KPMG

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KPMG report: International tax proposals in Biden Administration's budget for FY 2023

The U.S. Treasury Department on March 28, 2022, released details of tax proposals in the administration's budget recommendations for FY 2023 in the "Green Book."

- Read Treasury's "**Green Book**" [PDF 2.45 MB] for FY 2023—*General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals.*

- Read KPMG's report of initial impressions of the tax proposals in the FY 2023 budget: ***TaxNewsFlash***

International tax proposals

Significant international tax proposals in the FY 2023 budget include the following (this list sets outs a high-level description and is not exhaustive):

- **Repeal and replace BEAT with an "undertaxed profits rule" (UTPR)**

    - The most significant new U.S. international tax proposal included in the Green Book is to repeal the "base erosion and anti-abuse tax" (BEAT) and replace it with a new regime that is consistent with the UTPR described in the OECD Pillar Two "global anti-base erosion" (GloBE) rules, to better align the U.S. rules with the global tax reform effort embodied in Pillar Two. To protect U.S. revenue from the imposition of a UTPR by other jurisdictions, the Biden Administration would also include a domestic minimum top-up tax that would apply when another jurisdiction adopts a UTPR.

    - The administration's UTPR proposal goes significantly beyond its prior "stopping harmful inversions and ending low-tax developments" (SHIELD) proposal as well as the modifications to BEAT contained in H.R. 5376, the "Build Back Better Act," as passed by the House of Representatives on November 19, 2021 (the House BBBA bill) and represents a fundamental departure from the principles underlying BEAT.

- Broadly, the administration's UTPR proposal generally would apply to foreign-parented financial reporting groups that have global annual revenue of $850 million or more in at least two of the prior four years. It would not apply with respect to income subject to an "income inclusion rule" (IIR) that is consistent with the Pillar Two GloBE rules. Accordingly, the administration's UTPR proposal would generally exempt U.S.-parented multinationals because the UTPR would not apply with respect to income subject to the proposed "global intangible low-taxed income" (GILTI), subpart F, and foreign branch income regimes, as modified under the House BBBA bill.

- Unlike SHIELD and the BBBA's proposed modifications to BEAT, the UTPR proposal would apply a top-up tax by reference to low-taxed income of foreign entities and foreign branches, as determined on a jurisdiction-by-jurisdiction basis, and would coordinate the allocation of the top-up tax among the United States and the other foreign members of the group that apply a Pillar Two Qualified UTPR. As such, the UTPR proposal would not result in a cliff effect. Specifically, U.S. corporations and U.S. branches of foreign corporations would be disallowed U.S. tax deductions to the extent necessary to collect the hypothetical amount of top-up tax required for the financial reporting group to pay a 15% effective tax rate (ETR) (based on the group's adjusted consolidated financial statements) in each profitable foreign jurisdiction.

- The proposal would apply only to reduce U.S. tax deductions and would not apply to reduce costs of goods sold (COGS). Unlike the BEAT, which aimed to curb the base erosion of U.S. earned income through related-party deductible payments, the UTPR would disallow a domestic taxpayer's deductions (both related party and unrelated) when a foreign affiliate is low-taxed.

- To the extent the UTPR disallowance for a tax year exceeds the U.S. taxpayer's aggregate deductions for such year, the excess amount would be carried forward indefinitely. Special rules contained in this proposal as well as in the Pillar Two GloBE rules would apply if a prior year's UTPR disallowance did not result in cash tax liability equal to the allocated top-up tax amount.

- Similar to the Pillar Two GloBE rules, the administration's UTPR proposal would provide a substance-based income exclusion that would reduce a group's profit in a low-taxed jurisdiction that is subject to top-up tax by 5% of the book value of tangible assets and payroll in that jurisdiction (such amount, initially greater during a transition period).

- The Biden Administration's proposal would also introduce a domestic minimum top-up tax if and when another jurisdiction "adopts" the UTPR. The domestic minimum top-up tax would equal the excess of (1) 15% of the financial reporting group's U.S. profit (based on the UTPR methodology) over (2) all the group's income tax paid or accrued with respect to U.S. profits (including federal and state income taxes, corporate AMT, and creditable foreign income taxes incurred with respect to U.S. profits). The proposed scope and applicability date of the domestic minimum top-up tax rule is not entirely clear, as the term "adopts" is vague in this context and could be construed to mean either the date the UTPR is enacted by another jurisdiction or instead the date on which the UTPR becomes effective in such jurisdiction (which may occur in separate years). Further, although not made entirely explicit, it appears that domestic minimum top-up tax would become applicable when any foreign jurisdiction adopts a UTPR, without regard to whether the financial reporting group that includes the U.S. taxpayer operates in that jurisdiction.

- The Biden Administration's description of its UTPR proposal and domestic minimum tax-up tax proposals declares that it would "provide a mechanism to ensure U.S. taxpayers would continue to benefit from U.S. tax credits and other tax incentives that promote U.S. jobs and investment." The Pillar Two GloBE rules generally disfavor tax credits that are not refundable within four years, so it is unclear how the administration's UTPR proposal would achieve this objective while precluding the application of a separate jurisdiction's UTPR to tax U.S. member income.

- **Expand access to retroactive qualified electing fund elections**

  - The Biden Administration's proposal would allow taxpayers to make retroactive qualified electing fund (QEF) elections for passive foreign investment companies (PFICs) on amended returns in certain situations without obtaining a private letter ruling (PLR). Taxpayers would continue to need a PLR to make retroactive QEF elections that would apply to any closed tax year.

  - The administration's proposal generally would replace the existing statutory timing rules for making QEF elections with a grant of regulatory authority that would allow QEF elections to be made in the time and manner prescribed in regulations. This generally would remove the current statutory restrictions that limit the circumstances in which taxpayers can make retroactive QEF elections and provide specific authority for liberalizing the retroactive QEF procedures in the current regulations.

  - The administration proposes this provision would be effective as of the date of enactment, with the intention that taxpayers would be allowed to apply any subsequently revised retroactive QEF procedures to any open tax year in addition to post-enactment periods.

- **Expand the definition of foreign business entity to include taxable units**

  - The administration's proposal would expand the scope of information reporting required under section 6038 to treat as foreign business entities "taxable units" in a foreign jurisdiction—such as non-U.S. pass-through entities or branches.

  - Specifically, the administration's proposal is intended to increase information reporting by expanding existing information reporting requirements to encompass foreign entities other than foreign corporations and partnerships. The expanded class of foreign entities subject to reporting under section 6038, according to the administration's proposal, would be necessitated by the BBBA's shift to a jurisdiction-by-jurisdiction application of the GILTI and subpart F regimes, as well as the foreign tax credit rules, at the level of a tested unit.

  - Further, the proposal would provide that the annual accounting period of the owner (e.g., domestic corporation or CFC owner) of a branch or disregarded entity would apply for purposes of determining its annual accounting period.

  - The administration proposes that this provision would apply to tax years of a controlling U.S. person beginning in 2023, and to annual accounting periods of foreign entities that end with or within such tax years.

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