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International Tax Watch

Understanding the Real-World Consequences of Pillar II

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I. Introduction

On October 8, 2021, the Organisation for Economic Co-operation and Development (“OECD”)/G20 Inclusive Framework on Base Erosion and Profit Shifting (“BEPS”) (the “IF”) released the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the “Two-Pillar Statement”).¹ The Two-Pillar Statement announced that 136 jurisdictions had reached a landmark two-pillar solution to address the tax challenges arising from the digitalization of the economy, with the number climbing to 137 a few weeks later.² The IF has a total of 141 members, but the following four countries have yet to agree to the two-pillar solution: Kenya, Nigeria, Pakistan, and Sri Lanka.

The Two-Pillar Statement outlines two overarching mechanisms to “address the tax challenges arising from the digitalisation of the economy.” The first mechanism (“Pillar I”) applies to large, profitable groups of multinational entities. It allows for the reallocation of 25% of the profit certain large groups earn in excess of 10% of their revenue back to market jurisdictions. The second mechanism (“Pillar II”) attempts to ensure that every jurisdiction imposes (or has a compelling incentive to impose) a minimum corporate income tax of 15%.

The IF introduced this two-pillar solution in a 2019 policy note entitled *Addressing the Tax Challenges of the Digitalisation of the Economy* (the “Policy Note”).³ In the Policy Note, the IF observed that “the features of the digitalising economy exacerbate BEPS risks, and enable structures that shift profits to entities that escape taxation or are taxed at only very low rates.” Regarding Pillar II, the Policy Note envisioned a response that would provide “taxing rights that would strengthen the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits.” The Policy Note nevertheless stated:

The proposal under this pillar does not change the fact that countries or jurisdictions remain free to set their own tax rates or not to have a corporate income tax system at all. Instead, the proposal considers that in the absence

of multilateral action there is a risk of un-coordinated, unilateral action, both to attract more tax base and to protect the existing tax base, with adverse consequences for all countries, large and small, developed and developing.

In this column, we focus on Pillar II and the undertaxed profits regime. Specifically, after a brief discussion of the mechanics of the Pillar II rules, we note that Pillar II differs markedly from prior multilateral initiatives. Whereas prior initiatives sought to limit *harmful* corporate tax competition, Pillar II seeks to prevent “all” tax competition, at least below a certain amount. The OECD reinforces this point in the Commentary to the Global Anti-Base Erosion Model Rules (the “Commentary”) stating, “Rather than a typical direct tax on income, the tax imposed under the GloBE Rules is closer in design to an *international alternative minimum tax* ...”⁴

In so doing, Pillar II may present U.S. policymakers with a potentially difficult choice: either accept meaningful limits on the sovereign right of the United States to set U.S. corporate tax policy or accept that other countries will impose tax on profits that, up until now, were only subject to tax in the United States.

Over the years, Republicans and Democrats in Congress have inserted numerous provisions into the U.S. Internal Revenue Code (the “Code”) to provide taxpayers with an incentive for activities that Congress believes are beneficial (*e.g.*, the orphan drug credit and the low income housing credit). Depending on how it is implemented, Pillar II may diminish the effectiveness of these provisions because, to the extent they drive a corporate taxpayer’s effective tax rate (“ETR”) below 15%, another country may tax the income and eliminate the benefit. Because Congress enacted these incentive provisions, they could be regarded as representing the will of the American people as implemented through their duly elected representatives. The fact that these Congressional actions may be materially altered by a set of policies propounded by a multilateral international body has already raised concerns with some U.S. policymakers.⁵ Pillar II may also raise concerns in developing countries and other economies close to home (*e.g.*, Puerto Rico) that use lower tax rates to overcome other issues they face with attracting investment.

In our view, the primary concern motivating the design of Pillar II is the age-old problem of corporate tax competition, which is not specific to the digital economy, digitalization, digital transformation, or any other feature of technological change.⁶ Corporate tax competition is not a new phenomenon. To the extent that U.S. policymakers are concerned with corporate tax competition, in addition

to considering whether Pillar II is an appropriate method of addressing these concerns, they may wish to give fresh consideration to alternative approaches. These alternatives include, but are not limited to, a dividends paid deduction (“DPD”), which we address below, and which is specifically contemplated in the Pillar II framework.

II. The Pillar II Mechanics

Pillar II contains a complex set of overlapping and interconnected rules. As we demonstrate below, the intended consequence of these rules is to ensure that the earnings of large corporate multinational entities (“MNEs”) are taxed at a rate of at least 15%. The system, the Global Anti-Base Erosion Model Rules (the “GloBE Rules”) and the Commentary,⁷ ostensibly operates in the form of one of two top-up taxes—a primary tax under the Income Inclusion Rule (“IIR”), and an alternative tax under the Undertaxed Payments Rule (“UTPR”).

As a brief example, assume a corporation in Country A is part of a MNE subject to the Pillar II rules. The corporation earns \$100 that is not taxed locally at a 15% rate. In that case, the entity’s ultimate parent jurisdiction must tax the income under an anti-deferral regime that qualifies as an IIR and that ensures the income is taxed at a 15% rate. If that does not happen, then the country of incorporation for intermediate holding companies must impose a top-up tax so that the income is taxed at 15%. If those countries do not impose such a top-up tax, every other country in which the MNE operates may reach out and impose the tax that the other countries did not impose. Importantly, only those entities located in jurisdictions that have enacted the UTPR have this secondary right, and the resulting tax revenue is apportioned between them based on their share of employees and assets, not based on any other factual relationship to the profits in question. Hence, Pillar II is designed to give countries a big incentive to enact a UTPR to ensure a share of the apportioned tax revenue.

The OECD has grouped the application of these rules into five steps, which will be discussed in turn:

- 1) Identify MNE Groups (as defined below) within scope and the location of each Constituent Entity (as defined below) within each MNE Group;
- 2) Determine the GloBE income of each Constituent Entity;
- 3) Determine the taxes attributable to the income of a Constituent Entity;
- 4) Calculate the ETR of all Constituent Entities located in the same jurisdiction and determine the resulting top-up tax; and

- 5) Impose top-up tax under the IIR and UTPR in accordance with the agreed order.⁸

A. Identify MNE Groups Within Scope

The GloBE Rules first determine which groups of MNEs are in scope. A MNE Group is any collection of entities that are related through ownership or control and that have at least one entity or permanent establishment (“PE”) that is not located in the jurisdiction of the Ultimate Parent Entity (“UPE”).⁹ The GloBE Rules only apply to MNE Groups with a foreign presence and with revenue over EUR 750 million, based on their consolidated financial statements.¹⁰

B. Constituent Entities

“Constituent Entities” are entities and PEs within an in-scope MNE Group.¹¹ Certain entities, such as governmental entities, international organizations, non-profit organizations, and investment funds, are not subject to the GloBE Rules. The GloBE Rules refer to these entities as “Excluded Entities.”¹² Excluded Entities’ revenues are still considered when determining whether the MNE Group clears the EUR 750 million revenue threshold. The location of each Constituent Entity is determined so that the GloBE Rules can be applied on a jurisdictional basis. Each entity is located where it is a tax resident. The default rule is that an entity is located in the jurisdiction in which it was created.¹³ If an entity is a tax resident in a jurisdiction based on its management and control, it will be treated as located in that jurisdiction.¹⁴ Special rules apply to flow-through entities, and PEs are located where they are treated as a PE and subject to tax.¹⁵

C. GloBE Income

A Constituent Entity calculates its GloBE income by first determining its net income or loss according to its ultimate parent’s consolidated financial statements, prior to eliminating intra-group items.¹⁶ The Constituent Entity then adjusts its net income or loss for certain differences between the financial accounting results and income tax results (*i.e.*, book to tax differences).¹⁷ The Constituent Entity further adjusts its net income or loss to exclude international shipping income since this industry has alternative tax regimes that often place it beyond the scope of corporate income taxes.¹⁸ The Constituent Entity then allocates its adjusted financial statement net income or loss between a PE and its head office or to the owners of a flow-through entity to align the financial statement treatment with the applicable local tax rules.¹⁹

Importantly, for the discussion that follows, if a Constituent Entity is a UPE (meaning an entity that

controls other Constituent Entities but is not controlled by another Constituent Entity), there is a special rule for a DPD regime. Specifically, Article 7.2 of the GloBE Rules allows the UPE to reduce its GloBE income, under certain circumstances, to zero for any dividends that are paid pursuant to a qualified deductible dividends regime where the company’s shareholders meet certain criteria.

Critically, the UPE cannot reduce the income of, and therefore the top-up tax liability attributable to, lower-tier Constituent Entities. Nevertheless, the profits of these entities can ostensibly be protected if the United States enacts a Pillar II-compliant IIR by modifying its global intangible low-taxed income (“GILTI”) regime. As we address in more detail below, the interaction of a qualifying deductible dividends regime (*i.e.*, the DPD we refer to above) with the IIR, however, is not entirely clear. Specifically, it is unclear whether and to what extent the GloBE Rules allow a DPD to be claimed as a deduction against and reduce the revised imputation income the UPE recognizes under the IIR-compliant GILTI and yet still be considered a qualified deductible dividends regime.

D. Adjusted Covered Taxes

Once a Constituent Entity’s GloBE income or loss has been calculated, the next step is to calculate the entity’s “Adjusted Covered Taxes.” The definition of “Covered Taxes” for the GloBE is generally broader than “income taxes” for financial accounting purposes.²⁰ “Adjusted Covered Taxes” are the entity’s current tax expense accrued for financial accounting purposes adjusted for certain timing differences.²¹ The GloBE Rules further adjust Covered Taxes to account for temporary timing differences using deferred tax accounting, and provide an alternative elective rule to the use of the deferred tax accounting rules that effectively permits an entity to carry GloBE losses forward as a deemed deferred tax asset.²² Covered Taxes are then allocated as needed to take into account PEs, fiscally transparent entities, and hybrid entities, as well as taxes imposed as a result of a controlled foreign corporation (“CFC”) regime.²³ As a result of post-filing adjustments, which may arise from an audit or amended return, an entity may need to recalculate its GloBE income or loss and the related Covered Taxes for the prior year.²⁴

E. ETR & Top-Up Tax

A Constituent Entity’s jurisdictional ETR is equal to its Covered Taxes with respect to the jurisdiction over the GloBE income in the jurisdiction.²⁵ If the ETR is less than the 15% minimum rate, the top-up tax percentage is the difference between the two rates. The top-up tax equals the top-up tax percentage multiplied by the Excess Profit,

which is the GloBE income minus a routine return based on a small percentage of the entity's payroll and tangible assets.²⁶ These excluded items serve as a proxy for substance because they are viewed as generally less mobile, in contrast to intangible assets that the IF believes to be more likely to give rise to BEPS.²⁷ The top-up tax is increased by any amounts attributable to certain recalculations of prior years' top-up taxes and reduced by the amount of any tax payable pursuant to a qualified domestic minimum top-up tax ("QDMTT").²⁸

The local taxing jurisdiction for each legal entity is the first jurisdiction entitled to tax the Constituent Entity's profits if its ETR falls short of the 15% minimum rate. If a jurisdiction has a QDMTT, this tax would apply to local entities' jurisdictional excess profits before the IIR and UTPR. The GloBE Rules do not require jurisdictions to adopt a QDMTT, but the rules give them a strong incentive to do so. As a result, the IF expects that a QDMTT often will reduce the top-up tax to zero.²⁹

After accounting for the QDMTT, if present, the jurisdictional top-up tax is proportionally allocated to each Constituent Entity in the jurisdiction that has GloBE income.³⁰ No tax is allocated to those entities with GloBE losses. It is this allocation that determines whether a Constituent Entity will be subject to an IIR or the UTPR.

