2022

Do GILTI + BEAT + BMT = GloBE?

Mindy Herzfeld

University of Florida Levin College of Law, herzfeld@law.ufl.edu

Follow this and additional works at: https://scholarship.law.ufl.edu/facultypub

Part of the Tax Law Commons

Recommended Citation

50 Intertax 888-897 (2022)

This Article is brought to you for free and open access by the Faculty Scholarship at UF Law Scholarship Repository. It has been accepted for inclusion in UF Law Faculty Publications by an authorized administrator of UF Law Scholarship Repository. For more information, please contact jessicaejoseph@law.ufl.edu.
Do GILTI + BEAT + BMT = GloBE?

Mindy Herzfeld*

The enactment by the United States in August 2022 of a minimum tax on the global book earnings of large corporations (the book minimum tax, or BMT) raises the question of how the US minimum taxes— including the global intangible low-taxed income (GILTI), the base erosion and anti-abuse tax (the BEAT) and the BMT—interact with the global minimum tax, or GloBE, agreed to by over 135 countries under an OECD framework. Particularly important are questions regarding the hierarchy in application of different regimes. In the context of multiple agreements for global minimum taxes, how to determine who gets priority of taxing rights?

To answer these types of questions it’s helpful to parse the technical differences between the different minimum taxes outlined in the GloBE model rules and the US GILTI, BEAT, and BMT. The GloBE model rules fail to provide clear guidance as to whether or not either GILTI or the BMT will provide the United States with the first right to tax the earnings of US companies’ foreign subsidiaries and whether enactment of the BMT will shield US companies from having other countries impose additional taxes on their domestic earnings. But there are good reasons to conclude that taken as a whole, the panoply of minimum taxes enacted by the United States are at least equivalent to the regime for taxing multinationals’ global earnings proposed by the OECD.

Keywords: International tax, tax policy, OECD, minimum taxes, global minimum tax, alternative minimum tax, book minimum tax, pillar 2, GILTI.

The OECD proposal for a global minimum tax (also known as pillar 2) had its impetus in part in the US variation on a global minimum tax (the tax on global intangible low-taxed income, or GILTI1) passed as part of the tax law changes adopted in the 2017 Tax Cuts & Jobs Act.2 As the OECD proposal has gained broad agreement among countries and the details have become solidified, the specifics of how the US version of a global minimum tax will interact with the multilateral agreed upon version become more pertinent.3 Among the questions raised by the interaction of different global minimum tax regimes are those regarding ordering rules and hierarchy. Will the US version of minimum taxes on foreign earned income (including GILTI, the base erosion and anti-abuse tax, or BEAT,5 and the BMT) take precedence over, or be subject to, the minimum taxes agreed upon at the OECD? How does the newly enacted US minimum tax on domestic earnings fit into the GloBE regime? Which country/ies will have first taxing rights over the income of non-US subsidiaries of US multinational companies when the jurisdiction where such income was earned has declined to tax it at what is viewed as a high enough rate? More broadly, what happens when one considers all the different minimum taxes enacted by the United States in their totality, rather than individually?

To answer these questions, a comparison of the OECD model rules with the US GILTI rules, the BMT, and the

Notes

* Professor of Practice, University of Florida Levin College of Law, of counsel, Potomac Law Group. Email: herzfeld@law.ufl.edu.

1 I.R.C. § 951A.


4 I.R.C. § 59d.

5 I.R.C. § 59A.
BEAT is helpful. Comparing and contrasting the OECD’s GloBE model rules with the US provisions gives us a better understanding of how, collectively, the US rules might interact with the global minimum tax regime based on the pillar 2 model rules and affords some hints as to which rules and jurisdictions may take priority. But the analysis leaves many questions unanswered, while negotiations over the details of rules remain ongoing.

1 Income inclusion rules: IIR, GILTI and the BMT

The US tax on GILTI differs from the IIR – the OECD’s proposed income inclusion rule pursuant to which a parent (or intermediate holding) company imposes a top-up tax on low-taxed income of its subsidiaries – in a number of important ways. The BMT shares some similarities with GILTI in taxing the foreign earnings of US companies but in other respects is closer to the IIR. While GILTI applies to all US shareholders of controlled foreign companies (CFCs), regardless of size, both the BMT and the IIR have income thresholds before they apply. But in other respects the IIR and GILTI are closer relatives than the BMT is to either. While the IIR and GILTI are limited to taxing a shareholder on the income of its foreign subsidiaries, the BMT is a truly global minimum tax. The discussion below teases out some of the differences between the three regimes in order to try and get a sense of where these differences might be meaningful, or not.

1.1 Top-up v. Credit

The OECD income inclusion rule functions as a top-up tax – it imposes an additional tax on income earned in a jurisdiction that has been subject to too low a rate of tax (below 15%). Once the effective tax rate in a jurisdiction is determined to be below the agreed upon threshold, the IIR kicks in. If the parent company jurisdiction has an IIR in effect, it will impose a top-up tax equal to the difference between the effective tax rate in the low-taxed jurisdiction and 15%.

