FOREIGN MINIMUM TAX: BUILD BACK BETTER vs. OECD MODEL RULES

The House-passed Build Back Better (BBB) bill would impose a permanently harsher foreign minimum tax on U.S. companies, years before foreign countries adopt minimum taxes on their companies.

The Organization for Economic Co-Operation and Development (OECD) announced plans to establish a global foreign minimum tax in early October, with 137 countries of the Inclusive Framework (IF) signing a framework agreement. But actual adoption of a foreign minimum tax is *entirely voluntary* under the agreement, and the OECD set no deadline for countries to act. The U.S. is the only country in the world that has adopted a foreign minimum tax ("GILTI") and there's no assurance other countries will follow. Moreover, the BBB bill would modify GILTI in ways that would be more burdensome for U.S. companies than the OECD Model Rules.

The net result of BBB would be that a U.S. company would pay more minimum tax under GILTI than an identically situated foreign company under the OECD Model Rules.

ISSUE	GILTI UNDER BBB BILL	OECD MODEL RULES
Effective tax rate	15.8%[1]	15%
Book-tax timing differences	Minimum tax is imposed up front on timing differences, but may be reversed in later years due to a 5-year credit carryforward	No tax is imposed up front on timing differences, but may be imposed later for certain timing differences (excluding depreciation) if not reversed within 5 years
Substance-based exemption for in-country business activity	Exempts a 5% return only on tangible depreciable property	Exempts an 8% return on tangible assets (including non-depreciable assets) and a 10% return on payroll (phasing down to 5% for both over 10 years)
Reduction in substance-based exemption for interest expense	The BBB bill (and current law) reduce the substance-based exemption for certain interest expense	No provision
Refundable tax credits	Treated as a reduction in foreign tax payments, making it more likely the foreign tax rate is brought below 15.8% (triggering tax on GILTI)	Treated as an addition to income rather than a reduction in foreign tax payments, reducing the minimum tax impact compared to BBB
Credit for foreign taxes against minimum tax	Allows a credit for only 95% of foreign taxes	Allows an offset for 100% of foreign taxes
Treatment of losses	Pre-effective date loss carryforwards are not excluded in determining minimum tax liability, including potentially significant Covid-related losses	Pre-effective date loss carryforwards are excluded in determining minimum tax liability (due to a reduction in deferred tax assets)
Expense allocation	Rules allocating interest expense to GILTI would be repealed but a new interest deduction limitation (Code sec. 163(n)) would be imposed on interest expense allocable to GILTI	No provision
Effective date	1/1/2023	Voluntary for countries to enact; few if any are likely to enact before 2024[2]

[1] 15.015% GILTI rate (resulting from a 28.5% deduction) and a 95% credit for foreign taxes means GILTI applies up to a 15.805% foreign tax rate.

[2] Sweden, Estonia, Malta and Bulgaria have warned implementation of the Pillar Two foreign minimum tax in 2023, as called for in the draft European Union Directive, is too ambitious. In addition, Poland, Hungary, Estonia, Bulgaria and Malta want implementation of the foreign minimum tax conditioned on Pillar One. See, www.bloomberg.com/news/articles/2022-01-17/macron-s-push-for-eu-to-implement-global-tax-deal-hits-hurdles