September 3, 2021

Chairman Ron Wyden
Committee on Finance
United States Senate
217 Dirksen Senate Office Building
Washington, DC 20510

Senator Sherrod Brown
United States Senate
503 Hart Senate Office Building
Washington, DC 20510

Senator Mark Warner
United States Senate
703 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Wyden, Senator Brown, and Senator Warner:

The Information Technology Industry Council (ITI) appreciates the opportunity to share our perspectives on the discussion draft on international taxation released on August 25 (the discussion draft). ITI is the premier global advocate for technology, representing the world's most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries.

The U.S. international tax system is a complex and comprehensive system with interacting levers intended to incentivize equitable domestic growth and innovation, and, in conjunction with domestic provisions, provide revenue for the federal government. While beyond the immediate scope of this discussion draft, it is also important to consider the impact of domestic provisions, such as a competitive corporate tax rate, on the overall positioning of U.S. industry. We share the goal of ensuring that this system makes the United States more globally competitive for making job-creating investments, advancing research and development (R&D), and creating and owning intellectual property (IP). To that end, we share our high-level perspectives on the discussion draft and look forward to continued engagement with the Senate Finance Committee on these issues.

Companies in the U.S. lead the world in the delivery of goods and services, innovating at home to serve U.S. markets as well as the 95 percent of customers outside the U.S. The U.S. international tax system was designed to promote innovation, support U.S. competitiveness, and promote U.S. technology leadership. The technology industry accounts for a large percentage of U.S. R&D and is

a leader in innovation. U.S. exports of technology products and services totaled $338 billion in 2019 and supported 918,500 U.S. tech industry jobs.[1]

Regarding the U.S. international tax regime, the global intangible low-taxed income (GILTI) and the foreign-derived intangible income (FDII) regimes were designed to work together to help encourage investment and jobs in the United States and support U.S. companies in global competition for selling products and services throughout the world. In the intervening years since GILTI and FDII's creation, we have evidence that the current tax system is generating the desired results. Recent data has found that U.S. technology companies have shifted IP and profits back to the U.S. as a result of this system. A recent Tax Notes article found that, "domestic profits as a share of combined worldwide profits for 20 tech companies from 2016 through 2020 jumped . . . 15 percentage points in 2020 (from about 40 percent to 55 percent). In other words, domestic profits were about one-third of the worldwide total [before the enactment of the GILTI and FDII regimes], and now they are more than half."[2] The article goes on to state that "[f]or the 20 companies examined here, domestic profits in 2020 are estimated to be about $40 billion above what they would have been without passage of the Tax Cuts and Jobs Act" and that "based on the data available — it seems that after a two-year delay, the intended effects of the international provisions may be taking hold." Now is not the time to reverse course and eliminate these gains by enacting harmful and anti-competitive tax increases on the foreign earnings of U.S. companies as proposed in the discussion draft.

FDII

The intent of the FDII is to encourage the maintaining of IP in the U.S. and, in many instances, repatriation of IP to the U.S., both longstanding bipartisan objectives. With regard to the discussion draft's proposed treatment of FDII, we are beginning to better understand the Chairman's intent and anticipated execution of "innovation income," especially given the important relationship between R&D, IP, economic growth, and high-paying U.S. jobs. However, we are concerned that the proposed changes to FDII would undercut the policy goals that are now being achieved.

Currently, the FDII provides a deduction for a portion of U.S. profits derived from IP used in foreign sales. FDII rewards successful research by applying a reduced tax rate to a formulary category of "intangible income" earned by U.S. companies that sell products derived from that research into foreign markets. R&D incentives create U.S. research jobs while the FDII deduction encourages U.S. income from exports and U.S. manufacturing jobs. Even if the total measure of the FDII deduction is tied in some way to R&D and worker training expenses, overall, the reduction in the income-based benefit will result in lower revenues to the U.S. (with mobile income remaining outside the U.S.) and actually lower investment in high-value jobs that are connected to IP ownership, including engineering, manufacturing and other R&D jobs.

