

# TCJA'S BUSINESS TAX PROVISIONS: DESIGN FLAWS AND UNDEMOCRATIC IMPLEMENTATION

Testimony before the U.S. House of Representatives Ways and Means Committee

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Chairman Neal, Ranking Member Brady, and Members of the Committee. Thank you for inviting me to testify on the "Tax Cuts and Jobs Act" (TCJA) and, in particular, on the efficacy of its business provisions and issues surrounding their regulatory implementation. My name is Rebecca Kysar, and I am a professor of law at Fordham University School of Law. My primary areas of research are tax policy, international tax, statutory interpretation, and the tax legislative and regulatory processes. Before entering academia, I practiced tax law at Cravath, Swaine & Moore in New York, which included advising on cross-border mergers, acquisitions, and restructurings.

TCJA made the most significant changes to the tax code since 1986, and experts will endeavor to understand its effects for many years to come. Two concerning trends have already emerged, however:

- 1. TCJA has failed to live up to its promise of broadening the tax base on the foreign income of multinational corporations, which was the quid pro quo for a lower corporate tax rate.*
- 2. Treasury has weakened these already generous features of TCJA in the face of intense lobbying for business interests, which will further erode the U.S. tax base. Troublingly, many of these regulatory giveaways have no statutory basis.*<sup>2</sup>

The revenue costs of taxpayer giveaways through the regulations are in the tens, possibly hundreds, of billions of dollars. The Congressional Budget Office recently revised their projected revenues associated with certain provisions of the 2017 tax act. While there are many moving and offsetting pieces, CBO noted that one of those pieces was a reduction in corporate revenues of approximately \$110 billion (or 3.2 percent) over the ten-year budget window. According to CBO, this reduction stems mostly from projections related to TCJA's international provisions due to Treasury's implementation of the law, new tax and financial data, and updated information on taxpayers' responses.<sup>3</sup>

Notably, Congress was only able to pass TCJA through the reconciliation process because the statute as written fit within the \$1.5 trillion cap in the budget resolution. The regulations allow tax reductions that are not based on the statute, with the result being a greater revenue loss and therefore an end-run around Congress's budget rules.

Looking forward, Congress must exercise careful oversight of Treasury's implementation of the tax laws so that it does not continually tilt towards the connected and well-funded. Creative solutions to this problem exist, such as rescission of the regulation, the appointment of an ombudsman to protect the public interest in rulemaking, making more transparent different avenues for participating in the rulemaking process, highlighting the budgetary costs of irresponsible rulemaking, requiring more detailed disclosure of tax liability, and simply delegating

less through more precise statutory drafting. These changes can help further democratic legitimacy and protect revenues.

## **I. TCJA's new international base broadening provisions, which were the quid pro quo for the lower corporate tax rate, largely preserve incentives to profit shift.**

*TCJA's international base broadening provisions have failed to significantly reduce incentives for multinational corporations to shift their profits offshore. Notably, the international base broadening provisions were the quid pro quo for the low corporate tax rate. That they did not alter the status quo with regard to profit shifting makes for a costly trade.*

TCJA adopted a 10.5% minimum tax on certain foreign income of foreign subsidiaries to combat incentives for multinational corporations to shift their profits offshore under TCJA's new quasi-territorial regime. The design of the minimum tax, however, largely preserves profit shifting incentives as compared to pre-TCJA law.<sup>4</sup> This is illustrated by the fact that, leaving aside the one-time transition tax, the JCT's score for the international provisions in TCJA indicated a \$14 billion revenue *loss* for the ten years subsequent to enactment.<sup>5</sup> And now CBO has made a recent downward technical adjustment of \$110 billion, largely attributed to the law's international provisions, including from Treasury's regulations and new financial data. While CBO does not provide further information on which international regulations might be contributing to this downward adjustment in revenue, below I discuss some areas where the Treasury regulations have been overly generous to corporations, perhaps in ways that the scorekeepers did not anticipate in their initial estimate of the law.

The international base broadening provisions were the quid pro quo for the low corporate tax rate. That they did not alter the status quo with regard to profit shifting makes for a costly trade. The new 21% corporate tax rate loses significant revenue.<sup>6</sup> Moreover, it is an overly generous reduction of the overall tax burden on corporate income when one takes into account that many institutional shareholders are tax-exempt (thus eliminating the shareholder burden of the corporate double tax) and that expensing currently eliminates taxation on the normal return on capital. TCJA proponents cited competitiveness concerns as the reason for lowering the rate. Prior to TCJA, however, there was little evidence that U.S. corporations were competitively disadvantaged.<sup>7</sup>

## **II. Treasury has issued taxpayer friendly regulations in contravention of the statute, benefitting multinational corporations and large businesses, and further weakening an already flawed system.**

*The ambitious scope of TCJA, as well as the rushed process in which it was enacted, has posed an enormous challenge for Treasury, which is charged with interpreting and implementing the legislation. Several dynamics weight this process in favor of sophisticated taxpayers, particularly those that have resources to influence the regulatory process. This tilts the already generous provisions of TCJA even more towards benefitting multinational corporations, wealthy individuals, and large businesses.*

## A. The TCJA Regulatory Process

TCJA was enacted through the reconciliation process in a matter of weeks without a single Democratic vote or even a hearing. In contrast, Congress considered the bipartisan 1986 reform over the course of three years. In the bipartisan 1986 reform, members from both sides of the aisle painstakingly put together the legislation only after Treasury produced a 262-page report on the contours of the new tax plan, the Ways and Means Committee heard testimony from more than 450 witnesses, and the Senate Finance Committee held 33 days of hearings.<sup>8</sup>

Given the complexity of the new TCJA regime, its truncated legislative process was bound to create problems. Treasury was left in the position of interpreting and implementing hastily drafted provisions that interacted with old law in sometimes unforeseen ways. This opened the door for taxpayers with resources to exercise significant influence over the regulatory process, which lacks safeguards against such abuse. Even when career staff at Treasury protested proposed regulatory rules on the basis that they lacked statutory authority, political appointees within Treasury reportedly dismissed their concerns.<sup>9</sup> This illustrates that institutional safeguards cannot always withstand political pressures to pursue policy objectives.