The mechanics of the tax on GILTI imposed under I.R.C. section 951A are completely different. Under I.R.C. section 951A, which is essentially a broad expansion of the 1962 enacted US controlled foreign corporation rules (subpart F, I.R.C. sections 951–965), US tax is imposed on a US shareholder (a defined term) of a CFC on all of the CFC’s tested income (a broadly defined category under I.R.C. section 951A that includes all of a CFC’s income minus specifically excluded items), in excess of an amount equal to a fixed return on tangible assets. In other words, the US tax is imposed in full (albeit at a rate lower than the standard US corporate rate) on most of a CFC’s earnings. Relief from double taxation is provided by means of a foreign tax credit, the allowance of which is subject to a multitude of limitations and complex calculations (discussed in greater detail below at 1.3.2).

The IIR tax imposed as a top-up tax may be roughly equivalent to a tax on earnings minus a foreign tax credit, but the two numbers are unlikely to be precisely the same in any particular set of facts. Variations that will result in differences in the final amount of tax imposed under the IIR and GILTI can arise at each step of the calculations.

Like the IIR, the BMT only applies when a minimum tax rate on earnings has not been paid. But like GILTI, the BMT allows for a credit for foreign taxes paid.

1.2 Income Calculation

The GloBE income calculation starts with an entity’s financial statements computed according to accounting principles, with certain adjustments made thereto, as does the BMT. The GILTI tax base, on the other hand, calculates tested income – the amount on which the GILTI tax is imposed – strictly according to US tax rules. These may roughly correspond to financial accounts (because tax calculations always start from accounting books) but given the number of modifications to statutory accounts required by US tax rules to calculate the US tax base, the two sets of accounts rarely fully conform.

1.2.1 Model Rules: GloBE Income

Under the model rules (Article 3.1), the GloBE income or loss of a constituent entity is equal to the entity’s financial accounting net income or loss adjusted for certain items (described in Articles 3.2–3.5). Financial accounting net income or loss is defined as the net income or loss determined for a constituent entity in its consolidated financial statements (before any consolidation adjustments eliminating intragroup transactions).

Notes

6 While some of these differences may have been addressed by amendments proposed by the Biden administration and passed by the US House of Representatives as part of the Build Back Better Act that was passed by the House of Representatives in Nov. 2021, they have not been enacted, and the prospect of legislative changes to US international tax rules in the near future is highly unlikely.

7 The BMT applies to companies with in excess of USD 1 billion of income, for foreign multinationals, an additional test must be met, in that the US earned income must equal at least USD 100 million. Pillar 2 applies to companies with at least EUR 750 million in earnings.

Financial accounting net income or loss is adjusted to arrive at GloBE income or loss by the following items, each of which is separately defined in the model rules: net taxes expense; excluded dividends; excluded equity gain or loss; included revaluation method gain or loss; gain or loss from certain dispositions of assets and liabilities; asymmetric foreign currency gains or losses; policy disallowed expenses; prior period errors and changes in accounting principles; and accrued pension expense. As the long list makes clear, although the starting point for GloBE income is financial statements, a series of policy decisions were made to adjust that tax base, each of which was likely the result of extensive negotiation by Inclusive Framework members.

The model rules include a specific provision to adjust financial statement income for stock-based compensation deductions, often one of the biggest causes of discrepancies between book and taxable income. Article 3.2.2 provides that a constituent entity can elect to substitute the amount allowed as a deduction in the computation of its taxable income in its location for the amount expensed in its financial accounts for a cost or expense that was paid with stock-based compensation.

Another important adjustment or clarification to the GloBE tax base deals with tax credits. Article 3.2.4 provides that qualified refundable tax credits are treated as income in the computation of a constituent entity’s GloBE income or loss. In contrast, non-qualified refundable tax credits are not treated as income in the computation of the GloBE tax base. That means they directly reduce an entity’s effective tax rate, resulting in a greater likelihood that a top-up tax would be imposed.

1.2.2 GILTI Tax Base

In contrast to GloBE, GILTI does not start with financial statements in computing the tax base. In general, I.R.C. section 951A provides that each person who is a US shareholder of any CFC for any taxable year of such shareholder shall include in gross income the shareholder’s GILTI for such taxable year.

I.R.C. section 951A(b) defines GILTI to mean a shareholder’s net CFC tested income over its net deemed tangible income return (NDTIR) for the year. (See discussion below regarding NDTIR.) Net CFC tested income means the aggregate of a shareholder’s pro rata share of the tested income of each CFC with respect to which it’s a US shareholder over the aggregate of CFC tested losses. It’s through this provision that GILTI allows for blending of profits and losses not just within a jurisdiction, but between and among jurisdictions.

Tested income is defined in I.R.C. section 951A as all of a CFC’s gross income but excluding some specific items, including income effectively connected with a US trade or business (as described in I.R.C. section 952(b)), gross income taken into account in determining the CFC’s subpart F income, dividends received from related persons (as defined in I.R.C. section 954(d)(3)), and foreign oil and gas extraction income (as defined in I.R.C. section 907(c)(1)).

The Internal Revenue Code (section 61) provides a general definition of gross income, as including all income from whatever source derived. Treasury regulations elaborate and provide that gross income includes income realized in any form, whether in money, property, or services. Income may be realized, therefore, in the form of services, meals, accommodations, stock, or other property, as well as in cash. The statutory language has remained unchanged since 1954.

