EDITORIAL

The Return of the Phoenix? The G-7 Countries' *Agreement* on a 15% Minimum Tax

The so-called BEPS 2.0 initiative of the OECD, attempting to preserve public attention and political will in support of its leadership of a global effort to revise the norms of the international tax regime, was recently given a boost with the announcement by the G-7 organization of an agreement among its rich members to support the OECD initiative. The agreement was particularly celebratory since it outwardly brought back the United States to the forefront of the international tax discourse after quite a few years of minimal involvement (during the Trump Administration) and primarily defensive stance (during the BEPS project). This editorial does not doubt the importance of the United States to any international tax discourse, yet it wishes to express caution about its meaning for progress. Like always, the devil is in the details, and there are many of those in our case.

The core of the celebrated agreement, announced on 5 June 2021, by the G-7 organization was an agreement on a global 15% minimum tax on the largest multinational corporations (MNE). In a communiqué published jointly by various constituencies during this year's U.K. meeting of the organization it also announced support of the OECD two-pillars based work on the taxation of the digital economy, specifying that the outcome of such work should replace the uncoordinated digital service taxes that had proliferated around the world in response to the inability to reach global consensus over the proper way of taxing the digital economy.

But what exactly is the agreement? The communiqué is naturally vague, expressing only a commitment to 'a global minimum tax of at least 15% on a country by country basis'.[1] The OECD Secretary-General, celebrating the support expressed by the G7 to his organization's work, explained that the agreement was on the Pillar 2 proposal, setting the minimum rate at 15%.[2] The U.K. Chancellor (the host of the meeting) explained that the commitment is that multinational will pay a minimum of 15% tax *in each country they operate.*[3] US Treasury Secretary Janet Yellen seemed slightly more realistic when she said that it is not a 'finished agreement' and that 'this effort is far from over'.[4] One must ask therefore what is new. Is it the agreement over the minimum rate, which means that Ireland's 12.5% rate is unacceptably low?[5] Is it a strong signal of support for the OECD by the richest western jurisdictions? Or is it the renewed participation and leadership of the United States in the process?

Secretary Yellen's cautionary comments are particularly important since it is widely believed that the US 20 May 2021 proposal of a 15% minimum tax floor during meetings of the OECD Inclusive Framework steering group was the trigger for the progress and eventual G7 agreement on the matter.[6] The proposal and G-7 agreement moved forward in parallel to the Biden Administration's promotion of domestic tax reform, which faces formidable political obstacles and has already been amended a few times over the last few months.

The core goal of the US proposal was to eliminate the 'race to the bottom' in corporate tax rates and so-called inversions. The idea was to ensure that MNE have no incentive to change their residence to reduce their tax burden. This, of course, is in line with the global fight against aggressive tax planning, but (and this is a factor that is completely ignored in the discourse) it also puts an unequal, and maybe unfair burden on poorer jurisdictions that should now implement and enforce a minimum residence tax. This is de facto a revival, albeit a much-expanded revival of the failed attempt by the US to

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1 G7, *G7 Finance Ministers and Central Bank Governors Communiqué* (5 June 2021), https://www.g7uk.org/g7-finance-ministers-and-central-bank-governors-communique/ (accessed 28 June 2021).

2 *See* S. S. Johnston, *G-7 Global Tax Reform Accord a 'Big Step Forward', OECD Chief Says* Tax Notes (8 June 2021).

3 *See* U.K. Notes G-7 Global Tax Reform Agreement, Tax Notes (5 June 2021).

4 *See* Johnston, *supra* n. 2.

5 The United States will face a parallel, interesting semi-internal issue in this regard with the taxation of enterprises in Puerto Rico, which enjoys favourable tax regimes.