In order to protect the administrative state against democratic deficiencies, administrative law mandates that an agency must provide notice of proposed regulations and grant the public an opportunity to comment on them. Yet nothing prevents sophisticated actors from rushing directly to agency officials in hopes of catching their ear prior to this “notice and comment” period. These pre-notice communications, which are not transparent to the public, benefit from first-mover advantage.<sup>10</sup> If a special interest can influence Treasury toward a favorable interpretation initially, it is likely that interpretation carries over into the final regulations.<sup>11</sup>

In the case of the TCJA, sophisticated parties clearly benefitted from these nontransparent first-mover advantages. Before the ink was dry on the TCJA, business actors and representatives swarmed Treasury to advocate for their interests.<sup>12</sup> Treasury officials reportedly met with lobbyists for companies and industries roughly ten times a week.<sup>13</sup> At crucial turns, Treasury acquiesced to their demands, sometimes in contravention of clear statutory language. Notable examples of this can be found throughout the regulations implementing the new international tax provisions, Section 199A, and the opportunity zone incentives.

These first-mover advantages compound the greater participation that sophisticated parties already have in the formal notice and comment period. In the tax context, industry actors tend to dominate the formal notice and comment process. This is because they have resources to deploy and because they stand to gain more from a favorable interpretation than any particular member of the public stands to lose from it. Furthermore, members of the public who are disadvantaged by Treasury giveaways to sophisticated taxpayers likely do not have standing to challenge such giveaways under current law.<sup>14</sup> Tax practitioners and bar associations are further constrained by client interests from making anti-taxpayer comments.<sup>15</sup> These resource and incentive differentials generally result in little public-interested comment in the regulatory process.

The phenomena of delivering regulatory benefits to taxpayers without clear statutory authority is an old problem of bipartisan pedigree. During the financial crisis of 2008, for instance, the Bush-

era IRS issued guidance that allowed multi-billion-dollar relief from Section 382's loss limitations on acquired companies.<sup>16</sup> The guidance was tailored to benefit banks, purportedly Wells Fargo to facilitate its acquisition of Wachovia. The Obama-era IRS continued this approach to extend similar benefits to the Treasury Department upon a sale of its shares of General Motors, again without statutory support.<sup>17</sup>

The rushed and unorthodox manner in which Congress now legislates, however, creates more ambiguous and imperfect tax provisions than in the past.<sup>18</sup> In this new legislative environment, Treasury and the IRS will be under tremendous strain to provide guidance quickly to taxpayers. Exploring ways in which Congress can help protect against agency capture and democratic deficiencies is more pressing than ever.

The below examples are a non-exhaustive list of TCJA regulations that go beyond the text of the statute. Note that for space reasons, some of the interpretive analysis resides in the endnotes.

## **B. Examples of Treasury Overreach from the International Provisions**

### ***1. GILTI***

*Treasury exceeded its authority in issuing the high tax exception to the minimum tax regime and in regulations calculating the exempt deemed return under the regime. This incentivizes multinational corporations to engage in more profit shifting than exists under the statute.*

#### ***a. The High-Tax Exception Election***

The new 10.5% minimum tax (GILTI) on certain foreign source income allows corporations foreign tax credits for 80% of foreign income taxes. This generally means that no GILTI liability ensues if a taxpayer pays a tax rate of at least 13.125% abroad.<sup>19</sup>

Shortly after GILTI was enacted, however, tax experts quickly noticed that GILTI liability may occur even when the foreign tax rate exceeds 13.125%.<sup>20</sup> This is because, in determining the foreign tax credits, expense allocation rules require that some expenses that generally have worldwide benefits (like research, interest, and overhead) have to be allocated, in part, to reduce foreign source income (and hence their foreign tax credits) even though they are incurred in the United States. These rules thus strive to better match income with economic reality and to prevent taxpayers from improperly inflating their foreign source income to reduce their tax liability. In circumstances where such expenses are allocated to foreign source income, taxpayers may have GILTI tax liability even when they are paying a foreign effective tax rate exceeding 13.125%.

Taxpayers who were unhappy with this result lobbied Treasury to implement a high-tax exception that would eliminate GILTI tax liability whenever a taxpayer paid at least a 13.125% effective tax rate. In proposed regulations, Treasury acquiesced to their demands, specifically citing comments they had received from taxpayers in their decision to do so. For reasons explained below, however, Treasury granted the high tax exception only for those taxpayers paying at least an 18.9% rate abroad who elect into the exception.<sup>21</sup> In so doing, Treasury exceeded its statutory authority.

The route that Treasury used to justify the high-tax exception is through the subpart F regime, which requires current inclusion of generally passive income at the full 21% corporate rate (as opposed to the GILTI rate of 10.5%). Subpart F has a high-tax exception for certain categories of Subpart F income (specifically “foreign base company” income and “insurance company” income) taxed at a foreign rate that is more than 90% of the regular 21% corporate rate (or 18.9%). The new GILTI statutory provisions state that income excluded from Subpart F by reason of this pre-existing high-tax exception (in addition to subpart F income generally) is also excluded from GILTI.<sup>22</sup> Treasury seized upon this cross-reference as a means to provide corporate taxpayers with what they wanted. Unfortunately, the language of the cross-reference cannot bear the meaning given to it by Treasury.

