, if you have a $100 to split between buybacks and capital spending and that suddenly becomes $120, then there is $10 more going into capital investment.

With respect to the change in deferral or the change in the international provisions, you know the expression “better to be lucky than good?” We had debt in place from our spin-off. We spun off from ConocoPhillips in 2012, and that debt had been repaid at the beginning of 2017. We were starting to feel stress around the foreign cash issue, and there was just such a big rate differential between onshore and offshore earnings. So, the changes came at a really good time for us, and that’s been an advantage as well.

MR. DABROWSKI: All right, here’s where we’ll start our polling questions, get your views. When you think of the TCJA today, what’s the biggest impact: the rate; the other benefits taken kind of collectively, bonus, FDII, preservation of LIFO; the end of the deferral system is a separate one; or is the first thing that jumps out at you just too much complexity? Let us know what you think.

Polling Question #1: When you think of the TCJA today, what’s the biggest impact?

- a. The 21% rate
- b. Other TCJA benefits – bonus depreciation, FDII, preservation of LIFO
- c. End of deferral system, improved cash management
- d. Too much added complexity caused by the statute and the guidance rollout
- e. Other

All right, let’s see if we can get the results up. Where are we at? Yeah, that is the first among equals, right? The 21 percent rate really drives it. I think that’s not a surprise, right? That was what we were getting.

All right, but let’s go to the other end of the spectrum a little bit. We heard a lot of discussion this morning on the stability of this system. Some things are inherent, the law will change of its own, there’s obviously political uncertainty and where administrations are going to go in the future. We’re going to start here, I guess, with a polling question on stability, and so let me tee that up.
This is the big question, right? January 1st, 2024, your crystal ball says the corporate tax rate will be...

What do you think?

Polling Question #2: On January 1, 2024, the Federal corporate income tax rate will be:

All right, let’s tee up the answer. This will actually be pretty interesting. Wow. This says we actually expect political action, right? You know, it's interesting. Some things are automatic in the bill, a rate change would be an act of legislation and, you know, within four years you expect it to happen. Pretty interesting.

Heather, why don’t you start out here with thoughts on stability. How do you deal with the stability of the system when we have things beyond the rate? We have 163(j) changes, EBITDA to EBIT. We have R&D capitalization. How do you handle it kind of internally? How do you handle it externally?

MS. CROWDER: We have been very active post-tax-reform in monitoring regulations. Our first issue was dealing with the commodities exception related to repatriation. We started there, and that was a long discussion with Treasury. We pretty much worked directly with them provided a number of comments.

Second, we’ve been very active in providing comments on other proposed regulations. We have a government affairs office here, and we have somebody that’s dedicated to finance issues. So, we do a lot on our own, but we also rely on trade organizations. They’ve been pretty active, and we definitely appreciate the advocacy of these groups.

In summary, we’ve been doing blocking and tackling. We had some concerns under the proposed regulations, and we provided comments. We didn’t see all the desired changes, but we thought that the final regulations addressed some taxpayer concerns.

With respect to the rate, we are concerned about it. I don’t know who isn’t, and I think that those concerns are probably going to be heightened as we go through the 2020 election. But we haven’t really had anything tangible to engage on yet. Engagement would probably be through trade organizations and
our general advocacy approach. But we are concerned, and we'll just have to see what path it takes.

MR. CONWAY: In thinking about stability, if past is prologue, corporate tax rate increases are few and far between. If we go back to '86, the rate dropped from 46 to 34. I was a young tax lawyer in those days, very young. And seven years later, President Clinton increased it by 1 percent, right? We went from 34 to 35. And, in 27 years, we didn’t have another rate increase.

So, I'm in C. I think it will go up, but I think it's going to be longer and it’s going to be modest. The reason I say that is we can’t go back to 25. If we go back to 25 on the federal level, we’re going to be 30 when you throw in state and GILTI. We'll be at the high end, we’ll be up near France. I don’t think that will happen.

MS. CROUSE: Well, I think the OECD average now is about 24 percent, so our 21 percent, I agree with you, Kevin, it’s not really 21 percent. You add the state taxes, foreign taxes, some limits on foreign tax credits and we are about average with the OECD. When the U.S. reduced its rate to the 34 percent rate years ago, we were ahead. We were the leader in what I think is good economic policy for growth. But the issue I see with the rate is that the 21 percent rate came very late in the game, right? There were proposals originally 31 percent, 28 percent, and then all of a sudden it was 25 percent.

MR. DABROWSKI: The President ran on 15, though.

MS. CROUSE: I was surprised we got to 21.

MS. CROWDER: That’s because he started at 15.

MR. DABROWSKI: Yeah.

MS. CROUSE: I think we have some real risk, but the sixty-four-dollar question we always get is when we do our long-range forecast, what rate should we use. So, we build in the increases in the rate that will happen in 2026 for the GILTI and FDII. But then, we look at how do we assess this, this is going to be a wild year politically. So sometimes I’ll punt and say, well, let me ask our government affairs people what’s going to happen, but then I say, no, just stay tuned but don’t be surprised if there is some level of a rate increase. It really depends on what happens in the election cycle, I think.

MR. DABROWSKI: Yeah, I do find the results interesting that, you know, we have 0 percent at above 28. It’s sort of capped at -- I think the Obama Administration’s budget proposal number, so interesting results.

Jackie, let me pick up on your point and open it up for everybody else. Internally, how are you talking about stability and stability issues with your C-suite? How does it ripple into forecast, and is it tangible now? How does that play out?

MS. CROUSE: I think with the stability question, we make investment decisions and choices on where the law is today because we can’t predict. We keep it in mind, but as we look at investment choices, we’re using the current lower rate. One of the things that was good for us after tax reform is that -- and we were advocates on the Hill about investment in the U.S. -- we had a significant amount of money outside the U.S. that we had to invest outside the U.S. or we would have paid a 35 percent tax rate, much higher than ex-U.S.

We had a need to build a new manufacturing plant for our biologics. The year before tax reform, people were saying, well, we need to make a decision, we need to make a decision. So, I said, well, let’s look at it. Plant locations can be driven primarily by business reasons, but tax rates play an important part in that.

After tax reform, we made the decision that we wanted to support tax reform and the benefits that we received. We are in the process of building a new plant in Rhode Island. We’re spending about $250 million in capital. We’re going to hire 140-plus employees. We have 200 contractors and people working
on building the facility, and you have to do a lot of validation to get FDA approval for a biologics manufacturing plant. They’re not easy to build. They’re risky. Sometimes things don’t work right, and they take a while.

So, for us, when I heard the economists talking about, well, there’s been a decline in investment, I didn’t see that for us. I also saw our R&D expense. We spent $4 billion over the last year, probably about $500 million more than in prior years, so that was also a benefit for us.

**MR. DABROWSKI:** Kevin?

**MR. CONWAY:** We use the enacted tax rates in our long-range plan. And, I’ve made presentations to the board and talked about the potential for rate increases, and their response is we’ll see.

**MR. DABROWSKI:** Right. Just live in today, I guess, which is about all we can do.

Heather, anything?

**MS. CROWDER:** Like I said, we’re pretty much domestic, and there’s definitely been an energy renaissance in the U.S. So, there’s not been a big question about where we are going to invest. We’re enjoying the returns of the lower rate and the additional cash to invest. But with respect to the instability, I think there’s just a general feeling of chaos right now. I think that executives and boards are very aware of that, and I think that this is one part of it, so it’s kind of a wait-and-see this year.

**MR. DABROWSKI:** All right. Let’s focus on the international side a little bit more.

Perhaps the most reformed part, if you would, of the tax system was the end of the deferral system under Subpart F. Now we have more of a worldwide system with elements or hints of territoriality in there. But let’s focus on cash and cash management, and there’s different aspects that we’ve discussed this morning. I find it interesting that the discussions this morning didn’t really focus much on ending the lockout and the cash effect.

Kevin, let me start with you.

**MR. CONWAY:** Sure.

**MR. DABROWSKI:** I’ll make this direct. How has your relationship with your Treasury function changed because of the TCJA?

**MR. CONWAY:** I would say it’s better, much better. We are much more popular with our treasurer, and the reason for that is prior to tax reform, and actually for the past 20-plus years, I’ve been working on these intercompany loan arrangements. IRS and Treasury published guidelines under Section 956, so when you had offshore cash, you could loan it, but the loan had to be initiated after the first day of the quarter. You had to pay it back before the end of the quarter.

Once you closed the loan out, you couldn’t reinitiate it in that CFC chain until a period expired, which was the greater of the prior loan period or longer, right? So, you had this complex administrative process that we would go through with Treasury, and I did this my entire career. When I was in Big Pharma, United Technologies, media, entertainment. I had all these 956 charts, and it was extremely complicated.

After tax reform, Treasury and IRS published 956 regulations which were extremely helpful. Essentially now what we’re able to do is set up the intercompany loans we can access the cash during the year. We’re no longer permanently reinvested in our major cash-generating jurisdictions, and we can loan the money back as it’s earned. At year-end, we’ll pay it back. We’ll have distributable reserves, and declare a dividend.

So, I think it’s a huge benefit. And I think simplification. There’s a lot of complexity with the TCJA, but
this is a major simplification in terms of a chief tax officer. We no longer have to focus on, well, we’ve got to look at the foreign acquisitions, how do we repatriate the cash, do we really want to make this acquisition and lock up more cash offshore? It really is, I think, a very significant improvement structurally.

MR. DABROWSKI: Heather.

MS. CROWDER: Our Treasury folks don’t miss chatting with me, that’s for sure, so they’re very happy. We were having to start the 956 management process throughout 2017, and we had these color-coded charts to track all the timing and all the exceptions. It’s definitely, definitely been helpful in terms of cash management.

MS. CROUSE: I guess I’m more conservative than Kevin because we did not do intercompany loans, but we had pretty good borrowing capacity. What’s the saying, rather be lucky than smart, so we were able to borrow in a low-interest rate environment. Having the cash wherever you want it can sometimes also help in terms of what you want to do with your cash.

We just did an acquisition of a product, $13 billion-plus, from two pharma companies that were merging and had to dispose of it. The product’s primarily a U.S. product. We were able to be a successful bidder in that, and I think tax reform helped that a lot because we had access to our cash, and we also were able to be more competitive -- we’ll talk about that -- with our foreign peers because of our tax rate and not having that lockout effect or having to pay the 35 percent under prior law.

MR. DABROWSKI: It seems to me there are two sides of the coin, I guess, on cash coming back. There’s the international cash that you have access to, and then there’s also just the cash savings from tax reform itself.

MR. CONWAY: Oh, absolutely.

MR. DABROWSKI: You touched on that, and in our discussions before, I think you all noted how that’s changed and liberated. Any notes on that, just the fact of cash tax savings because of the 21 percent?

MR. CONWAY: It’s significant. One of our major metrics every year is free cash flow, and the rate reduction from 35 to 21 is a major factor in that. It’s provided us a lot more cash. We’re constantly retooling 26 distribution centers around the U.S., so that extra cash is now available in the U.S. for that capital investment.

MS. CROWDER: Yes, I think, ultimately, too, there are the benefits to profits and earnings per share from the lower rate. But companies are also evaluated on their cash flow.

The other thing I think is helpful for cash flow is the provision in the TCJA that repatriation tax could be paid over eight years. We had repatriation tax and paying that over the eight years is certainly an NPV benefit.

MR. CONWAY: The other impact of the rate which really didn’t occur to me at first but when you think about your risk exposures, the transfer pricing, Section 367, a 21 percent rate is, you know, a lot less risk. So, there’s a tax risk mitigation factor. The other thing, too, when you think about the transition tax, it was kind of the down payment to get the repatriation. I was around in ’86, and if someone would have said to me, all right, in, you know, 31 years, you’re going to have the option to take -- or you’re going to be required to repatriate, but it’s going to be between 8 and 15 percent, you know, we’re going to drop it from 46 to 34, what would you think of that? Would you sign up for that deal? And I think, looking back, yes, we’ve paid a toll tax, a transition tax, but it also eliminates the risk on those earnings, right? I’ve paid that tax. I no longer have any risk.

MR. DABROWSKI: Sleep better at night.
MR. CONWAY: That’s right.

MR. DABROWSKI: Thirty-five percent cliff.

MR. CONWAY: So, from a FIN 48 standpoint, the lower rate has a real impact.

MR. DABROWSKI: So, this has been all just great, rosy, good, positive things. On another side of the coin in TCJA, and I think as we come out of filing season, for your returns, as we come out of year-end closed-for-financial-statements, there seemed to be a lot of angst, and I think it put a lot of pressure on KPMG’s folks.

I want to get the audience’s reaction on the downsides of TCJA in terms of complexity and compliance. Let’s tee up the next polling question: how is your company handling the added complexity caused by the statute: Increased forms and form lengths; and the guidance rollout, so living in sort of an uncertain legal environment. So, four options there. How is it affecting your sort of companies?

**Polling Question #3: How is your company handling the added complexity caused by the statute, increased forms/form-lengths, and the guidance rollout?**

<table>
<thead>
<tr>
<th>Result</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>More work from existing staff</td>
<td>41.00%</td>
</tr>
<tr>
<td>Increased use of outside firms</td>
<td>13.00%</td>
</tr>
<tr>
<td>Investments in technology to improve efficiencies</td>
<td>0.00%</td>
</tr>
<tr>
<td>No change in workload, increases in complexities in some areas are offset by simplification in others</td>
<td>46.00%</td>
</tr>
</tbody>
</table>

* Option “D” polled 0%

All right, let’s tee that up and see if we can see the results.

MS. CROWDER: I’m glad D was 0 percent. –I was wondering…

MR. DABROWSKI: Yeah, that’s probably the most interesting -- whoever the states state, right? That person does not exist.

MS. CROWDER: I wanted to hear what the simplification was --

MS. CROUSE: Exactly.
MS. CROWDER: -- because maybe I missed it.

MR. DABROWSKI: All right, any reaction? What’s your experience been or how are you dealing with sort of the added complexity? I think you all have relatively small international footprints, but that’s become incrementally more complex.

MS. CROWDER: Right.

MR. DABROWSKI: How has that rippled through your tax function?

MS. CROWDER: I’ll start. We have a small international footprint, and we also have a small international compliance group. And so, we are probably A and C in terms of how we’re handling it. I mean, the forms have just doubled. The reporting that we have to do on international operations was many inches of our tax return, despite the fact that we were a relatively small international footprint. Now it’s literally doubled in size.

We had to retool, and we’ve had to bring more people in to do some of the international prep and just rearrange some work for folks. At the same time, and this would have happened whether or not there was tax reform, we are going through some business transformation and changes. It’s a good time. We’re updating our ERP system. I’m sure a number of people are going through that. We are investing in technologies and efficiencies, which is helpful.

That’s coming at a good time for us because we definitely taking more of a risk-based approach on our return. Some of the smaller, easier tax adjustments, we’re automating, and we’re investing in process improvements, better tools and things like that. It’s looking at everything that’s available to help, but the big frustration that I referenced earlier is, of course, the outside software providers. It was just a very rough tax filing season.

We file in 50 states. We have nexus everywhere. There are other local returns sometimes beyond just the 50 states, so it’s more than 50 filings, and often there’s more than one entity. It was just a huge disadvantage for us to file so late and so close to the deadline. It just put everything behind.

I’m hopeful that it will be better this year with respect to the tax preparation software, but the regulations are still moving, and small changes, for example, in the interest expense limitation, 163(j), have a ripple effect through different parts of the return and the supporting work papers. That’s of the type of thing that slows up development or release of the product. So, we’ll see.

MR. CONWAY: We’re in Category C. We’re making investments in technology, really going to a global provision software reporting. Most of our income is in the U.S., but we do have operations in 50 countries outside the U.S. So GILTI, 5471s are pretty complicated for us, and as Heather said, the reporting requirements are really complex. We also file numerous entities in 50 states, so I think it’s a huge burden, and our answer really is to migrate as quickly as we can to a better technology solution.

MR. DABROWSKI: Jackie.

MS. CROUSE: I probably would have answered more work from existing staff because one thing we didn’t get was simplification from tax reform. After tax reform was enacted, we tried to simplify the explanation for my CFO. Sometimes, no good deed goes unpunished, so it was like here’s the U.S. 21 percent, here’s this sort of a foreign minimum tax at 10 and a half, and then there’s this export benefit at 13.1 percent. And he’s like, oh, wow, that’s great.

So, do we need as many people? I said, well, I just really simplified it for you -- the forms, the analysis, we had to prepare models, is very complex. We had done a lot of modeling in tax reform, but remember, things did change very late in the game, so we had to redo models quite a bit. So, with the complexity of our first tax return filing, I would say our staff really had a huge burden, but now we’re moving into the use of more technology.
For us, we are primarily a U.S. company but we do have growing foreign operations. But with GILTI, we now are having to move our tax provision software to a global provision process like you're doing, Kevin. We're in the midst of that right now. It's a lot of work, but I think that gives you the benefit of seeing the technology improvements, and then from there, how do you make other further technology improvements. Before tax reform, we would have had a difficult time convincing people that we need to spend more money on tax compliance technology.

MR. DABROWSKI: Right, right.

MS. CROUSE: -- than on how to run clinical trials or manufacture our products.

MR. DABROWSKI: So, I guess from the prior two discussions, less time with the Treasury team, so that's probably more time with the IT teams and in design and having your people support information collection and what information you need.

MR. CONWAY: Yeah, and I think one of the positives that is coming out of this is we're trying to leverage all this into the compliance function. With this new software platform, we're really trying to go from the year-end provision to the federal return to the state return. We're really trying to leverage that all the way through.

MR. DABROWSKI: Is this facilitating more line of sight and communication with the business side? You know, again, like moving from sort of a Treasury which is all in the finance side to more on the operations? Is that plain enough?

MR. CONWAY: I think we're getting more access and more transparency, and data is part of this process.

MS. CROWDER: And to the extent that you want to take a FDII benefit, you definitely have to be in touch with the businesses, right?

MR. CONWAY: Yes, absolutely.

MS. CROWDER: The regulations are good in that they leave room for reasonable process, but getting specific cost allocations to figure out the calculation, it's not always as easy as it may seem. We definitely spent more time with the businesses based on that alone.

MR. DABROWSKI: Okay. Let's turn to the effect on investment decisions. So, Jackie, I think you had already teed this up a little bit on how the Ocean State had significant benefit, influenced by it.

Let me start over with you, Kevin. Investment decisions. Have you seen it being taken into account kind of U.S. versus foreign or incremental dollars to spend in the U.S.?

MR. CONWAY: I think the lower U.S. rate has really changed the equation in terms of looking at where to locate future operations. I don't think there's any question about the positive impact of the lower U.S. rate plus FDII. I think that really causes us to look at projects through a different lens. When it was 35, it was a very burdensome rate. Now you're at 21 with the potential of FDII. I think it has a clear positive effect.

MR. DABROWSKI: Jackie or Heather?

MS. CROUSE: I spoke about how we're building a new manufacturing plant in the U.S. We also are looking at new technology in California where we perform manufacturing for our clinical trials.

The other thing is -- and I go back to the economists a little bit on their comments that they're not seeing the investment yet. Companies aren't going to build a plant just because tax reform happened if you don't need it, so it's the timing of this. Biologics plants usually last about 15-plus years, even with
continuing investment along the way with new technology, but they’re very large investments. They can be anywhere from $200, $300 million to a billion-plus. So over time, I think you’ll see more of that investment, and having the U.S. be more competitive in terms of plant locations, I think, is really good. That will be the question of how stable tax reform is.

MR. DABROWSKI: Heather, you have the energy renaissance.

MS. CROWDER: Right, exactly. Well, if you think about what we do, we have to go where the energy is. So, moving things around based on tax rates is not very feasible. You can’t build a pipeline to nowhere… Coming back to the cash benefit and more cash flow in the system, there’s definitely an opportunity for incremental projects that may not even be a big Capex project, but money that is otherwise available to spend on improvements for U.S. facilities and the like. It’s helped both in terms of improving the business and incremental returns, as well as having more cash flow for the big projects.

MR. DABROWSKI: Okay, let’s do our last polling question, and this will be your chance to tell us how has the TCJA affected your company’s investment decisions.

Polling Question #4: Because of the TCJA, my company has:

![Polling Question #4](image)

All right, let’s see if we can check out the result and see what -- yeah, actually, pretty equal. So not noticeably affected kind of equal with more in the U.S.

MR. CONWAY: Pretty interesting.

MR. DABROWSKI: Yeah, a pretty equal spread.

All right. I think a lot of what has been discussed this morning, one of the key questions, at least from the international side of things, are U.S. companies more competitive? We had the discussion earlier today, and the economists hashed it out a little bit. I think a picture, though, is pretty interesting, right?
So, this is the OECD chart on tax rates, and the numbers are from 2018.

![OECD Corporate Income Tax Rates Chart](image)

Source: OECD Statutory Corporate Income Tax Rates database

We’re showing here the U.S. number in 2016, so combined state and federal impacts at about 38.9 percent. So, you know, kind of top of the charts in 2016.

2018 would have been discussed, but I think the visual is actually pretty powerful. You’ll note we’re in the middle of the pack for OECD and EU. We are below major trading partners like Japan, Mexico, and Canada. So, an interesting change. And, again, this is statutory rates, and you can get into sort of other metrics, but I think it is pretty telling, just as the baseline numbers.

Jackie, let me start with you. What’s your sense on competitiveness? Are U.S. companies better positioned today than before TCJA?

**MS. CROUSE:** I think they are, and interestingly when the economists were talking and also the videos that we saw where you heard Chairman Brady and Chairman Grassley talk about competitiveness for U.S. companies, that was a big issue for our industry. The biopharmaceutical industry has foreign competitors. Two of those are large ones, are in Switzerland. They have a low tax rate. Two are in the U.K. The U.K. has reduced their corporate tax rate. I think they’re down to 17 percent, somewhere around there, and they also have a patent box tax rate of 10 percent.

When our industry goes to look at acquisitions of smaller biotech companies, which is a traditional way the biotech starts with venture capital funding but you don’t have the big capital to make your product or sell your product. If something starts to look like it’s going well in clinical trials, then the larger companies come in and help them commercialize and get these products to patients.

In our industry from 2010 to 2017, two-thirds of the acquisitions of small biotech companies, whether they were in the U.S. or outside, were made by foreign acquirers. That made us very noncompetitive on the tax rate because what happened is the foreign acquirers came in with their 17 percent, 10 percent low rates, and when we came in and did the analysis of what we could afford to pay for a company, we had to consider the 35 percent U.S. rate, and that really made U.S. companies not as competitive.

Tax reform, there’s been an increase in investment in biotech, and the two largest acquisitions in our
industry -- one's been closed and one's been announced -- were U.S. companies acquiring, one, a U.S. company and one a foreign company. So BMS, Bristol-Myers Squibb, acquired Celgene, a U.S. company. In my personal view, I'm not sure that would have been a U.S. acquirer before tax reform.

The other is AbbVie announced that they're looking to acquire Allergen. Allergen, interestingly, was a Southern California company. It was a U.S. company, and then there were several transactions and an inversion along the way. It was an Irish company, and now they're being acquired by a U.S. company. So, I think this shows tangible results of competitiveness of U.S. companies.

**MR. CONWAY:** I spent the summer of '17 here talking to people on the Hill about tax reform, as a recurring refrain and concern by staff on Ways & Means and the Senate, was the fact that U.S. companies were clearly at a major competitive disadvantage on the acquisition front because of that high rate. So, when you look at this chart, where we are today, we're above the median when you look at where most countries are, and it'll be interesting to see what the response is from the international community, you know, what the U.K. does. Do they go to 16 or 15? So, I'm cautiously optimistic that when the rate is revisited, we don't wind up moving too far left.

**MR. DABROWSKI:** Yeah, certainly interesting. If you go back to '86, we dropped to the lowest corporate rate in the developed world, and then we spent the next 30 years watching everybody else catch and surpass us, right? So, it'll be interesting.

Heather?

**MS. CROWDER:** I don't really have much more to add.

**MR. DABROWSKI:** All right. Well, we've just about landed this plane right on time. I'd like to thank our panelists so much for your valuable insights. Let's give them a round of applause.

**MR. CONWAY:** Thank you, Ron.
From Hindsight to Insight: Assessing Tax Reform’s Effect on Innovation and Other High-value Activity

Description:
From R&D and scientific discovery to technology commercialization, spurring American innovation was a major goal of the TCJA. This panel assessed those elements of U.S. tax reform - including the FDII deduction, the BEAT, and the capitalization of Section 174 expenses - that were designed, either directly or indirectly, to incentivize and support innovation. The panel also evaluated the global state of play concerning innovation and brainstormed how America might enhance its environment for innovation through future tax changes.

Panelists:
- Louise Weingrod, Vice President, Global Taxation, Johnson & Johnson (moderator)
- Jennifer Acuña, Principal, Federal Legislative and Regulatory Services, Washington National Tax, KPMG
- John Bates, Principal, Washington National Tax, Deloitte Tax LLP
- B. Chase Wink, Partner, Tax, Skadden, Arps, Slate, Meagher & Flom LLP
- Christopher Wolter, Vice President, Taxes, The Boeing Company

MS. LOUISE WEINGROD: I’m Louise Weingrod from Johnson & Johnson, and I’m very delighted to be here with this very distinguished panel as we discuss assessing TCJA’s impact on innovation and other high-value activity.

Immediately to my left is Jen Acuna, principal federal legislative and regulatory services from KPMG. Directly next to Jen is Chase Wink from Skadden Arps. Everyone is a trooper in their own way. I just want to share Chase just flew in from Singapore overnight, so his dedication to this panel is remarkable.

To Chase’s left, we have Chris Wolter, who is bearing the consequences of a weekend injury to be with us today, but he’s here. Chris is, of course, from Boeing Company, the Head of Tax at Boeing. And directly to the left of Chris is John Bates from Deloitte. And not injured.

Our panel is going to focus on three topics. What did TCJA do for you as innovation? How competitive is the U.S. today for innovation? You’re going to hear some amplification of themes from earlier panels. And from a tax policy perspective, what’s special about innovation incentives? Why do they matter? With that, I’d like to turn to Jen, who as many of you know was one of the architects of the international provisions of TCJA in your role on Senate Finance. I hope you can share with us your perspectives on the intent behind the international provisions.

MS. JENNIFER ACUNA: Sure. And I was only the architect to the parts that people like, right?

No, there’s a lot of like, a lot of dislike, so that is an excellent question. Putting the assembling of an international tax system that ultimately was included in the TCJA, some people like to describe something that was whipped up in a few months. That would have been beyond our wildest dreams. Our families would be happy and everything would be worked out great. But it took years. There was a lot of staff on Senate Finance and Ways & Means that really worked on drafting international legislation for many, many years dating back to 2011.

The goal was always how to stop the bleed. We had a spreadsheet. There was an actual spreadsheet
where every time there was an announcement of a U.S. firm being acquired by foreign firms, it was identified in the spreadsheet. This wasn’t a handful of entries. There were dozens of entries in the spreadsheet, and they had to be explained to members of Congress. They wanted to understand, and we saw the members speaking earlier. They wanted to know what was causing this hemorrhage. When you have this kind of shift to headquarters overseas, that affects localities. I remember way back in 2015, which feels like a century ago, there was a meet there. At Ways & Means, we had a hearing about BEPS and about inversions and the shifting of U.S. headquarters overseas and what was causing it. Every single company said the same thing, every stakeholder: the rate was uncompetitive. The rate, the international system, rewarded behavior that was contrary to growing jobs in the U.S., to creating IP in the United States.

There was a need to fix that, and that’s where the territorial system came in. Many different iterations were discussed. That’s where the anti-base erosion provisions came in with the GILTI. There were many discussions about the difference between a GILTI-like system with a preferential rate versus just a Subpart F inclusion. That was discussed for years, and ultimately the stakeholders came back and said that a GILTI-like regime is the most efficient and will help solve for that problem that Congress is trying to solve.

When you have a preferential rate, you need to do something to stop the bleed because the rate differential between 21 percent or any percent in the territorial system, even with a preferential GILTI regime at 10 percent or 15 percent, there’s still a differential there. The need for the FDII was to stop that type of base erosion. That was kind of the overarching framework that Congress was trying to achieve. I was looking back at that Ways & Means hearing, back in 2015, at some of the transcripts. This is sad. This is literally what I do in my spare time, look at old transcripts. It’s very depressing.

It was again and again, company after company. That was the issue that Congress was trying to solve. We don’t know if it achieved that, but we are where we are now.

**MS. WEINGROD:** Thank you, thank you. With that insight and framing, we’ re going to turn to John, who is going to take us through some of the specific features of TCPI that are most relevant to innovation.

**MR. JOHN BATES:** As I volunteered for was probably the dry part of the panel, probably there should be a moment for self-reflection, but I’m going to proceed. The FDII regime was really the regime that was intended to incentivize the ownership of intangible property and conduct research and development and exploitation with respect to that intangible property in the United States.

I think it really had two fundamental purposes. One was to create parity with the GILTI regime, so to create, at least from a U.S. tax perspective, an indifference between whether intangible is owned and developed inside of the United States or outside the United States, and also to create a regime that’s more competitive globally to compete with foreign patent box type regimes.

It’s important to focus on some design features in the regime and then also to focus on certain discrete decisions made by Treasury and the IRS in developing regulations and the FDII space, the GILTI regime, BEAT regime, and foreign tax credit rules. This is because those decisions will affect the absolute attractiveness of either the FDII regime or the GILTI regime for particular taxpayers, which necessarily then will affect how attractive they are relative to each other.

To lay the groundwork, this first slide goes through the steps in going from gross income to the net item, FDII, which is eligible for the 37 and a half percent deduction under Section 250. The starting point is the first slice, where the benefit is available with respect to net items, so it requires apportioning expenses to the different types of income to reach taxable income.
The second cut is that certain items of gross income are excluded from deduction-eligible income that includes GILTI inclusion, Subpart F inclusions, dividends from related corporations, financial services income, and foreign branch income.

There’s a further cut for the deemed tangible income return, which is the imputed return on tangible property. That’s normal returns. I just would note there that going into the effective date of the TCJA, I wasn’t sure what effect the DTIR would have, and my anecdotal experience has been that it completely varies by industry. There’s a similar concept in the GILTI regime that affects the inclusion percentage with respect to tested income, and I’ve seen literally every inclusion percentages possible, from 0 to 100 percent or close to 100 percent. It really varies quite a bit by industry.

The last cut is that the incentive regime is only available for foreign-derived deduction-eligible income, so for non-FDDEI or U.S. DEI. The incentive is not provided.

In March of 2019, Treasury and the IRS issued proposed regulations under the FDII regime, and in my mind, the most important aspect of them that affects their attractiveness or their effectiveness, what were the documentation rules. The Government opted for requiring affirmative documentation rather than a presumption-based system for establishing the different elements of qualifying as FDDEI. That includes for property transactions that the property is transferred to a foreign person, is used for a foreign use, and in the case of services that the services are provided with respect to either a person located outside the United States or a property located outside the United States. The documentation rules probably in some context will require or would require, if they’re finalized as proposed, documents that are not available in the ordinary course of business, so some additional administrative burden for qualifying for the regime. I would note that for 2019 at least any reasonable documentation is permitted, so the rules are not in effect retroactively, and I think there’s some hope by the tax community that some of the rules will be softened.

**MR. CHRIS WOLTER:** I think Treasury received a number of comments on those specific areas. We are hopeful at we’ll see some change.

**MR. BATES:** Running through the different comparative features of the FDII regime and a GILTI regime, you’d start with what are the similarities, what are the differences, and are these differences so material that they really would drive decision-making, or do they get you to a place where you’re close enough that
there is effective U.S. tax parity? One difference is the rate, so if you take into account the full 250
deduction, the FDII rate would be around 16 percent and the GILTI rate would be around 10 and a half
percent.

One significant difference is that a GILTI tax or tax on GILTI inclusions is reduced both by a 250
deduction and foreign tax credit. An additional dollar of low-tax tested income really for most taxpayers
wouldn’t be taxed at 10 and a half percent; it would be taxed at something lower because they’d have the
ability to use that income to, in effect, permit the use of foreign taxes on high-tax tested income.

There’s the difference in the effect of the DTIR. Under the GILTI regime, those earnings that relate to
tangible property are effectively eligible for participation in the exemption system, the Section 245A DRD,
so zero U.S. tax. Under the FDII regime, those earnings are taxed at the full 21 percent rate.

Expense apportionment applies both under the FDII regime and the GILTI regime, although there are
significant differences in the rules that apply, so that may be partially a wash. Then there are the
guardrails for the FDII regime. It’s the requirement that must be satisfied in order for the income to be
foreign-derived, deduction-eligible income and the documentation rules. Under the GILTI regime, those
guardrails are historical Subpart F rules and at least theoretically the effectively connected inbound rules,
which would cause income to be taxed at the full 21 percent rather than the reduced rate for GILTI.

One final design feature that was proposed was the GILTI high-tax exception. That would be an elective
exception that would permit taxpayers to take income that is subject to an 18.9 or higher percent foreign
effective rate, remove it from the GILTI regime (so its costs weren’t being to tested income) to effectively
the DRD regime to go to the 0 percent rate. That’s favorable for taxpayers because even if tested income
is subject to, you know, a high enough foreign tax rate, there’s still residual U.S. tax on GILTI inclusions
because of expense apportionment to GILTI. This feature would be favorable moving from the residual
tax from that expense apportionment to the GILTI inclusion to effectively a 0 percent rate.

I just want to focus on one point on this slide, and that relates to the recently proposed R&E expense
apportionment rules.

The rules were dramatically changed and now R&E expenses are to be allocated to what’s referred to as
gross intangible income. In practice that will lead to a significant overlap between gross intangible
income and foreign-derived, deduction-eligible income, so a greater portion of R&E expenses would be
apportioned to and reduce FDII.
On the flip side, the proposed regulations would make clear that R&E expenses are not apportioned to GILTI inclusion, so it would not affect the GILTI foreign tax credit.

**MR. WOLTER:** From a FDII perspective, we look at this one and it’s not uncommon in the tax law, but it’s interesting that the act of innovating actually potentially decreases your innovation incentive, which is FDII via the allocation of R&E. There seems to be a bit of a tension there.

**MS. WEINGROD:** For some industries, Johnson & Johnson is over 50 percent pharma, we spend about 11 and a half billion on R&D, and to the extent that we own in the U.S. but our scientists doing the work are outside of the U.S., now we’re allocating and it’s further cutting the benefit of FDII. We are hoping that the final regs will at least adopt exclusive apportionment. I know many other high R&D companies are, too, so that we don’t have the inverted effect of killing our FDII because we’re doing a lot of R&D and trying to own here.

**MR. WOLTER:** Yeah, it seems counter.

**MS. WEINGROD:** It’s not intended.

We’re going to just make up a bit of time, John, and thank you so much. We’re going to turn to Chris quickly before we get to this polling question.

What’s changed in company behaviors, and how do you see the causes?

**MR. WOLTER:** When I think about this question, I go back to what Jen was talking about, the intention of the act. When you look at making business investment decisions around location, there’s a lot of factors that go into that. It’s not just purely a tax decision, and if I go back and I remember when we were in the throes of tax reform and working through that, Jen, like you say, it’s over a number of years. It wasn’t in the two weeks like people like to say happened. But we’re really talking about let’s get the U.S. on a level playing field. Let’s just take the tax decision a bit out of the equation so we’re not making investment decisions solely on the tax benefits. Ultimately, bring the rate down. The last panel just showed it. We’re right in the middle of the OECD average, and then you need to have that base erosion protection with the GILTI and then its partner of the FDII. Those things all essentially leveled the playing field on the decision then about where would you locate IP. It took tax essentially out of the equation on whether it’s foreign or whether it’s back in the U.S. And you had some thoughts, too.

**MS. WEINGROD:** Yes, we are so appreciative that now at least we’re in the middle of the OECD pack when we look at investment decisions and, in many ways, it’s changed behavior. We’re not the most attractive country in the world in terms of rate when you’re successful, but at least our goal is for tax not to be a major factor when we make business decisions around where to invest, where to build plants, where the best people are to do what needs to be done.

Just for now, I’d leave it at that, and I think we should go to the polling question.

How did TCJA change your company or your client’s company’s assessment of where to invest in IP, acquire assets, and/or move your IP or headquarters?
Polling Question #1: Did TCJA change how your company (or client’s company) assesses investing in new IP in the US or repatriating IP to the US, acquiring assets in the US (vs exUS) group or buying a US company or moving your IP or headquarters offshore?

Very interesting. More than half of those responding found that TCJA did change behaviors, and with that, we’re going to move into our next topic on how competitive is the U.S. for innovation. Jen, you’re going to share perspective on how the U.S. ranks for innovation post-TCJA.

MS. ACUNA: We were looking up to see if we could find some rankings, and there aren’t a whole lot of rankings that segregate. They usually talk about the environment, the climate for innovation, but we were able to pull up some factoids.

First, repatriation. The first seven quarters post-TCJA, U.S. companies have brought back over a trillion dollars in foreign earnings. Investment, S&P 500 companies have invested 1.22 trillion. That’s a 17 percent increase over the seven quarters before the enactment of TCJA. We had two panels of economists and we had our keynote, who is also an economist. There is a lot of movement in that. You can attribute it to TCJA. You can try to split it off, but the facts are facts. Seven quarters post-TCJA, there were these increases.

R&D, in particular, has increased by 18 percent, and that’s substantial. That’s R&D expenditures incurred in the United States. That is a lot. Louise, you know better than anyone, how does that impact jobs?

MS. WEINGROD: Tremendously, and we’re going to talk about this a bit more; the type of jobs that countries and localities really want. I was going to toss in that upon the enactment of TCJA or slightly after, Johnson & Johnson announced that different measurement window, but compared to the four years prior to TCJA and the four years following, which is our strategic frame window, we were going to invest $30 billion in investments and R&D in the U.S. That represents a 15 percent increase over the prior four years, so we were certainly completely within the trends we’re seeing there.

MS. ACUNA: That’s interesting. Cash to shareholders has increased 58 percent of the last seven
quarters, and I think this is the one that really strikes a chord because this is what congressional lawmakers are really kind of homed in on, preserving U.S.-headquartered companies as much as they could be leveling the playing field. We had a few transactions. We’re starting to see a trend in the other direction, would that have been possible?

**MS. WEINGROD:** It would have been, and Jackie hit on this on the last panel, also, is it would have been unimaginable that we would have seen BMS-Celgene pre-TCJA. That made no sense. In our headquarters, we were having streams of bankers coming in advocating for the value creation of moving offshore, moving businesses offshore. We knew the value of moving investments offshore. The idea of two large substantive U.S. companies merging was unimaginable.

Allergen was growing so large with each subsequent deal when it was offshore that it was soon going to be large enough under our rules to bring the largest of the U.S. companies offshore with it. The fact that Allergen is coming back to the U.S. with the AbbVie would have been unimaginable pre-TCJA. There are many other examples as well.

I think there’s going to be more study in this area. I certainly hope there’s going to be more study in this area reinforcing that the M&A trends have really shifted profoundly, and that was something we were very concerned about pre-TCJA, and I wish that got more press because it’s fact-based.

**MR. B. CHASE WINK:** Yeah, I completely agree on the M&A trends. If you look at it, and I know the last panel spoke to this, it’s just simple math. If you have a foreign- headquartered business with a lower tax rate, you can pay more.

I think the one thing that I’ve seen with a number of my clients is that, particularly when they’re looking at their current tax profile and considering the litany of all these amazing things that the TCJA has done, having the conversation between the tax professionals on the one side and the C-suite on the other is that the C-suite is expecting all these excellent things to reduce tax rates and ETR. However, that reduction doesn’t necessarily materialize because, as was pointed out earlier, a lot of these issues are so interdependent, which has caused, at least on the tax side, a lot more complexity in a way that doesn’t actually result in any particular company paying less taxes.

One way that I think that really comes out in the real world is, keeping FDII in the forefront as we think about innovation, whether tax policy is really causing the result that we’re expecting. One thing that I have not seen from my clients is people actually making affirmative decisions to change what they’re already doing. Certainly, it changes your investment and where you’re going to invest money and what you’re going to do going forward. However, changing the profile of actually moving IP, for example, back to the U.S. We at least haven’t seen FDII alone drive that behavior in companies that we work with.

**MS. WEINGROD:** Yeah, I’m aware, and there certainly are companies that have, not to speak for everyone, but the linkage to FDII is very critical, right? The U.S. is a very attractive place to have your IP, depending on how you stand on FDII, in particular.

**MR. WOLTER:** On innovation in the U.S., if you isolate that piece for the U.S., and the U.S. is a great place to innovate and hold your IP, and there’s a lot of things that are non-tax- related that are important there. Though we got the FDII, which is an IP type of benefit, and we talked about some of the reasons that doesn’t quite operate as effectively as it might, but specifically R&D credit didn’t change. A matter of fact, we took a little bit of a step backwards or we will in 2022 when you have to capitalize 174.

I would just put it out there that there’s some work to still be done in this space of innovation, and to really look at a way that I’d like Congress to think about and the companies in the room to think about how do we modernize the innovation incentives in the United States, and something that we’re going to be focused on over the next couple years.

**MS. WEINGROD:** Sure. This scheduled capitalization of R&D in 2022, combined with the scheduled rate
changes in 2026, and the discussion in the public realm around general rate increases have a chilling effect. When we’re talking about causation versus correlation, there are a lot of factors going on, including in the tax world.

With that, I think we ought to move to polling question number two. Scale of one to four, how competitive is the U.S. for investment in innovation?

**Polling Question #2: On a scale of 1 to 4, how competitive is the US tax system for investment in innovation compared to other countries? (1 represents very competitive and 4 represents very uncompetitive)**

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**MS. ACUNA:** This is very scientific. The results will be published.

**MR. WOLTER:** It’s very innovative.

**MS. WEINGROD:** Okay, one way to frame this is that 89 percent see the U.S. as very competitive or somewhat competitive, and I think we can agree that pre-TCJA that would look quite different.

Interesting, interesting. Okay, so we’re going to turn now to the last section, and Chris is going to lead us off on tax policy and why innovation incentives matter.

**MR. WOLTER:** I’m no economist, and I don’t even play on one TV, but I have taken a look at some of these things, and everyone thinks innovation is good for the most part, right? But why? Robert Solow, a Nobel-Prize-winning economist, looked at 80 years of U.S. growth and tried to dissect what is essentially driving this growth. Not surprisingly is that 87 percent of the growth in the U.S. over those 80 years was attributable directly to innovation as opposed to more inputs on the capital and the labor. It’s hugely important from the growth perspective.

We’ve got a slide here that tries to capture a number of different things, but one thing that I think anyone can agree to is our quality of life has increased substantially as a result of innovation, hopefully medical, energy, environmental, a number of different industries, aerospace. I’d be remiss in not mentioning that. What we’ve been able to do in our ability to innovate and create new technologies is really raise the
standard of living and the quality of life for all people.

R&D in itself is expensive and extraordinarily risky in the sense that you undertake the R&D and you don’t know that you’re going to actually have a resulting technology from it. If you do have a resulting technology, what’s the ability for you to put that into a product that can go into the marketplace? Now that that product is in the marketplace, what’s your opportunity for commercialization of that? Is it going to be profitable?

Ultimately, let’s say all goes well and you discover something that’s new and is successful in the market, how long does it survive? What’s the period of time before something comes that’s either a copycat or essentially a new technology that goes beyond what was already there? It’s just a new item. All those factors weigh into why governments will want to incentivize R&D-type activities or innovation-type activities.

**MS. WEINGROD:** Yeah, I would just add, turning to amplifying, Chris, your perspective and turning to the OECD digitalization project and a lot of the new rules we’re seeing in the European Union and elsewhere, it’s absolutely the case that transformational innovation flows cross-border. It benefits people everywhere in the world, and for that reason, like environmental policy incentivized by tax, it warrants special protection.

Innovation happens in ecosystems. It’s significant roles for big companies with big machines and workforce that can pull things forward, but in the healthcare industry, we find that the very early-stage transformational innovation tends to happen with scientists and engineers who are university or think tank or entrepreneurial startup. That’s a fragile ecosystem that we try to incentivize, and then we’re able to help develop further. That whole ecosystem must be preserved.

An example of that I just would love to throw out is in 2002, we purchased a foreign-based company, owned all of its IP outside of the U.S., that had really exciting HIV and other virology innovation. That company within Johnson & Johnson, along with many other phamas, has been part of what’s converted HIV from a death sentence to a chronic, manageable disease if you have access, which is another issue that we could focus on during another panel. We are today looking at those HIV/AIDS virology drugs as a possible solution for coronavirus.

The ways in which innovation just flows cross-border, that’s one of many examples for many industries, is so critical and so important to protect, and when we compare that to capitalization of R&D, there’s a lot for us to do and there’s a lot for us to think about as we look at global policy around the world.

**MR. WOLTER:** Continuing on your point, whether you call it dispersion or you call it spillover effect, but often when a technology is invented, it’s when the users take it and move it to the next level. There’s a number of different inventions over time that you can think of where the actual firm or the inventor that originally developed it, the users and those that came behind them, have really expanded the potential for it.

I mean, I think of electricity. Just think initially electricity, but all the tools and all the things that we’re able to use associated with electricity. Wilbur and Orville Wright made the first airplane or took the first flight. It wasn’t until 30 years later that there was actually somebody that could make a plane that was more commercial and was able to be utilized in the marketplace.

This idea that innovation breeds more innovation and when it gets in the hands of the users, as with smartphones and then apps, it just continually builds upon itself. That first expenditure that was made by that original firm doesn’t get to necessarily have all the benefits that are associated with that technology eventually.

**MS. WEINGROD:** Absolutely.
Any other comments before we go to the last polling question?

MR. WOLTER: Does that make you Alex Trebek?

MS. WEINGROD: That’s always been my dream.

MR. WOLTER: You have to answer it in the form of a question.

MS. WEINGROD: Has that always been my dream?

Polling Question #3: On a scale of 1 to 4, how important are tax incentives to your company’s (or clients’) decisions on whether and where to make innovation investments? (1 represents very important and 4 represents not important)

Again, I would say that 78 percent of respondents would say that tax incentives matter, and with that, we’re going to open up to some questions that came in through the app or otherwise.

MR. GIMIGLIANO: First question, where does BEAT fit into the discussion? It seems to have been somewhat overlooked here. Do you want to come back to BEAT and talk about how that fits into this conversation?

MR. BATES: Sure. Yeah, it was only overlooked because I took up too much time on other slides, but I think BEAT can factor into decisions relating to location of activities or ownership of intangible property in a couple of ways. One is that depending on the particular transactions, there could be an effect, a disincentive under the BEAT.

