EDITORIAL

Pillar Two Under Analysis

In October 2021, 137 countries and jurisdictions agreed on a common approach towards a global minimum tax of 15% on the profits of large multinational companies that is referred to as the Pillar Two Model Rules, 'Anti Global Base Erosion', or 'GloBE' Rules.[1]

Intertax is dedicating this first of two special issues on the topic of Pillar Two. The purpose is to provide readers, including those from relevant public institutions, with different perspectives and assessments on its impact in single jurisdictions, regions, and worldwide. Articles published herein combine different angles of the analysis of Pillar Two and include: a United States (US) perspective on the compatibility of the US Tax Cuts and Jobs Act (TCJA) with Pillar Two as observed by Reuven Avi-Yonah and Mohanad Salaini; the analysis about the possibility of designing a domestic minimum tax as a response to the Pillar Two proposals by Noam Noked; an empirical simulation of the revenue effects of the global minimum tax under Pillar Two by Mona Baraké, Paul-Emmanuel Chouc, Theresa Neef, and Gabriel Zucman; and reflections on Pillar Two and African countries including a proposal for a regional response by Afton Titus.

The purpose of Pillar Two is to globally reduce aggressive tax planning and arguably also to rein in international tax competition, however, a national or regional perspective is inevitable due to its impact and is expressed in the various articles published in this special issue. Although Baraké et al.'s[2] model examines the global implications of the introduction of Pillar Two in revenue collection and shifting, the focus is the same. Moreover, the authors' assessments generally focus on the consequences of the Pillar Two rules on profit shifting and the ensuing effects on tax revenue allocation and/or foreign direct investment. Some do suggest alternative measures that would allegedly prevent decreasing levels of investment in their jurisdictions or regions.

Avi-Yonah's and Salaimi's article is titled *Minimum Taxation in the United States in the Context of GloBE*[3] and assesses the relationship between Pillar Two and the US TCJA. They discuss the Global Intangible Low-Taxed Income (GILTI) (a minimum tax on foreign profits) and the Base Erosion and Anti-Abuse Tax (BEAT) (a minimum tax on income generated domestically) as precursors to the Pillar Two GloBE rules, the income inclusion rule (IIR), and the undertaxed payment rule (UTPR).

The authors highlight key differences between the US and Pillar Two minimum taxes mentioned above. For example, the former are primarily driven by US interests rather than an interest in international tax coordination. The primary motivation for their introduction was the generation of additional tax revenue in order to compensate for revenue deficiencies due to the simultaneous reduction of the corporation tax rate and the introduction of the territoriality principle. The authors contend that neither the GILTI (with a current rate of 10.5% as opposed to the GloBE minimum effective tax rate of 15% and global blending as opposed to the per jurisdiction approach of GloBE) nor the BEAT (that applies independently of the effective rate in the recipient country) are compatible with Pillar Two.

The authors further argue that it is unlikely that the US will adopt legislation in the foreseeable future that is fully compliant with Pillar Two. This has now indeed been confirmed by the fact that the US House of Representatives has recently reduced the scope of the more ambitious plans of the Biden Administration. The former has merely passed legislation that will introduce a book-based corporate alternative minimum tax (the CAMT) that fails to meet the Pillar Two requirements.[4] This will probably lead to a situation in which the IIR and the UTPR will be applied outside the US by

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1 OECD/G20 Base Erosion and Profit Shifting Project, *The Pillar Two Model Rules in a Nutshell (2021)*, https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf.

2 *Intertax*, Vol 50 (2022), issue 10.

3 *Ibid.*

4 *Ibid.*

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subscribers of Pillar Two to both US-based ultimate parent entities and their subsidiaries. In any case, the authors recall that Controlled Foreign Company (CFC) rules might still grant the US priority in revenue collection since CFC rules may possibly prevail over the IIR and the Qualified Domestic Top-Up Tax (QDMTT) which otherwise grants priority to source jurisdictions.