Specifically, the GILTI cross-reference carves out from the definition of income subject to GILTI:

[A]ny gross income excluded from the foreign base company income (as defined in section 954) and the insurance income (as defined in section 953) of such corporation by reason of section 954(b)(4) [the high-tax exception in subpart F].<sup>23</sup>

The clear reading of this language—indeed the only reasonable reading of it—excludes from GILTI only that income that would otherwise be *foreign base company* or *insurance income* but for the high-tax exception in subpart F. In the regulations, however, Treasury has twisted the words of the statute to exclude any income, be it within the enumerated categories or not, so long as the income is subject to an 18.9% or higher rate abroad. Effectively, Treasury’s strained reading adds the following nonsensical language to the statute:

[A]ny gross income excluded from the foreign base company income (as defined in section 954) and the insurance income (as defined in section 953) of such corporation by reason of section 954(b)(4) **as well as any income that would have been excluded by reason of that subsection but for the fact that it did not constitute foreign base company income and insurance income.**

Treasury justified its statutory reading by noting in the Preamble to the regulations that there is nothing in Section 954(b)(4) that restricts its application to income that “first qualifies as” foreign base company income or insurance income but instead that subsection applies to “any item of income received by a controlled foreign corporation.”<sup>24</sup> The language Treasury quotes from the statute reads in full: “*foreign base company income and insurance income shall not include any item of income received by a controlled foreign corporation*” that is taxed at the requisite high rate. No school of statutory interpretation would construe this language to include income other than those two enumerated categories. As Stephen Shay has succinctly reasoned, “under the statutory language, you do not even get to Section 954(b)(4) unless the income in question would otherwise be Subpart F foreign base company income or insurance income, so income excluded from Section 951A ‘by reason of’ Section 954(b)(4) cannot be read to cover any other income.”<sup>25</sup>

Not only does Treasury’s reading go beyond the clear terms of the statute in this regard, but Treasury went further to create a taxpayer election where one does not exist in the statute. Tax elections always serve to benefit the taxpayer since the taxpayer will only elect when it is in its interest to do so.<sup>26</sup> In this situation, the election is extremely taxpayer-friendly, since some taxpayers with income subject to high foreign tax rates would prefer to follow the statute and report the GILTI inclusion along with the related foreign tax credits, while other taxpayers would prefer

to make the election in the regulations and exclude the income from GILTI. Neither the text nor the legislative history justifies this result.<sup>27</sup>

#### *b. The Calculation of the Exempt Return in GILTI*

Although the high-tax exception to GILTI is perhaps the most egregious example of Treasury making a gift to taxpayers, in derogation of statutory language, the regulations implementing the international regulations contain other examples.

In determining GILTI, the statute allows the taxpayer to exclude a deemed 10% return on tangible assets held abroad, as measured by tax basis. This exclusion, however, is reduced by interest of the controlled foreign corporation (CFC). The more interest expense allocated to the deemed return, the lower the net deemed return and the greater the GILTI liability. Taxpayers thus wish to reduce the amount of interest allocated under the statute. Treasury has contravened the words of the statute by allowing the taxpayers to net *all* of their interest income against interest expense, rather than just the interest income received from related parties as is required by the statute<sup>28</sup> This rule reduces the amount of interest expense they have to subtract from the exempt deemed return, and, in turn, decreases their GILTI liability.<sup>29</sup>

#### *2. Bank Relief from BEAT*

*Treasury exceeded its authority in carving out certain foreign banks from the new base erosion and anti-abuse tax, in response to lobbying from banks like Credit Suisse and Barclays. Treasury's position allows those entities to erode the US tax base by making deductible payments to related parties.*

In addition to the GILTI regime, TCJA also created the new Base Erosion and Anti-Abuse Tax (BEAT), which is a minimum tax regime that applies to certain domestic corporations that make deductible payments to foreign affiliates. Specifically, the BEAT requires that a U.S. corporation calculate its normal corporate tax liability at the 21% rate and then recalculate its liability adding back in certain deductible payments to related parties, such as interest, royalties, and service payments, but at a 10% rate. If the latter recalculation exceeds the regular tax liability, the corporation owes the additional amount.<sup>30</sup>

The BEAT applies to foreign banks that lend money to their U.S. affiliates in order to meet American regulatory requirements, that is before Treasury decided otherwise. Specifically, the clear statutory language of the BEAT encompasses the interest paid from the U.S. entities to their foreign parent companies. The new rules did not incorporate any kind of test that hinged on taxpayer intent to avoid taxes. Congress instead chose bright-line rules for this anti-abuse regime. Thus, the regulatory impetus behind the banks undergoing these transactions is irrelevant under the statute.

A few large foreign banks, including Credit Suisse and Barclays, reportedly lobbied Treasury for relief from the BEAT.<sup>31</sup> Treasury granted their request in the form of an exception for interest payments on debt issued by domestic “global systemically important banking organizations” where the debt is issued in response to requirements imposed by the Federal Reserve to minimize the risk of insolvency.<sup>32</sup>

Treasury, in later regulations and again in response to business interests, expanded the non-statutory exception to apply to foreign and not just domestic institutions so long as they are subject to regulations similar to those issued by the Federal Reserve in the domestic context. Further, Treasury expanded the exemption for domestic institutions by allowing a buffer amount of excluded payments on interest on debt that exceeded the Federal Reserve's regulatory requirements. In so doing, they responded to industry arguments that banks regularly issued securities above the regulatory requirements in order to accommodate changing balance sheets.<sup>33</sup>

Treasury justified these exceptions, which have no roots in statutory text, by the specific grant of authority in § 59A(i), which, like many other Code provisions, directs Treasury to “prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.” Notably, this is distinct from more expansive grants of authority where Congress instructs Treasury to “carry out the purposes” of the section.<sup>34</sup> This more narrow grant of authority does not allow Treasury to contravene the requirements of the section by creating new exceptions to the minimum tax.<sup>35</sup>

In later communications, a Treasury spokesperson would defend the bank carve-out, stating that, “[w]e were responsive to job creators.”<sup>36</sup> This statement does not obviate Treasury's duty to abide by the law and instead indicates that the “notice and comment” process is in fact being dominated by special interests who are undermining the rule of law.