As an example, if R&E services are provided by a foreign affiliate to a U.S. owner of IP, the service fees normally would give rise to base erosion payments. Similarly, royalties paid by a domestic corporation to a foreign affiliate would give rise to base erosion payments. There could be incentives to enter into cost-sharing arrangements under the BEAT.
It’s a complicated answer, and it depends on the particular arrangements that are in place. I think another way in which the BEAT could be relevant is if you intend to bring IP into the United States, either if you’re an outbound client or an inbound client, but having it transferred by a non-U.S. IP transfer by a related foreign person, proposed regulations that have been issued in 2018 led to a very different result under the BEAT based on the form of the transaction by which the intangible property was transferred into the United States.

The final BEAT regulations very helpfully place less emphasis on that form. One of the types of base erosion payments are amounts paid or accrued to a foreign related person in the acquisition of a depreciable or amortizable property. So, if you, say, purchased intangible property from a foreign affiliate and future amortization deductions would give rise to base erosion payments and base erosion tax benefits, which would be adverse.

The final regulations provided an exception to that treatment for intangible property acquired in specified nonrecognition transactions, so very helpful. It’s another avenue to get intangible property back into the United States without a BEAT penalty.

**MS. WEINGROD:** I’d just add that I remember the moment when we realized that BEAT was a big issue potentially for us as a company that spends a lot of money in R&D and we’re agnostic as to where the R&D is done. Where the right scientists are to do it is where you want it done. To the extent that we own IP in the U.S. and we’re making payments to scientists in other parts of the world to work on the product, that’s BEAT-able, and the more you spend the more of an issue it becomes.

**MR. WINK:** I think that’s a consistent theme that I certainly hear from all my clients. I mean, the BEAT is actually a situation where business decisions may end up getting made based on tax effects as a result of the fact that is a cliff effect. Being in or out of BEAT actually can have a very material impact on how a company operates and what its tax profile is. As such, that is something that people do have to take into account when they’re thinking about R&D.

**MS. WEINGROD:** So, from an innovation policy perspective, it seems unfortunate.

**MR. GIMIGLIANO:** Okay, another question. What is more effective at encouraging innovation? A broader tax regime, i.e., the rate, or narrowly targeted innovation provisions?

**MR. WOLTER:** Well, I’ll go first, and I know there’s some conversation amongst economists, just take all the incentives away and just have the rate as low as possible. That’s great, but based on the work that Mr. Solow did that’s showing the importance of innovation to growth and then all the other factors that we discussed a little while ago about how there’s that spillover effect. How the inventing firm isn’t really the one that ultimately has benefit for that particular item to its fullest extent, it’s a broader concept than just the one individual firm.

To incentivize that behavior, it brings down the cost and the business decision around that is essentially cheaper. You might make decisions to do something that otherwise would not have been done.

**MS. ACUNA:** Yeah, and I will note that Congress was grappling over the years and tried to solve for this as well. There was an attempt to draft an IP box back in 2014 or 2015. One of the issues that we had while developing this policy was that IP boxes are really expensive unless you make them industry-specific. Right, so if you don’t narrowly target innovative industries, everyone has an opportunity to take advantage of it and the cost goes way up. It becomes unsustainable.

That was the issue. You don’t want to select winners and losers, but you want to provide some incentive, but if you provide a little bit of an incentive to everyone, no one is interested. We used to joke that it was one of the most expensive bills we ever drafted that everyone hated.
MR. GIMIGLIANO: What other countries have effective innovation regimes that the U.S. might seek to emulate?

MR. WINK: There’s always the patent boxes. Really the one that comes to mind is the U.K. patent box. I think they’ve been fairly successful at targeting the right industries. That’s certainly where I see a lot of people investing their time and money when we’re thinking about other countries’ specific provisions.

MS. WEINGROD: I would say among other countries, Ireland is a standout example because of the combination of incentives and confidence. The commitment to their rate has been consistent, and the commitment to providing business needs, it’s a whole ecosystem of commitment. The level of stability is very different than what we’ve seen as we’ve tried to move forward, but then we have a lot else going on in the United States. I think there may be other good examples, too, but Ireland is certainly a great example.

I want to thank the distinguished panelists, thank you very much, and thank you, everyone, for your attention and your input.
MR. MICHAEL DESMOND: Thanks for having me here today. Really great to be here to talk a little bit about what’s happening at IRS Headquarters, 1111 Constitution Avenue. I had spent about 20 years in practice in Washington, DC, before moving to California back in 2010, and had worked at the Treasury Department, worked on the Hill for a brief stint, worked in the judiciary, worked at the Justice Department, but moving to 1111 is a different place. That’s not necessarily new or bad; it’s just different from a lot of my experience in Washington, DC, prior to coming to the IRS.

I will say that having come on board as Chief Counsel a year ago, one of the real honors and privileges I’ve had is probably to work with some of the most talented and dedicated lawyers that I have ever worked with in my career. That has been not necessarily a surprise but certainly a real benefit of coming on board at the IRS.

So, I want to talk really just briefly this afternoon to give you some perspective on what we’re doing both in the Chief Counsel’s Office and also to talk about what’s happening over on the Commissioner’s side and how we’re working with the Commissioner’s side to implement the provisions of the Tax Cuts and Jobs Act.

As you know, the TCJA was passed in December of 2017. It’s been almost two years now or a little over two years since enactment, but for most taxpayers, the first full year of TCJA, the 2018 tax year, returns were just filed a few months ago. We are all wrestling with and struggling with implementation issues, getting those provisions on tax returns, and transitioning into an era of compliance, what I call sometimes the bridge to compliance.

A little premature in terms of the IRS’s examination and consideration of those returns, outside the CAP program anyway, but we are certainly starting to see those issues come in dealing with transition issues, dealing with compliance issues, and we will be seeing more of that going forward. Given that it’s only been a few months since we saw those 2018 returns filed, I think it’s very timely for us to be talking here at this conference about implementation issues and compliance issues relating to the Tax Cuts and Jobs Act.

As I indicated, I did start at Chief Counsel in March of 2019, so I came on board more than a year after the law was enacted and have for that reason a somewhat different and certainly more recent perspective on TCJA. In many ways I think that, plus my experience largely in the controversy space of the tax law, lends itself to what I want to talk about today and what I think you’re talking about a lot at this conference, which is next steps, so getting beyond the enactment of the legislation, getting beyond the promulgation of the regulations, what’s going to happen next with the TCJA implementation.

I did start in March of last year. By that time, we’d had two sets of final regulations out on some of the key provisions of TCJA, the 965 transition tax, regulations had been finalized earlier in the year, and also the Section 199A deduction regulations had been finalized before I came on board. And a lot, a lot of work had been done previously.

I did, as I describe it, jump into a number of very fast-moving rivers with the other guidance that was being worked on at the time and that we’ve gotten out since then. There was a push to get a couple of pieces of guidance out in June of last year, just a couple of months after I started, the GILTI regulations in particular, and then you all, I’m sure saw all the guidance that we got out through the rest of the year and
up through the end of the year with the final regulations on the opportunity zones, the BEAT regulations, the Section 168(k) regulations for bonus depreciation, and many, many other projects as well.

To date, we’ve got out probably 150 or so sets of published guidance under the Tax Cuts and Jobs Act. We’ve got dozens more on our plate to try to get out by the end of the fiscal year, so by the end of September, and are making a very strong push to get as much as possible out within a very short period of time, knowing that that’s all very helpful for all of you as taxpayers and advisors to have that guidance out and to figure out how to report these TCJA provisions on your tax returns.

To talk a little bit about what we’re doing at Counsel, the attorneys we have, we’ve got about 1,500 attorneys in 47 offices around the country. Around 500 of those attorneys are the ones that have been taking the laboring oar on the regulations that you’ve seen to implement the Tax Cuts and Jobs Act, so this 150-or-so-odd projects that we’ve gotten out so far.

Those attorneys are here in DC working in six technical offices, and again, a big focus of their work in the last few months has been on the Tax Cuts and Jobs Act. They’re also the ones that handle letter rulings and other kind of taxpayer-specific guidance in some areas. But recently, the bulk of their work has been focused on the Tax Cuts and Jobs Act.

I do want to pause and just talk about next steps with Tax Cuts and Jobs Act because we do have 1,000 other lawyers at Chief Counsel who work mainly in our field offices across the country. With some exceptions for taxpayers that have immediate issues with TCJA, for the most part, those attorneys have yet to see TCJA provisions, but we do expect very soon field agents and examination agents to start to ask questions of their lawyers out in the field. So, we are taking steps to try to prepare those lawyers for things that will come in, questions that will come in on the Tax Cuts and Jobs Act.

Our associate office attorneys are working very closely, not only with our attorneys in the field to bring them up to speed on everything we’ve been doing on the regulatory front, but also to work with exam agents and train some of the IRS folks on the TCJA provisions and make sure they’re prepared to start receiving those returns, looking at issues under the TCJA as those start to be selected for examination and the IRS starts looking at those issues out in the field.

I think it is very important to talk about the work that’s done by those field attorneys because those are the ones that are going to be involved once you start seeing returns getting filed and issues coming up with respect to filed tax returns and TCJA.

To talk about next steps with the Tax Cuts and Jobs Act, I want to connect it to some other legislation that’s been moving since December of 2017, and I think helps to put some of my comments in perspective. Last July, Congress enacted the Taxpayer First Act, and this is actually a provision that I have been spending a lot of time on working with our counterparts at the Internal Revenue Service. The Taxpayer First Act, I should say, was focused very much on getting the IRS to focus on taxpayers and taxpayer service, something that we’ve been focused on internally, and it was actually a very collaborative piece of legislation. A lot of what’s in there are things that the IRS worked with Congress and the tax-writing committees on collaboratively to try to get legislation in place that would help us help taxpayers and help their advisors.

But there are two pieces of that legislation that I think are relevant to our discussion about implementation of the Tax Cuts and Jobs Act. The first I mentioned briefly was the provisions in there that talk about structuring and perhaps restructuring the IRS to better serve all taxpayers. So, a big focus of the Taxpayer First Act was to do that.

Importantly, the legislation puts the onus on the IRS, and really at the IRS’s request, to come up with ideas on how we can better structure ourselves to serve all taxpayers. That piece of it we should see more on with some reports issued as soon as the summer about how the IRS thinks it can better structure itself to serve all taxpayers, things ranging from electronic filing of tax returns, telephone levels of service, IT modernization across the board.
With the Tax Cuts and Jobs Act, as you all know, we have the most sweeping tax legislation substantively in a generation, but compare that to what we have at the IRS. We’ve got an organization that was last restructured more than two decades ago when the economy looked very different than it does today. I think it’s important as we look at TCJA implementation to also look at the IRS, how it’s structured, how can it be better structured to serve taxpayers and to match the progress that was made with the enactment of the Tax Cuts and Jobs Act.

A second piece to talk about, and this also relates to transitioning to compliance issues in the TCJA, is the provisions in the Taxpayer First Act that relate, in particular, to controversies and resolution of controversies with the IRS. A big focus in the first part of the Taxpayer First Act on the Independent Office of Appeals and codifying practices the IRS has had in place for many years about ensuring that there’s a general right to access appeals to get disputes with the IRS resolved.

And, again, as we start to see tax returns get filed with TCJA, issues coming up on audit and examination, having those procedures in place and having some robust thinking happening inside the IRS will be very important to see what happens in next steps with the TCJA and make sure that the implementation will be successful.

As I mentioned, with TCJA, we’ve got the most comprehensive overhaul of the tax law in a generation. We are taking steps to try to modernize the IRS to match that. I do note in talking about these two pieces of legislation that as you look at implementation of a sweeping tax law like TCJA, there are many areas in which taxpayers in the IRS can work together collaboratively and loss of synergies between your interests and our interests as tax administrators.

Every issue that comes to us about how something gets reported on a tax return, the complexities of getting something reported on a tax return, has a parallel consideration on the IRS’s side. If it’s hard for you to get an item on a tax return to figure out what should be reported on a tax return and how that gets processed and filed, on the IRS’s side, there will be equal challenges in trying to examine that issue and figure out if it was properly reported.

Within Counsel, in particular, we’re always thinking about ways that we can make the IRS -- or the taxpayer experience in putting issues on tax returns more streamlined knowing that not only will that help taxpayers that will help us on the back side in processing returns that report those issues.

There are a number of areas that we’ve been looking at recently, and I think some of these you’ve seen, where we think that we can try to streamline taxpayer reporting and, again, ‘coup the benefit on the back side as well when tax returns are filed.

You’ve seen, and I’ll talk a little bit later this afternoon, about new tax provisions that have method changes associated with them. We’re always looking to streamline ways the taxpayers can change their method of accounting, you take advantage of new tax laws. A lot of our guidance has come out in notice and then proposed reg and final reg form. In general, and I think almost always, that tends to be more favorable as we get comments and make changes to our proposed regulations and our subregulatory guidance. That presents modeling issues of taxpayers. It also presents issues for how to get the more beneficial provisions reported on a final return or perhaps change their position if there are more beneficial provisions in final regulations.

And we have a mutual interest there. The IRS doesn’t like receiving lots of amended returns any more than taxpayers like preparing and filing lots of amended returns. So anytime we can work together to find ways to streamline the reporting of changes as guidance evolves is something that we can work well together on.

We do, of course, always try to get all questions answered through published guidance, but, of course, that also never happens. We have published quite a large volume of guidance and regulations, but we sometimes miss issues, and there are always unexpected, unanticipated consequences and issues that
arise that we haven’t addressed in our guidance. Within Counsel, in particular, we realize that, and I think some of our regulations in the preambles even foreshadow that, but we’ve tried to send a signal that we’re very receptive to hearing from taxpayers about potentially unintended consequences of our guidance and our regulations.

Sometimes these are very unique for one or two or a very small number of taxpayers, and we want to be careful that we’re not creating private law for any particular taxpayer, so we’re trying to be very transparent about what we’re doing, but we have put out a couple of notices and press releases that signal a willingness to consider one-off, unique circumstances for taxpayers that may not have been fully addressed or anticipated in the published guidance that we’ve put out.

As I said, at a minimum, even if we can’t offer relief through a letter ruling or through election relief or some other mechanism, it is critically important that we hear from taxpayers on what they think might be unintended consequences of our guidance. Every piece of guidance that we put out has a telephone number of an IRS counsel attorney on it who is one of the principal drafters. I’m always very encouraged to hear that they hear from taxpayers frequently with issues that they’re seeing as they start to take these provisions and put them on tax returns.

It’s never in anyone’s interest, and certainly not our interest if there are disconnects and unanticipated issues to wait for those to come up years down the road in examinations. So, again, we try to signal a willingness to address one-off situations, unique situations, unintended consequences through letter rulings. Closing agreements perhaps are on the table in some cases. And, again, always want to hear from taxpayers where they think there are issues that we need to address.

Shifting gears a little bit from the guidance and compliance issues to the other two-thirds of the work that Counsel attorneys do, which is on the enforcement side. As I said, two-thirds of our attorneys are out in the field advising clients and working with our 25,000 docketed cases in Tax Court, so from my perch as Chief Counsel, that’s really the vast majority of the work that we’re doing. It’s what happens after the regulations are done and after the tax returns are filed.

With any new law like TCJA, there are going to be issues, and I talked about this previously. But this, I think, does touch on, as I said, what is in the Taxpayer First Act, where Congress said to us, it’s important as you have, particularly in the context of a sweeping new tax law like TCJA, unanticipated issues and disputes that are inevitably going to arise and having a way to streamline resolution of those issues.

There are a couple of discrete provisions in the Taxpayer First Act that talk in particular about designation of cases for litigation, withholding cases from the Independent Office of Appeals. We’ve been giving an enormous amount of thought to those recently and putting procedures in place to provide for internal appeal review of decisions not to allow cases to go to appeals.

Those are very, very few and far between, but more importantly, I think they’ve caused us and certainly me to think in recent months about ways that we can think about how to get the right cases through the pipeline. So regardless of whether a case -- and, again, it’s very few and far between -- but regardless of whether a case is going to be designated for litigation, it’s very important that from day one when disputes arise with examiners on tax returns and audits that we think about resolving that dispute. Maybe it’s something that needs to be addressed by further guidance. And if not, maybe it’s something that needs to be postured for resolution in some other manner.

So even if it’s not ultimate trial in Tax Court or in a District Court, thinking strategically about how we resolve those disputes, I think, is very important. And, historically, I’m not sure we’ve done the best job that we can to think early on about the best way to resolve inconsistencies and disputes and ambiguities that we see as tax returns start to get filed.

I do hope with the Tax Cuts and Jobs Act that we will be thinking more strategically. There will, no doubt, be issues that arise as we start to get into examinations that can be addressed by further guidance, and that’s certainly the preferred way of addressing issues, but there are a lot of other tools that we can lean
on to help provide guidance to our examiners and to taxpayers going forward as well.

This change in the procedures that the Taxpayer First Act put into place has really caused us, and me in particular, to think about the best way to posture cases for resolution, disputes for resolution. And Appeals, the Independent Office of Appeals, is a very important part of that, but really is just a small part of that. And we need to think much more holistically about how to get disputes resolved successfully.

That will in some cases, of course, lead to litigation, but as a litigator by trade and a tax litigator by trade, I will be the first to say that’s not the preferred way to resolve disputes. Sometimes, as I said, it’s inevitable, but it’s not the preferred way to resolve disputes. There are many ways short of that, including appeals and guidance and other mechanisms, so something to stay tuned for. We’ll have some more out on that, but something that we’ve been giving a lot of thought to internally.

I think I’ve just got a few minutes left, but I’d like to close by noting on a somewhat unrelated point that the budget came out. The Administration’s budget was released on Monday of this week. I was very encouraged to see that it provides further support for the IRS. One of the best things for me to come on board on and have happen was bringing 150 new attorneys in large part under the budget authority that Congress gave us with TCJA. In December of last year, we had 150 attorneys in town for our new attorney orientation, and again, very encouraged to see the Administration’s providing continued support, not only for staffing but also for infrastructure, IT modernization, and the things that are set forth in the budget.

So, stay tuned on that front. I do see it as a positive sign, a continuation of the trend that I arrived at, bringing on new staff, energy around the lawyers in my office, working not only on TCJA implementation but next steps with implementation as well.

So, with that, I think I told John I’d have maybe a couple of minutes for questions.

MR. JOHN GIMIGLIANO: Yeah, can we squeeze in just maybe one or two questions?

MR. DESMOND: Of course.

MR. GIMIGLIANO: Well, you sort of hit on this in a couple of ways, but just to ask maybe in a different way. So, the question is with the task of TCJA implementation before the IRS, what would be most helpful to the IRS? Would it be more personnel? Would it be greater investment in technology?

MR. DESMOND: I think I’d maybe start with greater investment in technology. That’s certainly a very high priority in the President’s budget. One little factoid to give you, the IRS opened its filing season January 27th. The first week of the filing season, 12.9 million returns were processed by the IRS. So there’s a lot of disparaging commentary about IRS technology. It is, if you see it and you ever go to an IRS service center, a remarkable machine that the IRS has to process tax returns for the vast majority of taxpayers, but we can always use more, and there are a number of programs under way and projects under way supported by the Administration’s budget to further that technological capacity of the IRS.

There are a lot of things to be said about that, but I think it’s set forth at a high level in the budget and certainly would point to that as the first thing.

MR. GIMIGLIANO: Okay. Maybe one more, then. Without asking you about any specific item -- I just want to genericize this question, but there’s been much discussion about where the authority to issue guidance begins and ends. How do you evaluate that question when thinking about how to issue guidance or to implement the law? How do you make that evaluation in terms of where your authority begins and ends?

MR. DESMOND: The short answer is the statute. Our authority derives entirely from the statute, sometimes general statutes like Section 7805. Also, in TCJA, many of the statutes that we’re working to
implement do have their own grants of regulatory authority, so that’s really what we look to.

I’d also comment on that, and this is an authority question, but there is a very heavy emphasis on notice and comment guidance. So, we have the Administrative Procedures Act. We follow that very closely. The Treasury Policy Statement that came out about a year ago about guidance really puts a very heavy hand on putting out notice and comment guidance. The APA procedures that follow those statutory grants of authority are ones that we certainly try to adhere to and do adhere to in the regulations that we issue.

**MR. GIMIGLIANO:** Okay, thank you, Mike.

**MR. DESMOND:** Thanks for having me.
MS. WALKER: And I want to say -- I want to evoke someone who's near and dear to many of us in this group, Larry Gibbs. He has said on this podium before, at this podium before, I believe when he received our Pillar of Excellence Award, that he likes to see tax lawyers in the role that you’re in and to have a tax lawyer’s lawyer, which is what you are.

We are very, very happy to have you there. We’re very pleased you’re joining us here, and I was particularly touched last year when Michael came when he was cooling his jets, waiting on confirmation, and spent the entire symposium time with us, learning with us, participating with us. So we appreciate that more than you know, Michael.

MR. DESMOND: Nice to have more on my plate to do these days, but thank you.
Remarks by Grace Perez-Navarro, Recipient of the 2020 TCPI Pillar of Excellence Award

Thank you so much to TCPI for this prestigious award. It is a real honor to be among such a distinguished and accomplished group of prior recipients -- Marty Sullivan, Pam Olson, Larry Gibbs, Eric Solomon, Tom Barthold to name a few -- all professionals of the highest caliber, of high integrity and nice people too.

Now I don’t want to sound ungrateful or greedy or anything, but could I have another one? I’m a 2 pillar kind of gal. Makes for a nice package, don’t you think?

Believe me, I am thrilled to have this one, which some people are already calling Pillar Three.

All of the recipients of this award have spent some or all of their careers in public service contributing to shaping tax policy. I suppose what makes me different from them is the fact that most of my career has been focused on shaping tax policy at the international level rather than at the national level. **Multilateralism has been at the core of my work**, and is the essence of the OECD. The multilateral trading system has been under severe stress over the last decade. Interestingly, multilateralism in the tax area has thrived over that same period, but recent events show us that there may be risks here as well. So today I want to share my thoughts on the ongoing importance of multilateralism in the tax area.

**First a little bit of history on the OECD’s brand of multilateralism**

The OECD is an outgrowth of the Marshall Plan, a US initiative designed to help rebuild the economies of Europe following WWII. The Organisation for European Economic Cooperation (OEEC) was established to run the program, which proved to be so successful that in 1960 the OEEC was transformed into the OECD with the US and Canada becoming the first non-Europeans to join, followed by Japan. Today there are 36 member countries of the OECD committed to developing better policies for better lives. The OECD works across a number of key policy areas, such as health, labor, financial markets and innovation. One of the key areas of focus of the OECD has always been the elimination of barriers to cross-border trade and investment, and in the tax area that has meant developing common standards to increase tax certainty and reduce the risk of double taxation. Our “best sellers” to achieve this are the OECD Model Tax Convention, which is the basis for over 3000 bilateral treaties, and the OECD Transfer Pricing Guidelines.

**Multilateralism helps spread best practices**

My first foray into the OECD world of multilateralism was when the IRS sent me to work with the OECD for one year to launch the revision of its transfer pricing guidelines in 1993. This was the first time the IRS had done this but they did this because they were revising the 482 regs at the time to introduce profit methods and they knew that if their major trading partners were not on board this would lead to disputes and double taxation for its MNEs. Profit based methods were a radical new approach and highly controversial at the time but are now used around the world. It is this sharing of new approaches and best practices that is one of the key strengths of OECD multilateralism. By agreeing common standards, OECD members provide greater certainty to business and for tax administrations. Just imagine the transfer pricing disputes that would have arisen if the US had gone its own way on profit methods and other countries had retained the traditional methods.

**There is also the strength in numbers that the OECD provides in delivering change**
When I rejoined the OECD a few years later, my first project was to work on getting rid of bank secrecy for tax purposes. This was something that I had worked on at the Chief Counsel’s office, and I have to admit that our unilateral efforts were not terribly successful. When I was still at the Chief Counsel’s office, we did not succeed in persuading Treasury to put real pressure on secrecy jurisdictions nor were we able to negotiate effective exchange of information agreements with any of the major secrecy jurisdictions.

**But there is strength in numbers and at the OECD** we managed to make some progress, despite having some of the most secretive countries among our members and a consensus-based decision-making process. These were tense discussions and not always diplomatic. One of our Scandinavian delegates famously called out the secrecy jurisdictions within the OECD, saying we had “swine in the forest”. This kind of unilateral name-calling did not yield much in terms of change but the threat of a coordinated, multilateral black list of such countries did.

**International tax has become political**

What really propelled this agenda forward was the multilateral engagement at the political level that ensued following the financial and economic crisis. As a result of that strong political commitment to tackle tax evasion through increased transparency and information sharing at the G20 Summit in Pittsburgh in 2009, we saw multilateral discussions about international tax move from a technical level to a political one. That also led to a recognition that this issue was a global one that required the engagement of a broader set of countries than just the 36 OECD members.

**Inclusiveness**

Today, the OECD’s Global Forum on Transparency and Exchange of Information for Tax Purposes has 160 members, including all major financial centres. It just celebrated its 10-year anniversary and the results it has delivered during that time period are impressive:

- close to 100 jurisdictions exchanging information on financial accounts in 2019. While in 2008 there were only 40 exchange of information (EOI) relationships in place between secretive jurisdictions and other countries; in 2019, more than 6100 bilateral automatic exchanges of information (AEOI) took place between 95 jurisdictions.
- In September 2018, information was exchanged automatically on almost 50 million financial accounts, with a total value of almost EUR 5 trillion. Over 100 billion dollars of additional tax revenue has been identified for collection by tax administrations around the world. The ongoing implementation of AEOI will continue to increase tax revenues for tax administrations worldwide in the coming years.
- Moreover, our efforts are having an impact on taxpayer behaviour. We’ve assessed the effect of increasing tax transparency and exchange of information on cross-border financial activity using bank deposit data, and our study shows that there was a global decline in foreign-owned bank deposits in IFCs of 24% (USD 410 billion) between 2008 and 2019. The start of automatic exchange of information (AEOI) in 2017 and 2018 is associated with further average reductions in IFC bank deposits owned by non-IFC residents of 22%.

It would have taken years to try to achieve these kinds of results unilaterally or bilaterally. Further work is now underway to review the standard for AEOI to ensure that it remains up to date.

**Multilateralism has not only helped to strengthen enforcement efforts, it has also helped to strengthen tax certainty.**

I know many of you think Action 14 of the BEPS project on improving dispute resolution could have been better – and you are right. Nevertheless, the standards and peer review process is leading to real change:

- it helped to increase the number of countries that have signed up to mandatory binding arbitration from just a handful of countries to 28. That’s still not great but an improvement, and with more
countries gaining experience with arbitration, that may help give comfort to other countries who are reluctant to join.

- The time to close cases has rapidly decreased, there is greater transparency of the process and greater accountability by countries on the cases.
- There has been a marked increase in the number of cases dealt with by competent authorities, which is a good sign if it reflects the fact that taxpayers can more easily get access to MAP. Not so good if it just means there are more disputes.
- Access to MAP is now granted for transfer pricing cases even where the treaty does not contain Article 9(2) of the OECD Model Tax Convention, especially in those jurisdictions that did not provide access to MAP in such cases in the past. So countries like Brazil, which do not have Article 9(2) will now give access to MAP.
- The peer review process has spurred on changes regarding the structure and organisation of competent authorities to streamline better their processes for resolving MAP cases in a timely manner.
- We know this is not enough and the 2015 Action 14 report contemplated a review in 2020 of the standard and the peer review process to see how it could be improved and that is currently underway.

There has also been progress and innovation in the dispute prevention front with the OECD Forum on Tax Administration, which brings together 53 of the world’s most advanced tax administrations.

The OECD Forum on Tax Administration’s International Compliance Assurance Programme (ICAP) provides a framework for the co-ordinated risk assessment of large MNEs by tax administrations in jurisdictions where they have activity. ICAP currently includes 19 participating tax administrations, up from 8 tax administrations when it was first launched in January 2018.

In addition, we had a first OECD Tax Certainty Day on 16 September 2019. The event provided an opportunity for tax policy makers, tax administrations, business representatives and other stakeholders to take stock of the tax certainty agenda and move towards further improvements in both dispute prevention and dispute resolution. As a follow-up, work has commenced on three projects to support greater tax certainty for MNE groups through:

i. improvements to APA processes;
ii. greater use of multilateral dispute resolution and APAs; and,
iii. the use of standard benchmarks in common transfer pricing situations.

We now have a new opportunity to further strengthen dispute prevention and dispute resolution through the current project to address the tax challenges of digitalisation of the economy. (I guess you knew that I wouldn’t be able to resist talking about the “other” pillars!).

We'll hear more about this tomorrow, but I see this as a fundamental test of multilateralism in the tax area. We have 137 countries and jurisdictions working on this and committed to finding a consensus-based solution by the end of the year. It is probably the most challenging tax project we have ever undertaken. It is challenging because of the number of countries involved but that challenge is not as great as you might think. Some have suggested that this project would be easier if we were just trying to resolve this among OECD members but if you look at the chief protagonists in the digital services tax battle, it is mainly between OECD countries.

The very ambitious timeline is also a challenge but hard to alter because of the tremendous political pressure in many countries to act. Remember, some countries have been waiting since 2013 when the BEPS project was initiated to address this issue.

The other big challenge is the fact that we are talking about the reallocation of taxing rights. Unlike our other big projects on tax transparency and BEPS, which you could describe as addressing bad behaviour, here we are talking about who gets to tax what, and realigning the international tax rules for the 21st
century. The Inclusive Framework has just issued a Statement confirming its work on a two-Pillar approach. We know that for business and for many of the countries engaged in this negotiation, increased tax certainty has to be part of the deal and the Statement emphasizes that. For other countries, there is a lack of experience and trust with respect to things like mandatory binding arbitration and a concern about a loss of sovereignty and constitutional limitations. So we are looking at new and innovative ways to build up that trust and create processes that will produce an equivalent result to mandatory binding arbitration. Importantly, we are also looking at binding dispute prevention. This is essential because any dispute between two jurisdictions over Amount A will likely affect the taxation of Amount A in multiple jurisdictions. Resolving such disputes under the current bilateral system would be inefficient and lengthy. A more coordinated and multilateral approach is needed to prevent such disputes.

So, in the coming months there is a tremendous amount of work to be done on the technical design aspects of both Pillars and on the tax certainty components. It can be overwhelming at times but we remain convinced that it can be done. Why? Because countries and most businesses recognise that the alternative is so much worse. We have very much appreciated the strong support from business for this process and for the very constructive engagement of the business community.

And just look at the support we have received from TCPI – have you noticed their new logo? It is no accident. It’s a beautiful Ionic Pillar. It would of course be even more beautiful if there were two Pillars in the logo but for the moment, I am extremely honoured and happy to have been awarded One very solid and meaningful Pillar.

Thank you!
Description:
Enactment of the TCJA marked a new dawn for the U.S. tax system. But for domestic tax compliance leaders, it was just the first of countless changes to come - and to somehow manage. Post-tax reform, U.S. regulators issued technical guidance at an unprecedented pace, with each new development posing a new implementation challenge. This panel explored real-world survival stories from the 2018 compliance season, when most guidance was either not available or still in proposed form. It also looked ahead to the next filing season, offering tax compliance leaders practical options for handling continued uncertainty regarding key provisions such as cost recovery, income recognition, and the interest limitation.

Panelists:
- Heather Harman, Managing Director, Andersen (moderator)
- Madeleine Barber, Senior Vice President and Chief Tax Officer, CBRE
- Michael Desmond, Chief Counsel, Internal Revenue Service
- Mitch Thompson, Partner, Squire Patton Boggs

MS. HEATHER HARMAN: Welcome, this is Survival Mode: Staying Afloat in the Wake of the Flood of TCJA Domestic Tax Guidance. I'm Heather Harman, I'm a managing director at Andersen.

Joining me today is Mitch Thompson, who’s a partner at Squire Patton Boggs; rejoining us after his comments before lunch today we have Michael Desmond, Chief Counsel for the IRS. Thank you for being together today. We also have Madeleine Barber. She is the Senior Vice President and Chief Tax Officer at CBRE. So welcome, everyone.

Our discussion today is going to primarily focus on the body of guidance that’s been issued under TCJA kind of focusing on the more significant domestic provisions, specifically bonus depreciation, income recognition, and the interest limitation.

In particular, we'll be chatting about the transitional challenges encountered by taxpayers as we move through what seems to be an interim guidance process as we go from enactment to proposed regulations, final regulations, and then off to a second round of proposed regulations, hopefully followed by final regulations.

We’ll get wrapped into specific topics like talking to some of the various transition paths and themes that come out of our discussion today that kind of give taxpayers a path towards navigating this transitional time.

Looking back to the ’86 Act, there were a number of domestic provisions. It took six and seven, eight years, to go from enactment to a final and complete sets of regulations.

I would be remiss if I didn’t kick things off today by noting that many of the transitional challenges we’re going to be talking about today are here because of the large volume of guidance that has come out at unprecedented rates from the IRS and Treasury.
It’s thanks to the hard work and dedication of the professionals at the IRS and Treasury that we have so much to talk about. So, thank you, Mike, for that.

Kicking things off with bonus depreciation just as a quick recap of where things stand today. In August of 2018, we got our first set of proposed regulations. One year later, in August of 2019, we received our first piece of transitional guidance that allowed taxpayers to revisit some of their missed or made elections on their first year return that included 100 percent bonus depreciation generally issued in response to comments from taxpayers that the timing of the proposed regulations came so close to the tax return filing deadline for 2017 returns and they didn’t always have time to fully digest the proposed guidance and consider how the elections might affect them.

One month later then, in September of 2019, we received a package of final regulations as well as a second round of proposed regulations, which, among other things, retroactively expanded the scope of so-called self-constructed property that’s eligible for 100 percent bonus depreciation.

Finally, in regards to status of guidance, we can’t move on without also talking about technical corrections. One of the most well-known and high-profile technical corrections that’s been identified so far for TCJA is the technical correction regarding qualified improvement property to give it a 15-year recovery period, which isn’t just about giving it the shorter recovery period; it’s also what qualifies it for bonus depreciation.

We can look down the road here and anticipate that there might be another round of guidance that’s needed in the future to also take into account that additional expansion in the scope of bonus eligible property.

That will go over to our first polling question. Which bonus depreciation transition issue is of greatest concern to your company: Revisiting prior year elections; considering 2017 and ’18 assets that are newly eligible under the re-proposed regulations; the need to file multiple rounds of method changes to transition to the final and complete package of guidance; mergers and acquisition-related issues; or does not apply?
**Polling Question #1: Which bonus depreciation transition issue is of greatest concern to your company?**

![Polling Question Results]

- Revisiting prior year elections: 19.05%
- 2017 and 2018 assets that are newly eligible under the re-proposed regulations: 33.33%
- Filing multiple rounds of method changes: 14.29%
- Merger and acquisition related issues: 14.29%
- Does not apply: 59%

**MS. HARMAN:** Ellen asked me if there’s an “all of the above” option, which I do think is going to be a recurring theme today because there’s a lot of pretty big transition issues that we will be talking about today, and in a lot of cases it can be many that are affecting a company.

It looks like the majority of the folks, at least the biggest answer is the ‘17 and ‘18 assets that are now newly eligible under the re-proposed regulations. Interesting.

The first transitional issues that we kind of identified during our conversations to prepare for the day is the need to maybe potentially revisit 2018 and 2019 elections.

Similar to the concerns the taxpayers raised back for their 2017 returns, taxpayers may not have had time to fully digest or model or consider what to do in their 2018 returns given how closely the final and new proposed regulations came out to those tax return filing deadlines.

As a result, there may be companies now that are looking at the updated guidance that's available and thinking, “Well, if I knew then what I know now, would I have made a different choice?” We can certainly look down the road and see this becoming a repeated issue as we wait for the second round of proposed guidance to go final as well.

In recent public statements IRS professionals have indicated that transition rules similar to the first-year guidance which we already have might be in the works for subsequent years.

Mike, maybe I’ll bring you into the conversation here. So far, what is the government seeing in comments from taxpayers or practitioners in regards to missed and/or revisited elections that they previously made for bonus depreciation?

**MR. MICHAEL DESMOND:** I think reflective of the polling question, we have received a lot of questions. As I indicated when I spoke before lunch, we do strongly encourage folks to call into the folks working on
the guidance. Just the issue of the elections and what they’re facing and the timing of our regulations is certainly something we’ve heard a lot about and are considering how we can help folks with that.

One of the issues in particular, Section 168(k), that adds to the modeling complexity for taxpayers, which we are certainly sensitive to, is also the interaction with other provisions, 163(j) in particular. It’s not just the moving issues with one provision in TCJA, it’s the interaction with 163(j). We have other reg projects moving there that we’ll talk about in a moment. We’re certainly very sensitive to that.

As I said, getting amended returns is a problem for the IRS sometimes as well in terms of processing. If we can consider and think about ways and work with taxpayers to find alternatives to that while still allowing for full utilization of the elections and recognizing that sometimes the modeling does change and the considerations do change as we go from a proposed to a final set of regulations.

I certainly encourage folks to hear more. I can’t really say specifically how we’ll respond to that. But getting the input from people is critical to that.

**MS. MADELEINE BARBER:** Heather, one of the other things to keep in mind is the potential impact on financial statements. As you think about elections, you may need to consider whether a method change is the result of change in guidance or error. To the extent that the ASC 740 and other financial statement guidance is not necessarily keeping up at the same pace as guidance coming out of Treasury, I think there could be other considerations. Certainly, tax executives and accounting firms have to think about these issues in the context of changing elections.

To Mike’s point, don’t forget the ripple effect that elections and method changes have on other areas particularly in the international tax area such as GILTI, Section 163(j), BEAT, and Section 482. The considerations going into all of this are not one dimensional.

**MR. DESMOND:** Just to add to your point about financial statement reporting, that’s something that we don’t always have as much visibility as obviously you do. We think about it more from the pure tax perspective.

If there are issues and timing issues, and I know some questions have come in and I always get emails in all caps, you know the filing deadline is October 15th, but there are also financial statements year-end, quarter-end, considerations. So, it’s very helpful for us to hear that, particularly on the financial statement reporting which we may not be as tuned into as you are.

**MS. HARMAN:** Now, the elections that we’re discussing here in regards to bonus depreciation are regulatory elections, which certainly have had some ability to get access to 9100 relief as a regulatory election.

Mike, based on what you’re seeing from taxpayers so far over the past couple years, have you seen any changes in the traffic of folks coming in and requesting 9100 relief related to TCJA or how is that going to be evolved in response?

**MR. DESMOND:** Yes, we have. I think more from our passthroughs in our international group in terms of questions about 9100 relief. There are very generally some questions coming in about changes in perhaps reconsidering pre-TCJA elections in light of the reduction in the rates. Not as much in the ITNA space. I think that those questions will be coming in now. But certainly 9100 relief does come up a lot. I think we have signaled, and I have signaled in particular, thinking about changes in law and changes in fact and what all that means in terms of the availability of 9100 relief and taxpayers coming in and saying had I known there would be a 21 percent rate, I wouldn’t have made this election as a fairly obvious example of what we think is a change in fact. Well, the scenario is just different and so you’re now revisiting that.
But that’s a much more nuanced question when you get into the weeds of these issues. We have thought about that a little bit in the availability of 9100 relief. But, again, many of the questions I think have been coming through more the international and the passthroughs groups, although the ITNA groups have been hearing questions as well.

**MS. HARMAN:** I think that ties into one of the aspects of the transition guidance that we have so far, the taxpayers have appreciated so much, is that it goes beyond maybe what you could traditionally get access to under a 9100 relief procedure because it’s not just aimed at missed elections. It does allow people to go back and revisit elections that they did make. Which would otherwise be irrevocable but for this special transition guidance that we have.

**MR. MITCH THOMPSON:** Mike, you mentioned before lunch that the Service, just like taxpayers, doesn’t particularly look forward to mass numbers of amended returns. When you think about amended returns, though, compared to mass numbers of 9100 relief, what’s the IRS’s preference?

**MR. DESMOND:** Hard for me to speak to the IRS. I mean, what do you mean when you say mass numbers as well?

**MR. THOMPSON:** I guess given all other things being equal, which one seems more preferable for resolution of these issues?

**MR. DESMOND:** Yeah, that’s a good question that might turn on things like: is it an individual or a business return; is there electronic filings; some mechanical answers to that question probably beyond my bailiwick. To go back to the point that I did make before lunch, which is if there are ways that we can think of streamlined procedures and automatic procedures to avoid either the amended return or the 9100 relief, that’s certainly something we’re interested in hearing more about. That’s easier than any of those options.

**MS. HARMAN:** So maybe moving on to the second transition issue, which was the most popular response in our polling question, regarding the expansion of bonus eligible property for prior years as part of the second round of proposed regulations, in particular for 2017 and 2018 property that was maybe placed in service taken into account on a tax return before this expanded guidance was available.

I think what’s giving many taxpayers heartburn regarding these particular assets and property is that historically changing from one permissible depreciation method to another is generally implemented on a cutoff basis, you just true up your methods of depreciation going forward. There has not historically been a mechanism that lets you go back and true up or catch up your depreciation for the prior year, or maybe you missed potentially, at least in this case, depreciation.

As an additional wrinkle, bonus depreciation is one of the TCJA provisions that went into effect prior to 2018 when the rate dropped to 21 percent.

Another wrinkle here for taxpayers is that they’re not just missing potentially bonus depreciation, they’re missing in a year when the rate was higher at 35 percent. I think there’s concerns about their ability to go back and capture that rate differential.

Mike, based on the comments that the IRS is receiving from taxpayers, do they echo the popularity of this response in today’s room?

**MR. DESMOND:** Yeah. And I think you’re right. Historically, the 481 relief has not been applied in the context of cost-recovery measures. It has been a cutoff method. We’ve heard the comments that you just made as well. I’m not sure what options we might have available, but certainly understand the unique timing aspects in particular of the 168(k) provisions and their enactment.

**MS. HARMAN:** Great. I do think given the technical corrections that have already been identified for TCJA, especially in the bonus depreciation space. It seems like this is going to be a recurring or
repeating issue because hopefully someday when we have that correction for QIP property, we’re going to have another situation now where the pool of bonus depreciation for eligible property for earlier years has now been expanded retroactively.

Knowing that the second round of expansion is coming down the pipeline, does that influence the Government’s thinking or how they approach thinking about some of these issues?

**MR. DESMOND:** Yeah, it does raise some challenges. I personally have met with a number of taxpayers about the technical correction and the timing of it, and there’s some speculation out in the industry as to what the prospects are and the timing and so forth.

We’ve heard a lot of different suggestions and options out there, but I think from our perspective, we and the administration have certainly supported that change in that technical correction. We look forward to that happening. It’s good to get information about the transition issues and be prepared for that when it hopefully does come. But, we’re in the same position many of you are in terms of the prospects and the timing of the change to qualified improvement property.

**MS. HARMAN:** Okay. So these first two transition issues lead into the third transition issue that we’ve identified is that multiple rounds of traditional guidance and proposed regulations leading to final regulations may require also multiple rounds of method changes and/or revisit elections as taxpayers continue to try and true up their bonus depreciation treatment and decisions to match the continuously evolving guidance.

Mike, I don’t know if the government’s given any thought to addressing that issue to maybe try and streamline the number of times taxpayers need to come in and make those true-ups?

**MR. DESMOND:** Yeah. There are administrative challenges to that on both the taxpayer side and our side. As I said and I’ll echo again, we don’t necessarily encourage multiple rounds of amended returns particularly for large, complex taxpayers that will end up in examination that just creates additional complexity.

I realize there are also some timing considerations there. You only have a limited period of time in which to file an amended return, and the cascading effects for state tax returns as well every time you do that. We’re sensitive to that. Again, suggestions on how we might be able to streamline that with more generally applicable relief and guidance are something we’re always receptive to. But other than sort of feeling your pain, and we see that on the flip side as well, a lot of thought’s been given to that and if there are ways that folks can come up with to streamline those challenges; we’re certainly receptive to hearing them.

**MR. THOMPSON:** Well, one thought, Madeleine, I don’t know if you have a view on this, but apart from the stuff that was in 2017 that you can grab at the higher rate, in the interest of simplicity, is there an appetite to do a fix now or in the current year as opposed to going back with some extra relief?

**MS. BARBER:** I think it depends. Again, my concern is always in what are you locking yourself into and what is the correlative impact. Because guidance is coming out in waves, if we make or take a position under one set of rules and then roll it forward into other areas or calculations. What does that mean? In the case of a GILTI -- if any inputs change in your GILTI calculation that could lead to the loss of credits -- and since we can’t carry forward credits anymore -- that’s a lost attribute.

In addition, does that mean I have an amended return filing separate and apart from what I thought I was doing with respect to this particular change, and then do I have to keep doing that? Any guidance will just have to be very thoughtful in terms of not only the administrative burden but the potential “whipsaw” effects.
One question I’ve heard is whether or not Section 1341 mitigation could be a mechanism to provide relief under the right circumstances?

MR. DESMOND: Just to weigh in on it, 1341 is often considered when you’ve got a closed statute in the prior year so you’re looking to fix it.

It’s cumbersome for all of us to look through proposed regulations and final regulations that are quickly changed within a period of months. But, one of the advantages of that is that you can do all of this within open period. At least you’re not resorting to closed years and trying to figure out, okay, the advantage that I missed is in a closed year so I’ve got 1341. We’re certainly cognizant of that and one of the reasons you see the rapid pace of guidance coming out is not to wait three, four, five years down the road before finalizing regulations.

It’s a lot to digest now, but I think it avoids some of those adverse consequences of doing all of this when you’ve got one closed year and trying to figure out a way to get out of that box.

MS. HARMAN: We certainly don’t want to lose sight of that in today’s conversation. The challenges that we talk about here facing companies certainly affect the government, too. Because whatever we do, you have to process.

So, Mitch, why don’t we move over to the mergers and acquisition issues.

MR. THOMPSON: Sure. It was very welcome to see in the new proposed regs clarification on 336 and 338 made sense. But there are things that, at least to me and others I talk with, didn’t seem intuitively sensible. For example, when you transfer assets within a consolidated group and a target later leaves the group, the construct of making sure that the deemed asset acquisition occurs the day after it leaves. That’s great. But having it both have to be part of a series of related transactions and within 90 days, in the M&A context 90 days is a very short period of time. We often can’t control deconsolidation or when the deal closes.

Is there any sense of what’s behind that, number one, or if that could become a safe harbor instead of a requirement?

