Michigan Journal of International Law

Volume 43 | Issue 3

2022

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Recommended Citation

Reuven Avi-Yonah & Young R. Kim, *Tax Harmony: The Promise and Pitfalls of the Global Minimum Tax*, 43 MICH. J. INT'L L. 505 (2022).
Available at: https://repository.law.umich.edu/mjil/vol43/iss3/2

https://doi.org/10.36642/mjil.43.3.tax

TAX HARMONY: THE PROMISE AND PITFALLS OF THE GLOBAL MINIMUM TAX

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ABSTRACT

The rise of globalization has become a double-edged sword for countries seeking to implement a beneficial tax policy. On one hand, there are increased opportunities for attracting foreign capital and the benefits that increased jobs and tax revenue brings to a society. However, there is also much more tax competition among countries to attract foreign capital and investment. As tax competition has grown, effective corporate tax rates have continued to be cut, creating a "race-to-the-bottom" issue.

In 2021, 137 countries forming the OECD/G20 Inclusive Framework on BEPS passed a major milestone in reforming international tax by successfully introducing the framework of a global minimum corporate tax, known as Pillar Two. It aims to set a floor for corporate tax rates with various corrective measures so that multinational enterprises' income will be taxed once in either source country or residence country at a substantive tax rate. Hence, Pillar Two is the first implementation of the "single tax principle" at the global level. Because Pillar Two requires an unprecedented amount of coordination among countries, it is important to understand Pillar Two thoroughly so that countries can maneuver the challenges of implementation, while still enjoying the ultimate benefit that would come from this global tax harmony.

This Article analyzes the issues of tax competition and why most countries in the world have come to the conclusion that a global minimum tax is needed. This Article explains the single tax principle as the theoretical underpinning of Pillar Two, breaks down the principles and policies that comprise Pillar Two, and anticipates

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what promise and pitfalls passage of the global minimum tax will bring. Because the basis of Pillar Two is a direct extension of the Global Intangible Low Tax Income (GILTI) and Base Erosion and Anti-Abuse Tax (BEAT) provisions of the Tax Cuts and Jobs Act, it is reasonable to anticipate that the global minimum tax will be considered a success if it is implemented by all the G20 countries.

INTRODUCTION

On October 8, 2021, 136 countries signed the Organisation for Economic Co-operation and Development ("OECD") Base Erosion and Profit Shifting ("BEPS") statement ("the Statement"), which embodies the farthest-reaching revolution in international taxation since the 1920s.[1] The Statement marks the beginning of a new international tax regime for the twenty-first century. Fit for a modern, digital, globalized world, the Statement embraces the ideal of corporate tax harmonization to combat the race to the bottom that has dominated international taxation since the advent of globalization in the 1980s.[2]

This article will discuss the promises and pitfalls of the new international tax regime, as embodied in Pillar Two of the Statement. The Statement envisages this regime as built on two pillars.[3] Pillar One is focused on expanding source country taxing rights on the income of large multinational enterprises. In particular, it targets digital companies such as Facebook or Google that are able to extract profits from a source jurisdiction without a physical presence.[4] We address Pillar One in a companion article, thus we will not engage with it here.[5]

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1. *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, ORG. FOR ECON. COOP. & DEV. ["OECD"] (Oct. 8, 2021), http://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf [hereinafter, *Statement*]. At first, 136 jurisdictions out of the 140 members of the OECD/G20 Inclusive Framework on BEPS joined the deal, the G20 finance ministers approved the agreement on October 13, 2021, and the G20 leaders approved on October 31, 2021. *G20 Leaders Confirm Commitment to Global Tax Changes Under BEPS 2.0*, EY TAX NEWS UPDATE (Nov. 2, 2021), http://taxnews.ey.com/news/2021-1991-g20-leaders-confirm-commitment-to-global-tax-changes-under-beps-20. As of November 4, 2021, 137 countries and jurisdictions joined a new two-pillar plan. *OECD: BEPS, Inclusive Framework on Base Erosion and Profit Sharing*, OECD, http://www.oecd.org/tax/beps/ (last visited Mar. 11, 2021).

2. The race to the bottom is a term to describe tax competition. This Article uses the two terms interchangeably depending on the context.

3. *Statement*, *supra* note 1.

4. *See* Reuven Avi-Yonah, Young Ran (Christine) Kim & Karen Sam, *A New Framework for Digital Taxation*, 63 HARV. INT'L L.J. (forthcoming 2022).

5. *See id.*

This article will discuss the circumstances that led to more than 130 jurisdictions around the world agreeing to implement the global minimum tax and the single tax principle of Pillar Two. The double-edged sword of globalization and tax competition created difficulties for many countries, as they were being increasingly squeezed by multinational enterprises to provide lower corporate tax rates and tax holidays as conditions for receiving foreign investment. While increased foreign direct investment ("FDI") can create higher-paying job opportunities, economic growth, and the societal benefits of an increased tax base, these benefits are greatly diminished when the country needs to offer exceedingly low tax rates or tax holiday enticements to secure the FDI.[6] As tax competition has grown, global effective corporate tax rates have continued to be cut, creating a "race-to-the-bottom" where the tax rate needed to attract foreign investment is so low that there is almost no net benefit to the society securing the foreign capital.

Countries can address this problem by closing off their trade borders or by making cutbacks to their social safety net.[7] However, the better solution is to limit tax competition.[8] Pillar Two aims to address the issue of "race-to-the-bottom" tax competition and achieve tax harmonization through the adoption of a global minimum tax. Multinational enterprises that meet the €750 million Euro revenue threshold—regardless of which jurisdiction they are headquartered in or operate from—will be subject to a global minimum tax.[9] But the way this new regime works is quite complex, because multinational enterprises' income involves at least two countries—the source country where income is generated, and the residence country where investors are located.

As an example, consider that Orange, a hypothetical U.S. multinational enterprise, has a subsidiary corporation in Ireland.[10] The Irish subsidiary's income from its trade or business is considered active income, and Ireland (the source country) has primary jurisdiction to tax that income under the benefits principle.[11] Ideally, Ireland will tax the income at a substantive tax

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6. OPTIONS FOR LOW INCOME COUNTRIES' EFFECTIVE AND EFFICIENT USE OF TAX INCENTIVES FOR INVESTMENT, INT'L MONETARY FUND ["IMF"] (2015), http://www.imf.org/external/np/g20/pdf/101515.pdf.

7. *See infra* Part I.

8. *See id*.

9. *Statement*, *supra* note 1, at 4. Such a revenue threshold will be determined under Base Erosion and Profit Shifting ("BEPS") Action 13 (country by country reporting), and a tax base will be determined by reference to financial accounting income.

10. This hypothetical example is similar to Apple Inc.'s structure, which has been criticized for avoiding taxes through its Irish subsidiaries. *See, e.g.*, Simon Bowers, *Apple's Cash Mountain, How It Avoids Tax, and the Irish Link*, THE IRISH TIMES (Nov. 6, 2017), http://www.irishtimes.com/business/apple-s-cash-mountain-how-it-avoids-tax-and-the-irish-link-1.3281734.

11. Under the benefits principle, active income from trade or business is primarily assigned to the source country's tax jurisdiction (and the residence country has secondary jurisdiction), while passive income, such as dividends, interest, and royalty, is primarily assigned

rate. However, with the large negotiating power of massive multinational enterprises, source countries do not always tax them at substantive rates. Under Pillar Two's global minimum tax, if the Irish subsidiary's income is taxed below the agreed minimum tax rate of fifteen percent in Ireland (the source country), then the parent entity in the United States (the residence country) is required to include such under-taxed income in its U.S. tax base and pay the difference in additional taxes to the United States. If the United States (the residence country) has not enacted Pillar Two's income inclusion rule as a corrective measure, then the Irish subsidiary's tax deduction in Ireland (the source country) would be denied. Alternatively, an equivalent adjustment would be made to the extent that the low-tax income of the Irish subsidiary is not subject to minimum tax under an income inclusion rule.

As illustrated in the example, the mechanics of Pillar Two can be quite complicated. However, the objective of Pillar Two is clear: to implement the goal of the single tax principle (that is, "full taxation") in international tax, thereby solving the problems created by the tax competition prevalent in the twentieth century.[12] The single tax principle requires multinational enterprises' income to be subject to taxation *once*. By doing so, it prevents both double taxation and double non-taxation. However, there are nuances to the single tax principle. First, the country (residence or source country) that can exercise primary tax jurisdiction is determined based on whether income is active or passive according to the benefits principle.[13] With active income, the source country has primary tax jurisdiction, and the residence country has secondary jurisdiction. If taxation by the source country is substantial, the residence country will yield its secondary taxing right by allowing a foreign tax credit to prevent double taxation.[14] On the other hand, if the first taxation is nominal (below the minimum rate), it is not considered to have satisfied the imposition of a "single tax," and thus corrective rules by the secondary tax jurisdiction should apply to prevent double non-taxation. Thus, the single tax principle suggests that all income of multina-

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the residence country's tax jurisdiction (and the source country has secondary jurisdiction). This principle is a product of the compromise among nations in 1923, driven by four economists in the League of Nations. *See infra* Part II.A; Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1305 (1996).

12. The single tax principle provides that corporate profits should be subject to a minimum tax and that if the country with the primary right to tax such income (source or residence) does not impose tax at the minimum level, the other country involved should tax it. For a discussion of the single tax principle, *see e.g., infra* Part II.A.; Reuven S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy*, 59 N.Y.L. SCH. L. REV. 305 (2015) [hereinafter, *Single Tax Principle*]. For full taxation, *see* Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L L. 353 (2020) [hereinafter, *Transformation*].

13. For a discussion of the benefits principle, *see supra* note 11.

14. *See, e.g.*, I.R.C. § 901 (upholding a residence country's obligation to prevent double taxation by unilaterally granting foreign tax credits).

tionals must be taxed *once* at a *substantive tax rate*. Hence, Ruth Mason refers to this principle as "full taxation."[15]

The single tax principle was first conceived of in the early twentieth century as the basis for the foreign tax credit.[16] The United States and other countries began to practically implement the principle in the 1960s and 1970s.[17] However, until recently, it had not been fully integrated into international tax because of fierce tax competition and many unilateral tax policies that are inconsistent with the single tax principle.[18] Many scholars did not believe that reasonable tax harmony could be achieved through the single tax principle, and thus, it had been somewhat controversial.[19] Nonetheless, the OECD BEPS 1.0 Project in the 2010s aspired to achieve the single tax principle through global tax harmonization.[20] Perhaps because of lingering doubts about its feasibility, the project achieved limited success.[21]

The passage of the U.S. Tax Cuts and Jobs Act ("TCJA") of 2017 played a crucial role in establishing the feasibility of the single tax principle. The TCJA adopted two new innovative breakthrough tax mechanisms: the Global Intangible Low Tax Income ("GILTI") rule for residence taxation and the Base Erosion Anti-Abuse Tax ("BEAT") rule for source taxation.[22] These two rules showed how the single tax principle can be achieved unilaterally to combat base erosion and profit shifting by U.S. multinational enterprises. The success of the TCJA also demonstrated conceptually that there are ways to stop tax competition if the Group of Twenty ("G20") countries implement the single tax principle fully with proper corrective measures.[23]

Building upon those previous efforts, Pillar Two implements the single tax principle globally for the first time by introducing a global minimum tax rate of fifteen percent, and various corrective measures, such as the Income Inclusion Rule ("IIR") for residence taxation, and the Undertaxed Payment Rule ("UTPR") (denial of deduction) and Subject To Tax Rule ("STTR")

15. *Transformation*, *supra* note 12, at 22, 25.

16. *See infra* Part II.A.1.

17. *See id.*

18. *See id.*

19. *See infra* Part II.A.2.

20. *See infra* Part II.B.

21. *See, e.g.*, Mindy Herzfeld, *The Case Against BEPS: Lessons for Tax Coordination*, 21 FL. TAX REV. 1 (2017).

22. The Global Intangible Low Tax Income ("GILTI") rule imposed the U.S. tax as residence taxation on certain foreign subsidiaries' income from intangible assets, and Base Erosion Anti-Abuse Tax ("BEAT") denies deductions in the U.S. as source taxation if the deductible payments are unlikely to be subject to residence-based taxation. I.R.C. §§ 951A, 59A. *See infra* Part II.C.

23. *See* Lilian V. Faulhaber, *Taxing Tech: The Future of Digital Taxation*, 39 VA. TAX REV. 145, 175 (2019) [hereinafter, *Taxing Tech*].

for source taxation.[24] Unlike Pillar One, which requires changing more than 3,000 tax treaties with the participation of over 130 source jurisdictions, Pillar Two can generally be implemented unilaterally through domestic legislation with no changes to existing tax treaties.[25] More importantly, Pillar Two only requires cooperation by the G20, which are home to over ninety percent of the world's largest multinational enterprises ("MNEs"), because it offers strong corrective measures exercised by residence countries. Pillar Two is therefore more likely to be implemented than Pillar One. Also, the two pillars deal with different problems—Pillar One with physical presence and source taxation and Pillar Two with a global minimum tax and residence taxation—and can conceptually be separated from each other.

The benefits that Pillar Two is expected to bring to the world are significant. At a global minimum tax rate of fifteen percent, approximately $150 billion U.S. dollars in additional global tax revenues will be generated each year.[26] The various corrective measures imposed on both source and residence countries would reduce MNEs' motivation to engage in base erosion and profit shifting, because they would be paying a substantial "single tax" no matter where they are located, or where their profits are attributed.[27]

Despite its promise, there are still some concerns about Pillar Two. The fifteen percent global minimum tax rate is relatively low compared to the average G20 corporate tax rate of about twenty-seven percent.[28] The substance carve-outs in the Statement also raise concerns that Pillar Two may still allow a certain level of tax competition.[29] Also, there are concerns that, because Pillar Two gives the priority to residence taxation (via the IIR) over source taxation (via the UTPR/STTR), it is skewed toward the interests of the G20 countries over those of developing countries.[30] Although there is some truth to this critique, its significance depends on another question: are tax holidays for FDI the result of a careful cost/benefit analysis by source countries, or are tax holidays the result of pressure exerted by the MNEs and the availability of other potential jurisdictions for investment? If the answer is the latter, the critique is less convincing because the tax competition problem can be solved by the IIR and residence taxation, which neutralize the multinationals' incentive to shop around the source countries for lower tax rates.

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24. *See infra* Part III.A.

25. *See infra* Part IV.B.3.

26. *See infra* Part IV.A.1.

27. *See infra* Part IV.A.2.

28. *BEPS Monitoring Group Comments on the Model Rules for a Global Anti-Base-Erosion Minimum Corporate Tax*, 105 TAX NOTES INT'L 1421 (Mar. 21, 2022); Elke Asen, *Corporate Tax Rates Around the World, 2020*, TAX FOUND. (Dec. 9, 2020), http://taxfoundation.org/publications/corporate-tax-rates-around-the-world/. The average corporate tax rate, as of 2020, for the G20 is 26.96 percent.

29. *See infra* Part IV.B.2.

30. *See infra* Part IV.B.1.

This article is one of the first wave of comprehensive scholarly papers to describe Pillar Two of the new international tax regime and to analyze its theoretic underpinnings.[31] Part I defines the tax competition problem Pillar Two was designed to address. Part II presents the existing efforts to resolve tax competition. It discusses the historical origins and development of the single tax principle and explains the TCJA's crucial role in leading to the fruition of Pillar Two. Part III analyzes Pillar Two as a new solution to tax competition. It highlights three rules in the Statement (the IIR, UTPR, and STTR) and introduces the implementation plans by the OECD/G20 and the United States in the Build Back Better ("BBB") Act. Part IV addresses the contribution, benefits, and potential challenges of Pillar Two. It concludes by reflecting on how, in retrospect, Pillar Two fits in with the two principles underlying the century-old regime, namely the benefits principle and the single tax principle.

I. HE PROBLEM OF TAX COMPETITION

The current age of globalization has made countries face the trilemma of balancing (1) FDI-driven job creation and economic growth, (2) economic openness and competition from peers, and (3) securing a social safety net.[32] First, globalization has allowed many countries to utilize FDI to create more and better-paying jobs for their citizens,[33] to generate investment in their economic infrastructure, and to introduce technologies that allow for modernization.[34] The economic growth of Asian countries, such as Singapore, Hong Kong, South Korea, and Taiwan, is believed to have been primarily initiated by the influx of FDI in the 1950s.[35] These countries' econ-

31. *See e.g.,* Jinyan Li, *The Pillar 2 Undertaxed Payments Rule Departs from International Consensus and Tax Treaties*, 105 TAX NOTES INT'L 1401 (Mar. 21, 2022); Chris William Sanchirico, *A Game-Theoretic Analysis of Global Minimum Tax Design* (U of Penn, Inst for Law & Econ Research Paper No. 22-19, 2022); Wei Cui, *New Puzzles in International Tax Agreements*, TAX L. REV. (forthcoming).

32. On the importance of curbing tax competition to maintain democracy and the social safety net under globalization, *see* Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573 (2000) [hereinafter, *Tax Competition*]; Reuven S. Avi-Yonah, *Globalization, Tax Competition and the Fiscal Crisis of the Welfare State: A Twentieth Anniversary Retrospective, in* THINKER, TEACHER, TRAVELER: REIMAGINING INTERNATIONAL TAX, ESSAYS IN HONOR OF H. DAVID ROSENBLOOM 39 (Georg Kofler, Ruth Mason & Alexander Rust eds., 2021).

33. Foreign Direct Investment "is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor." OECD, OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT 17 (4th ed. 2008), http://www.oecd.org/daf/inv/investment-policy/2090148.pdf.