F. The IIR

The jurisdiction of the MNE Group's UPE is primarily responsible for imposing and collecting top-up taxes for the MNE Group's Constituent Entities.³¹ If the UPE's jurisdiction does not impose an IIR, the responsibility for imposing and collecting top-up tax liability falls to the next intermediate parent entity in the chain of ownership that has an IIR.³² The UPE is liable for an amount of the Constituent Entity's top-up tax in proportion to the share of the profits attributable to the UPE under accounting standards (*i.e.*, based on the proportion of GloBE income attributable to the UPE).³³ The GloBE Rules also contain a mechanism to prevent overlapping taxation in the event that there are multiple parent entities in the same ownership chain that all apply an IIR to the same top-up tax amount.³⁴

Importantly for U.S. MNEs, the U.S. tax on GILTI is not expected to be a qualifying IIR at this point in time. To conform to the requirements, GILTI would likely need to impose tax at a 15% minimum rate, rather than the 10.5-13.125% rates; GILTI would likely have to apply on a country-by-country basis, rather than the current global blending approach; and, in theory, GILTI also would have to apply based on the GloBE Rules' version of book income as opposed to taxable income. This last

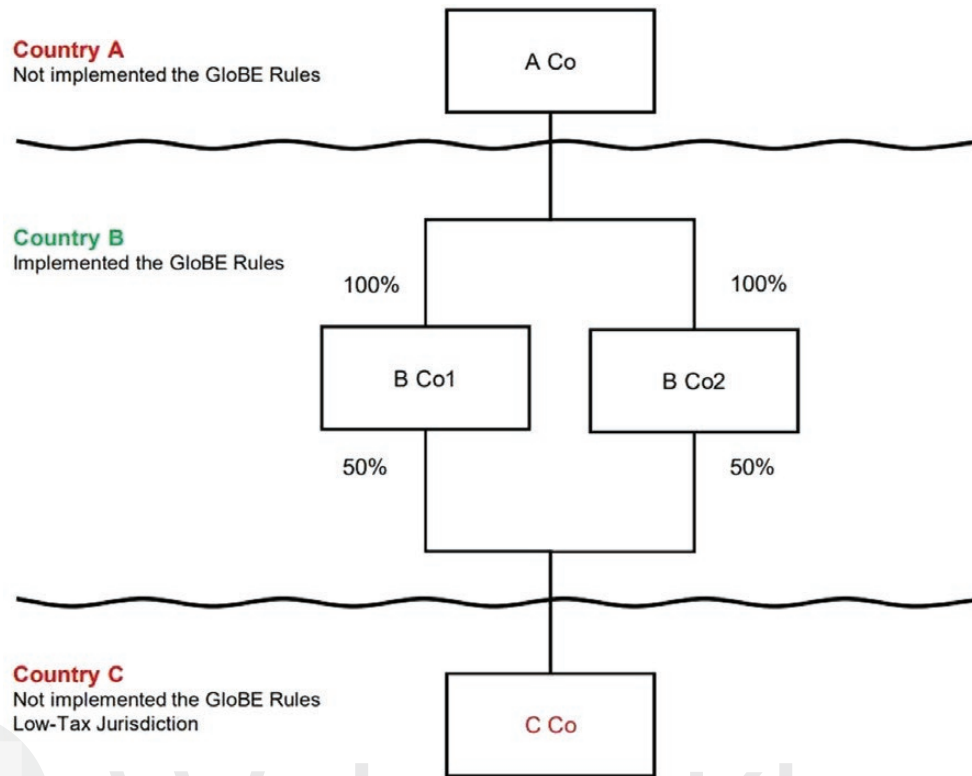
change may not be required for GILTI to be a qualifying IIR. Specifically, notwithstanding GILTI's current base of taxable income, a European Union ("EU") tax official said that a 15% GILTI rate that applies on a jurisdictional basis "would be deemed equivalent."³⁵ Whether other EU Member States, and other members of the IF, will agree remains to be seen. Absent changes to GILTI, subsidiaries of U.S.-parented companies that are located in jurisdictions without QDMTTs could be subject to the top-up taxes that other jurisdictions impose under the IIR, thereby incentivizing companies to adopt flatter structures, eliminating intermediate entities in the chain of ownership.

Example 2.1.3-1 of the Global Anti-Base Erosion Model Rules (Pillar 2) Examples (the "GloBE Rules Examples") illustrates the mechanics of the GloBE Rules' top-down approach when a UPE is not required to apply a qualified IIR. The ABC Group, depicted below, contains four entities. A Co wholly owns two subsidiaries, B Co1 and B Co2, which in turn each own 50% of C Co. C Co is a low-taxed Constituent Entity. A Co as the UPE would have priority to apply the IIR, but Country A has not implemented the GloBE Rules. B Co1 and B Co2, the two intermediate parent entities, are located in Country B, which has implemented a qualified IIR. Accordingly, B Co1 and B Co2 are required to apply the IIR based on their allocable share of C Co's top-up tax, or 50% each.

G. The UTPR

The catch-all in the GloBE Rules is the UTPR. For all entities that have less than a 15% jurisdictional ETR and are not brought into compliance with the minimum tax under a QDMTT or IIR, the GloBE Rules permit the other jurisdictions in which the MNE operates to impose and collect the remaining top-up tax amount under the UTPR.³⁶ The GloBE Rules allocate the UTPR top-up tax amount to each jurisdiction depending on the number of employees and net book value of tangible assets in the jurisdiction that are reflected on the MNE Group's country-by-country reports.³⁷ This allocation formula again serves as a proxy for substance. The use of the country-by-country reports by all jurisdictions ensures that the same figures are used, which facilitates coordination and minimizes the risk of disputes.³⁸ The UTPR, unlike the other taxes described, ostensibly operates by denying a Constituent Entity's otherwise allowable deductions for expenses to result in an additional cash tax expense equal to the UTPR top-up tax amount allocated to the jurisdiction.³⁹ The GloBE Rules do not specify the mechanism through which a jurisdiction must apply the UTPR, however. Thus, the UTPR can also "take the form of an adjustment that is equivalent to a denial of a deduction."⁴⁰ The GloBE Rules treat the

EXAMPLE 2.1.3-1.



decision as “a matter of domestic law implementation that is left to the UTPR Jurisdictions.”⁴¹

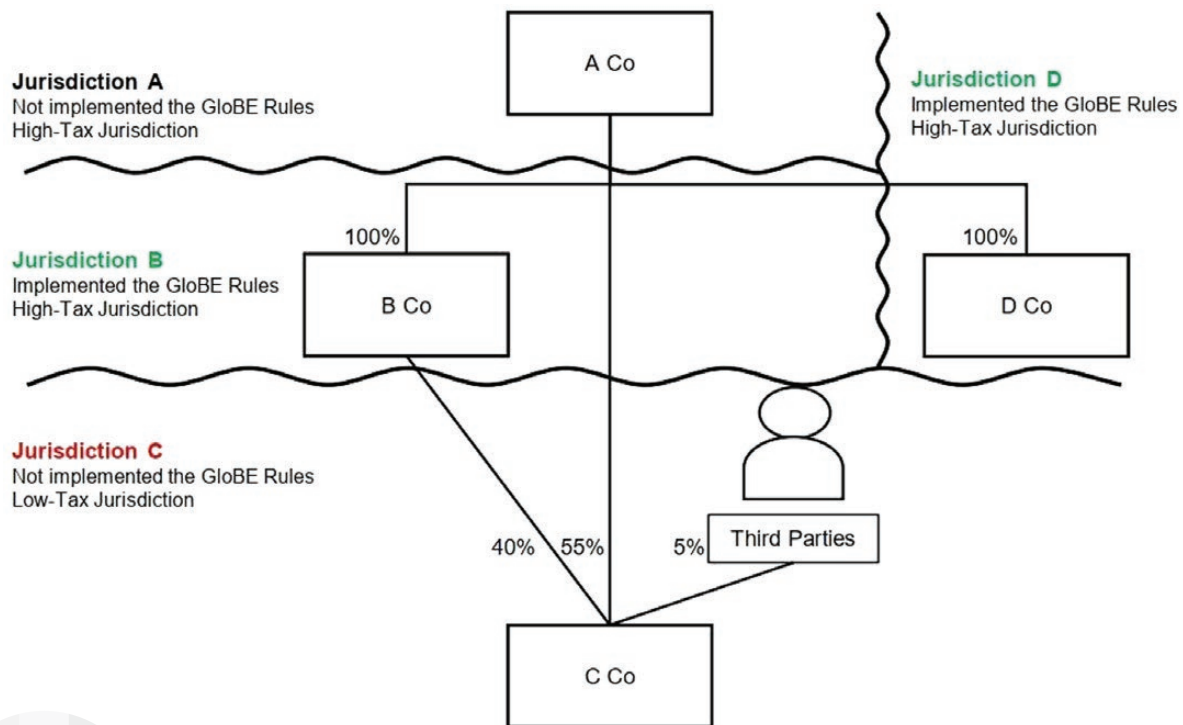
Example 2.5.3-1 of the GloBE Rules Examples illustrates how a MNE calculates the UTPR top-up tax amount. The ABC Group, depicted below, contains four entities. A Co owns 100% of B Co, 55% of C Co, and 100% of D Co. B Co owns 40% of C Co, and minority shareholders own the remaining 5%. C Co is a low-taxed Constituent Entity. The C Co top-up tax is EUR 100. A Co as the UPE would have priority to apply the IIR, but Country A has not implemented the GloBE Rules. B Co, the intermediate parent entity, is located in Country B, which has implemented a qualified IIR. B Co thus is required to apply the IIR with respect to its allocable share of C Co’s top-up tax, or EUR 40. Because not all of A Co’s combined direct and indirect ownership of C Co is subject to a qualified IIR (*i.e.*, the 55% direct interest that A Co holds), C Co’s EUR 100 top-up tax is reduced by B Co’s EUR 40 to calculate the UTPR top-up tax amount. Accordingly, the UTPR top-up tax amount is EUR 60. Example 2.5.3-1 does not address how the UTPR top-up tax amount is allocated. Presumably, the UTPR top-up tax is allocated between B Co and D Co based on their relative employees and tangible assets.⁴²

III. How Pillar II Is Materially Different from Prior Reform Efforts

The OECD has been focused on corporate tax competition for a long time. In 1998, the OECD released a report entitled *Harmful Tax Competition: An Emerging Global Issue*. By using the adjective “harmful,” the drafters implicitly acknowledged that there were at least some types of tax competition that were not harmful. Early on in the report, the drafters expressly acknowledged this point, stating, “The Report recognises the distinction between acceptable and harmful preferential tax regimes and carefully analyses the features of both residence and source country tax systems that may lead to the damaging impact of harmful preferential tax regimes.”⁴³ The drafters went on to recognize the real need that underdeveloped economies had to incentivize foreign direct investment (“FDI”) through tax incentives:

Tax competition and the interaction of tax systems can have effects that some countries may view as negative or harmful but others may not. For example, one country may view investment incentives as a policy instrument to stimulate new investment, while

EXAMPLE 2.5.3-1.



another may view investment incentives as diverting real investment from one country to another. In the context of this last effect, countries with specific structural disadvantages, such as poor geographical location, lack of natural resources, etc., frequently consider that special tax incentives or tax regimes are necessary to offset non-tax disadvantages, including any additional cost from locating in such areas.⁴⁴

The report's drafters therefore developed factors (*e.g.*, "no substantial activities" in the incentive jurisdiction) that could help to distinguish harmful tax regimes from those harmless or beneficial regimes that allowed for the encouragement of investment and development.⁴⁵

The OECD's position then was consistent with the view that many small island economies that lack natural resources face significant barriers to building up any kind of non-tourist industry, and that tax incentives may be an attractive way for such countries to attempt to level the playing field.⁴⁶

When the OECD began the BEPS Project in 2012, it appeared to continue to draw a distinction between the sovereign right of countries to engage in tax competition and the kinds of harmful tax practices that allowed income *via* transfer pricing, debt/equity arbitrage, or

other means to escape taxation altogether.⁴⁷ Pascal Saint-Amans, the Director of the OECD Centre for Tax Policy and Administration and the voice of the BEPS Project at that point in time, stated that "the solutions are not about any kind of harmonization, because the world is made of tax sovereignties, and every country decides on its own sovereignty."⁴⁸ Throughout the BEPS Project, the OECD continued to acknowledge the central role of sovereignty, noting that "[t]ax policy is at the core of countries' sovereignty, and each country has the right to design its tax system in the way it considers most appropriate."⁴⁹ The BEPS Project sought to address domestic and treaty law gaps that allowed for what was variously termed stateless income, nowhere-taxed income, and double non-taxation.