Noam Noked also reflects on the compatibility of domestic minimum tax regimes with the Pillar Two Model Rules in his article titled *Designing Domestic Minimum Taxes in Response to the Global Minimum Tax.*[5] He puts forward the hypothesis that many countries would prefer to adapt domestic minimum taxes that are compatible with the GloBE rules in order to collect revenues that other countries would otherwise obtain. In that case, tax revenues would be acquired by source jurisdictions instead of being shifted to the parent entities' jurisdictions. The article focuses on key design issues of such domestic minimum taxes and their implications for the application of the GloBE rules.

The author raises issues not clearly answered in the GloBE Model Rules or its commentary and, among them, the discussion on the following deserves special attention. The first relates to the application of the QDMTT when the low taxed constituent entity is partially owned by third-party minority holders. In this regard, the author identifies inconsistencies between the rules on the calculation of the GloBE and the QDMTT top-up tax and suggests amendments of the model rules to address this problem.

The second is the degree to which domestic minimum taxes need to align with the GloBE Model Rules in order to qualify as a QDMTT rather than an 'ordinary' minimum tax that will only affect the effective tax rate but will not be credited against the GloBE top-up tax liability. In this context, the author also examines the advantages and disadvantages of adopting minimum taxes that are not equivalent to the QDMTT and will thus only qualify as covered taxes. Finally, another key aspect addressed by Noked is the question of what type of (non-tax) benefits can be granted to Multinationals (MNEs) that are within the scope of Pillar Two without violating the prohibition of collateral benefits.

There are a number of topics raised in Noked's article that will plausibly often incite disputes between states. One is whether domestic minimum taxes are classified as QDMTTs. Others include the consequences of the levy of GloBE top-up taxes by the parent entity countries and the acknowledgment of benefits that are not forbidden under Pillar Two. According to the commentary, whether a benefit is related to the IIR or the QDMTT is to be decided according to the 'facts and circumstances of each case'. The commentary adds a little more detail by merely providing a few indications for the possible existence of a benefit not being compliant with Pillar Two. These include if the benefit is ring-fenced to MNEs that are subject to the GloBE rules, if it is marketed as part of the GloBE rules, or if the regime was introduced only after the OECD/G20 Inclusive Framework initiated discussion on the GloBE rules.[6] As discussed by Noked, this vague guidance on what is a forbidden collateral benefit is insufficient, and the application of an IIR by a parent entity jurisdiction based on the interpretation of what is a collateral benefit will create a significant number of uncertainties.

In their article, Mona Baraké et al. examine *Revenue Effects of the Global Minimum Tax under Pillar Two*.[7] They present simulations of the revenue effects of the GloBE minimum tax. The authors consider two possible scenarios, i.e., one in which the IIR is adopted by the headquarters country and another concerning the adoption of the QDMTT in source jurisdictions – the host country of the foreign MNE affiliates. Their analysis accentuates how the distribution of revenues varies depending on which country has the priority to collect them. Under the IIR, the more headquartered multinationals that a country has, the more revenues it receives. With the QDMTT that grants the host country the priority in collecting the top-up tax, low-tax jurisdictions that have attracted affiliates of many multinationals could be among the main beneficiaries of the reform. In Europe, Luxembourg, and the Netherlands in particular could collect QDMTT revenues in the double digit billions whereas France and Germany would revenue-wise be the primary losers of such a development. The authors also find that the least developed countries gain no or very limited revenues under either scenario.

In her article (titled *Pillar Two and African Countries: What Should Their Response Be? The Case for a Regional One*),[8] Afton Titus discusses possible responses available to a grouping of African countries for ensuring that their current corporate income tax policies are not undermined. She is particularly concerned with the risk of a decrease in tax rates and the related threat of loss of foreign direct investment by in-scope MNEs.

The author stresses that Pillar Two has far-reaching implications for developing countries and suggests that African countries adopt regional responses to it. More specifically, the article reflects on the possibility of

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[5] *Ibid.*

[6] *Ibid.*

[7] *Ibid.*

[8] *Ibid.*

African countries imposing a targeted domestic minimum tax that would apply to in-scope MNEs. It also indicates that they will convert their tax incentives into non-tax incentives compatible with Pillar Two rules. Titus also raises the issue of whether African countries should support the proposal for a United Nations international tax forum taking into account that the OECD proposals are contrary to African interests. The author further stresses that the complexity of Pillar Two would be avoided if states applied worldwide taxation and the credit system.

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