ONLINE

Ending the Vicious Cycle: Understanding "Pillar Two" and the Uncertain Progress Towards a Harmonized Global Minimum Tax

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In recent years, the international community has acted with unprecedented cooperation to rationalize, reform, and empower the international tax regime. Paramount among these reforms is broad international agreement on a global minimum corporate tax to end the vicious cycle of competitive tax cuts for the attraction of foreign capital. This agreement has the potential to revolutionize the international tax system and to truly reshape the power dynamics between states and the major multinational corporations who have until now been able to exempt ever-increasing proportions of their activities from state control.

In 2016, the Organization for Economic Co-operation and Development (OECD) established a working group—"framework"—with over 135 participating countries known as the OECD/G20 Inclusive Framework On BEPS (BEPS 2.0).[1] "BEPS" is an acronym for Base Erosion and Profit Sharing, which

> refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to locations with no/low tax rates and no/little economic activity, resulting in: little or no corporate tax being paid [and] annual revenue losses for governments of at least $100 – 240 billion USD, equivalent to 4 – 10% of global corporate income tax revenue.[2]

These countries have collaboratively produced a "historic" international tax package, agreed to by over 135 countries, to place multilaterally agreed

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1. OECD, OECD/G20 INCLUSIVE FRAMEWORK ON BEPS 1 (2018), https://www.oecd.org/tax/beps/flyer-inclusive-framework-on-beps.pdf. The OECD, or the Organization for Economic Co-operation and Development, is an intergovernmental organization with 38 member countries which are committed to democracy and the market economy by providing a platform to compare policy experiences, seek answers to common problems, identify good practices and coordinate domestic and international policies of its members. *About the OECD*, OECD (2022), https://www.oecd.org/about.

2. *Id.*

limits on tax competition. The key component to this reform is so-called "Pillar Two," an agreement that when a multinational enterprise's effective tax rate in a jurisdiction drops below 15%, the entity would potentially be subject to "top-up" tax liability, thereby discouraging the use of damaging tax incentive policy.[3] However, the OECD framework is a nonbinding technical agreement; actual implementation is left to the constituent states. Implementation has been varied and remains technically and politically challenging (though more so the latter).[4]

This paper will examine the policy itself, its background, and the pending implementation thereof. Part 1 of this paper will examine the underlying issue which necessitates this policy, which is the vicious, counter-productive cycle of countries competing for foreign capital via tax policy. Part 2 will examine the theoretical and historical basis for the reform, namely the single tax policy, in which all aspects of the revenue of multinational corporations are taxed once at internationally consistent real rates. Part 3 of this paper will explore the "Pillar Two" legal and policy framework for such international tax liability which were proposed by the OECD's Framework. Part 4 will explore the prospective and current implementation of the Pillar Two framework.

I. THE ISSUE OF TAX COMPETITION

The modern globalized financial order presents countries with a trilemma of "balancing (1) [Foreign Direct Investment (FDI)]-driven job creation and economic growth, (2) economic openness and competition from peers, and (3) securing a social safety net."[5] FDI "is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor."[6] That FDI, if attracted to a country, can be leveraged to create those jobs and economic growth by providing the capacity to build economic infrastructure and modernize technology.[7] While the economic

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3. OECD, OECD/G20 *Base Erosion and Profit Shifting Project: "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy"* 4 (2021) https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.

4. *Id.*

5. Reuven Avi-Yonah & Young R. Kim, *Tax Harmony: The Promise and Pitfalls of the Global Minimum Tax*, 43 MICH. J. INT'L. L. 505, 511 (2022).

6. OECD, OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT 17 (4th ed. 2008), https://www.oecd-ilibrary.org/oecd-benchmark-definition-of-foreign-direct-investment-2008_5kzpp64464r5.pdf?itemId=%2Fcontent%2Fpublication%2F9789264045743-en&mimeType=pdf.

7. *See* Yoram Y. Margalioth, *Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries*, 23 VA. TAX REV. 161 (2003).

benefits of FDI are traditionally associated with developing economies, they have very significant positive effects in developed countries as well—for example, in the United States, there is over $330 billion of annual FDI, and over twelve million jobs attributable thereto.[8]

However, the very globalized financial system which allows for the free flow of FDI into countries allows their easy outflow, creating the risk that other countries will attract finite FDI by lowering corporate tax burdens, a race to the bottom known as "tax competition."[9] Tax competition creates a positive feedback loop in which countries lower tax rates to retain FDI from other countries who have lowered tax rates, "running . . . tax rates down to the point where jurisdictions may receive little to no net revenue benefit from the FDI."[10]

The United States is no stranger to this vicious cycle of competition. Even though the United States retained a relatively high nominal tax into the twenty-first century,[11] it provided progressively more tax relief to foreign corporations over the past several decades. For example, the United States initially eliminated taxes on various types of corporate income to encourage FDI. These policies included exempting foreign corporations from taxes on portfolio interest,[12] exempting foreign corporations from taxes on capital gains from the sale of personal property,[13] and ultimately reducing marginal tax rates below the OECD average to 21% in 2017.[14]

The final aspect of the trilemma is the need for countries to have sufficient tax revenue to maintain the social welfare systems necessary for a stable society. For example, the United States government social benefits transfer payments (e.g., the earned income tax credit or child tax credits)[15] are equal to more than 10% of the U.S. GDP.[16] The aforementioned race to the bottom to attract FDI reduces national revenue and therefore the ability of countries to maintain those necessary systems.[17]

Acting alone, countries can only address two of these three issues—the benefits of FDI require the free flow of capital. This necessitates tax

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8. News Release, Bureau of Econ. Analysis, U.S. Dep't of Com., New Foreign Direct Investment in the United States (July 6, 2022), https://www.bea.gov/news/2022/new-foreign-direct-investment-united-states-2021 ($333.6BN FDI in the United States in 2021); U.S. Dep't of Com., Int'l Trade Admin., *Jobs Attributable to FDI* (2014), https://www.trade.gov/sites/default/files/2020-12/Jobs%20Attributable%20to%20FDI%20Infographic.pdf ("12 Million U.S. jobs attributable to FDI.").