This initial phase of the BEPS Project led the OECD to publish reports on 15 actions 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."⁵⁰ The OECD published the Action Plan on BEPS in 2013, and then followed with the reports on each action in 2014 and 2015. One of the reports continued the work on harmful tax practices that the OECD had begun in 1996. Under BEPS Action 5, the OECD published *Countering Harmful Tax Practices More*

Effectively, Taking into Account Transparency and Substance. In this report as well, the OECD expressly stated that “[t]he work on harmful tax practices is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates.”⁵¹ Instead, the final BEPS Action 5 report focused on ensuring that there was sufficient transparency around incentive regimes and that the regimes aligned operational substance with the benefits that companies derived. With this directive in mind, the OECD’s Forum on Harmful Tax Practices embarked on a multi-year evaluation of incentive regimes around the world and categorized the regimes based on their relative harmful/harmlessness.⁵²

BEPS Action 5 was consistent with the general thrust of the BEPS Project. The BEPS Project focused on eliminating stateless income and therefore sought to prevent MNEs from shifting profits to low-tax jurisdictions in which the MNEs conducted little or no economic activity.⁵³ A minimum tax rate was not within the BEPS Project’s scope.

In 2016, at the conclusion of the BEPS Project, the OECD promulgated the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the “Multilateral Convention”).⁵⁴ The Multilateral Convention allowed more than 100 jurisdictions to negotiate, and in some cases agree, on whether to incorporate various aspects of the actions into their bilateral tax treaties. On the domestic law front, jurisdictions around the world incorporated the transfer pricing proposals in BEPS Actions 8–10 into their transfer pricing rules and adopted anti-hybrid rules that reflected the recommendations in BEPS Action 2.

In response, companies changed their behavior. Transfer pricing policies took into account the development, enhancement, maintenance, protection, and exploitation or “DEMPE” activities that the new OECD Transfer Pricing Guidelines mandated. Allocations of profit reflected real management of commercial risks. Hybrid entity, tax haven, and non-resident structures began to rapidly disappear as companies moved valuable assets into substantive jurisdictions. And, as is relevant here, jurisdictions eliminated harmful incentive regimes or modified those regimes to fall in line with the substance and transparency requirements that the BEPS Project established.⁵⁵

Despite the apparent success of the BEPS Project in both changing the architecture of international tax and adjusting corporate behavior, some jurisdictions concluded that the BEPS actions were nevertheless insufficient to address specific challenges posed by the Internet and the digital economy. These jurisdictions, starting with India, France, Italy, Turkey, and the UK, began to unilaterally start taxing

the gross revenue MNEs generate from providing digital services to customers. In tandem, in June 2016, the then 34-member OECD joined with 48 other countries to form the IF “to ensure interested countries and jurisdictions, including developing economies, can participate on an equal footing in the development of standards on BEPS related issues, while reviewing and monitoring the implementation of the OECD/G20 BEPS Project.”⁵⁶ The IF has since grown to 141 member countries.⁵⁷

As noted above, in January 2019, the IF issued the Policy Note in which it introduced the two-pillar solution as a way to address the perceived opportunity for companies to shift their highly mobile income into low-tax jurisdictions.⁵⁸ As also noted above, this report observed that Pillar II would not change the fact that countries remained free to set their own tax rates or not have a corporate income tax system at all.

The IF positioned Pillars I and II as a continuation of the BEPS Project’s work, as evidenced by the repeated reference to income shifting and the digital economy.⁵⁹ But, as discussed above, the BEPS Project in general, and the work on harmful tax practices in particular, did not seek to establish a minimum rate of tax; rather, these efforts were focused on ensuring that profits followed people (as well as assets and risks), and not merely paper. To that end, Pillar II appears to represent a significant departure from previous multilateral attempts to address tax competition. Specifically, as the discussion above illustrates, the OECD is no longer drawing a distinction between “harmful” tax competition and “tax competition.” Instead, under Pillar II, the IF “agreed to explore on a ‘without prejudice’ basis taxing rights that would strengthen the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits.”⁶⁰

In sum, the OECD has moved beyond ensuring all profits are recognized somewhere to ensuring that all profits are taxed somewhere *at a certain specific rate*. As noted above, the Pillar II project is akin to an international alternative minimum tax. The fact that this was where the BEPS Project would (ultimately) lead was predicted by some years ago.⁶¹

IV. How Pillar II Could Impact a Country’s Ability to Set Its Own Tax Base and Rates

The IF has crafted the GloBE Rules to encourage countries to adopt a minimum 15% tax that qualifies as a QDMTT. If a Constituent Entity’s ETR is less than the 15% minimum

rate, its jurisdiction has the right to impose a QDMTT to bring the ETR up to the required 15%. Next, the UPE's jurisdiction has the right to impose an IIR to bring the ETR up to the required 15%. After that, the intermediate parent entity's jurisdiction has the right to impose an IIR to bring the ETR up to the required 15%. If none of those countries acts to bring the ETR up to 15%, then every other jurisdiction in which the MNE operates has the right to impose the UTPR to bring the ETR up to the required 15%.

If the EU, or any other significant taxing jurisdiction, implements Pillar II, in almost every case there will be at least one jurisdiction in which a major MNE operates that will impose a qualifying IIR or UTPR. Pillar II proponents (and many of the opponents as well) believe that no local taxing jurisdiction is going to simply cede its right to tax income that a Constituent Entity generates in its jurisdiction to another jurisdiction that may have only a tenuous connection to the Constituent Entity. The theory is that virtually every jurisdiction is going to conclude that if one jurisdiction or another is certain to tax the income the Constituent Entity generates in the local jurisdiction, the local jurisdiction should impose a qualifying QDMTT and impose the tax first.

For U.S. MNEs, Pillar II will result in foreign income being subject to multiple levels of taxation. The local jurisdiction in which the MNE earns the income first will impose its local tax. If the income is low-taxed, the local jurisdiction's QDMTT brings the rate to 15%. If the local jurisdiction does not have a QDMTT, and if GILTI is not considered a "qualified" IIR, another foreign jurisdiction will impose its IIR or the UTPR to top-up the tax. Lastly, the United States then may still impose GILTI.

Importantly, given the fact that the modality for imposing the incremental top-up tax may be the denial of deductions,⁶² and the fact that the Commentary explicitly states that the tax may be imposed on an entity with no factual relationship to the income,⁶³ these extra taxes that are imposed may not be creditable in the United States under the new U.S. foreign tax credit regulations. Moreover, the starting point for the GloBE Rules is accounting income, whereas GILTI is based on taxable income. Potential mismatches could lead to additional tax despite the income already being subject to 15% tax under the GloBE Rules.

V. How Pillar II Could Significantly Impact Many Developing Countries

One of the OECD's stated goals is to tackle inequities and end poverty:

We form a like-minded community, committed to the preservation of individual liberty, the values of democracy, the rule of law and the defence of human rights. We believe in open and transparent market economy principles. Guided by our Convention, we will pursue sustainable economic growth and employment, while protecting our planet. *Our shared endeavour is to end poverty, to tackle inequalities and to leave no one behind. We want to improve the lives and prospects of everyone, inside and outside the OECD.*⁶⁴

Despite the aforementioned goal, the actual implementation of the GloBE Rules may favor larger industrialized countries.⁶⁵ This may occur in at least two ways.

Specifically, by prioritizing the IIR over the UTPR, and giving higher-tier entities priority over lower-tier entities in imposing the IIR, the United States and other more developed countries that have the most MNEs would have the first opportunity to tax the untaxed profits, if there are any. That is, the MNEs that are most likely to be in a position to own low-taxed subsidiaries, dictate the ownership chains of those subsidiaries, and determine which IIR regime is most favorable would be MNEs based in the United States and other developed countries.⁶⁶

The counterargument is that, if all countries adopt a Pillar II-compliant regime, then there would be no under-taxed profits taxed under an IIR or UTPR. Yet, this is the second way the proposal may be seen to favor developed countries over developing countries. Although Pillar II does not require jurisdictions to implement a 15% tax rate, by ensuring that each dollar of income is subject to 15% tax *somewhere*, it may hinder a country's ability to attract investment through favorable tax policy. While Pillar II does not apply to the routine return, the proxy for substance, that amount in many fact patterns may be quite small. If the developing nation does not adopt a QDMTT, another country will tax the income. If the developing nation does adopt a QDMTT, that merely changes the type of tax the jurisdiction imposes from a corporate income tax to a QDMTT, thereby ensuring that no such country can offer incentives that reduce the effective rate below 15%.

The OECD recognizes that taxes serve as the primary means for financing public goods, such as maintenance of law and order and public infrastructure.⁶⁷ In a 2015 joint report, the International Monetary Fund ("IMF"), OECD, World Bank, and United Nations ("UN") studied countries' uses of tax incentives and the various forms those incentives took, particularly in developing nations.⁶⁸ The primary reason jurisdictions offer tax incentives is to stimulate investment in the jurisdiction with the hope of

promoting growth. In particular, developing nations wish to attract FDI.⁶⁹ The report interestingly found that many tax incentives developing nations offered were redundant, in that they attracted investment that likely would have been undertaken in that jurisdiction anyway. In contrast, effective tax incentive policies offered as part of a coordinated strategy to enhance investment have been a large driver of economic growth.

The 2015 joint report found that the effectiveness of incentives in attracting investment depends on international tax rules because of the interplay between the incentive structure and any home country tax that a MNE is subject to. MNEs located in countries with taxes on foreign source income, such as through CFC rules or repatriation taxes, are not able to benefit from tax incentives as much as those MNEs located in countries with territorial systems. The IMF, OECD, World Bank, and UN published this report before the OECD conceived of Pillar II. Based on the analysis in the report, it is likely that a global minimum corporate tax rate applied through the series of top-up taxes would render incentive regimes much less effective regardless of their design by hindering a country's ability to offer beneficial tax rates that attract meaningful, substantive investment.

Many countries have been offering tax incentives for years and those tax incentives can often be a critical component of the country's economic policy. Puerto Rico, a U.S. possession, has long had tax incentives to spur investment in its island economy. For years, as many readers will recall, the U.S. federal government recognized the need to provide an incentive to invest in Puerto Rico *via* sections 936 and then 30A of the Code. The Puerto Rican tax code also provided its own incentives, such as a 100% DPD for Puerto Rican entities that were more than 80% owned by foreign entities.⁷⁰ These incentives facilitated significant growth and development for decades. The United States' repeal of section 936 coincided with Puerto Rico entering into a recession, demonstrating just how critical incentives can be.⁷¹ Puerto Rico is not member of the IF.⁷² It is unclear how investment in Puerto Rico could be affected if Puerto Rico is forced to institute a mandatory 15% minimum corporate rate.

Similarly, the Malaysian Investment Development Authority ("MIDA") was formed in 1967. At the time, the World Bank hailed MIDA as "the necessary impetus for purposeful, positive, and coordinated promotional action" for Malaysia's industrial development.⁷³ MIDA offers tax incentives in various industries to attract companies to engage in beneficial practices and invest in Malaysia. For example, Malaysia offers tax incentives for companies that establish distribution hubs in Malaysia, locally

manufacture pharmaceutical products, invest in green technology, and commercialize R&D findings of public research institutions. In 2021, Malaysia received RM54.9 billion in net FDI inflows, compared to RM14.6 billion in 2020.⁷⁴ Total accumulated FDI expanded from RM26.7 billion to RM796.3 billion. Malaysia recorded a total of RM306.5 billion worth of approved investments in the manufacturing, services, and primary (agriculture, mining and plantation, and commodities) sectors for 2021. These approved investments involved 4,564 projects that MIDA expects will create 105,012 job opportunities.

Although it is challenging to draw precise conclusions regarding the effect of policy decisions on economic outcomes, it is undeniable that Malaysia's economy has seen steady improvement. The Malaysian infant mortality per 1,000 live births has declined from 48 in 1967 to 7 in 2020.⁷⁵ The gross domestic product ("GDP") per capita has increased from \$317.4 in 1967 to \$10,412.3 in 2020.⁷⁶ Similarly, the literacy rates for adults 15 years of age and older improved from 58.5% in 1970 to 95% in 2019.⁷⁷ As noted above, one of the OECD's stated goals is to tackle inequities and end poverty. Because Pillar II prevents developing countries from using tax incentives and tax rates below 15% to attract FDI, countries like Malaysia would need to explore alternative mechanisms to attract investment. MIDA's 2021 Malaysia Investment Performance Report commented on the ongoing review of its tax incentive framework and Pillar II's "undoubted[] influence" as the Malaysian government reviews its tax structure and refines its investment promotion strategies.

