

Remarks by Assistant Secretary for Tax Policy Lily Batchelder at the 2022 Tax Conference Hosted by the Federal Bar Association

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As prepared for Delivery

The Section on Taxation is such an incredible resource for the tax community, whether through your wonderful programming that I have personally benefited from, or your networking opportunities for young lawyers.

Today, I want to outline some of the work we have been doing since the start of the Administration at Treasury and the Office of Tax Policy, and also give a preview of what is to come.

I'd like to first acknowledge the challenges that we are facing at home and abroad. The events of the past week have been heartbreaking and tragic. Our thoughts are with the people of Ukraine, who are fighting for their lives, their families, and their country. This comes on the heels of a global pandemic that has left our fellow Americans weary and with understandable and serious concerns about the impact on their everyday lives. By most traditional metrics, under President Biden's leadership the pace of our recovery has exceeded even the most optimistic expectations, but the human impact from the pandemic has been enormous.

To address these challenges, Secretary Yellen has outlined a modern approach to supply-side economics, that will grow the economy by expanding potential output through investments in people and the factors of production—and do so in a way that promotes equity.

Tax policy is an important part of this Modern Supply Side economics approach. Rather than delivering tax cuts to the wealthy that fail to trickle down to the middle class and those who are less well off—as was the case with traditional supply side economics—our proposal would mitigate barriers to employment through policies like expanding the EITC, providing tax credits to make childcare affordable, and enacting universal pre-K.

In 2021, the American Rescue Plan, which included major expansions to the Child Tax Credit and EITC, led to the largest single-year drop in child poverty in history. Reducing child poverty is not only the right thing to do, but it promotes long-term growth. Study after study has

found that such investments in kids result in higher educational attainment, better health, and higher earnings over their lifetimes.

Another aspect of the Administration's modern supply side agenda relates to international tax, and is a subject I'd like to spend a little time on.

The current international tax system is desperately in need of reform because it rewards companies that make investments and shift real economic activities abroad purely for tax-motivated reasons.

One of the biggest accomplishments of the Administration to date has been the global agreement to stabilize the international tax landscape. This agreement removes these tax distortions in a way that benefits the American people and U.S. businesses.

In a remarkable testimony to multilateralism, 137 of 141 jurisdictions in the OECD Inclusive Framework have agreed to a global minimum tax, and to partially reallocating taxing rights from countries where companies are headquartered to those where they sell goods and services. This includes all G20 and EU countries, representing nearly 95% of the world's GDP.

Let me start with the global minimum tax. Currently, the United States is the only country with a formal minimum tax on foreign earnings. The global minimum tax rate is 0%. To be sure, some countries have anti-abuse regimes that limit profit shifting at the margins. But many of these regimes are leaky and poorly coordinated.

The agreement sets a floor so that multinational corporations, whether headquartered in the United States or abroad, will pay taxes on their foreign earnings of at least 15%. And in a novel step for international tax law, the agreement includes a strong enforcement mechanism—that was supported by both this Administration and the prior one—that ensures countries honor their commitments, while heavily incentivizing non-signatory countries to join the common framework.

These rules allow countries to impose top-up taxes on companies operating in their jurisdiction if the company's global effective tax rate falls below the minimum of 15%, on a country-by-country basis. These enforcement rules are what makes the regime so strong and protects against countries cheating the system.

But it is also true that the US has negotiated a path, consistent with the structure set forth in the prior administration, to ensure that companies continue to benefit from important tax incentives like those for research and development in the U.S.

The direct pay structure of the green credits in Build Back Better is one example of this commitment. Some form of refundability is another approach. Regardless, we remain entirely committed to working with Congress to ensure that tax credits and other tax incentives that promote US jobs and investment are protected.

So with that, let me step back and explain the problem at which the global minimum tax is aimed.

Fundamentally, we see the agreement as essential to saving the corporate income tax, which in turn is fundamentally about making sure we tax capital and not just labor income.

Although Treasury and the Administration are pursuing other reforms to the taxation of capital, the corporate tax is a key component in this effort. It is a straightforward way to reform capital taxation, and one of the most progressive components of the federal tax system. The problem is that nations have engaged in tax competition, which has driven down corporate tax rates, and diminished their important role in making sure that owners of capital bear their fair share of the tax burden.

Because of this race to the bottom, corporate tax rates have declined from an OECD average of over 40% forty years ago, to just 23% today. This race to the bottom means that not only are corporate tax rates driven down, but so are government resources, which could be used to build infrastructure, educate our citizens, incentivize R&D, and combat climate change. These kinds of government investments are just the kind of modern supply side policies Secretary Yellen has talked about, because they are critical to ensuring long-term, sustainable growth, and U.S. competitiveness. But to make matters worse, the race to the bottom also means someone else is left holding the bag. And to the extent that this shortfall in revenues is picked up by others, it is picked up by workers and small businesses.

We need to reverse this trend because it is fair, but also because it will help ensure that our political systems at home and abroad are stable and functioning. It will help ensure we all have the resources we need to make investments that expand opportunities. This is fundamentally why a multilateral solution is necessary. By agreeing to enact a minimum tax on foreign earnings, 137 countries have decided to put a floor on tax competition by large multinational corporations once and for all.