9. Avi-Yonah & Kim, *supra* note 5, at 512.

10. *Id.*

11. *See* I.R.C. § 11 (1993) (amended 2017) (imposing a top marginal corporate tax rate of 38%).

12. I.R.C. §§ 871(h), 881(c).

13. I.R.C. § 865.

14. I.R.C. § 11(b).

15. *See, e.g.*, I.R.C. §§ 24(a), 32(a).

16. Federal Government Current Transfer Payments: Government Social Benefits: To Persons, FED. RSRV. BANK ST. LOUIS (July 17, 2023), https://fred.stlouisfed.org/series/B087RC1Q027SBEA.

17. Avi-Yonah & Kim, *supra* note 5, at 513.

competition, which undermines the safety net. Thus, the only solution to this trilemma is for countries to cooperatively limit tax competition.[18] Even this is a fraught exercise (and a perfect example of the tragedy of the commons), as the mobility of FDI creates strong incentives for sole actors to undermine cooperation to attempt to attract FDI away from cooperative actors working in the collective interest.[19]

It would be hard to overstate the impact of tax competition on international capital flows and the revenues of countries. In 2015 alone, $616 billion in capital held by multinational enterprises was transferred internationally to countries with lower tax burdens, most of which are perceived as tax havens, as a result of tax competition.[20] In any given year, around 36% of multinational tax profits are shifted in any given year, and as a result, global governments are losing roughly 10% of corporate tax revenues.[21] This loss is felt acutely in more developed nations, as 18% of corporate tax revenues within the European Union are lost to such shifts, and 14% of tax revenues from the United States.[22]

II. SINGLE TAX PRINCIPLE

While the modern movement out of which the subject of this paper grew began in 1998 with the OECD's formal recognition of the issue with its seminal "Harmful Tax Competition Report,"[23] the problem of tax competition has long been studied. There is a clear "right answer" to solving the trilemma and rationalizing international tax policy—collective embrace of the "single taxation principle," in which "cross-border income should be taxed only once at the source-country rate for active income and at the residence-country rate for passive income"—i.e., all income of multinational enterprises are taxed exactly once.[24] The counterpoint to this system is "double non-taxation," in which income is taxed neither in the originating nor parent jurisdiction. For single taxation to be effective, the application of

18. *Id.*

19. *See, e.g.*, Clemens Fuest et al., *Capital Mobility and Tax Competition* (CESifo Econ. Stud., Working Paper No. 956, 2003) ("[T]here is no symmetric Nash equilibrium . . . There can only be an asymmetric equilibrium, where one country pursues a high tax strategy and the other country sets low taxes in order to attract tax part of the tax base from the high tax country. . . One issue is that taxable profits are highly mobile, leading to the "tax base flight" fiscal externality dominating other fiscal externalities in this case.").

20. Thomas Tørsløv et al., *The Missing Profits of Nations* 1, 17 (Rev. Econ. Std., Working Paper No. 24701, 2022).

21. *Id.*

22. *Id.*

23. OECD, HARMFUL TAX COMPETITION: AN EMERGING ISSUE (1998), http://www.oecd.org/ctp/harmful/1904176.pdf.

24. Reuven Avi-Yonah, *Who Invented the Single Tax Principle?: An Essay on the History of US Treaty Policy*, 59 N.Y. L. SCH. L. REV. 309, 310 (2015).

the principle requires the one-time application of a real substantive tax rate, regardless of the nominal rate.[25]

The implementation of the single tax principle requires both the agreement of participating nations to tax at similar effective tax rates regardless of the nominal rates and to apply a standard framework with which to determine in which jurisdiction what income will be taxed. Because FDI is typically in the form of spending by large multinational conglomerates, whose revenue derives in part from direct intra-national income as well as complex cross-border transactions, the profits of sprawling international business enterprises are not easily assignable to a single country. The single tax principle requires the "benefits principle" under which the "active" income accruing from conducting a trade or business is assigned to the country in which the trade or business occurred and any other passive income is assigned to the jurisdiction of the entity's country of residence.[26] This system works so long as the residence countries of entities grant tax credits for foreign taxes on the active income taxed abroad; otherwise active income would be taxed twice (and even then, such measures are insufficient to completely avoid double taxation).[27] Such measures are already widespread, including in the United States.[28]

The single tax principle requires bi- and multi-lateral cooperation between jurisdictions and nations. "Many countries enter into income tax treaties to avoid such double taxation [in which] source countries offer reduced withholding tax rates for aliens' income from domestic sources, whereas residence countries offer tax exemption or credit to foreign-source income."[29] This, to varying extent, is a longstanding area of cooperation between nations; the League of Nations' first model tax treaty voiced the opinion that:

> It is highly desirable that States should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international cooperation should prevent certain incomes from escaping taxation altogether. The most elementary and undisputed principles of fiscal justice, therefore, required that

25. *Id.*

26. Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507, 517 (1997).

27. Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 BERKELEY J. INT'L L.1, 9 (1986).

28. I.R.C. §§ 901(b)(1), 903 (exempting "the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country").

29. Avi-Yonah & Kim, *supra* note 5, at 518.

> the experts should devise a scheme whereby all incomes would be taxed once, and once only.[30]

However, the real-world implementation of this principle proved inadequate to the task of combatting the FDI trilemma of exacerbating the vagrancies of globalization's increasingly free-flowing capital, and consequent international competition for FDI, throughout the twentieth century.[31] As discussed, even the United States was not immune to this effect.[32] While the earlier-twentieth century tax code embodied this principle and wide-ranging tax liability for multinational corporations was embedded in the tax code and multilateral treaties, the implementation of this principle eroded gradually.

In addition to the aforementioned legislative changes with which the United States participated in tax competition, there was an explicit multi-decade attack on the taxation of extraterritorial income, thereby increasing the incentives of multinational corporations to respond to tax competition. For example, so-called "Subpart F" of the Internal Revenue Code, which provided for the extraterritorial application of domestic taxes on income earned abroad by qualifying multinational corporations, was amended to allow tax-paying entities to elect for the provision not to apply.[33] The mechanisms of this gradual degradation in enforcement are outside the scope of this paper.