6 US Department of the Treasury, *Readout: US Department of the Treasury's Office of Tax Policy Meetings* (20 May 2021), https://home.treasury.gov/news/press-releases/jy0189 (accessed 28 June 2021).

reach agreement within the BEPS project on global CFC legislation.[7] It could not do it in BEPS, so now the strategy is to introduce an expanded (and more costly and complex) version of it in BEPS 2.0, and do so as a dictate from the top, hence the G7 agreement first. The urgency for the United States to support the OECD initiative seemed to be the impact of the plethora of so-called digital service taxes (DSTs) unilaterally imposed in different formats by different countries around the globe, hurting MNE. It is difficult to see why such DSTs would be widely repealed in this context when the beneficiaries will be the typical residence countries led by the United States and the perception one of US forcing its hand after failure to promote a similar agenda during the BEPS project.

The agreement is not clear about its precise scope but to date we have only heard about progress on Pillar two and rumours that it may be possible to reach agreement on Pillar II first, not waiting for a Pillar I agreement. It is obvious, and even the OECD acknowledged that both Pillars in combination will have the effect of shifting revenue from poor to rich countries.[8] It is even more obvious that a Pillar II only agreement will have that result in complete disregard for the original reason for the global coming together to reform the international tax regime. Again, why would the losers agree to this deal? The typical response one hears (although no one has seriously demonstrated it) is that the minimum tax will eliminate unacceptable profit shifting and will assist in revealing the true profitable activities of MNE all over the world. That would eventually benefit source or market economies because MNE, knowing they will be taxed anyway, will have no incentives to engage in aggressive tax planning that robs revenue from these economies as well as from their residence countries. Another version of this is that the global minimum tax would relieve developing countries from the pressures to engage in aggressive tax competition and allow them to increase their domestic tax rates in tandem. Such arguments, first, require empirical backing, and second, depend on the details of the new rules that, at least at the present, seem to favour the fiscs of the residence jurisdictions of the largest MNE. Moreover, we are yet to hear what the G-7 meant by taxation in each country MNEs operate. A simple understanding of this statement would be to accept a 15% withholding, or Pillar I tax in each jurisdiction, but of course that cannot be what the G-7 agreed on since we know that they foresaw a different rate for source (market) taxation: 20% on whatever tops a 10% return. It is more likely that the G-7 meant that wherever MNEs (in fact, only the very large MNEs) make profits such profits will be taxed at a minimum of 15% – by the residence countries (unless some other rules already permit source taxation). This latter approach should hardly jurisdictions beyond the G-7 and perhaps a few additional rich countries.

Speaking of the details, and this editorial cannot, of course, provide an exhaustive analysis even of what one thinks they would be, a few notable intersections of the global and domestic US reforms are notable.[9] First, the United States views its proposal as based on the understanding that whatever is agreed in the OECD, the US GILTI regime will be considered as satisfying the requirement and no domestic law changes will be required from the US as a consequence of the agreement. This has at least two important implications: first, the minimum tax will be a residence tax and not a source tax on income of MNE 'in each country they operate'. True, Pillar II also includes anti-base erosion elements, themselves believed to be modelled after the US BEAT tax (and its proposed replacement the so-called SHIELD), but no one truly believes that that element was crafted to ensure source taxation by developing countries.[10] They have also multiple domestic issues, technical and political that cast doubt over what will actually come out of Congress, and the SHIELD is a surprising shift in US crafting of anti-deferral legislation, being essentially a blacklisting device, a common approach to CFC legislation that has traditionally been rejected by the United States.[11] It is unclear how exactly will all the rules be applied and in what order, since merely revising GILTI as proposed at the present by the Biden Administration keeps intact Subpart F and its priority over GILTI. In the United States we have grown accustomed to incongruous international tax rules in the last four years, but their proposed revisions do not seem to be more coherent.

Another important element of the GILTI regime is that it does not fully eliminate double taxation, basically permitting only 80% foreign tax credit for *bona fide* foreign taxes.[12] This feature of course increases the skew toward

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[7] *See* OECD, *Action 3 Controlled Foreign Company*, https://www.oecd.org/tax/beps/beps-actions/action3/ (accessed 28 June 2021).