Tax incentives have also been a core feature of Singapore's economic policy for over 50 years. In Singapore, the Economic Development Board ("EDB") grants corporations incentives such as the Pioneer Certificate Incentive ("PC") and the Development and Expansion Incentive ("DEI"), which "aim to encourage companies to grow capabilities and conduct new or expanded economic activities in Singapore."⁷⁸ The EDB grants corporate tax exemptions or concessionary rates of 5 or 10% on qualifying activities to those corporations for which it grants a PC or DEI. Companies must submit a detailed application presenting, among other things, the total number of additional jobs it expects to create and the total amount it will invest in the country. To obtain an incentive in Singapore, a company must demonstrate that it is committed to conducting significant business operations in Singapore that will contribute to the Singapore economy and that will grow over a number of years. In 2021, the EDB's efforts to attract FDI led to MNEs committing to invest S\$11.8 billion in fixed assets and S\$5.2 billion in total business expenditures.⁷⁹ These projects are expected

to create 17,376 new jobs in Singapore. From 2011 to 2021, incentives led to total fixed asset investment of S\$139 billion, total business expenditure of S\$76 billion, and approximately 237,000 new jobs.⁸⁰

Similar to Malaysia, Singapore's economy has appeared to benefit significantly from inward investment. Infant mortality per 1,000 live births in Singapore has declined from 33 in 1961, when the EDB was founded, to 2 in 2020.⁸¹ Incentives appear to have helped Singapore's per capita GDP grow from \$449.2 in 1961 to \$59,797.8 in 2020.⁸² Adult literacy rates also jumped from 53.8% to 97.1%.⁸³ As a result of Pillar II, Singapore announced its intent to evaluate a QDMTT. By topping up a MNE Group's Singapore ETR to 15%, Singapore will no longer be able to offer its tax incentives. Commentators acknowledge Singapore must now find other ways to compete for investment.⁸⁴

Despite these statistics, Singapore and Malaysia have both agreed to the Two-Pillar Statement, for now. Nigeria expressed serious concerns regarding how the rules would apply to its tax system, but its overall reasoning for not joining the Two-Pillar Statement is simple: the two pillars are not in the country's best interest.⁸⁵ Other developing nations may consider opting out as well.⁸⁶

One may wonder why developing countries would forgo revenue that could flow from enacting a QDMTT. After all, the OECD estimates that Pillar II will generate \$150 billion in additional tax revenue per year. Yet, the OECD does not discuss which countries will receive this additional tax revenue. The Tax Justice Network's analysis concluded that 60% of that additional tax revenue will go to G7 countries.⁸⁷ The GloBE Rules largely benefit UPEs, and the UPE of most MNE Groups is located in one of the G7 countries. At the risk of saying the quiet part out loud—Pillar II may have the effect of shifting a massive amount of tax revenue out of the developing world and into the most economically developed countries.

The OECD believes that Pillar II will result in a more stable international tax system and increased certainty.⁸⁸ Yet, this analysis should also consider possible second- and third-order effects. It is not at all clear that politicians and large companies have had the time to fully absorb and understand the level of complexity that Pillar II will usher in. After all, Pillar II does not have the force of law yet.

It is also not clear that politicians have had the time to fully absorb the potential impacts Pillar II may have on less developed nations. The average corporate tax rate in 2021 was 23.54%.⁸⁹ Of the 225 jurisdictions included in a Tax Foundation survey, 47 had a rate at or below 15%, and 15 of those 47 countries did not impose a corporate income tax. The high-tax jurisdictions have nothing to

lose and only top-up tax to gain. The jurisdictions with lower rates or with corporate tax rates greater than 15% that grant incentives resulting in low-taxed income may no longer be able to offer those incentives. Pillar II would force these jurisdictions, like Puerto Rico, Malaysia, and Singapore, to enact a QDMTT or change (or eliminate) their incentive terms.

VI. How Pillar II May Impact Hard-Fought Policy Choices Agreed to by Congress

There is an open issue as to how the various incentives the United States offers *via* credits (*e.g.*, energy credits, low-income housing credit, *etc.*) will be treated under Pillar II.⁹⁰ It is entirely possible that many credits may reduce the Covered Taxes that a Constituent Entity is deemed to pay, thereby potentially reducing the Constituent Entity's ETR below 15%. Yet, it is important to remember that the structure and design of these credit regimes are the result of hard-fought and often bipartisan negotiations in Congress.

This is why the IIR and the UTPR differ from prior attempts to combat "harmful" tax competition. As the above discussion demonstrates, the OECD has acknowledged that there are real differences between attempting to ensure that all income is taxed somewhere by some jurisdiction (to prevent nowhere or stateless income), on the one hand, versus superseding the policy choices by a country to utilize tax incentives to encourage inbound investment. This is another consequence that U.S. politicians from both parties might want to consider.

VII. There Are Alternatives

As noted above, Pillar II is not motivated by a desire to prevent "harmful" corporate tax competition. Instead, it appears to be an attempt to combat "all" corporate tax competition below a certain rate. Yet, if the OECD wishes to oppose corporate tax competition, it may wish to consider other potential approaches. Specifically, by shifting the burden of the corporate tax to individual shareholders, jurisdictions shift the burden of the tax away from a corporate entity whose activities are more and more mobile, to individuals, who are not. Although it would be a stretch to say that individuals are impervious to increases in tax rates, there are many factors (*e.g.*, family, friends, access to U.S. medical care, language fluency or lack thereof, national loyalty, the expatriation regimes in Code Secs. 877 and 877A, lack of cost-effective alternative

locations one can actually emigrate to⁹¹) that prevent even the wealthiest U.S. citizens from expatriating even when the tax rate gets higher (even substantially higher) than they would prefer.⁹² The same cannot be said about corporations, whose managers have a duty to find the best after-tax rate of return possible.

Many approaches have been discussed for shifting the burden of the corporate tax to the shareholder, but one of the more practical and administrable options is to adopt a DPD. Below we highlight: (i) some potential merits of the DPD; (ii) how the DPD responds to the perceived problem that Pillar II is attempting to solve; (iii) why U.S. politicians from both parties may want to consider whether a DPD or some other approach might be an alternative to Pillar II; (iv) why enacting a Pillar II-compliant regime will not necessarily result in international tax harmony; and (v) why simply doing nothing is probably not a viable option.

A. Brief Overview of the DPD

The DPD is by no means new. It has been discussed as far back as the years immediately following World War II.⁹³ The United States has also implemented it, albeit on a limited basis, for regulated investment companies (“RICs”), real estate investment trusts (“REITs”), and subchapter T cooperatives.⁹⁴

It was most recently considered in the run-up to the 2017 Tax Cuts and Jobs Act (“TCJA”).⁹⁵ Most readers will remember that prior to enactment of the TCJA two more fundamental reform plans were considered. It is worth revisiting those proposals and why they were not enacted.

The Border Adjustment Tax (“BAT”) originated in the Republican-controlled House of Representatives. It would have scrapped the corporate income tax altogether and replaced it with a value-added-tax-like regime. This proposal failed for a number of reasons. It was considered too dramatic a change by some.⁹⁶ It was also strongly opposed by retailers and industries that require significant raw material imports from abroad but who sell their products domestically.

In contrast, the DPD originated in the Senate, which was controlled by Republicans at the time. The late Senator Orrin Hatch (R-UT) headed the Senate Finance Committee, which held hearings on the DPD in Spring 2016.⁹⁷ The primary substantive concerns witnesses raised with respect to the DPD related to the impact on tax-preferenced accounts such as Individual Retirement Accounts (“IRAs”) and 401ks, treaty obligations, and debt markets.⁹⁸ All three concerns stemmed primarily from the fact that a necessary corollary to the DPD is a withholding tax on dividends. In fairness, the withholding tax

mechanism, its application (or non-application to interest payments), its generally accepted accounting principles (“GAAP”) treatment, and its impact on tax-preferenced accounts and treaties are all, admittedly, significant issues that have to be addressed squarely before DPD legislation can advance.⁹⁹

Yet, without legislative text, it was unclear how that withholding tax would apply, whether it would extend to interest as well, and what its effects would be on the preferential treatment granted to retirement accounts. Despite the concerns, the proposal was seriously considered.¹⁰⁰ Draft language was produced, but the proposal did not get out of committee.¹⁰¹ There were a number of reasons the DPD did not advance.¹⁰² Specifically, as mentioned, the House Republicans had their own proposal. We understand that the White House was generally supportive, but former Treasury Secretary Steven Mnuchin was adamantly opposed to the DPD proposal, perhaps because of his background in the capital markets. Moreover, before releasing the bill text the Senate Finance Committee wanted to demonstrate it could achieve three goals with the proposal: (i) promote growth; (ii) increase capital investment; and (iii) create jobs. By the time the proposal language had been modified sufficiently to obtain a positive score across all three objectives, the discussion had moved on to just lowering the corporate rate and what ultimately became the TCJA. Thus, Congress never publicly released the draft legislative text.

B. Comparing the DPD and Pillar II as Policy Responses

The reader may reasonably ask why a discussion of the DPD is relevant in an article discussing Pillar II. International tax policy is like a game of multidimensional chess played against more than one opponent. So, just like in chess, it is useful to consider what the relevant moves are, and whether a DPD helps or hurts in each of those scenarios. At the moment, there are a number of distinct possibilities that may unfold over the next two years.

First, every single country in the world could enact a Pillar II-compliant regime. Every country could, in theory, agree on how those rules actually apply in practice. Global harmony could ensue. We will leave it to the reader to assess the likelihood of that outcome.

Second, the United States and most countries in the world could enact a Pillar II-compliant regime, but there could be significant disputes as to how the regime is applied in specific circumstances. As noted above, the EU (or some countries within it) could, in theory, bless a revised U.S. GILTI regime, but Brazil (or some other country) may disagree, and impose tax on a foreign

subsidiary of a U.S.-based MNE. Alternatively, Brazil may not agree with how the United States treats credits *vis-à-vis* the measure of covered taxes and impose tax on the U.S. parent itself.

Third, a critical mass of countries in the world enact a Pillar II-compliant regime, but the United States may refuse to go along. It may refuse to modify its GILTI regime. Or, maybe it agrees to modify its GILTI regime but decides it will not make the requisite changes to domestic law to ensure a 15% minimum tax in all cases.

For the reasons discussed below, the United States may decide the DPD is worth considering in all three scenarios.

1. Impact of a DPD if Every Country Enacts a Pillar II-Compliant Regime, But There Are No Disputes About Implementation

In the first scenario, in theory, no country will ever impose a top-up tax, because no country would have to. Everyone is taxed at least at a 15% rate. In this case, there is still going to be an incentive for corporate managers to make decisions on an after-tax basis, so long as the U.S. federal and state rate substantially exceeds the 15% minimum rate. A DPD may operate to reduce that incentive. Some have argued that there would be no effect because the tax is simply moved to the shareholder level, but this ignores how corporate managers are compensated. So long as the DPD generates a permanent (and not temporary) deduction against tax liabilities in the financial statements, it could significantly reduce (and perhaps eliminate) the incentive of corporate managers to make decisions on an after-tax basis.

2. Impact of a DPD if There Is Controversy Surrounding Implementation of Pillar II

As we foreshadowed above, the GloBE Rules contemplate, and provide beneficial treatment for, countries with a DPD. Specifically, Article 7.2 of the GloBE Rules allows a parent of a MNE to reduce its GloBE income by deductible dividends paid out to certain persons pursuant to a qualifying DPD regime. The precise motivation for including this provision is not clear, but the Commentary indicates that it is not limited to investment entities (like U.S. RICs):

Although a Deductible Dividend Regime may apply to both Entities that qualify as Investment Entities under the GloBE Rules and other similar purpose Entities that do not meet the Investment Entity definition, *the rules in Article 7.2 are needed only for*

*those Entities that do not meet the Investment Entity definition because an Investment Entity that is the UPE is an Excluded Entity.*¹⁰³

Presumably, this provision was included to address the fact that some European countries permit a deduction for equity investment, as an attempt to reduce the tax incentive for debt financing. Similarly, Brazil is a very large country that has an “interest on equity” regime.