However, the financial crisis of 2008 and the subsequent strains on revenue among OECD countries provided a necessary catalyst to arrest the vicious cycle of tax competition and inaugurated a new era of international cooperation on effective tax enforcement.[34] For example, domestically, the United States passed the Tax Compliance Act of 2010 to reduce double non-taxation by increasing reporting requirements of foreign financial institutions, thereby reducing the ability of citizen persons to hide income

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30. LEAGUE OF NATIONS, COMM. OF TECH. EXPERTS ON DOUBLE TAX'N AND TAX EVASION, DOC. C.216M.85, DOUBLE TAXATION AND TAX EVASION (1927).

31. Reuven Avi-Yonah & Haiyan Xu, *Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight*, 6 HARV. BUS. L. REV. 185, 190 (2016) ("However, since the 1980s, tax competition has led many source jurisdictions to offer tax holidays to MNEs, while residence jurisdictions have become reluctant to tax MNEs on their global income to remain competitive without other jurisdictions. As a result, most MNEs are not taxed at source or residence.").

32. Janet L. Yellen, Sec'y, U.S. Dep't of the Treas., Remarks at the 2022 'Virtual Davos Agenda' Hosted by the World Economic Forum (January 21, 2022), https://home.treasury.gov/news/press-releases/jy0565; *see also* Reuven S. Avi-Yonah, *Globalization, Tax Competition and the Fiscal Crisis of the Welfare State: A Twentieth Anniversary Retrospective* 2–4 (U. of Mich. L. & Econ. Working Papers, Working Paper No. 19-002, May 1, 2019).

33. Treas. Reg. § 301.7701-3 (1997) (amending I.R.C. §§ 951–65 (2004)).

34. Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L L. 353, 355 (2020) ("[The] revenue pressures created by the 2008 crisis combined with public backlash against corporate tax dodging to generate the political impetus needed to embark upon the multilateral BEPS Project.").

from tax authorities.[35] This is just one example of a broader trend in which, since the global financial crisis, countries have demonstrated increased willingness to cooperatively build international systems which undercut the vicious cycle of tax competition.[36]

This increase in cooperation, however, had its limits; any fully effective regulatory regime which stymies the race to the bottom of tax competition through the harmonization of tax policy necessarily "require[s] countries to relinquish at least a portion of their tax sovereignty in return for collective action to address tax competition."[37] Thus, countries have pursued a system of conditional rules as an effective alternative to true harmonization; these are "fail-safe" measures which "guarantee full taxation and implement the single tax principle . . . 'by identifying conditions under which, if one country does not tax, another country fills the tax void.'"[38]

An example of such a measure is the European Union Anti-Tax Avoidance Directive, which lays down rules against tax avoidance practices by preventing multinational companies from exploiting mismatches in national tax law to avoid taxation.[39] These rules include (1) prohibitions on profit shifting to a low or no-tax country, (2) explicit requirements to tax incoming dividends to the citizens of European Union Member States which have not already been taxed in the originating jurisdiction, (3) taxing the value of products shipped out of Member States to be finalized before sale and not otherwise taxed, (4) limiting the amount of interest that a company can deduct (reducing the efficacy of artificial debt arrangements), and (5) providing a broad legal basis giving Member States the power to tackle artificial tax arrangements uncovered by other specific rules.[40]

The penultimate legislative approach to undercutting counter-productive international tax competition occurred in the United States in 2017, with the Tax Cuts and Job Creation Act. A major motivation for the passage of such was the desired repatriation of nearly $3 trillion worth of capital held in low-tax jurisdictions by United States-based multinational enterprises and the disincentivization of such foreign capital accumulation in the future.[41] Until that legislation, all income earned by the subsidiaries of United States multinational enterprises was not taxed in the "parent" jurisdiction until repatriation, and thus taxes could be delayed indefinitely by

35. Avi-Yonah & Kim, *supra* note 5, at 523; *see* I.R.C. §§ 1471-1474.

36. Agnés Bénassy-Quéré et al., *Tax Harmonization in Europe: Moving Forward*, 14 NOTES DU CONSEIL D'ANALYSE ÉCON. 1, 4 (2014).

37. James R. Hines Jr., *Evaluating Tax Harmonization* 1 (U. of Mich. & Nat'l Bureau of Econ. Rsch., Working Paper, 2021).

38. Avi-Yonah & Kim, *supra* note 5, at 525 (quoting Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L L. 353, 376 (2020)).

39. Council Directive 2016/1164, 2016 O.J. (L 193/1).

40. *Id.*

41. Avi-Yonah & Kim, *supra* note 5, at 505, 526–27.

investing that capital abroad.[42] The Tax Cuts and Job Creation Act contained a significant set of corporate tax cuts which significantly lowered marginal tax rates and reduced top-line national revenue by $1.47 trillion over ten years.[43]

However, for technical reasons of parliamentary procedure, the significant revenue reduction caused by these rate changes necessitated revenue increases to pass the Act.[44] These revenue increases were found by the re-amplification of the application of the single tax principle. The Act imposed a tax rate between 8 and 15% on all past-accumulated capital accumulated abroad by United States multinational corporations that had not been taxed, a legislative action that directly rolled back the weakening of the Subpart F regulations.[45] Furthermore, the Act began taxing qualifying income from intangible assets on foreign subsidiaries of United States multinationals, exactly as contemplated by the single tax principle.[46]

Finally, the Act advanced the single tax principle by strengthening source-based taxation on income from intangible assets, implementing an alternative minimum tax on United States multinationals who would otherwise avoid taxes entirely by categorizing capital accumulation as interest and royalties earned in the United States, payable to foreign subsidiaries in low-tax jurisdictions.[47] Without this provision, such companies could avoid tax on such income entirely as the domestic corporations payments would often be exempted from income, and the foreign entity would recognize such payments as income sourced in the United States and therefore not taxable.[48]

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42. *Id.* at 526.