Treasury's unilateral foreign bank relief will likely cost billions in revenue. Officials at the Joint Committee on Taxation (JCT) put the revenue loss of exempting international banks at up to \$50 billion, which is nearly a third of the BEAT's projected revenue collection.<sup>37</sup> UBS, which lobbied for the regulatory changes, reported in its public filings that it expected to owe no BEAT liability due to regulations “that were considered helpful to foreign banks.”<sup>38</sup>

### **C. Examples of Treasury Overreach from the 199A Regulations**

*Treasury exceeded its authority in allowing high income service providers a pass-through deduction for which they should have been ineligible under the statute.*

Section 199A is a new tax deduction for passthrough entities and sole proprietors. It attempted to appease noncorporate business interests that did not receive the benefit of the reduced corporate rate. The provision contains guardrails to narrow its scope, the efficacy of which were widely questioned prior to the enactment of TCJA.<sup>39</sup> The scope of these guardrails has been the subject of intense lobbying in the regulatory process, with Treasury adopting lenient stances in the face of such pressure.<sup>40</sup> Overwhelmingly, the comments received in both the pre- and formal notice period were from industry or business interests rather than those representing the public interest.<sup>41</sup>

Section 199A provides up to a 20% deduction on “qualified business income.” The deduction is denied for taxpayers with income above certain amounts if the business is providing services within certain categories (health, law, consulting, and financial, among others). In addition to these specified services, the statute also denies the deduction to a catch-all category of trade or businesses whose principal asset is the “reputation or skill” of the owners or employees. This catch-all clause, as written, should have significantly narrowed the application of the 199A deduction.

The final 199A regulations, however, come close to reading the catch-all clause out of the statute. Under the regulations, the clause only applies to fact patterns in which an individual or pass-through entity is engaged in the trade or business of receiving income from endorsements, the licensing of an individual's likeness or features, and appearance fees. The regulations thus essentially strike "skill" from the catch-all clause by focusing only on narrow circumstances that involve reputation.

The regulations go further to also grant the deduction if reputation is combined with skill. For instance, the regulations contain an example of a well-known chef who receives profits from restaurants as well as a fee for endorsing cookware. According to the regulations, the restaurant income receives the deduction whereas the endorsement fee does not.<sup>42</sup> Here the chef remains entitled to the deduction for the restaurant income presumably because the chef is generating returns in the restaurant by mixing labor with reputation.<sup>43</sup> But this result is in contravention of the statute, which limits the deduction if the principal asset of the business is attributable to reputation *or* skill.<sup>44</sup>

Rather than upholding Congressional intent, this regulation undermines it by providing high-income service providers a deduction for which they should have been ineligible under the statute. This contravenes the structure of Section 199A, which attempts to draw a distinction between businesses primarily based on "reputation and skill" (including the specifically enumerated ones) and other businesses.

Other examples of Treasury stretching the statute to accommodate lobbying interests include its implementation of the definition of "brokerage services," which is listed in the statute as one of the industries disfavored under § 199A. The regulations carve out real estate brokers and insurance brokers from that term.<sup>45</sup> Similarly, the regulations allow banks to qualify for § 199A by excluding deposits and making loans from the definition of "financial services," which is another disfavored industry under the statute. In the Preamble, Treasury noted that this carve-out was in response to comments from taxpayers.<sup>46</sup>

#### **D. Examples of Treasury Overreach from the Opportunity Zone Regulations**

*Treasury exceeded its authority in relaxing, sometimes completely lifting, the requirements to substantially improve property in the economically distressed opportunity zones.*

TCJA's opportunity zone provision lets investors defer capital gains on assets by "rolling" them into funds that make real estate investments in "opportunity zones" or areas that have been designated as low income.<sup>47</sup> If investors meet certain requirements, they can receive tax-free basis on their assets and even permanently exempt the gains under certain circumstances.

In order to further the provision's purpose of revitalizing disadvantaged areas, the statute defines the scope of permissible investments that a fund can make to qualify for the tax advantages. Among the permissible investments are purchases of "qualified opportunity zone property."<sup>48</sup> The statute cross-references Section 179 to require that such purchases be from *unrelated* parties. The regulations, however, extend the definition to leases from *related* parties.<sup>49</sup>



The statute also requires that these investments either coincide with the “original use of the property” or “substantially improve” the property, which is defined as “additions to basis.”<sup>50</sup> Basis is a tax concept that is defined as the original cost of property adjusted upward by capital expenditures made to the property and downward by depreciation deductions.<sup>51</sup> Capital expenditures are in turn defined as “permanent improvements or betterments made to increase the value of any property.”<sup>52</sup> The IRS has, in the residence context, illustrated this concept with the following examples: a home addition, replacing an entire roof, driveway paving, installing central air conditioning, or rewiring your home.

Flouting the common understanding of basis and “permanent improvements,” including its prior interpretations of the concept, in the opportunity zone context Treasury has expanded “additions to basis” beyond the statute to purchases of tangible property such as linens, mattresses, furniture, and gym equipment.<sup>53</sup>

Treasury went even further in creating a non-statutory exception for vacant land. Contrary to the text of the statute, as well as the intent of Congress in bettering underprivileged communities, vacant land need not satisfy the original use or substantial improvement test so long as the land is used in a trade or business or there is an intention to improve the land within 30 months of purchase.<sup>54</sup> Treasury justified this statutory departure on policy grounds.