MR. DESMOND: I won’t speak specifically to that. Certainly, we’ve talked about that in preparation for this panel. Just sort of the institutional challenges there. One is that we’ve had bonus depreciation in one form or another for many years.

That’s really changed in the M&A world with the ability to have used property with bonus depreciation which has taken the folks that have been working years on bonus depreciation and folded the corporate group into that.

Now they’re working together on that. Sometimes that’s a challenge to bring an M&A world into the bonus depreciation world. I think that’s sort of what you’re seeing. Some of that is just a sensitivity to deadlines and the having folks that are bonus depreciation experts appreciate the deadlines and the timing and the exigency of M&A deals, and while all trying to move this guidance as quickly as possible. I think it’s important for us to hear that, and we’re certainly sensitive to the timing challenges for deals and things don’t get done in 60 or 90 days necessarily. They evolve during that time period.

MR. THOMPSON: They can often be stalled for competition review or a million other reasons that are outside of the control of the taxpayer.

MR. DESMOND: And that’s by no means unique to this particular bonus depreciation. We see that in a number of different contexts. It’s an area where I think we get the most helpful comments on as well because it’s the business reality. You can look at the 168(k) rules in the abstract and just say 60 days seems fine.
But, not being out there doing deals, you don’t have the sensitivity to the timing. It’s very important for us to hear that part of it.

**MR. THOMPSON:** Yeah. I guess I could see that when it was limited to new property it was really, as you said, outside the M&A context for the most part.

This is a whole new set of fact patterns, right?

**MR. DESMOND:** Yes, and we’ve seen that throughout TCJA where many of our technical offices on 168(k) and in particular 163(j) it used to be that you would have one associate office that was the lead and kind of did the laboring, or now 163(j) I think all six technical associate offices have not only a role but a pretty significant role.

The coordination effort on our part is increasing. I think it’s not unique to TCJA, but you certainly see it more in these projects than you did 10 years ago when I was at Treasury.

**MR. THOMPSON:** Yeah. Certainly, the interconnectedness is a theme we’ve struck on repeatedly throughout the day today. It is maybe unprecedented. It’s great to see that level of coordination and the receptiveness to new problems and concepts that different groups might not have seen before.

**MR. DESMOND:** Yeah. One of the things that does help me sleep at night is to know that as the rule writers, we have flexibility and we sometimes see issues come out that have unintended consequences that we are alerted to.

It’s not like we’re leaving somebody on the operating room table. We can try to go back. I think you saw this with the 382 proposed regulations and it was exactly the same issue. Timing of deals and how do these proposed regulations intersect and impact deals that are ongoing. It is something that we have some flexibility on. We can’t turn the ship on a dime, but if we hear about things the ship can be turned, if necessary. But it’s important for us to hear about the business exigencies that our regulations are causing.

**MS. HARMAN:** Okay. Let’s transition to our second topic, which is the modifications to Section 451 for income recognition. This is a unique area for TCJA in that it overlaps with a very similar change being made in the GAAP world where GAAP is also changing its rules for revenue recognition.

For those of you are not aware, one of the modifications to 451 in TCJA was to impose a rule that says income should be recognized for tax purposes no later than when it’s recognized in your financial statements. In effect, we’ve tied the timing of our tax recognition to the book treatment, which is also changing at the exact same point in time.

We have new GAAP rules going into effect starting with 2018 calendar years for public companies and 2019 for private companies. These new rules generally result in an acceleration of revenue for goods or services that are provided to customers over time, in particular, in situations where you have licensing or software arrangements or longer term contracts where GAAP is recognizing income over time but the contracts do not qualify for percentage of completion treatment under the tax rules.

Just to quickly cover some of the key changes to the GAAP rules; one of the biggest changes it did is it took the preexisting revenue streams or ways of measuring and tracking your revenue for GAAP purposes and instead requires that companies combine or separate those revenue elements into what are referred to as performance obligations.

The second change is that it increases the transaction price assigned to each transaction to now include additional consideration such as variable or contingent consideration, which may or may not be something that we take into account for tax purposes.
In addition, the GAAP changes have resulted in accelerations or deferrals of recognizing when a performance obligation is deemed complete, which is the final event that triggers a recognition of revenue under the GAAP rules.

The GAAP rules require some capitalization of costs that are incurred to obtain a contract, which, again, might not be subject to capitalization under the tax rules, creating another GAAP tax difference.

In the area of 451 on the tax side, we did get proposed regulations in September of 2019 of last year, right before 2018 tax returns were due to be filed. We are still waiting on final regulations, but hopeful that we’ll see them sometime during 2020.

Because of the simultaneous changes in GAAP rules, this is an area where I feel like the IRS and Treasury were a little ahead of the curve compared to other areas of TCJA because the changes in the GAAP treatment alone were causing companies and taxpayers to understand that they were going to need to do something in 2018 for their tax revenue recognition methods, and then 451(b) added another layer of work on top of that. We already knew going in that we’d be doing revenue recognition work on the tax base for this year; we just didn’t know to what extent.

As a result, we already have quite a bit of accounting method change guidance in the space due to either preexisting automatic method changes, revisions to existing method changes, or the creation of brand new automatic method changes covering, as you’ll see on the slide, a wide range of different fact patterns and situations.

This brings us to our next polling question. What has been your company’s greatest challenge in applying the new income recognition rules: Complexities due to simultaneous changes in both the book and tax rules; evaluation return positions prior to the issuance of guidance; navigating the various method change procedures; or does not apply?

**Polling Question #2: What has been your company’s greatest challenge in applying the new income recognition rules?**

- Complexities due to simultaneous change in both the book and tax rules: 36.36%
- Evaluating return positions prior to the issuance of guidance: 22.73%
- Navigating the various method change procedures: 31.82%
- Does not apply: 9.09%
To echo Ellen’s comment before, there probably should be an option on here for also just all of the above. It looks like we’ve got a pretty even split between the complexities due to the simultaneous changes in book and tax and evaluating return positions prior to the issuance of guidance. Maybe we can move to the next Power Point slide, please.

Obviously, the first transition issue is the simultaneous change in the GAAP and tax rules. Madeleine, I know in our conversations preparing for today you mentioned your company had quite a bit of transition complexity triggered by the new GAAP rules.

**MS. BARBER:** Yes, our process for adopting 606 actually started about two years before the effective date in 2018.

Our colleagues in the controllership office did a tremendous amount of work analyzing contracts under the 606 criteria.

Given the complexities of our business and some uncertainty primarily as it related to a specific issue around the presentation of net versus gross revenue and expenses, I made the decision to go to the IRS National Office with a method change request. As part of that process, we went through everything that we were seeing and really requested their help and guidance as to whether or not any of these points resulted in a method change, and, if so, what would be the proper treatment. We actually had a very positive experience going through that. I think because we had so much information already gathered from the accounting and controllership side, we were able to respond very quickly to the national office’s request for information, answer questions, and they were very helpful in giving us the guidance that we needed.

**MS. HARMAN:** That’s an interesting point you raise, Madeleine, because as I noted we already have a number of automatic method changes that have been created to kind of help companies navigate this transitional period to the new GAAP and tax income recognition rules.
But you mentioned that you went to national office for the advanced consent process. What were some of the complexities that led you down that path?

**MS. BARBER:** Well, I think in our case, it was very fact-sensitive.

We basically had a sense of what the outcomes would be based on automatic change, but we were looking for additional confirmation given that we felt there were added complexities under our facts and circumstances.

**MS. HARMAN:** Okay. A couple of the other next transitions to maybe talk about; as I noted, there are already automatic method change procedures, quite a few actually, that govern this income recognition area.

However, automatic consent is often tied to ensuring that you are changing to a proper method and that you are filing under the correct automatic method change procedure. I think this is an area that’s kind of giving some taxpayers and tax advisors heartburn because we’re filing automatic method changes to change what we hope is a proper method, but we’re not entirely sure yet because our guidance is still in the process and still evolving.

In addition, given the multiple different automatic method changes that are available, there are sometimes fact patterns that appear to fall under more than one change and there’s not always agreement between tax advisor firms as to which is the correct change to cover that fact pattern. I think that’s also giving folks heartburn that maybe they’re doing everything they can to get into compliance, but maybe they still then have an exam issue because they just filed under the wrong change number.

Mike, I know you mentioned during your lunch chat that it’s a little “early days” to get into the exam issue, but maybe we can get you to kind of share your thoughts on that a little bit.

**MR. DESMOND:** Sure. I guess I’d start by going back to what Madeleine said about the approach to the national office and to the branch about perhaps you could even squeeze your situation into automatic method changes. But because of the scope and the complexity, you thought it was important to get some comfort.

I’m very encouraged to hear that. That’s exactly what I think I spoke about before lunch about having people come in. Even in the context of something even less formal than a pre-submission conference to vet those issues, particularly on something like Section 451 where, as you said, Heather, many of our folks have been living with this for a number of years because of the moving financial accounting. But others have not. I think we all have a learning curve on the symmetry between the tax provisions and the ASC 606 provision. It’s very encouraging to hear that folks are coming in and getting a good reception from our branches on that.

To the specific point about the mechanics of which election change and did you put the right number on the form and those kinds of things, I won’t speak for my colleagues on the IRS side, but I would be very surprised to learn that they’re going to try to play some game of ‘gotcha’ on this. If everyone is trying to do the right thing here and get to the right answer, this is not an area where I think we’re going to try to be trapping taxpayers and seeking to make adjustments based on those kinds of foot faults.

Things get a little bit more complicated in reality. If it’s certainly part of a pattern where it doesn’t look like somebody was acting in good faith to try to put a number on a return or make the right election, it could be a different story. But this is an area in general in where we’re talking with the Saudis, I think that we’re all trying to work together to get to the right answer and not trying to play a game on examination.

**MS. HARMAN:** Well, that’s very good to hear.
Let’s move onto the final transition issue that we’ve identified for 451. Because I know you mentioned during our preparatory conversations some of the impacts your company had on your GILTI tested income as a result to changes in your income recognition timing.

**MS. BARBER:** Yes. As I mentioned, part of our analysis included the potential impact on GILTI and other calculations.

It’s also important in terms of planning. Similar to what I mentioned before, it’s that ripple effect, right? If you’re looking at method changes, in some cases you may be thinking about inverse method changes, accelerating income for certain reasons; for example in the 163(j) context, higher ATI maybe more favorable.

On the GILTI side, however, higher income may result in higher tested income which could have a negative or different outcome on the GILTI calculation. So, there is no one right answer. It will take a lot of analysis and be thoughtful about all of the potential consequences and whether you can go back and say, “Oops, we shouldn’t have done that.”

**MR. THOMPSON:** Yeah. Maybe there’s a new definition of mistake, too. When you make a decision based on proposed rules that is sensible but the final rules change dramatically. Getting to Heather’s point, if you knew then what you know now, you would have made a different choice.

**MS. BARBER:** It’s hard because, as I mentioned earlier, you also have to be very conscious of the financial statement impacts. If you acted under proposed regs, and then you get final regs, I think that’s pretty well established and that’s a change in law.

But in the absence of that and in a case where you have a set of final regs or guidance that’s pretty definitive and you’re using hindsight, I think that’s a different issue.

**MR. DESMOND:** Well, and, Mitch, you made the point, too. 9100 traditionally has kind of reasonable cause elements to it where a practitioner has made a mistake and that practitioner comes in and takes ownership of that and you get 9100 relief. That isn’t really a good fit for the scenarios you’re talking about where the best advised taxpayer may have made the same decision you made. So there’s no clearly defined mistake there to point to.

**MS. HARMAN:** All right. So, Mitch, why don’t you quickly kick off 163(j)?

**MR. THOMPSON:** Sure. 163(j), well, speaking of retooling, 163(j) had a slight transformation in TCJA; went from related party interest disallowance to an overall interest deferral.

The status of guidance that we have right now, of course we’ve had proposed regs that came out at the end of 2018, I think December, with some corrections from an earlier release. That was following on a 2018 notice very quick, actually, on those proposed regs. We know that those proposed regs have been finalized and are out of OIRA review. I think we heard about it early February, but it happened a couple of weeks ago tomorrow on January 31st. We’re all just waiting to see those. We thought we might have them for today.

But we also know from speakers at other conferences that there are additional proposed regs addressing additional issues, and there’s an apparently strong desire, quite understandably, to release those at the same time that the final regs come out. Those round two proposed regs went to OIRA on the February 7th, so just about a week ago. It’s leap year, right? So, the 23rd, I think, of March if they use the whole 45 days and if they’re going to come out together. We’ve slowed down a little bit on that. We can all plan that weekend, I guess, to read 700 or 800 pages, probably.

**MS. HARMAN:** And do you want to chat about some of, like, the transition issues for 163(j) as well?
MR. THOMPSON: Sure. Certainly, we talk about ripple effects. I think in almost every speaker who’s touched on substantive topics today, whatever they’re talking about, 163(j) has come up. It ripples through. Its tentacles reach so much of every U.S. and multinational taxpayers returns. There are things that folks have focused on very strongly in the proposed regs that are touch points. The definition of BIE, the asymmetry between the interest expense and the interest income, a lot of concerns about that; how ATI is also addressed; consolidated return; passthrough treatment...the issues are numerous. Because they do trigger so many other considerations and can tier up and tier down, I guess I’m interested, Heather, in what you’re seeing.

MS. HARMAN: I don’t know. I think an important point that we kind of stumbled upon during our conversations to prepare for today is that unlike bonus depreciation or income recognition, 163(j) can be viewed as almost like a permanent or semi-permanent item. Maybe it doesn’t have access to the ease of catch-up or true-up procedures like an accounting method change as the new guidance evolves and changes over time. It seems to create a special transition issue in this space and it takes one of our tools for getting up to compliance with the final regs off the table.

MS. BARBER: Yes. Obviously, one of the biggest concerns is the CFC group election, right? That’s a binding election and most taxpayers are probably very wary of making that under the proposed regs. There is a lot of complexity involved in the bottoms up calculations and many questions just navigating the reporting process.

For a company like mine that has thousands of legal entities around the world, it’s not easy. Modeling and investing in technology for the tax department is going to be critical going forward.

MS. HARMAN: All right. I’m going to maybe skip ahead a little bit here. We’ve identified a few themes or pathways that are available to taxpayers to transition from the enacted statutes, through proposed regulations, through final regulations, and then maybe back through proposed and final again.

Certainly, we’ve touched on the ability to revisit missed elections or elections you made on a prior return that maybe you now wish you could revoke. We’ve talked about the availability of accounting method changes to address some of these transition issues. Then obviously there’s the ability to file amended returns to true up and take into account the final regulations as on your prior year returns.

But one point I want to make sure we found time to chat about before we end today is, are there nontraditional new approaches that we could be taking to kind of navigate this transitional period for TCJA? Potentially one thing we talked about was a one-time, all-in, TCJA-related true-up on a future return that would address things like the missed revisited elections, true-ups to your accounting method changes, maybe some things that we haven’t touched on today. For example, straight up errors, mechanical, mathematical errors because you were learning new rules and calculations, as well as the ripple or butterfly effect that seems to happen in TCJA where one change to how you’re thinking about one provision or position ripples through the rest of the TCJA interconnected universe and requires some pretty sophisticated modeling.

As we continue to get more guidance and our understanding grows, we certainly know that’s an issue now, but we don’t fully understand all the effects of it until we get a few more years down the road. Having a one-time true-up might give us an avenue to address some of those interconnected issues.

MR. THOMPSON: I wonder, though, about Mike’s client, the IRS, when they’re auditing, if you’re going to have this, I’m thinking about a python that eats a giant something, which then has to move through it, they’re going to have to audit that giant something, what’s in there, right?

MS. HARMAN: Well, that’s the tradeoff, right? Is it harder to audit one big, giant catch-up adjustment or is it harder to audit how many different iterations of amended returns the three different versions of your 2017 return, et cetera?
MR. THOMPSON: Right. We’ve touched on the ripple through every state you file in. Maybe you’ve got APAs with other countries that are going to be impacted.

MS. HARMAN: We did discuss this on our prep call, Mike, so I’ll just toss it over to you to see what you think about this idea.

MR. DESMOND: There’s a little tension there because what you’re suggesting is something that has a lot of practical appeal to it.

As I said before and a couple times on this panel, anything that makes your lives easier makes our lives easier on the processing side and the administration side. But in the accounting world, we do have rules. There are annual tax years and we go year by year. I know that sometimes as a practical matter, particularly in the partnership space, you’re filing returns and there are things that people do with a wink and a nod to make things true up in later years, and the IRS is aware of that. But doing that on a holistic basis, while it may have practical appeal, we’re a little cautious about that.

Then again, you’ve got year-by-year issues. If you have this huge python moving through in a later year, is that the open year? Are you looking at closed years? I think it’s got some practical appeal to it, but it might be the kind of thing to sit down and talk with folks about once things quiet down a little bit. Once we get final regs out on all these things and the issues of transition are more front and center, we can take a step back and think a little more holistically about these practical considerations and suggestions.

MS. HARMAN: Okay. Well, with that, why don’t we move to just our last polling question. Which transition procedure would be most helpful to your company: A, the ability to revisit prior elections; B, the ability to retroactively make a missed election; prospective accounting method changes; amended returns; or, a one-time, all-in true-up on a future return? Or the last answer, does not apply, which if you’re picking does not apply, please call your tax advisor.

Polling Question #3: Which transition procedure would be most helpful to your company?

* “amended return” polled 0%
MR. DESMOND: A jar of pixie dust, right?

MR. THOMPSON: A way-back machine.

MS. HARMAN: Wow, we’ve got some interesting results kind of already coming in. We’ve got a little bit of support growing here for the one-time catchup on a future return.

MR. DESMOND: Encouraging to see that people don’t like amended returns.

MS. HARMAN: That is a surprisingly unpopular answer. Well, I think that kind of covers everything we wanted to discuss today. Thank you, everybody, for your time and attention. Do we have any questions from the audience before we let Mike go?

MR. GIMIGLIANO: All right. The question is with previously issued guidance on 168(k), is there going to be additional guidance required to provide for the phase-out of 168(k)?

I think they’re talking about binding contracts and all that sort of thing.

MR. DESMOND: Yeah, sure. Possibly. How’s that for a non-answer, John?

MS. HARMAN: Thank you to Mitch and Madeleine for joining me today, and especially thank you to Mike for sticking around after lunch to chat with us. We really appreciate it.
Breakout Session: Will Non-OECD Nations Push the U.S. Toward a Destination-Based Tax System?

Description:
Many developing countries impose destination-based tax systems. As their share of global GDP increases, their consumer markets grow, and they attract more foreign investment, what challenges do these tax regimes present for multinational corporations doing business within their borders? Are destination-based tax systems sustainable in today’s global economy - and will the U.S. ever seriously consider such a system? This session explored these fundamental questions about the future of international tax and its impact on the U.S. business community.

Panelists:
- Harold Hancock, Shareholder, Brownstein Hyatt Farber & Schreck (moderator)
- Myrtle Jones, Senior Vice President - Tax, Halliburton
- Scarlet Pereira, Senior Vice President, International Tax Planning & Compliance, Mastercard
- Marijn Verhoeven, Head of the Global Tax Team and Lead Economist, World Bank

MR. RUSSELL SULLIVAN: We appreciate you coming to our international policy panel, and let me introduce to you your moderator. He is my colleague, a fellow shareholder at Brownstein Hyatt Farber Schreck. Harold Hancock served for six years at the Ways & Means Committee, Tax Counsel under three chairmen -- Camp, Ryan, and Brady. He will introduce the panel for us. We’re glad you all are here. Harold, take it away.

MR. HAROLD HANCOCK: Just to frame this at a top level, we want to have fun and have a good time out here. In thinking about this topic earlier today, when we were looking at non-OECD countries and tax, especially since the rest of the conference there’s so much about OECD and TCJA it made me think of the episode of The Brady Bunch where the middle sister, Jan, gets really upset at her big sister, Marcia, and you get the famous quote, “Marcia, Marcia, Marcia, everything is about Marcia, Marcia, Marcia.” So, we’re trying to get away from that. We’re going to look at the non-Marcia-Marcia-Marcia for a little bit here.

Let me introduce the panel, to my immediate right is Myrtle Jones. Myrtle Jones is Halliburton’s Senior Vice President of Tax based in Houston, Texas. She has a very small job, actually, though. She is responsible for managing the company’s global tax affairs in over 80 countries. I just want to point out there’s a lot more countries than that. Maybe you should step up to the plate a little bit.

MS. MYRTLE JONES: Well, we’re working on it.

MR. HANCOCK: Okay. To my immediate left is Marijn Verhoeven. He is the Head of the Global Tax Team at the World Bank. Before that, he worked at the IMF. He focuses on international tax policy issues and particularly strengthening tax systems in developing countries.

Then to my far left is Scarlet Pereira. She is responsible for international tax at Mastercard, another very small job.
We want to talk a little bit about what's happening in the non-OECD countries with regard to tax, and some of what we were thinking about in terms of destination-based terms. What came up in our discussions prior to this is when we're thinking about the non-OECD, and even the OECD, there's already a lot of destination-based taxes.

Just to name a few in this vein around the world, there's the BEAT. We thought of doing the VAT here in the United States. Australia has something called the MALL. And then there's the Indian equalization tax. There are VATs. Just as a first note here, I looked at some of these -- BEAT, VAT, MALL -- and I decided one of the things I want everyone here in the room to start doing is thinking of more really good names for taxes that attempt to protect a country's base. I came up with three: the cobra, the hammer, and the ax. Let's see what we can do on that.

I want to start with Marijn and we decided what we wanted to talk about were not necessarily these awful taxes that apply to people, but some of the other things that countries are doing to try to bind companies to them. Some of those things are intellectual property sharing agreements and arrangements, requiring domestic partners, even if there's not intellectual sharing of property. There are agreements where you have to site things in the country. To me, all of these felt like destination-based taxes.

We were talking earlier, and one of the things that Marijn pointed out was that many of the countries in the developing world, the non-OECD world, think about taxes in terms of source, but these are to me much more destination-based. I wonder if you wanted to just comment on that a little bit and why we sort of think about it in these countries in these terms, but you, given that you work on this on a day-to-day basis, immediately had a different impression.

**MR. MARIJN VERHOEVEN:** Right. Harold's painted a very complicated picture, a very complex web of issues to think about, that as a practitioner out there doing tax work with developing countries, we look at it slightly differently. So, I may not make it any clearer, I make it even more complex, but let's go.

I think you have to look at the situation that many of the developing countries in emerging markets are in. They typically are quite concerned about tax systems. They're trying to create revenue collections; they want to collect. At the same time, they're also very aware of issues like equity, "Are we taxing the poor, are we taxing the rich, are we taxing companies versus households?" et cetera. That's important to them. What's also incredibly important to them is, "How does it fit into my development strategy? Am I able to attract investment? Am I providing a good playing field for private business to come in and to help the economy to grow and create jobs?" So that's the context that they look at for a tax system. There's a lot of tradeoffs here.

Now, what has happened over the last 10-20 years, if you look broadly at data, and, for example, corporate income tax rates. Corporate income tax rates have gone down throughout the world, not just developing countries and emerging markets, but also in the developed world. A lot of that has to do with competition. Countries have tried to compete with each other in attracting investment, and having a lower rate is generally considered to be one of the ways to get there or to have some type of tax holidays or other types of exemptions and incentives.

There is a sense among some of the policymakers that it's a bit of a race to the bottom. Why are we all trying to compete with each other? The only place that we can end up over the long term is at the bottom where nobody charges any tax on the corporates, and that's a concern.

Then we have the global value change, globalization, and automation, which has made it so much easier for companies -- and you know this better than I do because that's your world -- trying to see "How can we make the arrangement so that we don't pay taxes more than we have to?" And that's not unreasonable, but it does have a reflection on the other side. Countries are concerned about all these forces: tax competitions; globalization; automation; opportunities to profit shift and to erode basis. What are we left with? That's the context.
Within that, you see countries emphasizing issues like destination. If there is a multinational corporation that is one of the platform companies and it operates in my country, there’s value that’s being derived from my country that has to do with user data, which they harvest and use, and that’s part of the profit. So, they come here; they do these things; and we never see a cent of that value added because the tax system is not designed that way.

That’s a very specific way in which countries can think about a destination basis for the tax system, and that’s where, for example, the digital services tax come in. The equalization levy in India is an example of that, but we’ve also heard recently about France doing this and getting into a fight with the U.S.

**MR. HANCOCK:** Does that mean that France is no longer going to be an OECD country?

**MR. VERHOEVEN:** Strange things are happening in the world, but, no, I think it’s part of a dialogue and a negotiation. You all are very aware of the inclusive framework and the discussion that happens there. It’s all part of a push-and-pull that has to do with countries like France that really want to see an agreement in the inclusive framework that allows for some of these destination principles, particularly for digital companies, to flow into the global tax system and to be adopted there. The U.S., for obvious reasons, is not so keen, so there’s a bit of a fight going on, and this is one of those elements of that fight.

**MR. HANCOCK:** Can I pick up one thing you just said and direct a question to Myrtle and Scarlet? You noted that one of the policy goals behind some of the policies that we’re talking about here is to create a good investment environment. Both of you have very different kinds of company profiles. What do you think? Has that been generally the trend? Are non-OECD countries achieving that goal, or is it mixed? Is it not happening?

**MS. JONES:** Well, I think that it depends on the country. For most of my career, I’ve had a lot of experience working in a lot of these -- you would think that by now some of them would have emerged since I’ve been doing this for over 30 years but they still are in that situation. Let’s take West Africa for example, where we’ve done a lot of work.

The energy business, we export a lot of natural resources from those countries. They have deemed profit regimes, and basically instead of trying to put in all the different infrastructure around figuring out the taxes, they say, “This is your revenue, we’re going to deem that your profit is this and this is what you’re going to tax on.”

I would say that earlier in my career those deemed profits probably were a fair reflection of the margins that we were earning, but what doesn’t happen now is that margins are shrinking and because the business is getting more competitive, the deemed profit hasn’t changed at all. Therefore, the same deemed profit rate that they were assessing on a 30 percent margin 30 years ago, which may have been what it cost, may have been a pretty fair reflection of the margins that we were earning, and it’s nowhere near that now. Our margins have shrunk significantly to where we’re in the area of 10 to 15 percent. Does that encourage investment? I don’t think so.

**MR. HANCOCK:** You would like to see a little bit more flexibility?

**MS. JONES:** Yeah, more flexibility, a bit more engagement with what’s going on and flexing to what actual business conditions are. Because those are certain things that I would say discourage investment. Now, as far as the energy business is concerned, I think Heather said it earlier today, we go where the oil is. We really don’t have a lot of choice.

**MR. HANCOCK:** I guess it’s a little hard to hide drilling for oil.

**MS. JONES:** It is very hard to hide the fact that you have all this equipment sitting in a country’s jurisdiction, but it doesn’t leave as much money left over after you pay your taxes to invest in the country,
to pay higher wages to the employees. I think that sometimes, governments lose sight of the fact that there is a knock-on effect from having higher taxes.

Maybe we could be paying higher wages to the employees or investing and we would be more encouraged to invest in, let’s say, manufacturing and put in more things along the supply chain in those countries. But when you’re faced with knowing that your tax rate is going to be, in some cases for us, 50-60 percent because of the deemed profit rate that’s being assessed, it doesn’t encourage additional investment or encourage you to want to do more in those countries.

**MS. SCARLET PEREIRA:** Yeah, I would add I think what you see is in a lot of the more developed countries you see a carrot approach.

**MR. HANCOCK:** We know about carrots, right?

**MS. PEREIRA:** We have IP regimes.

**MR. HANCOCK:** FDII?

**MS. PEREIRA:** We have R&D credit. Come and invest in my country. Then, what you’re seeing in some of these less developed countries that are coming up is more of a stick approach. In order to play in this market, you either have to have a JV partner or we’re not going to let you play on an even playing field with everyone else. Or you have to have a certain level of minimum investment within the country.

Even if that’s not the way that you would otherwise order your business because it’s not maybe the most efficient way. For example, we’re in a business where we can deliver our value proposition from the U.S. or from other jurisdictions. We don’t need to have a strong physical presence in a lot of different jurisdictions. So, to tell us, “No, you must put servers in this country and you must invest to this level,” it’s sort of driving the business decision for us. It doesn’t give you much choice if you want to be involved in that market.

**AUDIENCE QUESTION:** This is kind of along a similar theme to what we’re discussing here. You both cited examples of what isn’t working among non-OECD countries. What non-OECD country has most effectively used their tax structure to attract foreign investment? And which structures have helped them get there?

**MS. JONES:** When I think about some of the countries that we operate in that are non-OECD, if you’re requiring local content, make it where it is attractive to invest in the local content. Having a tax administration system that is reasonable, that we can work through issues with, and countries that have been willing to adjust their rates for changes in business conditions.

All I can say is, there are certain countries that are definitely easier for us to operate in. If you’re going to require a JV partner, then that JV partner ought to be required to provide some minimum amount. Not just the minimum amount, but a value in return for their inclusion in that partnership. We’ve had instances where we’ve had JV partners that were the countries need to require that those JV partners have skill sets that they are offering to us that make sense.

And we have that in certain countries, where they know the system, and they are very effective about helping us to get licenses, to hire and train people. You want to see them as a value add and not just as a drain on your bottom line because you want it to be a real business decision, not something just forced upon you. That’s not going to encourage a lot of additional investment.

**MR. HANCOCK:** I don’t know, I’ll take the opposite view. I’ve been a slacker my whole life, and I think people should be allowed to skate at times. Any thoughts?
MR. VERHOEVEN: First of all, I want to go back to this idea of source-based taxation because that’s the other big separation, is do you tax at source, where the production actually takes place, or do you tax based on residence, where the company is located, headquarter-wise? Things get difficult. If you look at developing countries, for them, often they are source countries. They are part of the value chain, they provide a production, but they’re not necessarily where the company resides.

If you look at the issues that we just discussed, a lot of them have to do with the country asking for the company to be sufficiently active economically in the country. “You can have access to my market, access to my labor force, access to my resources, but be here sufficiently, not just with the minimum so that you can extract and take it elsewhere.” Either the money or the resources or whatever it is. I think it’s particularly understandable for the resource extractive industry, but it’s a more general point.

But the international tax system right now doesn’t really work that way. It really favors residence principle. One big issue that might actually help this forward, at least for the tax part, to see whether the international tax system can be a bit more source-based, so that they get more out of it, developing countries that are source providers without necessarily resorting to these kinds of arrangements.

I think the question about what kind of a tax system or what kind of a foreign direct investment system helps to attract foreign direct investment. This is a question that the World Bank thinks about a lot. It’s at the core of what we need to think about.

One of the things that’s very surprising is that for you as tax practitioners, tax is really important in determining where the company goes. If you look at data, it’s actually much less important than you would think. Skills, infrastructure, agglomeration effect, cluster effects are far more important. And the tax –

MR. HANCOCK: Marijn, you are talking to a roomful of tax people. Are you sure you want to make that statement?

MR. VERHOEVEN: Well, I’m also a tax person. These are my main points, what I wanted to make, yeah.

MR. HANCOCK: I think this is a good spot for us to go to our first poll. We were talking about all these arrangements. We have three options. A, these are really just a money grab. Despite Marijn’s explanation of all the theory and thoughts behind all of it, it’s just a money grab. B, they’re actually a really smart response to the challenges people are facing in the world’s economy. Or C, they’re an inefficient and unfortunate response to what’s going on in the world economy.
Polling Question #1: Non-OECD countries are more and more using tools such as domestic partner requirements and intellectual property sharing arrangements (among many other options). Are these policies:

- A money grab
- A smart response to the challenges they are facing in world economy
- An inefficient and unfortunate response to dealing with international business

MS. JONES: And I agree with that.

MR. HANCOCK: I guess we should have had D, all of the above, which is what Marijn suggested, but he wasn’t there when I was creating the polls.

MS. JONES: I don’t think it’s B. I would disagree.

AUDIENCE QUESTION: This question is for Scarlet. How is your company responding to recent developments in Latin America where countries like Chile are imposing a high VAT on digital services and requiring credit card users to collect and pay over those taxes?

MS. PEREIRA: Yeah, I would say that that actually primarily affects our customers. Mastercard doesn’t issue cards, but our financial institutions that are our customers who do issue the cards are the ones seeing themselves in the situation where they have to withhold certain taxes and they have to have some kind of system in place to be able to have the right level of withholding and all of that.

I would say it affects us less, but nevertheless, we’ve been very involved from a public policy standpoint in various countries in Latin America to understand what the new rules are and whether they would impact our company and have the right level of conversation with the local authorities to understand what they’re trying to achieve and if a digital services tax is really the way to achieve that. I think in some countries you’re seeing -- Colombia is probably an example -- lots of challenges in being able to roll out this kind of system. One thing is to say that you want to implement a digital services tax, but how you go about doing that and how you institute a mechanism for collection and reporting of that is a lot harder than I think some of these countries realize at the beginning.

MR. VERHOEVEN: This is a bit of a different digital services tax than I earlier was talking about. The one I was talking about earlier is one where you want to tax the presence of platform companies in your
country. This is a little bit different. This is about using the payment system to actually collect your VAT. And, from a policymaker perspective, it makes a lot of sense.

We have trouble collecting VAT in our countries because compliance problems and people are just trying to cheat, but all the information that we actually need is available in the payment system, so why don’t we use that and it lowers our effort and we can make it the credit card companies’ efforts and the banks’ efforts?

That’s where they’re coming from, and when it’s technically feasible, you will actually probably find a lot of countries who at least will be thinking about it because it’s so attractive for them. I think one of the important things in this is to realize if governments are going to offload compliance costs to private companies, it should be fair, it should be compensated.

The other part of it is it may lead to people then trying to go outside of the payment system, and that would not be good for multiple reasons, right? So, there is a risk that this creates problems that over time may grow up to be pretty bad.

MS. PEREIRA: Agree.

MR. VERHOEVEN: It’s interesting, and in some cases, it could make sense, but there’s a lot of qualifiers that go into it.

MR. HANCOCK: Marijn, I want to ask you a follow up question on this poll because a number of things you were talking about in your work and what you do is you focus on inefficiencies and trying to help people respond. I thought it was interesting that it was the inefficient which is something you focus on, but then also unfortunate and yet so many countries are doing this, and I think you’ve articulated some really good reasons for why they do it. Speak to these people and explain to them why it’s not inefficient or unfortunate.

MR. VERHOEVEN: Well, I think my response to this question would be it’s one of these depending on circumstances or even a combination of things. Sometimes it’s very smart. If it’s well done and according to the kind of principles you outlined, Myrtle, then it could be fine. But it can also be ham-handed and in the sense, even abusive, right?

The point is countries, they have their political problems. For political reasons it may sometimes be good to beat up on certain groups of, you know, people, companies, et cetera. And then, inflicting pain is exactly the point. But often what’s really underpinning it is a capacity problem.

Here I want to come back to something we talked earlier about, the international tax system, and what’s needed in the international tax system. What we argue for in the inclusive framework is for simplicity, transparency, and up to a point mechanical rules. You talked earlier about the deemed profits, right?

MS. JONES: Right.

MR. VERHOEVEN: And deemed margins. We think deemed margins, if done well, can really have a place because otherwise you are going to be in the situation where tax authorities are dealing with very sophisticated companies like yours and it just doesn’t work because you never can agree.

Having smart mechanical and good rules can help to compensate for the fact that the tax authority, they don’t really have the knowledge, they don’t really know how to do it, they get confused sometimes, and the result may be that they get the order from above, you need to collect. And then they say, “Okay, well, you need to pay X.”
We need to find somewhere between all of us -- and you are a part of that -- a way of dealing with this in a reasonable manner. Like you were saying, if the deemed margin is reasonable, you’re very happy with that. Also, it probably simplifies your --

**MS. JONES:** It simplifies my life.

**MR. VERHOEVEN:** Exactly. That’s the reality in many countries, capacity problems are a real constraint, and taking that into account is important. I know that some of you are actually working very actively with your counterparts, you educate them, you train them, you explain to them how your business models work. Those are all very, very good practices, and I really strongly encourage that. But thinking about the larger scale is important.

**MR. HANCOCK:** Great. What I’d like to do now is transition a little bit to have Scarlet and Myrtle talk a little bit about their experiences and their history over time and with some concrete examples. With that in mind, we’re going to move to our second poll.

Over the last 10 years, your experience in non-OECD countries has been: A, much better than the OECD. Those other OECD countries, they’re losers. B, no better and no worse, the same wonderful, awful experience. C, much worse than the OECD, do not get me started. All right. Let’s see.

**Polling Question #2: Over the last ten years your experience with non-OECD countries has been:**

![Polling Question #2 Chart]

I deliberately did not say wonderful or awful. I said both, so presumably there’s some room in that question for it to be either one, but I guess it’s good that it’s no better, no worse. If everyone’s doing things badly, it’s the same level of bad, and hopefully people are doing things well so it’s the same level of well.
For those of you who answered C, don’t get me started, meet me afterwards to give me the war stories. That would be great for the next time I do this.

All right. Well, I think with that in mind I want to turn to Scarlet and Myrtle. I’m going to start with you, Myrtle, first. With your experience -- and we’ve talked a little bit about this already, but maybe putting a little more color on this, and in particular for you at Halliburton, you’ve been facing these issues for a very long time. I don’t mean this negatively, but we don’t really think of you as a digital company. I’m sure you have digital components.

But you have things on the ground, you’re mining, you’re constructing, you’re doing real physical things, so you’ve sort of experienced this for a while, and I wonder if you’d give me some examples of what you’ve gone through and what happened over time.

MS. JONES: Well, we can talk about some of the non-OECD countries again, in principle it should work. The countries are not that sophisticated. They need an effective means of collecting tax dollars, impose that revenue collection burden on the taxpayer, so our customers will withhold the tax from our payments. We file a return; we claim the taxes; that should be the end of it.

But when they need to collect more money, they create these new rules around the substantiation and they make getting the substantiation that those taxes have been paid very difficult. “I need you to show a tax receipt, and it can’t just be showing us your general ledger with a customer has withheld the taxes, and to the extent that you can’t produce that documentation, we’re going to make you pay again.”

We’ve fought a number of battles along those lines and the problem is helping the government to understand that what we need is something that’s fair, something that’s predictable to encourage us to invest even more in those countries. You have to have a stable, predictable, and fair system. You have to feel like you’re being treated fairly. And in those situations, you really don’t feel like you’re being treated fairly.

A lot of countries are now looking at the OECD and now say they’re cherry-picking, so we have, let’s say, one of the big West African countries that we operate in, they implemented transfer pricing, they (in theory) went away from deemed profits. You have to file an actual tax return and your tax liability is what’s reflected on the return itself. The taxes are being withheld, and you never get a refund.

MR. HANCOCK: Never get a refund? That’s not an experience anyone here in the U.S. has ever had with the Treasury Department.

MS. JONES: No, you never get a refund. You end up basically writing taxes off because what happens then is that they create disallowances. Oh, by the way, that’s not deductible. Or they’ll say, “Provide us documentation for every single item in this particular account, and we want to see the underlying documentation for every single transaction that went into that account,” and they will work it to the point where your final liability upon audit magically equals a little bit more than what’s been withheld.

MR. HANCOCK: That sounds like good tax administration, wouldn’t you say, Marijn?

MS. JONES: But you see that not just in West Africa, but you see that across the globe in a lot of jurisdictions.

And OECD. We have the same issue in Mexico, where the level of documentation that is required is basically meant to deny you deductions to ensure that you pay a certain amount of tax, rather than adjusting your tax rate or basically saying these items are deductible and these items aren’t deductible, they get at it in another way.

MR. HANCOCK: Has this influenced business decisions for you guys?
MS. JONES: Well, I think that it influences business decisions across the board.

I take your point. People don't move to countries because of tax, right? They don't not invest or invest because of tax, but if you do have a stable, reliable, fair tax system, it's usually reflective of the fact that a country has that type of system overall in their regulatory base, and it encourages investment.

We don't drill for any oil in Singapore. There's no drilling there, but we do a significant amount of manufacturing in Singapore because they have a very good work force, and they have regulations that you can depend upon, and when they tell you that this what your taxes are going to be, you can count on it being that.

There may be other parts of the world. Maybe you want to locate your supply chain for Latin America in Latin America. It makes a lot of sense because of proximity, import/export regimes that they will have. They have common regimes around there to make those things have a lower cost because it's manufactured in another Latin country. But we're not moving manufacturing there because -- one, the workforce; they have not invested in the workforce to bring them up to the standards that we need; and, two, we cannot depend upon the regulations to be administered, not just for tax, but across the board in the way that's actually in their books.

MR. HANCOCK: Scarlet, I'm going to shift to you because I think we can all appreciate that these are very different companies in probably critical ways. It's much more digital. You can explain to us all how you permanently site a server farm to contain information in a foreign country, how you handle digital taxes, so I think you've had a slightly different but similar experience in some ways.

MS. PEREIRA: I want to pick up from something that Marijn said, and he said that there's a political environment that's underpinning all of this. I fully agree with that. What we have been seeing for the last few years is this wave of nationalism. What's happening is it's tax and other regulations coming together to protect local industry, and also aimed at making sure that foreign investment as it comes into the country really starts to look more like domestic investment.

What I mean by that is this whole concept of needing to have a JV partner or having to have certain amount of local presence in the country from keeping servers there, for example, to even what you name your local entity that's operating in that country. There's a push from local government to make it look as local and feel as local as possible. Some of that is, you know, regulations around the way you're allowed to operate in the country. It could be data privacy in our case, or it could be a tax regulation as well.

I agree with Myrtle. You're dealing with a lot of different regimes and a lot of different jurisdictions, and when you're looking at some of these places that are requiring a JV partner or have very onerous regulatory requirements, you're talking about huge market opportunities at the same time. It's not as if you could just walk away from that and say it's too difficult, I'm not going to play in this country, because we're talking about China, we're talking about Brazil, we're talking about India. We're talking about huge opportunities from a business standpoint.

You do the best that you can do. You try to get as much certainty as possible and have engagement with government as much as you can. You know, but this is nothing new. U.S. companies have been dealing with this for a long time. I would say the change, this nationalistic wave, is making this more prevalent in other jurisdictions outside of your traditional India, China, Brazil. You're seeing Indonesia; you're seeing a lot of smaller nations also adopting this kind of stance.

MR. HANCOCK: I actually want to pick up on that for a moment and ask Marijn a question, and that is let's assume for a moment there is nationalism, not doubting your word, but do you think that some of what we're talking about here is driven by that, or is it driven more by changes in the world economy with people just trying to adjust?
MR. VERHOEVEN: I think the change in the world economy actually is pretty big in this, what I talked about earlier, globalization, automation is putting a lot of stress on the countries. It's interesting. In the extractive industry, there was a meeting that we had not so long ago, and somebody showed a picture -- and it might actually have been Halliburton -- of a control room for a mining operation. The control room was, I think, in Austin, and it drives completely what happens in the mine, which could be anywhere in the world.

MS. JONES: Yes, we're moving more and more to that, where there's not 100 people out at the well site drilling anymore. There's someone sitting in a control booth that's watching the entire operation and controlling what's happening.

MR. VERHOEVEN: So, that image encapsulates the tax and most of the other issues of this, right? The globalization of value chains is a real thing, and it makes it really hard to, for example, figure out where should the tax be paid, because what's the role of the control room and the person sitting there and doing that and what happens in the mine. It's really tough. These are real issues. And, yes, politics plays into that and politics gets partly shaped by it and then also influences it, but there are real fundamental things. Maybe, one other thing is it's the role of the World Bank, an organization like the IMF and the OECD to help to support the tax administrations and ministers of finance in setting up systems that actually work, that provide certainty, that are working in this way. So, when these issues pop up, it's good for us to know about them, to hear about them.

The other thing is particularly on what you mentioned, Myrtle, the documentation requirements for transfer pricing, and we have something called a Platform for Collaboration on Tax where we work as the World Bank with the IMF, the UN, and the OECD. A major thing that this platform does is it puts out guidance for non-OECD low-capacity parts of the non-OECD world to deal with the BEPS issues and related issues.

One of the toolkits that's coming out shortly has to do with documentation requirements for transfer pricing. We're trying to put in information for these tax administrations so that they're not unreasonable but they're also not asking for too little.

AUDIENCE MEMBER: Do you feel as though the significant expansion of the number of countries participating in the OECD is a positive thing or the beginning of the end when you need consensus?

MR. VERHOEVEN: I think it is unequivocally a good thing. The OECD -- the old system, the previous system where OECD countries set rules for international tax, which then have features which you can see are skewing the systems towards OECD countries, and it also does not take account of the specific needs of countries that have somewhat lower capacity and have difficulty dealing with complex rules, that doesn't help anybody, right? The way that Scarlet and Myrtle talked about it, it shows it's not good for anybody. So, the fact that all the countries are sitting there right now, or at least a fair portion, including of the developing world, is very helpful.

Now, you can then go into more detailed discussion of the different views and how exactly they're being dealt with, and you may complain about the fact that for developing countries it's not so easy to understand all of these issues. I don't know if anybody here in the room tries to track everything that comes out of the OECD on these issues, and if somebody is able to read all these documents, I want to meet them, because that's probably the only person except for Pascal Saint-Amans who does that.

It is very complex environment. Some of it is just inherent and so having them at the table doesn't solve all the issues, but it's at least a very important part of this being actually effective.

MR. HANCOCK: Okay. Well, I think we want to end on a little bit of a question here about the interaction of U.S. tax system and the non-OECD countries. I think historically the way it has worked is that the U.S. makes decisions on policy; other countries say, "Hey, stop being a bully, we don't like you for doing that,"
then they say, “Well, I guess we better pass some laws that look like that,” then they say, “Okay, U.S., are you going to comply with those too?” And then the U.S. says, “No, we’re not, but thank you for asking.”

Just future thoughts on U.S. tax policy. The TCJA should be viewed as, and I have three options. One is a triumph, and I hope this is not a spoiler for anyone, but I think of the last scene from the Star Wars movie, The Rise of Skywalker, where after eight previous movies of trying to defeat the empire they finally do, and it’s a total victory for the universe, and therefore everyone should be following the United States, and all of our talk about the non-OECD countries, what they should be doing is look at the TCJA.

Two, it was a false victory, and here, I don’t think of the final scene from Butch Cassidy and the Sundance Kid. I think of the scene right where they blow up the train car and there’s literally money falling down from the sky, because up to that point, things had been great for these guys. No one could catch them. They robbed the train every time it came by, and they had plenty of money. But after that, they got chased out of the United States and died in a hail of bullets.