43. TaxEDU, *Tax Cuts and Jobs Act (TCJA)*, TAX FOUNDATION (2018), https://taxfoundation.org/tax-basics/tax-cuts-and-jobs-act/; *see also* Avi-Yonah & Kim, *supra* note 5, at 527 ("The TCJA implemented a participation exemption for dividends from CFCs, cut the corporate tax rate from thirty-five percent to twenty-one percent, and cut the partnership and other pass-through tax rate from thirty-seven percent to 29.6 percent.").

44. Avi-Yonah & Kim, *supra* note 5, at 527.

45. *Id.* at 527–28; *see* I.R.C. § 965. These "U.S. multinationals" are technically defined as any foreign corporation with more than fifty percent ownership interest held by United States citizens. I.R.C. § 957(a).

46. Avi-Yonah & Kim, *supra* note 5, at 528; *see* U.S. DEP'T OF TREAS., I.R.S., 9412.11-00, CONCEPTS OF GLOBAL INTANGIBLE LOW-TAXED INCOME UNDER IRC 951A (2021), https://www.irs.gov/pub/irs-utl/global_intangible_low_taxed_income.pdf (noting that this provision is referred to as the GILTI provision, or Global Intangible Low-Taxed Income; the main priority for GILTI is to ensure U.S. shareholders of Controlled Foreign Corporations (CFCs) are paying necessary tax on certain income generated from foreign businesses—even if it is not repatriated).

47. Avi-Yonah & Kim, *supra* note 5, at 529. For the technical implementation of the source-based taxation on income from intangible assets, see U.S. DEP'T OF TREAS., I.R.S., 9425.00-00, IRC 59A BASE EROSION ANTI-ABUSE TAX OVERVIEW (2021), https://www.irs.gov/pub/irs-utl/irc59a-beat-overview.pdf.

48. Avi-Yonah & Kim, *supra* note 5, at 529.

This unilateral step by the United States back towards implementation of the single tax principle and against tax competition "demonstrated a means to feasibly achieve reasonable tax harmonization" and prompted a flurry of international efforts towards building a truly global semi-harmonized tax order.[49] It was this effort which inspired the OECD to launch the BEPS Project 2.0 in 2017, drawing off of those tax provisions in the United States' domestic tax reform legislation as model for the Pillar Two proposal, "implementing the single tax principle through a combination of rules strengthening residence-based taxation . . . and source-based taxation."[50]

III. TOWARDS A HARMONIZED GLOBAL MINIMUM TAX

The outcome of the Base Erosion and Profit Shifting Project (BEPS) was a global tax deal between 139 countries representing the development of consensus-based, long-term solutions to the existing international taxation rules.[51] These extant rules "have been criticized as being outdated—for example, requiring physical presence for nexus[-enabling taxation], and [for] being vulnerable to tax competition, tax base erosion, and profit shifting. Countries . . . came to a collective understanding after the financial crisis of 2008-10 that the rules must be changed."[52]

The initial result of this effort was the OECD's administration of the Base Erosion and Profit Shifting Project, which led to fifteen different sets of particular technical agreements designed to "equip governments with domestic and international rules and instruments to address tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created."[53] While the OECD leadership declared that these agreements would "put an end to double non-taxation" and "render BEPS-inspired tax planning structures ineffective,"[54] the agreement was not as successful as hoped and left much work undone.[55]

Thus, another round of work on addressing tax avoidance and tax competition was inaugurated by the OECD in 2018, leading eventually to a set of agreements both on a broader package of agreed-to tax reforms.[56]

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49. *Id.*

50. *Id.*

51. Reuven S. Avi-Yonah et al., *A New Framework for Digital Taxation*, 63 HARV. INT'L. L.J. 279, 289 (2023).

52. *Id.* at 286.

53. *BEPS Actions*, OECD, https://www.oecd.org/tax/beps/beps-actions/.

54. Avi-Yonah et al., *supra* note 51, at 286–87 (quoting *OECD Presents Outputs of OECD/G20 BEPS Project for Discussion at G20 Finance Ministers Meeting*, OECD (May 5, 2015), https://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discssion-at-g20-finance-ministers-meeting.htm).

55. Avi-Yonah et al., *supra* note 51, at 287.

56. Avi-Yonah et al., *supra* note 51, at 289.

These reforms are broader than the scope of this paper, and are broadly divided into two "pillars." Pillar One addresses how multinational enterprises allocate profits between tax jurisdictions, updating such rules for a more digitized economy in which the production of income is more attenuated from the physical capital stock within a jurisdiction.[57] Pillar Two intends to create a functionally harmonized international tax regime by introducing a substantive global minimum tax for multinational enterprises, and, as discussed, is a direct extension of "global intangible low-taxed income (GILTI)" and "base erosion and anti-abuse tax (BEAT)," enacted as part of the U.S. Tax Cuts and Jobs Act ("TCJA") of 2017."[58]

A. The Pillar Two Reforms

Pillar Two is, at its core, an internationally agreed-to codification of the single tax principle used to harmonize the international tax regime, and practically consists of:

> two interlocking domestic rules (together the Global anti-Base Erosion Rules (GloBE) rules): (i) an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and (ii) an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR, and a treaty-based rule (the Subject to Tax Rule (STTR) that allows source jurisdictions to impose limited source taxation on [some] payments subject to tax below a minimum rate . . . creditable as a covered tax under the GloBE rules.[59]

The GloBE rules are not enforceable in and of themselves, but rather "have the status of a common approach," meaning that signatories to the BEPS Framework are not required to adopt the rules, but agree in a non-binding manner to do so in a way consistent with model rules and guidelines promulgated by the BEPS working group.[60] The core of the GloBE rules

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57. OECD, FACT SHEET AMOUNT A: PROGRESS REPORT ON AMOUNT A OF PILLAR ONE 2, https://www.oecd.org/tax/beps/pillar-one-amount-a-fact-sheet.pdf.

