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Unfinished Tax Reform: Corporate Minimum Taxes

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The recently enacted Inflation Reduction Act (IRA) includes a 15 percent corporate minimum tax that will shut down some of the worst corporate tax dodging. But Congress has yet to enact another type of corporate minimum tax – a global corporate minimum tax of 15 percent – that the Biden administration agreed to implement with most of the world's governments. While the IRA's corporate minimum tax is a huge improvement in our tax system, implementing the global corporate minimum tax would improve it much more. And if other governments implement the global minimum tax, the United States will have an even stronger interest in joining them to ensure that new revenue collected from American corporations flows to the U.S. rather than to other countries.

Corporate Minimum Taxes are Necessary to Address Tax Avoidance

In 2017, Congress set the corporate income tax rate at 21 percent, but few corporations actually pay 21 percent of their profits in federal income taxes, thanks to the many special breaks and loopholes the 2017 law left in place.

Of the largest publicly traded corporations that were profitable in each of the first three years that the 2017 law was in effect (2018-2020), 39 paid no U.S. income taxes on their U.S. profits, as our 2021 analysis found.[1] Another 73 corporations paid an effective U.S. income tax rate of 10 percent or less. These companies included household names like Amazon, Bank of America, Deere, Domino's Pizza, Etsy, General Motors, Honeywell, Molson Coors, Motorola, Netflix, Nike, Verizon, Walt Disney, Whirlpool and Xerox.

That analysis examined only the U.S. income taxes corporations pay on their U.S. profits. There is also overwhelming evidence that American corporations often pay little or nothing on the profits they report to earn in other countries. Many of these "offshore" profits are really earned in the U.S. or in other countries with comparable tax systems. But corporations use accounting gimmicks to make profits appear to be earned in countries that have no corporate tax or a very weak corporate tax, even if they do little or no real business in those countries.

Offshore tax avoidance is evident from IRS data on where corporations say they earn their profits. For example, American corporations, as a group, reported to the IRS that they earned $60 billion in the Cayman Islands in 2019. This is impossible, because the entire gross domestic product (the entire economic output) of that tiny nation was just $6 billion that year. Similarly, American corporations reported that they earned $31 billion in Bermuda, even though that country's GDP was just $7 billion.

The table below includes data on the fifteen countries that are most likely to be offshore tax havens for American corporations, based on the size of the total profits they report in each country compared to its GDP.

The total profits that American corporations tell the IRS that they earned in these 15 countries exceeds the total profits they claim to have earned in the rest of the world. This is obviously a reflection of accounting gimmicks designed to avoid taxes, not a reflection of where corporations actually do business.

TABLE 1. Fifteen Most Likely Tax Havens in 2019 for U.S. Corporations

	Reported Profits of US Companies (billions)	National GDP (billions)	Profits as % of GDP	Foreign Tax Rate	Profits Per Employee
Cayman Islands	$60.4	$6	1016%	0.1%	$9,970,110
Bermuda	$30.7	$7	414%	0.9%	$35,873,384
Gibraltar	$7.8	$3	249%	0.1%	$59,656,465
British Virgin Islands	$3.2	$1	225%	0.6%	$4,962,699
Barbados	$8.8	$5	166%	0.5%	$12,028,539
Isle of Man	$6.1	$7	83%	-0.1%	$9,534,571
Curacao	$1.6	$3	55%	0.1%	$8,746,284
Puerto Rico	$33.4	$105	32%	3.6%	$453,586
Jersey	$2.0	$6	32%	2.4%	$4,700,652
St. Kitts and Nevis	$0.2	$1	20%	4.4%	$367,824
Singapore	$62.8	$375	17%	6.1%	$349,139
Ireland	$55.1	$399	14%	18.1%	$337,680
Malta	$1.7	$16	11%	2.9%	$688,308
Netherlands	$88.6	$910	10%	6.9%	$508,034
Switzerland	$60.2	$732	8%	5.8%	$729,739
Total for Most Likely Tax Havens	$422.7	$2,578	16%	5.9%	$615,949
Total for Other Countries	$349.3	$60,373	1%	27.3%	$27,006

Note: See appendix for more details.