Not every DPD regime would qualify under the GloBE Rules. To qualify, the regime must satisfy the conditions in Articles 7.2(a), (b), or (c). U.S. MNEs will likely find the scenario in Articles 7.2(b) most often applicable.¹⁰⁴

Assume, for this limited example, that a U.S. corporation (“USCO”) wholly owns a Luxembourg subsidiary (“LuxCo”), and LuxCo wholly owns a Brazilian subsidiary and a Malaysian subsidiary (“MCo”). Further assume Luxembourg and Brazil have enacted what everyone would agree is a Pillar II-compliant regime. Assume, for the sake of argument, that Malaysia does not. Instead, it continues to allow tax incentives that allow operations to be taxed at a less than 15% rate. Assume that the United States has also tweaked its GILTI regime in a way that the EU, the OECD, and everyone in the IF blesses, and imposes what the U.S. Congress believes is a qualifying domestic minimum tax, but which refuses to reduce “covered taxes” by certain credits. Assume that, if these credits reduced USCO’s covered taxes, USCO would fall below the 15% threshold.

In this scenario, in theory, Brazil could tax USCO’s GloBE income under Brazil’s UTPR if Brazil did not agree with the United States’ implementation of the United States’ domestic minimum tax. Yet, if the United States also has a DPD regime, the United States could conceivably reduce its GloBE income to zero *via* a DPD, thereby avoiding a Brazilian UTPR. This appears to be the case even if Brazil does not agree that USCO’s minimum tax is otherwise compliant.

What is less clear is how, precisely, the DPD would interact with the IIR. Specifically, in the foregoing example, if USCO recognizes imputed income from MCo under a revised GILTI regime that everyone believes is Pillar II compliant, but also allows the U.S. company to claim a deduction against that GILTI inclusion for a DPD, it is unclear whether that would then prevent the GILTI from being a compliant IIR, or whether this would be acceptable provided USCO’s shareholders are reasonably likely to be exempt (*e.g.*, local pension funds) or subject to rates in excess of 15%.¹⁰⁵

3. Impact of a DPD if the United States Refuses to Enact a Pillar II-Compliant Regime

The reduction of the parent entity's GloBE income noted above is certainly a benefit in this scenario.¹⁰⁶ In addition, however, and as noted previously, Pillar II is not limited to addressing specific issues arising from e-commerce or the "digital economy." It is not even directed at "harmful" tax competition, like prior proposals. Instead, it is an attempt to combat "all" corporate tax competition, as evidenced by the Commentary's reference to the regime as an international alternative minimum tax. By shifting the burden of the tax to the individual, the DPD removes (or substantially removes) the incentive or disincentive of corporate managers to make decisions about where to do business based on corporate tax rates. In this scenario then, at a minimum, the United States could argue to other countries that it is solving the same problem the OECD is attempting to solve (*i.e.*, preventing corporate tax competition). It is just choosing to do so in a different way.

C. Potential Advantages—and Challenges—of a DPD

Despite reports of its demise, the DPD remains an option for policymakers to consider if they believe they must "do something" to address corporate tax competition but have concerns with aspects of the OECD's Pillar II approach. Indeed, it appears that some policymakers may be interested in re-examining the DPD as a less comprehensive reform effort than the BAT.¹⁰⁷

Other policymakers may also wish to re-examine the DPD, based on the argument that the DPD would be a *more* progressive option than the *status quo*. At this point, it is useful to point out that the conversation around the DPD often gets bogged down in an entirely academic (and tedious) debate about corporate integration, in general, and equating corporate and flow-through taxation (or debt and equity), in particular.¹⁰⁸ It is why, historically, the DPD was discussed alongside an imputation credit system, for example. After all, both approaches reduce the levels of tax on corporate profits from two to one. Yet, there is a vast difference between an imputation credit and a DPD. An imputation credit system is unlikely to change the incentives of corporate managers one iota. In contrast, the DPD may be viewed by policymakers as more likely to reduce the incentive of corporate managers to make business decisions on an after-tax basis.

Some policymakers may also prefer a regime that imposes tax on individuals because that regime can be tailored to "pick" which individuals you want to tax. Why might this be important? It is important because even the

most progressive economists will acknowledge that *some* portion of the corporate tax falls on workers, not shareholders, creditors, or customers.¹⁰⁹ The DPD raises the possibility of reforming the tax law so that the corporate tax is *only* borne by shareholders.

The DPD is not without challenges, however. One of the biggest of those challenges is the possible effect on tax incentives. One of the features of the current corporate tax system is that it facilitates Congress's use of the Code to provide an incentive for activities and behaviors it deems beneficial.¹¹⁰ That is, it is easier to craft a deduction, credit, or excise tax regime to influence a couple of thousand large corporations who file copious amounts of information publicly, than it is to craft a similar regime to influence the behavior of millions of individuals, the idiosyncratic financial situations of which are unknown.

There is also a fiscal impact. Under a DPD, corporate tax revenues would certainly be lost. Yet, this may be a lower number than many would assume. U.S. corporate income tax generated \$372 billion in fiscal year 2021, a record amount of revenue. The corporate income tax accounted for only 9.19% of the \$4.05 trillion tax revenues that the United States collected.¹¹¹

Moreover, to our knowledge, no one has calculated what revenues may be *gained* from the DPD. Even assuming no change in the behavior of corporate managers, it would be interesting to model how much revenue would be raised with a DPD given that the corporation would have to withhold, for example, 30%, from all distributions which tax may then be credited against domestic tax liability or (possibly) refunded in whole or part under treaty. How much revenue is generated could depend on a series of design issues (*i.e.*, what to do about distributions to tax-exempt entities, retirement accounts, and foreign persons entitled to treaty benefits).¹¹² It would also be interesting to see some modeling as to whether requiring treaty beneficiaries to request a refund of withheld taxes would enhance compliance and revenue, for example.

Furthermore, the DPD, unlike the BAT, can be "phased in," to lessen its fiscal impact. The EU is, at this moment, considering providing some deductions for equity capital *via* a debt-equity bias reduction act ("DEBRA").¹¹³ Rome was not built in a day, and a complete shift to shareholder-based taxation need not be effected in one year.

In reality, eradicating (or nearly eradicating) the corporate tax line item from the income statements of U.S. corporations could, in our view, have a meaningful impact on the incentives of corporate managers,¹¹⁴ and could reduce the potentially distortive effects of corporate taxes on investment decisions. The competition would then center on labor costs, labor productivity, energy costs,

transportation costs, and other traditional non-tax costs of doing business.

Yet, even if the DPD did not raise revenue or attract additional investment, a relatively small change in the individual rate and/or changes to the taxation of dividend income specifically could be considered as mechanisms to make up for the revenue shortfall, although the political challenges of raising taxes on any group should not be underestimated.

D. Enacting a Minimum Tax Will Not Necessarily Ensure Global Tax Harmony

To be clear, we fully recognize that there is an exceedingly low probability that the OECD is going to change its direction. There is also a very low probability that every (or even a substantial number) of the G20 countries would enact a DPD. Nevertheless, policymakers in the U.S. Congress may want to also give consideration to other policy alternatives to Pillar II, which could include a DPD.

Pillar II proponents will argue that the United States needs to enact a Pillar II-compliant regime to be in sync with our trading partners and prevent the adverse consequences that would ensue when various other countries impose the UTPR on MNEs based in the world's largest economy. Unfortunately, the lack of a comprehensive, workable, and binding dispute resolution mechanism gives rise to the real possibility that the international tax system will be highly chaotic in the coming years, regardless of what the United States does.¹¹⁵

For example, assume the United States enacts a Pillar II-compliant regime. The fact that the United States and Brazil both enact a Pillar II regime does not prevent Brazil from disputing how the United States *applies* that regime. For one example of a possible issue, look to the recent pronouncement that EU officials have indicated that if certain changes to the U.S. GILTI regime were made, the regime would qualify as a valid IIR.¹¹⁶ Let's assume those changes are made. What is to stop Brazil from disagreeing? Moreover, there is no treaty (or competent authority process) between the United States and Brazil, nor is there any prospect of one.

One could argue that that is a risk U.S. companies run now. So what does it matter if Pillar II goes forward? If a U.S. company sells products to Brazil and the U.S. and Brazilian transfer pricing policies do not align, double tax could ensue. That risk exists today. That is certainly true, but the scope of that risk is limited to transactions U.S. MNEs engage in with their Brazilian affiliates. Pillar II would completely alter this dynamic as Article 2.6 of the GloBE Rules specifies that the top-up tax revenue is

shared among those countries that enact a UTPR. Those countries may not have had any factual relationship to the profit that is being taxed. In this way, as others have already noted, the UTPR represents a modified formulary apportionment system.¹¹⁷

E. Even if Pillar II Disappears, the Rationale for It Will Not

One could reasonably ask why the United States should do anything at all. After all, the United States just went through a tax-reform process with the TCJA. Why not just wait it out and hope the consensus changes?¹¹⁸ Why bother considering alternatives?

The answer to that is that the rationale for Pillar II (*i.e.*, combating corporate tax competition) is not going away anytime soon. A significant number of individuals who influence policy believe that corporate tax competition is *per se* "bad."¹¹⁹ There is likely little anyone can do to change their minds. Thus, variations on this theme are likely to reappear. If Pillar II fails, one has to prepare for the possibility that the next iteration may take an even more aggressive form, like an explicit formulary apportionment scheme instead of the apportionment-lite presented by the UTPR.

VIII. Conclusions

Some may argue that tax competition, when grounded in substance and which avoids stateless or nowhere income, is not a problem that needs to be solved.¹²⁰ Regardless, it would be prudent for policymakers to consider how Pillar II may impact the policy choices they have made. They may also want to consider how Pillar II may work to prevent developing nations from using tax policies to promote FDI, as well as how Pillar II may result in a shift of tax revenue from the developing world to the most well-developed and prosperous nations.

If we have gotten to a point where all corporate tax competition is "bad," then there are alternative ways to solve this problem that do not involve nullifying U.S. sovereignty or preventing developing countries and island economies from using tax incentives to stay economically relevant. Specifically, we can consider shifting the burden of the corporate tax to the individual. To that end, the U.S. Congress may want to start considering alternatives (including dusting off its work on Senator Hatch's DPD proposal), and soon. Congress could then argue that the United States has solved its corporate tax competition problem, and other countries are free to do the same if they so choose.

ENDNOTES

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¹ Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, OECD (Oct. 8, 2021), 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.

² Mauritania Joins the Inclusive Framework on BEPS and Participates in the Agreement to Address the Tax Challenges Arising from the Digitalisation of the Economy, OECD (Nov. 4, 2021), www.oecd.org/tax/beps/mauritania-joins-the-inclusive-framework-on-beps-and-participates-in-the-agreement-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm; see also Members of the OECD/G20 Inclusive Framework on BEPS Joining the October 2021 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy as of 4 November 2021, OECD, www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-october-2021.pdf.

³ Addressing the Tax Challenges of the Digitalisation of the Economy—Policy Note, OECD (Jan. 23, 2019) [hereinafter Policy Note], www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf.

⁴ OECD/G20 Base Erosion and Profit Shifting Project, Tax Challenges Arising from the Digitalisation of the Economy—Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two) at 8 [hereinafter Commentary], www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf (emphasis added).

⁵ See, e.g., *Trade Groups Ask Treasury to Protect Credits in Implementing OECD Minimum Tax Plan*, 2022 TNTI 67-26 (Apr. 5, 2022).

⁶ See, e.g., Mindy Herzfeld, *The Perils of Pillar 2*, 106 TAX NOTES 1119 (May 30, 2022) (“The OECD deal—which officially is supposed to address the tax challenges of the digitalized economy—has as much to do with the challenges posed by globalization as digitalization.”). This conclusion is based on the public statements of officials advocating for this new regime. Governments

and commentators alike have lauded Pillar II’s end of the “race to the bottom.” Alex Cobham, *US Treasury Secretary Yellen Confirms: It’s Time to End the Race to the Bottom on Corporate Tax*, TAX JUSTICE NETWORK (Apr. 7, 2021), taxjustice.net/2021/04/07/us-treasury-secretary-yellen-confirms-its-time-to-end-the-race-to-the-bottom-on-corporate-tax/ (“We are working with G20 nations to agree to a global minimum corporate tax rate that can stop the race to the bottom. Together we can use a global minimum tax to make sure the global economy thrives based on a more level playing field in the taxation of multinational corporations, and spurs innovation, growth, and prosperity.”); Remarks by Assistant Secretary for Tax Policy Lily Batchelder on Global Corporate Tax at the Hutchins Center at Brookings Institute and the Urban-Brookings Tax Policy Center (Apr. 15, 2022), home.treasury.gov/news/press-releases/jy0717 (“Over the past 40 years, nations have engaged in tax competition, generating a race to the bottom in corporate tax rates. The OECD average corporate tax rate has declined from 40% forty years ago, to just 23% today. The global agreement would end this race to the bottom by largely eliminating the benefits from engaging in it.”); OECD Pillar 2 (Global Minimum Tax), Tax Foundation, taxfoundation.org/tax-basics/oecd-pillar-2-global-minimum-tax/ (“Pillar 2 of the Organisation for Economic Co-operation and Development’s (OECD) Global Tax Deal would limit tax competition and the so-called ‘race to the bottom’ on corporate tax rates.”).