To sum up, the GloBE tax base and the GILTI tax base are alike and yet unlike: they both attempt to cast a wide net, but each also allows for adjustments as determined to be appropriate by different sets of rule-writers. The exemption provided by GloBE for a percentage of payroll costs means that in most cases, the tax bases probably won’t be the same; material differences in the calculation of a tax base under the two regimes on a global basis become more likely as the taxpayer is larger and its structure and payment streams are more complex.

1.2.3 The BMT Tax Base

Like the IIR, the BMT is a tax on financial statement income. Like the GloBE model rules, I.R.C. section 56A provides for several important adjustments to the net income as calculated in the financial statements on which the tax enacted by I.R.C. section 55(b) is imposed. However, the adjustments made by I.R.C. section 56A to financial statement income are not the same as the ones made by the GloBE model rules. For example, financial statement income may be reduced by financial statement net operating losses, depreciable tangible property, amortization of qualified wireless spectrum, amounts treated as a payment of certain credits (including general business credits), income from defined benefit pension plans, and some income related to mortgage servicing contracts. Special rules apply for how to include the income of entities that are not included in a US consolidated tax group, including income from foreign entities and partnerships.

Notes

10. In general, subpart F income is passive income or mobile sales or services income. See I.R.C. § 952. Also excluded are any gross income excluded from the foreign base company income (as defined in I.R.C. § 954) and the insurance income (as defined in s. 953) of such corporation by reason of I.R.C. § 954(d)(4).

890

Electronic copy available at: https://ssrn.com/abstract=4404283
The adjustments to financial statement income made in calculating the BMT tax base, like the adjustments made in computing the GloBE tax base, reflect a mix of technical necessity, policy considerations, and political compromises. While the tax base of the BMT is more like the GloBE tax base than the GILTI base, there are important differences between financial statement taxable income as defined under GLOBE and under the BMT.

The tax on GILTI and the BMT are essentially stacked one on top of another, and the tax base calculated for each differs in part but overlaps in part, suggesting that its more likely that a US company will end up having to pay a minimum tax as a result of the combination of the two regimes than it might if just a single regime applied – such as the GloBE. Moreover, while the BMT base is narrower in some respects than the GloBE base – for example, it allows for offset by credits that the GloBE does not – its broader in others, such as by not allowing for a reduction for payroll expense.

1.3 The Inclusion

The objective of a global minimum tax is to subject to tax in a jurisdiction other than the one where the income is earned, income that is determined to be low-taxed in the jurisdiction where earned (in many cases, the residual taxing jurisdiction will be that of the parent company). The US rules for determining whether income is low-taxed, whereby additional tax is imposed under the GILTI regime, are substantively different from the mechanics of the global minimum tax regime laid out in the OECD model rules. And the calculations needed to be performed under both those regimes differs from how the same determination is made under the BMT. Although the three regimes may share similar objectives, each of them reaches its goals from a different starting place and by taking a different route.

1.3.1 OECD Model Rules

Under Chapter 5 of the OECD model rules, the first step in determining the top-up tax for each low-taxed constituent entity is to aggregate the GloBE income or loss of each entity in a jurisdiction (as determined under the rules of Chapter 3) and adjusted covered taxes (determined under Chapter 4). Adjusted covered taxes divided by net GloBE income for a jurisdiction equals the jurisdiction’s effective tax rate. Once those jurisdictions considered low-taxed (those with an effective tax rate below the 15% minimum rate) have been identified, the top-up tax percentage (the difference between 15% and the effective rate) is determined for each. For each jurisdiction that is determined to be low-taxed, the substance-based income exclusion (SBIE) is then applied to reduce net GloBE income; net GloBE income minus the SBIE yields an amount equal to what is referred to as the jurisdiction’s excess profits. The top-up tax percentage is multiplied by the excess profits, and that amount is reduced by any qualified domestic minimum top-up tax (QDMTT) to reach the top-up tax to be imposed for each low-taxed jurisdiction. The top-up taxes then have to be allocated among the constituent entities in the low-tax jurisdiction in proportion to their GloBE income.

The top-up tax of each low-taxed constituent entity is the amount that a parent company jurisdiction includes under the IIR (or that another jurisdiction in which any constituent entity is located can tax under the undertaxed profits rule, or UTPR).

Because the top-up tax is only imposed if, in the aggregate, the entities in a jurisdiction are subject to too low an effective tax rate, determining the effective tax rate is a crucial part of the calculation. The OECD model rules define a jurisdiction’s effective tax rate as equal to the sum of the adjusted covered taxes of each constituent entity located in the jurisdiction divided by the jurisdiction’s net GloBE income in a fiscal year.