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

35. *See id.* at 163.

omies have since grown and flourished while the economies of other nations who were similarly developing in the 1950s have stalled. Many would attribute such contrast to these Asian countries' ability and success in attracting FDI.[36]

Second, a country that opens up its economy to FDI faces the risks that come with a dependency on foreign capital that may be diverted elsewhere. These risks come from competition from peer countries vying to attract foreign capital to their economy. The epitome of such rivalry is "tax competition," which has been prevalent since the twentieth century.[37] Many developing countries who want to invite FDI to their soil offer a low tax rate to foreign investors, such as overall low corporate tax rates, or tax holidays where foreign investors are exempt from taxation for a predetermined period of time.[38] Such tax competition is harmful to developing countries, which depend on corporate taxes to a much greater extent than developed countries.[39] On average, corporate tax accounts for approximately twenty-four percent of a developing country's tax revenue, and only around eight percent of a developed country's tax revenue.[40] This problem has worsened as developed countries like Ireland have also begun engaging in tax competition, putting even more downward pressure on corporate tax rates. Ireland's current corporate tax rate of 12.5 percent is much lower than the OECD's average corporate tax rate of 23.51 percent.[41] To compete, developing countries may have to drop their rates even lower. Tax competition creates an incentive to continue to lower tax rates or offer other tax incentives to attract more FDI, potentially running these tax rates down to the point where jurisdictions may receive little to no net revenue benefit from the FDI. This "race-to-the-bottom" issue may not be apparent if one only compares statutory tax rates by looking at countries' published tax rate(s) for corporate income, but if one looks at the rate foreign corporations are

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36. *Id.* For different uses of tax incentives for FDI across countries, *see* IMF, *supra* note 6.

37. *See, e.g.*, David Elkins, *The Merits of Tax Competition in a Globalized Economy*, 91 IND. L.J. 3 (2016).

38. Tax holiday refers to a government incentive program that offers a tax reduction or elimination to businesses. *See id.*

39. *See* Ivan O. Ozai, *Tax Competition and the Ethics of Burden Sharing*, 42 FORDHAM INT'L L. J. 61, 68 (2018).

40. Developed countries also have the benefit of their tax revenue from personal income tax typically being three to four times more than their corporate tax revenues. *See* Avi Nov, *The "Bidding War" to Attract Foreign Direct Investment: The Need for a Global Solution*, 25 VA. TAX REV. 835 (2006); Richard Bird, *The Personal Income Tax*, PREM NOTES: TAX POLICY NO. 137, June 2001 at 1; *Revenue Statistics 2021: Initial Impact of COVID-19 on OECD Tax Revenues*, OECD (2021), http://www.oecd-ilibrary.org/sites/6e87f932-en/index.html?itemId=/content/publication/6e87f932-en.

41. Asen, *supra* note 28. Developed countries' engagement in tax competition is especially problematic because they are better able to absorb the negative aspects of creating tax incentives while still gaining all the same benefits.

actually paying—the effective tax rates—it is evident that poorer countries' effective tax rates were basically cut in half from 1996 to 2007.[42]

Third, a country also needs to maintain an adequate social safety net and various welfare programs to protect its low-income population from poverty and hardship. In the United States, the earned income tax credit, child tax credits, and a cash transfer program called Temporary Assistance for Needy Families ("TANF") are examples of this safety net.[43] In Europe, these safety nets can encompass all health care costs, education, and housing. Such large safety nets require significant tax revenue, but countries reducing their corporate tax rates or offering tax holidays in order to retain foreign investors will find maintaining a robust social safety net much more difficult with a revenue stream that is vulnerable to such downward fluctuations.[44]

Therefore, only two sides of the trilemma can be addressed simultaneously. If a country is economically open, it must choose between (1) attracting FDI, which requires tax competition and cuts to the social safety net, and (2) losing FDI by foregoing tax competition and maintaining the social safety net. If tax competition is inevitable in a globalized economy, a country may then either (1) close up its economy, preserve its tax revenue, and forego the benefits of globalization, or (2) open its economy, endure tax competition, and subject the social safety net to potential volatility and cuts even though it serves as a crucial buffer against the downsides of globalization.

In fact, many European countries have reduced social safety net programs following the financial crisis in 2008.[45] The United States retreated from economic openness during the Trump administration.[46] However, neither approach has been praised as a reasonable solution to the trilemma because they are each destructive, requiring some fraction of the economy to sacrifice or be worse off.[47]

Hence, the best solution to this trilemma is finding a way to productively limit tax competition. Stopping destructive tax competition that races to the bottom is a constructive way to solve the trilemma, and every country

42. *See* Laura Abramovsky, Alexander Klem & David Phillips, *Corporate Tax in Developing Countries: Current Trends and Design Issues*, 35 FISCAL STUD. 4 (2014) (providing figure 1 at page 569 outlining trends in corporate income taxes in advanced and developing economies and figure 2 at 570 tracking effective tax rates at different rates of profitability).

43. *See* Earned I.R.C. § 32(a) (Earned Income Tax Credit); I.R.C. § 24(a) (Child Tax Credits); 42 U.S.C. §§601–19 (Temporary Assistance for Needy Families).

44. *See, e.g.*, IMF, *supra* note 6, at 3.

45. *See* Marianne Bitler & Hilary Hoynes, *The More Things Change, the More They Stay the Same? The Safety New and Poverty in the Great Recession.* 34 J. LAB. ECON. S403 (2016).

46. *See* Adam Posen, *The Price of Nostalgia; America's Self-Defeating Economic Retreat*, FOREIGN AFFS. (May 2021), http://www.foreignaffairs.com/articles/united-states/2021-04-20/america-price-nostalgia.

47. *See id.*

involved would benefit. The problem, however, is that source countries hosting FDI cannot curb tax competition unilaterally. If a country declares that it will not engage in tax competition by offering tax incentives, such as tax holidays, to MNEs, then these enterprises will invest elsewhere. For example, when the Philippines declined to give a tax exemption and $15 million USD in tax incentives to General Motors, the FDI was diverted to Thailand.[48] The fundamental problem is that modern MNEs are exceedingly mobile. They can be located in any country with adequate infrastructure and an educated workforce. The geographic location of the investment does not matter since intellectual property can be moved at no cost from one location to another. The need of manufacturing facilities to be regularly updated or retrofitted for new processes or innovations also serves to make moving to new locations less cumbersome.

A common practice of MNEs is to assemble a list of countries that are acceptable in terms of infrastructure and an educated workforce. The MNE then approaches the government of each country and asks what it would receive by way of tax breaks if it invested in the country. If confronted by a refusal to compromise on taxes, the MNE threatens to go elsewhere, and few politicians can resist the pressure of losing the favorable headlines that accompany job creation by a major MNE.[49]

For example, Intel in the 1990s conducted an auction for its new source country, pitting Ireland against Israel, and was able to obtain over $1 billion USD in tax concessions from both countries.[50] More recently, Amazon conducted an auction among U.S. localities to bid to become the locations of its second headquarters, which ended up in the vicinity of Washington D.C., an area not lacking in development.[51]

The problem of tax competition is most acute in developing countries because they depend more on corporate tax revenues than richer countries. The percentage of total revenues from corporate tax in the OECD member states is around seven to eight percent, but in developing countries it is closer to twenty-four percent.[52] Recognizing the negative impact of tax competition on the global economy, the OECD issued the Harmful Tax Competition Report in 1998 to address the problem.[53] However, the problem

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48. Gabriella Stern & Rebecca Blumenstein, *GM May Locate Major Plant in Thailand, Not Philippines*, WALL ST. J. (May 16, 1996), http://www.wsj.com/articles/SB832194544528469500.

49. *See* Avi-Yonah, *Tax Competition, supra* note 32, at 1645–46.

50. *Id.*

51. *See* Reuven Avi-Yonah, Orli Avi-Yonah, Nir Fishbien & Hayian Xu, *Federalizing Tax Justice,* 53 IND. L. REV. 479 (2020).

52. REVENUE STATISTICS BROCHURE INITIAL IMPACT OF COVID-19 ON OECD TAX REVENUES, OECD (2021), http://www.oecd.org/tax/tax-policy/revenue-statistics-highlights-brochure.pdf.

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

remained unaddressed, perhaps because it was unrealistic to expect that developed countries would craft a solution to a problem that more seriously affects developing countries.

Nevertheless, the harm from tax competition is not limited to developing countries. Even the OECD member states suffer from the decline in corporate tax revenues resulting from tax competition because they cannot raise other taxes, which are already quite high.[54] Instead, most OECD members had to implement austerity measures that cut the social safety net in the wake of the financial crisis of 2008, even though they understood the importance of the social safety net for their citizens. For instance, Greece, one of the European Union ("EU") members hardest hit by the financial crisis, was faced with either dramatically raising taxes or drastically curtailing public health spending, and chose to cut spending, which resulted in understaffed and underfunded hospitals and higher copays that drastically impacted vulnerable groups.[55] Similarly, the Netherlands' financial shortfalls necessitated a move to privatize insurance companies while Sweden switched many hospitals and primary health care services over to the private sector in order to cut costs.[56] These cuts of the social safety net were what led to the first BEPS Project of the OECD in 2013–15.[57] This BEPS 1.0 Project was designed to limit tax competition by introducing various measures to prevent tax base erosion and MNEs shifting profits to low-tax jurisdictions.[58]

A major question regarding potential solutions to curbing tax competition is whether they only address artificial profit shifting to low-tax jurisdiction, such as tax havens, or also target real investment shopping around the world. The OECD's Harmful Tax Competition report from 1998 focused on artificial profit shifting to low-tax jurisdictions, as did the BEPS 1.0 Project, which was based on the concept of "value creation."[59] Pillar One of the global tax deal also focuses on artificial profit shifting. Pillar Two, on the other hand, addresses both artificial profit shifting and real investment shifting, although the latter is limited only by the substance carve-out described in Parts III and IV.

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54. REVENUE STATISTICS BROCHURE INITIAL IMPACT OF COVID-19 ON OECD TAX REVENUES, supra note 52, at 9.

55. *See* Elisavet Athanasia Alexiadou, *Health Care Reforms and the Challenge of Inequality From a Human Rights Lens: Lessons From Europe*, 17 IND. HEALTH L. REV. 63 (2020).

56. *Id.* at 74.

57. *See* Reuven Avi-Yonah, *The Great Recession and the International Tax Regime*, KLUWER INT'L TAX BLOG (Apr. 23, 2019), http://kluwertaxblog.com/2019/04/23/the-great-recession-and-the-international-tax-regime.

58. *See* Itai Grinberg, *The New International Tax Diplomacy*, 104 GEO. L.J. 1137 (2016); *Transformation*, *supra* note 12, at 354.

59. *See* Reuven Avi-Yonah, *The OECD Harmful Tax Competition Report: A Retrospective After a Decade*, 34 BROOK. J. INT'L L. 783 (2009).

II. Existing Solutions to Tax Competition

Destructive tax competition would disappear if the international tax regime achieved tax harmony. The difficult part is how to achieve this harmony. Having a uniform tax system across the globe would be the simplest solution, but it is not realistic when each sovereign country has the ability and right to develop their own tax systems. Consequently, an international tax regime should offer a principle and framework that can systematically prevent tax competition if countries agree to participate. This Part introduces the single tax principle that we endorse and examines the existing efforts to combat tax competition prior to the Statement and Pillar Two.

A. *The Single Tax Principle, 1918 – 2015*

The best solution to the problems created by tax competition is the single tax principle, which requires that all income of MNEs be subject to taxation *once*.[60] However, there is nuance to the single tax principle. If the effective tax rate for single taxation was nominal, then it would be an empty solution to resolve tax competition. Thus, to make this principle effective, the single tax principle accompanies a practical principle—that is, that all income of MNEs be taxed once at a *substantive tax rate*, such as the average G20 tax rate (currently around 26.96 percent).[61] If this proposition is not met, corrective rules would need to apply to accomplish the result that MNEs' income be taxed at a substantive rate.

The income of MNEs' cross-border transactions involves more than one country. Thus, the next issue stemming from the single tax principle is which country should have primary jurisdiction to tax such income. The international tax regime answers this question with the benefits principle. The benefits principle was originally developed in 1923,[62] under which: (1) active income from trade or business is primarily assigned to the source country's tax jurisdiction (with the residence country having secondary jurisdiction), and (2) passive income, such as dividends, interest, and royalties, is primarily assigned to the residence country's tax jurisdiction (with the source country having secondary jurisdiction).[63] MNEs' corporate income from their trade or business is considered active income, and thus, is primarily assigned to source countries where such trade or business is conducted and income is generated. Because of the primacy of source taxation for active income under the benefits principle, residence countries of MNEs that

60. *See* Reuven Avi-Yonah, *Who Invented the Single Tax Principle?: An Essay on the History of US Treaty Policy,* 59 N.Y. L. SCH. L. REV. 305 (2015).

61. *See generally* Asen, *supra* note 28. The rate of tax for the single tax principle is the residence country's tax rate for passive income (earned mostly by individuals) and the average G20 source tax rate for active income (earned mostly by corporations).

62. THOMAS S. ADAMS, INTERSTATE AND INTERNATIONAL DOUBLE TAXATION, LECTURES ON TAXATION 101 (Roswell Magill ed., 1932).

63. *Id*.

have secondary tax jurisdiction over such income should grant a foreign tax credit for source taxes.[64]

However, the journey toward achieving the single tax principle encountered challenges. Globalization in the late twentieth century resulted in increased tax competition among source countries, which are mostly developing countries with strong needs to lure FDI. Hence, source-based taxation with a substantive tax rate was difficult to sustain. Furthermore, there are too many source countries to be able to effectively cooperate to curb tax competition.[65]

The single tax principle solves tax competition among source countries by requiring a secondary tax jurisdiction to enforce the single tax principle at a substantive tax rate if source-based taxation is nominal. Such nominal source taxation should not count as a full "once" for the purposes of the single tax principle. Ruth Mason (a Professor of Law and Taxation at the University of Virginia School of Law) refers to this concept as "full taxation."[66] Under the benefits principle, residence countries have secondary tax jurisdiction. If residence countries exercise the secondary tax jurisdiction at a substantial tax rate, the single tax principle can still be accomplished. This is relatively straightforward to accomplish compared to an effort to curb source country tax competition, because over ninety percent of the world's largest multinationals are residents of the G20.[67]

More importantly, if all residence countries exercise "full taxation" power on MNEs' global income, it would eliminate the problem of MNEs shopping source countries by removing the incentive to do so.[68] If an MNE's residence country is going to ensure that the MNE pays its full income tax regardless of the country or tax haven where they claim to have "earned" the income, there will be no economic benefit for MNEs to source country shop.

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64. *See* Mitchell A. Kane, *Strategy and Cooperation in National Response to International Tax Arbitrage*, 53 EMORY L.J. 89 (2004) ("Commitment to a single tax principle is in evidence whenever a country relieves double taxation through a foreign tax credit and will not agree to tax sparing."); *see also* I.R.C. §§ 901, 903.

65. *See* Reuven Avi-Yonah and Haiyan Xu, *Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight*, 6 HARV. BUS. L. REV. 185 (2016).

66. *Transformation*, *supra* note 12, at 22, 25.

67. *Role of the G20*, EUROPEAN COMM'N, http://ec.europa.eu/info/food-farming-fisheries/farming/international-cooperation/international-organisations/g20_en (last visited Mar. 11, 2022); Emmanuel Saez & Gabriel Zucman, *A Wealth Taxation on Corporations' Stock*, G20 INSIGHTS (2021), http://www.g20-insights.org/policy_briefs/a-wealth-tax-on-corporations-stock/ ("Corporations headquartered in the G20 represent over 90% of global corporate equity market value.").

68. *See* Reuven S. Avi-Yonah, *Hanging Together: A Multilateral Approach to Taxing Multinationals*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 137 (2016).

1. The Origins of the Single Tax Principle

The origins of the single tax principle can be traced back to the adoption of the U.S. foreign tax credit in 1918.[69] Double taxation occurs in international tax when a source country and residence country levy tax on the same declared income.[70] Many countries enter into income tax treaties to avoid such double taxation. Under such tax treaties, source countries offer reduced withholding tax rates for aliens' income from domestic sources, whereas residence countries offer tax exemption or credit to foreign-source income.[71] Thomas Adams, the U.S. Treasury advisor who introduced the credit, stated that he rejected the exemption system used by most European countries because it led to double non-taxation.[72]

The same formulation can be found in the commentary to the first model tax treaty, issued under the auspices of the League of Nations in 1927, which states as follows:

> It is highly desirable that States should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international cooperation should prevent certain incomes from escaping taxation altogether. The most elementary and undisputed principles of fiscal justice, therefore, required that the experts should devise a scheme whereby all incomes would be taxed once and only once.[73]

American tax policy began to change in the 1960s under the guidance of Stanley Surrey, the first Assistant Secretary for Tax Policy and the true intellectual father of the single tax principle. Surrey had publicly advocated for the single tax principle in 1957 when he testified in the U.S. Senate against a proposed United States-Pakistan tax treaty that provided for double non-taxation.[74] The treaty was not ratified. Surrey proposed imposing

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69. *See* Avi-Yonah*, supra* note 60.

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

71. *See* CHARLES H. GUSTAFSON, ROBERT J. PERONI & RICHARD CRAWFORD PUGH, TAXATION OF INTERNATIONAL TRANSACTIONS: MATERIALS, TEXT, AND PROBLEMS 63 (4th ed. 2011).

72. ADAMS, *supra* note 62, at 101, 112–13. For example, the first U.S. tax treaty with France in 1932 abolished the United States withholding tax on royalties despite the fact that France would not tax them, thereby creating certain double non-taxation in violation of the single tax principle.

73. *Reports Presented by the Comm. of Technical Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.216M.85 1927 II (1927). The first model tax treaty also included a provision imposing a withholding tax on interest, but provided that it would be refunded if the taxpayer could show that the income was declared to her country of residence.