FDII also provides a key support to U.S. companies for the widespread adoption of advanced technologies, such as 5G wireless technology and advanced semiconductors. Economists have found that "the U.S. is now a more attractive location for investment in intellectual property

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[1] Tech Trade Snapshot 2020, ComptTIA. https://connect.comptia.org/content/research/tech-trade-snapshot-2020

[2] Big Tech Is Moving Profit to the United States, Tax Notes posted on August 23, 2021.

compared to offshore options,"[3] and major U.S. companies brought their IP back to the United States in response to FDII, thereby broadening the U.S. tax base. Companies have been incentivized to bring back their IP into the U.S. under the FDII (with associated taxable mobile income): since 2017, multiple U.S. companies have repatriated IP to the U.S., spurred by FDII's incentive, and a recent University College Cork study found that the FDII regime is resulting in U.S. companies bringing assets back to the U.S., with royalty payments from Ireland to the U.S. jumping to €52 billion in 2020 after averaging €8 billion a year in the five previous years, and likely to be higher in future years.[4]

When companies hold their IP in the United States, this ensures that the United States has the first right to tax the income the IP generates, rather than just the right to impose a residual U.S. tax, if any, under GILTI. When IP remains outside the United States, high-value jobs are expected to also remain in that same foreign country. Keeping IP in the United States means those jobs also stay in the United States because where the IP is held effectively operates as the center of gravity for a company's activities related to that IP. Further, FDII enables U.S. technology operations to compete with technology companies in other countries that provide even more generous tax incentives (both rate and superdeduction incentives). When U.S. operations succeed at selling into foreign markets, the U.S. locations hire more skilled workers to manage the associated supply chains, logistics, marketing, and other activities to support the growing businesses. Any proposed amendments to FDII should take into account the benefits accrued by encouraging the location and further development of IP in the United States, including but not limited to the benefits for U.S. employment opportunities, investment, and the U.S. tax base.

GILTI

With respect to GILTI, we believe that GILTI already serves the intended purpose of providing a global minimum tax. Under GILTI, the United States is the only advanced economy that taxes the active foreign business income of its multinational companies on a current basis. Increasing the GILTI rate would make the United States even more of an outlier and further impact the competitiveness of U.S. companies, especially considering that the current effective GILTI rate of 13.125% is only slightly below the rate (15%) that has generally been understood to be the likely outcome of Pillar Two negotiations.[5] Further, the actual effective rate of tax under GILTI is often higher due to expense allocation rules. Raising GILTI's rate, and doing so far above the expected 15% Pillar Two rate, would quickly bring the U.S. even further out of line with global trading partners. Moreover, we are concerned that the U.S. will proceed with an increase in its minimum rate ahead of all other countries participating in the OECD/G20 Inclusive Framework, especially as governments are not expected to begin legislative consideration of Pillar Two until next year, at the earliest, putting U.S. companies at a further competitive disadvantage.

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[3] Daniel Bunn, "The Balancing Act of GILTI and FDII," *Tax Foundation*, April 7, 2021, https://taxfoundation.org/intellectual-property-ip-tax-gilti-fdii/.

[4] Seamus Coffey, *The changing nature of outbound royalties from Ireland and their impact on the taxation of the profits of US multinationals*, University College Cork, May 2021.

[5] Note that the current GILTI effective rate is equal to the headline rate divided by 80% to reflect the foreign tax credit haircut (10.5% / 80% = 13.125%). If a 15% rate were introduced consistent with Pillar Two negotiations but the foreign tax credit haircut was maintained, the effective rate would be 18.75% (15% / 80%), or 3.75% higher than the 15% rate included in the OECD/G20 Inclusive Framework's July 1 Statement.