Adjusted covered taxes for a constituent entity in a fiscal year are defined as current tax expense accrued in financial accounting net income or loss with respect to covered taxes, with certain adjustments. These adjustments reflect the fact that the definition of covered taxes starts from an accounting concept, and so represent a number not necessarily fully consistent with the goals of pillar 2. Adjustments to be made to the accounting definition of covered taxes include the net amount of additions and reductions to covered taxes for the fiscal year (as determined under Articles 4.1.2, and 4.1.3), the total deferred tax adjustment amount (as determined under Article 4.4); and any increase or decrease in covered taxes recorded in equity or other comprehensive income (an accounting term) relating to amounts included in the computation of GloBE income or loss subject to tax under local tax rules. Although the starting point for the GloBE calculations is financial statements, numerous adjustments are made to reflect the policy goals of pillar 2.

1.3.2 GILTI Inclusion

The inclusion required under GILTI by a US shareholder from a CFC’s income starts from a much different place than the calculation undertaken in computing the IIR under the GloBE rules, and follows a different path.

As described above, a US shareholder is required to include in taxable income an amount equal to its GILTI, defined as net tested income minus the NDTIR. That inclusion has nothing to do with the tax rate in the CFC’s jurisdiction. I.R.C. section 250 then allows a deduction against that amount (currently 50%, but scheduled to decrease in 2026) which results in a lower tax rate applied to GILTI than to domestic earnings (other than earnings that meet the definition of foreign derived intangible income under I.R.C. section 250). After the US tax
liability on GILTI is determined, a foreign tax credit is allowed to offset the US tax liability that would otherwise apply. The amount of foreign taxes paid that may be credited is limited to 80% of foreign taxes paid on the GILTI inclusion, and also may be further limited due to other required calculations, based on whether any CFCs had tested losses that offset CFC tested income, whether the amount of tested income subject to US tax was reduced due to the exclusion for NDTIR, and whether expenses generated in the US were allocable to tested income for this purpose.13

Under the changes proposed by the Build Back Better Act passed by the House of Representatives in 2021, the calculation of net tested income would be performed separately for each jurisdiction, and the foreign tax credit allowed would be subject to a per-country limitation.14 This change would have brought the GILTI calculation closer to the IIR but only with respect to one difference out of many.

A top-up tax imposed only on the income (minus a carve-out) of low-tax jurisdictions might reach a similar result as subjecting to US tax a CFC’s tested income after allowance of the foreign tax credit (subject to a limitation), but at a granular level, the result is likely to be different in each case. Whether such differences should be viewed as material, and who should make that determination, is a question that politicians and policymakers have not yet weighed in on in writing.15

1.3.3 BMT Alternative Tax

The BMT is a little like a top-up tax (like the IIR) but also has similarities to a tax on all income minus a credit (like GILTI). The BMT appears in the US Internal Revenue Code in section 55, which imposes alternative minimum taxes. Pursuant to I.R.C. section 55(a), the BMT is equal to the excess of 15% of the tentative BMT liability minus the regular tax for the year (its also reduced for any tax imposed by the BEAT). But the BMT liability also can be offset by the amount of the corporate alternative minimum tax foreign tax credit pursuant to I.R.C. section 55(b)(2)(A).

1.4 Substance Based Carve-Out

The OECD model rules and GILTI each contain a carve-out from the proposed tax on foreign earned income to reflect a normal rate of return. The BMT also includes a carve-out, in the form of adjustments to financial statement income. The calculation of each of the carve-outs is different.

1.4.1 OECD Model Rules

The OECD model rules define excess profit (the amount on which a top-up tax is imposed) as the positive amount, if any, after the SBIE is subtracted from net GLOBE income. Article 5.3 defines the SBIE amount for a jurisdiction as equal to the sum of the payroll carve-out and the tangible asset carve-out for each constituent entity in the jurisdiction (not including investment entities).

The payroll carve-out is equal to 5% of a jurisdiction’s eligible payroll costs for eligible employees that perform activities for the group in a jurisdiction. The amount specifically excludes payroll costs that are capitalized and included in the carrying value of eligible tangible assets and those that are attributable to international shipping income (which is excluded from the computation of GloBE income or loss).

The tangible asset carve-out is equal to 5% of the carrying value of eligible tangible assets located in a jurisdiction. Eligible tangible assets include property, plant, and equipment, natural resources, a lessee’s right of use of tangible assets located in that jurisdiction, and a licence or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets. Generally excluded from the definition are the carrying value of property (including land or buildings) held for sale, lease or investment and tangible assets used in the generation of international shipping income.

The 5% exclusion rate is not reached until ten years from implementation, however. Article 9 (transition rules) includes a schedule for a graduated decrease in the carve-out percentage, starting at 10% for payroll costs and only gradually decreasing to 5% over ten years; for tangible assets, the carve-out starts at 8% and decreases to 5% over the ten-year period.