74. Joseph J. Thorndike, *Stanley Surrey Knew a Thing or Two About Loopholes*, TAX ANALYSTS ARTICLE ARCHIVE ONLINE (Feb. 7, 2013), http://www.taxhistory.org/thp/readings.nsf/ArtWeb/05B6E5635C931F6F85257B160048DD4D?OpenDocument.

U.S. taxation in full on all Controlled Foreign Companies ("CFCs")[75] of U.S. MNEs. Although Subpart F enacted in 1962 only applied the tax in situations where the income was likely to escape source taxation,[76] Surrey achieved his main aim of generally imposing the single tax principle on U.S. MNEs. Surrey also incorporated the single tax principle into U.S. tax treaties (for example, the United States-Luxembourg tax treaty)[77] by making it clear that U.S. withholding taxes would not be reduced unless the income was subject to tax in the residence jurisdiction.[78] This provision was also included in the first U.S. Model Tax Treaty of 1981.[79]

In the same year, however, the United States succumbed to the pressures of globalization and the need to attract foreign investment by enacting the portfolio interest exemption, which abolished the U.S. withholding tax on portfolio interest regardless of whether it was taxed at the source.[80] The rule violated the single tax principle, but also led to massive capital flight into the United States. It is one of the first examples of U.S. tax competition during globalization.[81] Furthermore, in the 1990s, Congress began weakening Subpart F by adopting exceptions, such as for active banking and insurance, even though the income was mobile and not taxed at the source.[82]

The erosion of the single tax principle culminated with the establishment in 1997 of the "check the box" rule, which led to the complete undermining of Subpart F, especially after it was codified in 2006.[83] The "check

75. I.R.C. §§ 957(a), 951, 952; Controlled Foreign Corporations ("CFCs") are foreign corporations in which more than fifty percent of the vote or value is owned by U.S. shareholders who each own ten percent or more of the CFC.

76. I.R.C. §§ 951–65; The Subpart F provisions of the Internal Revenue Code eliminate deferral of U.S. tax on some categories of foreign income by taxing certain U.S. persons currently on their pro rata share of such income earned by their CFCs.

77. Income and Capital Tax Treaty, Lux.-U.S., art. XVI, Dec. 18, 1962, http://www.irs.gov/pub/irs-trty/luxem.pdf.

78. This is the origin of the Subject to Tax Rule ("STTR") in Pillar Two, discussed *infra* Part III.A.2.

79. *Single Tax Principle, supra* note 12; Reuven Avi-Yonah & Gianluca Mazzoni, *Stanley Surrey, the 1981 US Model, and the Single Tax Principle*, 49 INTERTAX 729 (2021). In 1984, the United States terminated its treaties with tax havens such as the Netherlands Antilles because they led to double non taxation in violation of the single tax principle.

80. I.R.C. § 871(h)(3); *see* Marilyn Franson, *Repeal of the Thirty Percent Withholding Tax on Portfolio Interest Paid to Foreign Investors*, 6 NW. J. INT'L L. & BUS. 3 (1984).

81. Reuven Avi-Yonah, *What Goes Around Comes Around: Why the USA is Responsible for Capital Flight (and What It Can Do About It),* 13 HAIFA L. REV. 321 (2019).

82. DAVID R. SICULAR, THE NEW LOOK-THROUGH RULE: W(H)ITHER SUBPART F? (Apr. 23, 2007), http://www.paulweiss.com/media/104725/SubPartF04-May-07.pdf.

83. A business entity may be treated as a pass-through entity (such as partnership or disregarded entity) or a corporation for U.S. income tax purposes. Prior to the entity classification regulations (also known as the "check-the-box"), an entity's tax classification as a corporation or flow-through entity was determined by a multifactor text. However, the check-the-box regulations enacted in 1997 allow an eligible (i.e., not automatically classified as a corpo-

the box" rule enables U.S. MNEs to shift income from both the United States and high-tax foreign countries to tax havens without triggering Subpart F.[84] The result of this erosion and violation of the single tax principle was that, by 2017, U.S. MNEs had amassed more than $3 trillion USD of income in low-tax foreign jurisdictions.[85]

Due to the increasingly intense and competitive nature of tax competition between countries over the past twenty-five years, the first author of this article, Reuven Avi-Yonah, has advocated for the single tax principle as a solution to tax competition since 1997.[86] Income from cross-border transactions should be subject to one-time taxation. However, taxing cross-border income just once also means care should be taken that it should not be *undertaxed*. With this in mind, Avi-Yonah has argued that the appropriate rate of tax for purposes of the single tax principle would be determined by the second principle of international taxation, the benefits principle. That means the active income should be taxed at least at the source tax rate (which tends to be lower than the residence rate), but at no more than the residence rate.

As Part III demonstrates, the underlying idea behind Pillar Two can be traced back to the concept of the single tax principle.[87] Specifically, Pillar Two offers various measures by which residual taxation by the residence (or source) jurisdiction should occur when the tax imposed by the source (or

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ration) entity to elect to be classified as a corporate or a pass-through for U.S. income tax purposes. I.R.C. § 7701; Treas. Reg. § 301.7701-2; *see also* SICULAR, *supra* note 82.

84. *Id*.

85. Richard Phillips, Matt Gardner, Alexandria Robins & Michelle Surka, *Offshore Shell Games 2017*, INST. ON TAX'N & ECON. POL'Y (Oct. 17, 2017), http://itep.org/offshoreshellgames2017.

86. Reuven Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507 (1997) [hereinafter*, Electronic Commerce*]. Avi-Yonah later developed a different normative argument for the single tax principle, basing it for corporate taxation on the need to curb the power of the largest multinationals. *See* Reuven Avi-Yonah, *Corporations, Society and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1202 (2004); Reuven Avi-Yonah, *A New Corporate Tax*, TAX NOTES FED. 653, 654 (2020).

87. This similarity has been noted by other scholars. *See, e.g.*, Elizabeth Gil García, *The Single Tax Principle: Fiction or Reality in a Non-Comprehensive International Tax Regime*? 11 WORLD TAX J. 497 (2019); *Transformation*, *supra* note 12, at 353 ("Because states already faithfully adhered to the no-double-tax norm, growing acceptance of full taxation as a goal of international tax brings states closer to implementing Avi-Yonah's "single-tax principle."); Leopoldo Parada, *Full Taxation: The Single Tax Emperor's New Clothes,* 24 FLA. TAX REV. 729 (2021) (identifying the BEPS 2.0 project (consisting of Pillars One and Two) as a modern approach to the single tax principle)*;* Wolfgang Schoen*, Is There Finally an International Tax System?* in THINKER, TEACHER, TRAVELER: REIMAGINING INTERNATIONAL TAX, ESSAYS IN HONOR OF H. DAVID ROSENBLOOM 475 (Georg Kofler et al. eds., IBFD 2021) ("What can one say about the "single tax principle"? Has it gained the status of a guiding and binding principle of international tax law? Here, it is evident that the BEPS Action Plan adopted Avi-Yonah's findings to a large extent. International taxation – it claims – should ensure that income from cross-border transactions is taxed exactly once – not more, not less.").

residence) jurisdiction falls below a specified level—that is, the global minimum tax rate. Such mechanic embodies the idea of corrective measures to prevent insufficient taxation as argued by the first author of this article in support of the single tax principle.[88]

2. Academic Debate

Scholars and commentators have engaged in a long debate on whether tax harmony or achieving the single tax principle would be possible in the real world. H. David Rosenbloom of New York University, in his famous Tillinghast Lecture in 1998,[89] characterized international tax arbitrage as "the deliberate exploitation of differences in national tax systems."[90] To Rosenbloom, international tax harmony was an unachievable ideal, whereas tax competition and the resulting arbitrage was an inevitable by-product of independent tax policymaking by sovereign states. Thus, preventing mismatches in tax policy "is not and should not be a first-rank policy objective of the United States."[91] Rosenbloom also identified line-drawing problems related to distinguishing impermissible arbitrage from permissible tax planning. Rosenbloom considered "international income" and the "international tax system" to be imaginary, rejected the single tax principle, and thus, argued that there was no principled objection to arbitrage.[92]

Academics, including the first author of this article, responded to Rosenbloom's critique by clarifying the policy concerns raised by international tax competition and tax arbitrage and further detailing the efficiencies and benefits of the single tax principle.[93] Adam Rosenzweig[94] and Diane Ring[95]

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88. *Electronic Commerce, supra* note 86, at 517.

89. H. David Rosenbloom, *The David R. Tillinghast Lecture International Tax Arbitrage and the "International Tax System"*, 53 TAX L. REV. 137, 137 (2000) [hereinafter, *Arbitrage*]; Reuven Avi-Yonah, *Commentary on Rosenbloom*, 53 TAX L. REV. 167, 167 (2000); Michael J. Graetz, *Taxing International Income - Inadequate Principles, Outdated Concepts, and Unsatisfactory Policy*, 54 TAX L. REV. 261, 335 (2001); DANIEL SHAVIRO, FIXING US INTERNATIONAL TAXATION 2 (2014), http://web.law.columbia.edu/sites/default/files/microsites/law-theory-workshop/files/DShaviro.pdf; Julie Roin, *Taxation Without Coordination*, 31 J. LEGAL STUD. S61, S61 (2002); *see* Kane, *supra* note 64, at 92; Yariv Brauner, *An International Tax Regime in Crystallization*, 56 TAX L. REV. 259, 262–63. For a summary of the academic debate, see Ruth Mason & Pascal Saint-Amans, *Has Cross-Border Arbitrage Met Its Match?,* in THINKER, TEACHER, TRAVELER: REIMAGINING INTERNATIONAL TAX. ESSAYS IN HONOR OF H. DAVID ROSENBLOOM (Georg Kofler et al. eds., IBFD 2021), *reprinted in* 41 VA. TAX REV. 1, 10–11 (2021).

90. *Arbitrage*, *supra* note 89, at 166. Recently, the term "mismatches" has been more often used to describe arbitrage.

91. H. David Rosenbloom, *Cross-Border Arbitrage: The Good, the Bad, and the Ugly*, 85 TAXES 115, 116 (2007).

92. *Id*. at 115.

93. Avi-Yonah, *supra* note 89, at 170–71.

94. Adam H. Rosenzweig, *Harnessing the Costs of International Tax Arbitrage*, 26 VA. TAX REV. 555, 564–65 (2007).

argued that international tax competition and the resulting arbitrage raised *equity* concerns because not everyone could benefit from it. Daniel Shaviro, Mitchell Kane, Ring, and Rosenzweig highlighted the *efficiency* concerns, arguing that tax competition and the resulting arbitrage could cause various behavioral responses of taxpayers, such as distorting the choice of location for investment.[96]

Some commentators were concerned about the *interaction effect* that could arise from U.S. tax policy responses to arbitrage. Shaviro pointed out that a unilateral response may cause retaliation by other countries.[97] Kane developed a model involving zero-sum tax competition among states seeking to attract capital and argued that a state might exploit the ambiguity of mismatching tax rules to win this competition without instigating retaliatory responses.[98] Omri Marian's study of the LuxLeaks rulings demonstrated how the country Luxembourg was able to exploit the mismatches/arbitrages of tax rules in such a way as to gain a significant economic advantage over its neighboring states without attracting notice.[99]

Rosenbloom also pushed back on the notion that tax competition and arbitrage was a threat to revenue. He argued that as long as the taxpayer complies with each national tax regime, no one country has cause to complain about revenue loss.[100] Kane and Rosenbloom rejected the conception of hypothetical, collective income, or revenue that could have been available had tax competition not existed.[101] However, the over 170 member jurisdictions of the BEPS Inclusive Framework who signed on to the Statement and Pillar Two clearly disagree.[102]

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95. *See* Diane M. Ring, *One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage*, 44 B.C. L. REV. 79, 125–28 (2002).

96. Daniel Shaviro, *Money on the Table?: Responding to Cross-Border Tax Arbitrage*, 3 CHI. J. INT'L L. 317, 323–25 (2002); Kane, *supra* note 64, at 114; Ring, *supra* note 95, at 126–27 (2002); Rosenzweig, *supra* note 94, at 564–65.

97. Shaviro, *supra* note 96, at 327.

98. Kane, *supra* note 64, at 142.

99. Until national legislators and the European Commission began to uncover the Luxembourg's secret tax ruling practice to offer favorable tax treatment, there had been no retaliation from other European Union ("EU") countries because they simply did not know about it. *See* Omri Marian, *The State Administration of International Tax Avoidance*, 7 HARV. BUS. L. REV. 1, 27–28 (2017).

100. Avi-Yonah, *supra* note 89, at 167.

101. Mason & Saint-Amans, *supra* note 89, at 5; *see* Kane, *supra* note 64, at 115 (arguing that the acceptance of the single tax principle suggests that there is some international consensus on the meaning of income, but no such consensus exists.).

102. OECD, HYBRID MISMATCH ARRANGEMENTS: TAX POLICY AND COMPLIANCE ISSUES 11 (2012), http://www.oecd.org/ctp/exchange-of-tax-information/hybrid-mismatch-arrangements-tax-policy-and-compliance-issues.pdf ("Although it is often difficult to determine which of countries involved has lost tax revenue [as a result of tax competition], it is clear that collectively the countries concerned lose tax revenue.").

On a more direct challenge to the single tax principle, scholars have raised concerns about what it means to tax only once.[103] Shaviro suggests that being taxed twice at low rates (for example, two percent and two percent) need not necessarily be worse than being taxed once (for example, five percent).[104] He further argues that the single tax principle would be hard to operationalize despite higher levels of international cooperation because it is "challenging to coordinate distinctive tax systems across multiple complex dimensions" and, worse, countries have little interest in harmonizing their tax rules.[105]

Nevertheless, recent developments, such as 137 Inclusive Framework member jurisdictions agreeing to the two-Pillar solution—including the global minimum tax in the Statement[106]—indicate that international interest in tax harmony is not as outlandish as some scholars suggest.[107] But the global tax deal in the Statement was not built in a day. The next subpart further explains the global reaction toward the single tax principle and tax harmony prior to the creation of Pillar Two.

B. *Global Efforts Begin in the Late 2000s*

The recent international struggle in combatting tax competition is well known among those in the field of international taxation. The first promising step toward the single tax principle occurred in the context of tax information transparency. Following the 2008 financial crisis, the Foreign Account Tax Compliance Act of 2010 ("FATCA") was enacted in the United States.[108] FATCA was designed to stop the practice of U.S. residents pretending to be foreigners in order to escape from U.S. taxation.[109] This prac-

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103. John Bentil, *Situating the International Tax System Within Public International Law*, 49 GEO. J. INT'L L. 1219, 1251–52 (2018); *see also* Daniel Shaviro, *The Two Faces of the Single Tax Principle*, 41 BROOK. J. INT'L L. 1293, 1294 (2016).

104. Shaviro, *supra* note 103, at 1294. However, this argument did not consider that taxing once in the single tax principle has more nuance than just one count—that is, cross-border income should be taxed *once* at a *substantive tax rate*.

105. Daniel Shaviro, *The Crossroads Versus the Seesaw: Getting a "Fix" on Recent International Tax Policy Developments*, 69 TAX L. REV. 1, 3–4 (2015).

106. *Statement*, *supra* note 1, at 4–5.

107. *See* Bentil, *supra* note 103, at 1251–52; Shaviro, *supra* note 96, at 330 (arguing the STP would be difficult to operationalize despite increased levels of international cooperation because "[s]hort of countries agreeing to harmonize their distinctive rules (which they appear to have little interest in doing), it is quite challenging to coordinate all of the interactions between distinctive systems across multiple complex dimensions.").

108. *See, e.g.*, Michael S. Kirsch, *Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice*, 16 FLA. TAX REV. 117, 122 (2014).

109. To explain this concept more technically, U.S. residents pretend to be foreigners to enjoy tax benefit from the portfolio interest exemption and other tax breaks for foreign portfolio investment, such as the exemption of capital gains. For an explanation of FATCA generally, see Young Ran (Christine) Kim, *Considering "Citizenship Taxation": In Defense of FATCA*, 20 FLA. TAX REV. 335, 359–62 (2017).

tice enabled double non-taxation of income hidden in offshore accounts, where such assets were rarely detected because of bank secrecy.[110] Thus, FATCA required foreign financial institutions, such as Swiss banks, to report accounts held by U.S. residents and citizens to the U.S. government.[111] If foreign financial institutions do not comply, they are subject to tax penalties and criminal charges. FATCA's major success directly led to the development of the Common Reporting Standard at the global level, which linked over 100 foreign jurisdictions in a system where they could automatically exchange tax information with each other.[112] The enhanced transparency in tax information among countries can help achieve the single tax principle because it prevents double non-taxation of passive investment income earned by individuals. It is still not perfect (as evidenced by the recent leaks, such as the Pandora Papers),[113] but it is a significant step forward to full implementation of the single tax principle.

Second, in recent years, many countries have been more willing to cooperate and harmonize substantive tax rules to resolve tax competition.[114] In Europe, the 2008 financial crisis led to massive austerity, which in turn put pressure on politicians to raise concerns that MNEs (especially U.S. MNEs) were not paying their fair share of tax to Europe as a source jurisdiction.[115] Some countries, such as the United Kingdom and France, realized that traditional international tax rules with a physical presence requirement did not allow them to tax Big Tech despite the fact that those companies collected and profited from the user data of their citizens.[116] Thus, they adopted digital services taxes ("DSTs").[117] This move caused heated debate around the world, leading the OECD to launch BEPS Project 1.0 to try to update the international tax regime that overlooked under-taxation of the digital economy and to prevent trade wars over individually-enacted DSTs.[118]

Through these efforts, countries realized that a complete harmonization of substantive tax law was unlikely to be fully successful as a comprehen-

110. *Id*.