58. Avi-Yonah et al., *supra* note 51, at 289; *see* OECD, TAX CHALLENGES ARISING FROM DIGITALISATION - REPORT ON PILLAR TWO BLUEPRINT: INCLUSIVE FRAMEWORK ON BEPS (2020), https://doi.org/10.1787/abb4c3d1-en [hereinafter OECD, TAX CHALLENGES 2020].

59. OECD, STATEMENT ON A TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY 3 (Oct. 8, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf [hereinafter OECD, STATEMENT ON A TWO-PILLAR SOLUTION].

60. *Id.*

require that multinational enterprises which meet a minimum €750 million annual revenue threshold are subject to the global minimum tax no matter where they are nominally based.[61]

The Income Inclusion Rule mandates that the countries in which multinational entities legally reside are obligated to impose a "top-up tax" of 15% on the ultimate parent entity of subsidiaries where one of their subsidiaries earns revenue from a source country which imposes tax below that 15% threshold.[62] This "allows residence countries to tax if source taxation is not substantial enough to 'count' once."[63] The flip side of this rule—the Undertaxed Payment Rule—is that if the country in which the parent company resides does not tax revenue passed through at the 15% rate, the country in which the subsidiary resides denies the deduction (or makes an equivalent adjustment) of such revenue so that the subsidiary's residence taxes will apply at no less than the 15% rate to said income.[64] However, this is not an absolute imposition of a 15% tax, as the rules provide exemptions for revenues from countries where less than €10 million are earned, from international shipping, and equivalent to a steadily declining proportion of payroll and tangible assets.[65]

The Subject to Tax Rule is a straightforward rule which governs international treaties between signatories to the BEPS agreement, applying to any members that apply nominal corporate income tax rates below a 9% rate to interest, royalties and similar payments, which may override treaty benefits in existing treaties.[66] Where the STTR applies, treaty relief that would otherwise have been provided may be denied, with the maximum applicable withholding tax being 7.5% to 9%. The STTR is a treaty-based measure and is anticipated to be enacted bilaterally following a request from either party to a treaty. "It is anticipated that the majority of jurisdictions requesting the introduction of the STTR will be developing countries and thus treaties entered into between larger economies are less likely to be affected by the STTR or may not be affected at all."[67]

B. Pillar Two Rules

The technical implementation of these agreed-upon principles is guided by Model Rules for Pillar Two, released by the OECD BEPS Framework in

61. *Id.* at 4.
62. Avi-Yonah et al., *supra* note 51, at 296.
63. Avi-Yonah & Kim, *supra* note 5, at 531.
64. *Id.*
65. *Id.* at 532.
66. OECD, STATEMENT ON A TWO-PILLAR SOLUTION, *supra* note 59.
67. DELOITTE, GLOBAL MINIMUM TAX (PILLAR TWO) FREQUENTLY ASKED QUESTIONS 3 (Aug. 2021), https://www2.deloitte.com/content/dam/Deloitte/xe/Documents/tax/dme_deloitte-global-minimum-tax-faq.pdf.

December 2021.[68] These rules "are designed to ensure large multinational enterprises (MNEs) pay a minimum level of tax on the income arising in each jurisdiction where they operate."[69] The core of the Model Rules outlines the calculation of the "top-up" tax liability which jurisdictions can charge income not otherwise taxed at 15%, a calculation which can be outlined as follows (in a very, very simplified manner):

First, there is a determination if a multinational entity is within the scope of the GLoBe rules and identifies the covered subsidiary entities and their locations.[70] Covered entities include all entities within a conglomerate with a total annual income of at least €750 million, except for certain exempt entities such as nonprofits and pension groups; covered entities are located in its tax residency if based on place of management, place of creation, or similar criteria or otherwise is located in its place of creation.[71]

Second, the applicable net income of each constituent entity is determined by taking the GAAP net income or loss of that entity, adjusted by excluding dividends, equity gains or losses, stock based compensation, and shipping income.[72] Third, the amount of a constituent entity's covered taxes are determined by taking that entity's current fiscal year taxes, adjusted for net operating income (among many other small technical adjustments).[73] Fourth, the "top-up tax" is computed by finding the effective tax rate in each tax jurisdiction, multiplying the entity's jurisdictional net income by the difference between the jurisdictional effective tax rate and a 15% rate, less certain safe harbor and de minimis exclusions.[74]

Finally, the actual tax is imposed. The ultimate parent entity of the entire conglomerate is held liable for the total "top-up tax" of all its subsidiaries; to whatever extent it cannot be held liable, the balance of the tax is attributed to the next-lower tier of holding entity, or to partially-owned entities in proportion to the ownership interest held.[75] Holding companies higher up the ownership chain can reduce their burden by the amount of

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68. OECD, GLOBAL ANTI-BASE EROSION MODEL RULES (PILLAR TWO), FREQUENTLY ASKED QUESTIONS (Dec. 2021), https://www.oecd.org/tax/beps/pillar-two-model-GloBE-rules-faqs.pdf.

69. OECD, THE PILLAR TWO RULES IN A NUTSHELL (Dec. 2021), http://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf; *see also* OECD, OVERVIEW OF THE KEY OPERATING PROVISION OF THE GLOBE RULES (Dec. 2021), http://www.oecd.org/tax/beps/pillar-two-GloBE-rules-fact-sheets.pdf.

70. OECD, TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY - GLOBAL ANTI-BASE EROSION MODEL RULES (PILLAR TWO) INCLUSIVE FRAMEWORK ON BEPS 8-11 (2021), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

71. *Id.* at 67.

72. *Id.* at 15-21 (noting that income is then allocated either to the entity or the conglomerate according to local tax treatment).

73. *Id.* at 22–23.

74. *Id.* at 28–31.