⁷ The IF published the GloBE Rules on December 20, 2021. OECD/G20 Base Erosion and Profit Shifting Project, Tax Challenges Arising from the Digitalisation of the Economy—Global Anti-Base Erosion Model Rules (Pillar Two) [hereinafter GloBE Rules], www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf. The IF then published the Commentary and the corresponding examples, discussed below, on March 14, 2022. Commentary, *supra* note 4; OECD/G20 Base Erosion and Profit Shifting Project, Tax Challenges Arising from the Digitalisation of the Economy—Global Anti-Base Erosion Model Rules (Pillar Two) Examples, www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

⁸ Pillar 2 GloBE Rules Fact Sheet, OECD, www.oecd.org/tax/beps/pillar-two-GloBE-rules-fact-sheets.pdf.

⁹ GloBE Rules, Art. 1.2.

¹⁰ *Id.* Art. 1.1.1. Thus, MNE Groups with revenue that falls below EUR 750 million are outside of Pillar II’s scope, at least in the manner that the IF currently envisions. Although not the focus of this column, this revenue threshold provides at least some comfort to emerging enterprises that they can still enjoy the benefits of tax incentives during the critical start-up phase, when every dollar may be a matter of success or failure.

¹¹ *Id.* Art. 1.3.

¹² *Id.* Art. 1.5.

¹³ *Id.* Art. 10.3.1.

¹⁴ *Id.*

¹⁵ See *id.* Art. 10.3.2.

¹⁶ *Id.* Art. 3.1.

¹⁷ *Id.* Art. 3.2. These adjustments include adding back net taxes expenses, excluding dividends and distributions from controlled entities and entities under the equity method, and disallowing deductions for certain policy-based expenses.

¹⁸ *Id.* Art. 3.3.

¹⁹ *Id.* Art. 3.4 & 3.5.

²⁰ See *id.* Art. 4.2.

²¹ *Id.* Art. 4.1. The GloBE Rules take Covered Taxes and add (1) any accrued liability for Covered Taxes that was reported as an ordinary expense, rather than income tax expense, in the financial statements (a corresponding change to one made in calculating GloBE income); (2) the amount of GloBE loss deferred tax asset that is used in a fiscal year; (3) the amount, if any, of Covered Taxes paid related to an uncertain tax position to the extent previously treated as a reduction to Covered Taxes; and (4) any amount of refund or credit related to a Qualified Refundable Tax Credit (as defined in the GloBE Rules) that has been recorded as a reduction to current tax expense. Several Covered Taxes also are subtracted to ensure that the calculation reflects only taxes that arise in respect of GloBE income or loss and that are expected to be paid within three years.

²² *Id.* Art. 4.4 & 4.5.

²³ *Id.* Art. 4.3.

²⁴ *Id.* Art. 4.6.

²⁵ *Id.* Art. 5.1. The GloBE Rules contain a *de minimis* exclusion that seeks to avoid an entity’s ETR calculation when the amount of any resulting top-up tax would not justify the compliance and administrative costs. *Id.* Art. 5.5. The rules also allow for the development of safe harbors for operations that are likely to be taxed above 15%. *Id.* Art. 8.2. The IF has not yet announced the criteria for these safe harbors.

²⁶ *Id.* Art. 5.2 & 5.3. Under this “Substance-based Income Exclusion,” the excluded routine return is 5% of payroll costs for eligible employees and 5% of the carrying value of eligible tangible assets. *Id.* Art. 5.3.

²⁷ While it may have once been the case that moving intangible assets to a given jurisdiction automatically attracted all the intangible income to that jurisdiction, that is not necessarily the case under the post-BEPS Project version of the OECD Transfer Pricing Guidelines. Moreover, it is not clear why the mobility of intangible assets is *per se* not indicative of substance in a given jurisdiction in light of the significant investments in R&D, marketing, and other activities that intangible assets entail. This question is beyond the scope of this column, however.

²⁸ GloBE Rules, Art. 5.2.3.

²⁹ See Commentary, Art. 5.2.3.

³⁰ GloBE Rules, Art. 5.2.4.

³¹ *Id.* Art. 2.1.1.

³² *Id.* Art. 2.1.2 & 2.1.3.

³³ *Id.* Art. 2.2. The parent entity's "Allocable Share" is the amount of the top-up tax multiplied by the "Inclusion Ratio," or the ratio of the Constituent Entity's GloBE income attributable to the parent entity over the Constituent Entity's total GloBE income. *Id.* Art. 2.2.1 & 2.2.2. The Commentary provides, "Where a subsidiary is wholly owned, the Inclusion Ratio will always be 1 and no additional computations are required." Commentary, Art. 2.2.2, ¶ 29.

³⁴ GloBE Rules, Art. 2.3. "This can occur, for example, where an upper-tier Intermediate Parent Entity has a non-controlling interest in a lower-tier Intermediate Parent Entity, which, in turn, holds all the Ownership Interests in [a Low-Taxed Constituent Entity ('LTCE')]. In this case, both Parent Entities will be required to apply the IIR under Article 2.1.2 in respect of the LTCE." Commentary, Art. 2.3.1, ¶ 38.

³⁵ Stephanie Soong Johnston, *Revised GILTI Would Align With GLOBE Rules, EU Official Says*, 106 TAX NOTES INT'L 1671 (Jun. 27, 2022) (quoting Benjamin Angel, director of direct taxation at the European Commission's Directorate General for Taxation and Customs).

³⁶ GloBE Rules, Art. 2.5.

³⁷ *Id.* Art. 2.6.

³⁸ Commentary, Art. 2.6.1.

³⁹ *Id.* Art. 2.4.1.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² Example 2.6.4-1 in the GloBE Rules Examples illustrates the allocation of the top-up tax for the UTPR. This example references the relevant entities' UTPR percentages "based on the formula under Article 2.6.1," which is based on number of employees and total value of tangible assets in the jurisdiction relative to of employees and total value of tangible assets in all UTPR jurisdictions.

⁴³ OECD, Harmful Tax Competition: An Emerging Global Issue at 8 (1998), www.oecd.org/ctp/harmful/1904176.pdf.

⁴⁴ *Id.* at 15.

⁴⁵ See *id.* at 23.

⁴⁶ See Scott Greenberg & Gavin Eakins, *Tax Policy Helped Create Puerto Rico's Fiscal Crisis*, TAX FOUNDATION (Jun. 30, 2015), taxfoundation.org/tax-policy-helped-create-puerto-rico-fiscal-crisis/; Oliver Oldman & Milton Taylor, *Tax Incentives for Economic Growth in the U.S. Virgin Islands*, 10 CARIBBEAN STUDIES 182 (1970), www.jstor.org/stable/25612330.

⁴⁷ OECD/G20 Base Erosion and Profit Shifting Project, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance (2015), www.oecd-ilibrary.org/docserver/9789264241190-en.pdf?expires=1656079788&id=id&accname=oid162118&checksum=7CFE5B43C4E3D771C6D1715F033DC0E4.

⁴⁸ Tax Reform: Tax Havens, Base Erosion and Profit Shifting, Hearing Before the Committee on Ways and Means, U.S. House of Representatives,

One Hundred Thirteenth Congress (Jun. 13, 2013), www.govinfo.gov/content/pkg/CHRG-113hrrg21122/html/CHRG-113hrrg21122.htm.

⁴⁹ OECD Secretary-General Report to the G20 Finance Ministers and Central Bank Governors, Moscow, Russia at 36 (Jul. 19–20, 2013) [hereinafter OECD 2013 Report].

⁵⁰ BEPS Actions, OECD, www.oecd.org/tax/beps/beps-actions/ (emphasis added).

⁵¹ OECD, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5—2015 Final Report (2015), www.oecd-ilibrary.org/docserver/9789264241190-en.pdf?expires=1656542019&id=id&accname=oid162118&checksum=D6FBDFF2ECA71CC150F78A2D3C498E02.

⁵² See, e.g., OECD/G20 Base Erosion and Profit Shifting Project, Harmful Tax Practices—2018 Progress Report on Preferential Regimes (2019) [hereinafter 2018 Progress Report on Preferential Regimes], www.oecd-ilibrary.org/docserver/9789264311480-en.pdf?expires=1656542470&id=id&accname=guest&checksum=AFEB9E8197A2B2289297477162288025; OECD/G20 Base Erosion and Profit Shifting Project, Harmful Tax Practices—2020 Peer Review Reports on the Exchange of Information on Tax Rulings (2021), www.oecd-ilibrary.org/docserver/f376127b-en.pdf?expires=1656542918&id=id&accname=oid162118&checksum=1EEC693B93F5964ED61F25B9F4CB5C0E.

⁵³ OECD/G20 Base Erosion and Profit Shifting Project, Addressing the Tax Challenges of the Digital Economy, Action 1: 2014 Deliverable [hereinafter Action 1: 2014 Deliverable], dx.doi.org/10.1787/9789264218789-en.

⁵⁴ Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, OECD, www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm.

⁵⁵ Compare 2018 Progress Report on Preferential Regimes, *supra* note 52, with OECD/G20 Base Erosion and Profit Shifting Project, Harmful Tax Practices—Peer Review Results Update (as of January 2022), www.oecd.org/tax/beps/harmful-tax-practices-consolidated-peer-review-results-on-preferential-regimes.pdf. For example, Malaysia's principal hub regime went from "In the process of being amended; Substantial activities factor addressed; ring-fencing not yet addressed." to "Not harmful (amended); Ring-fencing removed. Substance requirements (non-IP) in place. No grandfathering provided."

⁵⁶ Flyer: OECD/G20 Inclusive Framework on BEPS, OECD, www.oecd.org/tax/beps/flyer-inclusive-framework-on-beps.pdf; What is BEPS?, OECD, www.oecd.org/tax/beps/about/ ("At its inaugural meeting in Kyoto, Japan in June 2016 there were 82 members of the OECD/G20 Inclusive Framework on BEPS. Since then, the membership of the Inclusive Framework has grown to 141 countries and jurisdictions, including 14 observer organisations.").

⁵⁷ Members of the OECD/G20 Inclusive Framework on BEPS, OECD, www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf (last updated Nov. 2021).

⁵⁸ Policy Note, *supra* note 3.

⁵⁹ See OECD/G20 Inclusive Framework on BEPS Progress Report July 2020–September 2021 (2021) (noting that unresolved BEPS issues under Action 1 have been the top priority of the IF); What is BEPS?, *supra* note 56 ("OECD and G20 countries along with developing countries that are participating in the implementation of the BEPS Package and the ongoing development of anti-BEPS international standards are establishing a modern international tax framework to ensure profits are taxed where economic activity and value creation occur").

⁶⁰ Policy Note, *supra* note 3.

⁶¹ The fact that, once BEPS eliminated various stateless income techniques, countries would be forced to compete based on their statutory rate, and that statutory rate competition would then be the focus of concern, was predicted years ago. See, e.g., John D. McDonald, *A Taxing History—Why U.S. Corporate Tax Policy Needs to Come Full Circle and Once Again Reflect the Reality of the Individual as Taxpayer*, 94 TAXES 93 (Mar. 1, 2016) ("In this sense, BEPS just changed the nature of, rather than the fact of, tax competition. Instead of having a 12.5-percent headline statutory rate while tacitly accepting the use of techniques to reduce the effective rate, Ireland will now have a best in class innovation box so that a lower rate can be achieved while recognizing the income onshore. Expect a similar pattern in other countries. Tax competition will be shifted from off-label to on-label with countries incentivized to compete more explicitly by either lowering their rates, or expanding the scope of income they exempt ... As these competitive pressures become more pronounced, there will likely be a subsequent spasm of activity under a different acronym. Predictably, some quarters are already suggesting that BEPS does not go far enough. This article argues there is a better way forward, however, and the answer lies in focusing on the Shareholder as taxpayer.") (emphasis added) (citations omitted).