111. I.R.C. §§ 1471, 1472, 1473, 1474.

112. *See id.*

113. *See The Pandora Papers: An ICIJ Investigation,* INT'L CONSORTIUM INDEP. JOURNALISTS http://www.icij.org/investigations/pandora-papers/ (last visited Mar. 11, 2022). The Pandora Papers are 11.9 million leaked documents that the International Consortium of Investigative Journalists published that exposed the secret offshore accounts of thirty-five world leaders as well as more than 100 billionaires, celebrities and business leaders

114. *See* OECD, INCLUSIVE FRAMEWORK ON BASE EROSION AND PROFIT SHIFTING, http://www.oecd.org/tax/beps/ (last visited Mar. 11, 2022).

115. *See* Schreuer Rappepert & Singer Tankersley, *Europe's Planned Digital Tax Heightens Tensions with US,* N.Y. TIMES, Mar. 19, 2018, at 1–2, http://www.nytimes.com /2018/03/19/us/politics/europe-digital-tax-trade.html.

116. *Id*. at 3–4.

117. *See e.g.*, Young Ran (Christine) Kim, *Digital Services Tax: A Cross-border Variation of the Consumption Tax Debate*, 72 ALA. L. REV. 131, 136 (2020).

118. OECD, *supra* note 114.

sive solution to tax competition because individual states would be reluctant to defer to another states' underlying tax rules, or agree to implement a common set of rules for harmonization that may not match their tax objectives.[119] An alternative to harmonization that states have pursued recently are conditional rules.[120] Mason explains these conditional rules as "fiscal fail-safe" measures to guarantee full taxation and implement the single tax principle.[121] In other words, the conditional or secondary rules attempt to ensure that cross-border income does not escape tax by identifying "conditions under which, if one country does not tax, another country fills the tax void."[122] These conditional rules emerged in the BEPS Project 1.0, such as in Action 3 for expanding the CFC regimes[123] and Action 2 for anti-hybrid rules.[124] The BEPS Project 2.0 Pillar Two for a global minimum tax is also built on this conditional, fiscal fail-safe rules as demonstrated in Part III.A.[125] Although not extensively harmonious because of various carveouts and specific exceptions that various countries demanded, the examples reflect a new willingness to cooperatively coordinate efforts to address international tax arbitrage in a more comprehensive way.

On reflection, BEPS Project 1.0 included some significant steps toward tax harmony and the single tax principle. BEPS Project 1.0 is contrary to Rosenbloom's preferred solution of acquiescing to tax competition and arbitrage, which is doing nothing, because he did not believe there was a problem to solve. However, while this Project advanced the single tax principle, most of its actions have been recommendations, not requirements, and for the most part its recommendations went unimplemented throughout the world. However, the EU did adopt various action items of BEPS Project 1.0 through its own directives, such as the Anti-Tax Avoidance Directive ("ATAD").[126] But such a regional approach is limited in its ability to advance the single tax principle because of the need for global harmonization. BEPS Project 1.0 was disappointing because it did not fully implement the

119. *See e.g.,* Yariv Brauner, *Treaties in the Aftermath of BEPS*, 41 BROOK. J. INT'L L. 974, 976–77 (2016).

120. *See Transformation*, *supra* note 12, at 378–79. Mason offers two examples of conditional rules: penalty defaults and fiscal fail-safes. Penalty defaults may be set up in tax law and treaties if states do not resolve tax ambiguities against the taxpayer. Rules that deny tax-treaty benefits to fiscally transparent entities could be understood as penalty defaults. Fiscal fail safes are explained in the above text.

121. *Id.* at 374–75.

122. *Id.* at 381.

123. OECD, DESIGNING EFFECTIVE CONTROLLED FOREIGN COMPANY RULES, ACTION 3 – 2015 FINAL REPORT 12 (2015), http://dx.doi.org/10.1787/9789264241152-en.

124. OECD, NEUTRALISING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS, ACTION 2 – 2015 FINAL REPORT 49–50 (2015), http://dx.doi.org/10.1787/9789264241138-en.

125. *See infra* Part III.A.

126. Reuven Avi-Yonah & Gianluca Mazzoni, *BEPS, ATAP and the New Tax Dialogue: A Transatlantic Competition?* 46 INTERTAX 885, 885 (2018).

single tax principle on any meaningful scale or update the international tax regime for the twenty-first century.[127]

The shortcomings of BEPS Project 1.0 were addressed in BEPS Project 2.0. The new project developed a plan for international taxation that addressed the most pressing concerns in the plan's two Pillars. However, the impetus of the plan did not come from the EU or any other multilateral agreement – it was a direct result of the passage of the TCJA. The next subpart discusses the important provisions of the TCJA that inspired BEPS Project. 2.0.

C. *The TCJA as Constructive Unilateralism*

The United States has a long history of unilaterally adopting tax policies that are later enacted by many other countries around the world. This risk-taking on the part of the United States is considered by many to be internationally constructive because it allows other jurisdictions to evaluate the effectiveness of a tax policy before implementation.[128] Most notably, the United States has led the way with the Foreign Tax Credit, CFCs, and the two international tax rules in the TCJA—GILTI and BEAT, discussed in more detail below.[129]

Passage of the TCJA was not primarily motivated by a desire to implement the single tax principle. Instead, the U.S. government wanted to bring back and tax the nearly $3 trillion USD of offshore corporate profits of the U.S. MNEs.[130] Before the TCJA, U.S. parent companies with foreign subsidiaries were generally not taxed on the earnings of their subsidiaries until the earnings were distributed to them (or repatriated to the United States).[131] If the foreign corporation did not distribute earnings back to the United States, U.S. parents could indefinitely defer paying U.S. taxes at the thirty-five percent rate on this foreign income.[132] As a result, U.S. MNEs, such as Apple, could incorporate a subsidiary in tax havens or low-tax jurisdictions like Ireland (where the corporate tax rate is 12.5 percent) and allocate as

127. Reuven Avi-Yonah, *Full Circle: The Single Tax Principle, BEPS, and the New US Model,* 1 GLOBAL TAX'N 12, 12 (2016) (criticizing BEPS Project 1.0 for not changing the obsolete physical presence requirement in tax treaties and limiting the unworkable arm's length standard for transfer pricing).

128. Reuven Avi-Yonah, *Constructive Dialogue: BEPA and the TCJA* 2 (Univ. Mich. Pub. L. Rsch. Paper No. 665, 2020), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544065.).

129. *Id.* at 2, 4, 16.

130. Reuven S. Avi-Yonah, *The International Provisions of the TCJA: A Preliminary Summary and Assessment,* (Univ. Mich. Pub. L. Rsch. Paper No. 605, 2017), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3193278.

131. *Id.*

132. Upon repatriation of earnings from a foreign subsidiary, U.S. corporate shareholders' earnings were treated as dividends that were included in the parent corporation's income and were subject to U.S. taxation at a rate of up to thirty-five percent with a foreign tax credit based on foreign taxes paid.

much taxable income as possible to these low-tax jurisdictions in order to minimize U.S. corporate income tax.[133] Between 2005 and 2017, U.S. MNEs had accumulated $2.6 trillion USD of low-taxed foreign income offshore that had never been subject to the thirty-five percent corporate income tax rate.[134] Thus, one of the primary goals of the TCJA was to remove potential tax benefits from offshoring income, thus returning the $2.6 trillion USD in capital to the United States for taxation and deterring such profit-shifting activity in the future.[135]

At the same time, other corporations whose businesses are more focused on the domestic market, such as Walmart, lobbied to reduce the thirty-five percent corporate tax rate, while owners of pass-through entities (like then-President Trump) pushed for a reduction of the tax rate on partnerships.[136]

The result was the TCJA. The TCJA implemented a participation exemption for dividends from CFCs,[137] cut the corporate tax rate from thirty-five percent to twenty-one percent,[138] and cut the partnership and other pass-through tax rate from thirty-seven percent to 29.6 percent.[139] However, to pay for all these tax cuts within the confines of Budget Reconciliation, the Republican members of Congress decided to apply the single tax principle to U.S. MNEs to stop their base erosion and profit-shifting strategies that have harmed U.S. revenue.[140]

Three important provisions of the TCJA represented steps toward the single tax principle. First is the one-time mandatory "repatriation tax" (sometimes referred to as the "transition tax"). A significant tax rate (be-

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133. For example, in a recent high-profile tax case, the European Commission demanded that Apple pay Ireland €13.1 billion Euros in underpaid taxes because Ireland granted state aid to the company. Padraic Halpin, *Ireland Collects Disputed Apple Taxes in Full ahead of Appeal*, REUTERS (Sept. 18, 2018, 8:55 AM), http://reut.rs/38wQSLQ.

134. *Key Elements of the U.S. Tax System*, TAX POL'Y CTR. (last updated May 2020), http://www.taxpolicycenter.org/briefing-book/what-tcja-repatriation-tax-and-how-does-it-work.

135. *See* Avi-Yonah, *supra* note 130.

136. *See* John Ydstie, *How Trump's Corporate Tax Cut Is Playing Out for Wal-Mart*, NPR (Jan. 13, 2018, 5:47 PM), http://www.npr.org/2018/01/13/577900650/how-trump-s-corporate-tax-cut-is-playing-out-with-wal-mart; *see also* Reuven Avi-Yonah, *How Terrible is the New Tax Law? Reflections on TRA17*, (Univ. of Mich. Pub. L. Rsch. Paper No. 586, 2018), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3095830.

137. Before the Tax Cuts and Jobs Act ("TCJA"), U.S. taxpayers were subject to U.S. income taxes on their worldwide income. But income earned by the foreign subsidiaries of U.S. corporations was subject to tax only when repatriated to the United States as dividends. The TCJA changed the tax rules for multinational corporations by generally exempting the earnings of foreign subsidiaries' active businesses from U.S. corporate taxation, even if repatriated. Technically, there now is a 100 percent dividend-received deduction. This is called "participation exemption." I.R.C. § 245A.

138. I.R.C. § 11.

139. I.R.C. § 199A.

140. *See* Avi-Yonah, *supra* note 136, at 5–6.

tween eight and fifteen percent) was imposed on the past accumulated offshore profits of U.S. MNEs.[141] It was imposed only one time, and it did not matter whether those offshore profits were repatriated to the United States.[142] Those profits were parked in low-tax jurisdictions, resulting in nominal source taxation. They were not subject to residence taxation by the United States because the pre-TCJA tax law allowed the U.S. MNEs to defer taxation until the profits were repatriated.[143] Hence, the new temporary repatriation tax in the TCJA implemented the single tax principle because these profits were previously subject to double non-taxation through the "check the box" policy.

Second, the GILTI rule imposed a tax on certain foreign subsidiaries' income from intangible assets.[144] Although the TCJA lowered the top corporate income tax rate from thirty-five percent to a flat twenty-one percent, the U.S. corporate tax rate still exceeds the rate in many countries.[145] Thus, situating ownership of a profitable patent, for example, in a foreign subsidiary in a lower-rate or no-tax jurisdiction instead of in the United States still could produce a substantial tax savings for an MNE. GILTI aims to prevent such profit shifting from easily movable intangible assets by imposing the U.S. tax as residence taxation on foreign-source income from intangibles.[146] GILTI is foreign income earned by U.S. shareholders of CFCs from intangible assets, such as copyrights, trademarks, and patents. It is calculated as the total active income earned by a CFC that exceeds ten percent of the firm's depreciable tangible property (known as the Qualified Business Asset Investment, or "QBAI"). The resulting U.S. shareholders who own ten percent or more of a CFC are liable for the tax on its GILTI, which generally applies at a rate between 10.5 percent and 13.125 percent.[147] GILTI is perhaps the most successful and influential achievement of the single tax principle contained within the TCJA. Income subject to the GILTI rule would be subject to little-to-no tax in source and otherwise not be subject to U.S.

141. I.R.C. § 965.

142. *See* Reuven Avi-Yonah, *The International Provisions of the TCJA: Six Results After Six Months* (Univ. of Mich. Pub. L. Rsch. Paper No. 621, 2018), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3242008.

143. U.S. multinational enterprises ("MNEs") deployed complicated corporate structures with the check-the-box rule so that they could defer the U.S. taxation until the offshore profits were repatriated, which rarely happened.

144. *See* Avi-Yonah, *supra* note 142.

145. *Id.*

146. *Id.;* Avi-Yonah, *The Baby and the Bathwater: Reflections on the TCJA's International Provisions*, 101 TAX NOTES INT'L 599 (Feb. 1, 2021).

147. I.R.C. § 951A. Under current law, GILTI is defined as net foreign income after a deduction for 10 ten percent of the value of foreign tangible assets. Half of GILTI is taxed at the U.S. corporate rate of twenty one percent, which means the basic rate on GILTI is 10.5%. If a company pays foreign taxes, it can claim eighty percent of the value of those taxes as a credit against GILTI liability. Taking this foreign tax credit policy into account means the tax rate on GILTI moves up to 13.125%.

residence taxation. The exclusion for offshore tangible assets returns (the QBAI exemption) may tarnish the purpose of GILTI, but it is unlikely to be a major drawback because the largest U.S. MNEs had few tangible assets offshore.[148]

Finally, the BEAT provision addressed the problem of base erosion by foreign MNEs.[149] Suppose that a U.S. corporation pays deductible payments, such as interest and royalties, to a related foreign entity. From the foreign entity's perspective, such interest and royalties are U.S. source income. But suppose further that the foreign entity is not subject to U.S. withholding tax for various reasons, such as tax treaty benefits and statutory tax exemptions. This is a classic example of multinationals escaping source-based taxation (in this case, U.S. taxation) by accumulating large amounts of deductible payments offshore. Neither the U.S. corporation nor the foreign recipient pay tax to the source country. To avoid such base-erosion payment, the BEAT reverses deductions and imposes an alternative minimum tax set at ten percent (12.5 percent from 2026) on the modified tax base of the U.S. corporation.[150] The BEAT was enacted despite potentially violating the non-discrimination provision of all U.S. tax treaties because the rule applies to the case of "U.S. subsidiary-foreign parent" but not the case of "U.S. subsidiary-U.S. parent."[151] Nonetheless, BEAT effectively denies deductions in source countries for payments that are unlikely to be subject to residence-based taxation. BEAT achieves the single tax principle by strengthening source-based taxation.

The TCJA, albeit begrudgingly, moved the United States toward the single tax principle and combating tax competition. The global result was remarkably constructive, as the TCJA demonstrated a means to feasibly achieve reasonable tax harmonization. Inspired by the international tax provisions of the TCJA, the G20 and the OECD launched BEPS Project 2.0 in 2017, using GILTI and BEAT as the models for its Pillar Two proposal. Pillar One of the Statement focuses on updating outdated rules in source-based taxation.[152] Pillar Two is more directly on point for implementing the single tax principle through a combination of rules strengthening residence-based taxation (for example, the IIR) and source-based taxation (UTPR and STTR). The benchmark of "substantial tax" counted "once" for single tax

148. This also meant that the new participation exemption in the TCJA violates the single tax principle, but it is unlikely to benefit the multinationals much.

149. I.R.C. § 59A.

150. *Id.*

151. A tax treaty's non-discrimination provision promises to treat nationals of one country that is party to the tax treaty the same as nationals of the source country that is party to the tax treaty if both sets of nationals are in the same circumstance. Under BEAT, it is possible that two corporations in the same circumstance could be treated differently.

152. Pillar One focuses on source-based taxation and finally partially abolishes the obsolete physical presence requirement and the arm's length standard for some of the profits of large multinationals above a fixed return on assets. *See* Avi-Yonah, Kim & Sam, *supra* note 4.

purposes is set at fifteen percent, the global minimum tax. Part III will discuss Pillar Two in greater detail.

III. A NEW SOLUTION: PILLAR TWO AND GLOBAL MINIMUM TAX

The Statement presents Pillar Two and the global minimum tax as a new solution to tax competition. Together with Pillar One, the entire framework in the Statement represents a revolution in international taxation by offering many solutions, such as eliminating the obsolete permanent establishment requirement for Amount A in Pillar One and proposing a fifteen percent global minimum tax in Pillar Two. All of these are decisive breaks from the past, and have been suggested for twenty-five years but have gained little traction until now.[153] Thus, the Statement encompasses both revolution and evolution.

This Part focuses on Pillar Two of the Statement. Pillar Two is a new solution to tax competition. It is aimed at systematically preventing the race to the bottom and eliminating incentives for both states and MNEs to engage in tax competition. However, this novel solution builds upon past efforts. This article argues that Pillar Two has finally embodied the single tax principle which states that all income of MNEs ought to be taxed *once* at a *substantive tax rate*. If this proposition is not met, corrective rules apply to accomplish the result. This Part explains the details of Pillar Two and the relevant implementation rules, such as the proposed BBB Act of the United States. The rules are very technical and complex. Evaluating these rules through the lens of the single tax principle—that all income must be taxed once substantially—will help readers understand the rules intuitively if the technicalities overwhelm.

A. *Unpacking Pillar Two*

Pillar Two consists of (1) two interlocking domestic rules requiring income inclusion (for residence countries (IIR) and denial of deduction for source countries (UTPR), together referred to as the Global anti-Base Erosion ("GLoBE") Rules, and (2) a treaty-based rule (STTR).