American corporations report very few employees in most of these countries and, as the table illustrates, the implied profits they generate per employee based on what they report are simply not believable. (A more detailed version of this table is provided in the appendix to this report.)

Architects of corporate minimum taxes – the IRA's minimum tax and the global minimum tax that the international community agreed to – hope to dramatically reduce or eliminate this type of tax avoidance.

Of the 15 tax havens listed here, several are arguably under the control of other governments. Six are either British Overseas Territories (Cayman Islands, Bermuda, Gibraltar, British Virgin Islands) or British Crown Dependencies (Isle of Man and Jersey). One is a constituent country of the Netherlands (Curacao) and another is a U.S. territory (Puerto Rico). These jurisdictions are not entirely independent states but are sometimes treated as such for tax purposes. This suggests that the governments in London, the Hague and Washington, D.C., which have provided insufficient opportunities in these territories for real economic growth, are also complicit in their status as tax havens.

In a hopeful sign, all these tax havens have joined the global minimum tax agreement except for Puerto Rico, which as a dependent territory of the U.S. does not sign treaties.[2] Whether they implement the global minimum tax likely depends on whether the U.K., the U.S. and European countries do so.

The Corporate Minimum Tax in the Inflation Reduction Act

The Inflation Reduction Act requires the most profitable corporations to pay corporate income taxes of at least 15 percent of their worldwide "book" profits. Book profits are the profits that corporations make public for shareholders and potential investors. Many of the special breaks that corporations use to avoid taxes work by allowing companies to report profits to the IRS that are much smaller than their book profits. Corporate leaders prefer to report low profits to the IRS (to reduce taxes) and high profits to the public (to attract investors).

The IRA's minimum tax will block some of this tax avoidance because it applies to book profits. Under the IRA, if the corporation's total taxes (U.S. taxes and foreign taxes) paid comes to less than 15 percent of its book profits, this provision will require them to pay additional federal tax to raise their effective worldwide tax rate to 15 percent.

The IRA's minimum tax has some limits that make it less effective than it otherwise might be, including the small number of companies subject to it, the exceptions written into the minimum tax and its application to each company's profits worldwide rather than per country. These limits make it less effective in many ways than the global minimum tax.

Even with these limits, however, the IRA's minimum tax is likely to shut down some of the most significant corporate tax avoidance. According to Congress's official revenue estimators at the Joint Committee on Taxation, it will raise $222 billion over the coming decade.[3]

Limits of the IRA's Minimum Tax

It Will Affect a Small Number of Companies

The tax will apply to corporations with average profits exceeding $1 billion over a three-year period. (Foreign-owned companies operating in the U.S. would be subject to it if their three-year average profits in the U.S. exceed $100 million.) Taking this into account, as well as other limits discussed below, the Joint Committee on Taxation projects that only 150 companies will be subject to the minimum tax.[4]

There Are Exceptions and Carveouts

Companies are allowed to use tax credits and accelerated depreciation breaks to lower their minimum tax as they do with the regular corporate income tax.

Congress allows corporations to reduce their tax liability with tax credits for all sorts of reasons. This is not necessarily a problem. Credits are used to encourage certain types of investments, such as the production of green energy or products that use green energy.

The allowance in the minimum tax of accelerated depreciation is more problematic. Accelerated depreciation allows companies to write off the costs of investments in equipment more quickly than the equipment wears out and loses value. The most likely outcome is that this rewards companies for making investments they would have made absent any tax break.[5] Such depreciation breaks are a major reason why some corporations pay little in U.S. taxes.[6]

It Is Calculated Based on Worldwide Profits

As explained above, corporations sometimes use accounting gimmicks to make profits appear to be earned in tax havens with no or very weak corporate income taxes. The IRA's minimum tax will not entirely shut down this offshore tax avoidance because it applies to a company's worldwide profits. Effectively, that means higher taxes that a corporation pays in one country could offset very low taxes it pays in another country. So long as the total corporate income taxes it pays (in the U.S. and in other countries) comes to at least 15 percent of its worldwide profits, it will owe no minimum tax under the IRA.