### **III. A Congressional response to Treasury’s actions is warranted to defend the rule of law and to preserve the connection between taxation and representation.**

*In order to defend the rule of law and protect the connection between taxation and representation, there are possible avenues Congress could explore to respond to agency overreach. These include rescission of the regulation, the appointment of an ombudsman to protect the public interest in rulemaking, making more transparent different avenues for participating in the rulemaking process, highlighting the budgetary costs of irresponsible rulemaking, requiring more detailed disclosure of tax liability, and simply delegating less through more precise statutory drafting.*

***Statutory Fixes and Power of the Purse.*** When possible, Congress could rescind Treasury’s misguided implementation of the law through clarification of the statute. The House and Senate could also pass a joint disapproval resolution striking down a particular regulation or set of regulations under the Congressional Review Act (CRA), so long as certain procedural requirements are met. Finally, Congress has, in the past, put in an appropriations bill a provision that no money can be spent on implementing a specific regulatory provision with which it disagrees.

***Empower Federal Officials.*** One possible solution to the lack of standing to challenge Treasury and the IRS actions benefitting certain taxpayers would be a Congressional grant of power to an ombudsman, inspector general or other federal official to bring suit against Treasury and the IRS for regulatory decisions that contravene statutory authority.<sup>55</sup> Congress has taken such an approach in other circumstances.<sup>56</sup> Since the United States has standing to bring criminal suits, it has been suggested that Article III standing does not require injury in fact and suits by appointed federal

officials may meet the standing hurdles.<sup>57</sup> Nonetheless, the constitutionality of this approach is unclear.

***Improve the regulatory process.*** The failures of implementing TCJA indicate a need to improve transparency in the rulemaking process. First, Congress could mandate that Treasury publicize any written comments it receives during the pre-notice period as well as provide a record of in-person contacts with private parties if they pertain to the rulemaking process no matter if they occur pre- or post-notice.<sup>58</sup> Second, Congress could require Treasury to convene advisory councils that represent the public interest to assist Treasury in the rulemaking process.<sup>59</sup> Relatedly, Congress could also expand the Taxpayer Advocate Service to have a more direct role in the formation of regulations.<sup>60</sup>

***Making the costs transparent.*** One troubling aspect of regulatory giveaways to taxpayers is that they are never paid for. To the extent a regulation contravenes the statute, the cost of the rule will not be factored into the original JCT score of the legislation. When Treasury promulgates the regulation, however, it then becomes law. For purposes of enforcing the budget rules, the new non-statutory interpretation will be subsumed within the CBO baseline, which is primarily constructed from current law. This means that the cost of the taxpayer-friendly regulation will escape the budget process entirely.<sup>61</sup> Congress could task JCT with evaluating all Treasury and IRS tax guidance and producing a revenue estimate where that guidance is deemed significant. Congress could specify a threshold, such that guidance is deemed significant when it has an effect of greater than, say, \$100 million on receipts or spending (in either direction) relative to the baseline.<sup>62</sup>

***Require Better Public Disclosure of Tax Liability.*** U.S. securities laws require detailed disclosure of the components of income tax expense that exceed 5 percent of their income before tax, multiplied by the applicable statutory tax rate.<sup>63</sup> Many corporations, however, seem to be circumventing this rule by grouping GILTI liability with other expenses and benefits.<sup>64</sup> Congress should use its oversight authority to ensure the SEC is enforcing this provision adequately. Alternatively, Congress could make a statutory rule requiring disclosure of tax liability under TCJA's base erosion provisions. This would allow scrutiny of whether the new regime is working as intended and whether Treasury's implementation of it is overly generous.

***Delegate Less.*** Treasury's implementation of TCJA should serve as a cautionary tale to Congress in rushing complex tax legislation through the reconciliation process. The interpretive challenges underscore the necessity for Congress to slow down the process and legislate with more precision. It also serves to highlight the dangers in delegating broadly to Treasury without at least tightening the regulatory process. The lack of representation of the public interest, transparency and budget accountability, along with the inability for taxpayers to challenge improper revenue-losing regulations, means that the process will inevitably be weighted towards special interests. This exacerbates already existing problems with the legislative process. Rather than delegate broadly to Treasury, the TCJA regulatory process suggests that Congress should re-assert its primary role over tax lawmaking. It is vitally important that Congress guards its taxing and spending powers carefully in order to maintain ways to rein in the executive. This comports with the constitutional framework of entrusting Congress with special duties over taxation.<sup>65</sup>

## Conclusion

*Since the birth of the nation, taxation and democracy have been closely intertwined. Congress must exercise its oversight authority to ensure that agency actions do not sever that connection. The integrity of the tax system and the rule of law are at stake. Congress must give Treasury the tools it needs to weigh the public interest against private ones. Improving upon the tax legislative and regulatory processes will serve that end.*

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<sup>1</sup> This testimony represents only my views and not any organization with which I am or have been affiliated. I thank Kim Clausing, Samantha Jacoby, David Kamin, Leigh Osofsky, and Michael Schler for comments on earlier drafts.

<sup>2</sup> These developments were not unforeseen. Prior to TCJA's enactment, academics and other commentators warned of their possibilities given the inherent design flaws in the legislation, the rushed manner in which it was passed, and foreseeable dynamics in the regulatory process. *See, e.g.,* David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches under the House and Senate Tax Bills* (Dec. 7, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3084187](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3084187) [hereinafter Kamin et al., *Games I*]; David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439 (2019) (updated version) [hereinafter Kamin et al., *Games II*]. I co-authored these reports.

<sup>3</sup> CONG. BUDGET OFF., THE BUDGET AND ECONOMIC OUTLOOK: 2020-2030 (2020), 73-74, <https://www.cbo.gov/system/files/2020-01/56020-CBO-Outlook.pdf>. *See also* CONG. BUDGET OFF., *Recent Changes in CBO's Projections of Corporate Income Tax Revenues* (Feb. 7, 2020), at <https://www.cbo.gov/publication/56121> (reiterating that the revisions reflected, in part, implementation of the law, "including regulations announced by the Internal Revenue Service over the past year.").