1. Domestic Rules: Global Anti-Base Erosion ("GloBE") Rules

GloBE Rules, have two components: income inclusion (IIR) and denial of deduction (UTPR). MNEs that meet the €750 million Euros revenue threshold determined under BEPS Action 13 (country-by-country reporting) are subject to a global minimum tax regardless of the jurisdiction where

153. Reuven S. Avi-Yonah, *The New International Tax Framework: Evolution or Revolution*?, 25 AM. SOC'Y INT'L L. 11 (2021), http://www.asil.org/insights/volume/25/issue/11.

they are headquartered or operating.[154] Also, the Statement makes it clear that the U.S. GILTI regime will co-exist with the GloBE rules.[155]

First, the IIR requires the residence countries of multinational corporations to impose top-up tax[156] on an ultimate parent entity ("UPE") at a minimum rate of fifteen percent if the source country where a subsidiary operates imposes tax below such minimum rate on the subsidiary's income. The fifteen percent global minimum tax rate is an effective rate, not a nominal rate.[157] The IIR allocates top-up tax based on a top-down approach subject to a split-ownership rule for shareholdings below eighty percent.[158] With the single tax principle in mind, this rule acts as a corrective measure that allows residence countries to tax if source taxation is not substantial enough to count "once."

Second, if a residence country does not impose this minimum tax, the subsidiary's deduction for payment to the parent entity would be denied or an equivalent adjustment would be required as per the UTPR to the extent that the low tax income of a subsidiary is not subject to tax under an IIR.[159] This represents an additional corrective measure to guarantee substantial source taxation if residence countries do not cooperate.

To illustrate, suppose that a subsidiary in the source country earns $100 USD of income and the source country imposes tax at ten percent, which is below the fifteen percent global minimum tax rate. Then, the residence country of the parent entity includes the $100 USD in the parent's income and imposes tax at a rate that is equal to the difference between the fifteen percent of global minimum rate and the said ten percent tax rate. Suppose further that the subsidiary pays the $100 USD to the parent in a deductible form, such as a royalty. If the residence country does not have the IIR, the subsidiary's deduction for the $100 USD royalty payment will be denied.

Pascal Saint-Amans, the director of the OECD's Center for Tax Policy and Administration, explains that the UTPR is intended as an insurance pol-

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154. *Statement*, *supra* note 1, at 4 (explaining that government entities, international organizations, non-profit organizations, pension funds or investment funds that are Ultimate Parent Entities ("UPE") of an MNE Group or any holding vehicles used by such entities, organizations or funds are not subject to the Global Anti-Base Erosion ("GloBE") rules).

155. *Id*. at 5.

156. A top-up tax allows the residence country to tax the difference between the applicable tax rate in a particular country up to the agreed global minimum tax rate. David Lawder & Leigh Thomas, *Explainer: What is a Global Minimum Tax and How Could it Affect Companies, Countries?* REUTERS (Apr. 14, 2021, 8:50 AM), http://www.reuters.com/business/what-is-global-minimum-tax-how-could-it-affect-companies-countries-2021-04-14. For example, if a country only taxed at eleven percent, the residence country could tax the difference of four percent to ensure the fifteen percent global minimum was achieved.

157. *Statement*, *supra* note 1, at 4 (explaining that this effective tax rate is calculated on a jurisdictional basis and uses a common definition of covered taxes and tax a tax base determined by reference to financial accounting income).

158. *Id*.

159. *Id* at 3.

icy against countries that refuse to implement Pillar Two.[160] If companies move to non-cooperating jurisdictions in hope of gaining a tax advantage, the effect would be fully neutralized. However, certain MNEs will not be subject to the undertaxed payment rule for the first five years after meeting the €750 million Euros revenue threshold if their foreign tangible assets do not exceed €50 million Euros and they operate in no more than five foreign countries.[161]

There are important carve-outs to the GloBE rules.[162] First, the substance-based carve-out of income from the Pillar Two rules will exempt, in the first year, eight percent of the carrying value of tangible assets and ten percent of payroll. These percentages will decline by 0.2 percent each year for the next five years, and by 0.4 percent (for tangible assets) and 0.8 percent (for payroll) each year for the subsequent five years, after which the exemption will be five percent of both tangible assets and payroll. Second, a *de minimis* carve-out will exclude profits from countries where the MNE has less than €10 million Euros in revenue and less than €1 million Euros in profits. The Statement offers that there will be further carve-outs, such as safe harbors, in the implementation documents.[163] These substantial carve-outs harm the spirit of the single tax principle, and *infra* Part IV.B.2 discusses their pitfalls.

2. Treaty-Based Rule: Subject to Tax Rule ("STTR")

The STTR is a standalone treaty rule whose origin can be traced back to Stanley Surrey's U.S. tax treaty policy in the 1960s, discussed in Part II.A.1. It specifically targets intercompany payments that exploit treaties to shift profits to low-tax jurisdictions.[164] Therefore, this rule applies to certain categories of deductible payments that present a greater risk of base erosion, such as interest and royalties.[165] There were negotiations by the Inclusive Framework regarding the minimum rate for STTR, between 7.5 percent and nine percent,[166] however, the Statement stipulates that the minimum rate will be nine percent.[167]

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160. Alex Parker, *How the Global Tax Agreement Could Backfire for Biden*, LAW360 (Oct. 18, 2021), http://www.law360.com/tax-authority/articles/1431269/how-the-global-tax-agreement-could-backfire-for-biden.

161. *Statement*, *supra* note 1, at 4.

162. In addition to the two carve-outs in the text above, international shipping income is excluded from the GloBE rules. *Statement*, *supra* note 1, at 5.

163. *Id*. at 4–5.

164. OECD, TAX CHALLENGES ARISING FROM DIGITALISATION - REPORT ON PILLAR TWO BLUEPRINT: INCLUSIVE FRAMEWORK ON BEPS, OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT 150, ¶ 566 (2020), http://doi.org/10.1787/abb4c3d1-en [hereinafter, PILLAR TWO BLUEPRINT].

165. *Id.* at 150, ¶ 568.

166. OECD, STATEMENT ON A TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY 5 (July 1, 2021),

For example, suppose that a subsidiary in the source country pays a royalty to a parent company of $100 USD, and the parent's $100 USD royalty income is subject to a nominal tax rate of one percent below the minimum rate (nine percent) in the residence country. Then, the source country is allowed to impose withholding tax on the royalty payment at a rate that is equal to the difference between the minimum rate provided for under the STTR (nine percent) and the said nominal tax rate (one percent).[168]

3. Model Rules

The Statement provides, "[p]illar Two should be brought into law in 2022, to be effective in 2023, with the UTPR coming into effect in 2024."[169] The OECD/Inclusive Framework will present Model Rules for Pillar Two to define the scope and mechanics of the GloBE rules and provide a template for domestic legislation to implement the GloBE regime. The OECD /Inclusive Framework will also provide model treaty provisions to give effect to the STTR by mid-2022.[170] At the end of 2022, the OECD expects to have an implementation framework to facilitate the coordinated implementation of the GloBE rules.[171]

In December 2021, the OCED/Inclusive Framework released Model Rules for Pillar Two, consisting of ten chapters that explained the GloBE regime in detail.[172] In addition to this seventy-page document, the OECD /Inclusive Framework distributed Commentary to the Model Rules (Pillar Two) later in March 2022, which is about 230 pages long. There are multiple supplements issued by the OECD/Inclusive Framework,[173] but the authors found the six-page fact sheets most helpful for many readers.[174]

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http://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf [hereinafter JULY STATEMENT].

167. *Statement*, *supra* note 1, at 5.

168. PILLAR TWO BLUEPRINT, *supra* note 164, at 165, ¶ 650.

169. *Statement*, *supra* note 1, at 5.

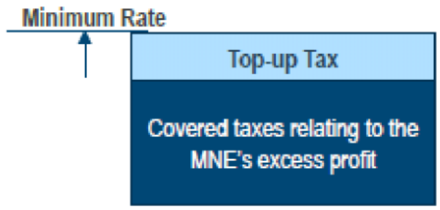
170. GLOBAL ANTI-BASE EROSION MODEL RULES (PILLAR TWO), FREQUENTLY ASKED QUESTIONS, OECD 6 (Dec. 2021). The model treaty provisions were supposed to be released in November 2021, but the released was delayed to mid-2022.

171. *Id.*

172. TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY – GLOBAL ANTI-BASE EROSION MODEL RULES (PILLAR TWO), OECD (Dec. 2021), http://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm [hereinafter, *Model Rules*]. Chapter 1 addresses questions of the GloBE scope. Chapters 2–5 contain the key operative rules. Chapter 6 deals with mergers and acquisitions. Chapter 7 provides special rules that apply to certain tax neutrality and existing distribution tax regimes. Chapter 8 deals with administration, Chapter 9 provides for rules on transition and Chapter 10 contains definitions. *Id*. at 7.

173. *See e.g.*, THE PILLAR TWO RULES IN A NUTSHELL, OECD (Dec. 2021), http://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf; OVERVIEW OF THE KEY OPERATING PROVISIONS OF THE GLOBE RULES, OECD (Dec. 2021), http://www.oecd.org/tax

FIGURE 1. TOP-UP TAX EXPLAINED[175]



First, the Model Rules explain what "top-up tax" means in Pillar Two. As Figure 1 shows, top-up tax first assumes a minimum tax amount relating to the MNE's excess profit calculated at the minimum tax rate of fifteen percent. If certain Covered Taxes (in Step 3 below) paid by constituent entities of the MNE do not reach the minimum tax amount, the GloBE Rules will impose an additional tax to fill the deficient tax amount. So, the top-up tax seems to describe the tax rules that pull the top of the tax liability amount up to a certain minimum level.

To determine top-up tax liability for an MNE, the Model Rules offer five steps:[176]

- Step 1: An MNE Group determines whether it is within the scope of the GloBE rules. If so, it identifies the location of each Constituent Entity within the MNE Group.
- Step 2: The MNE Group determines income of each constituent entity. This so-called GloBE Income of a constituent entity is the income used for preparing a consolidated financial statement of the ultimate parent entity.[177]
- Step 3: The MNE Group determines taxes attributable to income determined in Step 2. (Covered Taxes)
- Step 4: The MNE Group calculates the effective tax rate of all Constituent Entities located in the same jurisdiction. If an MNE is subject to an effective tax rate below fifteen percent in any jurisdiction, calculate the top-up tax with respect to that low tax jurisdiction.
- Step 5: The MNE Group is liable to the so-impose top-up tax under IIR in the residence country or UTPR in the source country in accordance with the agreed rule order.[178]

/beps/pillar-two-GloBE-rules-fact-sheets.pdf (referred to as "fact sheets" in the file name assigned by the OECD).

174. *Id*.

175. *Id*. at 1.

176. *Id*.

177. *Model Rules*, *supra* note 172, at 15, art. 3.1.

178. Jinyan Li makes a noteworthy observation on the Model Rules' revised approach on the UTPR. *See* Li, *supra* note 31 (explaining that the UTPR is similar to the U.S. BEAT rule as an anti-base-erosion rule with respect to MNEs' intragroup payments. But the Model

The initial and overwhelming responses from MNEs are that the Model Rules are so complex that they need to be simplified.[179] For example, Step 4 requires MNEs to calculate their effective tax rate in each jurisdiction where they do business. It is a novel compliance challenge that requires MNEs to prepare new information systems.[180] The OECD/Inclusive Framework also acknowledges the challenges, so the OECD/Inclusive Framework promises to develop safe harbors that let MNEs avoid full calculations of top-up tax in certain circumstances.[181] However, the Model Rules Commentary did not include the details on safe harbors, so MNEs have to wait until, hopefully, later in 2022 for this issue to be resolved.

B. *The U.S. Implementation of Pillar Two through the Build Back Better ("BBB") Act*

The recently unveiled international tax provisions of the BBB Act[182] represent the United States' plan to implement Pillar Two. They also serve as a significant move toward the United States' implementation of the single tax principle by introducing various mechanisms to ensure that cross-border income is taxed once at a substantive tax rate. This Subpart discusses the proposed changes in the BBB and how they fit in with the new international tax regime, especially Pillar Two.

1. Global Intangible Low Tax Income ("GILTI")

Probably the most important element in the BBB Act is the modification of the GILTI rules. The BBB Act raises the GILTI tax rate from 10.5

Rule removes the link to intragroup payments and makes the UTPR a modified formulary apportionment to share tax base among countries. Li concludes that such modified approach departs from the international consensus on the original version of Pillar Two UTPR and may be incompatible with tax treaties.).

179. *See e.g.*, Isabel Gottlieb, *Companies Eager to See Details on Minimum Tax Simplifications*, BLOOMBERG TAX (Mar. 23, 2022), http://news.bloombergtax.com/daily-tax-report-international/companies-eager-to-see-details-on-minimum-tax-simplifications; Allison Christians, Full Professor, H. Heward Stikeman Chair in Tax Law, McGill University Faculty of Law, Oral Presentation "Let the GILTI GloBE Games Begin" at the 4th Annual UCI Law–A. Lavar Taylor Tax Symposium (Mar. 21, 2022); *BEPS Monitoring Group Comments on the Model Rules for a Global Anti-Base-Erosion Minimum Corporate Tax*, *supra* note 28, at 1427.

180. Gottlieb, *supra* note 179.

181. *Model Rules*, *supra* note 172, at 47, art. 8.2. However, BEPS Monitoring Group criticizes that such safe harbors protect the interest of MNEs and may harm the goal of Pillar Two. *BEPS Monitoring Group Comments on the Model Rules for a Global Anti-Base-Erosion Minimum Corporate Tax*, *supra* note 28, at 1427.

182. H.R. 5376, 117th Cong. (2021) (Introduced in the House on Sept. 27, 2021, referred to the House Budget Committee, Build Back Better Act Rules Committee Print, updated Nov. 3, 2021) [hereinafter Build Back Better ("BBB") Act].

percent[183] to fifteen percent[184] (15.8 percent with foreign tax credits), reduces the exemption ratio of tangible assets (QBAI) from ten percent[185] to five percent,[186] and applies the GILTI rule on a country-by-country basis.[187]

GILTI has been the most successful unilateral implementation of the single tax principle by a residence country. But the proposed changes in the BBB Act are intended to implement Pillar Two's GloBE rules with other participating countries. The new GILTI rate of fifteen percent is the same as the global minimum tax rate of fifteen percent in Pillar Two. The reduction of the QBAI limit to five percent is similar to the substance carve-out permitted by the OECD.[188] Specifically, the OECD's substance carve-out under Pillar Two "will exclude an amount of income that is five percent of the carrying value of tangible assets and payroll."[189] Country-by-country application of GILTI is required by Pillar Two.[190]

These changes in the U.S. law, if enacted, make it much more promising that the other G20 countries will enact similar changes. If all the G20 members follow up on their commitments to the Statement, the world will be much closer to achieving the single tax principle. Since ninety percent of large MNEs are headquartered in the G20,[191] this means that they will be subject to the fifteen percent minimum tax in residence countries. That in turn should enable source countries to apply the UTPR and the STTR without worrying that an MNE can move its operations elsewhere to pay a lower rate. As the single tax principle proposes, substantive taxation will exist in either residence or source countries via corrective measures.

It is also important that the GILTI foreign tax credit limit is raised from eighty percent to ninety-five percent,[192] because that means that source

183. Daniel Bunn, *Piling on the GILTI Verdicts*, TAX FOUND. (July 15, 2021), http://taxfoundation.org/biden-gilti-proposal/ ("Half of GILTI is taxed at the U.S. corporate rate of 21 percent, which means the basic rate on GILTI is 10.5 percent.").

184. BBB Act, H.R. 5347, § 138131(a)(3) (2021).

185. I.R.C. § 951A(b)(2)(A).

186. BBB Act, H.R. 5347, § 138126(d) (2021).

187. BBB Act, H.R. 5347, § 138124(a) (2021). GILTI is currently calculated using MNEs' global average tax rates, but under BBB, GILTI would be calculated based on a MNEs operations in each individual country. Daniel Bunn, *GILTI by Country is not as Simple as it Seems,* TAX FOUND. (May 18, 2021), http://taxfoundation.org/gilti-by-country/. For game theoretic model analysis comparing a global average regime and a country-by-country regime, see Sanchirico, *supra* note 31 (suggesting that a global average model is superior to a country-by-country regime).

188. *Statement*, *supra* note 1, at 4.

189. *Id.*

190. *Statement*, *supra* note 1, at 5 ("It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the US GILTI regime will co-exist with the GloBE rules, to ensure a level playing field.").

191. Saez & Zucman, *supra* note 67.

192. BBB Act, H.R. 5347, § 138127(a) (2021).

country taxes that meet the global minimum tax rate will be almost fully creditable against residence taxation. This change shows another important element of the single tax principle, because if a source tax is substantial enough to satisfy the global minimum tax rate, it counts as taxing "once" and thus residence taxation yields to source to guarantee a "single" tax on such income. Then why not allow 100 percent of foreign tax credit instead of limiting it to ninety-five percent? The limitation presumably intends to remind U.S. MNEs to consider U.S. tax implications instead of simply paying foreign taxes without consideration at the expense of the U.S. tax revenue.

We would have preferred the global minimum tax rate in Pillar Two and the GILTI rate proposed by the Biden administration to be higher than fifteen percent—for example, twenty-one percent—because twenty-one percent is the current corporate income tax rate of the United States[193] and is closer to the average corporate tax rate of the G20 (26.96 percent).[194] Furthermore, we would have preferred to eliminate the QBAI exemption for offshore tangible assets because there is no reason to limit the corrective measures initiated by the residence country, such as GILTI, to income from offshore intangible assets. Nonetheless, the GILTI provisions in the BBB Act represent a reasonable compromise position to realize the single tax principle.