Or, three, is it neither, and here I thought about the end of the Indian Jones and The Raiders of the Lost Ark, as the Ark is being wheeled into the giant government warehouse. We had an epic adventure, near-death experiences, the Ark is recovered, it’s an incredible artifact, and then nothing. It just disappears. So those are our options for TCJA. Now, you may also think that the TCJA is really the end of the first Star Wars movie where they first blow up the Death Star, only to have them build a new one and then eventually Starkiller base. But let’s just focus on the last part. All right. Cue music.

Polling Question #3: Will non-OECD nations push the US toward a destination-based tax system?

<table>
<thead>
<tr>
<th>Result</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>A Triumph: The last scene from Star Wars The Rise of Skywalker. After years and years of struggle total victory for the universe!</td>
<td>28.05%</td>
</tr>
<tr>
<td>A False Victory: The scene in Butch Cassidy and the Sundance Kid where they blow up the train car and money is raining down from the sky. From that point they are chased out of the United States and die in a hail of bullets</td>
<td>47.56%</td>
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<tr>
<td>Neither: The end of Indiana Jones and the Raiders of the Lost Ark as the ark is being stored in a warehouse. After an epic adventure and near death, the ark is recovered and then…nothing.</td>
<td>24.39%</td>
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All right, whoever voted nothing, I recommend changing your vote. It’s at least a false victory.

So that implies as we’re framing this, it applies a lot of things, and we could ask a lot of different questions about, one, whether I picked the right movies; two, whether I really watch too many movies; three, whether I need to read more tax law. But on the nothing, just thinking about what we’ve been talking
about between the U.S. and the OECD and non-OECD, does that suggest maybe that the U.S. is losing its influence? Do you think that TCJA didn’t move the needle enough, or is the future more along the lines of, now that we know that Louisiana is a non-OECD country, Louisiana and those experiences, is the U.S. going to run into trouble because they didn’t take the right path in TCJA?

**MR. VERHOEVEN:** Well, just very briefly, for my part, of course, we don’t really deal with the U.S. tax policy, so I have to be careful, but I do think that the fact that the inclusive framework reopened the debate about the digital economy and in that process started to really look again at the consensus that was before, I think that was possible because the U.S. made changes to its tax policy that inspired and gave space to that kind of thinking. The BEAT is important in that, but that’s not the only part.

For me, it’s been at least a creating of an opening from the outside; the non-U.S. perspective.

**MS. JONES:** I hate to say neither, but I just don’t know yet. There feels like there is this big, what’s next? What happens after this? I agree, it’s a great opening. It has definitely benefitted Halliburton tremendously. For BEAT, we’re definitely there, it’s been fantastic, but for me, I feel like there’s just a lot of uncertainty. When we talk about digital and drilling the well from sitting in a truck remotely from that location, there’s a lot that the tax laws are going to have to catch up to that they just haven’t even thought about yet. So, it can’t be A.

**MR. HANCOCK:** Of course, it can be A.

**MS. JONES:** No.

**MR. HANCOCK:** Absolutely. I mean --

**MS. JONES:** That would mean you would never look at it again, and the world is changing, and the way we work is changing very, very rapidly and in ways that we had not envisioned. So, it may be A for now but not forever.

**MS. PEREIRA:** And there’s a lot going on right now in the international tax world, right? With Pillar 1 and Pillar 2, it still remains to be seen what comes out of that, and how countries react. I know this panel is not about that specifically, but there’s more on that to come, and whether the GILTI will be compliant with Pillar 2, all of that. So, we’ll see.

**MR. HANCOCK:** Okay. Thank you very much, and thank our panelists, please. Great job.
Breakout Session:
Transfer Pricing:
Developments and the Path Forward

Description:
Recent developments at home and abroad, including the enactment of several new international provisions under the TCJA and the OECD’s ongoing work addressing novel nexus and profit allocation issues presented by the digitalization of the economy, are making the management of transfer pricing challenges even more complex. This panel of senior tax executives and transfer pricing experts took an in-depth look at transfer pricing through the lens of these developments, and answered key questions including: What tensions exists between the well-established transfer pricing rules under section 482 and the inbound anti-base erosion measure codified under section 59A? What are the recent trends in transfer pricing litigation? Is the arm’s length standard dead, and if so, what are the alternatives in today’s constantly changing global economy?

Panelists:
- Melissa Hall, Senior Vice President – Tax, Assurant Inc. (moderator)
- Cory Hillier, Senior Counsel (Tax Law), International Monetary Fund
- Ron Lang, Chief Tax Officer, Ford Motor Company
- David Noren, Partner, McDermott Will & Emery LLP
- Loren Ponds, Member, Miller & Chevalier Chartered

MS. MELISSA HALL: Thanks everyone for coming to the international tax technical panel. This is obviously where the cool kids are, so appreciate you joining us. We have a really interesting agenda. I think we’re going to have fun today. I want to introduce the esteemed panel.

I’m Melissa Hall. I’m the Head of Tax at Assurant. I’ve been there for 25 years, so I decided it’s not relevant what I did before anymore.

I wanted to say that it was really nice that several people got to present the Pillar of Excellence Award, but I get the most fun presenting the most valuable player award to my friend to my left, Ron Lang. We had Tadd Fowler from P&G to speak on our panel, and he got stranded, so we pulled Ron out of the lunch line. Ron’s the Chief Tax Officer at Ford Motor Company, and with a background in controversy with the IRS and others, including arbitration and appeals.

To his left is Dave Noren. Dave is a Partner with McDermott Will & Emery, where he focuses on international tax planning. Prior to joining McDermott, he served on the staff of the Joint Committee on Taxation.

To his left is Cory Hillier. Cory is currently appointed as Senior Counsel in the Legal Department of the IMF. Cory is involved in providing tax law reform advice to various IMF member countries and has experience drafting legislation in all major areas of tax law, including international taxation. He’s also involved in the IMF’s legal and international tax policy work, including at the G20 level.

Last but not least, Loren Ponds. Loren is a Member in Miller & Chevalier’s tax practice, where she advises clients and APAs, MAP proceedings and international tax controversy matters before the IRS, as well as on transfer pricing and other international tax matters. She also provides strategic counsel to clients on legislative, regulatory, and other tax policy issues. Immediately prior to joining Miller, Loren served as Majority Tax Counsel for the Committee on Ways & Means, where she developed, analyzed,
and refined the international provisions of the TCJA. She brings a lot of recent and very interesting insights to our panel.

That’s our panel. Here’s our agenda today. We’re going to start with the BEAT. Very interesting, while the BEAT was enacted with the TCJA, and essentially is to disallow base-eroding payments from the U.S. to affiliates. Without further ado, I’ll turn it over to Loren and David, who will take us through the slides.

MS. LOREN PONDS: Thank you, Melissa. We’re going to start with a background of the BEAT from a policy perspective. We are presuming a baseline level of knowledge as to the mechanics of the rule, so we’re going to just jump into the current state. But before we do, let’s look back at the policy considerations into bringing the BEAT into existence. During tax reform and in the years leading up to tax reform, to be honest, U.S. multinationals were voicing concerns that under a worldwide taxation system with deferral and a Subpart F regime, they were unduly burdened in the global space, vis-a-vis their competitors.

Foreign-parented multinationals were not subject to these same constraints when operating in the U.S., and, in fact, were able to base erode by making outbound deductible payments, including payments for interest expense and related party services. With that understanding, there was a lot of support for an inbound base erosion measure in the tax reform package, and so that was the policy.

We know that what we ended up with (59A as enacted) does hit U.S. multinationals as well, by virtue of foreign tax credit clawback and NOL clawback. The stated policy aims as reflected in the statute are in reality are a little bit different. Where does that leave us in terms of transfer pricing? Your arm’s length price is irrelevant. So, you’ve got a rule that looks at your outbound deductible payments, and does not care about whether they’re arm’s length or not. It’s just the fact that they’re going out and they are deducted against the U.S. tax base.

If we move on, we just got final regulations, at the end of 2019. I do think that the regulations, in proposed and final form, offered some much-needed clarity and really put forth some thoughtful guidance, particularly around the services cost method. There was a retrenchment from some rules around nonrecognition transactions and treating repatriated IP as a base erosion payment, which was also welcome relief. So, all good news on that front.

I think the take-home message that we want to focus on here today is the fact that the Treasury regulations don’t really seek to change general tax principles. We have the operation of the BEAT within the larger context of how U.S. tax law works, and we’re going to look at some of these general tax law principles, some common structures and payment flows, and consider ways in which general tax principles might mitigate some potential BEAT liability.

This goes through some of the comments that Treasury addresses in the preamble of the final regulations reflecting comments that people submitted in response to the 2018 proposed package. A lot of these payments focused on related party transaction flows that are quite common in real life.

Pass-through payments, division of revenues from global services or a profit-split type of scenario, and then netting, which is a big pain point of 59A, in that the BEAT regs expressly do not allow netting. But a lot of transactions, particularly related party transactions, are going back and forth, such that they’re all netted and you get down to a final position from an internal point of view. Considering that and the inability to net under 59A could lead you to cross that 3 percent threshold quite quickly.

MR. DAVID NOREN: My reaction to where we ended up with the final regs and the new proposed regs with the deduction waiver option is that the statute does a lot of weird things and creates a lot of weird results, but Treasury did their best to work with what they had and to make sure that the rules were catching what’s supposed to be caught and not catching what’s not supposed to be caught.
On all these taxpayer comments seeking various new exceptions or new rules that would provide more clarity to eliminate the possibility of these odd results, Treasury by and large declined to adopt those rules. The good news part of the story is that Treasury and the IRS basically confirmed what I think a lot of us in the business community had been thinking ever since the statute was enacted, which is that this operates based on general concepts of a U.S. taxpayer claiming a “deduction.”

There are a lot of general tax principles around that, and we’ll get into all that, but it’s a real self-help environment between the code and what Treasury has done via regulations. The good news is that there is self-help to be had.

MS. PONDS: Right, so it gives taxpayers some flexibility and the ability to be a little bit creative, which is always fun.

MR. RON LANG: It’s not an understatement to say we were panicked about the rule because we have substantial foreign tax credit carryovers. The cash tax effect of exceeding the threshold was just devastating. We did substantial restructuring, mostly around our licensor model for global IP. The U.S. pays for research conducted in other countries, so in those other countries, for those CFCs, we had to hive off the research function into a separate check-the-box entities to avoid the base-eroding payment.

We use the services cost method and are very pleased now to know that if we did something that didn’t quite work, we can forgo deductions to still get within the 3 percent.

MR. NOREN: Yes, it’s rarely your first choice, but the option of forgoing deductions helped you sleep at night, I bet.

MS. PONDS: It’s a good safety valve to have. If we move on to the next slide, we’ve highlighted here a few generally applicable tax principles that exist that might be able to be relied upon when you’re looking at ways to mitigate BEAT exposure. I should say when I say, “mitigate BEAT exposure,” it’s really to not have base erosion payments. Agency principles, reimbursement doctrine, trust doctrine, conduit are all longstanding principles that have been established through case law that could provide some relief.

I do think it’s interesting to note that a base erosion payment is predicated upon the availability or the allowability of a deduction. Some of these principles speak not to deduction, but to income recognition. It
is a nuanced point, but a point worth making, that if one is to rely on one of these principles that don’t explicitly speak to a deduction not being allowed, how you might be able to shoehorn your facts into that principle to make it work.

Notably, the reimbursement doctrine does speak directly to the allowability or availability of a deduction by expressly saying there is no deduction allowed if all you’re doing is reimbursing. On other side, the person who’s being reimbursed is not recognizing in the income. Next, we’re going to go through more than a couple structures that are common and give some commentary on how these principles might be applied.

MR. NOREN: The first two examples both involve money passing through a U.S. company’s hands under circumstances in which there may be a position that the U.S. company is to some extent operating as a mere conduit, nominee, or not the party in interest. The first one involves payments going out of the corporate group to unrelated parties. Then in the next one we’ll talk about payments coming into the group from customers.

Here, we have a U.S. company, it owns IP and it’s developing IP. This requires development activities all over the world, including in markets where the group has CFCs. The CFCs are involved in helping to develop the IP, and they have to engage third-party service providers to do that. This is fairly common in pharma, right? This could be an early-stage drug product. A U.S. company owns the IP; you have to do clinical trials all over the world. This could be your CFC in a local market, and it might be engaging a third-party contract research organization to assist with clinical trials.

To the extent that the third party is engaged by the CFC, you could have payment for intercompany R&D services going from USCo of the CFC and then that payment goes straight out to an unrelated party. It would be a shame for that 150 to be a BEAT payment given that it’s just rolling all the way out of the corporate group to a third party.

Treasury and IRS say, “No, we’re not going to come up with some new definition of a middleman or a passthrough, and create some new exception, but we are going to say that you just look to all federal tax principles.” Here, you say, “Okay, maybe the CFC really doesn’t have the claim of right to any of the 150 because it has to pay it out.” The BEAT makes these issues important even though they might not have been important in the past. Pre-TCJA, third-party agreements and inter-company agreements generally don’t map neatly onto these distinctions that the BEAT makes.
You might have to restructure or redraft some of your inter-company agreements. You may even want to approach third parties and try to establish that you’re actually operating to some extent on behalf of the USCo here. Obviously, it’s harder to approach a third party. The third party may want to be paid generously for helping you out.

We’ve seen a lot of variations on this kind of fact pattern. How far can we get just restructuring our inter-company agreements? What, if anything, can we do in terms of sending a letter, a notice, sort of an interpretation of existing third-party agreements to let the third party know that it’s dealing with the USCo, without actually amending the agreement? What would happen if we had a markup by CFC here, as opposed to a pure passthrough? Those are some common issues that we face.

Moving on, and I’ll go quickly through this one. Same principles, just payments moving in a different direction. So here we could be talking about any kind of service business. USCo and CFC are going to market together, earning revenue from customers. It’s very common to require the resources that you have in different parts of the world to deliver on a customer contract, but perhaps the U.S. company is the only legal contracting party vis-a-vis the customers. So, you have a fee coming into a U.S. company, but it has to remit a good portion of that fee to the CFC.

Looking at nothing more than that, it looks like 150 may be a BEAT payment, but, again, you face this question of what can you do to your inter-company agreements? What can you do to your third-party agreements to establish the concept that the CFC is really contracting with the customer, is really earning revenue from the customer in order to take that BEAT payment out?

We’ve seen all kinds of fact patterns along these lines. Sometimes we feel pretty good about interpretations of the existing third-party agreements that are available, and we can patch in what’s needed by adjusting the inter-company agreement. Sometimes we feel like we have to loop in the third party in some manner. Thinking through the economics and who’s getting a markup for what, those are all interesting problems.

MS. PONDS: These next two slides highlight the issues around netting. The first is outside the context of a CSA, and the second one that I will go through is within the context of a CSA. We discussed earlier the BEAT regs are very clear that netting is not permissible in the context of 59A, but we have here a common fact pattern where we have a kind of cross-payment. CFC is paying a royalty up to the parent;
meanwhile, parent is paying CFC a marketing fee for activities it conducts in the local market. Part of that is paid onto a third party for advertising. The CFC just keeps this little bit of a markup, this little $10 spread for itself for performing that activity.

If we were netting the net result is a 50 payment up and theoretically, at least, you would have no base erosion because it is income coming into the U.S. At this point, just on a plain reading of the regulations, the 150 marketing fee would be considered a base erosion payment. Even though the net effect is income coming into the U.S. fisc, we still have the impact of that $150 deductible payment being subject to 59A.

So, what could the related party group do to mitigate this effect? There are some principles that exist. You have aggregation principles. I think that there is a provision in the -1 regs under 482 that talks about setoff, which does allow for netting when you don’t have an arm’s length payment. If the same taxpayers in the same taxable year have kind of cross-payments, much like this example, and it turns out that they were not made at arm’s length, you can adjust, and whatever the net is, is your actual adjustment. Now, the concept is similar, but the context is different because setoff is made in an ex-post scenario. You have a notice of proposed adjustment that has come from the IRS, and then you’re kind of looking back and saying, “All right, well, if we look at everything together, here’s the net result.”

But, to Dave’s point, we can look at the contractual terms. Could we say we’re just going to pay a $50 royalty up and the CFC is going to take care of marketing on its own? That way it’s not losing any money; it’s just not paying the full royalty. Is that royalty then non-arm’s length? Unclear.

**MR. LANG:** And those two are very closely connected. It’s basically the same transaction.

**MS. PONDS:** Yes. On the next slide, we have a similar concept but we’re in a CSA. This is a much better position to be in if you’re already in a CSA.
It’s hard to get into one just for this benefit, but under the -7 regulations under section 482, netting is expressly permitted. There is an example in the cost sharing regulations that shows when multiple CSA participants are contributing platform contributions and have intangible development costs, you throw it all together, look at their RAB shares and come up with a net either payment into or payment from the arrangement, depending on each of the participants.

As I said, if you’re already in a cost-sharing situation, this is a great feature of the regulations, but if not, it could be hard to take advantage of and hard to structure into.

Dave, we were talking about what do you do when you have dueling regulations.

MR. NOREN: Right. The BEAT regulations say that you don’t get the benefit of contractual-type netting. This is a significant exception to the general point of the regulation saying it’s all facts and circumstances, your agreements matter a whole lot, and you can apply the whole family of judicial doctrines and case law. Netting is an exception to that.

The BEAT regulations say, with respect to contractual netting, we’re not going to follow it, but to the extent that it’s available by regulation, at least under the current regs, you should be able to follow it. That helps in this cost-sharing scenario, and query whether it might set up something that Loren mentioned before about the setoff idea.

MS. PONDS: If you can take it.

MS. HALL: Right. Thank you. I don’t know if, Cory, you wanted to make any comments before we move on to our polling question.

MR. CORY HILLIER: Well, I can make a quick observation, which is a slightly different one. The IMF is concerned with cross-country spillovers, so one observation that we’ve seen is that with the structuring of the BEAT, obviously you can try to structure to avoid its bite, but to the extent that it does bite, then there’s an issue about double taxation.

Actually, what might be created is an incentive for the payment to be received instead of by a high-tax jurisdiction, and to actually shift it into a low-tax jurisdiction and potentially a tax haven, which is quite an interesting result when you think about what the policy behind the rule is. I think that is one factor that’s
being considered with Pillar II at the OECD level, which looks at the effective tax rate of the payment in the hands of the recipient as to whether the rule will bite.

**MS. HALL:** It’s interesting because we talked about maybe foregoing deductions and moving to tax havens as a result of some of these new rules.

All right, let’s take our polling question. What have you done to mitigate your company’s BEAT exposure liability? Have you restructured? Have you monitored your intercompany payments to avoid exceeding the threshold? Have you reorganized your supply chain agreements? Or have you done nothing because BEAT’s not a concern? Or have you said I’m out, I’m getting a new job?

**Polling Question: What have you done to mitigate your company’s BEAT exposure/liability?**

![Polling Question Results]

- Restructured to avoid having base erosion payments altogether (e.g., checked open structures)
- Monitored intercompany payments to avoid exceeding the 2%/3% threshold
- Reorganized supply chain agreements to minimize outbound deductible payments
- Nothing - BEAT is not a concern for my company
- Got a new job

All right, thought-provoking. The BEAT is not a concern. Well, you’ve all been very patient with us. Thank you. But it could be that the BEAT is not a concern because you’ve monitored your intercompany payments, reorganized, and such.

Let’s move on to transfer pricing controversy. We did want to just make a few comments around the real-world implications of transfer pricing controversy post-TCJA. We do feel like essentially that the IRS and some of this was really actually reinforced with Michael’s speech earlier, right before lunch, just to say that the IRS has really been very quiet with audit activity right now. They seem to be circling the wagons and really just training up and putting together their audit toolkit. Really the expectation at least with the panel and our conversations was that we could expect a lot more controversy experience in the not-too-distant future.

To get our conversation started with the panel, I thought I would just read a statement of my company’s guiding principles with respect to international tax controversy. I think you’ll see the theme here around certainty as we get into the conversation.
Our guiding principles are that Assurant conducts its tax affairs with integrity and fairness using a focus on prefiling controversy management. Assurant seeks certainty sooner. At Assurant, our deep understanding of the business environment allows us to proactively plan and anticipate challenges to tax positions. We work with governments to explain issues, clarify objectives, and achieve successful outcomes for both parties.

The key takeaway for me with that policy statement is that we want certainty around our tax positions and our strategies. When I speak to the CFO and I tell him all the great things we’re doing, he says, “That’s great, when will you know?” because he’s not really interested in waiting three years or six years to know the outcome of a strategy and carrying an uncertainty on his financial statements anymore. These days, CFOs aren’t really interested in that.

I thought, well, I’m not crazy because in the economist panel earlier today, I think they said economists like certainty, and they felt that the TCJA has introduced some uncertainty for companies. There are some expiring provisions, and of course, if Democrats come in, there’s some concern that the rates are going to go up. What does that do to sort of the restructuring that companies have done, some of the planning that they’ve done? When you talk about certainty, ways to do that are prefiling controversy management and advance pricing agreements.

And I know, Ron, we were talking about that earlier and some of your experiences with that.

**MR. LANG:** We are also a proponent of advance pricing agreements for major transfer pricing relationships. In fact, I think we’re about to file in the next few months for a revised European transfer pricing structure. Parts of the world, though, are not of that nature at all. The concept of an APA isn’t developed, and in some you really don’t have too much recourse really even to the arm’s length standard.

It’s just continuing disputes that go on for years and years and years. I was mentioning Indonesia, where we have an APA application that’s six or seven years old, and we just learned that Indonesia’s position is now that an APA can’t apply for more than two years before the current date, even though the application was filed seven years ago. So, you get into very difficult situations in South America, Indonesia, India -- long disputes.

In other parts of the world, you still have significant controversy, but it’s in the context of the arm’s length standard. It’s usually a battle over the methodology or the comp set or something like that.

**MS. HALL:** Yes, and it was interesting hearing Grace’s acceptance speech at lunch today, too, talking about how they feel really good at the OECD around the certainty that they’re going to be providing and predictability in the future. Music to our ears, but not necessarily what we’re seeing right now in the controversy space. As well, when the IRS does gear up with their audit toolkit and un-circles the wagons and comes into audit, so that remains to be seen.

**MR. LANG:** The absence of arbitration provisions is a problem in many parts of the world. Where you have a treaty arbitration provision, it is really useful in the countries coming to an agreement. Where you don’t, the can just go on and on and on.

**MS. HALL:** Moving ahead of myself here. So, in the remaining of our time, we wanted to talk about and contemplate the future of transfer pricing. Is the arm’s length standard done or dying a slow death? Will the OECD’s work be the answer? The OECD issued a report with transfer pricing guidance early this week on February 11th, which after all, in their words, contributes to the consistency and the interpretation of the arm’s length principle and help avoid transfer pricing disputes and double taxation. Looking forward to that.

Further, with the BEAT, does anyone care if you’re making arm’s length payments anymore? Beats me. But, Cory, I know you have thoughts on these existential questions, so I’ll turn it over to you.
MR. HILLIER: Sure. Thanks, Melissa.

The IMF in March last year released a policy paper where management asked IMF staff to look at the state of the international tax system given its macro criticality as well as it being a cause of cross-country spillovers. The conclusion, which I think is kind of broad background for the current debate, particularly at the OECD level, is that there were two significant risks. One was that profit shifting was alive and well and really hadn’t been fully dealt with in BEPS 1.0, and also that tax competition is largely unconstrained. Those two factors have led to large residual profits being shifted to low-tax jurisdictions, and so it re-engages or reinvigorates the debate over what is the fair allocation of taxing rights.

So, typically that debate has been between residence and source countries, but now for the first time ever, we’re seeing advanced countries wearing source-country shoes, and they don’t like the fit. We see G20 as well as G7 countries prosecuting the case for a reallocation. I guess what we’ve also seen is countries trying to deal with this in very unilateral ways, which potentially creates its own distortions, by adopting a whole series of unilateral measures that try to deal with profit shifting within the current system.

One way, because you can’t tax the nonresident, is to deny deductions for the payer. We can see the BEAT has its own kind of assessing function, but other jurisdictions just simply deny deductions. Germany has a provision like that with intellectual property and as well as the U.K. tax on offshore receipts, again directed at lowly taxed intangible income being shifted outside the U.K.

There’s another kind of approach that countries have taken, that’s within the current system, but that also risk creating distortions. The other one is just by trying to treat it on an anti-avoidance level, and we see the U.K. DPT being a good example of that. They are thinking that anti-avoidance rules are not inconsistent with the current architecture, so let’s just treat companies as if they’ve structured their arrangements to avoid a taxable presence, and we’ll assess them on the basis that they have a taxable presence.

Of course, anti-avoidance instruments create uncertainty, so they’re not always the best instrument to deal with structural flaws in the system itself. We move to the next round of measures, which are really about the current system; we’ve got the current constraints, and so how do we design instruments to deal with and try to get to those residual profits that are in low-tax jurisdictions without conflicting with the current system? That’s about designing new instruments, and we’ve seen things like the digital services taxes, equalization levies, withholding taxes on turnover basis, designed to be beyond the scope of tax treaties. But, of course, these create their own distortions too.

We then get to the philosophical question which is what does this mean for the arm’s length principle if the arm’s length principle is attributed to creating this current conflict? I guess to answer the specific question as to whether the arm’s length standard will be saved? If you look at Pillar I, then it will be saved at the OECD level. I think there’s some political will to definitely save it, but we’re seeing a shift away from it.

If you look at Pillar I, this is the first sign of the shift because the Amount, A, under Pillar I is really a residual profit split with allocation on a formulaic basis, with it being sales as the attribution factor. When I talked initially about the two key weaknesses of the current system being: profit shifting; and tax competition, if you look at the shift to a residual profit split with a sales allocation, what does that do to both of those weaknesses? Well it helps because once you consolidate profit, you eliminate or you at least better mitigate the profit-shifting risk, and if you allocate by sales, this is an immobile factor as you can get. This helps with tax competition, similar to the way a VAT works on a destination basis, which also raises the last question about whether it will signal a shift further down the road, and is the consensus to the extent it’s reached in the OECD/G20’s Inclusive Framework going to be sustainable? Does it signal a kind of shift towards more destination-based taxation? I guess this is the philosophical question, about possibly eventually moving completely away from the arm’s length principle?
MR. LANG: I would just point out, Amount B is also not necessarily arm’s length at all. It will depend upon how it’s formulated, what percentage is used, and whether it’s different by industry. It seems to only be connected to the arm’s length principle in a way that’s almost random.

MS. PONDS: Yes. Cory, I think you raised some interesting points earlier about the tension between source and residence, and I know in the context of BEAT, because of certain features, we end up with a rule that is supposed to target inbound base erosion but instead has shifted that burden onto domestic taxpayers largely. When we were thinking about kind of a BEAT on a net basis, the excise tax provision, one of the more difficult features of that rule was how to get jurisdiction on the actual bad actor, right? So, the person actually eroding the base -- the targeted taxpayer in the Budget Committee’s report explaining why the BEAT came to be, is really supposed to be foreign parented multinationals. Then you have a question of jurisdiction: well, how in the source country do we go after these folks in a realistic and administrable way? It turns out it’s really hard to do.

Then you end up with the BEAT, which says, “We’re not going to worry about the bad actors; we’re going to worry about the taxpayers we actually have jurisdiction over.” And those are the ones here. There’s some tension, for sure.

I would also note that in the BEAT context, I think that was the first step away from kind of a consideration of arm’s length. It really is that your price is inapposite in a BEAT context. I think at first people might have said that this is going to complicate the U.S.’s negotiating position on an international level because we did kind of stray further than we’d ever gone in terms of a domestic rule. However, if you look at Pillar II, it turns out that people seem to like the BEAT, and they want to adopt it for themselves. It puts that question about being a source country, how to get jurisdiction -- it puts it into focus, and it says that we don’t have to worry about that. We can just look at denying deductions. That’s the easiest, fastest way to get the result we’re looking for.

MS. HALL: I think the policy and the theory is interesting, but as a tax director of a company I have to explain how this would apply to us. As you’re talking about the digital tax and people might start to just daydream because they say we don’t have digital services. That’s not going to apply to me, for example, I would say pay very close attention to that because the way that it’s defined and how your exclusions might work in theory may not always work in practice.

For us, Assurant is a company that protects what matters most. We’ve protected home, protected auto, protected mobile device, insurance and warranty on those devices and their connectivity. I do end up having concerns with the GILTI tax, and I have to explain to the CFO and the management committee that although we have no intangibles, and we don’t operate in low-tax jurisdictions, we’re in Brazil and we’re in Japan which are generally high-tax jurisdictions. I still have a GILTI tax concern, right? It’s because we’re financial services, we don’t have a lot of property that would get us out of the GILTI, so it is a concern. That’s why my radar is up on the OECD work, the pillar, the digital tax and so forth because it’s important to monitor the developments and make sure that the way that the theory is written and comes into play actually ends up doing what it’s intended to do.

MS. PONDS: I think that’s a very good point. I would say during tax reform, a lot of tax payers also were surprised after enactment because after a plain reading of the words, you think, “I’m home free.” And so, it speaks to the importance of being engaged particularly in the digital context because these rules are not like anything we’ve ever really seen before in action. Engagement, as they’re being developed, is key.

MR. NOREN: One thing that strikes me about both the U.S. developments, like the BEAT, or Pillar I and Pillar II and the scoping questions that are going into Pillar I (for example, in terms of consumer-facing versus non-consumer-facing, and other characterization type questions) is that increasingly a lot of characterization type questions are creeping into a space that had been really dominated by transfer pricing type thinking. With transfer pricing type thinking, you care about getting the price right. You can be kind of bottom-line-oriented.
The whole point of recent IRS regulations has been to iron out characterization-based differences in determining transfer pricing results. But now, increasingly, it doesn't matter that you have minus 100 in your taxable income calculation. You care about whether it's COGS or a "deduction." Similarly, there could end up being definitional issues around whether you're in or out of some of this OECD stuff. I think we kind of went away from caring so much about characterization to all of a sudden thinking it's going to become more important than ever in weird and unpredictable ways.

MS. HALL: Ron and I were speaking a little bit right before the panel started, about how we've both been in our jobs 25 years at the same company, and I can't intuit an answer these days. I have to say I've got to model that because it's complex, and things are happening. The rules are applying in ways that you may not have thought of or couldn't really contemplate. If you move another piece of your business, you're going to get a different result. It's been a challenge to kind of stay on top of that and be able to give the business the guidance that we need to.

MR. LANG: What you really need is a model that works over a set of many years and is completely integrated with all of the affected areas, and no such model exists at this point, except what you cobble together on your own using Excel.

The accounting firms now have some modeling software. But it's a challenge.

MS. HALL: Yeah, exactly right. We had to build a model that was iterative and working all through at the same time we're trying to implement tax reform, we're trying to do major transactions. We're building things internally, and then we've got to hire firms to come in and make sure what we did was right and the formulas work. It's really grass roots by us at the moment. But it's been fun. I think we have a few minutes for questions if we have some.

AUDIENCE MEMBER: Yes, we do. Do you see Congress or any President supporting the enactment of legislative changes to implement the concepts described in the OECD International Framework Project?

MR. NOREN: That's a great question. Parliamentary systems can change their laws a little easier than we can in the United States, so even if there were an inclination to do something, once you run it through the unique American sausage factory of lawmaking… I think it's appropriate to be skeptical about both whether U.S. implementation can happen and, if so, how long it might take and what adjustments might be required throughout the process.

MS. PONDS: Yes, I think Pillar I presents some fundamental structural changes. I would note that some of the BEPS concepts are reflected in TCJA, and it did take some time, but we had interest expense limitations rules, we had hybrid rules, and CFC tighteners. Those were concepts that came out at a multinational level, at the OECD level, and did find their way into U.S. tax law, not immediately, and perhaps modified for domestic use. But, broadly speaking, the concepts are here.

It's hard to say whether or when Pillar I might be implemented because it is very different. The BEPS rules were easier and more easily adopted if countries had the inclination, but this is wholesale change.

MS. HALL: I think we're out of time. I do have a quote to leave you with, and in honor of Black History Month, I'll leave you with a Maya Angelou quote: "As you go forth and conquer [tax policy] all of us knows not what is expedient, not what is going to make us popular, not what the policy is or the company policy, but in truth each of us knows what is the right thing to do."

And with that, we'll end our panel.
Myrtle Jones, Halliburton; Harold Hancock, Brownstein Hyatt Farber & Schreck; Marijn Verhoeven, World Bank; Scarlet Pereira, Mastercard

Melissa Hall, Assurant; Ron Lang, Ford Motor Company; David Noren, McDermott Will & Emery; Cory Hillier, International Monetary Fund; Loren Ponds, Miller & Chevalier Chartered

Lyn Walker, TCPI; Tiffany Smith, Senate Finance Committee; Mark Warren, Senate Finance Committee; Tom Roesser, Microsoft Corporation; Beth Bell, House Committee on Ways and Means; Randy Gartin, House Committee on Ways and Means

Itai Grinberg, Georgetown Law

Danielle Rolfes, KPMG; Anthony Gedeller, Mars; George Callas, Steptoe & Johnson; Patrick Brown, PwC

TCPI Planning Committee
(Some members not present)
Full list of committee members available here
Breakout Session:  
The Future Role of the Corporate Income Tax

Description:
The TCJA was one of the largest overhauls of the U.S. tax code ever. And the new, lower corporate rate was considered by many to be the most significant change. This panel explored the real-world impact of business tax changes under the TCJA and what they might mean for domestic tax policy in the future - particularly if a separate tax on corporate income would still be relevant in America’s changing economic and political climate.

Panelists:
- Hank Gutman, Of Counsel, Ivins, Phillips & Barker (moderator)
- Beth Bell, Tax Counsel, House Committee on Ways and Means
- Mark Mazur, Robert C. Pozen Director, Urban-Brookings Tax Policy Center
- Saul Rosen, Senior Tax Counsel, Citigroup
- Alan D. Viard, Resident Scholar, American Enterprise Institute

MR. HANK GUTMAN: Our topic is the Future Role of the Corporate Income Tax. It's a follow-on to some of the economist’s discussion this morning so you will hear some familiar themes but maybe we will explore it a bit more thoroughly. Obviously, the future role of the tax is a relevant question in today’s both uncertain legislative and economic climate.

I have a number of distinguished panelists joining me. On my right but on your left, is Mark Mazur. Mark is the director of the Urban-Brookings Tax Policy Center. In a prior incarnation, he was, among other things, the assistant secretary of the Treasury for Tax Policy.

Alan Viard is a resident scholar and a prominent tax economist at AEI. We heard from his colleague, Kyle Pomerleau, this morning.

Beth Bell is currently the tax counsel on the Ways and Means Committee. Previously she was tax counsel in the office of Senator Cardin where, among other things, she was heavily involved in the development of Senator Cardin’s progressive consumption tax, which we’re going to discuss later.

Finally, Saul Rosen, currently senior tax counsel to CitiBank because they won’t let him go. And they’re right. One of the most thoughtful observers, in my view, of business taxation in the private sector.

Just as an aside, I can personally vouch for Alan and Mark because we all worked together on the Joint Committee on Taxation at one time. I have been the beneficiary of their sound advice for many years.

To turn to our agenda, you’ve heard the introduction. Traditionally the corporate tax has been justified as a convenient way to include corporate income in the tax base rather than taxing owners of corporations directly and also to capture the returns on foreign investors.

Neither of those rationales explains why corporate income ought to be taxed twice, by the way, both at the corporate level and then when distributed as dividends or when stock ownership is sold. A discussion of whether and how to address that issue, which is commonly described as integration and fully discussed in the tax literature, is not going to be the focus of our panel except that I want to point out that a shareholder-credit integration system may end up being the appropriate mechanism to assure that corporate income is actually taxed at least once. But hold that in the back because that’s not on the table.
right now and we want to talk about what might be on the table right now.

The way we’re going to do that is to discuss the external pressures that we think are going to influence the future role of the corporate income tax. A bit of that was explored this morning. Then in a little bit of a departure, we will talk about the extent to which the adoption of a mark-to-market regime for some or all forms of corporate ownership could affect the corporate tax structure. Alan is going to address that.

Beth is going to talk about consumption tax options in the form of a credit invoice VAT or its equivalence, a border adjustable cash flow tax that is, in fact, a subtraction-method VAT. This is generally hidden from sight because the “VAT” word is political death. Nonetheless, the cash-flow tax is the economic equivalent of a VAT — a consumption tax in a different form. We will take a quick look at the potential effect of wealth taxation, and also the impact on this discussion of eliminating the capital gains preferences or preferences for capital income, as well as “step-up” in basis. Those things are all intertwined and will affect the corporate tax discussion.

Finally, after we’ve done that, someone has to be practical. Saul is going to address the practical aspects of this from the perspective of a tax director. We’re happy to take questions. Hopefully we’ll be able to have some time to answer them. Otherwise, Mark, why don’t we just get going?

MR. MARK MAZUR: Okay. Good afternoon, everybody. It’s really a pleasure to be here with you all and talk about this important topic. I want to start today with a brief review of three slides. Here’s the first one. Basically, it looks at the tax revenues’ share GDP for all the OECD countries. The U.S. is the red line sort of toward the bottom, 33rd out of 36 OECD nations. Just a takeaway here, the U.S. is not an overtaxed country. That’s kind of point one.

The second chart looks at the same 36 OECD countries but looks at how they finance their governments. And the U.S. again is the red line at the bottom. That shows there’s about 6 percent of GDP deficit run at all levels of government. So, you can look at this and you can say the U.S. is 36th out of 36 or you can flip it the other way and say the U.S. is number one. That’s another example of U.S. exceptionalism.
The future really doesn’t look that much better for the United States. If you think about the fiscal pressures that we’re facing as a country, we have retiring baby boomers that will increase demands on Social Security, Medicare, and Medicaid, and interest on the debt is also a growing part of the federal budget.

One of my colleagues at the Tax Policy Center likes to say that if you look at the growth of federal revenues for the next couple decades, it’s all taken up by health care, Social Security, and interest on the debt, in which case there’s nothing left over for any other investments in things that you may normally think of as the rest of government.

Just to provide some context, if you think back to the last time that a budget was balanced, the late 1990s/early 2000s, the U.S. had federal revenues around 20 percent of GDP. So, if you think that you like a balanced budget, revenues used to be 20 percent of GDP more or less to balance it. The fiscal situation looks a little bit worse going forward. Maybe you should be looking at something north of 20 percent of GDP for revenues if you’re concerned about budget balancing in the future. Right now, U.S. revenues are about 16 percent of GDP. There’s a big gap between people who claim to be fiscally conservative and where federal revenues are at the moment.

Because this is about corporate tax, I want to just give a little picture of corporate tax revenues as a share of GDP over the last six decades or so. You see it’s an up and down pattern largely reflecting business cycles. But the downward trend is unmistakable, right? Where corporate revenues used to be 3 to 4 percent of GDP, this year they’re around 1 percent of GDP; right around the all-time low.
MR. SAUL ROSEN: Mark, one question on that. A lot of people have said that a factor that is driving that graph is the fact that we had a lot more income in flow throughs; that 50 percent of businesses were conducted in flow through entities and therefore there were fewer corporate receipts.

MR. MAZUR: Yes, that’s partly true. If you look at the share of U.S. business activity taking place in corporate form versus flow through form, there’s been an inexorable trend over the last several decades of more and more flow through businesses and more and more activity taking place in flow throughs. So, that is one of the drivers. Probably another one would be the drop in rate from 35 to 21 percent.

MR. ROSEN: Probably.

MR. MAZUR: Just pulling this all together, there are a couple of things. One: the U.S. has a long-term revenue shortfall. Two: lower corporate tax receipts have contributed to that. But there’s also a public perception issue. The public perception issue is that companies, large companies, in particular multinational firms, don’t pay their -- and you can put this in air quotes -- “fair share” of taxes.

The question is, what is that fair share? In the U.S., that’s a bit of an issue among observers. In other countries, fair is a much bigger issue and it really becomes a reputational risk, I think, for larger companies if they’re perceived as not making whatever contributions to the workings of government that the public thinks the fair amount.

My take on this is that going forward there’s going to be a lot of pressure on policy makers both in the U.S. and elsewhere to do something about the situation.

One possibility is a reinvigorated corporate income tax along the lines of “Let’s take the Tax Cuts and Jobs Act and undo some of those parts.” The reason for maybe doing that is, you think that the corporate income tax is an important part of the federal portfolio of revenues, that the corporate income tax is a backstop to individual income tax, that the corporate tax adds to the progressivity of tax burdens, and it’s perceived as a fair tax at least among the public as a whole.

One approach would be to fix the Tax Cuts and Jobs Act, make it work better. Another approach would be wait until the OECD acts and then adopt whatever form of corporate taxes that they want to go with, or you could develop non-corporate sources of revenue. And that’s really where we want to take this to the
next step. So, I'll turn it over to Alan who will talk a little bit about that.

**MR. ALAN VIARD:** Thanks, Mark. As Hank mentioned, I'm going to focus on mark-to-market taxation, an approach that would have been viewed as somewhat esoteric a few years ago but is now getting more attention, with proposals being put forward. It may still be a while until any actual enactment, but perhaps not.

I will discuss the various rationales that are being put forward for some type of mark-to-market taxation and how one might respond to those rationales. I will then consider the implications for the corporate income tax if market-to-market taxation is adopted.

The realization principle is, of course, a long-standing feature of the income tax system. Although a few people say otherwise, it is almost certainly not a constitutional requirement. It obviously helps avoid liquidity and valuation problems.

However, from a tax policy perspective, there are many grounds on which to criticize the realization principle. A realization-based tax, as I said in a 2014 *Tax Notes* article, is neither fish nor fowl. A mark-to-market income tax would consistently tax increases in the power to consume while a consumption tax would consistently tax the exercises of that power.

A realization-based income tax does neither of those things on a consistent basis.

On the one hand, tax is triggered if you merely rebalance your portfolio from one asset to another, which is not an exercise of the power to consume. On the other hand, if you borrow against an appreciated asset or write options against it, you can finance consumption from that asset without having a realization event take place under current law.

From a tax policy perspective, a realization-based income tax is an odd creature.

At first glance, it may seem that realization is a natural occasion to tax a gain that has accrued. That is often true for illiquid assets that are difficult to value. But in many other contexts, realization is a rather artificial concept. If I own shares in a mutual fund, I must recognize gain if the mutual fund sells appreciated shares to rebalance its portfolio holdings, even if I have the resulting mutual fund “distribution” automatically reinvested in the fund. There is no liquidity or valuation reason for my taxable income to depend upon what is done at the fund level.

A realization-based system also requires artificial basis allocation rules. Any specification of which shares of a security I sell on a particular date is economically meaningless and arbitrary.

A realization-based tax system also creates problems such as lock-in and cherry picking of losses. Naturally, we have a host of responses to those problems.

For example, the preferential capital gains tax rate is partly motivated by the desire to mitigate the lock-in effect. And, of course, we have the wash sale rules and the capital loss limitation to combat cherry-picking. These rules are imperfect responses to the problems they address, and they also create complications of their own and impede other tax policy goals.

Long ago, Bill Andrews called the realization concept the Achilles heel of the income tax. I think you could make a strong case that he was right.

If you agree with the general critique that I have outlined, what might you support? You might support a universal accrual system that moves away from the realization principle for all taxpayers. Mark-to-market would apply to assets that are publicly traded. For non-publicly traded assets, you could use a deferral charge method, which is a highly imperfect substitute for mark-to-market taxation but cancels out the advantages of deferral in simple cases.
This universal approach would put everybody on a mark-to-market and deferral charge system with the caveat that a modest amount of gains would be tax-free. Very small asset holders would not have to deal with capital gains taxes at all, but everybody who pays capital gains tax would be subject to the same tax rules, mark-to-market for publicly traded assets and deferral charge for assets that are not publicly traded.

Eric Toder of the Urban Institute and I developed a plan along these lines, except that we did not adopt the deferral charge for non-publicly traded assets. But it was a universal system that applied the same tax rules to everyone.

A universal accrual system is conceptually appealing. However, it would face significant political resistance. Many people object to taxation before realization as a matter of principle. Even for publicly traded assets, there may be real or perceived liquidity challenges. Because mark-to-market capital gains and losses can be so volatile, there would be pressure for some type of averaging or smoothing of the tax base, which would add at least a little complication.

MR. GUTMAN: Alan, can you explain a deferral charge mechanism?

MR. VIARD: Yes. Under the mechanism, no tax is imposed on a gain until it is realized or until the taxpayer’s death. Once the gain is taxed, however, you pay a deferral charge, which is a form of interest, in addition to the tax on the capital gain.

A hypothetical price appreciation path is constructed, probably by assuming that the asset price had appreciated at a uniform rate. Interest is charged to reflect the tax deferral from the time when each part of the gain is assumed to have accrued, based on the hypothetical price path, and the time when it was taxed.

Because tax is not imposed until sale or death, the deferral charge method largely avoids the liquidity and valuation problems of mark-to-market taxation, although there may still be some of those problems at death. However, the deferral charge approximately counteracts the advantage of tax deferral, because the taxpayer must pay for the deferral privilege.

MR. GUTMAN: I’d point out that in a properly designed system only marketable securities would be subject to gains at death. A deferral regime would apply or could apply to non-marketable assets; same type of concept.

MR. VIARD: Many different gradations are possible. The most minimal response would tax the publicly traded, or marketable, assets at death and delay tax until sale for non-publicly-traded assets. I have outlined a general tax policy critique of the realization principle, which might motivate the adoption of a universal system that applies mark-to-market taxation and the deferral charge method to all taxpayers. However, recent mark-to-market proposals are motivated by a different, though not contradictory, critique, which leads to a different policy design.

The alternative critique is that the realization principle enables the wealthy, particularly the very wealthy, to avoid tax on much of their economic income. The critique based on tax avoidance by the wealthy does not contradict the general tax policy critique. In fact, the former can be viewed as a special example of the latter.

In any event, the Democratic presidential candidates who have proposed mark-to-market taxation, as well as Senator Wyden, have focused on tax avoidance by the wealthy rather than the general tax policy critique. To address that concern, they propose a selective accrual regime that applies only to the wealthy while everybody else remains on the realization system.

Under that selective system, 99 percent of the public still pay taxes on realization, but the wealthiest 1 percent, who account for a significant portion of capital gains, pay tax on an accrual basis, with a mark-to-market taxation for publicly traded assets and the deferral charge method for other assets. The selective system avoids many of the challenges that arise under a universal system. Liquidity is less of an issue.
for the very wealthy and there is probably less need for averaging. But the selective system maintains the defects of the realization principle for a large segment of the population. You also have to have criteria for who is on the accrual system, rules for moving on and off the accrual system, and rules for partnerships with some partners on the accrual system and other partners on the realization system.