<sup>4</sup> *See* Rebecca M. Kysar, *Judging the New International Tax Regime*, Testimony before the U.S. Senate Committee on Finance (Apr. 24, 2018). Specifically, the minimum tax currently allows multinationals to blend their tax credits from high and low tax countries, thereby incentivizing profit shifting towards *both* types of jurisdictions. Applying the minimum tax on a per-country basis would foreclose the existing ability of corporate taxpayers to offset their U.S. tax liability of foreign income in low-tax countries with foreign tax credits on income from high-tax countries. Professor Kimberly Clausing estimates that a per-country minimum tax reduces haven profits by 23 to 31 percent as compared to 12 to 16 percent under a global minimum tax. Kimberly A. Clausing, *Profit Shifting Before and After the Tax Cuts and Jobs Act*, (Working Paper January 20, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3274827](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3274827). Additionally, the generous GILTI deduction taxes foreign income at half the rate of domestic income, encouraging profit shifting. Decreasing the effective rate differential between the two types of income would decrease incentives to shift profits. Prior minimum tax proposals set the minimum tax rate at 67% of the regular corporate rate. The White House and Dep't of the Treasury, *The President's Framework for Business Tax Reform: An Update 4* (2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf>. Finally, the 10% exempt deemed return on assets is arbitrary and too high given that the average risk-free rate of return has been much lower. This encourages the shifting of tangible assets such as manufacturing assets from the U.S. to offshore locations in order to obtain the benefit of the exemption. Instead, the exempt return could be eliminated, or the rate could be pegged to a dynamically adjusting market interest rate or lowered to something closer to the risk-free return on Treasury yields.

<sup>5</sup> Estimated Budget Effects of the Conference Agreement for H.R. 1, The "Tax Cuts and Jobs Act," JCX-67-17 (Dec. 18, 2017), <https://www.jct.gov/publications.html?func=startdown&id=5053>.

<sup>6</sup> Note that a corporate rate increase to 28% would raise approximately \$730 billion over ten years. Lily Batchelder & David Kamin, *Taxing the Rich: Issues and Options* 10 (Sept. 11, 2019), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3452274](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452274).

<sup>7</sup> Kimberly A. Clausing, *Fixing Five Flaws of the Tax Cuts and Jobs Act* 23 (Working Paper Feb. 3, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3397387](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3397387).

<sup>8</sup> Jacob Leibenluft & Chye-Ching Huang, *GOP Process Designed to Obscure Tax Plan's Effects*, CTR. ON BUDGET AND POL'Y PRIORITIES (Nov. 28, 2017), <https://www.cbpp.org/research/federal-tax/gop-process-designed-to-obscure-tax-plans-effects>.

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<sup>9</sup> Jesse Drucker & Jim Tankersley, *How Big Companies Won New Tax Breaks From the Trump Administration*, N.Y. TIMES (Dec. 30, 2019), <https://www.nytimes.com/2019/12/30/business/trump-tax-cuts-beat-gilti.html>.

<sup>10</sup> Shu-Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations*, 69 EMORY L.J. 209 (2019). Importantly, courts do not require transparency of pre-notice activity. Some of this activity can be reconstructed after the fact due to press reports, Treasury’s own references to it in its notice of proposed rulemaking, and information released related to OIRA/OMB review. *Id.*

<sup>11</sup> Oei & Osofsky, *supra* note 10.

<sup>12</sup> Oei & Osofsky, *supra* note 10.

<sup>13</sup> Druker & Tankersley, *supra* note 9.

<sup>14</sup> See *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 46 (1976) (Stewart, J., concurring) (stating that he could not “imagine a case, at least outside the First Amendment area, where a person whose own tax liability was not affected ever could have standing to litigate the federal tax liability of someone else”); *Allen v. Wright*, 468 U.S. 737, 740 (1984) (denying taxpayer standing for a challenge to the tax exemption of segregated schools); *DaimlerChrysler Corp v. Cuno*, 547 U.S. 332, 340-46 (2006) (denying standing for third party challenges to state and local tax breaks); *Hein v. Freedom From Religion Foundation*, 551 U.S. 587 (2007) (denying taxpayer standing to challenge favorable administrative decisions, contrary to the statute, under First Amendment grounds). For a discussion of these issues, see Daniel Hemel; *The President’s Power to Tax*, 102 CORNELL L. REV. 633 (2017); Linda Sugin, *Invisible Taxpayers*, 69 TAX L. REV. 617 (2016); Lawrence Zelenak, *Custom and the Rule of Law in the Administration of the Income Tax*, 62 DUKE L.J. 829-855 (2012).

<sup>15</sup> Stephen E. Shay, *A GILTI High-Tax Exclusion Election Would Erode the U.S. Tax Base*, 165 TAX NOTES 1129, 1145 (2019).

<sup>16</sup> I.R.S. Notice 2008-83, 2008-2 C.B. 905.

<sup>17</sup> I.R.S. Notice 2010-2, 2010-1 C.B. 251.

<sup>18</sup> See Rebecca M. Kysar, *Tax Law and the Eroding Budget Process*, 81 LAW & CONTEMP. PROBS. 61 (2018); Rebecca M. Kysar, *Reconciling Congress to Tax Reform*, 88 NOTRE DAME L. REV. 2121 (2013); Oei & Osofsky, *supra* note 10.

<sup>19</sup> Eighty percent of 13.125% equals the GILTI rate of 10.5%, thereby completely offsetting GILTI liability.

<sup>20</sup> Martin A. Sullivan, *More GILTI Than You Thought*, 158 TAX NOTES 845 (2018).