But I want to emphasize that this agreement is not a zero-sum game. Workers will benefit significantly because it will ensure that the owners of capital fairly share the burden of financing government. But it will also bring important benefits to US businesses. Small

businesses will benefit because they will no longer face a competitive disadvantage compared to large multinationals that can shift profits on paper to low-tax jurisdictions, while they pay the full US rates. But even our larger corporations will benefit. They will no longer be based in the only country that formally requires them to pay a minimum tax on their foreign earnings. This level playing field will enhance their competitiveness relative to foreign corporations—along with all of the other extraordinary benefits that US residence offers. And it will help stop the offshoring of jobs and corporate inversions.

A level playing field has been the single most frequent international tax policy request from the US multinational community. Not only will it ensure our corporate revenue stream is sustainable, but it will enhance economic growth through a more competitive and less distortive international tax system.

Finally, on Pillar Two, I want to emphasize the benefits of strengthening our current minimum tax system to align with the global deal.

Our current GILTI rules are poorly designed to combat profit shifting. Because they apply globally—meaning companies can blend income from high tax countries with income from low tax countries—they effectively mean the US is often the last place where a US multinational would want to earn income.

Our international tax proposals would strengthen and reform GILTI so that it aligns with the global deal, including by applying on a per country basis. They would dramatically reduce profit shifting incentives, which inefficiently inhibit domestic productivity. And the revenue they raise could be used to finance the transformative investments that I discussed earlier.

There is broad support across the Democratic caucus for these international tax proposals. And we are optimistic that we will meet our commitment to enact Pillar Two in 2022, as the many, many other countries that have joined the agreement move forward with their plans to do so as well.

Shifting to Pillar One, it has similar benefits for US business by stabilizing a system that has frankly been upended.

Over the last 15 years, the current system for allocating taxing rights has simply lost the support of foreign sovereigns. It ignores the realities of doing business in a modern world, and instead demands physical presence for taxing rights to be triggered. This led to longstanding complaints by countries that are primarily market economies rather than headquarters jurisdictions. More recently, these objections were joined by complaints from

developed economies, especially in Europe, that historically supported the current system, but were frustrated by the ability of so-called digital giants to escape taxes in their jurisdictions.

In response to these calls for change, the prior Administration acknowledged that there was a problem with the international taxing rights allocation system writ large. But they strongly, and correctly, emphasized that it was not limited to digital services. At the same time, political pressures abroad began creating a chaotic array of digital services taxes and other unilateral measures that discriminated against US businesses, threatened them with multiple layers of taxation, and escalated tax-related trade tensions that could harm economic growth.

Moreover, as more sectors digitize and nations get more creative, these measures threatened to expand beyond the digital sector. When we inherited the negotiations, they were on life support. The former Administration had proposed a safe harbor approach to Pillar 1, which would have essentially made it voluntary. This was understandably a nonstarter for the rest of the world.

But when Secretary Yellen dropped the safe harbor demand last February, the negotiations restarted in earnest. There have been a host of challenging issues along the way. The original proposal—to limit any reallocation of taxing rights to the digital tech companies—was popular abroad. But it was conceptually indefensible, discriminatory against US business, and not future proofed because the global economy will continue to digitize. Other proposals, for example to also include consumer-facing businesses, introduced definitional problems that potentially discriminated against US businesses as well. But ultimately we reached a compromise—again supported by 137 countries—that applies Pillar 1 reallocation to the largest and most profitable companies in almost all sectors.

Pillar One as it now stands promises to restabilize the system in a manner that would be sustainable and will put an end to unilateral, discriminatory measures. Importantly, the agreement protects US interests. As one of the largest market economies in the world, we stand to benefit from Pillar One's partial reallocation of taxing rights to market jurisdictions.

Our companies will also benefit from the increased tax certainty it will create. They will be able to plan for the future and invest their capital based on economic and not tax considerations. No longer will they face unilateral tax measures that threaten them with multiple layers of taxation. And no longer will they face the threat of escalating tariff retaliations and trade wars that are bad for US business.

Shifting gears a bit from the corporate side to the individual side, I also want to take some time to discuss important work by the IRS and Administration in making sure that eligible individuals and families receive all the tax benefits to which they are entitled. These efforts started with the economic impact payments, also called stimulus payments, which provided Americans with critical relief during the early stages of the pandemic so they could pay bills and put food on their tables.

Overall, since 2020, Treasury and the IRS have made more than 163 million EIP payments, totaling \$390 billion, to 85% of American households. This work on tax benefit delivery continued with the expanded and monthly Child Tax Credit (CTC). Between July and December of last year, the IRS delivered almost \$93 billion of advance monthly CTC payments to families of about 61 million children. In addition, the full refundability of the CTC last year meant that families of more than 26 million lower-income kids became eligible for the full CTC for the first time.

