Corporation-Friendly Treasury Regulations Reducing Federal Revenues

By Samantha Jacoby

Certain Treasury Department regulations implementing the 2017 tax law’s international tax provisions are more generous than scorekeepers previously anticipated, the recent Congressional Budget Office (CBO) annual report on the budget and the economy shows. Together with new information on corporations’ financial reporting and how multinationals may be planning around the law, these corporation-friendly regulations are now projected to lower projected revenues by roughly $110 billion over ten years relative to earlier estimates.

These new estimates highlight that implementing regulations can have revenue implications of billions — or even hundreds of billions — of dollars. Given the many generous regulations across the 2017 tax law’s implementation, this is likely an issue across other tax regulations that have been issued. Policymakers should pursue tax reform that ends various loopholes, tax shelters, and gaming opportunities in the tax code — including those created by the 2017 law.

What CBO’s Baseline Update Shows (and Doesn’t Show)

CBO’s new estimates, known as its “baseline,” project slightly higher deficits over the 2020-2029 time period than the agency’s previous estimates from August 2019, taking into account changes in the economic outlook, legislation enacted, and technical revisions to CBO’s estimating assumptions. For instance, CBO’s revisions to its economic projections lowered its deficit projections, while repeal of health-related tax provisions included in the 2019 year-end tax and spending legislation increased projected deficits.

CBO’s updated ten-year estimate of corporate tax revenues is $127 billion (or 4 percent) lower than its last baseline, with various factors pushing in different directions. One of those factors was a $110 billion reduction in projected revenues over 2020-2029 from certain provisions in the 2017 tax law.

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law. CBO said this reduction resulted, in large part, from Treasury Department regulations governing the law’s international provisions, along with new financial data and information about how businesses are responding to the provisions. CBO didn’t specify exactly which of Treasury’s regulations led to the downward revision, but several of Treasury’s recent business-friendly regulations could contribute to weaker revenues in this area than CBO originally anticipated.

Understanding CBO’s Baseline

It’s important to note two things about CBO’s baseline. First, it doesn’t explain how CBO’s estimate of the overall cost of the 2017 tax law has changed, or even whether all the regulations announced to date have moved that cost up or down relative to scorekeepers’ initial estimates in 2017. Second, in flagging these updates to the baseline, CBPP means no criticism of Congress’ scorekeepers. They did their best to analyze the new law within an extraordinarily tight timeframe in 2017 and with imperfect information on how Treasury would use its significant discretion to make regulations and how taxpayers would react. Indeed, CBO should be commended for providing clarity about its ongoing refinements to the baseline to incorporate new information.

How New International Tax Regulations Reduce Revenues

The 2017 tax law made major changes to U.S. international tax laws — in particular, moving to a “territorial” tax system, which exempts from U.S. tax most profits that U.S. multinational corporations earn from their foreign subsidiaries. The law includes several provisions that attempt to limit corporations’ incentive to shift profits and investments overseas to benefit from this exemption. For example, the law added a new 10.5 percent minimum tax on certain foreign income that’s supposed to ensure U.S. companies pay at least some U.S. tax on their foreign profits, and created another new tax intended to limit corporate profit shifting, known as the base erosion and anti-abuse tax, or the BEAT.5

As we’ve noted, Congress left many key decisions to Treasury as it writes regulations implementing the law.6 Multinational corporations seized on this opportunity by engaging in an extensive lobbying campaign to persuade Treasury to exempt their businesses from some of the

4 Together, the cost of the corporate-friendly international tax regulations, new financial data, and tax-avoiding corporate behavior likely exceeds $110 billion. That’s because the $110 billion is a net figure showing multiple changes to revenue projections from the 2017 tax law, and it includes some upward adjustments (or revenue savings) from technical changes CBO made related to the 2017 tax law’s cost recovery rules for businesses’ research and development spending.

5 The BEAT targets corporations that artificially shift their profits using so-called “earnings-stripping” techniques, in which U.S. corporations use debt, for example, to siphon profits out of the United States and into low-tax countries, or tax havens.

law’s new restrictions, including the minimum tax and the BEAT. For example, multinationals sought — and received — a special exemption from the minimum tax if their foreign tax bills are sufficiently high, even if the tax would otherwise apply to them. Similarly, after facing pressure from a number of foreign banks, Treasury issued regulations largely exempting foreign banks with U.S. divisions from the new BEAT.

Although CBO didn’t specify which Treasury regulations caused it to lower its corporate revenue projections, these exemptions are likely part of the reason. In addition, legal experts have argued that Treasury’s decision to create these exemptions without a directive from Congress went beyond its legal authority. Law professor and former Treasury official Stephen Shay, for example, called the exception to the minimum tax “an unjustified subsidy for foreign investment that does not advance United States welfare.”

CBO Suggests Tax Avoidance Also Affects Revenues

In addition to lax Treasury rules, CBO said other factors contributed to its downward revision of certain revenues from the 2017 tax law, including “updated information on taxpayers’ responses” to the law’s international provisions — that is, how corporations are changing their behavior to pay less in taxes. Hence, it appears that, in this area at least, the scope of corporate tax avoidance in response to the 2017 tax law will likely exceed what CBO previously anticipated. Though it’s not clear exactly what types of corporate activities CBO expects to cause this effect, revenue loss could result from greater-than-anticipated corporate profit shifting, increased investment in overseas markets for tax reasons, or other forms of corporate tax avoidance.

8 Sony Kassam, “IRS Expands High-Tax Exclusion Under Global Minimum Tax,” Bloomberg, June 14, 2019, https://news.bloombergtax.com/daily-tax-report-international/irs-expands-high-tax-exclusion-under-global-minimum-tax. To avoid double taxation, U.S. corporations generally get tax credits (known as foreign tax credits) for the taxes they pay to foreign countries. In the case of the new minimum tax, 80 percent of any such foreign taxes paid can be credited back to corporations. This and other technical rules related to how corporate expenses are accounted for may mean that some companies could pay somewhat higher effective tax rates on their foreign income than the 10.5 percent minimum tax rate.
11 Congressional Budget Office.
After Congress and the President enacted the 2017 tax law, CBPP and other tax experts warned that its changes to the international tax system would create incentives for companies to move profits, investment, and jobs overseas, and that the law’s provisions to stem abuse would likely be largely ineffective (and potentially create other perverse incentives), posing a risk to the integrity of the U.S. tax system as a whole.\(^\text{13}\)

CBO’s latest baseline suggests that this could already be happening, and that Treasury’s implementation of the law could be making matters worse. It’s not just the law’s international provisions; similar dynamics have played out in other areas of the 2017 tax law, with lobbyists using the regulatory process to secure significant tax breaks that benefit affluent owners of certain kinds of businesses, known as pass-through businesses, and wealthy investors in “opportunity zones.”\(^\text{14}\)

Policymakers should begin considering how to reverse the damage the 2017 law is causing by crafting meaningful tax reform that eliminates various loopholes, tax shelters, and gaming opportunities the tax code now contains.