Those are issues to be worked out. But that’s what several Democratic candidates and Senator Wyden, have proposed. We will see where those proposals go.

What are the implications for the role of the corporate tax? As Hank mentioned earlier, there are two principal rationales for having a corporate income tax. One is to prevent tax deferral. Having an accrual system certainly takes care of that for those taxpayers who are subject to it. With a universal accrual system, the rationale entirely goes away; with selective, maybe less so.

However, there is a separate rationale for the corporate tax as a way to tax foreigners’ investment in the United States. It is generally in the United States’ national interest to exploit our market power in international capital markets.

Taxing tax-exempt organizations that hold corporate stock is another possible rationale for the corporate income tax, although there are alternative ways to tax those organizations.

Mark-to-market taxation of shareholders offers a way, if you want to do so, to lower the corporate income tax without a loss of revenue and progressivity. For example, Eric Toder, Rosanne Altshuler, Harry Grubert and I have talked about getting the corporate rate down to 15 percent. We talked about that when the corporate tax rate was 35 percent, and so it would be easier to get there from 21 percent.

Now, you may choose not to do that. Instead, you may choose to increase the corporate tax while also increasing the shareholder taxes.

MR. GUTMAN: Why 15?

MR. VIARD: It seems to be a number that people gravitate towards. I am not aware of any scientific rationale for that exact number.

MR. GUTMAN: Well, what would you think about if you examined the average effect of the tax rate of European countries or our trade competitors and concluded that it was about 17 percent. Then you might say, “15 percent looks pretty good. And, guess what? Then I can have a worldwide system.”

MR. VIARD: Yes.

MR. GUTMAN: And I can get rid of all the complicated anti-abuse provisions that are in the Code now, right?

MR. VIARD: If you want to, yes.

MR. GUTMAN: Maybe that would be why you’d want to do it!

MR. VIARD: In general, a lower corporate tax rate takes some of the pressure off of the international tax regime. The territorial and the worldwide systems become more equivalent to each other and the problems that each of them has become less severe.

MR. ROSEN: Sounds good to me.

MR. GUTMAN: Sounds good to a lot of people, I think. But we’ve got to finance this, don’t we? Maybe you can get some money out of an accrual taxation system, and we heard commentary this morning on this from both Kyle and from Bob Carroll.
Beth, why don’t you explore the obvious alternative that 162 other countries in the world do?

**MS. BETH BELL:** I’m more than happy to do that. Thank you. I need to start, though, with my standard Hill staffer caveat that a lot of you are familiar with. I’m here to express my own opinion. Nothing I say should be attributed to Chairman Neal or to the Ways & Means Committee or to my office. That also needs an addendum because, as Hank said, I’m formerly of the Office of Senator Ben Cardin, who has worked on legislation that creates a federal progressive consumption tax. So, in an abundance of caution, I will also say that nothing I say should be attributed to Senator Cardin or the Cardin office or my heirs or my pets or maybe even myself.

Anyway, now that that is out of the way, I do want to go back to this implicit tension that we’ve been discussing today between what we would prefer to do economically versus what seems to be politically feasible.

I know that tension is, when we work on policies, in everything we do because we often come to a correct answer as a policy matter that might not be the most feasible answer politically.

To be fair, sometimes those two circles do overlap, economic and political. Often, they seem very far apart, now more than ever. I think they seem like one of those old screen savers where the bubbles bounce around and they may never quite cross, even though it’s really satisfying when one of them goes, right in the corner. You guys know what I’m talking about.

Especially with alternative revenue sources, I think that the economic merit and viability concept often repels the political bubble very far away. I thought I’d talk a bit more about why a credit invoice VAT is really great as an economically viable concept; why my former boss certainly thought it could be a politically viable concept; and touch a little bit on the other taxes that seem to have more political prevalence.

Let me start with the federal progressive consumption tax. That is Cardin office branding because I think we all know value added taxes, or VATs, are something that people prefer not to talk about politically but have a lot of economic merit and viability. By that, I mean, as Hank mentioned, the U.S. is vastly out of step with the rest of the world in the way we rely on income taxes.

By refusing to institute consumption tax on the federal level, we’re essentially taking away a tax policy tool from the U.S. when what we really need, especially if you care about raising revenue in what I think is really a post-base broadening era is more flexibility to change the mix of our taxes.

There is empirical evidence from the OECD that consumption taxes are also more pro-growth and efficient than individually and especially corporate income taxes. One of the big drivers for the TCJA was a more growth-oriented tax reform bill --

**MR. GUTMAN:** Beth, could you stop there for a second and explain why that’s the case?

**MS. BELL:** Absolutely.

**MR. GUTMAN:** And maybe since I’m not really an economist, I’ll just pretend.

**MS. BELL:** Oh, well I’m not really an economist, either.

**MR. GUTMAN:** One of the economists can talk about what happens to the return on capital in a consumption tax.

**MS. BELL:** I am happy to do that even though I’ll turn to the real economist on the panel.

**MR. GUTMAN:** Well, be my guest.
MS. BELL: Well, in a consumption tax, your base is consumption. So, you’re exempting the normal return on capital from any form of taxation. That is the main driver of why you see, when we study consumption taxes versus income taxes, and particularly corporate income taxes, they’re less distortive, they’re less associated with slower GDP growth than other taxes. Did I get a B-plus?

MR. MAZUR: We’ll go for that.

MS. BELL: Another thing: Measuring income is hard. We talked about the realization principle here. We see that in a lot of the international discussion these days. When you tax consumption, you have a particular point in time where you tax a transaction. For a lot of people, it seems fairer to tax consumption than to tax income.

For those of you who care about enforcement, credit invoice VAT in particular, like Senator Cardin’s progressive consumption tax, is transparent. It’s separately stated that it relies on everyone to report in the supply chain. So, everyone needs to get along to get their credits and there’s a lot of self-enforcement benefits. In other words, if we’d want to raise revenue with the smallest amount of leakage, this would be a good way to do it.

It’s also possible, I think, to address some of the common policy questions that have hounded consumption taxes in the past and which you’re all probably thinking of in the back of your heads now. Senator Cardin’s bill, just for context, imposed a very, very broad-base consumption tax of 10 percent on almost all goods and services consumed in the U.S. Of course, because it was a flat 10 percent rate, one of the biggest things we were concerned about was progressivity. To address that, the bill provided rebates not in the forms of exemption of certain goods, but actual money to people to alleviate the consumption tax burden.

The revenues generated by the new consumption tax were used to exempt most households from an income tax liability. The 2016 version of the bill cut the corporate rate to 17 percent, which is not so impressive these days. But you see the intent.

In terms of this economic bubble that I’m visualizing, we thought it was an efficient tax. We thought it was enforceable. We thought it was progressive and we also thought it was competitive.

I think as this crowd knows, too, the reason why this hasn’t worked so well is that consumption taxes have always existed in this really strange political space.

When I was working in the Cardin office, almost everyone who I discussed this with -- and some of you are in this room right now -- said that this was probably where we would need to end up as a fiscal matter. And it wasn’t just the lobbyists who were visiting who were incentivized to be nice to me. It was other offices, too. But we found that if this was presented as a value added tax, there’s close to no desire in the outside world to provide any political cover for this stuff. And for that reason, I think political opposition still flourishes.

Occasionally consumption taxes do get political traction, though. And I wanted to touch briefly on the most recent of these moments, which was during the debate over the border adjustment tax that the House Republicans put out in 2016 and in 2017 in the lead up to the 2017 tax bill.

So that was a destination-based cash flow tax. It did allow for the deduction of wages so it wasn’t exactly the same as a subtraction method VAT. But it ran into two problems on a policy level that also I think translated into political problems, although, I think there are some in the audience who might have the inside track on this more than me.

First there was an argument that the VAT was not WTO compatible. We can pass over that one because the one I really want to get to is that it revived this debate over currency exchanges and the adjustment of exchange rates, which is something that really dogs consumption taxes.
There was a debate as to whether exchange rates would rise immediately if the VAT was implemented so that the value of the dollar would basically go up to the extent of the tax. If that theory was correct, the VAT wouldn’t have had any impact on the trade deficit or the net profitability of importers and exporters.

If the theory was incorrect and the exchange rates didn’t adjust, the trade deficit would fall. Some people see this as a good thing related to consumption taxes if there’s no immediate adjustment. But the import cost could be higher and prices could rise on consumers. And that really split industries that were very reliant on imports.

MR. GUTMAN: I’d like to just pursue that just a little bit with Alan or anybody, actually. Every VAT is border adjustable, right?

MS. BELL: Yep.

MR. GUTMAN: 162 countries have imposed VATs. The world hasn’t collapsed. So why was the world going to collapse if the United States imposed VAT equivalent that was destination-based? That’s part one.

And part two is—we have a Federal Reserve Bank? Can’t the Fed deal with some of these monetary issues?

MR. VIARD: In an article in the June 2018 National Tax Journal, I discussed why the business cash flow tax proposal encountered a variety of objections that VATs in other countries have not faced. The objections do not make much economic sense. One of them was the concern that a business cash flow tax might not be WTO compliant, even though it is well settled that a VAT is WTO compliant. That is an arbitrary trade law distinction with no economic basis.

Another concern, which also had no economic basis, was the fear that the exchange rate would not adjust. It is worth noting that a conventional VAT with no wage deduction typically does not confront that issue.

In equilibrium, the adoption of a border-adjusted tax causes the prices paid and received by domestic residents to rise relative to the prices paid and received by foreigners, when expressed in any common currency. That can happen through an increase in the domestic price level or through a currency appreciation.

When a conventional VAT without a wage deduction is adopted, the central bank almost always raises the price level so that nominal wages don’t have to fall. In that case, the equilibrium exchange rate adjustment is zero and there is no need to worry about whether the adjustment would occur.

If a VAT with a wage deduction, as in the Republican plan, was adopted, though, the Federal Reserve would probably not raise the consumer price level because there would be no need for nominal wages to fall. The equilibrium change in the relative prices paid and received by domestic residents and foreigners would then occur through a currency appreciation. There is no economic reason to think that that the appreciation wouldn’t happen, but people tied themselves up in knots worrying that it might not happen.

More generally, people think about the cash flow tax differently than the VAT. They think about it using the terminology and framework of income taxation, which, to be fair, many supporters of the cash flow tax encouraged them to do. The cash flow tax looks ridiculous if it is viewed through an income tax lens because importing firms have huge tax liabilities and exporting firms get gigantic refunds. Of course, those things happen every day under a VAT and nobody is troubled by it. Because people do not view the VAT as a tax liability of the firm, they do not compare how much different firms are remitting to judge whether the firms are being treated fairly. In contrast, people viewed the cash flow tax as a tax liability of the firm and judged it to be unfair and unreasonable.

MR. MAZUR: Part of that was the supporters, right? The supporters wanted to make the point that these
are being paid by corporations. They didn’t say, “Oh, when you drive the Buick you bought in Canada across the border, there’ll be some guy there to tax you on it.” That was not part of the discussion. I think it was part trying to hide the ball a little bit.

**MR. VIARD:** Absolutely. The supporters bear much of the blame. If they had said this was a VAT with a wage deduction, I think people would have been able to understand it. But the supporters did not do that because they were afraid that the VAT label, or the V word, would be politically toxic, as Beth mentioned. So, the supporters deceptively tried to make people think that the cash flow tax was an income tax. In the end, the crime carried its own punishment because once people thought the cash flow tax was an income tax, they predictably concluded that it made no sense at all. Deceptively marketing the cash flow tax as an income tax made it even more unpopular than it would have been if it had been honestly marketed as a VAT with a wage reduction.

**MR. ROSEN:** The way it was sold on day one caused a lot of companies to listen to the thing about forex and they say, “Yeah, right, sure, and we’re going to pay all this money.” No one was talking about a transitional rule, which would have made a lot of sense. I think we kind of missed a real good opportunity there.

**MS. BELL:** I think the uncertainty point is a big one. That is what eventually came out of that whole debate at least on the Senate side at the time. We were not as involved in the day-to-day. But that was ultimately what we heard, this is too uncertain with the WTO problems and even with the general economic consensus on the exchange rate situation coming together, it was just easier to rely on a traditional lower the rate, broaden the base type of mindset.

**MR. GUTMAN:** It’s worth making the point that a VAT raises a lot of money. I think Kyle threw out $100 billion a point, a $1 trillion a year, for a 10 percent VAT. That number may be high, at least in my experience. But suppose it’s a mere $75 million a point. That gives you a lot of room to move on the corporate side, or as Senator Cardin did on the individual side. There’s a lot of flexibility there.

**MS. BELL:** Yes. I think that the Cardin office is working on introducing an updated bill. Perhaps we’ll see TCJA adjusted numbers sometime in the future.

Having worked on this with the Senator for five years and really studied it, we really realized the political obstacles. It seemed to be a very meritorious way to go. But we were realistic about how it was a long-term project. I think especially you haven’t seen since the VAT debate VATs being picked up too much. Things are actually swinging the other way.

I just wanted to touch on a way this concept that capital is too lightly taxed right now. I will say that the progressive consumption tax bill recognized that and basically made everything taxed at an ordinary rate. And I don’t mean to suggest that there aren’t reasonable economic or other policy arguments behind going after capital. In fact, I think it would be needed if we went to more of a consumption tax base. Much like I think the currency uncertainty and the WTO uncertainty that surrounds consumption taxes, there might be some uncertainty, say, for a pure wealth tax, you often hear of constitutional questions that are raised. I wanted to raise that to highlight that even if something is politically salient, and while taxes right now are certainly something that’s getting a lot of public attention, unless we reach a major political or economic inflection point, I think another thing that’s implicit in this discussion so far is that working within the income tax structures that we already have is somewhat of a safe space for everyone. Because they’re familiar to policy makers mostly, but also more to the point, to the taxpayers who have to implement a lot of this stuff on the ground.

**MR. GUTMAN:** Let me now put up two polling questions. And while you’re thinking about that, I’d like you to summarize where I think we got. People would like to see stability in the system. They’re worried about rates going back up. They’re worried about an extremely complicated system that has been created to deal with income that’s earned abroad.

Imagine a world where you can have a corporate rate of 15 percent, where you can have a worldwide tax
at 15 percent, and you finance it through an alternative source. That really has to be a very attractive world.

**Polling Question #1: Do you think the United States will enact a VAT in the next ten years?**

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<td>62.22%</td>
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Okay. Let’s ask the second question now. A little more personal. I wanted to say would your company, but I didn’t want to put it in.
Polling Question #2: Would you support the enactment of a VAT if all or part of the revenue was used to reduce the corporate income tax rate?

I’m fascinated by the answer because look at the disconnect. Okay. Very interesting.

Saul, now let’s get to real life.

MR. ROSEN: Okay. As the group of tax directors said this morning, 21 percent is really nice. I think, to make it a little more personal with respect to Citi, our effective tax rate that we’re projecting for 2020 is around 23 percent. Prior to the rate going down, it averaged around 30 percent. That’s quite a difference. It makes us a stronger company. It makes us a more competitive company. I know those are kind of buzz words, but let me be even more specific on that. We earn about half our earnings from outside the United States. We still operate, banks do, in branch form. And so half of our earnings outside the United States, roughly, are through branches. So that income is taxed in the U.S. immediately.

Assume if we were operating in a foreign jurisdiction with a 21 percent tax rate. That income is taxed in the U.S. immediately. There is no deferral, nothing to do with APB 23, no CFCs, immediately we’re being taxed in the U.S. at 35 percent. Plus, some state and local depending. Whereas a competitor that we’re dealing with, be it a local bank who often are our competitors, or be it a Santander or some large foreign bank of that nature, they’re going to be taxed at the 21 percent rate. Now the U.S. rate’s down to 21; we can effectively compete with those banks. So that makes all the difference in the world to us when you think about that’s 25 percent of our total profits.

That’s the good news, the rate’s down to 21 percent. As TCJA was being debated, there were a lot of pundits out there that said, “Gee, you know, the only way to do tax reform was the way we did it in ’86, and it had to be bipartisan. If you don’t do it on a bipartisan basis, you’re never going to get it done.”

Well, they were right and they were wrong. I mean, obviously it got done. It got done through reconciliation. But they had to deal with the Byrd rule and all sorts of other things that I can never quite understand. And because of that we have a situation where, as you all know, we have effective dates, phase-outs, that don’t make much sense at all. You get to the international arena, what’s been done
there is at best a major headache and at worst costs you some real bucks.

A lot left to be desired. But most importantly, I think -- and Hank was alluding to this a moment ago and others have said this today -- certainty. What’s going to happen? The Democrats will come in. We’ve all seen the Democrat presidential candidate proposals that the corporate rate is going to go up, the more rational ones to 28, back to the Obama rate. But certainly, it would go up if the Democrats come into power. I don’t think there’s any doubt about that.

What does that mean? Is the new way of doing things is that if Republicans come in, our rate is 21 percent; Democrats then come in, rate is now 28 percent; Republicans come in again and its now 21 percent? As you all know, that’s insanity. How do we plan? How do you acquire a company? Gee, what rate do we use? At one point we’re sitting around working on particular planning and we said, “Well, gee, why don’t we project out the Democrats winning and then we’ll also run alternatives at 28 percent.” We thought about that for a while. We thought about how we present that to our CEO and we figured, well, that way lies madness. You can’t do that.

If this becomes the new normal, I think our lives certainly become a lot more difficult. Frankly, without being overly dramatic it’s just not good for the country as we try to deal with that.

Do deficits matter? A lot of talk today about the deficits. There’s actually a simple answer to this. If you are the party in power, they don’t matter. If you are the party out of power, they do matter.

Hopefully our government will at some point recognize, even to those who are in power, yes, they matter. We need to do something about that. Of course, what that means is the real new examination (at least I think it means a new examination) of how we tax. And corporate tax becomes part of that. We heard this with Rosenthal as he was debating Aparna Mathur. A lot of arguments that come up in the corporate debate make no sense at all. Who cares if Trump went out and told people that they’d be getting $4,000? That’s just not part of the debate. There’s really rationally nothing to do with whether the corporate rate ought to be 21 percent or whether it ought to be 28 percent.

The comparisons (and I think they’re good reference points) to the way the rest of the world may handle their taxes, the comparison of rate to the gross national product, they’re good points. But why does it necessarily dictate what the rate ought to be?

We’re running out of time, so maybe just get to the bottom line. We need to look at this all together. We need to consider a VAT. The idea of, I used the word radical change in my slide, but listening to Alan, I’m thinking maybe the word ought to be rational. Do we go to some sort of mark-to-market system that is able to tax the shareholders at that point?

And this has nothing to do with really taxes, per se. I’m a baby boomer. I’m 71. It’s not our fault. You know, the fact that we’ve gotten older, everything you read -- and Mark said it, “Well, gee, because of baby boomers getting older we got this problem.” No, because Congress refused to deal with the problem 20 years ago.

MR. MAZUR: They could have taxed you 20 years ago.

MR. ROSEN: It’s not our fault. The alternative, which I hope is not on the table, is not a very attractive one. I’ll stop at that.

MR. GUTMAN: All right. Thank you very much.
Debating Debt: What’s the Real Deal with the Interest Limitation

Description:
Since the TCJA was enacted, taxpayers have been consumed with a host of technical questions about how the new limit on the deductibility of business debt applies. But there’s a bigger question: Do the new rules really reverse the tax code’s preferential treatment of debt and tip the scales toward equity? The panel addressed how the new limitation affected C-suite decisions and business behavior, its real-world impact, and how the scheduled future change to the limitation might affect the tax landscape.

Panelists:
- Tom West, Principal, Passthroughs Group, KPMG (moderator)
- Vipul Amin, Managing Director, The Carlyle Group
- Morgan Holtman, Partner, Baker Hostetler
- Robert Levine, Director, Tax Strategy, Anheuser-Busch
- Agnieszka Samoc, Vice President, Tax Counsel, Danaher Corporation

MR. TOM WEST: Good afternoon. My name is Tom West. I’m a Principal with KPMG here in Washington. I have a great panel up here with me today. Just thinking about the overall theme of the day and hindsight, I think it’s interesting that this panel, as you’ll hear, started out as one thing, and we changed it a little bit on the fly in the last week or two. Based on the conversations I’ve heard throughout the day, this panel fits in with everything else people have been saying about it’s not any one provision of TCJA that’s necessarily having an impact, but it’s kind of the whole patchwork that’s really interesting to people or affecting people, and seeing how the different provisions work together and interact has really been what I’ve heard in the panels I’ve been on today.

Let me have my panelists introduce themselves because I think we have people up here with some really interesting backgrounds, and understanding where they’re coming from will help you understand the issues we’re going to talk about and the issues they’re confronting with respect to TCJA, post-TCJA implementation.

So, I’m going to throw it over to Ag to start.

MS. AGNIESZKA SAMOC: Good afternoon. My name is Ag Samoc. I am the VP, Tax Counsel, for Danaher Corporation. I have been there for about 10 years, so through the tax reform period. To provide context in terms of debt, Danaher is a fairly well-funded public corporation, U.S.-based, Fortune 200 with fairly good cash flows. We are considered an “outbound” taxpayer. We are very acquisitive. With that context, we can talk about debt as something that we care about and how TCJA has or has not affected some of our decisions around debt versus equity funding.

MR. WEST: Thanks, Ag.

Morgan?

MS. MORGAN HOLTMAN: Hi, I’m Morgan Holtman. I am a Partner in the Tax Group at Baker Hostetler. Until recently, I was a colleague of Tom’s at KPMG. I joined Baker in mid-December. Before that, I spent about 12 to 13 years, all told, at KPMG in the National Tax Office. I focused almost entirely on partnership tax matters and in particular cross-border corporate joint ventures. I also spent six years at a
law firm, Dewey Ballantine. I’m thrilled to be here, so thanks for having me.

MR. WEST: Thanks.

Robert?

MR. ROBERT LEVINE: Good afternoon. I’m Robert Levine. I’m the Director of Tax Strategy at Anheuser-Busch. To give you a little background on how we approach things, we are an inbound company, but we also have a variety of outbound issues from legacy structures. We’re very acquisitive and also very well funded with robust cash flows that need managing. We can talk about that also in our context.

MR. WEST: Thanks. Vipul?

MR. VIPUL AMIN: Vipul Amin. I’m a Managing Director at the Carlyle Group in the U.S. biofund. I focus most of my time on industrial investments. I would say with great confidence that I probably know the least about tax in this room, but…

MR. WEST: I insisted that that’s an asset.

MS. HOLTMAN: Yeah, it’s not a bad thing.

MS. SAMOC: When we think about investing, tax is a factor, but not the only factor. My goal in planning is to make sure that my investors get the highest return possible. Tax has an impact on the investor returns, and tax reform has therefore affected those returns. In that context, we can discuss how TCJA has impacted how we invest and how we think about investing. Thank you.

MR. WEST: Well, thank you all. So, we’re going to have a great discussion here. I’m going to throw it over to Morgan to touch on which of the tax reform kind of provisions have been most critical in thinking about debt and capital and some of the issues we’re going to talk about for the rest of the panel and give Vipul a little tax primer.

MS. HOLTMAN: That’s right. Thank you. As Tom indicated, when this panel was being planned, it was envisioned that we would discuss at length recently issued proposed and final regs under Section 163(j). Obviously, we’re not going to do that this afternoon. We’re all still eagerly awaiting the release of those regs. As we began to anticipate that we would not have those regs to discuss today, we shifted our focus to, as Tom indicated, the way that Section 163(j) and other TCJA provisions, like GILTI and BEAT, have impacted business decision-making.

Before we dive into that discussion, I thought I would just spend a moment level-setting and laying the groundwork. So Section 163(j), of course, as we all know, is the business interest expense limitation. A taxpayer can deduct business interest expense for a particular year, generally speaking, to the extent of 30 percent of its adjusted taxable income, which for the time being is akin to EBITDA. We’ll talk about how that will change in the coming years.

If a taxpayer’s interest expense is disallowed, the disallowed interest expense carries forward and can be deducted in future or succeeding tax years. Tom and I have spent a lot of time thinking about partnership tax issues -- I indicated as much in my intro -- and there is a particular and highly articulated series of rules for partnerships: interest expense disallowance is determined at the partnership level, and to the extent there is disallowed excess business interest expense, it’s allocated (it passes through) to the partners, and they can then take a deduction with respect to that interest expense in succeeding years to the extent they are allocated excess taxable income. So, that’s Section 163(j) in a nutshell, if you will.

Other provisions that are really important, and we’ll see that as the discussion ensues, are GILTI and BEAT. There are lots of TCJA provisions that impact business decision-making, but GILTI and BEAT we’ll see have particular significance. GILTI, Section 951A, is a new inclusion, very much akin to a
Subpart F inclusion. A U.S. shareholder of a CFC is now required to include its share of the CFC’s global intangible low tax income.

BEAT, Section 59A, gives us the base erosion anti-abuse tax. It applies, if certain requirements are satisfied, to payments made by a U.S. taxpayer to a related foreign affiliate, and in particular, we’re looking for payments that give rise to a deduction or that are made to acquire depreciable or amortizable property.

With that groundwork, maybe we’ll turn to the business discussion.

MR. WEST: Thank you. I did try to get us an advanced copy of the 163(j) final regulations. You know, I still have some friends in government, but I think the OIRA people found my Twitter account finally, and I’m persona non grata at this point. Thanks. I think that’s a good level-set, Morgan.

I was going to ask Ag about the fact that in preparing for this in discussions with you and discussions with others in the audience today, I’ve consistently heard that outside of certain specific industries and certain specific taxpayers with profiles, 163(j) has not had the bite, at least not yet, that a lot of people thought coming out of tax reform. A lot of people thought in a macro sense this is going to cause deleverage all over the place; it’s going to be really significant.

What I have heard from a lot of corporate multinationals is that that has not been the case yet, or at least that is only a small part of the calculus you’re doing that includes what Morgan just alluded to, BEAT and GILTI. So, could you just talk about what has been most consequential for you in terms of some of these decisions?

MS. SAMOC: Yes. When thinking about 163(j) or just debt in general and how much debt to take on, you have to consider that a public company scrutinized by the SEC has to report their earnings to shareholders. Those stakeholders will be interested in your total income and expenses. So, when you think about debt decisions, the interest component is part of the P&L, balance sheet and cash flow statement. The impact debt has on those public reports is ultimately the primary measure. A decision on how much debt can be sustained by the P&L is therefore not primarily tax-driven. The business decision in terms of how to fund, whether it’s your expansion, your M&A activity, or your free cash flow has to be taken holistically. I’m sure we’ll talk in a PE context here a return on investment. And as such, there is a number of factors that you have to consider.

You have to think about your interest rate, your currency risk, your availability of debt in the various markets. When you think about those decisions, they’re the ones that really drive that debt-versus-equity decision, and if you want to be an investment-grade stock, then that’s really what drives the decisions of whether to take on debt.

I don’t think that 163(j) from that perspective has as much impact on debt versus equity decisions, especially when you’re fairly well funded and you want to keep your investment-grade rating. 163(j) seems to be more of an issue when your leverage is 10 to 1 as opposed to 3 to 1, for example. From that perspective, it doesn’t quite have the same impact.

However, when you think about debt and 163(j) and tax reform more broadly, I think of it as a game of Whac-a-Mole, because not only do you have to make the decision on whether something is debt or equity-funded; once you do make the decision that is debt, then maybe you have some flexibility around where to put that debt. Do you want your debt to be in U.S. dollars, in euros? Do you want it to be incurred by your parent, by your subsidiary? Which jurisdictions should you place it? So, I think that’s where tax perhaps does play a role in helping to design those decisions around the edges of what happens if you have that interest expense in one jurisdiction versus another.

So to expand on the analogy to a game of Whac-a-Mole. Let’s say I place my debt in the U.S. I then have to consider 163(j). But, maybe I want to put that debt somewhere in a high-tax jurisdiction, let’s say Australia. If I put my debt in Australia, not only do I have to worry about Australian tax laws; I have to
worry about the impact of the interest on GILTI. Let’s assume I solve any GILTI issue, but maybe by solving the GILTI issue I create a BEAT issue. So then maybe I’ve solved my BEAT issue, but when I do have some other NOL issue. That balancing and modeling exercise certainly needs to be done.

I will say that around those edges, it is important to think about 163(j) in that modeling context.

One matter to keep in mind in the modeling exercise is what do you care about most – cash or effective tax rate (“ETR”). I think most of us tend to care about cash, but maybe not all taxpayers do. Maybe sometimes how much your effective tax rate is affected by your debt and where it’s placed may be more important. If that’s the case, 163(j) with its unlimited carryforward, it doesn’t have an impact on your ETR. It only has an impact on your cash.

So, I think it really depends on the profile of the company on how much they care about cash to care about 163(j). However, if you are a fairly well funded company -- and debt today is still cheap -- you’re still going to take on debt even with the 163(j) limitation. The next question on where to place it, well, it depends. It really does depend on where your cash is coming from, where is it going to, how can you service debt, and what other risks do you want to take on.

MR. WEST:  Yeah. That’s interesting, the GAAP tax versus the cash tax distinction, certainly something I’ve heard come up repeatedly. I don’t recall how much it came up in terms of anything that I had line of sight to in planning how 163(j) was going to work, but the perpetual carryforward, it just becomes timing for a lot of corporations like your own. And it loses some of the intended effects, if that was an intended effect. I’m not suggesting it was.

I want to hear from Robert on this issue about inbounds, but first I wanted to go to our first polling question. You all can see it. To what extent has the Section 163(j) interest limitation affected financing decisions made by your business or your clients so far, including debt/equity decisions? I think that will be interesting. Any bets? What do you think?

**Polling Question #1: To what extent has the Section 163(j) interest limitation affected financing decisions made by your business or your clients so far, including debt/equity decisions?**

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Not at all, wow. Look at that. Nice. Who’s it supposed to raise all that revenue from? I’m surprised. I guess it’s all the partnerships who Morgan and I have been hearing from for the last year who are paying the 163(j) price. Well, thank you all.

So, Robert, you talked about inbound perspective. Would you have some of the same reflections as Ag, or do you think you’re in a slightly different position?

MR. LEVINE: I think we’re different and we definitely aren’t reflective of the audience because I’d say it affected us a little bit more than not at all. We have the double-whammy of being an inbound, an outbound, and a manufacturer. Since 98 percent of the Budweiser you drink is brewed in the United States, all that capital expenditure goes into cost of goods sold. And that has a disproportionate impact on manufacturers because we’re suddenly suffering under an EBIT standard when the rest of the world and the rest of the companies who don’t produce something and aren’t forced to capitalize depreciation or amortization into cost of goods, it hurts us.

So, we have that on one end, and then also as an inbound, I think to Ag’s point, it dictates where we put the debt. You solve one issue, but then you have a BEAT issue. When you’ve solved the BEAT issue, and then you have another issue. So, I think being an inbound, it makes it a little easier to place debt because you have options beyond just the U.S. or below the U.S. You also have above the U.S. It’s certainly helpful, but at the same time, you’re still playing that cat-and-mouse or that Whac-a-Mole game of, okay, if you put it in the U.S., then you have 163(j); if you put it outside the U.S. then you have BEAT, which is the better of the two evils at that point?

MR. WEST: I wish I could do a polling question on the fly, do we prefer Whac-a-Mole or cat-and-mouse? I think Ag might take that one, no offense, Robert.

MR. LEVINE: None taken.

MR. WEST: Vipul, you’ve heard that experience, the corporate experience, inbound, outbound. Talk about what you’re seeing in the private equity context and, I mean, I’m going to get to everybody in the M&A context because I know multiple panelists up here have that experience, but tell us what’s important to you. I know you don’t have to use code sections like some of the tax nerds up here.

MR. AMIN: I’ll try.

Taking a big step back, and I’ll come to debt in a minute, but the amount of impact that tax reform has had on our industry has been pretty high, and it’s very universally positive. It’s made the United States a much more competitive place in the world. Before tax reform, we would never even consider domiciling a company, a top-co, in the United States. Today, it’s actually part of the conversation. I mean, it just didn’t make sense before.

We’ve been able to generate more cash. We care about that quite a bit in private equity. We’ve been able to invest more cash because of the R&D tax credits, because of the accelerated depreciation. That’s led to increased investments, increased returns, increased jobs. And I think everybody in this room and in Washington cares about jobs, and I think it’s been a positive for that.

Going to debt, I’d say that the 163(j) limitation, I have two big issues with it. One is the death spiral effect. Interest rates today are very, very low. When they rise, and this 30 percent limitation starts to hit, you’re going to have less cash, even than at times you really need it. And so that’s going to cause potentially putting on more debt and potentially further bankruptcies or things that are really unintended and cause job losses.

The other thing is when companies are struggling and they do in tough times, this will actually push them over the edge. That death spiral effect is something that we’re very concerned about.

When you have the flipover from EBITDA to EBIT, you are at cross-purposes. You’re trying to encourage
us to invest, to create jobs, and then when you nick us on the D&A reduction, and so that makes it kind of what are you really trying to do. And ultimately less cash to our companies means less investment and less jobs, and that’s just something that we feel very strongly about, the limitation itself we don’t love. Taking the D&A off of that makes it that much worse.

**MR. WEST:** Interesting. I’m going to flip to our next polling question. To what extent have the overall changes made by the 2017 tax law affected financing decisions made by your business or your clients so far, including source and location of financing?

**Polling Question #2:** To what extent have the overall changes made by the 2017 tax law affected financing decisions made by your business or your clients so far (including decisions regarding source/location of financing)?

Okay, not much again. A few more people affected by this. I’m going to open this up to the panel. In some of the conversations we were having earlier today even we were talking about historically the location of debt wasn’t really driven by tax from your perspectives. Do you want to touch on that? And that’s changed a little bit at least, it sounds like.

**MR. AMIN:** Yeah, I would say from my perspective, we didn’t think a lot about tax when placing debt before tax reform. I would say not much at this point is probably right. We think most about -- and Ag brought these things up -- we think most about where the cash flows are, currency risks, availability of debt just given that capital markets in other jurisdictions are maybe not as developed as the United States. You do pay a premium for debt in Europe or in Asia, and so those are the things that really impact it.

I wouldn’t say that tax reform has really changed our view on where you raise the debt. And, like I said earlier on, tax is one important, but it’s just one aspect of how we make investment decisions, and for me it hasn’t impacted, but I don’t know if the other panelists have a different view.

**MR. LEVINE:** I think tax has a larger seat at the table now. I think we’re trying to inform decisions, and if we’re indifferent or the business is generally indifferent, tax can push us over the edge as to one or the other, or if there’s a very large overriding issue, maybe tax has a disproportion today more so than ever.
But at least in the corporate context as an inbound, wherever we place the debt, we have a parent guarantee. I mean, that’s just what the commercial terms are going to be and what the markets are going to require. So, once you have apparent guarantee, that creates its own host of issues on its own. At the end of the day, again going back to the Whac-A-Mole, we solve one issue, but then you just create this whole other issue.

**MS. SAMOC:** I do think that tax has an impact, but I don’t think it’s only the TCJA that you have to consider when you think about deductibility of interest expense, which is effectively what we’re talking about here. If you’re a U.S.-based outbound taxpayer, I mean, yes, there’s the 163(j) limitation in the U.S. However, depending on your facts other considerations may prevail. For example, what if you have a deficit in your branch basket and you try to place the debt there and hence limit your foreign tax credits as a result? So, maybe that’s not a good idea. Also, when you think about the allocation of that interest expense and the source of your cash funds in order to pay it, you have to start thinking about BEPS and the various other OECD initiatives as well.

When looking at the sources of your cash, what may be more important are the kinds of limitations you may have from a local tax perspective. For example, let’s say you have 30 percent of your income from Germany and 30 percent of your income from Australia. Then you would want that debt to be pushed down to those jurisdictions. In some ways the way that the rules are designed to incentivize you to go to a local bank in the jurisdiction in which you have income to take on the debt. However, that may not be realistic in many jurisdictions.

Pick a local jurisdiction that you don’t normally work with too much, and, of course, that depends on the company, but let’s say it’s Argentina. Are you going to go in and get a facility in Argentina to get that local deduction in Argentina? If that was the biggest target that you’re buying and that was the income, you probably would do it, right?

So to the extent that you can get deduction in your high-tax jurisdictions you would. The U.S. being a 21 percent jurisdiction is no longer as high-taxed as before, but it is still higher than some, so maybe you still want to take that deduction in the U.S. One other matter is that when you’re a U.S.-based company, you have to consider that the GILTI has removed deferral. So, at the end of the day, what you have is a U.S. tax on your total worldwide operation. It may be at a rate of 13.125%, but it’s still at U.S. tax.

**MR. AMIN:** I would make just one distinction, though, from my fellow panelists, they have high credit quality companies. Our companies are just not that high credit quality. And so, your ability to raise money in, say, Argentina if you wanted to is possible. We just can’t. It’s simply not possible.

We very recently raised money in China at low credit quality that was almost unheard before, and so we’re sort of breaking new ground on this stuff. We’re really limited on where we can even place it so it matters a little less to us because if we had the option of shopping for tax jurisdictions, we might actually do that, but we just, at this point, don’t.

**MR. WEST:** Interesting. You touched on BEPS and some of the other initiatives that have come up a lot today. Another topic that’s come up a lot today, even though we’re talking about hindsight, is that there’s a lot of unknowns, there’s a lot of changes that we know are coming. Thinking about some of those, we don’t have the final 163(j) regulations yet, but I suspect there are specific things that some of us are anticipating or hoping to see in those.

Robert, is there anything in particular you’d like to see in the final 163(j) regulations?

**MR. LEVINE:** A D&A back from COGS would be awesome.

**MR. WEST:** Yeah. We don’t have that as a poll, but I think there’s a lot of people in the room who would say the same thing. I think people have heard through the grapevine that that’s certainly something that a lot of people are anticipating seeing in the final regulations when those are finally released sometime.
soon. I don’t exactly know how they’re going to do that fix, but I think that’s one that would be helpful.

What would be in particularly helpful is figuring out a way to push the EBIT/EBITDA toggle out. I know people are working on that. One of the things that we talked about in leading up to this panel is although 163(j) isn’t necessarily affecting a lot of people yet, I think there’s certainly the expectation that more people will be in the position that lots of manufacturing finds themselves in now. If and when we go to an EBIT thing, can folks on the panel just speak a little bit to whether you think that will become an issue? It will become an issue for you then, or are you still talking about, like, high credit quality, you know, lower leverage ratios that are still not going to bite for you guys yet?

**MR. AMIN**: For us, it’s a real threat. We’ve done some modeling, and we see that the removal of D&A is going to have a material impact on our cash flows. And it’s, you know, look, and that’s in good environments, and look, we don’t expect a recession anytime soon, but we’re in one of the longest expansions in history, and so there will be a downturn at some point, and that death spiral effect that is already embedded in just the concept of the limitation is going to get even worse. I think that could have some real impacts, and you’ll see some potential bankruptcy driven by this. And that’s not something any of us want.

**MR. WEST**: Robert?

**MR. LEVINE**: I mean, we already suffer under it, so we’re already at even.

**MR. WEST**: You’re going to get relief for a year or two hopefully, and then --

**MR. LEVINE**: It will switch right back, yeah.

**MR. WEST**: -- and maybe it will switch back.

I’m going to flip to our last polling question here. To what extent do you think the scheduled increase in the interest limitation will change your business or your clients’ financing decisions if it comes into effect?
Polling Question #3: To what extent do you think the scheduled increase in the interest limitation will change your business’s (or your clients’) financing decisions if it comes into effect?

Wow, I was expecting more than that on a lot, but a moderate amount.

**MS. SAMOC:** Well, when you think about it, with bonus depreciation being available, many taxpayers already claimed then depreciation deductions, right? So, to the extent they don’t have a lot of capital investment, then maybe the DA isn’t that large for them.

**MR. WEST:** Yeah.

**MS. SAMOC:** But who knows?

**MR. WEST:** Are you all already planning in advance of that? Are there things you’re doing like that or you’re seeing folks doing? I’ve heard some conversation about accelerating certain kinds of investment, certain deductions now, but I don’t know. That’s more anecdotal.

**MS. SAMOC:** I can’t say that, not for that specific issue.

**MR. AMIN:** We’re not.

**MR. LEVINE:** The business is going to do what their business is going to do. They have to brew the beer, so...

**MS. SAMOC:** You also have to consider that with the carryforward of 163(j), to the extent you care about ETR, then you’re not as affected by it. However, you still have to try to manage your cash flows. So Section 163(j) likely is mostly an issue for taxpayers in those heavily leveraged situations.

**MR. WEST:** So, in terms of other kinds of changes that may be coming, you touched on international initiatives, Ag. Are there particular international initiatives that any of you all are watching with any kind of specificity? Or is it just trying to absorb the changes in the interaction of the changes, OECD, U.S. tax reform, changes in the EU? What are you looking at, if anything, specifically?
MS. SAMOC: All of the above.

MR. WEST: All of the above.

MS. SAMOC: But maybe not as much with respect to debt. To the extent that you can push down debt through intercompany arrangements, you would because it is too hard to place debt directly in Argentina or China or another complex jurisdiction. So, the international initiatives may limit your ability to push down debt through inter-company arrangements. If those are no longer possible, then we have to work on cleaning it up.

Apart from the international initiatives, there’s other factors that can affect debt placement a lot more, which is currency, for example. Currency can be something you cannot predict. So, to the extent that you have some type of a currency fluctuation, you try to plan for it, but I think that that can actually affect some of those debt kind of decisions a lot more than even the pending legislation. But, yes, you need to model out the impact of pending legislation.

MR. WEST: I think we wanted to open this up for questions, given, you know, the diverse experience of this panel and knowing that with respect to this particular topic there’s lots of different tax situations that might, you know, be more specific to folks in the audience. There may be any number of you who are more impacted by some of these issues than others. So, we’re going to open it up to questions. Has anything come in, John?

MR. JOHN GIMIGLIANO: Yeah, we’ve got a few here, and please submit them if you’ve got one in your head. Let me go with this first one. In the debt-versus-equity calculus -- I think they mean choosing to debt finance or equity finance -- how sensitive is that outcome to rising interest rates? In other words, do higher interest rates lead to a different answer?

MR. WEST: Anyone?

MR. GIMIGLIANO: I guess on the one hand you get your deduction --

MR. AMIN: I guess if you’re talking about the private equity context, it’s pretty sensitive, but, look, it’s not that I would say we’re going to put more equity because interest rates are high. It’s going to be that we’re just not going to make the investment. Our investors demand a certain amount of returns, and if the math works, we’ll make the investment. If the math doesn’t work, we won’t make the investment, and that just leads to not a great outcome for anybody. So, you know, the increase in interest rates are something we’d factor in, but I’m not sure tax necessarily impacts how we think about that.

MR. WEST: There’s a lot of economists in the room who can probably speak to this better than I can, but I consistently read about going into 163(j) and wondering about the potential impacts after tax reform. There seem to be experiments around the world where this has happened, and we have not seen the deleveraging that folks predicted in a macro sense.

There’s definitely been some change. I think Germany’s had an interest limitation for going on 10 or 12 years, I think. Now, they don’t have the perpetual carryforwards, and on a macro level, they did see some deleveraging, but the DE debt is very sticky in terms of coming down. We’ve been in lower interest rate environments for quite a while, so I don’t know how much recent experience there is with that.

MR. GIMIGLIANO: Okay. Next one? All right. This isn’t an easy one either, but let’s try it. Would it have been more or less disruptive if 163(j) had a rule grandfathering existing debt instead of the rule that it has, which is the EBITDA to EBIT standard? Right, in other words, if they just said, all old debt grandfathered, full interest -- or no interest limitation on new debt, subject to interest limitation. Would that have been more disruptive, or is this conversion from EBITDA to EBIT more problematic?

MR. WEST: I’ll let the experts weigh in here, but it doesn’t seem like the lack of grandfathering -- I know
there was a lot of concern about that, but it doesn’t seem like we’re hearing a lot of problems brought on by the lack of grandfathering. The ratios under EBITDA just are not biting, but...

**MS. SAMOC:** I know one of the things that I was expecting to see, and maybe it hasn’t flushed through the system yet, was the M&A impact of Section 163(j). In this context, let’s say a company does run into a 163(j) limitation and that company is then sold. Given the 163(j) limitation is a forever carryforward (at least under current rules), I was expecting to see sellers try to start selling you the Section 163(j) attribute.

I haven’t seen that yet, but like we just said, maybe it hasn’t flushed through the system. Whether it’s something grandfathered or not, people made decisions based on economic realities to take on a certain amount of debt, not to get a tax deduction. The fact that you get a tax deduction, that’s great, but you still have to be able to service the debt.

**MR. GIMIGLIANO:** Okay. All right, there’s a couple of other questions that all sort of hint at getting around the same question, which is the preservation of the DA starting in 2023, I guess it is and how important that is, and I guess it depends. I think the questions are sort of all around. If you’re forced to give something to preserve DA, are people really prepared to give something, whatever that might be, whether that’s an increase in the corporate rate, or for your partnership the loss of 199A, for example, or the loss of bonus depreciation. And maybe the answer is it depends, but how important is DA, and are companies going to be, in this effort to save it, be prepared to give something for it?

**MR. AMIN:** I would say for private equity companies, lower credit quality companies, it’s very important, and I think it depends on what it is that you have to trade for it, but I would certainly think that that would be something that we would be in favor of. I think as you get to the higher credit quality companies, I would imagine that the tradeoffs they would be willing to make are very different than the ones we would. So, we hope there’s some sort of compromise that can be struck.

But, you know, that is something that if you go to the four options you have, the DA to us is going to be really disruptive. And EBITDA to this point has not been as disruptive, but DA will because the companies, especially that I invest in in terms of industrial companies, invest capital, and that’s going to be something that we think a lot about. And so, we want to find a way to kind of preserve that and make other tradeoffs that are less disruptive.

**MR. WEST:** Yeah, it’s interesting. In the scoring of 163(j), I know I think in the first few years it’s about 17 a year, and then it jumps up to 25. That change is big, but it doesn’t seem as existential as I consistently hear from the folks who are really modeling this out. I don’t know what the scoring model was based on, but it does seem like a lot of folks think the DA is existential.

**MR. AMIN:** My biggest worry is just an increase in bankruptcies of the lower credit quality companies, and I think that just this is something that can cause a death spiral. And that’s something that I really want to avoid.