1.4.2 GILTI Carve-Out

The GILTI carve-out for a substance-based return is found in I.R.C. section 951A, which defines GILTI as the difference between net CFC tested income and NDTIR. NDTIR is defined for any US shareholder of a CFC as 10% of the aggregate of such shareholder’s pro rata share of the qualified business asset investment (QBAI) of each CFC with respect to which such shareholder is a US shareholder, over the amount of interest expense taken into account in determining the shareholder’s net CFC tested income (to the extent the interest income is not

Notes

13 See generally the rules of I.R.C. § 861 and regulations thereunder.
15 For an overview of politicians’ statements promising that GILTI would be viewed as conforming to GloBE so long as it is amended to apply on a country-by-country basis, see Mindy Herzfeld, The Promise of GILTI Conformity Questioned, 107 Tax Notes Int’l 115 (11 Jul. 2022).
1.5 Tax Rates

A jurisdiction with an effective tax rate below 15% will be subject to the top-up tax imposed under pillar 2 to reach the 15% minimum rate. Under current US law, the corporate statutory rate of 21%, minus the 50% deduction allowed under I.R.C. section 167, is applied to the extent of the amount allowed as deductions in computing taxable income for the taxable year. In general, the reduction is limited to depreciation on tangible assets, but there is also a specific reduction for amortization on wireless spectrum. As with GILTI, there is no reduction for payroll expenses.

1.4.3 BMT Adjustments

Rather than a separate carve-out, the BMT includes as an adjustment to financial statement net income (the base on which the tax is imposed) a reduction for depreciation deductions allowed in connection with I.R.C. section 168 property to the extent of the amount allowed as deductions in computing taxable income for the taxable year. In general, the reduction is limited to depreciation on tangible assets, but there is also a specific reduction for amortization on wireless spectrum. As with GILTI, there is no reduction for payroll expenses.

1.6 Jurisdictional v. Blended

The mechanism by which the top-up tax calculation is performed under GloBE means that the IIR applies on a jurisdictional basis — if any jurisdiction is considered low-taxed, a top-up tax will apply to the income of that jurisdiction, regardless of the group’s overall tax rate (a carryover credit provides some measure of a smoothing out mechanism). In contrast, both GILTI and the BMT are assessed on a blended basis. Although the GILTI tax base starts with a local country calculation, offsets for losses incurred in other countries, and a blending of local tax rates, are allowed as part of the mechanism for arriving at the final GILTI tax base. The BMT, meanwhile, is assessed at the level of consolidated financial statements, taking into account both US and foreign income.

The difference between a minimum tax calculated on a blended basis and that imposed on a country-by-country basis is often highlighted as the most important differentiator between GILTI and the IIR — and the reason why GILTI should not be considered a qualifying IIR. Under that same logic, the BMT would fail to qualify as well.

But as the above discussion highlights, the difference between a minimum tax computed on a blended as compared to that calculated on a jurisdictional basis is by no means the only important distinction between the different versions of a global minimum tax. Moreover, many of the other significant differences between GILTI and the IIR — such as the tax base and the rate — have been obsoleted or at least reduced by passage of a global minimum tax on book income as part of the Inflation Reduction Act. GILTI plus the BMT may not reach precisely the same result as an IIR does, but it comes much closer than GILTI alone would — even a GILTI that would have been modified to be imposed on a country-by-country basis as per the House-passed Build Back Better Act.

Notes

16 I.R.C. § 951A(b)(2). The Build Back Better Act would have modified the NDTIR calculation to limit it to a 5% rate of return (§ 138120) while the Biden administration’s fiscal year 2022 budget would have eliminated the QBAI exemption altogether. But neither proposal would have modified the NDTIR to include an exemption based on a CFC’s employment expenses.

17 I.R.C. § 167. Under I.R.C. § 168, a depreciation deduction is provided for a reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, or property held for the production of income.

18 The Build Back Better Act would have reduced the deduction further to 28.5%. The Biden administration also proposed to increase the corporate tax rate from 21 to 28%, which would also have resulted in an increase in the rate on GILTI.

19 In its fiscal year 2022 budget, the Biden administration proposed revisions to GILTI so that it would be imposed on a separate jurisdictional basis. The House of Representatives acted on the administration’s proposal and included such changes to GILTI in the Build Back Better Act that passed the House in Nov. 2021. Build Back Better Act § 138121. After passage of the Inflation Reduction Act without the inclusion of any international tax changes, it appears unlikely that such proposed changes will be enacted in the near term.

2 The BEAT, the BMT and the UTPR

Both US tax law and GloBE include a provision that would allow for the collection of a minimum tax by jurisdictions in which a multinational group has operations, aside from the jurisdiction of the parent or an intermediate holding company. The OECD’s UTPR and the US BEAT are in theory intended to provide a back-up to the IIR and GILTI, respectively, to encourage other countries to adopt and impose a minimum tax at the parent level. Again, the US version of the alternative minimum tax works much differently than the OECD one.21

2.1 The BEAT

I.R.C. section 59A, enacted in 2017, imposes a BEAT liability on some corporate taxpayers on top of their regular tax liability. In general (and unlike GILTI), BEAT only applies to large corporate taxpayers (those with three-year average gross receipts in excess of USD 500 million),22 and even then only when a company makes deductible payments to foreign related parties above a specified threshold (the base erosion percentage) – generally, when a taxpayer has deductions attributable to outbound payments exceeding 5% of overall deductions.23 That threshold is generally determined by dividing a taxpayer’s base erosion tax benefits by the amount of all allowable deductions. Generally, a base erosion tax benefit is the deduction allowed in the taxable year for a base erosion payment. Base erosion payments include payments to related foreign parties (including deductible payments such as interest, rents, royalties, and services), the purchase of depreciable or amortizable property, certain reinsurance payments, and payments to inverted firms. Payments for cost of goods sold are generally not included, and payments equal to the cost of services may also be excluded in limited cases.24 Base erosion payments are reduced to the extent that the amount is subject to withholding tax.25

