

Congress of the United States

Washington, DC 20515

April 26, 2024

The Honorable Janet Yellen
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Yellen,

On November 15th, 2023, Representatives LaHood and DelBene led a bipartisan letter to Ambassador Katherine Tai to express opposition to the U.S. Trade Representative's (USTR) decision to abandon longstanding bipartisan digital trade proposals at the World Trade Organization, a position that also has been reflected in the lack of ambition in USTR's digital trade proposals in other contexts such as the Indo-Pacific Economic Framework negotiations. As that letter argued, the action was made without sufficient consultation with Congress and runs counter to the interests of American workers and businesses, while ceding leverage over digital trade rules to foreign countries. It also undermines high-standard digital trade provisions that the United States successfully pushed for in recent trade agreements, including the United States-Mexico-Canada Agreement. With the decision, USTR determined that it will no longer defend against foreign governments' demands for American businesses to locate facilities, equipment, employees, and intellectual property in those countries.

In addition to the harmful impacts on the U.S. economy and the concession of leadership on global digital trade rules, we are concerned about the implications of USTR's digital trade decision for U.S. tax policy. First, the data-localization requirements that would be allowed to proliferate in the absence of U.S. leadership could, in practice, require some U.S. based companies to have a taxable presence (and, in some cases, a 'permanent establishment' pursuant to a bilateral tax treaty) in foreign jurisdictions where common business practice otherwise would not require such presence. This could have the effect of diverting investment from the United States. Second, this new requirement has significant international tax implications allowing foreign governments to claim a right to tax business revenue that would be taxed in the United States under existing law and treaties. Finally, the policy appears to be at odds with many of the objectives outlined by the Department of the Treasury, both in negotiations over Pillar One of the Organization for Economic Co-operation and Development's (OECD) Inclusive Framework on Base Erosion and Profit Shifting, and positions described in the General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals (FY25 Greenbook).

As you are aware, the overarching aim of Pillar One is to reorient international taxation to changes brought by the digitalization of the economy, primarily by recognizing market jurisdictions as having taxing rights over a portion of the profits of multinational enterprises (MNE) regardless of whether the MNE has a taxable presence in that jurisdiction under existing laws and bilateral tax treaties. As such, Pillar One has been described as a reallocation of taxing

rights in that there is no fundamental change in the source of profits, but instead a post-hoc reallocation of who may tax those profits. The digital trade decision at USTR does the opposite, moving the source of profits abroad as economic assets are shifted away from the U.S. and towards countries with data storage requirements, bringing jobs, intellectual property, and tax revenue with them. In a recent article titled “How to Protect the U.S. Tax Base: Don’t Give it Away,” Tax Professor Mindy Herzfeld states that:

“To a significant degree, this is precisely the result many countries have been seeking on the tax side: for U.S. companies to move real operations to their jurisdictions (generating a physical presence and significant profits) rather than simply selling into them.”

With Pillar One proposing to reallocate some taxing rights “on paper,” market jurisdictions could assert certain primary taxing rights over a portion of the profits generated by globally-engaged companies without the need to show a legal or economic nexus to value creating assets or activities in such jurisdictions. Given that 64% of the profits of Amount A’s in-scope companies are U.S. based, any such real restructuring of operations that may be required as a result of USTR’s digital trade position is more likely to harm jobs and investment currently based in the United States. A number of outstanding concerns with regard to Pillar One still need to be addressed for it to achieve the necessary support in Congress, with many of these highlighted at the recent Ways and Means Tax Subcommittee Hearing on Pillar One. Given these outstanding concerns surrounding Pillar One, it is not clear why USTR would decide on a policy that is at odds with the current Pillar One proposal negotiated by the Treasury Department, particularly if Congressional approval of Pillar One is an objective of the Biden Administration.

The Department of the Treasury has long recognized the general policy aim of preserving and promoting U.S. based jobs and investment. For example, the FY25 Greenbook notes the President’s concern with “undesirable incentives to locate certain economic activity abroad.”

However, this policy objective is clearly in contradiction to USTR’s digital trade decision. If local-data storage requirements are allowed to proliferate throughout the world, U.S. based MNEs will face not just an incentive to invest abroad but a requirement to do so. At the same time, any potential advantage of Pillar One to the United States is undermined, with the real reallocation of company operations towards market jurisdictions occurring despite the proposed agreement attempting only to reallocate taxing rights.

With U.S. MNE’s investing in new facilities to comply with the local data laws, investment would be diverted away from the United States, along with the facilities, jobs, intellectual property, and tax revenue that follow them. At the same time, as companies’ taxable presence in countries with local-data storage requirements grows, U.S. foreign tax credit claims are bound to grow with it. Together, these shifts are likely to result in more taxes to foreign jurisdictions and less to the United States.

In short, the reversal on digital trade policy by USTR reflects an acquiescence with US tax base erosion through increased foreign tax payments in lieu of tax payments to the US Treasury. This appears to contradict the position of the Department of the Treasury as noted above and

longstanding bipartisan objectives to promote domestic investment and grow the U.S. tax base. While many companies depend on investing in foreign markets in order to deliver their products to those markets, the nature of the internet means many digital companies do not currently face the same requirement for foreign market access. Artificially creating those requirements through regulations would create an unnecessary drag on the growth of the digital economy.

Given the inconsistency between U.S. Department of the Treasury's stated policy objectives and USTR's digital trade decision, we are additionally concerned that USTR may have made such a decision without adequate consultation with the Department of the Treasury. Given the significant tax implications of the decision, inadequate interagency review would be highly concerning. For a decision such as this, it is important that the Treasury provides guidance as to the potential tax and economic implications of the decision.

As we approach your FY25 Budget Hearing before the Ways and Means Committee, we look forward to having the opportunity to discuss these matters with you, including whether the Department of the Treasury estimated the tax implications of USTR's reversal of the U.S. position on digital trade rules, as well as the broader economic implications of the decision.

Sincerely,



Randy Feenstra
Member of Congress



Darin LaHood
Member of Congress



Mike Kelly
Member of Congress



Ron Estes
Member of Congress




Kevin Hern
Member of Congress



Carol D. Miller
Member of Congress



Nicole Malliotakis
Member of Congress



Claudia Tenney
Member of Congress



Adrian Smith
Member of Congress



Beth Van Duyne
Member of Congress