Treasury Green Book: Proposals to Change U.S. Tax Rules Impacting Foreign Investors

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The U.S. Treasury published “General Explanations of the Administration’s Fiscal Year 2022 Revenue Proposals” on May 28, 2021. The document, that is also called the “Green Book,” includes President Biden’s proposals to make changes to the Internal Revenue Code (Code). The changes would not only modernize and improve tax administration but would also raise revenue. This article provides an overview of major tax proposals in the Green Book that would have an impact on tax planning of foreign investors in the U.S.

Increased Ordinary Tax Rates for Corporations

The Tax Cuts and Jobs Act of 2017 (TCJA) introduced a flat federal tax rate of 21 percent on taxable business income of C-Corporations. The flat tax rate replaced a graduated tax schedule where most corporate income was taxed at a marginal and average rate of 35 percent. The proposal would increase the flat tax rate to 28 percent.

Reform the Taxation of Capital Income

Currently, realized long-term gains and qualified dividends are taxed on a federal level at graduated rates, with 20 percent being the highest. Under certain circumstances, a net investment income tax of 3.8% has to be added so that the total capital gain tax rate is 23.8 percent.

It is planned to tax capital gain at ordinary income tax rates for taxpayers with adjusted gross income of more than $1 million. 39.6% would be the highest and the net investment income tax of 3.8 percent would also have to be added under certain circumstances. Thus, the total capital gain tax rate could be as high as 43.4 percent.

The new rules would be effective for gains to be recognized after the date of announcement. Thus, taxpayers have to closely follow the legislation process and make any tax planning decisions accordingly.

New Minimum Tax on Book Income

A 15 percent minimum tax on worldwide book income has been proposed. Corporations with book income in excess of $2 billion would have to pay the minimum tax. Generally, the minimum tax would be calculated as follows.

15 percent on Worldwide Pre-Tax Book Income (book income less book net operating loss deductions)
Less General Business Credits (including R&D, clean energy and housing tax credits)
Less Foreign Tax Credits

The minimum tax on book income would equal the excess, if any, over regular tax.

Limits on Interest Deductions for Disproportionate Borrowing in the U.S.

Currently, interest expenses are generally deductible from regular taxable income. However, they are limited to the sum of

- Business interest income,
- 30 percent of adjusted taxable income, and
- Floor plan financing interest.

The proposal would introduce a new limitation on interest deductions for entities that are a member of a multinational group that is preparing consolidated financial statements under U.S. GAAP, IFRS or any other method under regulations to be published.

Generally, interest expenses for U.S. tax purposes would be limited if the entity has net interest expenses exceeding its proportionate share of the financial reporting group's net interest expense reported on the group's consolidated financial statements. The entity's proportionate share would be calculated based on the proportionate share of the group's earnings reflected in the group's consolidated financial statements. The earnings would be computed by adding back net interest expense, tax expense, depreciation, depletion, and amortization.

Interest expenses exceeding the entity's share of the group's earnings would be disallowed for U.S. tax purposes but could be carried forward indefinitely.

Replacement of BEAT with SHIELD

The TCJA introduced a tax on certain corporate taxpayers in addition to their regular tax liability. Taxpayers with three-year average gross receipts in excess of $500 million and a "base erosion percentage" exceeding a specific threshold are potentially liable to pay this tax.

The proposal suggests repealing BEAT and implementing a Stopping Harmful Inversions and Ending Low-Tax Developments rule (SHIELD). SHIELD would disallow deductions to a domestic corporation or branch in whole or in part related to all payments that are made (or deemed made) to "low-taxed" members. A "low-taxed" member would be any financial reporting group member whose income is taxed at an effective tax rate that is below a minimum tax rate to be determined.

Repeal of the Deduction for Foreign-Derived Intangible Income (FDII)

The TCJA changed the Code to introduce a deduction to domestic corporations on their foreign-derived intangible income. 37.5 percent is allowed as a deduction for any taxable year beginning after December 31, 2017, and 21.875 percent for any taxable year beginning after December 31, 2025.

The proposal would repeal the deduction allowed for FDII.

Changes to Global Intangible Low-Taxed Income (GILTI) and Subpart F Income

Currently, certain income can be excluded from GILTI and subpart F income under the high-tax exception. If the relevant net item of income is subject to tax in a foreign country at an effective rate of greater than 90% of the maximum U.S. corporate tax rate, the exclusion can be applied. The proposal would repeal the high tax exception for both GILTI and subpart F income.

The proposal would also reduce the section 250 deduction to 25 percent from 50 percent when calculating the GILTI tax. This would increase the GILTI tax from currently 10.5 percent to 21 percent.

Another change would impact U.S. shareholders with subsidiaries in multiple countries. GILTI inclusion and foreign tax credit (FTC) limitations would be determined on a country-by-country basis. This would prevent businesses from reducing tax using excess FTCs from high-tax jurisdictions that currently can be credited against GILTI inclusions from low-tax jurisdictions. The country-by-country limitation would also apply to branch income.

PKF O'Connor Davies Guidance

None of the suggested changes are implemented yet and a lot of open questions are unanswered. The proposed changes would need to be approved by the Congress and signed by the President. Most of the proposed changes would be effective for tax years beginning after December 31, 2021. Some changes are proposed to be effective for transactions completed after the date of enactment. Foreign investors should follow the discussion and consult with their tax advisors to consider potential changes when structuring U.S. investments.

Contact Us

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