75. *Id.* at 11.

top-up tax otherwise paid by their subsidiaries.[76] The actual collection of the "top-up tax" is done through the denial of deduction for any deductible expenses made by the liable entity, or by equivalent adjustments under domestic law.[77] Unsurprisingly, the feedback from multinational entities covered by these regulations has been overwhelming complaints about the complexity of application.[78] Whether these complaints are valid or made in bad faith is beyond the scope of this paper.[79]

C. Possible Treaty Conflicts

The current international MNE taxation framework is established largely by bilateral income tax treaties based on the OECD Model Treaty and the U.S. Model Treaty.[80] Although model treaties are not legally binding, their language often is incorporated verbatim (or with only minor alterations) in the text of bilateral treaties. While such bilateral treaties usually provide that they do not impose limits on a country's ability to tax its own residents, they typically require correlative adjustments by the taxing jurisdictions "to mitigate economic double taxation . . . [and] include non-discrimination provisions, under which the contracting states agree in relevant part not to impose taxation requirements on resident subsidiaries of foreign MNEs that are more burdensome than those that would apply to other similarly situated resident companies."[81]

There has been concern that the UTPR provisions are inconsistent with existing bilateral tax treaties, especially those to which the U.S. is party.[82] Even U.S. government officials have argued "that the Pillar Two UTPR is inconsistent with our bilateral tax treaties" because the reforms could allow foreign countries to collect extraterritorial taxes from U.S. citizens, which is not permitted under Article 7 of U.S. bilateral tax treaties.[83] However, this

76. *Id.* at 13–14.

77. *Id.* at 12–13.

78. *See, e.g.*, Isabel Gottlieb, *Companies Eager to See Details on Minimum Tax Simplifications*, BLOOMBERG TAX (Mar. 23, 2022), https://news.bloombergtax.com/transfer-pricing/companies-eager-to-see-details-on-minimum-tax-simplifications.

79. But the author, frankly, would be astonished if the response was anything but.

80. David G. Noren, *Modifying Bilateral Income Tax Treaties to Accommodate Pillar Two UTPR Rules*, TAX MGMT. MEMORANDUM 2 (Dec. 5, 2022), https://www.mwe.com/media/modifying-bilateral-income-tax-treaties-to-accommodate-pillar-two-utpr-rules/.

81. *Id.* at 3.

82. Allison Christians & Stephen E. Shay, *The Consistency of Pillar 2 UTPR with U.S. Bilateral Tax Treaties*, TAXNOTES (Jan. 23, 2023), https://www.taxnotes.com/featured-analysis/consistency-pillar-2-utpr-us-bilateral-tax-treaties/2023/01/20/7fvmc.

83. Letter from U.S. Senator Mike Crapo et al. to U.S. Sec'y of Treas. Janet Yellen (Dec. 14, 2022), https://www.finance.senate.gov/imo/media/doc/sfc-sfrc-wm-r_letter_to_secretary_yellen.pdf (regarding OECD negotiations).

concern is ill-founded, and existing treaties would not impose obligations that would preclude application of the UTPR.[84]

The OECD itself addressed the matter directly in its Report on the Pillar Two Blueprint, explaining that "[as] tax treaties are not intended to restrict a jurisdiction's right to tax its own residents . . . tax treaties should not present any obstacle to jurisdictions implementing an . . . UTPR along the lines envisaged under the GloBE."[85] Because the UTPR can be residence- or source-based, computed by reference to a defined category of book income of constituent entities, and collectible in any manner, "the UTPR tax amount can best be understood as an additional tax, in the nature of an excise tax, imposed on the constituent entities of an MNE group in a UTPR jurisdiction by virtue of their being members of that group."[86] "[I]t is for the domestic law of each Contracting State to determine whether and how such profits should be taxed."[87]

Furthermore, the UTPR does not violate the anti-discrimination rules of tax treaties because "UTPR will apply in the same way payments made to domestic and non-resident group entities without any distinction."[88] "[N]on-discrimination provisions [do] not prohibit differing treatment of entities that are in differing circumstances . . . a protected enterprise is only required to be treated in the same manner as other enterprises that, from the point of view of the application of the tax law, are in substantially similar circumstances both in law and in fact."[89] Any UTPR "discrimination" is permissible discrimination founded in different circumstances, rather than treaty-barred discrimination founded in residency. "A constituent entity of an MNE group parented from a non-pillar 2 country is not in the same circumstances as a constituent entity of an MNE group parented from a pillar 2 country."[90]

IV. IMPLEMENTATION OF THE GLOBAL MINIMUM TAX

To this point in the paper, the discussion has centered around the generalized agreement between participant states to the BEPS Framework and the promulgated model rules, all of which amount to a true revolution in international global tax treatment and a significant blow to multinational enterprises' power to drive tax competition and shield revenue from

84. Christians & Shay, *supra* note 82.
85. OECD, TAX CHALLENGES 2020, *supra* note 58.
86. Christians & Shay, *supra* note 82.
87. OECD, TAX CHALLENGES 2020, *supra* note 58.
88. *Id.*
89. Christians & Shay, *supra* note 82 (quoting UNITED STATES MODEL TECHNICAL EXPLANATION ACCOMPANYING THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006 81 (U.S. DEP'T OF TREAS. 2006)).
90. *Id.*

taxation. However, these commitments are neither binding on the individual countries nor in any way enforceable as provisions of a tax code; they are just white papers the signatory countries promise to take seriously.[91] This section will discuss the implementation of Pillar Two of the Framework. As there are nearly 200 signatory countries, this will be a severely abbreviated discussion of the overall patterns of implementation. I will focus my discussion on the United States, as compared to international implementation.