A recent study by EY for the National Association of Manufacturers (NAM) analyzed the effect of changes to GILTI similar to those proposed in the discussion draft. The results of the study on U.S. multinationals were a loss of between 500,000 and 1 million U.S. jobs and $10-$20 billion of U.S. investment.[6]

Regarding the GILTI country-by-country (CBC) proposal, multinational companies structure their complex, integrated supply chains across countries and regions based on a variety of commercial factors. The current "aggregate" approach for calculating GILTI not only reflects the integrated nature of the foreign operations of multinational companies, but it reduces the complexity of the GILTI calculation and mitigates, in part, the distortions caused by the lack of multi-year averaging of profit and loss and lack of a carryforward of excess foreign tax credits. Our members appreciate the goal of reducing complexity but do not believe an approach based on the mandatory high-tax exclusion would meaningfully do so as a CBC analysis would still be needed in order to categorize each country. Further, requiring the GILTI calculation to be based on separate tested units of controlled foreign corporations or foreign branches would add to the complexity of the calculation. There would also be no mitigation of the distortions mentioned above since timing issues have not yet been addressed.

New international tax legislation should fix the distortions caused by the lack of multi-year averaging of profit and loss and lack of a carryforward of excess foreign tax credits. To that end, GILTI should be amended to provide for the carryforward/carryback of GILTI losses and excess foreign tax credits, and calculations of effective tax rates should not penalize U.S. taxpayers in years in which non-U.S. subsidiaries are reducing their foreign tax burden through the carryforward/carryback of foreign economic losses. Likewise, the section 250 deduction should be taken into account before net operating loss deductions.

Separately, although we are encouraged by the framework's consideration of eliminating the adverse foreign tax credit impacts associated with expenses for research and management taking place in the United States, we also ask the Committee to consider the elimination of the allocation of interest expense for GILTI purposes, especially in view of the section 163(j) deductibility cap. Finally, it is important to keep in mind how GILTI significantly broadened the U.S. tax base as a revenue raiser.

Qualified Business Asset Investment

Additionally, we are concerned by the discussion draft's proposal to repeal GILTI and FDII's deemed return for tangible assets (qualified business asset investment, or QBAI), which incorrectly considers QBAI as an offshoring incentive. Companies invest overseas to meet the needs of their customers outside of the United States. Any claims that QBAI is an offshoring incentive ignore other key features of the U.S. tax code, such as capital expensing and complexities to GILTI's calculation. A recent analysis of 2018 IRS data on GILTI inclusions indicate that "the QBAI exemption reduced the inclusion only by about 10 percent, implying little shifting of tangible investment overseas (one argument made in favor of repeal) to take advantage of the exemption."[7]

Repealing QBAI at this time significantly undermines the global competitiveness of U.S. operations. Moreover, the OECD/G20 Inclusive Framework's Pillar Two agreement envisions a substance-based

[6] https://www.nam.org/proposed-tax-changes-to-cost-up-to-1-million-u-s-jobs-14821/?stream=news-insights
[7] What Can GILTI Teach Us About Minimum Taxes?, Tax Notes, posted on August 30, 2021.

carve out that is even more generous than QBAI, at 5 to 7.5% of tangible assets and payroll, compared to the current 10% of tangible assets for GILTI (and FDII) purposes. Repealing QBAI domestically while supporting a similar provision internationally puts U.S.-based operations at an even greater disadvantage given that no other government has taken steps to enact a minimum tax.