**MR. LEVINE:** If you look around the rest of the world, no one else has an EBIT standard. Everyone has an EBITDA standard, so it seems awkward that if we’re trying to goose investment and make the U.S. a good place to invest for jobs for manufacturers, that we would move back towards an EBITDA standard and away from an EBIT standard.

**MS. SAMOC:** I think intellectually speaking, if you’re talking about “save the DA,” I’m not sure a tax rate increase would be something anybody would agree as a pay for. That ask seems disproportionate to the benefit. If you start modeling it out, you possibly could have other pay fors, but it’s just going to be so industry-specific. One taxpayer is going to say, I’ll give up Section 199; another one is going to say, yeah, I’ll take a higher BEAT rate. These are all calculations that would be made, but I’m not sure if you can have a consistent answer to save the DA, especially with the Section 163(j) unlimited carryforward.

**MR. WEST:** Yeah, and, to your point, I think under the EBITDA standard, it seems like 163(j) is not falling proportionately across corporate America, just based on anecdotal experiences. Again, there are some
industries where it’s really hitting but many where it’s not. I wonder if moving to the DA or losing the DA means that more people kind of unite and say, okay, now we’re willing to trade something to get back, you know, the DA. I don’t know.

MR. WEST: Well, thank you to our panelists. Really appreciate it. I enjoyed the discussion. Thank you. And thanks, everybody.
Mr. Tom Roesser: Good morning. I'm Tom Roesser with Microsoft, and we are very fortunate today to have a wonderful panel of House Ways & Means and Finance staffers. We have Beth Bell and Randy Gartin from the Ways & Means Committee; and we have, from the Senate Finance Committee, Tiffany Smith and Mark Warren.

Before we begin, as always, the panelists are not speaking on behalf of their respective Members or Committees.

I hope there are plenty of questions, and I think this will be a fascinating panel. So, thank you all very much for participating.

It's interesting many countries that are involved in the OECD Inclusive Framework effort have parliamentary systems, and they're not quite familiar with this notion that we have a divided government. In other countries, if an administration is speaking, well, of course it is speaking on behalf of the full government. In the United States, obviously, we have separation of powers between the Congress and Administration.

Over the past several years, in the BEPS effort and now in the Inclusive Framework effort, Congress has weighed in on numerous occasions to reinforce, I think, the Treasury's position in many cases and the U.S. position. As a former staffer and someone who's involved in this project, I think that effort has been very helpful.

Today's conversation will be more in a question-and-answer format. I believe you may be interested in some of the notions that will be discussed in the next 20 minutes or so.

First of all, the Administration obviously has been very engaged in this OECD Inclusive Framework effort. I know the Joint Tax Committee has been attending some of the public consultations which is very important.

How do you get information about the project? Do you get it from constituents? Do you get it from the press? Do you get it from Treasury, or a combination of all? But just as a baseline, where do you get your information?

Randy?

Mr. Randell J. Gartin: It's a combination of it all, and it started in earnest last year. We've gotten a lot of good information from JCT, who's gone into those consultations. We have briefings at the staff level from the Treasury as well. What I think is really important is getting feedback from stakeholders. Our Members are very interested in that type of feedback to see how it would affect companies here in the
U.S. It’s an important aspect of what’s going on, right? The more feedback we get, I think, the better for our Members.

MR. ROESSER: Mark?

MR. MARK WARREN: I agree with Randy. I sort of think about it like a triangle in a way. In this case, there’s been a lot of very helpful unanimity among the four of our bosses in trying to be supportive of Treasury, but my triangle is Treasury being the lead negotiator on behalf of the country, Congress being a key part in that, and then the business community, our U.S. businesses.

We get a lot of the information from the other two corners of that triangle, but part of our effort, at least from Senator Grassley’s perspective, has been to make sure that those two points are both talking to us, but also talking to each other. I think the only way that this is going to work is if it’s a good deal for the United States, and that means that it’s representative of where the U.S. business community is and that Congress can support that as well.

MS. BETH BELL: Echo all of the above. I’d also note that in a lot of cases our member offices view this as a trade issue as well, so we keep open lines of communication with the trade world. This is very much a tax-and-trade overlap. We review all the OECD documents. We meet regularly with the stakeholders. We feel like we have a pretty good handle on the issues.

I’d echo specifically Randy and Mark’s comments on coming in to see the Members of Congress, not only the committee staff, who are probably the most well-informed on this issue, but also the individual member offices, I think that will become more and more important as this process moves forward.

MS. TIFFANY SMITH: I would agree with that. We, on our staff level, have done briefings for our member offices so that they are aware from the 50,000 feet on into the weeds, and so it’s important that you not only talk to committee staff but you also talk to member offices to keep it on their radar. While we are able to do that in some way, along with the briefings from Treasury, it’s also important for them to hear from companies and your businesses so that they are aware of what’s going on and the impact.

MS. SMITH: Sure. In this case, we’ve written letters, we’ve released bicameral statements. I work closely with my counterpart, Mark, and we talk to each other regularly. We’ve done bipartisan briefings. We actually get along very well, so we were a little surprised. We were like, what, Mark’s not sitting next to me? He’s supposed to be sitting next to me. You’re messing up the flow of our world tour.

But we actually talk often on this issue. Our staffs work together and talk often, so we’ve actually kept the lines of communication open between our offices, so that always helps.

MS. BELL: Same here. It’s been a very good bipartisan, bicameral effort. It’s been nice to work with my Senate colleagues again, across the Capitol campus. I think that we’re all very committed to supporting U.S. engagement in the process. The devil is obviously in the details of any agreement, but we’ve been able to present a unified message to both our Administration and to those participating in the OECD negotiations.

MR. WARREN: Beth is secretly our plant because she’s from the Senate, so you can walk away, but you really can’t leave. So, I totally agree with what Tiffany said. I think this, at least the way we sort of think about it, is we have to be united because this is kind of us, the United States, against the world. So, I mean, trying to stay as cohesive as we can and as supportive in terms of Treasury staying at the table and advancing the U.S. position, as that develops based on the ongoing negotiations has been important but I think helpful in picking up the bipartisan relationships that we’ve long had. So, it’s worked well.
MR. GARTIN: Yeah, I'll just echo the comments of my colleagues. It's nice to be able to have issues that we can see eye to eye on. Oftentimes we are not on the same side of issues, but it is a pleasure to be on the same front as my colleagues up here.

MR. ROESSER: Well, thank you. The bipartisan effort has been great. The next question is how does your particular office think about the pros and cons of the OECD inclusive framework effort, and how do your office and your caucus message it for your side of the aisle?

MR. GARTIN: Yeah, and this is something that I don't want to necessarily say we're struggling with, but the process is a little vague so it's a little hard sometimes to wrap your arms around what's going on, where it's headed. So, getting a message around that and how we communicate with our members on that front, it's important. The briefings we get from Treasury and from others, to come in and talk to us to help us frame that discussion is very, very important.

As for the pros and cons, I think we're going to have to wait to see where this is going. We certainly hear from the business community that there's certainly some pros here, but it quickly can turn to a con depending on what the details look like.

MR. ROESSER: Thank you.

Mark?

MR. WARREN: I agree in the sense that from the pro side of it that if there can be an agreement that is workable and workable for U.S. businesses, which clearly are the most in the cross-hairs here, then that's a desirable outcome. I think part of the motivating factor for us at least is to keep urging Treasury to stay at the table and the United States to stay at the table here as the consequences seem fairly dire. There isn't a Plan B that we can see, other than just massive numbers of unilateral measures. That doesn't seem in any way a workable solution.

I think those stark pros and cons are out there. Depending on what the details are, and this is evolving, it's somewhat of a challenge to keep members informed as to what those details are and the pros and cons as they come together. We rely a lot on the Joint Tax Committee. They've been our representative, for all four of us, since our bosses ask them to attend the consultations on our behalf. So, I think engagement is the primary objective at this point, and pushing toward an outcome based on what we are hearing from the business community is workable at this point.

MS. BELL: We're glad everyone is at the table, too. We do appreciate the focus on creating certainty in this space, to the extent that's possible. We appreciate also the acknowledgment that a global solution would result in the withdrawal of DSTs. But as I think my colleagues have already said, the task is pretty complex, and there are a lot of open issues.

That creates a challenge, communicating with Members, who would like to hear more specifics both on the structure front and on the revenue front. I think that as those concepts become more solidified and those details develop, there will be much more engagement with our membership on the Committee, but so far we really are just very appreciative that everyone has remained at the table.

MS. SMITH: We would agree with that. We support the multilateral negotiations and it is a bit tough to relay information to Members when it's not solidified. It's important we get our information from Joint Committee, Treasury, and from all of you, so it's important for us to continue having those open dialogues. We also talk to each other so that's important. It is an aggressive timeline, and a lot of folks are at the table, which is good, but those are the pros and cons of it, and we just have to be abreast of the issues as they come up.

MR. ROESSER: Thank you. Let's dive into something that Beth said. An argument in favor of the OECD Inclusive Framework approach is to create more certainty. Obviously, it's too early to tell what the actual
proposal will be, but do you have any sense, at least from a U.S. perspective, whether the U.S. would be a net winner or loser from a revenue perspective? In addition, do you believe the project will actually result in more tax certainty and clarity? Do your offices have a sense of that? How do you think about that?

Obviously, it’s an election year as well. If the U.S. is a net loser, how does that play out? I don’t think the Administration would want to be a net loser. I don’t think any member of Congress would want the U.S. to be a net loser from a revenue perspective.

**MS. BELL:** You’re right. The revenue outcome will be very important to Members of Congress. From our perspective, the impact on the U.S. tax base is going to be one very determinative factor for how Members think of all of this. I think as to our sense of it, it’s a little too early to tell. There’s so much open about the final design. Just thinking about the threshold, the formula for Amount A, the activities covered by Amount B, the GILTI grandfather question. All those could have a pretty material impact.

I know the OECD has released some preliminary estimates. Those are based on earlier data that are actually pre-TCA. Although it’s a good start, it gives us kind of a sense, I think we’ll be looking for more specificity as the final details and kind of medium-level details come together. I think that the revenue impact and the importance to Congress is something that Treasury knows of and should really guide them in their negotiations.

**MS. SMITH:** I agree with that.

**MR. ROESSER:** I’m not going to let you get off that easy.

Others on the panel?

**MS. SMITH:** Revenue is going to be very important to our Members.

**MR. WARREN:** You can also see some of the vagaries in it from what was released yesterday, and there were some key assumptions that they made in terms of the allocation percentages, which I think was a bit of a surprise. I think there’s a lot of uncertainty as to how accurate the base even is, given, as Beth mentioned, the time frame of using 2016 data long before some of the changes that were made, at least in terms of U.S. law. It’s clearly hard to estimate based on a shifting landscape, which is where we are in terms of both Pillar I and Pillar II it seems, but even making some of those aggressive assumptions that they did and kind of moving from a modest allocation to a more substantial one.

Again, if U.S. businesses are the ones that are primarily in the cross-hairs, I think we can have a sense of where that’s coming from, and that’s going to be an alarm to us. A good outcome really has two prongs. It’s good for U.S. business on the certainty side of it, but it’s got to be good for the U.S. fisc. So, that’s clearly something we’re going to be watching for and trying to judge whether this is good or bad.

**MS. SMITH:** And you would hope those numbers adjust as more financial data and more information becomes available, because you’re right, it’s before the 2017 bill, so they’re not actual accurate numbers.

**MS. BELL:** And pre-BEPS.

**MS. SMITH:** Yep, pre-BEPS, too.

**MR. GARTIN:** And the discussion about the hit to the fisc, it’s one thing to have revenues decrease and have those revenues going to staying with businesses that can then reinvest and do what they please with it, but this is a shift from the U.S. to other countries where the tax is going, so I think that has a different component to it as well.

Talking about certainty here, I mean, I could be wrong. I’m just a humble Hill staffer. But with the one component of we’ll say Pillar I with the Amount B is the one that I kind of view as being the one where you
can provide the most certainty, but are we just shifting the discussion from the amount of the return to just, well, what’s the scope of what falls into the Amount B? So, does it provide the certainty that people will be looking for, I guess that will play out on that front.

**MR. ROESSER:** Just to dive into that a little more, from a political perspective, you’re weighing revenue versus certainty. Is one more weighty than the other in the political realm? I would think the revenue issue would be the biggest political touch point but curious to know your thoughts.

**MS. BELL:** I’m going to be unhelpful and say that both are very important. I think that one is really important to a large number of stakeholders, and the other is always on top of mind of Members of Congress.

**MR. WARREN:** They really are two sides of the same coin, where’s the revenue coming from in large measure.

**MS. SMITH:** And it’s going to be important to hear from stakeholders on the impact of what any agreement looks like.

**MR. GARTIN:** I agree with that.

**MR. ROESSER:** Great. So obviously Pascal Saint-Amans mentioned in the video this is a very ambitious timetable. I believe there’s a meeting in Berlin in July, and then there’s a hope to try to reach some type of kind of broader resolution by the end of the year. If you look at the working party assignments and the document that was released a week or so ago, those work programs go through November.

Do you think that is a realistic timeline? And, we have an election coming up in November. I’m curious to know how that plays into all this as well.

**MR. GARTIN:** Realistic timeline? I think we heard from Pascal that he thought that was an aggressive timeline and maybe too aggressive, I think he said. I think whether or not it’s realistic, well, I guess we’ll see it play out, but it’s difficult to get such broad consensus on a global basis.

The elections will definitely be playing into that. There’s still a lot of uncertainty going into November that could change the landscape a bit on what the Administration may think or others may think about where the correct way to go. There’s a lot of things still up in the air, I would say.

**MR. WARREN:** I definitely agree. I think he said very aggressive. It was a stronger term than very, maybe go with that, but it also depends on what your target is. If they’re looking for an agreement on broad principles, I think that is going to be a challenge because there are so many details that go into what those principles or components really would look like to be able to have a clearer sense of what the effect is going to be for particular countries and in particular for us, the United States. I hope they can do it, but it won’t surprise me if it ends up slipping.

**MS. BELL:** Right, it is very ambitious. I know that the OECD has acknowledged that even if that timeline is met there will be maybe a year, a year and a half of technical work to come before implementation is possible. I think there’s an acknowledgment that maybe we can reach a principal agreement and then the details will need to be worked out afterwards, but it’s very ambitious.

**MS. SMITH:** Yeah, it’s not going to be wrapped up in a bow as of November. There’s going to be a lot of time after that where there has to be decisions made on details and adoption and how things are incorporated and whether folks are going to even get an agreement.

**MR. ROESSER:** Thank you. From a separation of powers perspective, as the OECD Inclusive Framework continues, you have Pillar I and Pillar II. Do you think aspects of a Pillar I or Pillar II require U.S. legislation if there’s an agreement? Are there particular issues that definitely need U.S. legislation or
could be done via treaty or otherwise? How do your offices think about that?

Tiffany, do you want to start?

**MS. SMITH:** I think we need more details. It’s possible that there would need to be a combination of those things, legislation and tax treaties. We can’t make a determination just yet on what Congress will have to do to get it done until we know more.

**MS. BELL:** I will preserve the prerogative of the House here and say that, yes, to the extent that we change the activities that give rise to U.S. income and U.S. markets, we’ll need to change the ECI, the effectively connected income, rules by statute. I don’t think that can be done by treaty.

Those rules could be further refined in the treaty context, I think, then both of those require congressional action. I think there was a suggestion in the most recent paper that maybe a formulaic Amount B could be done within the arm’s length standard, but I think that even if that’s the case, it’s not really clear whether that could be imposed on companies doing business here without statutory changes. I expect that Congress will continue to have a role, not only in the negotiations but if an agreement comes together in implementing the ultimate outcome.

**MR. WARREN:** I definitely agree, and I’ll preserve the prerogative of the Senate that if it’s a treaty route, then we’re also going to have to bring in another whole committee, the Foreign Relations Committee, which we work closely with on tax treaties. Clearly more work will need to be done, and I think that underscores the need for our bosses, Congress on both sides of the Capitol, to stay engaged in this process because it’s going to require more work even after an agreement is reached.

**MR. GARTIN:** Yeah, and I’ll agree with this. People talk about in Pillar I the Amount A being a new taxing right. If it is a new taxing right, it seems like it should be done through legislation if that’s the case. As Beth mentioned ECI rules, we also have sourcing rules that may need to be changed as well, and whether or not in Pillar II GILTI is grandfathered, or would need to have some changes to that to fit in within the framework.

As everyone up here said, there’s uncertainty right now as to what it’s going to look like, but there’s certainly avenues there you can point out that legislation looks like is probably the way to go, but time will tell.

**MR. ROESSER:** So, from your comments, it sounds like it’s a mix of both legislation and treaty efforts. From a business community perspective, if you’re going to have the U.S. participate in a multilateral treaty, it’s very important to keep the bipartisan effort and support of the Administration’s efforts so everybody’s on the same page.

**MS. BELL:** I think.

**MS. SMITH:** And I did say combination.

**MR. ROESSER:** That was the slow pitch.

**MS. BELL:** One more note on this that I think is interesting. Someone reminded me yesterday that when we have the Senate Foreign Relations Committee involved, which is the committee that processes the treaties, there are not scores associated with treaty changes. There are scores associated with legislative changes. That can create an interesting dynamic with the way that members consider the revenue impacts of any agreement.

So, we’ll also be keeping an eye out to see whether both of those are needed and whether we’ll need to adjust our thinking on how members traditionally perceive the revenue impacts of something coming together.
MR. WARREN: Also, I think we have to keep in mind that we have a whole treaty network of existing agreements that may or may not have to be brought into this whole discussion as well.

MR. ROESSER: I asked earlier whether you had any sense of whether the U.S. would be a net winner or a loser from a revenue perspective. Has the Joint Committee on Taxation provided any sense of magnitude or revenue estimate on the actual impact on the U.S.? It seems many Inclusive Framework countries are now starting to engage in their own revenue estimating, which is difficult because you don’t even know what you’re estimating.

MR. GARTIN: Yeah, usually when I ask JCT for a score, they want some specifics on what we want to do. I certainly have not asked them to ever score, and I have not seen one, and I don’t know if there’s ever been any discussion on that front with them.

MR. WARREN: I’ll associate myself with the gentleman’s remarks.

MS. BELL: Same here.

MS. SMITH: That’s the answer.

MR. ROESSER: I had to try.

I know we don’t have a lot of details on Pillar I or Pillar II, but Pillar I has three amounts -- Amount A, which has the new nexus requirements for big companies that are consumer-facing that have automated digital services, and there’s a reallocation of revenue or profits to various market jurisdictions under A. Amount B is intended to be a baseline distribution return using a fixed percentage. Amount C, as I understand it, is if a country asserts a business has additional functions in a jurisdiction, then it would be subject to mandatory dispute prevention and resolution mechanisms.

When you look at Amount A, do you have a sense regarding the number of U.S. businesses that would be impacted by Amount A? Are U.S. businesses disproportionately impacted? Do you have any sense of that, or is it too early for Amount A with the new nexus requirement?

MS. BELL: I suspect this will be the answer to a lot of the detailed questions, is it is a little too early to tell. We have heard from a lot of U.S. businesses who are within scope. We have heard from others who are not within scope. Certainly, based just on public statements around DSTs, there has been what I think we all agree has been an unfair targeting of U.S. businesses on that front in terms of whether Amount A largely captures U.S. businesses. I mean, we’ll just have to wait for the final details.

I guess I would also note that I think there are some in the business community that would support the efforts because it wouldn’t lead to a retreat from those unilateral measures. So even those within scope may be okay with that, even if it is a proportion -- a large amount of U.S. businesses because the DSTs are targeted at U.S. businesses. But, again, far too early to tell what the absolute magnitude is, I think.

MR. WARREN: All right. Well, we’ve heard the message, certainly from the companies that think they’re going to be affected and have come in to give us a read, and I think the most of the feedback has been from those that believe that they are in scope.

Once we have more details, then we have a better basis to be able to assess and seek help from the Joint Tax Committee in terms of an analysis of how broadly this is going to apply. But the general sense is, yes, it’s going to be potentially heavy on the backs of U.S. businesses, and then how much of a tradeoff, how much willingness is there for the certainty and how much certainty really is there. I think that’s what we’re trying to assess and with a moving landscape.

MR. ROESSER: Thank you very much to the panel. It’s obviously a very important issue. We had U.S. tax reform, and now we have global international tax reform. The business community is very interested and engaged in the OECD international tax reform efforts and very much appreciate the Congress’
bipartisan participation in this effort which is very important.

With that, please join me in thanking our panel. Thank you.
Grappling with Global Reform

Description:
The OECD continues to push toward a global solution to address the tax challenges presented by the digital economy. The specter of major changes to the international tax system looms large, yet nothing is certain - even whether consensus will be reached. However the OECD’s work unfolds, businesses will need to adapt and react. This panel helped multinational businesses manage the uncertainty of this moment with insights on the latest OECD proposals and practical discussion on how to navigate the current fluid state of international tax rules.

Panelists:
- **Brett Weaver**, Partner, National Leader, Value Chain Management, KPMG (moderator)
- **William Morris**, Deputy Global Tax Policy Leader, PwC
- **Grace Perez-Navarro**, Deputy Director, Centre for Tax Policy and Administration, OECD
- **Sandy Radmanesh**, Tax Attaché, German Embassy Washington DC
- **Amy Roberti**, US Federal Government Relations Leader and Global Tax Policy Director, Procter & Gamble

**MR. BRETT WEAVER:** Good morning, everyone. We're pleased to be here. We have a fantastic panel. This truly is a panel that requires no real introduction. I know that you all know this panel incredibly well.

We're pleased to be joined with Grace Perez-Navarro, Deputy Director of the Center of Tax Policy and Administration for the OECD. And, again, congratulations on receiving the 2020 TCPI Pillar of Excellence Award, Grace. It really, truly is something very special and well deserved.

Next to me, Will Morris, who is Deputy Global Tax Policy Leader for PwC. And then next to Will, we have Amy Roberti, who leads Global Tax Policy for Procter and Gamble, and also wears two hats – her global tax policy hat and, if that’s not enough, is also dealing with domestic federal policy for P&G.

Then Sandy Radmanesh who is joining us from the German Embassy here in Washington, DC, and is the Tax Attaché assigned to the Embassy. So, thank you, panelists. We appreciate you joining us today.

There’s a number of things that we’ll cover in addition to what’s in our agenda. The video interview with Manal and Pascal really highlighted a number of key issues, and we want to drill down on a number of those issues and hopefully have a really good discussion amongst our panelists.

To start out with, maybe I’ll turn, Grace, to you first of all. I think one of the things that really came out to me in watching the interview with Pascal and Manal was that in some sense this whole effort seems to be a negotiation amongst countries. Maybe you could address how that negotiation is going and share your thoughts on some of the things you heard on the prior panel related to that negotiation.

**MS. GRACE PEREZ-NAVARRO:** Thank you, Brett, and good morning, everyone. Well, yes, it is a negotiation. We are, of course, trying to rewrite the international tax rules to address the fact that they don’t currently take into account the rapid digitalization of the economy. We are trying to address a policy issue, but, of course, policy issues can be addressed in a number of different ways. And so, that is where the negotiation of the deal comes in.
You heard on the previous panel, I think it was Tiffany who said the only way the U.S. will support this is if it’s good for U.S. business and good for the U.S. revenue. Well, obviously every country coming to the table has that same thing in mind for their own country so that is one of the things that makes this process very challenging.

But at the same time, everyone, as Pascal said, wants to find a solution because the alternative for all countries is bad. As Beth said, the devil is in the detail. Maybe we can wrap this whole panel up rather quickly because I think a lot of our answers will be, we’re working on it, stay tuned. It’s not that we haven’t been working; we have been working very hard but we are in the middle of a process right now.

If you think back, there’s been an awful lot that has happened in the last year. We started in January with a policy note that set out three different options for Pillar I on nexus and profit allocation, and then we had Pillar II. We then developed a work plan to develop those three streams of work under Pillar I, plus the work under Pillar II.

We then spent a lot of time trying to narrow down those first three options under Pillar I because we knew there was no way we could achieve consensus within the timeline if we had to continue developing all of the technical elements of those three proposals at the same time. So we’re now, I think, in a very good place but an awkward place for purposes of having this kind of conversation in a way because we just agreed two weeks ago that we are going to focus on the unified approach for Pillar I, so a lot of the detail has not yet been developed, and that’s really what we’re going to be focusing on now.

So, that is where we are. I was very happy to hear in the prior panel that we do have bipartisan support for the process. Obviously, everyone has to wait and see and look at what the detail is. I was a little disappointed they didn’t mention engagement with the OECD because we have gone to the Hill and we have had delegations from Congress come to the OECD. And, in fact, at the end of this month, the OECD is having a meeting of congressional people from all over the world, parliamentarians, everyone’s invited, including the U.S. Congress, to come and talk about different issues that the OECD is working on, and obviously tax is one of those. But we stand ready to engage with everybody up on the Hill at any time.

We know that this is a process for all countries that involves the delegates who come to our meetings, but also ultimately parliamentarians and congress people have to be involved. We will do our best to make sure that our message gets out, what it is we’re doing, as we develop more of this, we will try to communicate that so that everyone knows what is going on.

MR. WEAVER: Okay, thanks, Grace.

Sandy, I’d like to get you to weigh in on this, you know, just kind of setting the stage regarding this negotiation that’s happening now. As we make progress on all of these issues, it certainly seems like, at the end of the day, with the rules changing the way they’ve been set out here, that there’s going to be some winners and losers from a country perspective.

I’d appreciate your perspective in terms of what’s the tradeoff here -- why would “loser countries,” so to speak, be willing to move forward? What does that tradeoff look like?

MS. SANDY RADMANESH: Well, I wouldn’t consider it as winners and losers. I really don’t like the term “losers.” I think what we all want and what all countries want is a win/win situation but that requires taking into account counterparties’ interests as well.

The problematic thing is that we’re dealing with 137 countries within the Inclusive Framework. You can imagine that they all come from different economic backgrounds. Many of the countries have a different perception of what value creation is within the digitalized economy, and that obviously drives the magnitude of changes they’re expecting.
We started off with three different proposals, and they were supported by different groups. And now, and I think that’s the big success at this stage, the IF came up with one proposal that merges those three initial proposals. The Inclusive Framework now continues to work on the unified approach as the basis for further negotiations.

We will see what further negotiations will take us to. I guess we are all aware that we have a lot of technical issues to resolve. I think the main driver of the negotiations will be the tax fairness question because there is the perception in many countries, and also the public that highly digitalized companies that are substantially operating in foreign markets without a physical presence don’t pay their fair share of taxes.

There are also concerns about an uncontrolled, unprincipled shift to a destination-based tax. So, this is something we need to address on a principled basis. That’s why we are trying to work out all the technical details in Pillar I, not to forget Pillar II which is the backbone of each project. I think at the moment, we’re in pretty good shape.

MR. WEAVER: Great. Thanks, Sandy. In fact, I’d like to maybe stay with you for the next question here. And that is, listening to Pascal on the video, it came across to me that there’s really two significant hurdles to making progress that he called out. One being the U.S. safe harbor idea and the other being tax certainty. Are those the big hurdles? And, if so, could you add some color to that?

MS. RADMANESH: Well, the safe harbor came as a surprise. A lot of countries in the Inclusive Framework didn’t like the idea of the safe harbor because it looks like a voluntary tax, so there is a bad taste to it as tax needs to be compulsory to create a level playing field.

So, this is something many countries would not agree upon. Basically, it’s a tradeoff. Some countries give up some taxing rights. There will be a modest reallocation of taxing rights to some countries in exchange for more tax certainty for others. I think the safe harbor approach doesn’t really help to advance the discussions especially as no one really knows what it actually means. It looks like optionality, electivity, or something voluntary, but we don’t really know what the technical details are. Moreover, I think the safe harbor doesn’t look like it would be a feature that would actually increase tax certainty.

MS. PEREZ-NAVARRO: Yeah, I think if I could chime in a little bit, on the previous panel, Beth said that she was very pleased to see that part of the statement referred to the fact that DSTs would be removed, but one of the big questions around the issue of safe harbor is, well, it’s a safe harbor from what. And so, it does seem that the DSTs would be expected to remain if it is a safe harbor, and so I think that throws up a whole other question. I think everybody’s read the letter from Secretary Mnuchin, and there was not a lot of detail there, so there will have to be work on this to see what was actually intended and what was meant, but, for now, it does throw a little bit of uncertainty in terms of what happens to the DSTs.

MR. WEAVER: Will, maybe turning to you. You’re really good at drawing insights out of something that appears to be incredibly complex. What do you think safe harbor means?

MS. PEREZ-NAVARRO: Get the crystal ball out.

MR. WILL MORRIS: Well, Steve Mnuchin was saying to me only the other day…

Let me answer that, but I want to take a step back for a second, and being at least originally British, I’m allowed to retreat into understatement to cover this up, but I think that there’s a little bit of dissonance around the description of the project at the moment. There are, to be sure, the statements in the Inclusive Framework, which talk about how much things have moved. Indeed, they have moved. But I think also we’re making a mistake if we don’t -- this is the understatement, okay? -- I think we’re making a mistake if we don’t acknowledge that this project is also at quite a tricky point right now. And part of that trickiness comes from the safe harbor, but not all of it, by any manner of means.
And as Grace said right at the beginning, this is a project which changes all of the international tax rules. At least 137 countries around the table -- more probably interested -- and that was never going to be easy. And the timetable, which the congressional panel very, very elegantly ducked, is a real issue as well. The idea of a full-consensus agreement by the end of this year is -- understatement again -- really ambitious. And therefore, I think that we need to think about this project.

I remain convinced that a bad deal is not better than no deal, but that a good deal is certainly better than no deal. And, therefore, if we sort of sleepwalk towards the edge of a precipice by thinking this is going well until all of a sudden it collapses, we are not going to do ourselves any favors.

We need to acknowledge the progress which has already been made, but at the same time, we also need to be realistic about what some of the difficulties are and to help get over some elements of a timetable and some elements of what people think about it.

Okay, now I’ll answer your question on safe harbors, but as a leadup to that, I think we have to acknowledge that a number of countries look at this project and feel their self-interest to be so challenged by it that they are proposing modifications which could blow the project apart. It’s not just the U.S, okay, just to be clear about that. A bunch of countries bring a bunch of interests. Are those insoluble? No, they’re not. But it will require compromises amongst countries.

Okay, so on the safe harbor, I didn’t have that conversation [with the Treasury Secretary], sorry, so I can’t tell you exactly what was going on. There are obviously a number of ways of thinking about it. The first is that bear in mind, it moved from optionality to elective safe harbor. If you take that at its face value in relation to Pillar I, it means you either elect into a whole of Pillar I or you don’t. If you don’t, then you continue to be subject to the current rules. You don’t get dispute resolution, to be sure, as Grace was saying before but you don’t elect into effectively Amount A. There’s a question as to whether whether B and C would be covered by that safe harbor as well. From the face of the letter, it looks like that.

On the other hand, if you’re trying to refine the idea of a safe harbor to meet U.S. interest and meet the concerns that the Secretary clearly has (or has had expressed to him), then you can break it down. You can say, well, maybe the safe harbor relates to part of Pillar I, not just to the whole of Pillar I. So maybe as a number of people have said, and was suggested in the comments, maybe it just applies to Amount B. There are concerns about Amount B and whether it’s a really, really minimal amount and just relates to the most stripped-down of LRD activities, or is it something larger than that. If it’s something larger than that, I’m going to get into the arguments about what’s in B, and the interaction of B and C. So, as you can envisage a situation where you go, oh, forget it, let’s just treat both B and C under the arm’s length principle. You can see that.

There are other ways of doing it as well. You can see that if this were -- and to my point before about the timetable -- if this becomes a much more elongated process, you could take an incremental approach to it. So, at least for most people, the vast majority of people, it would be an elective system. There would be some people who would be covered by it.

You could also spin that around and for those people who are in it in the first place, they could actually elect out of, let us say, the income tax system and the DST system and into this. And now you could phrase that in ways which would make it look more or less compulsory, but you could say it was that. It can be a safe harbor as to relevance. There are safe harbors obviously which are not elective. You just fall into certain safe harbors, which are there for purposes of simplicity. So, there is nothing in this which necessarily ties it to be full electivity for Amounts A, B, and C. But if that’s the narrative which hardens over the next couple of months, then that’s going to be a real problem.

MR. WEAVER: Great insights.

Amy, let’s get your perspective on this. Is safe harbor something that you envision is really workable at the end of the day?
MS. AMY ROBERTI: I always find myself on these panels being the most optimistic person on the panel, so I think if I’m not, everyone should go to their bunkers or something because there’s a real problem. I don’t disagree with what Will just said about the challenges and that there is a great deal of misunderstanding surrounding this project. The concept of a safe harbor is not common in every jurisdiction as it is in the U.S., so U.S. practitioners and policy makers might feel more comfortable with it because it’s familiar to us, which is understandable.

For P&G we’ve been constructively engaged in this project because we think it is clear that the choice is not between a DST that doesn’t hit us or we’ll have the OECD project. We have always viewed this as either DSTs with an expansion of DSTs beyond just the platform companies that they currently hit to consumer products and beyond. There is no shortage of ways to levy a gross receipts tax on any profitable company.

If we do have DSTs, it is the U.S. position that they come with tariffs. It’s not a binary choice. DSTs with tariffs or the OECD process goes forward and we find some kind of agreement. So, for many of us, these have always been the stakes. It would be a shame if this project were to fall apart over the concept of a safe harbor, and I hope it won’t because there are so many concepts that are now out there to address the taxation of the digital economy that we need to find agreement on.

It is important to note that these ideas are already out of the box. There are public papers that talk about consumer-facing companies and whether there should be a bigger return in a market jurisdiction. You can’t put those ideas back in the box. Even if we don’t get global consensus, there will be countries that want to take that idea and run with it. And so, I think that multinational companies have a strong interest in getting to a global consensus and therefore certainty.

I was very encouraged -- here’s where the optimism kicks in -- by the panel before us. I think you heard from the top people who are helping their bosses make policy in the U.S. Congress that they want the U.S. to stay at the table. And to me, that’s really encouraging. As they articulated, they have concerns. There are clearly concerns about revenue. In my view, whether this project loses revenue depends on how you look at it. It depends whether you think the status quo is maintainable or whether things could get much worse. If this project falls apart, I see some pretty bad things ahead that are very negative for U.S. companies.

MS. PEREZ-NAVARRO: I just wanted to comment since Amy brought up the issue of revenue. The previous panel talked about the impact assessment and the webcast we did yesterday, which produced some numbers. We do know the data underlying those figures is not the best data. We know it’s before BEPS implementation started. We know it is before you had the U.S. tax reform. That is the data that we currently have, and obviously we will continue to refine this.

Also, as the key parameters of the project are agreed or we come closer to agreement, we will be able to improve and refine the impact assessment. That is part of the reason why you didn’t see yesterday jurisdiction-by-jurisdiction data; we know that the current information that we have is not of the best quality. But at the same time, there’s a big demand for, what is the impact of this. Obviously, countries want to know; companies want to know; decision-makers want to know.

MR. WEAVER: Yeah, we all want to know that one, definitely.

MS. PEREZ-NAVARRO: Yeah.

MR. WEAVER: Let’s stick with Amy’s vibe of positivity here, right?

MS. ROBERTI: Good.

MR. WEAVER: The two big issues we’ve identified, which are safe harbor and tax certainty, let’s assume
that’s satisfactorily addressed at the end of the day. I’d like to turn to the panel and get your perspective on all the other difficult design features that also have to be addressed. Amy, I’ll just stay with you for the first one here, but I’d like each of you to just cover one of the key design issues that we keep thinking about and we keep hearing about -- whether it’s segmentation or whether it’s scope or whatever it might be.

These things ultimately could be really difficult to get done as well, right? Maybe they’re not in that category with the big hurdles, but they’re not going to be easy by any means. I’d love your perspective on maybe your favorite one that you’re watching at this point.

**MS. ROBERTI:** I’ll start with Amount A. Regional segmentation is an important issue. This was also reflected in the previous panel’s discussion about revenue implications. Whether this project is economically feasible or more importantly politically feasible depends on how big a shift you’re making. For company like P&G doing business in the U.S. for 183 years, segmentation could make a big difference. We’ve invested in our U.S. business. Almost all of our IP is here, and the idea that you would allocate a significant amount of U.S. profits outside the U.S. is politically infeasible. And so, I think the OECD has been very open to ideas about segmentation in their public papers. Also, there are other countries for whom this is really important. And so, segmentation is an important design element of Amount A.

I feel strongly that we need to get to a solution on Amount B. Amount B has the potential to bring the tax certainty that’s at the heart of this project. Most MAP cases and most disputes are around the remuneration for distributors, and so the fact that Amount B is so difficult to figure out what the answer should be is exactly the reason that we should try to figure out the answer to Amount B. The concept that maybe we could just get an agreement around Amount A and it would only impact a few companies is false.

If you can envision those companies that are in scope in Amount A and paying Amount A, but there is no agreement around Amount B would put huge pressure on Amount B, because every country is not going to get Amount A. A lot of countries might not like how much they’re getting out of Amount A, and they might think they want more. I think that would just push all of the pressure into Amount B in a way that is unsustainable and inadministrable.

So, we feel pretty strongly that we need to roll up our sleeves and put in the work to figure out how to do Amount B. It’s not going to be perfect. We might all have to live with a system that’s not facts and circumstances, and maybe it’s a formula, but we should at least make the effort to get there because you’re not going to get the tax certainty that’s the carrot in this project if you don’t solve Amount B.

**MR. WEAVER:** All right. That’s helpful. You’ve explained why a lot of us have been watching, with interest, the P&G proposal for Amount B. So, yeah, that’s very helpful.

Sandy, turning to you, what design feature is particularly important to Germany?

**MS. RADMANESH:** Well, I guess Amount A is in our focus in order to get tax certainty we need to reallocate some of the taxing rights, and I guess certainty is something which is crucial to our businesses. We know that we might be a revenue loser because we’re an exporting country. Germany might lose on Amount A; however, we also have Pillar II, which we’ll hopefully talk about later. We think that a combination of the two would give us enough revenue to also be able to reallocate some of the taxing rights under Amount A.

However, we are really concerned that this may be an amount that is not as modest as we think it would be. We think it’s a good way to still talk about the technical features. Amy was talking about segmentation, so there are a lot of things that are still kind of up in the air, but I think countries are working on it, and since everybody knows what is at stake, it’s not helping to kick the can down the road. So, we need to act now, and it’s really important to be flexible and to show a spirit of compromise.
Amount A under Pillar I is something that is conceptually different to Amount B, but both Amounts come as a package. You have Amount A where some countries get a little bit more of the taxing rights, and you have Amount B, which gives you more certainty on baseline functions.

However, I would like to point out that Pillar II is more important for Germany. Germany wouldn’t sign on to Pillar I, if there is no agreement on Pillar II.

**MR. WEAVER:** Great.

Grace, from your perspective, what design features are particularly problematic?

**MS. PEREZ-NAVARRO:** Well, there are many, and we’re going to address them all. No, there are many difficult issues in this, but I guess I would rather focus on what is really critical. I would say getting the tax certainty right is really very important and very challenging because different countries have different experiences with different types of tax certainty components.

If you think about it, most developed countries have a lot of experience with things like APAs and dispute prevention-type mechanisms, developing countries have less experience. They also have no experience with arbitration except as I mentioned yesterday, maybe some bad experiences in the trade area. And so, they take that experience and say, ugh, we don’t want to go into any kind of binding arbitration in the tax area.

So, trying to find solutions that are workable, administrable, and acceptable to all countries is going to be the challenge. And I think every country is like the U.S. We heard on the previous panel that Congress is listening to what business has to say, and we know, because we hear it from business, too, that tax certainty is critical. And, as Amy just said, it’s a key part of the package.

Amount B for developing countries is also a key part of that tax certainty package and simplification. One of the reasons that developing countries put forward as part of the original Pillar I proposals the significant economic presence test is because they saw the marketing intangibles proposal that the U.S. had made as being far too complicated for them to be able to implement. The U.K. proposal was too narrow so they said, okay, let’s put something out there as a counterpoint to all this that would bring greater simplification and certainty.

And so, that’s the reason why we put this amount B in there, is because one of the challenges they all face is precisely what Amy said, these limited-risk distributors are the ones that end up in MAP all the time. Developing countries don’t have the resources to spend all this time on what are essentially not such difficult cases. We should be able to come up with an approach which is -- and I want to emphasize our idea -- is that Amount B would be consistent with the arm’s length principle, as would Amount C. The only part of Pillar I that deviates from the arm’s length principle is Amount A.

**MR. WEAVER:** Yeah, thank you, Grace.

Will, love to get your perspective on design features.

**MR. MORRIS:** Did I mention this was a tricky project?

**MS. ROBERTI:** Yes.

**MR. MORRIS:** Yes, I did. A couple of points, and obviously if you go fourth and last, you’re going to cover what somebody else has covered a little bit already. I think at a conceptual level, there has been agreement for a while on where this project could land and what most people would be able to live with. It’s expressed in general terms, so a modest reallocation under Amount A, a limited -- not everybody agrees with this -- but, you know, a very limited amount under B for LRDs, and then really good dispute
resolution, particularly underpinning Amount C, but covering the rest of them.

The trouble is the moment you get beyond that and start talking about details, and I know people don’t like the “winners and losers” language, but it is actually illustrative of what’s happening here. Some people gain and some people lose, and that’s both countries and businesses. And that makes it much trickier.

With Amount B, there could be, should be ways of doing it which would link back to the arm’s length standard. There are ways you can envisage, for example, using various global benchmarks, but there are also ways that the calculation could be done, which if there are interactions between A and B, come up with some slightly odd results at different points on the progression. So, again, all of this becomes much more complicated when we start to drill down in the details.

Likewise, with Amount A, in the end, I think most people would say if it’s modest, that’s fine… but what’s modest? So, you know, for quite a long time now, there’s been some discussion of 10 and 10, or 10 over 10 (i.e. 10 percent of the amount over a 10 percent Op Margin would be reallocated to the destination countries based on some factors, or allocation keys.

When they were talking about the impact assessment yesterday, one of the pieces of modeling that was done was on 20 over 10. Now, 20 over 10 is, to state the blindingly obvious, double 10 over 10. I’m not very good at math, but even I got that one. And, again, for some people, that’s going to be a significant bite of profit. And it goes to the question, which is not really answered which is what are we trying to do here? While we have an articulation of the very highest level of the profit reallocation idea, there is not a strong theoretical construct under that which tells you what you’re doing and why you’re doing it.

When it comes to the reallocation, is this key. Because without that all we’re trying to do is come up with a number that currently everybody can live with, which is almost, by definition, an unstable number, because what I want today isn’t going to be what I want tomorrow, isn’t going to be what you want tomorrow.

So, what is the underpinning here? Because it then becomes crucial in these design details, you know, is 10 over 10 around/about right? Or actually is 20 over 10 what we need? And then you’ve got to do all the stuff which goes to the tax certainty point that Grace was talking about, except another aspect of it, which is, okay, if it is 10 over 10, but we know that half the world really wants 20 over 10, then how do we ensure that it stays at 10 over 10? What are the mechanisms that you lose to lock that down?

So, again, I go back to what I said the last time I mentioned this, which is this is not impossible, but it is hard, and I think we need to be realistic about that and eventually we need to take the time to make that work -- but wishing it to be so won’t necessarily make it so.

MR. WEAVER: Right. Thank you. Actually, I’ve noticed you’ve all mentioned Amount A, Amount B, and tax certainty. Maybe taking each of those a little bit further, starting with Amount B, one of the things that came out in the January Statement -- and this will be a question for you, Grace -- is that it defined Amount B as the income that’s attributable to routine marketing and distribution functions. Thus, excluding no profit attributable to intangibles and risk.

That sounded a lot like LRD-type returns and it didn’t seem to me that countries would be satisfied with LRD returns for Amount B. If that’s the case, aren’t we back in the soup of arguing about what the return should be for in-market activities? I’m just curious on your perspective as to at least why that appeared to me to be an LRD-type return.

MS. PEREZ-NAVARRO: Yeah, I think that’s what’s imagined. This is a simplification-type measure to provide certainty for businesses but also for tax administrations. And so, we are going to have to work out the details. This is tricky.
I think Will is right to point out -- although maybe he’s a little too pessimistic -- but he is right to point out that there are a lot of difficult issues we need to address, and there are a lot of competing interests here that will have to be resolved. And that is really the big challenge.

MR. WEAVER: Great. Thank you for that perspective.

Let’s move to one of our polling questions, and then we’ll pick up on some of the issues that you’ve raised here. So, here’s our question: What do you believe will come of the U.S.-proposed safe harbor approach? We spent a fair amount of time talking about that. Well, give you a few moments to access your app and to log in with your answers.

Polling Question #1: What do you believe will come of the US’ proposed “safe harbor” approach?

- a. It will kill Pillar I and result in the proliferation of unilateral measures
- b. It can be crafted in a way that both digital and consumer facing companies will want to “opt in”
- c. It will ultimately become mandatory for digital companies, but an available safe harbor for consumer facing companies
- d. The US will ultimately drop this approach

MR. WEAVER: Well, once again, no clear winner. Well, that’s exactly what you were talking about, Will, that maybe there’s a certain group of companies where it’s de facto mandatory, so somewhat interesting.

Okay. Let’s move on. I’d like to take up the next point here -- the tax certainty issue that you all raised. One of the things that I found interesting in the January Statement was what appeared to be a fairly novel concept of “representative panels” that would provide certainty on an up-front basis.

Grace, starting with you, Pascal mentioned that, but if you could drill down a little bit further, what would that look like? Who’s on the panels, what would they do, et cetera?

MS. PEREZ-NAVARRO: Well, the short answer is we’re working on it. It’s a new and novel idea. Maybe a little bit longer answer is that the reason that we are proposing this type of approach is that Amount A is computed on the basis of looking at the whole group’s profits rather than a specific entity’s transactions. It’s a whole different type of calculation for determining the profits allocated across counties; it’s formulaic and non-arm’s-length. Traditional approaches will not work. If each country is auditing this separately, then you may end up with a lot of different determinations about Amount A, and what we want with Amount A is certainty. That’s why we have proposed this formulaic approach.
The idea would be to have a panel made up of different representatives from the Inclusive Framework but representative. So, whether it’s geographical representation, size of economy representation, we haven’t really developed this fully yet. It’s a new idea, but we hope the panel would help avoid disputes. --

**MR. WEAVER:** Would taxpayers have representation on that panel?

**MS. PEREZ-NAVARRO:** No, that’s not currently the idea because it would be bringing together this representative group to try and look at and agree on all of the elements of Amount A. Who is in Amount A, et cetera? But this idea is in very early stages. We are really just within the Secretariat starting to develop this.