For example, an American corporation might claim that a portion of its profits are earned in Country A where it pays an effective tax rate of just 5 percent. This is likely the result of transactions designed to avoid taxes rather than real investments, but the company would not necessarily be affected by the IRA's minimum tax. For example, the corporation might pay an effective rate of 19 percent in the U.S., and it might pay effective rates of 25 percent in Country B and 22 percent in Country C. Its overall effective tax rate calculated on its worldwide profits could be more than 15 percent, so the IRA's minimum tax would not affect it.

The Global Minimum Tax

Last year, the Biden administration brokered an international agreement with the Organization for Cooperation and Development (OECD) to create a global minimum tax. Altogether, 137 nations that account for 95 percent of global economic output have joined the agreement.[7] But the U.S. will not participate in the agreement unless Congress enacts legislation to implement it.

Congress nearly did so last year. In November 2021, the House of Representatives passed the Build Back Better Act, a package of tax reforms and public investments that included two types of corporate minimum taxes. However, the version of that legislation enacted into law, the Inflation Reduction Act, left out the global minimum tax provision that would have brought the U.S. in compliance with the OECD agreement.

This is unfortunate because the global minimum tax is quite different, and in many ways more effective, than the IRA's minimum tax. While both are minimum taxes with a rate of 15 percent, that is where the similarities end.

The IRA's minimum tax is designed to generally limit corporate tax avoidance, while the global minimum tax is designed more specifically to address corporations using accounting fictions to shift profits into offshore tax havens. In theory, the U.S. already has a minimum tax that applies specifically to offshore profits of American corporations, which is the 2017 law's tax on "global intangible low-taxed income" (GILTI). But the GILTI rules in effect now are riddled with weaknesses.[8] The table provided earlier to illustrate profits shifted to 15 tax havens demonstrates that the GILTI rules in the 2017 tax law have completely failed to stop offshore tax avoidance.

The OECD global minimum tax is a 15 percent minimum tax that countries participating in the agreement apply to the offshore profits of the multinational corporations based within their borders.

The idea behind it is to stop the race to the bottom among countries that perceive an incentive to cut their corporate tax rates to lure companies from abroad or to keep their own companies from moving investment to countries with lower tax rates.

As already explained, much of the "investment" that corporations move abroad for tax reasons is more accounting gimmickry than real operations moved offshore. But the result is nonetheless that companies benefiting from infrastructure and other public investments avoid contributing to pay for it. By acting collectively to set a minimum effective tax rate, governments could end this race to the bottom and achieve a result that would be better for everyone.

How the Global Minimum Tax Differs from the IRA's Minimum Tax

Compared to the IRA's minimum tax, the global minimum tax is more focused on preventing offshore tax avoidance. It may be more effective than the IRA's minimum tax in some ways because it would affect more companies and because it would be applied per country, as explained below.

Larger Group of Companies Affected

The global minimum tax applies to corporations with annual ***revenue*** of more than 750 million euros (about $750 million currently). A company could have profits of just, say, $10 million, but could still have ***revenue*** exceeding $750 million. For American companies, this means that many more could be affected by the global minimum tax than by the IRA's minimum tax, which applies only to companies with average profits exceeding $1 billion. As already explained, the IRA's minimum tax is projected to apply to about 150 corporations. The global minimum tax could apply to well more than 1,000 American corporations.[9]

Exceptions and Carveouts

The global minimum tax has exceptions and carveouts that in some cases overlap with those of the IRA's minimum tax and in other cases differ a great deal. For example, while the details are complicated, most of tax credits provided in the U.S. corporate income tax can be taken against the IRA's minimum tax but they generally cannot be taken against the global minimum tax.

On the other hand, the global minimum tax exempts a certain amount of profits that a corporation reports in a foreign country where it has real business operations. The calculation of the global minimum tax due for a corporation's profits in a specific country exempts a "substance-based carve-out" equal to 5 percent of the company's payroll in that country and 5 percent of the company's tangible assets in that country.[10] (Higher percentages apply for the first ten years as a transition rule.) The idea is that a 5 percent or less return on investments and personnel is likely to be real profits generated from real business and not the result of accounting gimmicks that merely shift numbers around to make profits to appear to be earned in low-tax countries.[11]

Per-Country Application of the Global Minimum Tax

While the IRA's minimum tax applies to a corporation's profits worldwide, the global minimum tax would apply per country. This means that if the U.S. enacts legislation to implement the global minimum tax, American corporations would be required to pay at least 15 percent of the profits they generate in each country where they report profits, calculated separately.