BEAT

We appreciate the restoration of the full value of domestic business tax credits under the base erosion and anti-abuse tax (BEAT) and look forward to engaging with policymakers to make improvements to the current regime. This would include narrowing its application to actual base erosion income that does not include day-to-day business transactions and does not expand the BEAT to a two-tiered system. In addition, in the interests of maintaining global competitiveness, we recommend: (1) allowing for foreign tax credit utilization in a revised BEAT regime; (2) establishing the tax rate applicable to payments included in the BEAT base be maintained at the current rate; (3) continuing the exemption for cost of goods sold (COGS) (or equivalent deductions), including the royalty component of COGS, in determining BEAT payments; (4) changing to the definition of "base erosion payment" for BEAT purposes to exclude any payment by a US taxpayer to a related foreign taxpayer that is included in US tax calculations of the US Shareholder, including as an item of subpart F income or in the determination of tested income or loss under the GILTI regime; and (5) expanding exemptions from BEAT to include an outright exemption for the cost of services, in line with the cost of goods sold exception, not just those services (or portion of services) qualifying under the Services Cost Method.

Subpart F and Branch Income

We oppose applying foreign tax credit limitations to subpart F and branch income, which are already fully taxed at the current U.S. corporate rate of 21%. Double taxing this income would severely disadvantage U.S. businesses vis-à-vis other competitors that would face no such similar negative treatment. If the Committee is interested in providing consistency between GILTI and these types of fully-taxed income, then we would encourage the Committee to remove the foreign tax credit limitations under GILTI.

Other U.S. tax provisions relevant to stated objectives

Relatedly, while not specifically an international tax provision, policymakers should promote U.S. competitiveness and protect U.S. R&D jobs by taking the immediate, critical step of preserving the ability to deduct R&D expenses for tax purposes. Beginning in 2022, companies will be required to amortize these expenses over five years, which will further detract from the United States' ability to compete for R&D investment and jobs. Notably, if companies lose the ability to currently deduct R&D expenses (a large portion of which are wages and salaries for U.S. R&D employees) – which will happen in 2022 if Congress does not act – the U.S. will lose approximately 23,400 jobs in each of the first five years.[8] Such a change would further detract from U.S. competitiveness and sit in marked contrast to both bipartisan efforts in the United States to promote domestic R&D investment and efforts by other jurisdictions around the world to launch or expand initiatives to attract corporate R&D investments. The discussion draft underscores the importance of locating R&D in the United States; letting R&D amortization take effect counteracts the senators' intended objectives.

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[8] Impact of the amortization of certain R&D expenditures on R&D spending in the United States, Prepared by Ernst and Young, October 2019.

Finally, we want to acknowledge U.S. participation in the ongoing OECD/G20 Inclusive Framework negotiations to address the tax challenges arising from the digitalization of the global economy. Of the 140 governments participating in the OECD/G20 Inclusive Framework, 134 governments have reached a political agreement on a multilateral, consensus-based approach to these challenges, and we anticipate further details in October. This is particularly relevant as it relates to understanding the impacts of proposed changes to GILTI and the BEAT vis-à-vis simultaneous Pillar Two discussions concerning a global minimum tax (including the Income Inclusion Rule, the Undertaxed Payments Rule, and the Subject to Tax Rule).

As noted above, the discussion draft contemplates changes to GILTI (and BEAT and FDII) that would make the U.S. international tax regime much more costly and onerous for U.S. multinationals than that of all other jurisdictions operating under a Pillar Two framework. This regime in the U.S. likely could take effect years before any other government implements a global minimum tax. We therefore recommend that the U.S. government evaluates global minimum taxes enacted by other governments before contemplating onerous modifications to the current GILTI and BEAT regimes.

We appreciate the Chairman's continuing opposition to the proliferation of unilateral digital services taxes (DSTs) and similar levies and excise taxes (DSTs by another name) and encourage the Committee to continue working closely on these issues with the U.S. Department of the Treasury, the Office of U.S. Trade Representative, and the rest of the U.S. interagency. As the United States continues to engage, we would appreciate Congress's support in reiterating our expectation for the OECD/G20 Inclusive Framework's project to result in the urgent removal of all relevant unilateral measures, which also have significant implications for the ability of U.S. companies to engage with markets around the world.

Thank you very much for your consideration of our perspectives. We look forward to engaging with you.

Cc: Members of the U.S. Senate Finance Committee