<sup>21</sup> *Guidance Under Section 958 (Rules for Determining Stock Ownership) and Section 951A (Global Intangible Low-Taxed Income)*, 84 Fed. Reg. 29114 (June 21, 2019) [hereinafter *Proposed GILTI Regulations*].

<sup>22</sup> 26 U.S.C. § 951A(c)(2)(A)(i)(III) (2018).

<sup>23</sup> *Id.*

<sup>24</sup> *Proposed GILTI Regulations*, Preamble.

<sup>25</sup> Shay, *supra* note 15, at 1139.

<sup>26</sup> Heather M. Field, *Choosing Tax: Explicit Elections as an Element of Design in the Federal Income Tax System*, 47 HARV. J. ON LEGIS. 21, 30-31 (2010).

<sup>27</sup> In the Preamble, Treasury echoed taxpayer arguments that the GILTI high tax exclusion election comports with legislative history. S. Comm. on the Budget, *Committee Recommendations as Submitted to the Committee on the Budget Pursuant to H. Con. Res. 71, S. Print No. 115-20*, at 371 (2017). It is a basic tenet of statutory interpretation that clear text trumps legislative history. This is even more so the case when the legislative history is ambiguous at best. The legislative history invoked by Treasury states that items of income excluded from GILTI “include income subject to high levels of foreign tax.” This statement likely references the category of income excluded by means of Section 954(b)(4) rather than contemplates a broad high-tax exclusion from GILTI. Moreover, nothing in the legislative history refers to electivity, which as noted above is far better for taxpayers than a mandatory exclusion of high taxed income from GILTI. Treasury itself recently stated in the Preamble to the final foreign tax credit regulations that Congress intended the expense allocation rules of the Code to apply to GILTI income. *Guidance Related to the Foreign Tax Credit*, 84 Fed. Reg. 69022 (Dec. 17, 2019) (to be codified at 26 C.F.R. pt. 1). The principal effect of the high-tax exclusion is to avoid the adverse consequences to taxpayers of such expense allocation. It is impossible to reconcile Treasury’s acknowledgment of Congress’ intent to require expense allocation with Treasury’s claim that the high-tax exclusion is consistent with Congressional intent. In addition, it is hard to imagine that Congress intended that foreign income that is subject to a foreign tax rate of 18.9% or above is eligible for the high-tax exemption and therefore exempt from expense allocation and any additional U.S. tax, but foreign income subject to a foreign tax rate below 18.9% is subject to expense allocation and therefore to a total U.S. and foreign tax in excess of 21%. Finally, some may point to the title of the section itself, “Global intangible low-taxed income,” as evidence of congressional intent to only tax income subject to a low tax rate abroad. A heading cannot limit the plain meaning of the text and “has no power to give what the statute takes away.” *Trainmen v. Baltimore & Ohio R.R.*, 331 U.S. 519, 529 (1947);

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Hawaii v. Office of Hawaiian Affairs, 556 U.S. 163, 175 (2009). Even if we take an unorthodox view that the title of a statute may trump its operative text, the GILTI acronym itself is a misnomer in other respects. Although the title refers to intangible income, the statute applies the minimum tax to income from both tangible and intangible assets. And of course, the statute does not contain the term “election.” Moreover, this argument assumes its conclusion in that the “low-taxed income” term could accommodate the expense allocation regime. The “income” portion of the phrase could be understood to represent true income net of properly allocated expenses.

<sup>28</sup> See Symposium, *The Future of the New International Tax Regime*, 24 *FORDHAM J. CORP. & FIN. L.* 219, 290-91 (2019) (comments from David Rosenbloom).

<sup>29</sup> Guidance Related to Section 951A (Global Intangible Low-Taxed Income), 83 *Fed. Reg.* 51072 (Oct. 10, 2018) (to be codified at 26 C.F.R. pt. 1).

<sup>30</sup> 26 U.S.C. § 59A (2018).

<sup>31</sup> Druker & Tankersley, *supra* note 9. Records from OIRA indicate that representatives of Credit Suisse continued to meet with Treasury officials about the BEAT regulations in September 2019, although the precise topic of the meeting was not disclosed. See OFF. OF INFO. AND REG. AFF., EO 12866 Meeting 1545-BP36 (Sept. 27, 2019), <https://www.reginfo.gov/public/do/viewEO12866Meeting?viewRule=true&rin=1545-BP36&meetingId=4533&acronym=1545-TREAS/IRS>.

<sup>32</sup> Base Erosion and Anti-Abuse Tax, 83 *Fed. Reg.* 65956 (Dec. 21, 2018) (to be codified at 26 C.F.R. pt. 1). This is not the only example of special interest influence on the BEAT regulations. Treasury initially issued a rule that would have disallowed a complex currency transaction designed to circumvent the BEAT. It later withdrew the rule after objections from The Organization for International Investment, which represents foreign multinational corporations Nestle and LyondellBassell. Druker & Tankersley, *supra* note 9

<sup>33</sup> *Preamble*, Base Erosion and Anti-Abuse Tax, 83 *Fed. Reg.* 65956 (Dec. 21, 2018) (to be codified at 26 C.F.R. pt. 1).

<sup>34</sup> See, e.g. 26 U.S.C. 1298(g).

<sup>35</sup> Moreover, even if a court were to construe this grant of authority to encompass purpose, the purpose of Section 59A appears to be to limit earnings stripping through an override of the arm’s length principle. If Congress had wished to allow non-tax motivated transactions to escape taxation, it could have simply deferred to the transfer pricing regime. Additionally, the five examples of appropriate regulations set forth in the specific grant of authority are aimed at preventing taxpayer avoidance of the statute. The interpretive principle of *eiusdem generis* would suggest that Congress envisioned the Treasury Regulations under BEAT to be in this ilk. Treasury has instead issued guidance aimed at *abetting* taxpayer avoidance.

<sup>36</sup> Druker & Tankersley, *supra* note 9.