Some Democrats in the U.S. House of Representatives, such as Congressmen Tom O'Halleran, Henry Cuellar, and Lou Correa, expressed concern that the changes to GILTI in the BBB Act could reduce the competitiveness of U.S. MNEs.[195] Their concern is primarily that the U.S. government has moved too quickly by instituting these rules before the rest of the world and creating what they argue are new rules, specifically, the country-by-country regime.[196] These Congressmen posit that the "new rules in the [Ways and Means Committee's] draft would allow other countries to take advantage of our rules, and harm U.S. companies. If we wait, it will allow Congress the opportunity to adjust the implementation of the policy based on how G20 countries write their own GILTI regimes."[197]

193. I.R.C. § 11.

194. Asen, *supra* note 28.

195. *Lawmakers Recommend Caution on GILTI Changes*, TAX NOTES (Oct. 8, 2021), http://www.taxnotes.com/tax-notes-today-international/global-intangible-low-taxed-income-gilti/lawmakers-recommend-caution-gilti-changes/2021/10/20/7bcn7?highlight=headquartered%20G20.

196. *Id.*

197. *Id.*

2. Foreign Tax Credit ("FTC") Limitations

The BBB Act requires FTC determinations on a country-by-country basis.[198] This tightens up the availability of the FTC by adding another cap to the creditable amount of foreign taxes per country. The new per-country limitation on top of the existing basket limitations (per category of income) in the FTC rules[199] finally achieves the Reagan Administration's proposal from 1985,[200] which suggested both per category and per country limits applicable to FTCs.

Since the TCJA reduced the corporate tax rate to twenty-one percent, most U.S. MNEs paying taxes to foreign countries would be in an excess FTC position, meaning that the MNEs' foreign taxes exceed the credit limit allowed by the U.S. tax law.[201] Furthermore, the proposed global minimum tax rate of fifteen percent is still lower than the U.S. corporate tax rate of twenty-one percent, which may still offer room for moderate tax competition among countries. Hence, allowing generous FTCs to U.S. MNEs would reduce U.S. tax revenue, undermining its social safety net. In that regard, the BBB Act's tightened FTC rule is essential to prevent cross-crediting[202] (as allowed by the TCJA) and to curb an incentive to invest in lower tax foreign jurisdictions. Furthermore, this change would also reduce the incentives of source countries to engage in tax competition by granting a tax holiday, because even if they offer a low tax rate to U.S. MNEs, that would only decrease the MNEs' overall FTC availability due to the BBB Act's per-country limitation.[203]

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198. BBB Act, H.R. 5347, § 138124(a) (2021).

199. *Cf.* Michael Smith, *Complexity of Biden's FTC Proposals Sparks Worry*, TAX NOTES (Nov. 15, 2021), http://www.taxnotes.com/tax-notes-federal/corporate-taxation/complexity-bidens-ftc-proposals-sparks-worry/2021/11/15/7cl9w?highlight=build%20back%20better (commenting that the new rule will add complication and thus administrability concerns: "While the rules may look like those historically used when analyzing FTCs, the differences between the Biden proposal and the per-country system of 1932 and 1960 are massive").

200. WHITE HOUSE, THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY (May 1985), 389–96.

201. Garrett Watson, *Tax Reform's Broader Corporate Tax Base Opens More to Biden's Proposed Rate Hike*, TAX FOUND. (June 22, 2021), http://taxfoundation.org/us-corporate-tax-base/ ("The TCJA reduced the corporate tax rate from 35 percent to 21 percent beginning in 2018. . .").

202. CONG. RSCH. SERV., R45186, ISSUES IN INTERNATIONAL CORPORATE TAXATION: THE 2017 REVISION (P.L. 115-97) 3 (2021), http://sgp.fas.org/crs/misc/R45186.pdf ("Cross-crediting occurs when credits for taxes paid to one country that are in excess of the U.S. tax due on income from that country can be used to offset U.S. tax due on income earned in a second country that imposes little or no tax.").

203. The foregone cross-crediting eliminated by the BBB Act might have a synergy with the anti-deferral rules in the TCJA.

3. Foreign-Derived Intangible Income ("FDII")

The Foreign-Derived Intangible Income ("FDII") rule provides that owners of intellectual property held in the United States with sales to foreign customers are subject to a lower tax rate than the regular corporate tax rate of twenty-one percent.[204] Currently the effective tax rate is 13.125 percent.[205] FDII has given an important advantage to U.S. MNEs with valuable intangible property and significant exports, such as Apple and Google.

The BBB Act only raises the FDII effective tax rate from 13.125 percent to 15.8 percent.[206] The effective tax rate increases because the BBB Act reduces the deduction under Section 250 of the Internal Revenue Code for FDII to 21.875 percent.[207] The proposed effective tax rate is still lower than the regular corporate tax rate of twenty-one percent. However, recently there has been some evidence that the FDII rule does induce intangible property migration to the United States.[208] So, on balance, the revised rule in the BBB Act shows improvement.

Nonetheless, the fundamental problem with FDII, besides its complexity, persists: Allowing a lower tax rate for U.S. MNEs with intangibles associated with export is a blatant violation of the World Trade Organization subsidies code.[209] The fact that FDII may be working increases the incentive

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204. Daniel Bunn, *Will FDII Stay or Will It Go?*, TAX FOUND. (Aug. 10, 2021), http://taxfoundation.org/will-fdii-stay-will-go/ ("Like a patent box, FDII was meant to encourage companies to keep their intellectual property (IP) in the U.S. or bring it back to the U.S. from offshore locations.").

205. I.R.C. § 250(a). The Foreign-Derived Intangible Income ("FDII") deduction reduces the effective tax rate from twenty-one percent to 13.125%. Frank J. Vari, *Foreign-derived Intangible Income Deduction: Tax Reform's Overlooked New Benefit for U.S. Corporate Exporters*, TAX ADVISER (Aug. 2, 2018), http://www.thetaxadviser.com/newsletters/2018/aug/foreign-derived-intangible-income-deduction.html.

206. Alex Durante, Cody Kallen, Huaqun Li, William McBride, Alex Muresianu, Erica York & Garret Watson, *Build Back Better Act: Details & Analysis of Tax Provisions in the $1.75 Trillion Reconciliation Bill*, TAX FOUND. (Nov. 5, 2021), http://taxfoundation.org/build-back-better-plan-reconciliation-bill-tax ("[BBB] reduce[s] the deduction for Foreign-Derived Intangible Income (FDII) to 21.875 percent, resulting in a tax rate of 15.8 percent, effective for tax years beginning after December 31, 2022.").

207. *Id*.

208. Martin A. Sullivan, *Big Tech Is Moving Profit to the United States*, TAX NOTES (Aug. 23, 2021), http://www.taxnotes.com/tax-notes-federal/corporate-taxation/big-tech-moving-profit-united-states/2021/08/23/776cs; Daniel Bunn, *Intellectual Property Came Back to U.S. After Tax Reform, But Proposals Could Change That*, TAX FOUND. (July 21, 2021), http://taxfoundation.org/intellectual-property-tax-proposals.

209. Agreement on Subsidies and Countervailing Measures, Marrakesh Agreement on Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14; *see also* INT'L TRADE ADMIN., TRADE GUIDE: WTO SUBSIDIES AGREEMENT, http://www.trade.gov/trade-guide-wto-subsidies (last visited Mar. 2, 2022) ("A subsidy granted by a WTO member government is prohibited by the Subsidies Agreement if it is contingent, in law or in fact, on export performance, or on the use of domestic over imported goods. These prohibited subsidies are commonly referred to as export subsidies and import substitution subsidies, respectively.

for foreign trading partners to sue the United States in the World Trade Organization.

4. Base Erosion and Anti-Abuse Tax ("BEAT")

The TCJA introduced the Base Erosion and Anti-Abuse Tax ("BEAT") to prevent base erosion and profit shifting.[210] It denies deductions for certain otherwise deductible payments from a U.S. corporation to a related foreign corporation and instead imposes a tax at ten percent (12.5 percent starting in 2026) payable to the United States.[211] This rule is intended to protect sufficient taxation in source countries.

However, the BEAT has not been very successful so far in raising the revenue that policymakers expected in 2017 when they introduced it.[212] But there is evidence that BEAT revenue may be increasing and that this is likely to continue, as the BBB Act increases the BEAT rate applicable to the base erosion payments from ten percent in 2022 (12.5 percent in 2023, fifteen percent in 2024) to eighteen percent starting in 2025.[213] The BBB Act also fixes some important problems with the BEAT by applying the BEAT to, for example, interest expenses capitalized into inventory.[214] The most important change is making the BEAT application by source countries conditional on the tax rate of residence countries, which is consistent with the single tax principle and the UTPR of Pillar Two.[215]

5. Alternative Minimum Tax ("AMT") for Corporations

A domestic tax provision in the BBB Act that is also relevant to the single tax principle in the new international tax regime is the new book-based[216] alternative minimum tax ("AMT") for corporations, set at fifteen

They are deemed to be specific and are viewed as particularly harmful under the Subsidies Agreement and U.S. law.").

210. INTERNAL REVENUE SERV., IRS PROVIDES ADDITIONAL GUIDANCE ON BASE EROSION AND ANTI-ABUSE TAX, (2020), http://www.irs.gov/newsroom/irs-provides-additional-guidance-on-base-erosion-and-anti-abuse-tax.

211. I.R.C. §§ 59A(b)(1)(A), 59A(b)(2)(A).

212. Martin A. Sullivan, *Economic Analysis: The BEAT Is Down but Not out*, TAX NOTES (Aug. 9, 2021), http://www.taxnotes.com/tax-notes-today-international/base-erosion-and-antiabuse-tax-beat/economic-analysis-beat-down-not-out/2021/08/09/76zw8; *see also* U.S. DEP'T TREASURY, THE MADE IN AMERICA TAX PLAN 12 (2021), http://home.treasury.gov/system/files/136/MadeInAmericaTaxPlan_Report.pdf.

213. BBB Act, H.R. 5376, § 138131(a)(3) (2021) (indicating that the BEAT rate will be ten percent in 2022, 12.5 percent in 2023, fifteen percent in 2024, and eighteen percent in 2025 and thereafter); *see also* Sullivan, *supra* note 212.

214. BBB Act, H.R. 5376, § 138131(b)(2).

215. *See infra* Part III.A.1.

216. Referring to the amount of income corporations publicly report to shareholders in financial statements. Durante, et al., *supra* note 206.

percent.[217] The AMT was designed to reduce a taxpayer's ability to avoid taxes by using certain deductions and other tax benefit items.[218] The TCJA repealed the AMT for corporations, but the BBB Act reintroduces it.[219] The new rule applies to MNEs with an average revenue of over $1 billion USD.[220] The modified corporate AMT rule applies to both U.S. MNEs and foreign MNEs whose U.S. revenue exceeds $100 million USD over three years.[221] Thus, it is an important backstop to the BEAT as well as GILTI by offering another minimum tax rate. It is also consistent with both the IIR for residence country and the UTPR for source country.[222]

6. A New Cap on Interest Expense Deduction

For domestic subsidiaries of foreign MNEs, the BBB Act contains a new cap on net interest expense deduction. The provision limits deductions of net interest expenses to 110 percent of the ratio of the domestic subsidiary's Earnings Before Interest, Tax, Depreciation and Amortization ("EBITDA") to the MNE's EBITDA.[223] This is another protection in addition to the BEAT to prevent the base-erosion payments by MNEs.

7. Room for Improvement

Overall, the international tax provisions in the BBB Act show commitment by the United States to the implementation of Pillar Two and a global minimum tax. They also mark a substantial improvement over the TCJA's international tax provisions, as shown in the increased GILTI and BEAT rates and the tightened FTC rules. They are likely to produce significant revenue and therefore help strengthen the U.S. social safety net.

However, like any legislation that needs to receive a majority vote in Congress, the provisions of the BBB Act represent a compromise. To better realize the single tax principle and combat tax competition, the BBB Act could have proposed a higher GILTI rate with more rigorous anti-base erosion rules.

Furthermore, the BBB Act still lacks an anti-inversion rule. Corporate inversion, also known as tax inversion, occurs when a domestic company moves its headquarters or base of operations overseas to reduce its tax burdens.[224] Inversion occurs when MNEs shop around countries looking for

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217. BBB Act, H.R. 5376, § 138101(a).

218. INTERNAL REVENUE SERV., TOPIC NO. 556 ALTERNATIVE MINIMUM TAX (last updated Jan. 21, 2022), http://www.irs.gov/taxtopics/tc556.

219. BBB Act, H.R. 5376, § 138101.

220. BBB Act, H.R. 5376, § 138101(a)(2), at 1733.

221. BBB Act, H.R. 5376, § 138101(a)(2), at 1733.

222. *See infra* Part III.A.1.

223. BBB Act, H.R. 5376, § 138111(a).

224. *See* Omri Marian, *Home-Country Effects of Corporate Inversions*, 90 WASH. L. REV. 1 (2015); Cathy Hwang, *The New Corporate Migration: Tax Diversion Through Inversion*, 80 BROOK. L. REV. 807 (2015).

low(er) tax rates, resulting in tax competition among countries hoping to host migrating MNEs. Before the TCJA, when the maximum corporate tax rate was thirty-five percent, a lot of U.S. pharmaceutical companies with valuable intangible assets inverted, and low-tax Ireland was a popular new corporate home.[225] In 2004, Congress added Section 7874 to the Internal Revenue Code, which significantly limits the tax benefits associated with corporate inversions.[226] However, more than twenty high-profile inversions were still reported in the early 2010s.[227] The number has reduced significantly since the TCJA reduced the corporate tax rate to twenty-one percent, and the BBB Act maintains the corporate tax rate as twenty-one percent.[228] But twenty-one percent is still higher than the global minimum tax rate of fifteen percent, and U.S. MNEs may still want to relocate to other countries with the minimum tax rate of fifteen percent. A corporate inversion that manages to avoid Section 7874 will not be subject to GILTI or the anti-inversion provisions of the BEAT, because that corporation will no longer be a U.S. taxpayer. Such an inversion may keep tax competition going among countries until the global effective tax rate hits fifteen percent. Given that Pillar Two does not guarantee the full harmony of global corporate tax rates, the BBB Act should have included a more robust anti-inversion rule.[229]

8. Compatibility with Pillar Two Model Rules

The proposed BBB Act was passed by the House of Representatives in November 2021, but not by the Senate.[230] If the BBB Act is enacted in the version that passed the House, the United States will be fully compliant with Pillar Two Model Rules, because both the GILTI rate and the BEAT rate would be raised to fifteen percent, and the BEAT rate would be made contingent upon low taxation at residence, so that the BEAT operates as a UTPR.

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225. Zachary Midler, *Quick Take: Tax Inversion*, BLOOMBERG (Mar. 2, 2017, 4:35 PM), http://www.bloomberg.com/quicktake/tax-inversion.

226. *See* I.R.C. § 7874(a)(1).

227. Midler, *supra* note 225.

228. Garrett Watson, *Tax Base Opens More to Biden's Proposed Rate Hike*, TAX FOUND. (June 22, 2021) http://taxfoundation.org/us-corporate-tax-base (indicating the TCJA reduced the corporate income tax rate from thirty-five to twenty-one percent).

229. For example, policymakers may consider reducing the threshold in Section 7874 to, for example, fifty percent and including a managed and controlled alternative definition of corporate residency.

230. Christina Wilkie, *House Passes $1.75 Trillion Biden Plan That Funds Universal Pre-K, Medicare Expansion and Renewable Energy Credits*, CNBC (Nov. 19, 2021), http://www.cnbc.com/2021/11/19/biden-build-back-better-bill-house-passes-social-safety-net-and-climate-plan.html; Yacob Reyes, *Tim Kaine: Build Back Better Is 'Dead' But Core Provisions Will Pass*, AXIOS (Jan. 16, 2022), http://www.axios.com/tim-kaine-spending-package-6560dd77-b5bc-4d86-893e-dabfebc7e57a.html.

First, raising the GILTI rate to fifteen percent is consistent with the IIR, for which the Pillar Two Model Rules require a top-up tax to fifteen percent imposed at the parent level of a multinational. The QBAI exception to GILTI is consistent with Pillar Two's substance carve-out from IIR.[231] In this context, the OECD stated in a recent document that—

> As noted in the Preamble to the Pillar Two Model Rules, consideration will be given to the conditions under which the US Global Intangible Low-Taxed Income (GILTI) regime will co-exist with the GloBE rules, to ensure a level playing field.[232]

This assurance suggests that the Biden Administration has obtained a concession that the GILTI will be considered as satisfying the IIR as long as the rate is raised to at least fifteen percent.

Second, making BEAT contingent on the level of taxation in the residence country will ensure that BEAT operates in practice in a way that is compatible with the UTPR.[233] In addition, the fact that UTPR comes after IIR makes it less crucial whether the U.S. BEAT rule will firmly comply with Pillar Two, because most foreign MNEs that are potentially subject to the BEAT rule in the United States will be subject to IIR in their residence countries first.[234]

If the BBB Act is not enacted, however, then it is less likely that GILTI and BEAT as enacted by the TCJA will be considered compatible with Pillar Two. First, the current GILTI rate of 10.5 percent is well below the IIR minimum tax rate of fifteen percent in the residence country. As a result, U.S. MNEs will in many cases be subject to UTPR in the source country. Unfortunately, it is not certain whether those corrective taxes imposed by the source country under UTPR would be creditable against the U.S. MNEs' U.S. tax liabilities. Some commentators seem to believe that the source taxation under UTPR is creditable, resulting in significant shifting of tax revenue from the United States to foreign jurisdictions.[235] However, it is also possible that the source taxation under UTPR is not creditable. The United States has recently amended its foreign tax credit rules to make it more difficult to get a credit for foreign taxes in the absence of what the United

231. I.R.C. § 951A(b)(2)(A). Even though the BBB Act calculates the QBAI exception a bit differently (based on assets rather than assets and payroll), it would be considered a minor variation.

232. OECD, THE PILLAR TWO RULES IN A NUTSHELL 2 (Dec. 2021), http://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf.

233. BEAT was introduced as an alternative minimum tax in the TCJA and not a top-up tax mechanism as envisioned by Pillar Two. However, the BBB Act's revision of BEAT rule may make it compliant to UTPR.