If BEAT applies, a taxpayer is subject to an additional tax, above its normal tax liability. The BEAT liability is computed on a tax base equal to modified taxable income minus the taxpayer’s regular tax liability. For this purpose, the regular tax liability is reduced by some credits, including by foreign tax credits. Modified taxable income equals taxable income increased by base erosion tax benefits and adjusted for net operating loss deductions. The BEAT liability generally equals the difference between 10% of modified taxable income and the regular tax liability.26

Although the principle behind the BEAT’s enactment was prevention of inbound base erosion by foreign parented multinationals, the mechanics of the BEAT’s calculations – in particular, its failure to allow foreign tax credits on GILTI inclusions to offset the BEAT liability – means that it has broader application to US parented companies as well. Moreover, because BEAT does not apply to all taxpayers with related party payments, but only to taxpayers with base erosion payments that are large relative to their taxable income, it has odd and probably unintended effects: because it is a minimum tax, it imposes more significant penalties on companies with thin profit margins than highly profitable ones and also impacts services companies more heavily than manufacturing companies (because of the exception for payments for cost of goods sold).

The calculation of the BEAT liability is separate and different from the calculation of the global minimum tax under I.R.C. section 951A. Unlike subpart F or GILTI, BEAT does not require a taxpayer to include an otherwise excluded amount in income, but applies by denying – albeit in a roundabout and convoluted manner – the benefit of otherwise allowable deductions. The mechanics of the calculation of the BEAT liability means that there has been a robust debate over whether the provision may constitute a treaty violation (due to the application of the non-discrimination clause).

2.2 UTPR

The proposed UTPR, although having a similar rationale as the BEAT – a backup to the primary means of imposing a global minimum tax on low-taxed foreign earned income – works very differently than its US counterpart. The calculation of the base and the rate at which the UTPR is imposed is essentially the same as the IIR. The UTPR computation starts with the calculation of GloBE income and effective tax rates in each jurisdiction, just like the IIR does. But the UTPR applies only where there is no IIR to impose a top-up tax by a parent (or intermediate holding) company jurisdiction. In such case, the right to tax jurisdictions’ low-taxed profits is allocated among group members’ jurisdictions, in proportion to their relative percentage of tangible assets and employees of the group. The UTPR outlined in the OECD model rules is not triggered by, nor

Notes

21 The Biden administration has proposed changes to BEAT so that it better conforms to the OECD proposal.
22 The BEAT threshold is different from both the GLOBE threshold (EUR 750 million) and the BMT threshold (USD 1 billion).
23 For taxpayers that are members of an affiliated group that includes a bank or registered securities dealer, the tax applies when base erosion payments exceed 2% of receipts in excess of USD 500 million, and for non-large corporate taxpayers on top of their regular tax liability. For this purpose, the regular tax liability is reduced by some credits, including by foreign tax credits. Modified taxable income equals taxable income increased by base erosion tax benefits and adjusted for net operating loss deductions.
24 The services cost method exception is available only for the cost portion of a payment that otherwise meets the requirements for the exception. See Reg. § 1.59A-3(b)(3)(i)(B).
26 Beginning after 2025, the BEAT rate increases to 12.5%.
is it based on, outbound payments of group members, low-taxed, deductible, or otherwise. It’s simply an alternative means of collecting the top-up tax on low-taxed income of the group as determined according to the same rules that apply in calculating the IIR.

Specifically, the model rules provide that the UTPR top-up tax amount allocated to a jurisdiction is determined by multiplying the total UTPR top-up tax amount by the jurisdiction’s UTPR percentage. That percentage is determined based on a formula. Half of the amount is based on the number of employees in the jurisdiction divided by all of the UTPR employees (equal to the total number of employees of all of a group’s constituent entities located in a jurisdiction that has a qualified UTPR in force), and half is based on the net book value of tangible assets in the jurisdiction divided by the total net book value of the group’s tangible assets.

The model rules leave open the means by which a jurisdiction seeking to collect a top-up tax under the UTPR may do so. Article 2.4.1 of the model rules says that constituent entities located in an implementing jurisdiction shall be denied a deduction (or required to make an equivalent adjustment under domestic law) in an amount resulting in those constituent entities having an additional cash tax expense equal to the UTPR top-up tax amount allocated to that jurisdiction.

2.3 The BMT

The BMT, which is itself an alternative minimum tax, doesn’t need a backup in the form of the BEAT, and indeed the BMT liability is reduced by the amount of any BEAT. It also doesn’t grant taxing rights to other jurisdictions, as does the UTPR. But its similar to the BEAT in that it’s a minimum tax on domestic income, and its similar to the UTPR in that it provides a back-up to other minimum taxes.