<sup>37</sup> Druker & Tankersley, *supra* note 9.

<sup>38</sup> UBS Group AG, Report of Foreign Private Issuer (Form 6-K) (Jan. 21, 2020).

<sup>39</sup> See, e.g., Kamin et al., *Games II*, *supra* note 2.

<sup>40</sup> Oei & Osofsky, *supra* note 10.

<sup>41</sup> For instance, of 337 comments received in the formal notice period, Oei and Osofsky counted only six that represented the public interest. *Id.* at 36. See also Clinton G. Wallace, *Congressional Control of Tax Rulemaking*, 71 *TAX L. REV.* 179, 182 (2017) (finding private interests dominating the tax notice and comment period).

<sup>42</sup> 26 C.F.R. § 1.199A-5(b)(3)(xv).

<sup>43</sup> David Kamin, “*Reputation or Skill*” in the New Pass-Through Regulations, *MEDIUM* (Aug. 10, 2018), [https://medium.com/whatever-source-derived/reputation-or-skill-in-the-new-pass-through-regulations-efac160f4fbe#\\_ftn1](https://medium.com/whatever-source-derived/reputation-or-skill-in-the-new-pass-through-regulations-efac160f4fbe#_ftn1).

<sup>44</sup> In the preamble to the regulations, Treasury and the IRS justified this narrow interpretation based on the concern that a broad interpretation would result in “substantial uncertainty” for taxpayers and the IRS. A broad reading, under their view, would also have the potential to exclude all service businesses, in contravention of Congressional intent. This argument overreaches because the statute contains a qualifier such that the “principal asset” must be reputation or skill, thus, on its own terms, limiting the reach of the catch-all to certain types of service businesses. Although there is an administrative challenge to enforcing the statute as written, Treasury and the IRS have no discretion to abandon its clear language simply because the fact-based inquiry creates uncertainty to the taxpayers. Indeed, one administrable option would have been to interpret the owner’s portion of reputation and skill by formula, i.e. deeming a normal rate of return of x% to the business with any excess being deemed to be derived from reputation and skill. Lily Batchelder (@lilybatch), TWITTER (Aug. 8, 2018, 11:11 AM), <https://twitter.com/lilybatch/status/1027210665788940293>.

<sup>45</sup> 26 C.F.R. § 1.199A-5(b)(2)(x).

<sup>46</sup> 26 C.F.R. § 1.199A-5(b)(2)(ix).

<sup>47</sup> 26 U.S.C. § 1400Z-2.

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- <sup>48</sup> *Id.* at § 1400Z-2(d)(2)(D)(i).
- <sup>49</sup> Treas. Reg. § 1.1400Z2(d)-(2)(c).
- <sup>50</sup> 26 U.S.C. § 1400Z-2(d)(2)(D)(ii).
- <sup>51</sup> *Id.* at § 1016.
- <sup>52</sup> *Id.* at § 263 and regulations thereunder.
- <sup>53</sup> Treas. Reg. § 1.1400Z2(d)-2(b)(4)(iii)(D)(1).
- <sup>54</sup> Treas. Reg. § 1.1400Z2(d)-2(b)(4)(iv)(B)-(C).
- <sup>55</sup> See MICHAEL J. GRAETZ ET AL., FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 81 (2018) (introducing such an approach as a possibility); see also Sugin, *supra* note 14, at 667 (suggesting an ombudsman, such as the Taxpayer Advocate, to monitor constitutional issues arising from tax regulation).
- <sup>56</sup> See, e.g., § 301 of the Voting Rights Act Amendments of 1975, 42 U.S.C. § 1973bb; Title VII of the Civil Rights Act of 1964, §§ 706-07, as amended, 42 U.S.C. §§ 2000e-5 to 2000e-6. Another possible model is the cause of action given to the Comptroller General in the event of an illegal impoundment. Impoundment Control Act of 1974, 2 U.S.C. § 687.
- <sup>57</sup> See Edward A. Hartnett, *The Standing of the United States: How Criminal Prosecutions Show that Standing Doctrine Is Looking for Answers in All the Wrong Places*, 97 MICH. L. REV. 2239, 2255-58 (1999).
- <sup>58</sup> Oei & Osofsky, *supra* note 10. At least one agency has adopted a policy that mandates that ex parte communications about pending rulemaking be documented in writing in order to ensure transparency. Patricia A. McCoy, *Comment of Financial Regulation and Consumer Protection Scholars and Former Regulators on Docket No. CFPB-2018-0009 33* (June 7, 2018), available at <https://www.regulations.gov/document?D=CFPB-2018-0009-0121> (discussing the CFPB’s rulemaking process).
- <sup>59</sup> The CFPB has done this voluntarily. *Id.*
- <sup>60</sup> Leslie Book, *A New Paradigm for IRS Guidance: Ensuring Input and Enhancing Participation*, 12 FLA. TAX REV. 517, 568–83 (2012).
- <sup>61</sup> See David Kamin & Rebecca Kysar, *Temporary Tax Laws and the Budget Baseline*, 157 TAX NOTES 125 (2017) (discussing the need for consistent baselines in ensuring the budget process captures the cost of legislation).
- <sup>62</sup> The \$100 million threshold would match the threshold for “economically significant” regulatory action for purposes of OIRA review.
- <sup>63</sup> 17 C.F.R. § 210.4-08(h)(1) (2018).
- <sup>64</sup> Peter Eavis, *Why the Impact of the Trump Taxes Remains Partly Hidden*, N.Y. TIMES (Dec. 30, 2019), <https://www.nytimes.com/2019/12/30/business/corporate-tax-cuts-impact.html>.
- <sup>65</sup> See Rebecca M. Kysar, *On the Constitutionality of Tax Treaties*, 38 YALE J. INT’L L. 1 (2013) (tracing the history of the Origination Clause).