I can’t really say that much more about it, except that the basic idea is really to ensure up front that taxpayers have certainty and that tax administrations all agree so that the allocation can be made across the board, because you’re talking about multiple jurisdictions being involved, and so traditional methods of eliminating double taxation won’t work because those are bilateral.

**MR. WEAVER:** Yeah, that makes sense.

Sandy, anything to add from Germany’s perspective?

**MS. RADMANESH:** Maybe just one thing which may be tough for countries that may not have the resources of doing the actual work and the audits to assess whether Amount A is rightly allocated and whether it has been determined in a correct way. I think it will help, and that’s where one of the focuses should be, to figure out a way that countries which may have been underrepresented in the past, get some support to have better tools to assess whatever the outcome may be under Amount A.

**MR. WEAVER:** Okay. Thank you.

Let’s get the business perspective on the tax certainty issue and these representative panels. Will, let me start with you.

**MR. MORRIS:** Sure. Let me switch out of my pessimistic mode for a second. I want to acknowledge what amazing work the OECD has done over the past 5, 10 years, particularly in relation to the Forum on Tax Administration around dispute resolution, and some of the thinking has been really incredibly inventive. If you look at ICAP, if you look at joint audits, if you look at the dispute prevention side of it, you know, in addition to the dispute resolution stuff, which came out of BEPS, not everybody thought that it went quite as far as it could have done, but if you look at the effects of the peer review process, for example, all of these things are actually really important.

They are, of course, resource-intensive.

That issue has been raised, and rolling some of these out across a huge spectrum of taxpayers, in this project would be very difficult. But, again, if you go back to what I said before about thinking about how you do this incrementally, how do you pull in a few people to start off with and test it out, then I think some of the things that they’re talking about, including these panels, could work really well.

The other thing that I want to say is that they talk about the one-stop-shop process. What’s one-stop shop? It’s the European idea, which really exists only in actuality in the VAT area but has also been talked about in relation to the otherwise dreaded CCCTB. And essentially it is you only deal with one tax authority, your home tax authority. That tax authority deals with all the other tax authorities.

Do tax authorities like giving up audit power or various other things? No, they don’t. So, again, it’s not straightforward, but in this area, there are lots of interesting ideas which could be built on, so long, again, as the rest of the project approaches this realistically and does it in a way which doesn’t essentially crash
the system when you’re trying to boot up in the first place. Then the efforts being done on tax certainty I think could be a really important part of helping to make that work.

**MR. WEAVER:** Thanks, Will.

Amy, let’s get your cut on tax certainty.

**MS. ROBERTI:** I agree with Will. I can’t think of another way to do Amount A other than to have some kind of pre-agreement. In the video Pascal mentioned global ICAP. I don’t know what they’re going to call it, but P&G was in the first pilot of ICAP when it was just seven countries, and we were the U.S. company involved. It works exactly as Will described for the European model on VAT, where all of your communications go through your parent country and then the parent country handles.

You have an opportunity to explain your facts to the countries, and they have an open conversation about what is risk. While the process and those conversations are time-consuming and resource-intensive, and they certainly don’t all walk away agreeing on exactly what risk is by any means, but it does move the conversation forward, and you can start to get some kind of understanding. I think that if Amount A were limited, as Pascal described, to a small number of companies and those companies would tend to be more sophisticated companies, bigger multinationals it could work. In ICAP, we found that it was very resource intensive but probably moreso for tax administrations than it was for taxpayers because we could largely use country-by-country reports and documents that we had already created.

I think it depends on what kind of documentation you require, but if you found a way to make it a simplified process that could be binding for a period of time, so maybe not go through this process every year, but perhaps more like APAs where you get five years of certainty going forward as long as the facts don’t change. I think it’s the only way that I could see this working. Otherwise, you’re just adding to uncertainty and audits and MAP.

**MS. PEREZ-NAVARRO:** Yeah, I think the biggest challenge is just going to be the question of trust, because clearly you cannot have 137 countries in the panel. Other countries will have to put trust in other countries that are on the panel that they are doing this in the right way, fair way that they can accept. This is essentially relinquishing some authority to the panel, and so that is going to be a great challenge.

I think we can do it, because we do have the ICAP model, and some countries have some experience with that, we can build on that, but just getting the trust of countries to have somebody else make these determinations is going to be a big challenge. We’ll have to figure out how we put in mechanisms to provide that level of trust.

**MR. WEAVER:** Yeah, well, although this is certainly a challenge, it sounds like a complete thumbs-up from the panel here that it’s heading the right direction.

**MS. ROBERTI:** It depends on how big Amount A is, also, I think.

**MR. WEAVER:** Let’s spend the balance of our time on Pillar II. Sandy, you mentioned this is important to Germany. I’d be interested in your perspective. What are the difficult issues of pulling Pillar II together and finding consensus there?

**MS. RADMANESH:** I guess there are a couple issues that are still in limbo -- mostly technical issues, which is very fortunate. There’s obviously the issue of whether we would have a global blending versus country-by-country or jurisdiction-by-jurisdiction blending. Obviously, that plays into the question of whether we grandfather the GILTI or not. I guess there is a possibility that we grandfather the GILTI because it fulfills similar objectives as the global minimum tax.

We also need to talk about tax rates in this context because if you have global blending, Germany feels that this would go against the objective of the global minimum tax which may justify a higher minimum tax.
Moreover, for European countries like Germany, there could be a state aid issue because if you do global blending one company may benefit from it and will not be subject to a minimum tax while another one will be. So, we may have to look into that as well.

In addition, carveouts are a major issue. We’d like to see more formulaic, mechanical carveouts. We could imagine that the carveout, for example, like the QBAI in the GILTI rules, would be something that could work in the system. We would like to refrain from having any substance or facts and circumstances carveout because those tests are most of the time controversial. We would like to eliminate as much controversy as possible.

A lot of countries are asking for a carveout for FHTP compliant systems. Germany doesn’t support this because in our view it contravenes and defeats the purpose of the global minimum tax. We’d like to limit the carveout to a mechanical formulaic approach which doesn’t require further assessment.

Priority rules are a big issue as well. Countries always ask, what comes first, what’s the primary and what’s the secondary rule. We are in favor of the inclusion rule to come first, because global minimum taxation is trying to prevent profit shifting, and we think that the inclusion rule accommodates this objective best.

Also, thresholds may be something we need to talk about again, but I think the issues I just mentioned are the main technical issues that we still need to do further work on.

MR. WEAVER: Yeah, Sandy, you and I were joking right before we came up here that looking at the impact assessment, it seems as you “follow the money”, it validates Germany’s position as to why it was always interested in Pillar II. That was the big number.

MS. RADMANESH: Well, I think it makes sense because as I said before, we are an exporting country, so we would likely lose under Pillar I. Pillar II will most likely make up for potential losses. We consider Pillar II the backbone of the OECD-project.

MR. WEAVER: Yeah.

MR. WEAVER: Grace, let’s get your perspective on Pillar II.

MS. PEREZ-NAVARRO: I really don’t have that much to add to what Sandy said. Obviously, the blending issue is a big one. I think most countries in the Inclusive Framework would not want global blending for the reason she mentioned. There is a big debate on carveouts. We have a lot of jurisdictions within the Inclusive Framework that have been through the Forum on Harmful Tax Practices reviews, and so they think there should be a carveout for that. There’s a lot still to be debated here and resolve.

MR. WEAVER: Okay. On that issue of global blending, let’s give that a different name and turn to you, Amy, about GILTI grandfathering. That’s important to a lot of U.S. companies, certainly the U.S. government. What’s your perspective on that issue?

MS. ROBERTI: I don’t think of it as grandfathering because to me grandfathering sounds like something that goes away or could potentially go away at some point. I think GILTI should just be compliant with whatever system Pillar II comes out with.

My bigger concern going back to what happens if the OECD project doesn’t come together, is that potentially the EU could take up this concept, and then I worry that GILTI would not be grandfathered or compliant, though. I would hope it would be. To me that’s the bigger concern and a driving force for U.S. companies who already have GILTI. The concern is that if we don’t get agreement either fast enough or at all at the OECD that then you would have some kind of EU-wide global minimum tax where GILTI
might not qualify.

**MR. WEAVER:** Okay. So, Will, at the end of the day, will GILTI actually be compliant, and what will be the tradeoffs to get there?

**MR. MORRIS:** Yes, a tricky project.

**MR. WEAVER:** I heard that somewhere before.

**MR. MORRIS:** Yes, you have! I think my sense of this, and this is more of a political answer than a technical answer, is that unlike some of the disagreements about Pillar I, there is a general agreement, at least amongst the other large countries that if the U.S. is to be part of this process, then GILTI needs to be, I agree, not grandfathered but a compliant regime.

I've heard people say that relatively consistently. You need to dig down to figure out exactly what that means, and it's fine if GILTI as a minimum tax meets the minimum tax requirements. Okay, great. But one of the concerns about this project is what happens on the under-tax payment side, and Sandy's talked about the priority. But, there is going to be a temptation.

We were discussing if you sort of press on Amount B, then there's more pressure on Amount C. Likewise, if you take GILTI and U.S.-- you know, the U.S. out of that stream, there's going to be a temptation to press harder on the under-tax payments rule and define circumstances under which that apply. And, as the case has been made in relation to global versus jurisdictional blending, that even if somebody meets an overall rate of 13 and a bit percent, folks may not get the joke if in the case of them, they're getting a deduction of the 25 percent tax rate and it's going into a 0 percent tax rate where it gets blended.

So, there are those issues, so we need to watch the under-tax payment rule and to ensure that if the GILTI carveout is absolutely bulletproof, then it needs to be very clear about how that works in relation to all sorts of payments to any jurisdiction where there's this Sub of a U.S. corporation. More of those details need to be worked out.

There are also a couple of other issues. As you know, there's an FHTP challenge against FDII or “fiddy,” which has been sitting out there for a while now and has been parked while this process goes on. There are questions around that.

There’s the issue that Amy raised, which I think is a very live one, and Sandy again alluded to it slightly with the state aid issue, which is if this doesn't come off, and indeed even if it does come off, there are going to be EU law issues. Those will play a significant role in this, not just in relation to global blending, which may give some people an advantage, but there are other EU law issues going back to Cadbury-Schweppes and whether you could make that work inside of the EU.

So, again, there's more to this than meets the eye, unfortunately. Even when it comes to GILTI, which I think other countries are actually prepared to accept, nailing down the details is going to be very important because if you cast your mind back to BEPS, to what happened with the anti-hybrid rules and now look at the way that that's playing out in terms of what some countries say about GILTI as not being a compliant regime for turning off their anti-hybrid rules, you can see this gets, again, quite squirrely quite quickly.

**MR. WEAVER:** Thanks, Will, particularly for the insights.

We're getting close to the end of our time. Let's move to our last polling question, and we want to make sure that everyone has an opportunity to address it, get it in your app. Here's our question. By the end of 2020, I expect the OECD project to accomplish the following. So please go ahead and pick your favorite answer. We'll see if we get our music back, and then we'll wrap up here.
Polling Question #2: By the end of 2020, I expect the OECD project to accomplish the following:

- A consensus on digital taxes, allowing countries to stand-down from unilateral measures
- A partial consensus, allowing most, but not all, countries to stand-down from unilateral measures
- No consensus, leading to a proliferation of unilateral measures
- No clear resolution, but enough progress to delay implementation of unilateral measures

While you’re answering the question, I’ll give the panel here some notice. We’ll give you all 30 seconds to give your wrap-up perspective, and if you’re brave enough to call how it’s going to end, feel free. If you want to give some other comment, go ahead and do that, and last we’ll turn to you, Grace, since you’re kind of sitting on top of all of this anyway. I’m not blaming you, so...

All right, well, over half of our respondents have registered their view, right, no clear resolution. Interesting.

Let me just move across the panel, then. Thirty seconds, Will, closing comments.

**MR. MORRIS:** Tricky, worth working on, needs longer.

**MR. WEAVER:** Perfect. You beat the clock.

So, Amy.

**MS. ROBERTI:** I’d just reiterate that I think it’s really important that the U.S. stay engaged, stay at the table. The ideas are out there. We need to find workable solutions to these issues. They’re not going away, so let’s keep working on it.

**MR. WEAVER:** Perfect.

Sandy.

**MS. RADMANESH:** Yeah, I agree. I think the most important issue is that we stay engaged. I think we will come up with key features by the end of the year, solutions that will help everybody to get a good deal. I really trust countries are willing to further engage in order to avoid unilateral measures which may
lead to on-going trade conflicts.

**MR. WEAVER:** Great, thank you.

And, Grace.

**MS. PEREZ-NAVARRO:** Yeah, I am in agreement with Sandy. I do think we will make progress on this and be able to come up with some key features of the solution so that we can stave off a trade war and a tax war. I do want to say that it’s very important for business to stay engaged. We’ve had probably the most constructive engagement in any OECD project from what I’ve seen in my 22 years at the OECD. These are hard issues we’re trying to resolve, and we really welcome any ideas that you have to make this easier and workable.

**MR. WEAVER:** Great. Thank you, Grace, and thank you to the panel. If you would, join me with a round of applause for our panel members. Thank you.
Mini-Session: Weighing Unilateral Options Available to the U.S.

Description:
As the OECD seeks a global solution on digital taxation, single jurisdictions are pursuing unilateral actions, creating great complexity for multinational businesses. This mini-session debated the possible responses available to U.S. policymakers. Is doubling the tax rate on other countries under section 891 a real option? Are there other tax measures available? Or is trade the most likely retaliatory tool?

Speaker:
• Itai Grinberg, Professor of Law, Georgetown Law

MR. ITAI GRINBERG: Hi, everybody. We’ve heard this morning various interesting remarks about what could be agreed this year in order to get us to a deal at the OECD on international tax matters. My job, though, is to talk about the dark side. In other words, I’m asked to take you back to Pascal’s video with Manal. Remember Pascal suggested that either there will be success at the OECD in 2020 or DSTs will be on, there will be other unilateral measures, and then a trade war?

Everyone else thereafter talked about how to get to success. I was asked to talk about what if there is failure, how will we fight that ensuing fight. I’ve agreed to talk about this. It’s incumbent on me, before I start the bulk of my remarks, to be very clear. I’m against that trade war. On balance, I prefer some sort of agreement within the international tax community to a mercantilist conflict that potentially pulls in trade remedies.

That’s not because I love this OECD result. Actually, I think Pillar I plus Pillar II is a nutty, Rube Goldberg construct. I’m not for this because it’s good. Quite to the contrary. I’m supportive because I think the alternative is worse. I’m supportive but grim.

To prove to you all that I’m against the trade war, I have in the back 250 copies of an article I published in Foreign Affairs a month ago that the editors titled “The Looming Tax War.” In that article, I am positive about the OECD’s attempt and efforts, and I talk about the perils of failure.

That said, I’m nevertheless quite concerned about the prospects for OECD success, so the endpoint for my article is the starting point for this talk: What happens if the OECD fails? The first question is when does failure start. Because of the so-called “Deal at Davos,” if the OECD fails, failure is most likely to begin playing out just shortly after the next U.S. presidential election, instead of in July as was previously the case. Of course, that’s part of why the French did the deal. They like the idea of buying an option on the U.S. election.

Now, what did the U.S. get in return? All of delayed collection of 2020 DST. I’m not sure that was a ‘greatest negotiator’ moment. Nevertheless, if Donald Trump remains president and the OECD project fails, the French option expires valueless. At the same time, at that point, if the OECD has not succeeded yet, meaning staved off DSTs and unilateral measures, the old international tax order will continue to decay, only faster.

Many countries will bring DSTs into force. The scope of those DSTs will grow, almost certainly to cover cloud computing and digital streaming. How much farther will gross basis taxes spread? No one really knows. What we can predict is that governments will likely continue seeking to tax foreign corporations headquartered outside their jurisdictions under new and novel rules, and the conflicting rules of different
governments will likely lead to increasing, perhaps frequent, cases of growing double taxation. So, DSTs won’t be the only consequence of failure.

In Europe, the European Commission is out there prepared for, and perhaps even preferring, OECD failure, and will start to act in 2021. Why? Because unilateral action against U.S.-based tech companies at the EU level would be politically popular and populist and provide the Commission and pro-EU politicians a populist vote boost. In the European political environment where Euro-skeptic parties are making huge strides forward, that’s just a big political win.

In December, the European Parliament passed a resolution by 479 to 141 endorsing the commitment made by Ursula van der Leyen, the new German president of the European Commission, to set aside multilateralism and move on a pan-EU approach to taxing the digital economy if a global agreement is not reached in 2020. The Commission’s plan is to go back to the proposed EU-wide DST. Notably, while Germany was the main government that blocked an EU-wide DST a couple years ago, German government officials have recently been stating on the record that while they badly want a deal at the OECD, they will support the DST in 2021 at the EU level if there is no agreement at the OECD.

Now, as most people in the room know, also in December of last year, Robert Lighthizer’s Office of the USTR concluded its investigation of the French DST. The USTR found that the French DST discriminates against U.S. companies and is inconsistent with prevailing principles of international tax policy. Their conclusion laid the groundwork for USTR and the President to use Section 301 authority to impose retaliatory tariffs on any French good at any time.

Most people think this is how the U.S. would fight in a DST-related trade war. In the Trump Presidency, that might be right. But I see this as just one of three possible unilateral executive actions. Moreover, I fear that if the only retaliatory actions from international tax problems that anyone considers are in the trade area, then tax policymakers and the tax community will find themselves losing sway over what is in the end a tax issue.

Another potential retaliatory option against the DST involves Internal Revenue Code Section 891. As folks know, the U.S. tax code empowers the President to double the corporate tax rate on corporations of a foreign country if the President proclaims that such foreign country is imposing discriminatory taxes on corporations of the United States. Of historical note, that provision actually came into law to threaten retaliation against the French on another French tax, one they eventually backed down about.

Section 891 is old, and strange. Notably, it does not put its grant of authority in the hands of the Treasury. Rather, it places the authority in the President personally. All he has to do is proclaim that France is imposing a discriminatory tax on corporations of the United States. It takes so few words it fits in one tweet.

Section 891 used against a specific country is crazy. Most notably, as written, the provision doubles the tax rates on individuals who are citizens of the relevant country but resident here in the same act that doubles the taxes on corporations of that country. One has to think that’s overkill.

Section 896 is another retaliatory provision in the code that theoretically allows for more targeted retaliation, but using it may raise some notable technical challenges.

However, for Section 891 legal purposes, the European Union as a whole is likely a country. If we end up with an EU-wide DST, one could imagine section 891 being used against the European Union. This sounds way worse, right? But it is actually much milder. First, because while an 891 declaration against an EU member state affects individuals, an 891 declaration against the EU does not, because the U.S. does not recognize a concept of EU citizenship, nor does the EU actually as a legal matter, despite the fact that they talk about EU citizens.

Second, it turns out that corporations of the EU for 891 purposes need not mean every MNC headquartered in the EU. It likely only encompasses corporations that are incorporate under EU law, and
there aren’t very many of those. However, the short list include some big pan-European names. The first one alphabetically happens to be Airbus. Of course, there is an issue about the relationship between 891 and all the U.S. tax treaties concluded after 891 was enacted, but making that argument requires the affected companies to go to court.

In the meantime, these affected publicly traded MNCs face boatloads of uncertainty, and perhaps, more importantly, probably an immediate negative financial statement consequence.

If it were me, I would at the same time 891 was invoked against the EU ask for consultation under the MAP provisions of every US tax treaty with EU countries as to whether DSTs violated the nondiscrimination provision of the treaties. Many of those treaties say the nondiscrimination provision covers all taxes, not just income taxes. And as someone who is uniquely situated because I personally negotiate the relevant mandatory binding arbitration protocol with France, I get to say that at least the U.S./France treaty reads as to make it possible to invoke the MAP provision with respect to a tax that is not an income tax.

So I would ask to take to mandatory binding arbitration the question of whether the French DST violates the nondiscrimination provision of the tax treaty because I think a truly independent tribunal would conclude that the French DST is discriminatory.

Finally, note that the executives’ options get broader if the President wants to engage in cross-issue linkage and bargaining. If we head down that road, the map gets too broad to describe in 15 minutes, but the retaliatory possibilities and tit for tat also can get really pretty scary.

That leads to the other point I want to make. The options I’ve described thus far are the ones the executive can take on its own. But another, potentially much better way for this to go is for Congress to decide that it wants to respond and start working on legislation soon. If they do that, the precision or breadth of retaliation is limited only by the imagination of statutory drafters.

But one can certainly imagine a provision that, for example, both revises 891 to narrow its impact. Let’s start by taking individuals out of scope, while giving some role in triggering that provision to the Congress, the Treasury, or both. Starting that process would be both an additional source of leverage against DST-enacting countries and an implicit form of executive oversight.

Finally, remember, my analysis thus far about the tax and trade war we all should not want in 2021 assumed Donald Trump remains president. But that result is a coin toss. What will happen if a Democrat becomes president? Well, it might depend on which Democrat, but on that score, I know nothing, and at this moment neither does anyone else.

What the Democrat does may also depend on the situation that person inherits. The first thing is the French and the others will call their option. They will put everything on hold for a bit and wait to meet the new U.S. team. Imagine if DSTs are in effect and retaliatory measures are not in effect at the first meeting of a Democratic president’s team with their European counterparts, though, and some DSTs will be in effect.

One might expect a Democratic administration to say and to want to say, “Of course, we’re not threatening you with tariffs like Trump did; we’re different.” The cooperative multilateralists are back. But then DSTs will be validated as interim measures.

In contrast, if tariffs apply to countries that have already imposed DSTs, at the moment a Democratic president shows on the scene, when the French say that they need a more cooperative United States that understands and takes seriously the issues with the digital economy, the new administration might say “Sure, we agree, cooperation is back, you turn off your DSTs, we’ll turn off the tariffs, and we’ll all work together at the OECD in a spirit of goodwill and without the acrimony or the unilateralist transactionalism that pervaded the Trump Administration.”
From the perspective of U.S. national interest, which is the better default going into 2021? I tend to suspect it’s the latter one: tariffs on. But the key point is that this issue needs to be talked about; what happens if the Trump Administration loses and the French unilaterally are still imposing DST but, say, delay collection for a few months? Can Lighthizer set an autopilot to turn tariffs on starting the date the DST is scheduled to be collected? If he can, will he? Will he think about it? Should he think about it?

We spend most of our time in the digital tax discussion talking about what a potential settlement might be within the terms of the current debate. Indeed, the OECD wants the community to spend all of its time there: get fixated on the technical details, help them come up with vaguely plausible solutions. All well and good, seriously. But we also need to spend some fraction of that time on how to finesse the end game so that if this round ends in failure, the next round begins on terms that are most favorable to the United States.

That should also be gamed out by the community with folks thinking around corners and talking the chess game out, because I’ve talked about the first act of U.S. retaliation, but we should expect European countermoves and think them through. too. For example, European national-level politics must be taken into account as well in ways I have lots to say about, but that I just can’t get into in a 15-minute speech.

So, I end with a plea. Let’s work together for a productive and commercially acceptable solution at the OECD, but let’s also start spending some time thinking through Plan B. Thank you.

Description:
The GILTI was designed as the principal outbound anti-base erosion measure of the new U.S. international tax system. Does the provision hit the mark? This panel examined the design of the GILTI regime, its interaction with BEAT, the key issues it raised for U.S.-based multinationals, and practical considerations for corporations adapting to the new law. Symposium attendees heard analysis of complex questions, including: Has the GILTI regime succeeded in preventing outbound base erosion? How have policy decisions by U.S. authorities influenced its effectiveness? What alternatives have been proposed by domestic and international policymakers and what impact would they have on taxpayers in different industries?

Panelists:
- Danielle Rolfes, Partner, Co-lead International Tax, Washington National Tax, KPMG (moderator)
- Patrick Brown, US International Tax Policy Leader, PwC
- George Callas, Managing Director, Government Affairs & Public Policy, Steptoe & Johnson
- Anthony Gedeller, Global Tax & Currency Director, Mars, Incorporated

MS. DANIELLE ROLFES: Good morning! We’re going to do something a little bit different and actually start with a polling question. Our panel is here to talk about the case for GILTI and do a little bit of a deeper dive into a number of the policy design choices that were made in designing GILTI and talk about those tradeoffs, why didn’t we appreciate the tradeoffs when GILTI was enacted and how do we think about it now with the benefit of hindsight.

But one choice that I know has sometimes garnered an emotional reaction was the name. So, we thought we would just start off with a polling question. We’re going to wait to see the results to let you think hard about your reaction to this question.

In the meantime, I have the pleasure to welcome my panelists here to the panel. I’m Danielle Rolfes. I colead the Washington National Tax Group for International at KPMG, and I’m going to allow my panelists to introduce themselves, and maybe as part of that if you could offer a little bit of the perspective you bring to this panel, because we’re really lucky to have all of you with us.

MR. ANTHONY GEDELLER: Okay, let me go first. I’m Tony Gedeller. I’m Head of Tax at Mars, Incorporated. You probably know us in terms of our confectionary products, but we also have a lot in pet nutrition and also vet health, 140 factories around the world. We are very heavy in terms of our global presence. About two-thirds of our operations are outside of the United States. I think what I bring to the panel is the business pragmatism side of dealing with GILTI.

MS. ROLFES: In the GILTI discussion that we had yesterday, we had company representation, but they tended to have a more domestic footprint, it seemed, on that panel. You come at it from the truly global perspective.

MR. GEDELLER: Yes.
MR. GEORGE CALLAS: George Callas at Steptoe & Johnson. I’m both in the Government Affairs Practice and the Tax Practice there, as well as the Tax Policy Practice which bridges the two and leverages the two. However, I was on the Hill really from the creation to the enactment of tax reform and the TCJA. I was on Ways & Means for many years with Chairman Camp and Chairman Ryan and very briefly Chairman Brady, starting with Chairman Camp’s development of the first international tax reform draft in 2011 that had the first territorial system and options for base erosion rules, and the release of his 2014 tax reform plan. Then I was in the Speaker’s Office with then-Speaker Paul Ryan for the 2017 process that led to the TCJA. From the development of what was once called Option C, which became GILTI and FDII collectively, I was in the room seeing all the design choices and the decisions and tradeoffs that had to be made.

MR. PATRICK BROWN: Hi, everybody. Pat Brown. I just passed my one-year anniversary with PwC. Prior to that, I spent a number of years -- 17 years, I think -- with a large U.S. multinational, and I spent a lot of time in the runup to tax reform meeting with the guy immediately to my right talking about how tax reform would impact that company and other U.S. multinationals.

I think I bring a little bit of a perspective like Tony’s perspective to this. My former employer was very heavily globally engaged, is very heavily globally engaged still to this day. And, anyway, that’s my perspective on things.

MS. ROLFES: Thank you, Pat.

May we see the poll results on the name?

Polling Question #1: What do you think of the name?

Hate it. The haters win.

MS. ROLFES: Sorry, Jen. I don’t know if she’s still here.
Did you vote?

MR. CALLAS: It’s not a clear majority, though, and there can be a runoff.

MS. ROLFES: A plurality. Fair enough, a runoff is in order.

We thought we’d start off with kind of an everything-in-the-kitchen-sink list of the policy design choices that fed into the GILTI that we got.

### Significant GILTI Design Choices

- Worldwide current taxation that relies on FTC regime
- Use of qualified business asset investment (QBAI) to define territorial feature
- Country-by-country versus global averaging
- Decision to exclude branches
- Preferential rate (sometimes) for GILTI and FDII
- Treatment of loss companies
- Different treatment for stock sales vs. taxation of underlying earnings
- Treatment of previously taxed E&P — continued significance of basis and complexity of repatriation
- Retention of subpart F

The first three on this slide we intend to do a little bit of a deeper dive and talk more about, but I personally couldn’t let a panel about GILTI policy go by without mentioning at least a few of my own pet peeves, and I invite the panelists also to chime in if any your pet peeves are not on the slide. Some of these may be features, but I will say as the person pulling the slides together, I did tend to focus a little on the negative.

The first one, as I mentioned, we’re going to talk more about. What you have to look forward to is worldwide current taxation, GILTI, and obviously we’re going to also talk about QBAI, that there is an exemption feature, but by-and-large tax reform relies on the foreign tax credit in order to get you to that exemption feature, and we’ll talk about the consequences that flowed from that with hindsight being 20/20, what do we think about those today.

The next was we did say there’s a territorial feature, so we do have QBAI. We’ll maybe dump on QBAI a little bit for being narrow but talk about how significant is it really in this whole story. Is it a little bit of a red herring in the debate about incentives?

Country-by-country versus global averaging, I was a little disappointed that this morning they finally got to Pillar II on a panel. I thought we might be the first panel ever to actually talk about Pillar II, but they had nice coverage of Pillar II, but a chance for us to talk a little bit about the design choices, country-by-
country versus global averaging.

The rest of these, this is our only opportunity to talk about them, so I invite my panelists to chime in. A significant choice was to exclude branches from the GILTI regime, and I understand -- George, you might be able to speak a little bit to how that choice came to pass. I don't think that was there in the first draft of Camp, but we did ultimately exclude branches with other knock-on consequences if I think it was then felt that we needed the branch basket because there is this electivity in or out of GILTI due to the exclusion of branches from the GILTI regime. I assume that’s a significant part of why we have the branch basket, which I think a simplification to exclude branches from GILTI, branch basket, brings its own complexities.

George, if you have anything to add --

**MR. CALLAS**: No, I think that’s right. In Chairman Camp’s 2011 draft, staff thought we might be doing taxpayers a favor by giving branches an exemption through the mechanism of deeming them to be CFCs and then they would be eligible for what was then a 95 percent DRD that eventually became a 100 percent DRD. We were mildly surprised, but then we got it pretty quickly when people started freaking out about that, talking about creating transfer pricing issues, creating major 367 issues.

**MS. ROLFES**: We weren’t just going to exclude them. There was a transition element. If you’re going to exclude branches, you thought you needed some kind of transition regime. When you say 367 element, I think there was a trigger of taxation.

**MR. CALLAS**: Well, yes, correct. In effect, incorporating the branch creates transactions between the CFC and the U.S. parent that trigger these issues. Despite some of the rhetoric about how everything was rushed through, going back to as early as 2011, meetings with stakeholders, meetings with taxpayers, led Congress to conclude that somehow bringing branches into it -- and, you know, whenever you do something like that -- it’s not limited to this issue and Joint Tax is often incredibly helpful in identifying these issues -- you create avoidance opportunities, and then you have to create rules to deal with the avoidance opportunities.

And sometimes you say, well, people don’t seem to be demanding this. They don’t seem to care that much about it, and they’re more worried about the new rules and what some of the unintended consequences might be, so let’s just leave it alone. We got plenty to do, and you’re never going to have enough time in Congress, so let’s just put it aside and focus on other items. And so, we ended up dropping that and left the status quo largely intact, with the knock-on effects, I think, that you legitimately pointed out.

**MS. ROLFES**: As much as people complain about the branch basket, I don’t hear people saying that the solution to it is to take back on those challenges of trying -- have deemed incorporation of branches, so I sense that might be a stable feature. I don’t know if others have any different perceptions.

The next is another, I think, probably stable feature from my own perspective, is the choice to have a preferential rate for GILTI. I guess FDII, we leave that to the side. This is a GILTI panel, so we don’t need to make FDII predictions. But the choice to have a preferential rate for GILTI, I’ll start with it by saying that I was at the Treasury Department during the Obama Administration. We had our own proposal for something that was similar to GILTI.

It also had a preferential rate, with the justification being sort of a compromise between capital export neutrality and capital import neutrality. Maybe people can debate the rate, but I don’t think there’s a serious debate about having a preferential rate if you’re going to tax these wide swaths of foreign earnings.

**MR. GEDEPPER**: Yeah, I would say that you need to have that because you don’t want that to be your primary taxation system. GILTI is meant to be the trap that catches these other types of income. I think
having the preferential rate excludes a lot of taxation from that. Now, this being said, and I’ll probably also skip down to the second-to-the-last one, which is my personal pet peeve, is the complexity that we’re dealing with. I’m doing a lot of work to calculate GILTI, and at the end of the day, it does nothing to the tax liability.

Same thing with tracking basis and PTI. A tremendous amount of complexity built into our regulations with very little, let’s say, economic effect.

MR. BROWN: So, Danielle, just picking up on what Tony said, and I know you asked about pet peeves, I wouldn’t necessarily describe this as a pet peeve, but to me it’s a question of unmet expectations or unmet hopes.

With respect to GILTI, Tony talked about simplification. We obviously haven’t seen a great deal of that, but taking a step back from that and again going back to the preferential rate, the promise of GILTI at some level is the Goldilocks of international taxation, right? Prior to this, you had either complete deferral or you had full U.S. tax at the full rate, current U.S. tax at the full rate. The idea of having this not-too-hot, not-too-cold, split-it-right-down-the-middle really does offer a promise for trying to strike a new balance between base erosion concerns and legitimate competitive concerns that really animated a lot of U.S. multinationals as we were making the rounds on the Hill talking about tax reform.

Whether you think about it from a standpoint of some of what became design features of GILTI, so expense apportionment, things like that that we’ll talk about, or complexity, or some of the other issues as well, there is to me, at least, the sense of unmet expectations in terms of what could have been. I think that is a frustration, thinking of it as a peeve is maybe not right, but it’s a frustration.

MS. ROLFES: That feels like more than a peeve.

MR. BROWN: We could have done better potentially, and I think a lot of that may come down to defining what goes into these three categories, so that gets into the QBAI point, you know, is that really just a fig leaf rather than what it potentially could be? When I think about GILTI and where we are, I also think about maybe what could have been. And, again, I’ll call it a frustration.

MR. CALLAS: I think it’s a fair point, and what could have been also informs what might be in the future. I look at the TCJA, frankly, as not the end of tax reform but sort of the end of the beginning of tax reform. Implementation is the second stage. As implementation is starting to wind down now - and there are still some big things hanging out there but it’s starting to wind down, there’s going to be another stage of additional legislative modifications to the system we put in place.

I always analogize it to the first year of a model car, the new version of a car, right? When I was young, everybody said don’t buy the first year because there are bugs in it and wait until the second or third year of the new version of the car because there are going to be bugs in the first year. I think that’s where we are now. It doesn’t mean you don’t create new versions of cars. I mean, over the long term, you want advancement. I feel like that’s the stage we’re in where we had to get a new system in place. It’s easy to forget that we had a 35 percent rate.

MR. BROWN: Right.

MR. CALLAS: You know, and a worldwide system with deferral.

MR. BROWN: Right.

MR. CALLAS: And it was a mess, and we had an opportunity to get the new system in place. If we missed that opportunity, if the window closed, it might have been another generation before we had another chance. That new system is going to -- because it’s very new -- is going to have a bunch of bugs in it. Let’s identify those bugs, which is what we’re doing, and let’s set about going forward trying to
improve the car, you know?

**MS. ROLFES:** I appreciate the framing. I appreciate, Pat, that you’ve moved off the “split the baby” as a mother, the “split the baby” analogy for the way and went to Goldilocks. What I was hoping we would do with this conversation is talk about what are the features, these features that we think are stable and make sense, you know, branches. I feel like we left out one and said, yeah, fine, or would we want to tweak as we move on to Version 2.0?

Now, that gets to my what I will call kind of a pet peeve, is the treatment of loss companies, and could Congress possibly have appreciated that if a company had the misfortune of losing money in the United States in a year but it somehow was able to still make money offshore that that company would have to consume that domestic loss at a 21 percent rate? So that means your foreign earnings are being taxed at an effective rate of 21 percent, but because there’s no foreign tax credit carryforward in GILTI and you can’t claim a foreign tax credit if you don’t have positive taxable income, that company would have no relief from double taxation.

I call it a pet peeve because I’m not losing money as a company, but, gosh, sure don’t do that. How did that happen? Is there a defense? Or does Version 2.0 come out in the first recession on this? Was that in Camp? One feature of this is the fact that the deduction is taxable-income-limited.

**MR. CALLAS:** Right.

**MS. ROLFES:** So that’s one way we get there, and then relying on the foreign tax credit mechanism and not have carryforwards, which is a topic we’ll talk more about.

**MR. CALLAS:** Right, and I think the issue of a limitation on the deduction is that the model for that is old 199 that was repealed as part of the TCJA, that what you’re really trying to effectively do is impose a reduced rate, but you do it through the mechanism of a deduction, a percentage of income deduction rather than a separate rate structure like for capital gains, for example. Then you say, well, if it’s a reduced rate, then you don’t want it to go into NOLs, and have a rate cut increase your NOLs.

That’s why 199, I think, had that limitation, right? Now, in the international context, there are some interactions there that you generally wouldn’t have with 199. And I think again, yes, those are potentially problematic.

**MR. BROWN:** See, I think about -- and, George, love your thoughts on this, Tony’s as well -- I think about this as going back to the FTC point, because if you think about the logic of no carryover, no carryback in GILTI, to me, and this is what I thought when I first saw the legislative text, what became -- GILTI, I guess, saw the House tax first. To me, that made perfect sense if what you were really trying to do is just take an annual snapshot, look at a company’s foreign earnings and foreign taxes, blend it all together and say did you pay enough tax essentially. If not, you effectively get topped out. And the way you get there is treat GILTI as a separate foreign tax credit basket and provide no carryover and no carryback because I’m really just looking at that year.

I think what’s left out of that is what you call treatment of loss companies, and I call it interaction between the baskets, treating domestic income for this purpose as a basket, right? If I have an overall domestic loss, the code provides, yeah, you get that income back as far as source income in a later year, and that works great for every foreign tax credit basket except GILTI.

If we’d been able to further somehow complete this walling off of GILTI from the other baskets, including domestic, by maybe not doing it as a foreign tax credit basket, taking a different approach, we would solve that problem. And, instead, I think we’d put it in the foreign tax credit basket and put in features that were intended, I think, to wall off but we didn’t actually wall it off, and so now we have these other features coming in and affecting the overall GILTI computation, which I don’t think -- well, George can speak to it. I don’t know that all of that was fully anticipated by members of Congress.
MS. ROLFES: And nobody thinks they’re a loser.

MR. BROWN: I guess.

MR. GEDELLER: I don’t think that you’re going to plan into that. As George said, this is a step to make in the right direction. I think when you know you have those choices. It seemed very obvious to rely on the foreign tax credit regime for GILTI. I think it had the majority of the plumbing, not all of the plumbing, but the majority of the plumbing to do that. But you do have these unintended consequences, and we will work our way through those consequences.

MR. CALLAS: I think that’s well put. In all my years on Capitol Hill, we always had a bias towards piggybacking on an existing regime that taxpayers had experience with, where there’s decades of guidance surrounding the rules rather than trying to create some new mechanism that will have a multiplicity of unintended consequences and ambiguities because there’s no experience with it. If there are problems, if there are unintended consequences, which I think there are, that we’re all in agreement here that there are, then target those and try to fix those as they come out.

MS. ROLFES: There are two additional points on this slide that could warrant revisiting. Many other countries that have territorial systems provide a similar parallel treatment for stock sales, and our tax reform retained the traditional treatment of a stock sale by a company so the sale of the stock isn’t taxed the same way as the underlying earnings would be.

I know when I was at Treasury, the Obama proposals, the economists all told us that it was important from an economic efficiency standpoint, you should tax the sale of an asset in the same way that you tax the underlying earnings. I don’t know if there’s any perspective on that decision to not extend the territorial treatment to a sale of stock.

MR. CALLAS: Sure. So, again, at the risk of sounding like a broken record, going back to Chairman Camp’s 2011 draft, we actually had a provision in there, because we agreed with that argument, you know, on Ways & Means that kind of like with Section 1(h), a lower rate on long-term capital gains and a lower rate on dividends, that that’s economically the correct way to treat those items.

And so, we had an exception for gains on sales of CFC stock to go along with the DRD. That in turn created concerns about tax avoidance. For example, if you exempted gains but allowed losses you’d have tax arbitrage, so there was a capital loss disallowance rule that went along with it. There were some other anti-avoidance rules to prevent gaming put in there.

The feedback that Ways & Means received from taxpayers was that this is really complicated, and some people might have felt that the loss disallowance rule was problematic for them. Meanwhile, nobody seemed to really think the exemption was that important. After working through it a little bit, we said, you know what, to the extent you actually have E&P to support it, 1248 is going to recharacterize the gain as a deemed dividend anyway. The deemed dividend will be eligible for the DRD, and so as long as you have the E&P, you’re going to get that capital gains exemption treatment anyway.

I don’t remember us having any data on the amount of gains that would be supported by E&P versus the amount that wouldn’t.

MS. ROLFES: Well, I think Treasury has essentially blessed the idea you can self-help and trigger E&P. It’s an opportunity, I suppose for practitioners. It seems like unneeded complexity, but for many companies, there may be a way to plan into it.

MR. CALLAS: Yeah, so I think the view was 1248 is at least partially helpful, and there were concerns about a separate provision, so Congress moved forward in that manner.
MS. ROLFES: For me, that choice leads to what you described as maybe your pet peeve about then the complexity of repatriation because that means that basis is still extremely significant --

MR. CALLAS: Absolutely.

MS. ROLFES: -- if you have a distribution in excess of basis, you can trigger yourself into this capital gain that is being treated differently, so now I need to go create E&P. I think those two are hand in hand. I have to say I think there is a little bit of an unmet expectation in terms of the complexity around repatriation.

The last one is the fact that we’ve totally retained Subpart F. You might have thought in this reformed world we wouldn’t need all of the complexity of Subpart F. In full confession, when the Obama Administration was putting together its proposal, it came to the exact same conclusion of conscious choice, that Subpart F, in contrast to the preferential rate, was protection of acute base erosion against the U.S. You know, just pay dividends -- or, I’m sorry, pay royalties or the invoicing company that is stripping the U.S. that you needed to retain a system of full inclusion in order to protect the base. It does seem like there are some simplifications that could be done in Subpart F to get rid of its history rooted in, you know, maybe sometimes caring about foreign-to-foreign to make it really fit for purpose. But I guess maybe that was just a matter of time.

MR. BROWN: It’s hard to imagine, I think. And this goes back to the Goldilocks point. It’s hard to imagine a framework where you don’t have some version of Subpart F in some form. The possibilities for stripping the U.S. base are just -- you know, they present themselves too easily, and it cries out for rules to police it. And so, I think it’s not shocking to me. It would have been shocking to me if we didn’t have Subpart F. It would basically be tantamount to lowering the effective rate for any globally engaged company on all earnings to the GILTI rate, right? And that, I don’t think, was what was intended, so...

MR. CALLAS: Well, I think it’s certainly needed for passive income, right?

MR. BROWN: Absolutely.

MR. CALLAS: You don’t want to just throw true foreign personal holding company income into the GILTI regime at a reduced rate or people are just going to set up offshore corporations to invest. You need it for at least that. There was a lot of work done on trying to either get rid of or scale back sales and services income. It’s a simplification issue, because a lot of that’s foreign-to-foreign base erosion, not U.S. base erosion, but I think time and revenue constraints and priorities -- I mean, member of Congress priorities -- meant that we just couldn’t get there in the TCJA. I think it’s something that should be on the list of things to revisit in the future because I do think it would be good if we could at least scale them back.

MS. ROLFES: One suggestion I’ve heard to try to tailor the base company rules to not focus on foreign-to-foreign so much would be to treat all foreign countries as one for purposes of those rules. Then you wouldn’t trigger foreign-based company services income because the corporation incorporated in Germany has people performing services in the Netherlands, like who cares? That is not the concern Pat was expressing that Subpart F, you know, maybe is still needed for.

MR. BROWN: Yeah, I also think there are other features. We talked about the foreign-to-foreign stuff, but the focus on place of incorporation doesn’t necessarily always make sense anymore. This was, of course, apparent to the Treasury Department not long after it issued the check-the-box regulations and followed that up with Notice 9811 and all the ensuing aftermath. So, there are areas in there that I think are ripe for reexamination in George’s Tax Reform 2.0.

MS. MANAL CORWIN: So, Danielle, there’s a question that’s come in, and maybe it’s a segue, but wondering whether anyone on the panel would have preferred a country-by-country or CFC-by-CFC approach to GILTI.
MS. ROLFES: Any takers on that one?

MR. CALLAS: Well, that’s sort of an easy one in the sense that it once was called Option C -- and I know there’s a separate GILTI panel and a separate FDII panel, but I’m always uneasy about talking about them differently because they used to be called the carrot and the stick of Option C, and there’s WTO implications for talking about them together, to create neutrality in the location, and all that.

So, when we were working on Option C, I think it was called foreign base company intangible income, and it was a category of Subpart F income. And so, it was done on a CFC-by-CFC basis, not country-by-country, which is even more onerous than CFC-by-CFC, but it was on a CFC-by-CFC basis. Whoever was here yesterday morning for the economist panel, Roseanne Altshuler was too humble. She and the late Harry Grubert do deserve credit for the paper they did talking about the aggregate approach because, you know, after Chairman Camp’s 2014 proposal came out it was still foreign base company intangible income.

There was too much political opposition to that, and we started looking for ways to rebalance the priorities of protecting the fisc versus competitiveness and move the balance more towards competitiveness. We became aware of that work that they had done, and that led to the development of the aggregate approach because it was viewed as a more competitive framework than the CFC-by-CFC approach, which is more competitive than a country-by-country approach.

MR. BROWN: I think the only thing -- and I’d love Tony’s perspective on this -- from my time with a significant U.S. multinational, I think the way companies manage supply chains today is very much not country-by-country-focused. I think supply chain is almost an oversimplification. It’s really more like a supply web. I’m sure folks hear from companies, manufacturing enterprises, and I’m sure Tony can speak to this, you’re very often pivoting between where you manufacture in one location versus where you manufacture in another. You source from different locations. It’s a very complicated web.

When I think about a country-by-country approach, one of the things that I find frustrating about that framework is it actually creates horizontal inequities between companies, both of which have the same overall ETR, and so therefore are competing on a level playing field based on that, but now one of those companies operates, let’s say, primarily in 15 percent rate jurisdictions; the other one’s split half between 10 percent rate and 20 percent rate jurisdictions.

Why should a system that’s targeting base erosion treat those two enterprises differently? If you treat them differently and you tax one more heavily than the other, you have now introduced a competitive imbalance where there was not one before. To me, that’s very counterintuitive. And, again, it’s very inconsistent with the way companies actually manufacture source materials and go to market.