2.4 The BEAT, the BMT and the UTPR Compared

The differences between the BEAT and the UTPR described in the model rules are so significant that it is hard to call them the same type of tax. Changes proposed by the Biden administration would bring the US regime closer to the OECD model, but are unlikely to pass in the near term. Meanwhile, the BMT, because it functions as a top-up tax imposed on the parent company of the group, includes no provision similar to either the BEAT or the UTPR. But because it applies as a minimum tax on the US operations of foreign companies that meet a USD 100 million threshold (provided the group also has net income in excess of USD 1 billion) it may share some similarities to the BEAT and the UTPR as well.

3 Domestic minimum taxes

3.1 OECD Model Rules QDMTT

The QDMTT (qualified domestic minimum top-up tax) is featured in a minor way in the OECD model rules but has come to take on much larger significance than the space allotted to it. It’s necessary, therefore, to consider how a QDMTT imposed either by the United States (in the form of the BMT) or other jurisdictions might interact with the other types of taxes outlined by the GloBE and the other US minimum taxes. The guidance released to date is sparse.

The OECD model rules define a QDMTT as a minimum tax included in the domestic law of a jurisdiction that determines excess profits of constituent entities located in that jurisdiction in a manner equivalent to the GloBE rules, increases the domestic tax liability on domestic excess profits to the 15% minimum rate, and is implemented and administered consistently with the outcomes provided for under the GloBE rules, but only so long as the jurisdiction does not provide any benefits related to such rules. A QDMTT can compute domestic excess profits based on an acceptable financial accounting standard permitted by the authorized accounting body or an authorized financial accounting standard adjusted to prevent material competitive distortions, rather than the financial accounting standard used in the consolidated financial statements. The commentary to the model rules says that QDMTTs are creditable against the GloBE top-up tax that would otherwise apply under the IIR and UTPR.

The model rules’ definition of the QDMTT makes clear that a local country’s QDMTT takes priority over a global minimum tax imposed by the parent company jurisdiction, an intermediate holding company jurisdiction, or a jurisdiction that implements a UTPR. That’s because if a country enacts a QDMTT, the tax often will reduce to...

Notes


29 The Biden administration had proposed a different type of QDMTT in its FY2023 budget, to apply when another jurisdiction adopted a UTPR. That proposal would have imposed a tax equal to the excess of 15% of the financial reporting group’s US profits (determined using the same rules as under its proposed UTPR to determine the group’s profit for a jurisdiction) over all the group’s income tax paid or accrued on US profits.

zero the top-up tax that other countries would apply to the income earned in that jurisdiction. At the same time, under the OECD model rules, covered taxes (i.e., those taxes that count in determining a jurisdiction’s effective tax rate for purposes of determining whether the minimum tax rate threshold has been met) do not include any amount of top-up tax accrued under a QDMTT.

3.2 BMT

The BMT is a tax imposed on the global profits of US multinational companies with net income in excess of USD 1 billion or of foreign parented companies with global income of USD 1 billion and income from US operations of USD 100 million or more. Unlike the QDMTT as described in the GloBE rules, the BMT is imposed on both domestic and foreign profits. There are other differences as well. Although both the QDMTT and the BMT are imposed on a tax base of income as computed on financial accounts, the QDMTT, as described above, is determined in a manner equivalent to the GloBE rules. But as outlined above, the adjustments to financial statements prescribed by I.R.C. section 56A for the BMT are not the same ones allowed by the GloBE rules. In particular, the BMT may be reduced for general business credits, including the credit for research and development expenses. Nonetheless, at least some scholars have argued that ‘the variances between the [BMT] and the GloBE rules should be viewed as minor such that the [BMT] should be viewed as substantially equivalent to the GloBE rules, at least in their practical operation vis-à-vis the US jurisdiction’. Reductions to the tax base allowed by the BMT (such as general business credits) are balanced out by some of the reductions allowed by the GloBE rules (such as for a percentage of payroll costs).

Consistent with the general theme, the BMT both has significant similarities to an aspect of the GloBE and enough differences that mean that it doesn’t match up if the 2 are held side by side.

3.3 US Foreign Tax Credits

Final foreign tax credit regulations released by US Treasury in early 2022 would render taxes imposed by another country’s QDMTT or under the UTPR uncreditable. That’s because the regulations deny a credit for foreign taxes imposed on a base that doesn’t allow for deductions that are generally allowable under US law, or that are imposed on a base that includes income sourced under jurisdictional principles not consistent with US rules. In the preamble to these final regulations, Treasury acknowledged that future changes in US law might require rethinking the rules for determining creditable foreign income taxes. But it nevertheless said that it was important to release the final regulations to address ‘novel extraterritorial taxes’, a reference to other countries’ digital services taxes. In the pream-ble to the proposed foreign tax credit regulations that were released the year prior, Treasury said that if an agreement is reached on a new international framework for allocating taxing rights that includes the United States, changes to the foreign tax credit system may be required.

Without further changes to US law there would be no foreign tax credit provided for top-up taxes imposed pursuant to the OECD’s UTPR or QDMTT. The US versions of a global minimum tax — including both GILTI and the BMT — would be imposed in addition to any minimum taxes assessed by other countries under the OECD regime. Although the BMT is imposed on financial statement income and so in theory should allow a credit for foreign taxes paid as reflected in the financial statements, the corporate alternative minimum tax (AMT) foreign tax credit allowed in I.R.C. section 59(b) limits the credit to taxes otherwise creditable under I.R.C. section 901, and so under the parameters of the new Reg. § 1.901–2.