In the example described earlier, an American corporation reports profits in Country A that are taxed at an effective rate of just 5 percent. If the U.S. had implemented the global minimum tax, that corporation would be required to pay a "top up" tax to the U.S. to increase the effective tax rate to 15 percent for its profits in Country A. This would be true regardless of what taxes the corporation pays on profits in other countries and regardless of the fact that it pays a worldwide effective rate of more than 15 percent.

International Agreement Creates Strong Incentives to Implement the Global Minimum Tax

What happens now? The OECD plan consists of two main parts. The one that has received the most attention in the United States is known as Pillar Two, which includes the global minimum tax.[12] If a significant number of large countries implement Pillar Two, it will create incentives for others, including the U.S., to join them.

When a multinational corporation based in a country that is not participating in the deal does business in a participating country, the latter can impose taxes on the company to ensure that its overall effective tax rate is at least 15 percent. This means if the U.S. does not participate, American corporations could still be subject to higher taxes but – and this is key – the revenue would go to other countries where these corporations operate, not to the U.S.

This would happen because Pillar Two has two main components, an “income inclusion rule” (IIR) and an “under-taxed payments rule” (UTPR).

Under the IIR, participating countries implement the global minimum tax already described, ensuring that corporations based in their borders pay an effective tax rate of at least 15 percent on the profits they report in each country where they do business.

The UTPR is how the participating governments prevent corporations based in non-participant countries from gaining a tax advantage over their own corporations. If the U.S. does not participate in the deal, an American corporation might find itself paying “top up” taxes in all the participating countries where it operates, and these top up taxes would be designed to bring its worldwide effective tax rate up to 15 percent.[13]

Under the international agreement, countries imposing a top up tax under the UTPR would allocate the revenue raised amongst themselves through a formula based on employees and assets a corporation has in each country.

One way to implement the UTPR would be to limit certain tax deductions that foreign-owned companies often claim in the countries where they operate for interest payments or royalty payments they make to their parent companies. These payments are often just accounting gimmicks to make it appear, for tax purposes, that profits are not earned in the countries where multinational corporations are really doing business.

President Biden’s budget plan for fiscal year 2023 includes a proposal to implement the UTPR in this way, which alone would raise $239 billion over a decade according to the administration.[14]

The 2017 Tax Cuts and Jobs Act included a provision called the Base Erosion and Anti-Abuse Tax (BEAT) that is supposed to serve a similar purpose but is generally recognized as being weak. The House-passed Build Back Better Act included provisions to strengthen the BEAT and make it conform more to the UTPR concept, but this provision was left out of the legislation ultimately enacted. The UTPR proposal in the President’s budget is designed to align with more recent details hammered out in international negotiations and would replace the BEAT entirely.

At the time the international deal was negotiated, many observers probably imagined the U.S. would participate in the deal, implement the IIR to ensure adequate taxation for its own corporations and use the UTPR for corporations based in some small country like Switzerland or Bermuda. But, right now, the U.S. is the non-participating country and other governments may use the UTPR to raise taxes on American corporations. This could very quickly create pressure on U.S. lawmakers to get on board and implement the agreement.

How Likely Are Other Countries to Implement the Global Minimum Tax?

All eyes are currently on Europe. The European Union could adopt and implement the global minimum tax with unanimous consent from all its member countries. Right now, the authoritarian government of Hungary is the sole EU member to object (with the encouragement of Congressional Republicans from the U.S.) There is discussion among EU members of using a technical procedure that would allow members who support the tax to act without Hungary, and even some discussion of member countries acting alone.[15]

The legal and procedural details are complex, but the bottom line is that the majority of Europe's economic engines could soon implement the agreement and they would surely be followed by other governments, creating real pressure for the U.S. to join.