A. Implementation within the United States

Domestic implementation of Pillar Two is a story of lost potential. In 2021, the full implementation of Pillar Two was included in the first version of the "Build Back Better" bill (what was to be the signature legislative vehicle for President Biden's first term), which would have represented a "significant move toward the United States' implementation of the single tax principle by introducing various mechanisms to ensure that cross-border income is taxed once at a substantive tax rate."[92]

The keystone provision of the Build Back Better bill vis-à-vis Pillar Two implementation was its expansion and reform of the GILTI tax rules in accordance with Pillar Two principles and Model Rules, which has already been the most successful international implementation of a single tax principle to address.[93] "GILTI" is a term of art referring to a tax base measured by the income of controlled foreign corporations, such as corporate subsidiaries of U.S.-parented multinationals.[94] GILTI is included in U.S. shareholders' tax base subject to the allowance of a 50% deduction.[95] "The tax on GILTI is reduced by a . . . tax credit equal to 80% of foreign taxes paid or accrued on the same income, where foreign taxes are calculated in the aggregate and not on a per-country basis."[96]

> The [U.S.] does not tax GILTI where non-U.S. jurisdictions, in aggregate, impose corporate tax on GILTI at a rate that at least equals [a set percentage] of the maximum U.S. corporate rate . . .

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91. OECD, STATEMENT ON A TWO-PILLAR SOLUTION, *supra* note 59.

92. Avi-Yonah & Kim, *supra* note 5, at 535.

93. *Id.* at 536.

94. Susan C. Morse, *The Quasi-Global GILTI Tax*, 18 PITT. TAX REV. 273, 274 (2021) (summarizing I.R.C. § 951A as "providing for shareholders' current inclusion of GILTI, which is defined as non-subpart F income earned by a controlled foreign corporation in excess of net deemed tangible income return; net deemed tangible return equals 10% of qualified business asset investment (or QBAI, a measure of tangible asset investment) to the extent that 10% of QBAI exceeds net interest expense"); *see also* I.R.C. § 957(a) (defining CFC).

95. Morse, *supra* note 94, at 274.

96. *Id.* at 274–75.

GILTI threshold thus sets an implied minimum tax rate at which excess cross-border corporate profit will be taxed.[97]

The GILTI regime, unlike Pillar Two's proposed GloBE rules, does not undertake to divide extraterritorial jurisdiction to tax, but rather calculates the tax imposed by non-U.S. jurisdictions on an aggregate basis.[98]

In this regard, the bill proposed to (1) raise the GILTI tax rate to 15%,[99] (2) reduce the exemption ratio of tangible assets to only 5%, as contemplated in the Pillar Two Model Rules[100] (3) apply the GILTI rule on a jurisdictional basis, as required by the Pillar Two Model Rules, and (4) raise the GILTI foreign tax credit to 95%, as called for by Pillar Two's UTPR.[101]

Furthermore, the Build Back Better bill proposed additional reforms to the tax code in line with Pillar Two provisions; these proposed reforms included (1) limiting foreign tax credits to be in line with those contemplated of part ii of Pillar Two,[102] (2) raising corporate tax rates on intangible intellectual property profits,[103] (3) making anti-profit shifting deductions for otherwise deductible payments from a United States entity to a foreign parent entity contingent on parent entity residence tax rates, consistent with the UTPR,[104] and (4) introducing a 15% corporate Alternative Minimum Tax, providing a backstop consistent with the overall Pillar Two principles.[105]

It is difficult to describe the potential impact of such measures' passage without appearing hyperbolic; had the United States passed the bill as written, it would have likely set a chain of events in motion, thereby ending global tax competition.[106] United States implementation of Pillar Two would have made general G20 adoption significantly more likely; as 90% of major

97. *Id.*

98. *Id.* at 277.

99. Build Back Better Act, H.R. 5376, 117th Cong. § 138131(a)(3) (2021).

100. Build Back Better Act, H.R. 5376, 117th Cong. § 138126(d) (2021).

101. Build Back Better Act, H.R. 5376, 117th Cong. § 138127(a) (2021).

102. Christians & Shay, *supra* note 82.

103. Avi-Yonah & Kim, *supra* note 5, at 539 (noting that this provision is not in line with Pillar Two *per se*, but rather makes the U.S. tax code less in violation of both international law generally and the Pillar specifically).

104. Build Back Better Act, H.R. 5376, 117th Cong. § 138131(b)(3)(A) ("An amount shall not be treated as a base erosion payment if the taxpayer establishes to the satisfaction of the Secretary that such amount was subject to an effective rate of foreign income tax…which is not less than the [statutory Base Erosion minimum tax rate] in effect … for the taxable year in which such amount is paid or accrued.").

105. *Id.* at § 138131(a)(1) ("In the case of an applicable corporation, the tentative minimum tax for the taxable year shall be the excess of (i) 15 percent of the adjusted financial statement income for the taxable year, over (ii) the corporate AMT foreign tax credit for the taxable year" if the average annual adjusted financial statement income of such corporation for the taxable-year period ending with such taxable year exceeds $1,000,000,000); *see also* Avi-Yonah & Kim, *supra* note 5, at 535-36 (discussing the applicability of the provision to the Pillar).

106. Avi-Yonah & Kim, *supra* note 5, at 536.

multinational entities legally reside in G20 member states, almost all would thus be subject to the 15% global minimum tax.[107] Without the effective threat of withdrawing FDI to chase lower tax rates, countries could apply the UTPR and STTR with relative impunity, and with that full implementation, the global tax system would have been harmonized sufficiently to prevent tax competition and re-empower states as the dominant partner in the state-multinational enterprise relationship.

For broad reasons of United States domestic politics, the Build Back Better bill did not become law, but was instead renegotiated and repackaged as the "Inflation Reduction Act."[108] The Inflation Reduction Act did not include almost the entirety of the previously discussed provisions implementing Pillar Two, but instead a fig leaf of a "Book Minimum Tax."[109]

> The Book Minimum Tax would impose on any "applicable corporation" a tax equal to the excess of (1) 15% of the applicable corporation's adjusted financial statement income for the taxable year, reduced by "its corporate AMT foreign tax credit," for the taxable year . . . over (2) its regular tax liability plus any base erosion and anti-abuse tax (BEAT) imposed . . . for the taxable year.[110]

While this does technically include a new 15% minimum tax, this is not a top-up tax in line with Pillar Two, and the proposed changes in line with Pillar Two were left out of the bill.[111]

Full domestic implementation of the Pillar Two regime remains politically contentious, and any legislation codifying it would be unlikely to pass the current Congress. Leaders of the U.S. Senate Foreign Relations and Finance and House Ways and Means Committees have formally called on the Treasury Department to "recognize the fundamental flaws with the Pillar Two enforcement mechanism—the UTPR—and stop encouraging other countries to assert it on U.S. companies."[112] Indeed, the Chair of the Trade Subcommittee of the U.S. House Ways and Means Committee threatened U.S. funding for the OECD generally because the "OECD continues to produce implementation guidance for Pillars 1 and 2, which

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107. *Id.*

108. Melissa Quinn, *Senate Passes Democrats' Sweeping Climate, Health and Tax Bill, Delivering Win for Biden,* CBS NEWS (Aug. 8, 2022), https://www.cbsnews.com/news/inflation-reduction-act-senate-pass-climate-healthcare-tax-bill/.

