It would be difficult to disagree with Professor Avi-Yonah that the Tax Cuts and Jobs Act of 2017 (the “TCJA”)’s “foreign derived intangible income” (“FDII”) provisions are vulnerable under WTO’s Agreement on Subsidies and Countervailing Measures (SCM). The SCM bars “prohibited subsidies,” which include “the allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption,” in the calculation of income taxes. The TCJA’s FDII provisions appear to provide just that: a special deduction for the export of goods that does not apply to sale of the same goods for domestic consumption.

There are some additional points to consider. FDII does not apply to all exports, only to exports by U.S. taxpayers that have overall income in excess of a deemed return on their tangible assets. But this does not mean that the export subsidy is limited to intangible income. An export of goods can give rise to an FDII benefit even if the excess return is attributable entirely to domestic activities.

FDII is not the only part of the TCJA that could attract WTO challenge, and there is uncertainty about whether such a challenge would take a different course from past challenges to U.S. tax law.

The TCJA’s “base erosion and anti-abuse tax” (“BEAT”) may similarly constitute a prohibited subsidy. In fact, as the TCJA raced its way through Congress, the finance ministers of the five largest European economies called out BEAT, in addition to FDII, as potentially illegal under WTO agreements.

BEAT imposes a minimum tax designed to limit a large, multinational corporation’s ability to reduce its normal U.S. taxes through payments to foreign related parties. Although BEAT is styled as a 10% minimum tax, it is applied to an income base that excludes certain payments to foreign related parties and ignores certain tax credits, potentially increasing the effective tax rate to much more than the statutory rate of 21%.

Deductions that can trigger BEAT include amounts paid or accrued by a taxpayer to a foreign related person for depreciable or amortizable property and, in the

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3 Anne-Sylvaine Chassany & Chris Giles, Europeans issue warning to Trump on tax overhaul, Financial Times (Dec. 11, 2017), https://www.ft.com/content/eeb17eaa-de91-11e7-a8a4-0a1e63a52f9c.
4 TCJA § 14401.
case of inverted companies, for the cost of goods. Because of the potentially higher rate of tax on these payments, BEAT could be viewed as an import charge, creating an implicit subsidy contingent upon the use of domestic over imported goods, potentially a “prohibited subsidy” under the SCM. Alternatively, BEAT could be viewed as an unscheduled tariff on imported goods in violation of 1994 GATT Part II.1(b).5

As noted, there is uncertainty about whether the TCJA will be challenged in the WTO, and what reaction the United States might have to such a challenge. The prior U.S. export subsidies that Professor Avi-Yonah describes were challenged through the WTO’s dispute settlement body (“DSB”) in a process that took many years and was followed by cure periods. Within these periods, the United States could, and did, repeal the offending statute before any retaliatory measures took effect. Although the same could happen here, for a variety of reasons, this time may be different.

First, our trading partners may opt to challenge FDII and BEAT provisions by pursuing countervailing measures against the United States instead of launching a full-blown DSB process. Our trading partners may find this route more effective if they are concerned that the United States will not comply with an adverse WTO ruling by repealing FDII and BEAT.

This concern is not without merit. The prior U.S. export subsidies that Professor Avi-Yonah describes were not enacted in connection with major tax reform and were modified or repealed without the need for a broader revision of the U.S. international tax system then in effect. That is arguably not the case with FDII and BEAT. The TCJA is the most fundamental revision of the Internal Revenue Code (“the Code”) since 1986, and FDII and BEAT provisions are integral parts of the TCJA’s new international tax system. Indeed, the deduction for FDII is associated with, and is in the same Code section as, the deduction for “global low-taxed intangible income” (“GILTI”) of foreign subsidiaries.6 Some have suggested that if FDII provisions were repealed, the GILTI regime would need to be changed as well, which might trigger the need for additional modifications across the U.S. international tax system.

Moreover, the TCJA was enacted along partisan lines, making changes to the TCJA politically difficult. But, even if Congress were able to modify the TCJA, the current administration is skeptical about international trade agreements in general (see, for example, the recent tariffs on aluminum and steel). This raises the question whether the current administration may prefer to take its own retaliatory actions against trading partners that challenge FDII and BEAT provisions rather than support a repeal of the offending provisions themselves. For these reasons, it is unclear whether the United States would or could repeal and replace FDII and BEAT in the near term.

If challenges to FDII and BEAT take a more traditional path through the WTO’s DSB, however, the U.S. response would likely occur in a later Congress, and

5 1994 GATT Article II(1)(b) prohibits the imposition of unscheduled duties or charges in connection with the importation of goods in excess of those imposed on the date the Agreement went into effect (or those required by domestic law in effect on that date). General Agreement on Tariffs and Trade 1994, art. II(1)(b), Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994).

6 The TCJA’s GILTI provisions impose current taxation on certain income generated by foreign subsidiaries of U.S. taxpayers, but at a lower effective rate. TCJA § 14201.
possibly in a subsequent administration, in which case a more traditional outcome might be possible.

   The story is far from over; the beat goes on.