APPENDIX

TABLE 2. More Details on the 15 Most Likely Tax Havens

	Political Status	Signed Global Minimum Tax Agreement	Reported Profits of US Companies (billions)	National GDP (billions)	Profits as % of GDP	Foreign Income Taxes Paid (billions)	Foreign Tax Rate	Number of employees	Profits Per Employee
Cayman Islands	British Overseas Territory	Yes	$60.4	$6	1016%	$0.1	0.1%	6,055	$9,970,110
Bermuda	British Overseas Territory	Yes	$30.7	$7	414%	$0.3	0.9%	856	$35,873,384
Gibraltar	British Overseas Territory	Yes	$7.8	$3	249%	$0.0	0.1%	131	$59,656,465
British Virgin Islands	British Overseas Territory	Yes	$3.2	$1	225%	$0.0	0.6%	652	$4,962,699
Barbados	Independent	Yes	$8.8	$5	166%	$0.0	0.5%	733	$12,028,539
Isle of Man	British Crown Dependency	Yes	$6.1	$7	83%	$0.0	-0.1%	640	$9,534,571
Curacao	Constituent Country of Netherlands	Yes	$1.6	$3	55%	$0.0	0.1%	188	$8,746,284
Puerto Rico	U.S. Territory	N/A	$33.4	$105	32%	$1.2	3.6%	73,556	$453,586
Jersey	British Crown Dependency	Yes	$2.0	$6	32%	$0.0	2.4%	420	$4,700,652
St. Kitts and Nevis	Independent	Yes	$0.2	$1	20%	$0.0	4.4%	638	$367,824
Singapore	Independent	Yes	$62.8	$375	17%	$3.8	6.1%	179,748	$349,139
Ireland	Independent	Yes	$55.1	$399	14%	$10.0	18.1%	163,179	$337,680
Malta	Independent	Yes	$1.7	$16	11%	$0.0	2.9%	2,524	$688,308
Netherlands	Independent	Yes	$88.6	$910	10%	$6.1	6.9%	174,328	$508,034
Switzerland	Independent	Yes	$60.2	$732	8%	$3.5	5.8%	82,532	$729,739
Total for Most Likely Tax Havens			$422.7	$2,578	16%	$25	5.9%	686,180	$615,949
Total for Other Countries			$349.3	$60,373	1%	$96	27.3%	12,935,476	$27,006

Source: Profit and tax data from IRS SOI Country by Country Report for 2019; 2019 GDP data from World Bank, UN Statistics Division, Government of Gibraltar, Government of Guernsey, Government of Jersey.
Notes: Jurisdictions where U.S. corporations reported an overall net loss are not included.
These calculations also exclude any jurisdiction that the IRS did not report separately.

ENDNOTES

1. Matthew Gardner and Steve Wamhoff, "Corporate Tax Avoidance Under the Tax Cuts and Jobs Act," July 29, 2021, Institute on Taxation and Economic Policy. **https://itep.org/corporate-tax-avoidance-under-the-tax-cuts-and-jobs-act/**

2. All the tax havens listed in the table, aside from Ireland and Puerto Rico, joined the OECD agreement with most other governments in August of 2021. See "Members of the OECD/G20 Inclusive Framework on BEPS joining the Statement on a Two–Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy as of 31 August 2021." **https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-july-2021.pdf**. Ireland joined in October of that year. See Padraic Halpin and Conor Humphries, "Ireland Agrees to Global Tax Deal, Sacrificing Prized Low Rate," October 7, 2021, Reuters. **https://www.reuters.com/business/ireland-backs-global-tax-deal-gives-up-prized-125-rate-2021-10-07/**

3. See the official revenue estimate of the Inflation Reduction Act. Joint Committee on Taxation, JCX-18-22, August 9, 2022. **https://www.jct.gov/publications/2022/jcx-18-22/**

4. Joint Committee on Taxation, letter to Sen. Ron Wyden, August 1, 2022. **https://www.finance.senate.gov/imo/media/doc/CAMT%20JCT%20Data.pdf**

5. Steve Wamhoff and Richard Phillips, "The Failure of Expensing and Other Depreciation Tax Breaks," November 19, 2018, Institute on Taxation and Economic Policy. **https://itep.org/the-failure-of-expensing-and-other-depreciation-tax-breaks/**