109. Brian H. Jenn et al., *The Inflation Reduction Act: Overview of New Corporate Minimum Tax,* 12 NAT'L L. REV. 224 (2022).

110. *Id.*

111. Anuj Kapoor et al., *Key Updates on the Global Implementation of Pillar 2*, GRANT THORNTON (Sept. 15, 2022), https://www.grantthornton.global/en/insights/articles/implications-of-pillar-2/#US.

112. Letter from U.S. Senator Mike Crapo et al. to U.S Sec'y of Treas. Janet Yellen, *supra* note 83.

could ultimately lead to foreign countries levying additional taxes on American companies."[113]

B. International Implementation

While the United States is *primus inter pares* within the international financial (and tax) system, progress is not dependent thereon. Many of the other signatories to the BEPS Framework are moving forward with rapidly implementing the full proposed Global Minimum Tax provisions, including full Pillar Two components.

The European Union, representing around one sixth of the entire global economy,[114] has made significant progress in fully implementing the Pillar Two framework.[115] The European Council has approved a Council Directive "on ensuring a global minimum level of taxation for multinational enterprise groups . . . in the Union."[116] As a Council Directive, it is governing law throughout the entire European Union, and it is a wholesale implementation of the OECD's suggested single taxation-based Pillar Two statutory scheme. Indeed, it explicitly states that "this Directive has the aim of implementing Pillar Two" and that "in implementing this Directive, Member States should use the OECD Model Rules and . . . Commentary to the Global Anti- Base Erosion Model Rules (Pillar Two) released by the OECD/G20 Inclusive Framework on BEPS"[117] The directive is a full implementation of Pillar Two's suggested statutory reforms ; the Directive imposes the top-up tax[118] and the Undertaxed Payments Rule[119] all "in line with the timeline set out in the Statement on a Two-Pillar Solution."[120]

Such straightforward implementation is not merely limited to the Eurozone, but rather to the global community of nations more broadly. For example, the United Kingdom, notwithstanding even its recent move to reduce financial regulation to attract FDI,[121] has committed to the implementation of the Pillar Two regulatory scheme, and the Pillar Two

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113. Letter from Congressman Adrian Smith et al. to the Hon. Mario Diaz-Balart, Chairman, House Appropriations Comm., and the Hon. Barbara Lee, Ranking Member, House Appropriations Comm. (Mar. 24, 2022), https://us.eversheds-sutherland.com/portalresource/7dH.pdf.

114. INT'L MONETARY FUND, REPORT FOR SELECTED COUNTRY GROUPS AND SUBJECTS: WORLD ECONOMIC OUTLOOK (Oct. 12, 2022), https://www.imf.org/en/Publications/WEO/weo-database/2022/October/weo-report?a=1&c=001,998,&s=NGDPD,&sy=2021&ey=2022&ssm=0&scsm=1&scc=0&ssd=1&ssc=0&sic=0&sort=country&ds=.&br=1.

115. *Progress Rep. on Pillar One*, at 1, COM (2023) 377 final (June 30, 2023).

116. Council Directive 2022/2523, 2022 O.J. (L 328) (EU).

117. *Id.* at 6.

118. *Id.* at 16–17.

119. *Id.* at 19.

120. *Id.* at 6.

121. Jill Lawless, *UK to Ease Financial Regulations in Post-Brexit Shakeup*, AP NEWS (Dec. 9, 2022), https://apnews.com/article/europe-business-financial-crisis-services-united-kingdom-government-20919298aa06099ee68ecb499b4608f3.

Rules will apply in the United Kingdom beginning in 2024.[122] Even Ireland, whose entire economic resurgence has been in no small part driven by the attraction of FDI through effective tax competition, anticipates full implementation of the Pillar Two Rules by 2024, an implementation which has been "welcomed" by Irish policymakers.[123]

Indeed, the United States' rejection of Pillar Two and effective wholesale implementation of single tax policy is increasingly an outlier on the global stage, which is moving towards tax harmonization without the United States.

V. CONCLUSION

Countries around the world have been faced with the until-now unsolvable trilemma balancing FDI-driven economic growth, globalized capital flows, and stable public finances. While there has long been a theoretical understanding of the solution—global tax harmonization around the single tax principle—implementation has proven impossible, as countries are bedeviled by the tragedy of the commons that is tax competition. However, in recent years, almost 200 countries have worked together through the auspices of the OECD to come to a comprehensive agreement for a globally harmonized international tax system predicated on that single tax principle; the major component of which is the so-called Pillar Two reforms, which provide for a global minimum corporate tax of 15%. While the United States Government attempted, but recently failed, to implement Pillar Two reforms, the global movement toward tax harmonization has continued nonetheless, and it appears as though a significant portion of the global economy will be covered by a global minimum corporate tax no later than 2025. Truly, the only remaining question is whether the United States will join the movement towards harmonization as it becomes increasingly real or if it will continue to resist and turn toward choices as a bad actor spoiling the global tax commons and re-igniting the zero-sum game of tax competition.

122. Vikas Vasal et al., *Key Updates on the Global Implementation of Pillar 2*, GRANT THORNTON (Sept. 15, 2022), https://www.grantthornton.global/en/insights/articles/implications-of-pillar-2/#US.

123. *Id.*