234. The BEAT has a $500 million USD revenue threshold. I.R.C. § 59A(e)(1)(B).

235. Dylan Moroses, *US Could Lose Tax Revenue If It Neglects OECD's Pillar 2*, LAW360 TAX AUTHORITY (Mar. 18, 2022), http://www.law360.com/tax-authority/articles/1475431/us-could-lose-tax-revenue-if-it-neglects-oecd-s-pillar-2.

States considers adequate nexus to a foreign country.[236] This change was designed to clarify that DSTs are not creditable.[237] But the scope of the new foreign tax credit rule is broad and may apply to the source taxation under UTPR to deny foreign tax credits, causing double taxation in the residence (U.S.) and source countries.

Second, the current BEAT rate of ten percent is likewise too low for UTPR purposes in the source country. In addition, the current BEAT is not contingent on the level of the residence country taxation. As a result, it is likely that BEAT will not be compliant with Pillar Two, and thus, foreign residence countries will not respect the U.S. tax paid under BEAT rules when they apply IIR, causing double taxation in the residence and source countries.[238]

Therefore, the tax consequences of not complying with Pillar Two when the rest of the world does comply are likely to be tax revenue loss in the United States and the increased risk of double taxation by taxpayers. The results harm the single tax principle that the global deal aims to accomplish. Hence, the authors of this article hope that Congress will pass the provisions relating to Pillar Two in 2022 as is proposed in the BBB Act, regardless of how they are rebranded and repromoted.

In March 2022, the U.S. Department of the Treasury released the Greenbook for fiscal year 2023.[239] This publication outlines and explains the Biden Administration's tax proposals. The budget released by Treasury assumes that the BBB Act, as passed by the House of Representatives on November 19, 2021, will be enacted.[240] However, if the corporate tax rate would increase to twenty-eight percent, the GILTI rate would automatically increase to twenty-one percent.

IV. PROMISES AND PITFALLS OF THE GLOBAL MINIMUM TAX

Pillar Two would significantly reduce MNEs' incentives to change their place of residence or the location of their headquarters to exploit tax compe-

236. 87 Fed. Reg. 276 (Jan. 4, 2022) (Guidance Related to the Foreign Tax Credit; Clarification of Foreign-Derived Intangible Income).

237. *Id*. at 289–90.

238. Current BEAT may not only be incompatible with Pillar Two, but also has another problem. Some commentators argue that BEAT is discriminatory because it applies only to payments to related foreign parties by partially denying deductions, and thus may violate Art. 24 (nondiscrimination) of most tax treaties. *See* H. David Rosenbloom and Fadi Shaheen, *The BEAT and the Treaties*, 92 TAX NOTES INT'L 53 (2018); Reuven S. Avi-Yonah and Brett Wells, *The Beat and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen*, 6 (UNIV. MICH. LAW & ECON. Working Papers, 2018).

239. U.S. DEP'T TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2023 REVENUE PROPOSALS (2022).

240. *Id.* at iii (stating that the revenue proposals based on provisions of Title XIII of H.R. 5376 as passed by the House of Representatives on November 19, 2021, except for Sec. 137601).

tition by source countries. However, it is important to note that Pillar Two also offers measures for effective residence-based taxation. This Part discusses the promises and pitfalls of Pillar Two. First, we discuss the promise of global tax reform, specifically, raising additional revenue and reducing profit shifting. Second, we explore the various challenges facing Pillar Two, notably, concerns of developing countries, various carve-outs, and the logistical puzzle of implementation.

A. *Promise of the New International Tax Regime*

Many policymakers who participated in the global tax deal hail the Statement as a long-waited international tax reform and an important step in combatting tax competition, tax base erosion, and profit shifting. Mathias Cormann, OECD Secretary-General said that "the deal would make the international corporate tax system 'fairer and work better.'"[241] We believe that Pillar Two, in particular, would generate substantial revenue and lead to behavioral changes in both countries and taxpayers to engage in less tax competition. In short, Pillar Two is the modern embodiment of the single tax principle.

1. Additional Revenue

Pillar Two, with its global minimum corporate income tax of fifteen percent, is expected to generate approximately $150 billion USD in additional global tax revenues each year.[242] While the primary revenue effects of Pillar One will be the reallocation of profits (about $100 billion USD) to source countries annually,[243] Pillar Two is a true revenue generator. Hence, from a global perspective, the global tax reform will benefit the world via revenue generation.[244] The International Monetary Fund ("IMF"), representing an additional fifty-one countries, also backs the plan, indicating broader global support outside the Inclusive Framework.[245] The additional revenue

241. Chris Giles, Emma Agyemang & Aime Williams, *136 Nations Agree to Biggest Corporate Tax Deal in a Century*, FIN. TIMES (Oct. 8, 2021), http://www.ft.com/content/5dc4e2d5-d7bd-4000-bf94-088f17e21936.

242. OECD, TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITILISATION OF THE ECONOMY 5 (Oct. 2021), http://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.

243. *130 Countries and Jurisdictions Join Bold New Framework for International Tax Reform*, OECD (July 1, 2021), http://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm.

244. William Horobin, *Global Tax Overhaul Endorsed by 130 Nations as Deal Gets Closer*, BLOOMBERG (July 1, 2021, 9:57 AM), http://www.bloomberg.com/news/articles/2021-07-01/global-tax-overhaul-endorsed-by-130-nations-as-deal-gets-closer.

245. Eric Martin, *IMF Sees Room to Simplify Global Tax Deal to Boost Participation*, BLOOMBERG (July 10, 2021), http://www.bloomberg.com/news/articles/2021-07-10/imf-sees-room-to-simplify-global-tax-deal-to-boost-participation.

generated by Pillar Two may be used to recover national economies from the pandemic or to support sustainable tax policies relating to Environmental, Social, and Corporate Governance ("ESG").[246]

2. Reducing Profit Shifting and Tax Competition: A Realization of the Single Tax Principle

Pillar Two mandates a fifteen percent global minimum tax, compelling the global community to stop tax competition and the race to the bottom. As a result, Pillar Two is expected to reduce profit shifting by MNEs. If enough large economies agree to implement Pillar Two, there will be no incentive for companies to move their businesses to low-tax jurisdictions. U.S. Treasury Secretary Janet L. Yellen, who negotiated the deal, praised Pillar Two as ending the race to the bottom on corporate taxation rates.[247]

Therefore, Pillar Two resolves the traditional economics debate between advocates of capital export neutrality ("CEN") and supporters of capital import/ownership neutrality ("CIN"/ "CON"),[248] because this debate rests on the assumption that corporate tax rates cannot be harmonized and thus companies have different incentives for choice of location under each theory.[249] However, if corporate tax rates are harmonized, as expected in Pillar Two, then CEN, CIN, and CON can be achieved simultaneously.[250]

Importantly, Pillar Two eliminates the main critique that has bedeviled the United States' attempts to raise taxes on its MNEs since the 1960s. The argument that the unilateral adoption of higher rates of corporate tax on MNEs' foreign source income puts U.S. MNEs_at a competitive disad-

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246. Stephen Cooper, *House Sends Biden's $1.75T Budget Plan to Senate*, LAW360 (Nov. 19, 2021), http://www.law360.com/tax-authority/federal/articles/1442179 (explaining how the BBB Act plans to use revenue to pay for new or expanded tax incentives for child care, renewable energy, and health care).

247. David J. Lynch, *Global Minimum Tax Effort Moves Forward as Ireland and Hungary Join Pact*, WASH. POST (Oct. 8, 2021), http://www.washingtonpost.com/us-policy/2021/10/08/minimum-corporate-tax-oecd-biden.

248. Capital export neutrality ("CEN") refers to an investor's choice between investing her savings in her country of residence or in a foreign source country. CEN exists when residence and source country investments that earn the same pretax return also yield the same after-tax return. On the other hand, capital import neutrality ("CIN") requires that the earnings from capital in a source country be taxed at the same rate for both domestic and foreign investors. Capital ownership neutrality ("CON") is an alternative neutrality, demanding that taxation not influence who owns assets. *See* Mihir A. Desai & James R. Hines Jr., *Evaluating International Tax Reform*, 56 NAT'L TAX J. 487 (2003); Michael J. Graetz, *David R. Tillinghast Lecture Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 270–77 (2001); Daniel Shaviro, *The David R. Tillinghast Lecture - The Rising Tax-Electivity of U.S. Corporate Residence*, 64 TAX L. REV. 377, 386–87 (2010).

249. Desai & Hines, *supra* note 248; Graetz, *supra* note 248; Shaviro *supra* note 248.

250. Reuven S. Avi-Yonah, *Is It Time to Coordinate Corporate Tax Rates? A Note on Horst* (U. of Mich. Pub. L. & Legal Theory Rsch. Series, Paper No. 382, 2014), http://ssrn.com/abstract=2389959 or http://dx.doi.org/10.2139/ssrn.2389959.

vantage vis-a-vis MNEs from other countries is often used.[251] This argument has never been persuasive because, both in the 1960s and today, U.S. MNEs dominate their competition.[252] But it had political appeal, leading to the TCJA reducing the corporate tax rate to twenty-one percent.[253] However, such competitive rhetoric would disappear as a concern if all the G20 MNEs, which comprise over ninety percent of all MNEs, were subject to the same minimum tax rate.

An important aspect of Pillar Two that is not addressed in the Statement but is essential for successful implementation is the prevention of MNEs from leaving the G20 and thereby escaping the IIR of residence country (although perhaps not the UTPR/STTR). In most EU countries this is unlikely because of their corporate exit taxes.[254] But the United States and the United Kingdom do not have such taxes, making corporate exodus a viable concern.[255] Furthermore, the United States has a different definition of corporate residency from the rest of the world: A business incorporated in the United States is a U.S. tax resident regardless of its domiciliary or place of management,[256] whereas other countries, to a broad extent, use both the place of incorporation and place of management tests.[257] Such mismatches of corporate residence rules may aggravate the concern that, even if Pillar Two firmly established the single tax principle in the G20, another form of tax competition among non-G20 countries may emerge for hosting migrating companies.

B. *Potential Challenges*

So far, Pillar Two has received overall positive responses from the media and commentators. However, there have also been criticisms about the specifics of the agreement. Common criticisms are that Pillar Two does not

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251. Daniel Bunn, *U.S. Cross-Border Tax Reform and the Cautionary Tale of GILTI*, TAX FOUND. (Feb. 17, 2021), http://taxfoundation.org/gilti-us-cross-border-tax-reform/#Key.

252. Reuven S. Avi-Yonah & Nicola Sartori, *Symposium on International Taxation and Competitiveness: Introduction and Overview*, 65 TAX L. REV 313, 319 (2012); *see also Biggest Companies in the World 2022*, FINANCECHARTS, http://www.financecharts.com/screener/biggest (last visited Mar. 29, 2022) (indicating the top 10 companies are from the United States).

253. I.R.C. § 11.

254. Sebastian Dueñas & Daniel Bunn, *Tax Avoidance Rules Increase the Compliance Burden in EU Member Countries*, TAX FOUND. (Mar. 28, 2019), http://taxfoundation.org/eu-tax-avoidance-rules-increase-tax-compliance-burden (indicating that seventeen of twenty-eight EU countries have exit taxes).

255. Reuven S. Avi-Yonah, *For Haven's Sake: Reflections on Inversion Transactions*, 95 TAX NOTES 1793 (June 17, 2002).

256. *See* David R. Tillinghast, *A Matter of Definition: Foreign and Domestic Taxpayers*, 2 INT'L TAX & BUS. L. 239, 252–53 (1984).

257. Christos Theophilou, *Insight: Corporate Residence Post-BEPS and Global Mobility*, BLOOMBERG TAX (June 10, 2020, 3:00 AM), http://news.bloombergtax.com/daily-tax-report-international/insight-corporate-residence-post-beps-and-global-mobility.

go far enough to ensure MNEs are taxed fairly, that various carve-outs and exceptions make the agreement unbalanced, and that it is unclear what would happen to Pillar Two in the implementation stage. This Subpart discusses these challenges and offers possible responses.

1. Priority to Residence-Based Taxation and Developing Countries' Concerns

It is true that Pillar Two is quite complex and possibly flawed since it accords primacy to the country of residence by giving priority to IIR for residence taxation over UTPR and STTR for source taxation. Thus, the source country's tax will only be applicable if the residence country chooses not to tax.

The precedence of the IIR over the UTPR/STTR in Pillar Two has also led to critiques of Pillar Two—namely that it is not reflective of the concerns of developing countries that largely consist of source countries. For example, the Tax Justice Network and Oxfam criticized the global minimum tax for unfairly providing advantages to the world's wealthier countries.[258] Specifically, they argue that the imposition of residence-based tax on MNEs under the IIR will make it impossible for developing countries to attract FDI by granting tax concessions, and that the UTPR and STTR are meaningless if all the income of MNEs is already subject to the minimum tax rate of fifteen percent under the IIR.[259] Despite lofty goals of ending tax havens and tax competition, the critiques highlight sizeable incentives for profit shifting that still remain due to exemptions and loopholes that the global tax deal was supposed to curtail.[260]

This critique is only partially valid, however. The first criticism about the ability to attract FDI assumes that developing countries actually wish to grant tax concessions to MNEs based on a cost/benefit analysis. This is not true. Most empirical studies suggest that the main reason to allow tax concessions, tax holidays, and tax competition is the threat of the MNEs going elsewhere.[261] If that is the case, developing countries would benefit from the IIR because it neutralizes the MNE's ability to conduct such an auction by subjecting it to the minimum tax wherever it goes.

It is true that if the UTPR/STTR for source taxation were given primacy over the IIR for residence taxation then developing countries might gain more revenue. However, it is not clear that in the absence of the IIR, devel-

258. Hamish Boland-Rudder & Spencer Woodman, *136 Countries Agree to Global Minimum Tax for Corporations in 'Historic' OECD Deal*, INT'L CONSORTIUM INVESTIGATIVE JOURNALISM (Oct. 8, 2021), http://www.icij.org/investigations/paradise-papers/136-countries-agree-to-global-minimum-tax-for-corporations-in-historic-oecd-deal.

259. *Id*.

260. *Id.*

261. Reuven S. Avi-Yonah, *Bridging the North-South Divide: International Redistribution and Tax Competition*, 26 MICH. J. INT'L L. 371 (2004).

oping countries would be able to impose taxes under the UTPR/STTR because, without the IIR for residence taxation, the MNE could threaten to go elsewhere. In other words, the IIR neutralizes the behavioral incentives of multinational taxpayers to engage in location shopping and the UTTR /STTR neutralizes the incentive of source countries to engage in tax competition.

In addition, foreign tax credits will be available under the IIR just like they are (with limitations) under GILTI. This means that, in practice, developing countries can impose source taxation on MNEs' FDI, and those MNEs will not suffer because these taxes will be credited against the residence taxation imposed by the IIR.

Finally, the substance carve-outs will enable developing countries to engage in some level of tax competition for real investment. Large developing countries are also expected to gain significant additional revenue from Pillar One. For all these reasons, we believe that the critique that Pillar Two disadvantages developing countries is exaggerated.[262]

Nonetheless, there might be an alternative to Pillar Two that implements the single tax principle more effectively with fewer concerns to developing countries. That is, Pillar Two may be tweaked in order to ensure that countries can tax MNEs on both inbound and outbound investments. This could be done by applying a substance-based test using a fractional apportionment method in transfer pricing. This method would allocate MNEs' profits that have not been effectively taxed amongst all countries in which a MNE has a taxable presence. Once profits of MNEs are allocated among relevant countries based on the substance-based test, each country would impose taxes on such profits according to their own respective tax rates. This alternative would not require the application of the complex IIR and UTPR, and instead rely on fractional apportionment based on assets, personnel, and sales revenue (by locations of customers or users). While the GloBE rules impose a top-up tax only in the country of residence,[263] this alternative would allow all affected countries, either as residence or source, to impose tax based on their respective shares of the undertaxed profits.

2. Various Carve-Outs

During the negotiation of Pillar Two in mid-2021, there were nine countries that opposed it.[264] These countries included several in Europe,

262. For similar reasons, we respectfully oppose the argument that tax harmony and cooperation envisioned in Pillar Two does not help developing countries. *See* Cui, *supra* note 31.

263. *Statement*, *supra* note 1, at 3–4.

264. Cliff Taylor & Ellen O'Riordan, *Ireland One of 9 Countries to Hold Out on Signing OECD Global Tax Deal*, IRISH TIMES (July 1, 2021, 5:08 PM), http://www.irishtimes.com /business/economy/ireland-one-of-9-countries-to-hold-out-on-signing-oecd-global-tax-deal-1.4609129; *see also* Jorge Liboreiro, *Ireland, Hungary and Estonia Opt out of OECD Tax Deal and Cast Shadow over EU's Unified Position*, EURONEWS (Aug. 26, 2021),

namely Hungary, Ireland, and Estonia. Although they account for just four percent of the EU's economic output, they were in a position to deal a significant blow to the prospects of the OECD's tax plan.[265] Tax directives in the EU require the unanimous consent of all twenty-seven member states, effectively giving a single EU member veto power over the agreement.[266]

Statements made by officials in each country emphasized that Ireland, Hungary, and Estonia did not present a united front or adhere to a common core principle.[267] Ireland supported Pillar One but demanded that the fifteen percent global minimum tax rate be lower because its corporate tax rate is 12.5 percent.[268] Hungary had issues with the plan's industry carve-outs.[269] Finally, Estonia simply wanted to preserve its unique tax system.[270]

Eventually, the EU hold-out did not occur. One hundred and thirty-seven countries, including Ireland, Hungary, and Estonia, agreed to the global tax deal, including Pillar Two. However, the global tax deal now includes various carve-outs and reservations. For example, Ireland agreed to

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http://www.euronews.com/2021/07/02/ireland-hungary-and-estonia-opt-out-of-oecd-tax-deal-and-cast-shadow-over-eu-s-unified-pos (indicating the nine countries that did not sign on to the OECD global deal are Ireland, Hungary, Estonia, Kenya, Nigeria, Peru, Sri Lanka, Barbados, and Saint Vincent and the Grenadines).