6. Matthew Gardner and Steve Wamhoff, "Depreciation Breaks Have Saved 20 Major Corporations $26.5 Billion Over Past Two Years," June 2, 2020, Institute on Taxation and Economic Policy. **https://itep.org/depreciation-breaks-have-saved-20-major-corporations-26-5-billion-over-past-two-years/**

7. Remarks by Secretary of the Treasury Janet L. Yellen at the Brussels Economic Forum, May 17, 2022. **https://home.treasury.gov/news/press-releases/jy0788**

8. For example, while the OECD minimum tax has a rate of 15 percent, under the existing GILTI rules, offshore corporate profits can be taxed at just 10.5 percent. Whereas the OECD global minimum tax exempts some offshore profits under its substance-based carve-out as discussed further on, the GILTI rules exempt even more (offshore profits equal to up to 10 percent of tangible assets that a corporation holds offshore). Most importantly, the GILTI tax is calculated on each corporations' profits worldwide while the OECD minimum tax is calculated on each corporation's profits per country, as explained further on.

9. In 2019, about 1,600 corporations complied with reporting requirements that applied to corporations above a similar revenue threshold -- $850,000. See Internal Revenue Service, "Table 1A. Country-by-Country Report: Tax Jurisdiction Information by Major Geographic Region and Selected Tax Jurisdiction, Tax Year 2019." **https://www.irs.gov/statistics/soi-tax-stats-country-by-country-report**

10. OECD, Global Anti-Base Erosion Model Rules (Pillar Two): Frequently Asked Questions, December 2021. **https://www.oecd.org/tax/beps/pillar-two-model-GloBE-rules-faqs.pdf**

11. Some exceptions in the global minimum tax coud make it more generous to corporations than the IRA's minimum tax in certain ways. For example, the global minimum tax allows corporations to claim deductions for stock options (a form of compensation that companies pay mainly to executives) that are larger for tax purposes than the expenses for those stock options that they report on the books for investors. (See OECD, "Overview of the Key Operating Provisions of the GloBE Rules." **https://www.oecd.org/tax/beps/pillar-two-GloBE-rules-fact-sheets.pdf**.) This is one way in which the global minimum tax is more generous to corporations than the IRA's minimum tax, which some corporations could pay precisely because the profits they report to the IRS and the profits they report on the books are different because of this mismatched treatment of stock options. This seems to be one area where the IRA's minimum tax is a better policy because it cracks down on the U.S. tax code's otherwise overly permissive treatment of stock options. (See Elise Bean, Matthew Gardner and Steve Wamhoff, "How Congress Can Stop Corporations from Using Stock Options to Dodge Taxes," December 10, 2019, Institute on Taxation and Economic Policy. **https://itep.org/how-congress-can-stop-corporations-from-using-stock-options-to-dodge-taxes/**.)

12. Pillar One allocates the right to tax corporate profits to countries partially based on where a corporation is selling goods or services. Until now, the general rule has been that countries are allowed to tax businesses that are physically present within their borders. More corporations (particularly American corporations) are now generating profits by selling to customers in countries where they have little or no physical presence. This means that governments have less ability to tax profits from commerce within their own borders under the traditional approach. While American multinational corporations could face higher taxes under Pillar One, for many of them this is preferable to the alternative, which would be many different governments imposing new (and possibly more significant) taxes on their profits in completely different ways with no coordination.

13. Whereas the IIR is calculated on each corporation's profits per-country, the UTPR is calculated on each corporation's profits worldwide.

14. For more information about President Biden's UTPR proposal, see Steve Wamhoff and Joe Hughes, "Revenue-Raising Proposals in President Biden's Fiscal Year 2023 Budget Plan," April 26, 2022, Institute on Taxation and Economic Policy. **https://itep.org/revenue-raising-proposals-in-president-bidens-fiscal-year-2023-budget-plan/**

15. Jorge Valero, Kamil Kowalcze, and William Horobin, "EU Nations Commit to Global Minimum Tax Despite Hungary Veto," September 9, 2022, Bloomberg. **https://www.bloomberg.com/news/articles/2022-09-09/eu-nations-commit-to-global-minimum-tax-despite-hungary-veto?leadSource=uverify%20wall**