⁶² Although the Commentary makes it clear that the precise modality is up to the local jurisdictions imposing the tax, it specifically identifies denial of deduction as a mechanism to mechanically impose the tax. Commentary, Art. 2.4.1, ¶ 43 ("Article 2.4.1 provides that the Constituent Entities of a MNE Group shall be denied a deduction for otherwise deductible expenses (or be subject to an equivalent adjustment under domestic law) in an amount sufficient to result in the Constituent Entities located in the UTPR Jurisdiction having an additional cash tax expense equal to the UTPR Top-up Tax Amount allocated to that jurisdiction. The timing of the UTPR adjustment is addressed in Article 2.4.2."); *id.* Art. 2.4.1, ¶ 47 ("For example, the adjustment under the UTPR could take the form of an additional Tax levied directly on a resident taxpayer in an amount equal to the allocated UTPR Top-up Tax Amount. Alternatively, a jurisdiction could include an additional amount of deemed income representing a reversal of deductible

expenses incurred in current or prior period or a jurisdiction could choose to reduce an allowance or deemed deduction to reflect an allocation of Top-up Tax.”)

⁶³ See *id.* Art. 2.4.1, ¶ 53 (“Article 2.4.1 does not require that the additional cash tax expense is paid by the same Constituent Entities as those that were denied a deduction (or required to make an equivalent adjustment). For instance, the UTPR Jurisdiction may deny a deduction to (or impose an equivalent adjustment on) a Tax Transparent Entity, the effect of which flows through to the owners. In this case, the additional cash tax expense collected by the UTPR Jurisdiction may be levied or borne by the owners of the Tax Transparent Entity itself. As such, this additional cash tax expense may be taken into account for the purposes of assessing whether the adjustment has resulted in an additional cash tax expense that is equal to the UTPR Top-up Tax Amount.”)

⁶⁴ OECD 60th Anniversary, OECD, www.oecd.org/60-years/.

⁶⁵ This fact has not gone unnoticed. See African Tax Administration Forum, *130 Inclusive Framework Countries and Jurisdictions Join a New Two-Pillar Plan to Reform International Taxation Rules – What Does This Mean for Africa?* (Jul. 1, 2021).

⁶⁶ Commentary, *supra* note 4, at 9 (“The IIR incorporates a top-down approach which ensures priority in the application of the IIR is given to the Parent Entity at the highest point in the ownership chain. Under this approach, an Intermediate Parent Entity shall not apply the IIR where it is controlled by another parent entity further up the ownership chain that is subject to a Qualified IIR.”); *id.* Art. 2.1.3, ¶ 19 (“Article 2.1.3(b) regulates the ‘top-down approach’ where two or more Intermediate Parent Entities are required to apply the IIR to the same LTCE. It prevents the application of the IIR at the level of an Intermediate Parent Entity when the Controlling Interests of such Entity are held directly or indirectly by another Intermediate Parent Entity which is required to apply a Qualified IIR.”)

⁶⁷ Action 1: 2014 Deliverable, *supra* note 53.

⁶⁸ Options for Low Income Countries’ Effective and Efficient Use of Tax Incentives for Investment: A Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank (2015), www.imf.org/external/np/g20/pdf/101515.pdf.

⁶⁹ *Id.* at 8 (“FDI inflows, for instance, are believed to not only bring capital and (high-wage) jobs to a country, but can also spur competition and increase the efficiency of domestic markets more widely, thus contributing to a country’s overall economic development.”)

⁷⁰ Greenberg & Eakins, *supra* note 46.

⁷¹ *Id.*

⁷² See Members of the OECD/G20 Inclusive Framework on BEPS, *supra* note 57.

⁷³ Our Principles, MIDA, www.mida.gov.my/about-mida/our-principles/.

⁷⁴ 2021 Malaysia Investment Performance Report, MIDA, www.mida.gov.my/wp-content/uploads/2022/03/MIDA-IPR-2021-1.pdf.

⁷⁵ Mortality Rate, Infant (per 1,000 Live Births)—Malaysia, World Bank, data.worldbank.org/indicator/SP.DYN.IMRT.IN?locations=MY.

⁷⁶ GDP per Capita (current US\$)—Malaysia, World Bank, data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=MY.

⁷⁷ Literacy Rate, Adult Total (% of people ages 15 and above)—Malaysia, World Bank, data.worldbank.org/indicator/SE.ADT.LITR.ZS?locations=MY.

⁷⁸ Incentives & Schemes for Businesses, EDB, www.edb.gov.sg/en/how-we-help/incentives-and-schemes.html (last updated June 9, 2022).

⁷⁹ EDB Year 2021 in Review, EDB (Jan. 26, 2022), www.edb.gov.sg/en/about-edb/media-releases-publications/edb-year-2021-in-review.html.

⁸⁰ See EDB Singapore, Annual Report 2020–2021, www.edb.gov.sg/en/about-edb/media-releases-publications.html?tab=annual-reports.

⁸¹ Mortality Rate, Infant (per 1,000 Live Births)—Singapore, World Bank, data.worldbank.org/indicator/SP.DYN.IMRT.IN?locations=SG.

⁸² GDP per Capita (current US\$)—Singapore, World Bank, data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=SG; see also Nafis Alam, *How Lee Kuan Yew Transformed Singapore*, WORLD ECONOMIC FORUM (Mar. 23, 2015), www.weforum.org/agenda/2015/03/how-lee-kuan-yew-transformed-singapore/.

⁸³ SingStat Table Builder, Indicators on Education and Literacy, Dep’t of Statistics, Singapore, tablebuilder.singstat.gov.sg/table/TS/JM850001.

⁸⁴ See, e.g., Johannes Candra, *Reimagining Singapore’s Incentive Schemes: What’s Next?*, EY (May 31, 2022), www.ey.com/en_sg/you-and-the-taxman/reimagining-singapore-s-incentive-schemes-what-s-next.

⁸⁵ Victor Balogun, *Why Nigeria Didn’t Endorse OECD Two-Pillar Solution On Tax—FIRS*, INDEPENDENT (May 23, 2022), independent.ng/why-nigeria-didnt-endorse-oecd-two-pillar-solution-on-tax-firs/.

⁸⁶ It is the case that the OECD has sometimes found it challenging to reach the level of consensus required to finalize its proposals, and that challenge increases when the group that needed to reach consensus was expanded to include the IF. That challenge may be even greater in the current environment due to the political tension the war in Ukraine created and the fact that many nations currently have very high inflation and fear that they may be slipping into a recession. The EU requires unanimity to enact tax proposals, and jurisdictions are voicing their concerns. Poland vetoed the EU measure adopting Pillar II in April 2022, and then engaged in months of negotiations and concessions leading up to the June 17 vote. A few days prior to the vote, Hungary indicated that it objected to Pillar II. Hungary expressed concerns over the EU’s competitiveness and argued Pillar II should not be approved because of “war inflation and the economic crisis due to the war.” Elodie Lamer, *Hungary Tells EU Ambassadors It Can’t Support Pillar 2*, TAX NOTES (June 16, 2022), www.taxnotes.com/tax-notes-today-international/corporate-taxation/hungary-tells-eu-ambassadors-it-cant-support-pillar-2/2022/06/16/7dktp. Hungary objected to the OECD’s decision to

delay implementing Pillar I. Hungary believes that Pillar I and Pillar II should be linked and argued that moving forward on Pillar II without Pillar I would mean companies creating jobs in Hungary would be taxed immediately. Krisztina Than, *Hungary Flags Objections to EU Implementation of Global Minimum Tax*, REUTERS (Jun. 14, 2022), www.reuters.com/business/hungary-flags-objections-eu-implementation-global-minimum-tax-2022-06-14/.

⁸⁷ The G7 countries are: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. Alex Cobham, *Is Today a Turning Point Against Corporate Tax Abuse?*, TAX JUSTICE NETWORK (June 4, 2021), taxjustice.net/2021/06/04/is-today-a-turning-point-against-corporate-tax-abuse/.

⁸⁸ OECD/G20 Base Erosion and Profit Shifting Project, Addressing the Tax Challenges Arising from the Digitalisation of the Economy (July 2021), www.oecd.org/tax/beps/brochure-addressing-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.

⁸⁹ Sean Bray, *Corporate Tax Rates Around the World, 2021* (2021), files.taxfoundation.org/20211207171421/Corporate-Tax-Rates-around-the-World-2021.pdf.

⁹⁰ See Mindy Herzfeld, *Tax Credits and Incentives Under a Global Minimum Tax Regime*, 106 TAX NOTES INT’L 1605 (June 27, 2022) (“In short, the receipt of nonqualified or nonrefundable credits reduces the amount of covered taxes an entity is considered to have paid and so can result in a group owing a GLOBE top-up tax While Treasury officials have acknowledged those concerns and promised to work with the OECD, they’ve been vague about potential solutions. In May, Lily Batchelder, Treasury assistant secretary for tax policy, said she’s confident that the ‘value of many of our general business credits is preserved under the OECD rules’ and that Treasury has ‘established a process with the OECD for working towards additional clarifications.’ Even so, it’s unclear what that might look like, given Peterson’s remarks that the rules won’t change.”)

⁹¹ Many people “talk” about emigrating from the United States, but they rarely look at how difficult it is to actually gain citizenship somewhere else. See, e.g., Angela Colley, *Serious About Moving to Canada? Here’s How (It’s Not as Easy as You Might Think)*, www.realtor.com/advice/move/how-to-move-to-canada/.

⁹² There was a surge in expatriations when the foreign account tax compliance act (“FATCA”) was enacted. Stories abound about how emotionally difficult it was to give up U.S. citizenship, even for people who had lived abroad for years. Kim Hjelmgaard, *Americans Abroad Find Citizenship Too Taxing to Keep*, www.usatoday.com/story/news/world/2014/03/08/usa-citizens-relinquish-passports-tax-filing/5859371/ (quoting one expatriate as saying she felt like she had gone through a divorce and become physically ill after expatriating); Lorie Konish, *More Americans Are Considering Cutting Their*

Ties with the US—Here's Why, CNBC (June 30, 2018), www.cnbc.com/2018/06/27/more-americans-are-considering-cutting-their-ties-with-the-us-heres.html; Linda Dimyan, *Expatriates Choosing to Leave the US Rather than Pay Taxes*, CNBC (Sept. 12, 2015), www.cnbc.com/2015/09/11/expatriates-choosing-to-leave-the-us-rather-than-pay-taxes.html; Tom Geoghegan, *Why Are Americans Giving Up Their Citizenship?*, BBC (Sept. 27, 2013), www.bbc.com/news/magazine-24135021 (“Bridget, who asked the BBC not to use her real name, gave up her US citizenship in 2011, 32 years after leaving for a new life in Scandinavia. This has nothing to do with avoiding taxes. I was never in danger of having to pay taxes in the US since I pay more here. The issue for me was that it was becoming harder and harder to follow the tax code and comply. It was difficult already but when I knew Fatma was coming, I thought, Do I want to go through with it anymore?”); Siri Srinivas, *I Was Terrified We'd Lose All Our Money: Banks Tell US Customers They Won't Work with Americans*, GUARDIAN (Sept. 24, 2014), www.theguardian.com/money/2014/sep/24/americans-chased-by-irs-give-up-citizenship-after-being-forced-out-of-bank-accounts.

⁹³ Hearings Before the House Committee on Ways and Means, 80th Cong., 1st Sess. Part 2, at 1136 (Jul. 1, 1947).

⁹⁴ A key difference between a broad-based DPD and these regimes is, of course, that RICs and REITs are required to distribute a fixed percent of their profits each year to maintain their status.

⁹⁵ Integrating the Corporate and Individual Tax Systems: The Dividends Paid Deduction Considered, Hearing Before the Senate Committee on Finance, 114th Cong., 2d Sess. (May 17, 2016), www.finance.senate.gov/hearings/integrating-the-corporate-and-individual-tax-systems-the-dividends-paid-deduction-considered; Debt versus Equity: Corporate Integration Considerations, Hearing Before the Senate Committee on Finance, 114th Cong., 2d Sess. (May 24, 2016), www.finance.senate.gov/hearings/debt-versus-equity-corporate-integration-considerations; see also Senate Committee on Finance, Republican Staff, Staff Report on Comprehensive Tax Reform for 2015 and Beyond, S. Rep. No. 113-31, Dec. 2014, at 198-199.