4 CFC regimes

The QDMTT is one type of tax that operates alongside but takes precedence over the main taxes imposed by the GloBE: the IIR and the UTPR. Also taking priority over the GloBE minimum taxes are taxes imposed under CFC regimes. The model rules define a CFC tax regime as a set of tax rules (other than an IIR) under which a direct or indirect shareholder of a CFC is subject to current tax on its share of part or all of the income earned by the CFC, irrespective of whether that income is distributed currently. Under that definition, GILTI and the BMT should constitute CFC regimes.

Article 4.3.2 of the model rules, which provides rules for allocating covered taxes among constituent entities, provides that where the owners of a constituent entity are subject to a CFC regime, the amount of any covered taxes included in the financial accounts of the owners on their share of the CFC’s income are allocated to the constituent entity. In other words, taxes imposed under a CFC regime are reflected in the calculation of an entity’s

Notes

effective tax rate under GloBE, increase an entity’s GloBE effective tax rate, and therefore reduce the amount of any top-up tax that might otherwise be imposed under an IIR or UTPR. The commentary explains that the reason for the rule that allocates CFC regime taxes imposed on a shareholder to the CFC is that the GloBE rules are supposed to apply after the application of the Subject to Tax Rule (the STTR, a special withholding tax for developing countries) and domestic tax regimes, including regimes for the taxation of permanent establishments and CFCs.

An IIR is specifically excluded from the definition of a CFC tax regime. The commentary distinguishes taxes imposed by the IIR from those imposed by CFC regimes on the grounds that the IIR top-up tax is initially computed on a jurisdictional basis so as to bring the tax paid on excess profits in that jurisdiction up to an agreed minimum tax rate. Those taxes are then allocated to each low-taxed constituent entity in proportion to that entity’s GloBE income before being brought into charge by the parent company. The commentary says that given the policy and mechanical differences between an IIR and a tax imposed under a CFC regime, a jurisdiction is not required to replace an existing CFC regime with the IIR and is permitted to employ both an IIR and a CFC regime in its domestic tax laws.

The allocation and ordering rules for covered taxes imposed under a CFC regime and the explanations provided by the model rules and commentary raise many questions. The OECD’s rationale for distinguishing between the IIR and CFC regimes isn’t based on any principled reasoning. IIR and UTPR taxes are not covered taxes for purposes of computing a QDMTT, but the rules are silent as to whether CFC regime taxes might be, or whether CFC regimes could or should give credit for QDMTTs (or for UTPRs). The lack of guidance as to how taxes imposed under CFC regimes might interact with taxes imposed under QDMTTs (which are calculated in a manner equivalent to IRs and UTPRs but don’t provide a credit for those taxes) is compounded by the lack of any guiding principles that might be helpful in reaching an answer as to which tax regimes should take priority.

5 Conclusion: A single regime compared to interlocking parts

One of the most complicated aspects of an interlocking and hierarchical set of rules such as the global minimum taxes proposed by the GloBE is getting the ordering rules correct. The OECD model rules and commentary suggest that the GloBE rules should apply after domestic tax regimes, including those that tax the earnings of CFCs. To preserve the intended rule order, the commentary says domestic regimes shouldn’t provide a foreign tax credit for any tax imposed under a qualified UTPR or IIR in a foreign jurisdiction. Otherwise, applying that domestic regime would create circularity problems because those taxes have already been determined before applying the UTPR or IIR. However, the OECD guidance is silent on priority between CFC regime taxes and QDMTTs, even while one might expect broad adoption of QDMTTs.

If neither GILTI nor BMT is considered a qualified IIR, they should be considered qualified CFC regimes. But that doesn’t fully settle questions regarding priority of taxing rights. The model rules say that CFC regime taxes are allocated to a jurisdiction as covered taxes, but giving credit to taxes imposed by GILTI as covered taxes assumes some congruity between how US foreign tax credit rules allocate foreign taxes among entities (or jurisdictions) and how the model rules do so. That type of guidance is simply absent from the model rules and, given the complexities of US foreign tax credit rules, it’s hard to imagine how differences between the regimes would be resolved in a way that would allow for conformity of results. If other jurisdictions decide not to accept the US allocation, regardless of GILTI’s status as a CFC regime, and regardless of the GILTI rate, a foreign subsidiary of a US company may be determined to be low-taxed, with group income potentially subject to an additional UTPR.

Nonetheless, there are good reasons to view the interlocking set of US minimum taxes – comprising a minimum tax on foreign earnings (GILTI), a minimum tax on outbound payments (the BEAT), and a global minimum tax on book earnings (the BMT) as at least equivalent to the regime outlined by the GLOBE model rules. Combined, the US rules impose a rigorous set of minimum taxes on both domestic and foreign earnings of US companies and foreign companies with US operations. They represent a meaningful and substantive step in advancing the overall objectives of the OECD 2-pillar project that should be acknowledged and recognized by other jurisdictions.

897

Notes

55 Article 10, Par. 8.
56 See Wardell-Burns, supra n. 28.