MR. GEDELLER: Here, here. Yeah, so just to pile on to what Pat said, I do believe that companies manage global businesses. We have a global value chain. When you boil it down to the country-by-country and ultimately it gets entity-by-entity, it just creates the possibility of these inequities. I think that goes against this Goldilocks spirit of, you know, we’re trying to move forward, we’re trying to introduce this concept, and if you make it such a minefield of, you know, these pitfalls that you could unintendedly fall into, I think it brings down the whole system. It isn’t how companies actually view their businesses. When I’m talking to CFOs or GMs, we don’t talk about legal entities; we talk about their business.

MR. BROWN: Yes.

MR. GEDELLER: And that transcends these borders.

MR. BROWN: Very well said, Tony. Couldn’t agree more, yeah.

MS. ROLFES: Now, I won’t be the one to advocate for country-by-country GILTI. What I will do, though, is repeat something that was said yesterday morning, which is for companies that are in an excess
foreign tax credit capacity in GILTI, because you have the cross-crediting between countries, the incentive on the margin when you're saying how is GILTI changing incentives about eroding the U.S. base, you are talking about comparing 21 percent in the U.S. or maybe a lower FDII rate to zero on the margin if you would be able to shelter that with excess credit. So that was the reasoning the Obama Administration proposed a country-by-country proposal, and it sounds like that is the reason Germany and others at the OECD are advocating for country-by-country.

So just for this room, as we look forward with 20/20 vision, I think we need to keep in mind if there was a political shift, now one of the arguments was it's too complicated, we could never do it. I would point us to two things. One, it sounds like the OECD may undertake this experiment for us. Two is just the Treasury Department in developing the high-tax exception to GILTI has, you know, at least in the proposed regs, I don’t know what the final reg said, but in the proposed regs, they have gotten even more granular. They don't say country-by-country. They say QBU-by-QBU and actually don’t even propose to aggregate QBUs that are operating in different countries. Obama would have at least done that.

It’s very interesting, if you read the economic analysis explaining that choice, that policy choice in the proposed regs that the Treasury economists wrote, I don’t know if they just recycled something from defending the Obama country-by-country minimum tax, but it was all about “we don’t want to create incentives on the margin for companies to shift over into low-tax income; we think it’s really important this be QBU-by-QBU.” It was quite jarring in the context of Congress having very deliberately rejected the complexity, rejected that choice to then see an expense allocation proposal, all of a sudden this strong defense of that policy concern.

MR. CALLAS: By the way, the complexity I think is enormous with country-by-country, but it’s not just complexity. The tax liability consequences of it are also enormous. I haven’t looked at the numbers lately. I think I’ve got them in a banker’s box somewhere in my old files, but, you know, I remember when -- as a kind of a guidepost, Ron Wyden, his old tax reform bill 10 years ago, he cut the corporate rate to 24 percent -- among other provisions, he cut the corporate from 35 to 24. He went to a full inclusion system and what we used to call repealing deferral, and then he went to a per-country limitation on the foreign tax credit.

The current inclusion piece might have raised a couple hundred billion dollars, and then when you layered on the per-country limitation, the two combined became a half a trillion dollars, so it more than doubled the impact of the current inclusion rule at the full rate.

Now, you would think that at 21 percent there’s going to be more excess credits than there would have been at 24. Other countries have changed their rates, too, and so forth. So, you know, it's not increasing the bite of GILTI by 10 or 20 or 30 percent. It might be doubling or tripling the bite on top of the complexity of having what, 200 baskets, however many countries there are in the world.

MS. ROLFES: I think that all depends on the rate. If I remember, and I don’t know if Roseanne is still here, if I remember Harry and Roseanne’s paper, they thought a 15 percent country-by-country tax might be roughly equivalent to a 20 percent overall rate, you know, that allowed in the blending. And I'm sure that changes as the rates do.

MR. CALLAS: I think the five-point differential -- that’s what they found in that paper, I think that’s right.

MR. BROWN: There is -- and I don’t mean to disparage any economists in the room, but there is a point to this marginal dollar of investment point that I think is -- there’s a corollary to the point that both Tony and I made with respect to the way companies organize their supply chains, and that is tax departments don’t run companies. And so, this concept of fretting about unless we do it this country-by-country approach, there will be disincentive for that next marginal dollar of investment.

Back in my old job, that would have been a very short conversation with my CFO, to say, hey, there’s a marginal dollar of investment opportunity we have right here if we can just pick up and move our factory
to a different location. My CFO would have said, what are you doing in my office, and why are you still here?

And so, you know, I think it’s just leavening the economic analysis, which I take your point, I think Roseanne and Harry’s paper was phenomenal in terms of the thinking involved and obviously very influential. Leavening it with a bit of real-world practicality is also important in this analysis, in this exercise.

**MS. ROLFES:** I think that tax departments don’t run companies might be a good segue to polling question number 2, which is, Does the treatment of QBAI affect your company’s choice of location for investment? I don’t know if the tax department has any more sway in your company than Pat apparently did in his.

**Polling Question #2:** Does the treatment of QBAI affect your company’s choice of location for investment?

![Polling Question #2: Does the treatment of QBAI affect your company’s choice of location for investment?](image)

We will discuss what we think about QBAI because we shouldn’t have a conversation about GILTI go by without talking about the little, itty-bitty part of the exemption system that we have, which is QBAI.

I will just say the Obama proposal -- and I just refer to it because it’s what I know, but there are a lot of different proposals out there that had a much broader base. The thought was, why should depreciable tangible property be the only basis? The idea is given an exemption on a normal return -- this was said yesterday by the economists -- you should exempt the normal return because otherwise you distort capital expert decisions. U.S. companies won’t be as competitive offshore in making the choice about where to put that factory if the U.S. is going to come over on top and tax that income.

When we were talking about that in the Obama Administration, one of the considerations -- you know, we had the privilege of seeing the Camp paper, which was extremely helpful, but why if you go and purchase a patent should you not get -- you know, you have purchase basis in a patent, the first dollar of income you earn on a purchased patent is not an excess return. It’s not mobile income. It’s just you trying to
earn, trying your best, to earn a normal return on that purchased patents, and we know a lot of them don’t work out. Or you’re a service company and you have invested a boatload of money in having a workforce in place that you’re trying to break in, why shouldn’t you get a normal return? So we do have this narrow sliver. It’s QBAI.

Now the other side of that coin is we have the Democrats in 2018 putting out a paper saying, QBAI is this terrible incentive that is going to drive companies to locate income offshore. So, I wonder if at this moment we might look at the polling results to see -- big no. Still a plurality. No, no, big no, because not applicable to me does not count.

MR. BROWN: Exactly.

MR. CALLAS: B and D can kind of be added together there.

MR. GEDELLER: Right, right.

MS. ROLFES: Yeah.

MS. CORWIN: Another question coming from the audience: Were alternatives to QBAI considered?

MR. CALLAS: So, this all started with a view that in moving -- it’s easy to forget that this all started with a desire to move to a territorial system, right? In moving to a territorial system, it was understood that that would actually increase the incentive to profit shift because now the earnings wouldn’t be trapped. You could just bring them back. And so, you needed something to deal with that. You needed some kind of anti-profit-shifting rule to deal with that.

Well, part of that conversation is profit shifting isn’t done with hard assets. It’s not done with factories. It’s not done with land. It’s not done with inventory.

MS. ROLFES: Pat gets to pick where the IP goes. He doesn’t get to pick where the factory goes.

MR. CALLAS: A patent, if you ever held a patent in your hand, it weighs a lot less than a factory, right? So, the thought was, well, then we should retain full territorial treatment for a return on assets that are not generally used or useable for profit shifting and exempt that from any kind of anti-profit-shifting rule. And that’s where QBAI came from.

The Obama Administration had a similar concept but with a different kind of formula. And so, you can debate the asset base and the correct rate of return, but that was the thinking, as opposed to the first dollar of profit should be subject to tax. Well, the first dollar probably isn’t profits that were shifted. It’s the high returns that may be evidence of shifting.

MR. BROWN: And, George, I may be recalling wrong, but am I recalling right that there was an earlier version of Camp that actually, I think you might have even said this, that actually tried to define intangible property directly, like the income return --

MR. CALLAS: Yeah, 936.

MR. BROWN: -- actual intangible property, right.

MR. CALLAS: 936 intangibles.

MR. BROWN: Right, the 936 indefinite definition, right?

MR. CALLAS: Right.
MR. BROWN: Obviously QBAI was a way of saying that’s really hard, and so let’s take a different approach. Rather than defining the return to intangible, let’s define the return to tangible, and by inference, everything else will be intangible.

MR. CALLAS: That’s exactly right. In the early days, folks were thinking in terms more of royalties being paid back, right? That’s more easily identifiable, but then what about embedded intangibles and people were using the phrase -- I’ll never forget the phrase “unscrewing the economic egg.” It became very clear very quickly that that was not going to be workable and we were going to need some kind of rough justice formula. QBAI is essentially a high return rule, and so, Pat, you said it very eloquently, that’s how we ended there, understanding that it is a proxy for those kinds of returns and not a perfect identification of them.

MR. GEDELLER: Yeah, I mean if I look at this, I do think it is a red herring because its impact is really, really small in terms of both where you’re going to invest and also the taxation consequences of it. Part of that’s the mechanics of what we’ve defined, but just also part of it is the state of business. As we move more to the digital age, hard physical assets, as your whole value chain is decreasing, and, therefore, if you’re doing a return off of that, by definition, you’re going to have a much smaller impact.

MS. ROLFES: When Obama looked at a much broader base, and of course that proposal included a lower rate, it was a normal return, like keying off of T-bills or something. It was extremely low, but the base was extremely broad that they were going to get that return on, and it basically cost, like, nothing. So to the point of, like, because I think this is the point of, like, the profit shifting is not where the actual investment and basis is, that I think it is a little bit of a red herring -- I mean I think it's more than a little bit of a red herring. I think it’s unfortunate. If this ends up being where the political dialogue is on how to fix GILTI, that is an unfortunate place to be.

MR. BROWN: One could ask the question differently, and the economists asked the question in terms of normal returns and above-normal returns. One could ask the question differently, and that is, let’s try to identify relatively easy-to-identify indicia of either activity that is susceptible of base erosion or activity that is not. That’s, of course, what Subpart F did effectively going back to 1962.

It’s not hard to understand why that exercise was not where folks ended up, yet at the same time, it still feels to me like, I don’t know, there’s an itch there that I feel like can be scratched by looking at that question, not in terms of normal/super-normal, but, you know, is there really a significant possibility for base erosion here or is there not. And so, the paradigm for that, at least in my mind, is the hotel in Bermuda. You know, it’s a tax haven, but the hotel is not there because of no tax. It’s because that’s where the customers are.

MS. ROLFES: Yeah, but what about the brand? The hotel in Bermuda was definitely discussed. It’s interesting you go back to some facts and circumstances. I was going to say subjective, which isn’t fair. I thought a place where we’d come to alignment and something we would not go back to is I think this formulaic approach. The Obama proposal did it; Camp got there in -- I don’t know if you got there as soon as 2014, but as soon as you rejected the intangible notion, it seems like now the OECD, we heard Germany saying we think it needs to be a formulaic approach, I don’t want facts and circumstances. I would have thought that wasn’t an area that might be revisited, but never say never.

Any closing comments from my panelists?

MR. BROWN: Well, I’ll start, just because somebody needs to start. So, I’m looking forward to 2.0 and working closely with George and folks like that and kind of figuring through these problems and ways to get to a better place. I will say I think one of the things that I find frustrating about GILTI is its harshest impacts are as it’s currently been enacted and implemented are largely reserved for the companies that were supposed to be least impacted by it. That suggests to me that we either have a flaw in design somewhere, a flaw in implementation somewhere, or both. That is where I think we should start in 2.0 in figuring out how to fix it.
**MR. CALLAS:** Yeah, I think the aggregate approach was an attempt to avoid that outcome that you just described, avoided it clearly and perfectly, and as I mentioned before, we have a new version of this model, the car, and there are bugs in it and we need to work on the bugs. I remember 2004 in AJCA there were a bunch of mid-range reforms, not full-blown reforms, but mid-range reforms to the international tax rules.

That’s where we theoretically got 864(f), but it’s never come into effect. That’s where we reduced the number of foreign tax credit baskets to two and a number of other simplifications and procompetitive changes to the system.

And, again, as we work through implementation that phases down, and we’re seeing what Treasury can’t fix, it doesn’t have the authority to fix, and is going to require legislation, starting to make that list GILTI, FDII, the BEAT, other provisions as well, 958(b)(4) repeal, some other smaller international provisions, and, you know, it’s time to set about work saying, look, this is what we were trying to do.

To the extent certain features are not achieving that or are even counterproductive, let’s tweak those provisions in these new regimes we’ve created to better target the provisions at what we were originally trying to do.

**MR. GEDELLER:** Keeping it short and sweet, I would say great first step; we really need to follow up because there’s a lot of complexity, a lot of unwary traps in the current provisions.

**MS. ROLFES:** And all I would say, following on Pat’s comment about it hitting maybe the companies that we wouldn’t have thought was the target, I know expense allocation is one of the knock-on effects of relying on a foreign tax credit regime. It’s a really weird result to deny the deductions for the companies operating in high-tax jurisdiction, but if you’re operating in Bermuda, you’re fully allowed your deductions that are allocable to the foreign earnings. Really weird result in terms of who are we hitting and why.

**MR. CALLAS:** Trivia fact that the 2011 discussion draft repealed the allocation of indirect expenses.

**MR. BROWN:** I remember that, yeah.

**MS. ROLFES:** Must have been expensive.

**MR. CALLAS:** It cost money and no one came in and said it was important, and so in later drafts, when revenue was needed elsewhere, it fell out to free up revenue.

**MS. ROLFES:** Well, that’s all why we have to stay engaged. With that, I will thank my panelists and thank you for all of your attention.
MR. PAUL NOLAN: Good morning, everybody. I want to say thank you very much for being here. I want to recognize John and Manal for great conference planning. One of our goals was for this panel to have this strong attendance here, and I think it’s because of the conference planner and also the esteemed guests and panelists that we have with us today.

We’re going to do some quick introductions, I’ll do them, and then we’re going to do some quick polling questions for the audience to take the temperature of the room. The purpose of this panel is to build on all the discussions over the past day and a half and take this forward. So, this is the fun panel. This is the cool panel because we get to say what’s going to happen. And, of course, no one knows, but there’s been so much policy discussion and development, and we know we’re sitting on a volatile mix in terms of TCJA and where we stand today and the current political system.

With the expertise that we have up here, we’ll get some really knowledgeable views about what could happen. Of course, we don’t know what will happen, but what could happen.

So, to my immediate left, Barbara Angus, currently Leader of Global Tax Policy at EY, but as you well know, with TCJA was working with Chairman Brady as the Chief Tax Counsel.

To her left, Shahira Knight, she’s now Deputy Managing Principal of Policy at Deloitte, but, of course, was in the White House during the TCJA.

Arshi Siddiqui, who worked with Speaker Pelosi for an extended period of time, and before that in key policy roles, and before that work with Eva Clayton and others on the Hill.

And then, of course, Eric Solomon, who needs no introduction. Unfortunately, his bio is not in your materials because he’s a late-minute pitch-in. And not only that, he’s the only other person on this dais right here who’s a recipient of the Pillar of Excellence from the TCPI. And so that’s part of the duties in getting that Pillar, you have to come back, and he’s lived up to it.

With that, why don’t we go to polling question number one. The outcome of the 2020 elections will be,
and this is going to help shape our discussion: A, Democratic President but Congress is divided; 2, Democrats run the table; 3, Trump II, status quo; and then, D, a GOP wave. We’ll run the music very quickly, but I’ll give you 15 seconds.

Polling Question #1: The outcome of the 2020 elections will be:

<table>
<thead>
<tr>
<th>Result</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Democratic President but Congress Divided</td>
<td>32.93%</td>
</tr>
<tr>
<td>“Democrats Run the Table” – White House &amp; Congress</td>
<td>43.90%</td>
</tr>
<tr>
<td>“Trump II” &amp; Status Quo – Divided Congress</td>
<td>13.41%</td>
</tr>
<tr>
<td>GOP Wave - “Trump II”, House Flips and Senate Holds</td>
<td>9.76%</td>
</tr>
</tbody>
</table>

MS. BARBARA ANGUS: Will the app work better than it did in Iowa?

MR. NOLAN: It’s worked very well so far, Barbara.

MS. ANGUS: We should learn.

MR. NOLAN: All right, let’s see the results. I’m sure people will quickly know. All right, so, all right, we’ll spend some time there.

All right, second question, regardless of the 2020 outcome, on a scale of one to five, one being not at all likely, five being very likely, will there be significant tax legislation in the next two years? Run the music.
Polling Question #2: Regardless of 2020 Election Outcome – Likelihood of Significant Tax Legislation Enacted in 2021-22 on a scale of 1-5 (1 is least likely and 5 most likely)

Not at all likely. Ooh, stagnation, okay. But a plurality for stagnation, all right.

Next question, this is my favorite. TCJA provision most likely to be changed: the corporate tax rate; unpass the SALT, which is get rid of the deductibility limitation on state and local taxes; save the DA; GILTI pleasures, which could go in either direction, you could make the GILTI tax tighter or you could loosen it up; or other, some other provision. Run.

All right, let’s see.
Polling Question #3: TCJA Provision “Most Likely to be Changed” before the 2022 Mid-Term Elections

**Result**

- **a. Corporate Tax Rate**
- **b. “Un-Pass” the SALT – Modify or eliminate the deductibility limit on State and Local Taxes**
- **c. “Da” is Saved - Section 163(j) interest expense limit test remains EBITDA based**
- **d. “GILTI Pleasures” – Reformed by either: alleviating expense rules or replacing blended calculation with a per country rule**
- **e. Other – “Fill in the blank” on your least favorite (or most favorite) TCJA provision**

Wow, interesting. Okay.

All right, so we’re going to take our conversation today and we’re going to break it into three pieces. The first piece will be assuming there was a Democratic wave, and so we’ll start there, and then we’ll talk about a Republican wave and then sort of mixed message, which, you know, reflects maybe the divided representative government we have today.

I’ll take the first question, and, Arshi, if you don’t mind, we’re going to throw it at you. The most innovative and norm-breaking tax proposals like the wealth tax, financial transactions tax, carbon tax seem possible only if the Democrats control the House and Senate and the White House next year. Do you agree with that assessment? If so, what’s the most likely of them?

**MS. ARSHI SIDDQUI**: I agree with the assessment, but with a very strong caveat there’s been a lot of focus on the most liberal flank of the Democratic party and equating those positions as representing the Democratic consensus position. As far as the next election goes, it’s hard, as you mentioned, to predict on what’s going to happen, but I think on the Democratic side, it would be a mistake to underestimate this President.

The President is also very astute on the campaign trail, so for that reason, whoever the Democratic nominee will be, they will have to lay out a vision for the country. I think that vision will be a pretty strong kind of clash in terms of which way the country should move on major policy issues. If we do actually see a Democratic wave, the campaign on the Democratic side for the nominee will be very indicative of where we go in terms of the legislative agenda.

That said -- I don’t know if my Republican colleagues would agree with me -- under the scenario where
the House stays status quo and the Senate becomes Democratic. Under that scenario, I think what we will really see is reinforcing the moderate wing of the Democratic party. This is largely lost in the press because it’s just not as good of a story, if you do look at the House majority, it is built on the backs of moderates, and mainly suburban women, but across the board, those are the types of members that won, that have been really working hard to stay in office, and they will be very concerned about the midterms and the types of issues their constituents want addressed.

Under a Democratic president, there is always a tendency for the controlling party to lose seats in the House. So, I think we have to think about that dynamic, and then there’s obviously the inherent nature of the Senate towards the middle ground, so I think this can be viewed in a good way from the business community perspective.

Actually, I would say I think very likely that all of these ideas are fully litigated. If I had to make a prediction, I’d put more money on the Democratic vision being more about the question of how you tax work and how you tax capital. That’s where probably we’re trending, and I think that’s probably where we see some tension in terms of income inequality. But I think we can also expect for better or worse, for all the people that we work for, that there are going to be a lot of ideas out there, and it’s going to take a lot of organization, and it’s going to take a lot of political heft but also kind of policy positioning to make sure that the perspective of the business community is factored into these deliberations.

MR. NOLAN: Thank you.

Eric, what do you think?

MR. ERIC SOLOMON: I agree with everything you say. Just as a matter of process, it’s going to be done by reconciliation. Even if the Democrats win the Senate, it’s going to be close and, therefore, we’re going to be in reconciliation again. Last night, I did a little bit of homework to prepare for this panel, and I’ll tell you how many seats are coming up in November. There are 21 Republican seats, 12 Democratic seats. But, on the other hand, if you look at the Republican seats that are up, they’re mostly in safe places.

It’s going to be very close even if the Democrats win, so it’s going to be under reconciliation. If there is legislation, it will be more towards the moderate, and I think it’s things like rates, capital gains and dividends and issues like that.

MS. SIDDQUI: And to that point, I want to say maybe six months ago, the idea of the Senate flipping was not even a consideration. I think now it’s become a little bit more of a possibility, but it likely would be close if it happened.

MR. SOLOMON: It would be very close because they have to win basically four seats.

MR. NOLAN: So, fortunately, we have two people on the panel who have experienced doing legislation under reconciliation. Barbara, share your thoughts about doing legislation under reconciliation and the pros and cons within a party as that occurs.

MS. BARBARA ANGUS: Well, there certainly are challenges in doing legislation under reconciliation, and we’ve seen them over the last decade or so. I think we first saw them with President Bush’s legislation, which was pretty simple legislation from a policy perspective. It was significant rate cuts, but they had to expire at the end of 10 years. It included the provision that had the estate tax ratcheting down, disappearing, and then springing in the 11th year back to the full old estate tax.

I was at Treasury at the time and remember the challenge of explaining to foreign officials that would be the U.S. policy. The rules around reconciliation create a lot of challenges. There are also challenges -- that may not be obvious -- when one party controls all of the entities. There tends to be an enthusiasm that there are huge things that can be done, even though within any party there are always some
divisions.

The easier thing, the thing that ultimately can get done, is the more moderate, not the extreme, position. But it is harder to convince those who have the extreme view that they can’t get their way when the same party controls all three bodies. With the dynamics in the Senate, that is always the case. It’s just harder to swallow, and so accepting that takes some time.

MR. NOLAN: Shahira, what are your thoughts?

MS. SHAHIRA KNIGHT: Where I would probably disagree with what everybody says is you based your question on is it norm-breaking, and I don’t think any of the proposals out there are norm-breaking. All of the proposals are things that have been discussed. We all like to say there’s no new ideas in tax, and there really aren’t, so I don’t think that any of the proposals out there are norm-breaking in that they’re not new.

What’s different about them is how widely accepted they are, and I think some of the proposals that the Democratic candidates are talking about have a lot of acceptance. Others have some acceptance, but they’re not as widely embraced. So, I think that’s sort of one thing to look at. But the other is that I do think we’ll see tax legislation in the Democratic wave, because if you look at modern history, when a new president has taken over, we have had a major tax bill in the first year of every new president in modern history. I think it would suggest that we could see that again.

The last thing I would say is what I found interesting about the proposals on the table right now is that I don’t feel any of the candidates have tax policy platforms in and of themselves the way they have a climate change platform or a platform on other issues. Mostly the tax proposals are either proposals to pay for other programs or to deal with income inequality.

I also think that what we see in a first year would depend a lot on what they’re trying to pay for or what goal they’re trying to achieve. When we did tax reform under tax reconciliation, tax reform was a policy platform in and of itself, whereas a lot of the proposals on the table right now feel more like pay-fors than flat-out policy platforms.

MS. ANGUS: I would agree with that but I would add to it.

It’s either pay-fors or addressing income inequality, but I would say that those policies are a platform for Democrats. They see the missed opportunity with the tax bill as those policies.

MS. SIDDIQUI: Agree.

MR. NOLAN: Right. So, let me ask another question. In terms of the legislative filibuster, which is in many respects what forces reconciliation, let’s start with start of the D side and, Eric, you’re the purple side, do you foresee a circumstance in which a Senate majority on the Democratic side would take out the legislative filibuster?

MR. SOLOMON: What goes around comes around. My personal view is that Democrats would look down the road and anticipate that someday the tables may be turned.

MS. SIDDIQUI: I think it’s a fair question. It’s a toss-up because I do think that that’s right, and I think there are some Democrats that believe that’s what happened in the Supreme Court discussion, and that was a mistake. Also, the nature of the Senate has changed in recent years, so I think there is less of a sentimentality about the institution, and there’s much more “how do we get things done.” With that said, I think it would be a very high bar, so it would not happen unless there was a groundswell of frustration.

MS. ANGUS: That’s exactly what I was going to say. I think it depends on how big of a win the Democrats would have. If a Democratic president won with very large margins and flipped the Senate, it
could be viewed as a voter mandate to implement that agenda. So, that might create more impetus for changing the rules, but I think they would try first with reconciliation. That would be the first go-to tool. And so, I agree it’s a possibility, but a high bar.

**MR. NOLAN:** Did we hear anything this week at the House Ways & Means Committee that was an indication in terms of a policy thrust or developments?

**MS. ANGUS:** I’m not sure that we really heard a lot that was new. It seemed like it was a repeat of messaging about reaction to the Tax Cuts and Jobs Act, and so a lot of ground that has been covered before. I think something that was quite interesting and will deserve some more study over time is the data that JCT put out. That will require a lot more analysis and work.

**MR. NOLAN:** All right, so we’re going to go to our next polling question. In a Democratic wave, the most likely new tax policy enacted would be: a carbon tax, wealth tax, capital gains, mark-to-market, some sort of financial statement tax, a financial transaction tax, or none of the above? We’ll give a little more time on that because there’s six choices.

**Democratic Wave Polling Question #1: In a Democratic wave, the most likely “new” tax policy enacted change would be:**

![Pie chart showing the results of the polling question.

- a. Carbon tax: 16.67%
- b. Wealth tax: 12.82%
- c. Capital Gains mark-to-market tax: 16.67%
- d. Financial Statement Tax – income tax on companies based on US GAAP/IFRS audited book income in addition to traditional taxable income: 20.51%
- e. Financial transactions tax: 1.28%
- f. None of the above: 32.05%]

All right, let’s see the answer.

**MR. NOLAN:** Our next question is: In a Democratic wave, the most likely corporate tax rate will be...
Democratic Wave Polling Question #2: In a Democratic wave, the most likely corporate tax enacted would be:

Want to take some bets? All right, let’s see, 28 percent.

**MS. ANGUS:** Wow.

**MR. NOLAN:** Eric is shocked. Why?

**MR. SOLOMON:** I thought going back up to 28 percent might be too high, even for Democrats.

**MR. NOLAN:** Doing what other panels have done, adding the two largest answers, 41.25% and 51.25% percent voted for a 25% tax rate and 28% tax rate respectively, that may mean compromise might be range of 26 or 27. I would like to get reactions from the panel to that.

**MR. SOLOMON:** This doesn’t even include state taxes either.

**MR. NOLAN:** No.

**MS. ANGUS:** One of the things that’s interesting when you think about the corporate rate increasing, and I don’t think that everyone is thinking about it this way, there’s a significant interaction with the international sector. I don’t just mean the fact that some of the international rates are keyed off of a fraction of the corporate rate, but the biggest provision in the TCJA in terms of preventing base erosion was the dramatic reduction in the corporate tax rate.

As the corporate tax rate goes back up -- and most of these rates in the options here are above the OECD average -- the need for strong base erosion protection ratchets up. If you drive the corporate rate up, you could end up with a counterintuitive need to also tighten the international rules.

Some people say, well, do you raise the corporate rate or do you tighten international, because they’re
thinking about it from a revenue perspective. But when you think about that dynamic, driving the corporate rate up could force a discussion of further tightening and making more unfriendly the international rules, which, if both are combined, would be very bad for competitiveness.

**MR. NOLAN:** All right. Any other thoughts before we transition to the Republican wave?

**MS. SIDDQUI:** Sure. I would say a couple things, and I don’t know if my Republican colleagues agree with me, but Chairman Neal has been very responsible and very focused in how he’s talked about the tax bill. And so, I think that any kind of corporate rate discussion will be done in the same way. It’s probably more an issue of what’s on the other side of the ledger, but I would say I don’t think there’s going to be a wholesale move to just see a corporate rate increase as a huge piggybank. I think the Democrats would move in a very deliberative way; it will be taken cautiously, especially since there are different world views on where the economy is going. If we look at the history of tax reform in the past, besides this last bill, there was a lot of bipartisan convergence on lowering the corporate rate.

I think there are a number of Democrats who go back to the Obama rate in terms of his proposal, but I would also say that I think this last two years Chairman Neal could have really pursued a different approach, and he could have taken an ACA model, which he did absolutely the opposite. We certainly will see a discussion of the corporate rate. We certainly will see a discussion on whether there needs to be changes, but I don’t think it will be done in an aggressive way.

**MR. NOLAN:** Okay. Thank you.

We’re going to switch gears now and imagine a world in which it’s a red wave, not a blue wave. And so, it’s time for the Republicans with control of the three branches, a reelected Trump. Do we think the policy changes up to here from a tax perspective are incremental, or do we see something more significant?

**MS. KNIGHT:** I think if it’s a Republican wave, meaning Republicans back in control of the House and Trump being reelected President, I would think that the changes would be more incremental because we just got major tax reform done. And so I think it would focus on things like technical corrections, on permanence of the individual side, and then go back to whatever Tax 2.0 might be if that comes to fruition in some form. But I always go back to what Chairman, or Ranking Member now, Brady has said, Chairman Brady at the time.

**MS. ANGUS:** He’d be Chairman again under this scenario.

**MS. KNIGHT:** He’d be Chairman again, but he said we shouldn’t be doing tax reform every 30 years. We should be tweaking the tax code all the time so that we’re not in a position where we have to make these massive changes every 30 years. And so that really is, I think, an indication that the goal would be to keep updating in an incremental way. I think they would really focus on technical fixes, incremental changes, permanence, and then, of course, the things that are on the table that are going to force action like the three little cliffs that are in the bill.

**MR. NOLAN:** Right.

Barbara, would you like to address this?

**MS. ANGUS:** I agree with that. And, in this instance, I wouldn’t think of incremental as a negative-seeming word.

**MS. KNIGHT:** Right.

**MS. ANGUS:** Chairman Brady, and I’m going to call him Chairman, because we’re now in a world that he’s Chairman again, was really vocal about the fact that we should be doing tax reform every year. He meant that it should be a constant focus on how to improve the tax code, how to make it more
competitive, how to make it fit better in the global world. He meant that when we’re doing tax legislation, it should always be about improving the tax code and not having some other objective. And so, I think that that’s what we would continue to see.

A big area that he focused on early on and that has been the subject of a lot of discussion here are the international provisions. The TCJA made major changes in the international rules because we needed major changes in the international rules, but getting it exactly right was not possible in one fell swoop. So, a key focus area would be continuing to modernize the international rules, as well as continuing to respond to the developments in the rest of the world.

MR. NOLAN: Thoughts, Eric?

MR. SOLOMON: Well, once again, it will have to be done by reconciliation because the Senate is going to be closely divided, so that is going to affect the process, as we’ve discussed. I agree completely, permanence is going to be first, then technical corrections and some substantive improvements. I think George Callas said it very well, it’s like the first model of a car, and you want to improve the car with each iteration. So, I agree with the comments that others have made.

MR. NOLAN: Let me loft the same question about the Senate and the legislative procedural rules. Do we see that being changed in a red wave?

MS. KNIGHT: I personally don’t. I think that discussion has been had, and there are a lot of Republican Senators who do not want to change the filibuster. I don’t think the support was there for it over the past couple years. I don’t think it will be there for it in the future.

MR. NOLAN: Okay.

MS. ANGUS: And they didn’t do it in the last Congress.

MS. KNIGHT: Right.

MS. ANGUS: Which even in our new world of next year will be relatively recent.

MR. NOLAN: Okay. So, we do see growing interest among Republicans around climate change and issues surrounding climate change. To what extent would GOP-crafted policies address this in the tax code, and would they be carrots or sticks, Shahira?

MS. KNIGHT: I think we’ve seen some proposals come out already, and they are more in the form of carrots. And it’s, you know, tax incentives for innovation, for carbon sequestration. So whether those are the types of things that gain broad acceptance in the Republican party, I don’t know, but those are the types of proposals that are already out there, and they are some rooted in tax, some not, but they are more carrots than sticks from what we’ve seen so far.

MR. NOLAN: Interesting.

MS. ANGUS: It’s important to also be thinking as we’re looking at this world about incentives or other responses that are outside of the tax code. Again, if you look back at the philosophy that drove certainly on the House side the design of the TCJA, it was about eliminating special incentive provisions in favor of lowering the rates and allowing businesses to choose where and how they invested -- to not try to use the tax code to be driving particular behavior. To the extent that philosophy is still present, that might argue in favor of looking for measures outside of the tax system.

MR. NOLAN: Interesting.

Any thoughts?
MS. SIDDIQUI: I would say that on the Democratic side I would say that there is real interest on bipartisanship in this area specifically. I think people are hopeful that things will continue to evolve.

MR. NOLAN: Do you perceive there to be a stronger interest in that respect now than, say, five years ago, six years ago?

MS. SIDDIQUI: Absolutely, and I think the millennials are really also driving that quite a bit. I think that we’ll continue and grow.

MR. SOLOMON: I’ll just note that use of the tax code for all sorts of social purposes continues. It’s almost taken for granted that we will drive policy in this country through the tax code.

MS. KNIGHT: Well, I think one of the interesting things, looking back at a lot of the energy tax incentives that exist already, they were done under a Republican Congress so a lot of the renewable energy incentives came from Republican policies. And while, yes, that was the goal of tax reform, we also just extended all the extenders, too.

MR. NOLAN: There we go. All right, so we’re going to do a couple Republican polling questions and then shift into the mixed message environment, which may be more likely based on what our audience, I think said. So the first question is in the Republican wave, Tax Reform 2.0, what would be most likely: a lower corporate rate; lower individual rates targeted, middle class; 100 percent expensing of business assets, whether temporary or permanent; GILTI reform; and then eliminate the TCJA adverse phase-ins and phase-outs, basically to level out all the changes that happened for budget reconciliation. Let’s run the music, please, and give people a few seconds to parse those out.
Republican Wave Polling Question #1: Tax Reform 2.0 would most likely tax change would be:

Okay, let’s see what we all think. I have no prediction. All right, phase-in -- you know, smoothing out the phase-ins and phase-outs looks like the winner, but then rates targeted, middle class. Lower corporate tax rate, 1 percent, interesting. I’m surprised by that, but I’m just the moderator, so I’m not going to say anything. I would have thought 15 percent or 10 percent or something like that.

Is anyone on the panel surprised that the audience doesn’t think that a Republican Tax 2.0 would go for a lower corporate tax rate?

**MS. KNIGHT:** I agree with the audience on this one, but, yeah.

**MS. SIDDIQUI:** I’m surprised by B, actually. That’s interesting.

**MR. NOLAN:** Okay. All right, let’s poll the next question even though no one in the audience thinks it’s going to happen. This is for the 1 percent that answered the rate’s going to go low.
Republican Wave Polling Question #2: In a Republican wave, the most likely corporate tax rate enacted would be:

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<thead>
<tr>
<th>Result</th>
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<tr>
<td>a. 21%</td>
<td>87.84%</td>
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<td>b. 20%</td>
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<td>c. 17%</td>
<td>4.05%</td>
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<td>d. 15%</td>
<td>2.70%</td>
</tr>
<tr>
<td>e. 10%</td>
<td>0%</td>
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</table>

* 15% polled 0%

**MS. ANGUS:** And then they get hit with the OECD minimum tax.

**MR. NOLAN:** Exactly. Let’s just say --

**MR. SOLOMON:** I want to emphasize an interesting point Barbara has made. There are outside factors, including contingent events, that we can’t predict which will affect the economy and tax policy in the future.

**MR. NOLAN:** Right. Let’s see the polling result. Everyone should be at the -- yeah, there it is. All right. This audience is very consistent. Very good.

**MS. MANAL CORWIN:** We have a question that came from the audience, is there any scenario that you could see a Republican Congress raising rates?

**MR. NOLAN:** Ooh, good question.

**MS. KNIGHT:** I sure don’t see it, but I guess it would depend on: combined with what? raising rates to do what? or to pay for what? or if the OECD miraculously agreed to something and Congress was voting on that and making changes. But, again, it goes back to the point that the corporate rate is very married to the international provisions and to the base broadeners. I think this is an issue of: are you changing the base broadeners? are you changing some of the GILTI BEAT provisions? And then maybe in that context. But in and of itself, I don’t see them raising the rate unless it is combined with something else that is a net tax cut at the end of the day.

**MS. ANGUS:** Especially when you see what’s happening in the rest of the world with corporate rates continuing to come down.
MR. NOLAN: All right. We’re now going to discuss the mixed message, which is either the continuation of what we have right now or, say, a Democratic president but the Senate holds, or Senate flips and the House flips. Are we doomed to bump along like we have for the past two years? Will the next two years be like the last two years and be sort of a Groundhog Day? What does tax policy look like in those two years?

MS. ANGUS: Well, I don’t think we should lose sight of the fact that there were some things done this year that took many people by surprise. The IRS reform bill that was part of the efforts at the end of the last Congress was passed. It was a bipartisan effort in the last Congress, and it passed in this Congress. Also, the SECURE Act, which was something that passed the House at the end of the last Congress, not in exactly the same form, but this Congress they reached bipartisan agreement on something that looked a lot like it.

I think they’re important accomplishments in an extremely fractured environment.

MS. KNIGHT: Yeah, and I would go back to something Barbara said earlier, that in the wake of a massive tax reform, I wouldn’t look at only big changes are good changes. I Incremental changes are also, I think, good changes, but I don’t feel like we bumped along. We did $426 billion of tax cuts or tax provisions in the year-end funding bill, which I think was very significant. I feel like a lot has gotten done, but I think more importantly, there is going to be the 2022 tax cliff that is going to be facing them in the next two years. I think they are going to be preparing for that one way or another starting in 2021.

I do think that there are going to be some of those expiration dates that are going to be forcing a discussion on tax changes. And, the big ones obviously are expensing, saving the DA, and then amortization of R&E expenses. I think those are going to force a discussion on taxes in the next two years that could provide a vehicle for a tax bill. If that’s on the table, certainly SALT and all these other things go on the table as well.

MR. NOLAN: Right.

Arshi, what are your views?

MS. SIDDQUI: I would agree. I would actually just take a step back and say that I don’t think a divided government is necessarily a bad thing, so I would start with that premise.

MR. NOLAN: Right.

MS. SIDDQUI: If we see a second term for the Trump Administration, that could also open up opportunities for more bipartisan deals. When I was in the Speaker’s Office many of the bills that passed and that were enacted into law, a number of them bipartisan, and there was one defining factor. It was political will. It was when the principals decided that let’s get a deal, everything kind of flows from that.

I think what we’ve seen in recent years is the political calculus that each side has made, when they’ve made the calculus that, you know what, we actually want to move the ball forward. USMCA is a great example. I spent the last year and a half telling very skeptical people around town that it was going to happen and there was a concerted decision to make it happen, but until we saw fruits of that labor, people were very skeptical. That reality was very much a function of political will because there were so many different factors that were working against Democrats supporting the agreement, and despite the headwinds, it did happen. So, to me, I think that if we do have divided government, the outside factors, the environment, will really drive that political calculus.

MR. SOLOMON: I do think there are going to be action-forcing events. Expiring provisions will act as an action-forcing event, and there may be other events. There are other issues we haven’t talked about, such as Social Security. For example, we may need to address Social Security. Action-forcing events will make tax legislation necessary.
MR. NOLAN: How about technical corrections and extenders? Do we see that happening in this environment, in this mixed message environment?

MR. SOLOMON: I think technical corrections always happen. It’s only a question of which ones and how long it takes. That’s the way the process has been, we learn from history.

MS. CORWIN: We have one other question from the audience: Do you view a grand compromise at the OECD as an action-forcing event that might lead to a significant tax bill?

MS. ANGUS: I think it depends on what the agreement is and when the agreement is reached at the OECD. I think we’re a long way away. I am a big believer that the OECD and the Inclusive Framework needs more time to actually get to an agreement at the granular level that’s necessary. The kinds of things they’re talking about would require dramatic changes to the U.S. international rules. ECI is just the start; sourcing rules, foreign tax credit, there would have to be massive changes.

On the flip side, I think that we really need to worry about the OECD and the Inclusive Framework process on Pillar II looking at doing a country-by-country approach instead of a blended approach with respect to minimum taxes. That, for some, could drive a rethinking of the GILTI rules that I think would be really concerning. And there have been proposals for doing a country-by-country approach for GILTI. So, I think what happens in the OECD will be part of the consideration.

The U.S. has gotten beyond writing tax law just in a vacuum and not watching what’s happening in the rest of the world. I don’t think the U.S. would want to think about the results of the Inclusive Framework process as driving what happens here, but it would be taken into account.

MS. KNIGHT: I’ll just say it’s a hypothetical based on getting a deal in the OECD, and that’s a heavy lift in and of itself, but I agree in that it depends on what that deal is, and it’s hard to see appetite for another massive tax reform measure, especially focused on international taxes.

I think that if there is a new president, it would be hard for reform of GILTI and BEAT to be our top priority as a new president. If Trump were reelected, I think, again, it depends on whether it is some kind of major form. I just don’t know if the appetite is there for another major tax reform right now, but I think, again, it all depends on whether that big hypothetical, if they actually could reach a deal.

MR. NOLAN: So that was an external event. Suppose there is an internal event that’s a bipartisan coalition around, say, infrastructure. What sort of tax reforms do you think are possible or necessary in the event an infrastructure package came about?

MS. SIDDIQUI: I think the goal right now is that if there’s an infrastructure package at least on the Democratic side, in an ideal world, it would be bipartisan. And, I think the goal on revenue offsets is to have some sort of nexus to something infrastructure-related. Going back to the OECD point, I think I agree with everything that was said, but I think on the Democratic side if there was a deal reached, it might provide, especially under a Democratic administration, an opening platform to actually look at the international rules more carefully.

On infrastructure, I think, again, bipartisanship would be front and center, and that also reinforces the idea that it would be solely focused on infrastructure. If they went past that, then I think it would be something kind of global, maybe corporate rate cut or increase, but I think they would start there.

MR. NOLAN: How about one of the novel taxes like a carbon tax or something like that because you could see energy concerns being woven into it?

MS. SIDDIQUI: Yeah, absolutely, and I think that in the House document that was the one big piece that really shined brightly. Most people will agree it was more of a messaging opportunity to present a
Democratic vision and the environmental bent to the Democratic proposal was quite significant. That was a huge shift.

That said, on the carbon tax, I think the idea has been on the Democratic side that it's better to move on a bipartisan basis if we go in that direction, but there is a fair amount of interest on the Ways & Means Committee Democratic side historically to explore that approach. I just think Democrat would want a Republican partner. If they think that's not possible, then they go to Plan B.

MR. NOLAN: In this mixed environment, do we see a Republican partner emerging?

MS. KNIGHT: It's possible.

MS. ANGUS: The question is what kind of partner do they want. Do they want just one Republican, or do they want some Republican groundswell as their partner? That would be much harder, I think.

MS. SIDDQUI: I think it's probably a middle ground, because I think groundswell would be hard on the Republican side, but I think it would be something very significant if there could be a core group of Republicans, I think that would be the goal. For a long time on infrastructure the goal had been securing a deal with the Administration. That's why we didn't see a rollout for a long time because Chairman Neal was very hopeful that his talks with Secretary Mnuchin would bear fruit. The idea being that if it is a bipartisan piece, it's much more sustainable, and it's less political.

MS. KNIGHT: Even if you look back to healthcare, the Affordable Care Act that started as a bipartisan exercise, there was a gang of six or eight or whatever it was. There was a bipartisan group that actually produced legislation, tax reform. People may not like the process, but it was a function of many, many bipartisan working groups and papers and everything else. A lot of these discussions always have willing partners on both sides, and so I think possible is the right word.

It’s just where does the proposal go and do those partners stay at the table because of the way the proposal develops. In the Senate now there’s a bipartisan working group on energy, so I think all of them have the very strong potential, whether it’s infrastructure, any of these, to be bipartisan proposals, and then it’s just where do they go and can you get the broader buy-in of both caucuses outside of those working groups.

MR. NOLAN: Did the prior bipartisan efforts like the Simpson-Bowles Commission and the working groups that happened earlier in tax reform, is there any learnings from those that you think would happen in this new mixed message environment?

MS. ANGUS: I guess I would look to an example that you didn’t mention, which was the ‘97 Act. That bill had its roots in a congressional bill from ’95 that President Clinton vetoed. That was the first big tax bill that came out of the Republican control of the House for the first time in 40 years, and it was vetoed. Then they spent the next years in discussions between the House and Senate and with the White House on all of those policies. Some of them were enacted in ’96 as part of some smaller legislation, and a lot of them were part of the ’97 Act. I do think there is potential for bipartisan legislation -- divided government can -- create ways for people to come together.

MR. NOLAN: Let’s see what the audience thinks. We have a question on that. In a divided government, the most likely tax policy outcome 2021 to 2022: complete stalemate; substantive stalemate but some sort of deal to get extenders and a technical corrections bill done; true, substantive compromise, including TCJA reform to address the detrimental outyear changes; some sort of, you know, tax reform moving into infrastructure; and like the question from the group, legislation that's responsive to OECD.
In a Divided Government, the most likely tax policy outcome in 2021-2022:

- 21.13%: Substantive Compromise - TJCA reform to address detrimental outyear changes with small rate increase and other balancing benefits for Democrat constituencies
- 15.49%: TJCA changes woven into Infrastructure Legislation
- 12.68%: Complete Stalemate – no action, not even extenders or technical corrections
- 9.86%: Tax legislation to protect US competitiveness from OCED “Inclusive Framework” proposals
- 40.85%: Substantive Stalemate, but a technical deal cut - extenders and technical corrections with balancing benefits for Democrat constituencies

All right, let’s see. Let’s see the results, please. Substantive stalemate but technical deal cut wins. Or complete stalemate if you add it together. Interesting. Okay.

All right, so I’m going to thank the panel, but I want to thank the panel in this way. Melissa Hall, yesterday had a quote from Maya Angelou yesterday to end the panel that she moderated. It was very profound and it moved me to find a really good quote. There’s a noted philosopher, Yogi Berra, who once said, “it’s tough to make predictions, especially about the future.” We asked you to do that today, so thank you very much, each of you, for doing this.