⁹⁶ Mindy Herzfeld, *A Post-Mortem for the Border Adjustment Tax*, 87 TAX NOTES INT'L 840 (Aug. 28, 2017).

⁹⁷ Alexandra Minkovich, *Corporate Integration: Chairman Hatch's Straightforward Approach to Tax Reform*, TAX EXECUTIVE (Sep. 30, 2016), taxexecutive.org/corporate-integration-chairman-hatchs-straightforward-approach-to-tax-reform/ (discussing two days of hearings in May 2016); SFC Hearing on Business Tax Reform (Sep. 19, 2017), www.sifma.org/resources/general/sep-19-sfc-hearing-on-business-tax-reform/ (discussing hearing in Sep. 2017).

⁹⁸ See generally Judy A. Miller, *Testimony to Senate Finance Committee on Behalf of the American Retirement Association* (2016).

⁹⁹ Some members also raised concerns about promoting what they described as an incentive to reduce or eliminate retained earnings.

¹⁰⁰ Jane G. Gravelle, Corporate Tax Integration and Tax Reform, Congressional Research Service (Sep. 16, 2016), sgp.fas.org/crs/misc/R44638.pdf; Hatch Opening Statement at Finance Committee Hearing on Business Tax Reform (Sep. 19, 2017), www.finance.senate.gov/chairmans-news/hatch-opening-statement-at-finance-committee-hearing-on-business-tax-reform; Alexandra Minkovich et al., *Time for Tax Reform?*, BAKER MCKENZIE NEWSLETTER (Oct. 2017), f.datasrv.com/fr1/019/21997/Tax_News_and_Developments_-_October_2017.pdf; Asha Glover et al., *Senate GOP Tax Reform Plan Increases Brackets, Keeps Credits*, TAX NOTES (Nov. 20, 2017), www.taxnotes.com/taxpractice/tax-reform/senate-gop-tax-reform-plan-increases-brackets-keeps-credits/2017/11/20/1x9tv (“While corporate integration is not addressed in the Senate bill, Finance Committee Chair Orrin G. Hatch, R-Utah, is still considering it, an aide said. ‘It’s still a possibility; it’s a priority for him. But I will tell you that bringing the rate down to 20 percent takes some pressure off of that issue We’re going to assess that as we move forward,’ the aide said.”); Andrew Velarde, *Can Corporate Integration Jump From Understudy to Center Stage?*, TAX NOTES (Sep. 5, 2017), www.taxnotes.com/tax-notes-today-federal/tax-reform/can-corporate-integration-jump-understudy-center-stage/2017/09/05/1wbbh (“Now that we’re in a situation where the border adjustment [tax] has been declared dead, we’re back to the original problem of how do you craft rules that address base erosion but don’t disadvantage U.S. companies,” Peter Merrill of PwC said. “While we were debating this a couple of years ago, a number of us had the idea that maybe corporate integration would be a twofor: Corporate integration would address both the disparity between corporate and noncorporate business, and at the same time it would address base erosion.”); Comprehensive Tax Reform for 2015 and Beyond, Report by Republican Staff Committee on Finance, U.S. Senate (2014), [www.finance.senate.gov/imo/media/doc/Comprehensive%20Tax%20Reform%20for%202015%20and%20Beyond%20\(C\).pdf](http://www.finance.senate.gov/imo/media/doc/Comprehensive%20Tax%20Reform%20for%202015%20and%20Beyond%20(C).pdf) (2014 report in which Senator Hatch first discussed corporate integration).

¹⁰¹ Note Chairman Hatch filed a placeholder amendment for a DPD during the markup. Hatch Amendment #1 to Chairman’s Mark of “Tax Cuts and Jobs Act,” www.finance.senate.gov/imo/media/doc/Master%20Tax%20Amendments.pdf.

¹⁰² Christopher H. Hanna, *Corporate Tax Integration: Past, Present, and Future*, 75 TAX LAW. 307, 334-336 (2022) (“In any business tax reform proposal, there are generally three documents of critical importance to policymakers. First, is the JCT revenue estimate of the business tax reform proposal A second document of critical importance is the JCT analysis of the distribution of the tax burden The third document of critical importance to policymakers is

the JCT macroeconomic analysis of the proposal Corporate integration, structured as a dividends-paid deduction, can be revenue neutral and distributionally neutral, as well as increasing economic growth, increasing business capital investment, and increasing (very slightly) private sector employment. As a result, it is one of the few business tax reform proposals that can positively hit all the economic parameters.”).

¹⁰³ Commentary, Art. 7.2, ¶ 34 (emphasis added).

¹⁰⁴ Importantly, Article 7.2(b) addresses situations where the owners are resident in the parent entity’s jurisdiction (i.e., the United States) and own 5% or less of the entity’s stock. Multinational corporations can presumably rely on SEC Schedule 13D filings to conclude who is (and who is not) a 5% shareholder. In terms of determining their residence, the Commentary states, “The UPE may use reasonable means of determining whether its owners are tax resident in the jurisdiction. For example, a UPE in a jurisdiction that imposes a withholding tax on the profits or distributions from the UPE with respect to foreign owners of the UPE may rely on an owner’s representation as to whether it is exempt from a withholding tax or eligible for a lower withholding tax rate based on a Tax Treaty.” Commentary, Art. 7.1.1, ¶ 17.

¹⁰⁵ The issue would be whether the DPD is somehow considered a tax benefit that causes the IIR to cease to be compliant. Interestingly, the Commentary states, “A tax benefit or grant provided to all taxpayers is not related to the GloBE Rules. Facts that are relevant but not decisive include whether the tax benefit or grant benefits only taxpayers subject to the GloBE Rules, whether the benefit is marketed as part of the GloBE Rules and if the regime was introduced after the OECD/G20 Inclusive Framework started discussing the GloBE Rules.” Commentary, Art. 10.1, ¶ 126 (emphasis added). The other issue that has to be considered is what will happen to dividends payable to tax-exempt non-pension accounts like individual retirement accounts and 401ks. If a final withholding tax is imposed on payments to those accounts above 15%, then, presumably the requirement that the shareholders be subject to a minimum rate would be satisfied.

¹⁰⁶ The profits of lower-tier foreign Constituent Entities, however, will not be protected unless the parent jurisdiction enacts a Pillar II compliant IIR.

¹⁰⁷ Republican Study Committee, RSC Releases FY2023 Budget, “Blueprint to Save America” 26 (2022), banks.house.gov/uploadedfiles/fy23_budget_final_copy.pdf (“The RSC Budget would encourage the integration of corporate profits into individual income taxes to avoid double taxation. This could be achieved by allowing corporations to deduct dividends paid from their taxable income, but subjecting income received through dividends to ordinary individual income taxes and not long-term capital gains taxes.”).

¹⁰⁸ See, e.g., Anthony P. Polito, *Corporate Tax Integration and the TCJA: How Near the Mark?*, 74 TAX LAWYER 267 (2021) (discussing how the combination of a lower corporate rate and a lower rate of tax on qualifying dividends may or may not approximate a theoretical comparison of corporate flow-through taxation).

¹⁰⁹ David M. Schizer, *Between Scylla and Charybdis: Taxing Corporations or Shareholders (or Both)*, 116 COLUM. L. REV. 1849 (2016), columbialawreview.org/wp-content/uploads/2016/11/November-2016-10-Schizer.pdf. Stephen J. Entin, *Labor Bears Much of the Cost of the Corporate Tax*, TAX FOUNDATION (Oct. 24, 2017), taxfoundation.org/labor-bears-corporate-tax/; Paul Krugman, *Opinion, Tax Cuts and Leprechauns (Wonkish)*, NY TIMES (Jun. 15, 2018), www.nytimes.com/2018/06/15/opinion/tax-cuts-and-leprechauns-wonkish.html (“So cutting the tax rate, according to this story, will bring in lots of capital from abroad. This will drive the rate of return down and wages up, so that in the long run the benefits of the tax cut will flow to workers rather than shareholders. Even if this story were right, long run effects aren’t the whole story for policy—in the long run, we are all dead, and meanwhile capital owners have a chance to take the money and run. So even if the eventual effect of the tax cut were to raise wages, there might well be years, even decades, when a tax cut for corporations is mainly a tax cut for wealthy shareholders.”).

¹¹⁰ The fact that the DPD would reduce Congress’s ability to directly incentivize corporate behavior appeared to be one of the fundamental objections raised by lawmakers during the hearings on the DPD. John D. McDonald, *Hatch’s Integration Plan: Trojan Horse or Reasonable Alternative?*, 152 TAX NOTES 1585 (Sep. 12, 2016) (“One answer may have revealed itself in the May 24 Senate hearing on corporate integration. During that hearing, it became clear that

the chief concern of some of the senators was that the DPD would reduce Congress’s ability to influence corporate behavior. Specifically if corporations could reduce or eliminate their corporate tax by paying a dividend distribution, there would be less need for corporations to invest in projects that generate, for example, rehabilitation credits and renewable energy credits.

Yet, creating a system that incentivizes corporate managers to hoard cash so that Congress can pass tax credits and incentives to influence how that cash is spent appears to be bad tax and social policy on its face. Moreover, as Hatch noted at the May 24 hearing, the money that corporations pay to their shareholders does not disappear. It does not evaporate. It will be used by investors for consumption or alternative investments that Congress can incentivize if it chooses to. If Congress is intent on favoring specific social policies through the code, nothing prevents Congress from tailoring those tax breaks to individual investors.”).

¹¹¹ William McBride, *Federal Corporate Tax Revenue and All Federal Tax Collections Headed for Another Record High*, TAX FOUNDATION (Apr. 13, 2022), taxfoundation.org/corporate-tax-revenue-federal-tax-collections/.

¹¹² A number of these issues were discussed in the lead-up to the Senate Finance Committee Hearings on the DPD and during the hearings. See McDonald, *supra* note 110.

¹¹³ William Hoke, *EU to Propose Withholding Tax Procedures in First Half of 2023*, 106 TAX NOTES INT’L 1300 (Jun. 6, 2022).

¹¹⁴ See generally Hanna, *supra* note 102, at 327 (noting that a dividends paid deduction should give rise to a “permanent” tax benefit in the U.S. GAAP financial statements). The impact on incentives was a focus of some of the witnesses at the Hatch hearings. See, e.g., McDonald, *supra* note 110.

¹¹⁵ According to one U.S. Treasury official, options that the IF is consideration include a multistate treaty that will set implementation standards the GloBE Rules. Hamza Ali, *Countries Mull Dispute Resolution Options for Global Minimum Tax*, BLOOMBERG TAX (June 28, 2022), www.bloomberglaw.com/product/tax/bloombergtaxnews/daily-tax-report/BNA%200000181-abde-d5c5-a9ab-abdf54570001?bwid=00000181-abde-d5c5-a9ab-abdf54570001 (“We are looking at ways to try and resolve disputes through existing treaties and a potential multilateral convention,” Michael Plowgian, counselor at the U.S. Treasury’s Office of Tax Policy, said at a conference in Washington hosted by the US Council for International Business and the OECD.).

¹¹⁶ Johnston, *supra* note 35.

¹¹⁷ Jinyan Li, *The Pillar 2 Undertaxed Payments Rule Departs From International Consensus and Tax Treaties*, 103 TAX NOTES STATES 1283 (Mar. 21, 2022).

¹¹⁸ See e.g., Balazs Orban, *The Worst Time for a Global Minimum Tax*, WALL ST. J. (June 21, 2022), www.wsj.com/articles/hungary-global-minimum-tax-european-union-european-commission-competition-economic-crisis-investment-big-tech-fair-share-11655839990?mod=opinion_major_pos6 (WSJ Op-Ed by member of Hungarian Parliament).

¹¹⁹ Cobham, *supra* note 6 (“We are working with G20 nations to agree to a global minimum corporate tax rate that can stop the race to the bottom. Together we can use a global minimum tax to make sure the global economy thrives based on a more level playing field in the taxation of multinational corporations, and spurs innovation, growth, and prosperity.”).

¹²⁰ This competition plays out every day in the United States between the various states. Some believe this enhances U.S. well-being while others believe it starves some of the states of needed revenue. The same division of opinion prevails at the international level.

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