Part of how the IRS reached all of these individuals and children was through a novel set of outreach efforts. Most of the stimulus and CTC payments were provided automatically using tax return information from prior years. But many eligible taxpayers didn't have a filing obligation in recent years. To reach them, the IRS and Treasury partnered with other federal agencies, like the SSA, and an incredible array of community organizations.

Ultimately, more than 26 million stimulus payments went to taxpayers without recent tax returns. This reflects the emphasis we are placing on ensuring that the tax system is focused both on collecting taxes that are owed, especially from wealthy tax cheats, but also on ensuring that all Americans are aware of and receive tax benefits for which they are eligible.

Although these outreach efforts were unprecedented, we want to learn from them so we can do even better next time. So to this end, Treasury's Office of Tax Policy, with support from the IRS Research, Applied Analytics, and Statistics Division, is examining whether and how eligible adults and families received EIPs, and how a letter campaign impacted take-up.

We hope this work will give us a better understanding of the barriers to uptake among some of our most vulnerable communities. But this work is also important because it will represent the first time the Office of Tax Policy will examine the racial equity impacts of a tax program.

President Biden's Day One executive order directed agencies to examine whether and how their policies and programs perpetuate barriers to equal opportunity, and having data is essential to performing this task. Our research on the EIPs is part of a broader effort by OTP

to develop a reliable methodology for imputing demographic data, including race and ethnicity, on to tax data. An imputation model is necessary because the IRS does not collect this information and cannot acquire it from other agencies. Once the model is validated, we plan to publish statistics on the demographic characteristics of EIP recipients, including estimates of their race and ethnicity.

And we plan to use the model in other similar contexts, for example to examine the equity impacts of delivery of the monthly CTC by income, race, and other demographic characteristics.

This work is going extend over several years as data becomes available. All of it will of course be done following strict protocols that prevent disclosure of taxpayer information. But eventually, we hope the imputation model will enable outside researchers to analyze the demographic and equity effects of a variety of tax policies.

The final subject I want to touch on is this year's filing season. I have to start by acknowledging that it is and will be a challenging one, as you are all well aware. But it is important for us to recognize that the challenges the IRS is facing stem from two things: First, systematically underfunding for more than a decade. And second, a global pandemic that forced the IRS to adjust staff levels and operations, at the same time that it was providing critical support to families, for example through the three rounds of economic impact payments I just mentioned.

Like all of us, the IRS has been hugely impacted by COVID-19. For months in 2020, it closed down processing centers entirely, and since mail is opened manually, this meant no paper returns were processed or correspondence answered for months. In addition, about 20 percent of the customer services workforce has been on leave over the past two years, largely due to COVID.

On top of these direct COVID impacts, the IRS took on new and far greater responsibilities as a result of COVID relief legislation. It delivered necessary lifelines individuals and businesses, whether through programs like the stimulus payments or the employee retention tax credit.

But it is important to remember that the IRS's challenges date back much further than the pandemic. Chronic underfunding has decimated the agency, making its tasks herculean in normal times. And the past two years have not been normal times. Over the past decade, the IRS budget has been cut by nearly 20% in real terms. As a result, its workforce is the same size as it was in 1970, even though the US population has grown by 60% since then, and the

economy is far more complex. And the agency's technology is also archaic, with some processing technology dating back to the 1960s. So much of its work that could be efficiently automated—like processing paper returns—is still being done manually: Agents transcribe information from these forms by hand. This is because the IRS has no resources to invest in a much-needed overhaul of its technological ecosystem.

The result of the pandemic and this chronic underfunding is an IRS that doesn't have the capacity to serve taxpayers the way that they deserve this filing season. Phone calls to the IRS more than tripled last year relative to the historic norm. For example, in the first half of the last year, the IRS received nearly 200 million calls. Because it had fewer than 15,000 customer service reps, that translated to roughly one person per 13,000 calls.

The Biden Administration has made overhauling the IRS a priority by making efforts to secure adequate funding at every turn, including proposing a mandatory, stable funding stream of \$80 billion over the course of the next decade. This funding would allow the IRS to enter the 21st century with a more robust workforce and modern technology, finally allowing it to adequately serve the American public.

It would also bolster the IRS's capacity to meaningfully attack the tax gap, by pursuing high-end evaders who accrue income in increasingly opaque ways. Training personnel to effectively audit these high-end evaders takes years, which is why multi-year funding is so critical. In the meantime, the IRS and Treasury are doing all we can to ensure to make the current tax filing process less painful.

For example, we relaunched ChildTaxCredit.gov, which now includes several features that help simplify tax filing, including directing taxpayers to the best free filing options, and helping them determine their eligibility for remaining credits. The IRS is also increasing the availability of customer callback technology, which is now available for up to 70% of the types of calls that the IRS receives. And it is providing more automated phone assistance. But nothing will substitute for funding the IRS adequately and stably so that it can serve taxpayers in the way they deserve.

In closing, I am confident that many of the Biden Administration's top priorities will ultimately be enacted, including investing in the IRS and strengthening of our minimum tax on foreign earnings.

The revenue these proposals would bring in would also transform lives, by funding investments in our children and our communities, initiatives to combat climate change, and

supporting broadly-shared economic growth.