[8] *See* OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment*, OECD/G20 Base Erosion and Profit Shifting Project (12 Oct. 2020), https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-economic-impact-assessment-0e3cc2d4-en.htm (accessed 28 June 2021). *See also* L. Eden, *Leap of Faith: The Economic Impact Assessment of the Pillar One and Pillar Two Blueprints*, 49(12) Tax Mgmt. Int'l J. 591 (2020); and L. Eden, *Winners and Losers: The OECD's Economic Impact Assessment of Pillar One*, 49(12) Tax Mgmt. Int'l J. 597 (2020).

[9] *See* White House, *FACT SHEET: The American Jobs Plan* (31 Mar. 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/ (accessed 28 June 2021). The plan includes the 'Made in America Tax Plan' that includes the Biden Administration's tax reform ideas.

[10] *See* L. A. Sheppard, *Papering Over SHIELD*, 171 Tax Notes Fed. 1683 (14 June 2021).

[11] *Ibid.*

[12] US: Internal Revenue Code s. 960(d).

residence taxation, but also raises the question of true implementation of the global minimum tax. It seems that, again, the devil will be in the details, and we may find ourselves in a situation where countries resume their tax competition in the darkness of the tax base rules rather than in the relative light of tax rate competition. One can add the proposal to shift to country-based foreign tax credit limitations from the current baskets (income type) system to the mix of relevant rules that may not be followed by all jurisdictions. Unless the OECD is able to convince a large portion of the inclusive framework to harmonize at least a large portion of the relevant rules an agreement on a minimum rate would serve only as a façade of cooperation that hides a much fiercer, opaque form of tax competition than the one we are so worried about at the present.

The incongruity of rules is most easily observed in the most mysterious part of the Biden Administration's tax reform proposal: the desire to require large MNE to include a 15% tax on their book income in alternative to the regular corporate tax. This is a new idea in US tax reform, but the device – an alternative minimum tax – is far from new or exciting. We had had a corporate alternative minimum tax that was rather quickly repealed due to its lack of popularity and the complexity it infused into an already complex, burdensome and expensive corporate tax regime. It is not clear whether the Administration can really enact this reform, but it is even less clear how would it work with the global minimum tax. The 15% rate mutual to both proposals is supposedly accidental but is bound to increase confusion over the parallel reform efforts. Any attempt to draw parallels from the domestic AMT proposal will be even more hazardous, since tax accounting rules and traditions differ even among the G-7 sisterhood.

In conclusion, I apologize if the reader is not by now clear what exactly have the G-7 countries agreed; I doubt that one can call what they came up with as an agreement, but it is clear, and I think desirable, that they United States is playing again a central role in the effort to reach a global agreement on the future of the international tax regime. This editorial primarily wishes to caution against celebrating too early the G-7 agreement. First, it would be dangerous to promote the revenue interests of the richest countries in the form of a global minimum tax or Pillar II agreement without due respect to the revenue interests of developing countries, at the least in the form of Pillar I. The latter do have alternatives: they may keep their DSTs, they may adopt measures like UN Model Article 12B, or even better withholding tax regimes.[13] Second, it is important to examine the US proposal for the global minimum tax and its new leadership role in BEPS 2.0 against the parallel domestic tax reform effort, to understand the distinct US interests in reform that may conflict with the general spirit of the global effort, and to appreciate the distinct political difficulty that the Biden Administration must face before it could pass any reform by Congress. Finally, and relatedly, the details of any tax reform are crucial to its understanding, but, I argue, they are uniquely important and in the context of a large-scale global effort such as BEPS 2.0. They are important because of the scale, because of the vast opportunities for incongruity among the rules, and because BEPS 1.0 has demonstrated that celebrating an agreement was more important to politicians than reaching an agreement for the benefit of all stakeholders. A façade of a global agreement may very well exacerbate and complicate the very tax competition it was supposedly designed to curb.

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[13] See A. Báez Moreno & Y. Brauner, *Taxing the Digital Economy Post-BEPS … Seriously*, 58(1) Colum. J. Transnat'l L. 121 (2019).