265. Zoltan Simon & Peter Flanagan, *European Trio Cast Dissatisfied Shadow over Global Tax Accord*, BLOOMBERG (July 2, 2021), http://www.bloomberg.com/news/articles/2021-07-02/europe-s-new-awkward-squad-casts-shadow-over-global-tax-deal. https://www.bloomberg.com/news/articles/2021-07-02/europe-s-new-awkward-squad-casts-shadow-over-global-tax-deal

266. Christopher Condon, *G-20 Finance Chiefs Back Tax Deal and Vow to Clear Hurdles*, BLOOMBERG (July 10, 2021), http://www.bloomberg.com/news/articles/2021-07-10/yellen-optimistic-congress-will-back-part-of-global-tax-deal. *Cf.* Faulhaber, *supra* note 23 (suggesting that even if one of the member states remains a hold-out, the EU can possibly still implement the global minimum tax portion of the OECD plan through the issuance of a directive. Whether the directive would survive a legal challenge is uncertain, but the fact that the tax is a minimum tax makes winning the challenge more likely).

267. Stephanie Soong Johnston & Sarah Paez, *Ireland, Estonia to Join OECD Global Tax Reform Deal*, TAX NOTES (Oct. 11, 2021), http://www.taxnotes.com/tax-notes-international/base-erosion-and-profit-shifting-beps/ireland-estonia-join-oecd-global-tax-reform-deal/2021/10/11/7bbn3?highlight=opposition%20to%20OECD%20g.

268. Liz Alderman, *Ireland's Days as a Tax Haven May Be Ending, but Not Without a Fight*, N.Y. TIMES (July 12, 2021), http://www.nytimes.com/2021/07/08/business/ireland-minimum-corporate-tax.html.

269. Elodie Lamer, *Growing Unease in EU Over Global Tax Deal's Next Steps*, TAX NOTES (July 12, 2021), http://www.taxnotes.com/tax-notes-today-international/corporate-taxation/growing-unease-eu-over-global-tax-deals-next-steps/2021/07/12/76rz4?highlight=OECD.

270. Todd Buell, *Estonian Official Airs Country's Objections to Global Minimum Tax*, LAW 360 (July 16, 2021), http://www.law360.com/tax-authority/international/articles/1403781/estonian-official-airs-country-s-objections-to-global-minimum-tax. *See also* Kyle Pomerleau, *The Key Component of the Estonia's Competitive Tax System*, TAX FOUND. (Oct. 6, 2015), http://taxfoundation.org/key-component-estonia-s-competitive-tax-system (explaining that the unique feature of Estonia's corporate income tax system is a cash-flow tax, meaning corporate income tax is only levied when business pay out to shareholders).

end its 12.5 percent corporate tax rate and join the deal at the last minute, "with assurances sought and received from the EU that it would not seek to increase the tax rate further down the line."[271] Hungary obtained the ten-year transition period, during which it may "offer a lower rate of tax for tangible investments in its jurisdiction—such as automotive plants."[272] China also succeeded in having a clause inserted that would limit the effect of the global minimum tax on companies who are starting to expand internationally—because of concerns that its growing domestic companies would be clipped by the measures.[273]

Commentators argue that these carve-outs and exemptions failed the original ambition of the global tax deal. Instead of leveling the playing field, the watered-down measures mean that only a "sliver of the profits" of MNEs will become taxable, while incentives to shift profits remain sizable.[274] Alex Coham, CEO of the Tax Justice Network, commented in a statement that, "[i]t's no wonder that Ireland and other havens have embraced the deal, especially after obtaining various concessions."[275] Civil society organization, Oxfam, also criticized that the global deal panders to tax havens and multinational corporations with exemptions and loopholes that meant the new measures have "practically no teeth" and will offer no revenue help to the world's poorest countries.[276]

We also disfavor these carve-outs. Some level of compromise is inevitable to achieve a global tax deal and bring almost 140 member states to the negotiation table. However, the purpose of seeking a global deal for Pillar Two is to accomplish tax harmony to end tax competition. These carve-outs clearly violate the single tax principle by offering various methods for certain countries to continue tax competition, especially among source countries. What is worse, the carve-outs disturb tax harmony, weakening the effectiveness of Pillar Two measures among countries who are fully committed to the single tax principle.

3. Logistical Puzzle

There is an additional concern about whether the global tax deal consisting of Pillars One and Two could actually be implemented, especially in

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271. Lisa O'Carroll, *Ireland Ends 12.5% Tax Rate in OECD Global Pact*, THE GUARDIAN, (Oct. 7, 2021), http://www.theguardian.com/world/2021/oct/07/ireland-poised-to-drop-125-tax-rate-in-oecd-global-pact.

272. Giles, et al., *supra* note 241.

273. *Id.*

274. Boland-Rudder & Woodman, *supra* note 258.

275. Alex Cobham, *OECD Tax Deal Fails to Deliver*, TAX JUST. NETWORK (Oct. 8, 2021), http://taxjustice.net/press/oecd-tax-deal-fails-to-deliver.

276. Press Release, OXFAM Int'l, OECD Tax Deal is a Mockery of Fairness: Oxfam (Oct. 8, 2021), http://www.oxfam.org/en/press-releases/oecd-tax-deal-mockery-fairness-oxfam.

the United States.[277] The goal is for countries to sign a multilateral convention during 2022 with an effective date of 2023, although most practitioners view this timeline as highly unlikely. Political realities in the United States illustrate the complexities of implementing the global tax agreement.[278] The Biden Administration has a pretty thin majority in the Senate and in the House of Representatives, so it is very doubtful that the G20/OECD international tax plan will be passed by the U.S. Congress in a single bill, increasing the difficulty of ratification in the U.S. Senate.[279] Considering that the United States is important to have on board to ensure the effective implementation of both Pillars, the successful implementation of the global tax deal is an open question.

Pillar One will alter U.S. treaties with other countries, and therefore will need to be implemented through a multilateral treaty approved by two-thirds of the U.S. Senate.[280] However, getting seventeen Republican senators to support a treaty measure that many view as penalizing U.S. companies may be a non-starter in the current economic and political climate.[281] The senior Republicans on the tax-writing Senate Finance and House Ways and Means committees already expressed opposition to Pillar One.[282] Furthermore, in a joint statement, Senator Mike Crapo (R-Idaho) and Congressman Kevin Brady (R-Texas) criticized the Biden Administration for pursuing the global tax deal agreement before Congress has acted on the administration's proposed changes to U.S. tax law, such as GILTI, calling into question how quickly lawmakers may act on needed change.[283] They also mentioned in a joint statement that "as other countries delay implementation and secure side agreements and carve-outs to protect their own companies, U.S. businesses will be hit by tax increases ultimately borne by American workers,

277. Aime Williams, *G7 Tax Deal Faces Opposition in US Congress*, FIN. TIMES (June 9, 2021), http://www.ft.com/content/6c98b271-bd13-4517-81bb-6ef7f1798085.

278. James-Paul Galligan, Christine Green, Kevin Kelly & Kenneth Wear, *OECD Tax Deal: When Does it Become Law?*, JDSUPRA (Oct. 18, 2021), http://www.jdsupra.com/legalnews/oecd-tax-deal-when-does-it-become-law-3448977.

279. Stephanie Soong Johnston, *The End is Nigh: An Update on the OECD Tax Reform Plan*, FORBES (Oct. 19, 2021), http://www.forbes.com/sites/taxnotes/2021/10/19/the-end-is-nigh-an-update-on-the-oecd-tax-reform-plan/?sh=353cdb891634.

280. Lilian Faulhaber, *Will the OECD Plan Fix International Taxation?,* LAW360 (July 7, 2021), http://www.law360.com/articles/1400693.

281. Mindy Herzfeld, *Pushing Pillar 1 Past Congress*, TAX NOTES (July 19, 2021), http://www.taxnotes.com/tax-notes-today-federal/fundamental-tax-system-structure/pushing-pillar-1-past-congress/2021/07/19/76vyv?highlight=base%20erosion.

282. Lynch, *supra* note 247.

283. Letter from Senator Mike Crapo, Ranking Member, Comm. on Fin. & Congressman Kevin Brady, Ranking Member, Comm. on Ways and Means, to Senator Ron Wyden, Chairman, Comm. on Fin. and Congressman Richard Neal, Chairman, Comm. on Ways and Means (Sept. 2, 2021).

savers and consumers."[284] Hence, Senate approval of Pillar One in any form will almost certainly require the inclusion of a ban on all current and future DSTs, including the proposed EU digital levy.[285]

Pillar Two, on the other hand, is generally compatible with existing tax treaties and can likely be implemented with changes to domestic tax legislation.[286] Unlike Pillar One, Pillar Two can be implemented without any changes in existing tax treaties as far as the IIR is concerned, as evidenced by the United States unilaterally adopting GILTI.[287] UTPR and STTR may require changes in tax treaties, but they are of secondary importance because they work conditionally. Since treaties are hard to change in the United States because of Senate ratification, this is an important advantage of Pillar Two over Pillar One. We also anticipate that a lot of countries will be implementing Pillar Two by domestic legislation, given the strong interest in its development and the fact that it helps countries protect their tax base by embodying a modern single tax principle.

Therefore, the Biden Administration may attempt to use the reconciliation process, only requiring a majority vote in the U.S. Senate, to push through changes related to Pillar Two's tax reform plan in the BBB Act and negotiate with the Senate on Pillar One at a later time.[288]

However, the $3.5 trillion USD BBB Act still faces obstacles in the closely divided House and Senate. Some House Democrats have pushed back against any increases to the GILTI tax.[289] Furthermore, the piecemeal implementation of the global tax reform plan that will likely happen in the United States will unfortunately create tension between the United States and the EU when good faith and trust are required in order for the plan to be fully implemented. Nonetheless, the logistical puzzle for implementing Pillar Two in the United States is less significant compared to that for Pillar One, which should go through treaty ratification process in the Senate.

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284. *Brady, Crapo: Biden Global Tax Deal Puts Politics Over Progress, Surrenders Fate of U.S. Economy to Foreign Competitors*, U.S. SENATE COMM. ON FIN. (Oct. 8, 2021), http://www.finance.senate.gov/ranking-members-news/brady-crapo-biden-global-tax-deal-puts-politics-over-progress-surrenders-fate-of-us-economy-to-foreign-competitors.

285. Stephanie Soong Johnston, *Crapo and Brady Urge Yellen to Push for Immediate End to DSTs*, TAX NOTES (July 12, 2021), http://www.taxnotes.com/tax-notes-federal/digital-economy/crapo-and-brady-urge-yellen-push-immediate-end-dsts/2021/07/12/76rtc?highlight=OECD.

286. Faulhaber, *supra* note 23.

287. I.R.C. § 951A; *see also* Daniel Bunn, *U.S. Cross-border Tax Reform and the Cautionary Tale of GILTI*, TAX FOUND. (Feb. 17, 2021), http://taxfoundation.org/gilti-us-cross-border-tax-reform (indicating that the U.S. adopted GILTI as an anti-base erosion rule).

288. Stephanie Soong Johnston, *Reconciliation Bill May Have Global Minimum Tax Provisions*, TAX NOTES (July 12, 2021), http://www.taxnotes.com/tax-notes-federal/politics-taxation/reconciliation-bill-may-have-global-minimum-tax-provisions/2021/07/12/76rl1?highlight=Pillar%201.

289. Alex Parker, *How the Global Tax Agreement Could Backfire for Biden*, LAW360, (Oct. 18, 2021), http://www.law360.com/tax-authority/articles/1431269/how-the-global-tax-agreement-could-backfire-for-biden.

Hence, the United States' enacting domestic legislation to implement Pillar Two is the key to solving the logistical puzzle for the overall success of the global tax reform plan as well as the modern single tax principle. To make it possible, the two Pillars could be severed. The objective of both the OECD and the United States seems to be to adopt both Pillars One and Two as a package deal.[290] Both address the tax challenges in the digitalized economy and combat the base erosion and profit shifting by MNEs. However, Pillars One and Two are conceptually separate from each other—Pillar One modernizes source-based taxation, whereas Pillar Two embodies the single tax principle by reinforcing residence-based taxation. There is no logical reason to treat the two Pillars as "linked by more than just politics," as the United States argues.[291]

Furthermore, Pillar Two can be implemented by the G20 even if Pillar One collapses because some countries refuse to abolish DSTs. In other words, Pillar Two does not need universal implementation by all IF member states because it is a measure that a country can implement to protect its own tax base, irrespective of what other countries do. Hence, it is less critical, although not desirable, if a low-tax jurisdiction does not implement Pillar Two, because the domestic legislation resulting from Pillar Two will allow the residence country to essentially tax back the income that has not been taxed in the low-tax jurisdiction. Moreover, over ninety percent of large MNEs are headquartered in the G20,[292] so only a relatively small number of countries need to agree to implement an effective global minimum tax. However, Pillar Two still requires international cooperation among the G20 countries to adopt the harmonized domestic legislation that is essential to stopping tax competition, base erosion, and profit shifting. Thus, the United States should cooperate with the G20 countries to enact Pillar Two even if Pillar One fails. Risking Pillar Two to salvage Pillar One is unwise and regrettable because Pillar Two would be the first global tax harmony in substantive tax law guided by the single tax principle.

CONCLUSION

In *L'ancien Regime et la Revolution (1856),* Alexis de Tocqueville argued that the roots of the radical changes imposed by the French Revolution could be found in the Old Regime it sought to replace.[293] Similarly, the roots of the new international tax regime as embodied in the Statement can be traced to the benefits principle and the single tax principle, both of which

290. U.S. Dep't of the Treasury, Presentation by the United States to the Steering Group of the Inclusive Framework Meeting (2021), http://www.politico.com/f/?id=00000178-b389-d098-a97a-f79960510001 (slide seven).

291. *Id*.

292. Saez & Zucman, *supra* note 67.

293. ALEXIS DE TOCQUEVILLE, L'ANCIEN RÉGIME ET LA RÉVOLUTION [THE OLD REGIME AND THE REVOLUTION] (7th ed. 1866).

stem from the origins of the international tax regime a century ago. The benefits principle was the compromise between the claims of residence and source jurisdictions reached by the four economists in 1923,[294] while the single tax principle can be traced to Thomas Adams in 1918 and the League of Nations experts in 1927.[295] However, unlike what happened in the French Revolution, the Statement does not entirely replace the old international tax regime. Instead, the Statement is an evolution from, or improvement of, the benefits principle and the single tax principle.

Nevertheless, the new international tax regime envisaged in the two Pillars in the Statement is also revolutionary. Pillar One (if implemented) will partially remove the two main obstacles to taxing modern MNEs operating in the digital economy, namely the physical presence requirement and the arm's-length standard. Pillar Two will fully implement the single tax principle on a global level for the first time through strengthening both source and residence taxation with various secondary corrective measures. It will raise significant revenue for the participating countries, stop tax competition, and reduce base erosion and profit shifting. However, the proposed global minimum tax rate of fifteen percent would be lower than the average G20 corporate tax rate, and substance carve-outs would maintain some double non-taxation. Additionally, it may disproportionately harm developing countries more than developed countries.

However, these flaws in Pillar Two could be eliminated based on the outcome of current negotiations in the United States over reforming GILTI. The U.S. GILTI rule, together with BEAT, has been grandfathered as fulfilling the IIR and UTPR of Pillar Two. President Biden has proposed raising the GILTI rate to twenty-one percent and eliminating the participation exemption. Also, the President has proposed replacing BEAT with Stopping Harmful Inversions and Ending Low-Tax Developments ("SHIELD"), which is designed explicitly to fit the UTPR of Pillar Two, because it imposes withholding tax on U.S. source income only if there is not adequate taxation at the residence country.[296] Unfortunately, the BBB Act did not incorporate all of the President's proposals. If, however, the United States adopts these reforms, it is likely to generate a race to the "top" as other

294. *See supra* text accompanying notes 62–64.

295. *See supra* text accompanying notes 73–74.

296. Stopping Harmful Inversions and Ending Low-Tax Developments ("SHIELD") would deny corporate deductions by reference to payments to foreign related persons that are subject to a low effective tax rate, unless the income is subject to an acceptable minimum tax regime. SHIELD is intended to more effectively target profit shifting to low-taxed jurisdictions compared to BEAT, while simultaneously providing a strong incentive for other nations to enact global minimum tax regimes. U.S. DEP'T OF THE TREASURY, THE MADE IN AMERICA TAX PLAN 11–12 (2021), http://home.treasury.gov/system/files/136/MadeInAmericaTaxPlan_Report.pdf.

countries follow suit, especially since SHIELD will put pressure on residence countries to adopt the IIR.[297]

Overall, Pillar Two promises to finally break the back of tax competition by implementing the single tax principle harmoniously. Successful implementation of Pillar Two should enable both developed and developing countries to maintain free trade and globalization while also retaining and strengthening the social safety net from the added revenues extracted from the world's largest corporations. We should all hope that in the face of the pressures of de-globalization and rising nationalism, the new international tax regime seeking tax harmony will survive and enable all countries to overcome tax competition and maintain a robust social safety net for their citizens.

297. A similar race to the top occurred when the United States adopted the CFC rules in the 1960s, followed by over thirty other countries, including most of the G20. Reuven S. Avi-Yonah, *Constructive Unilateralism: U.S. Leadership and International Taxation,* 42 INT'L TAX J. 17 (2016).