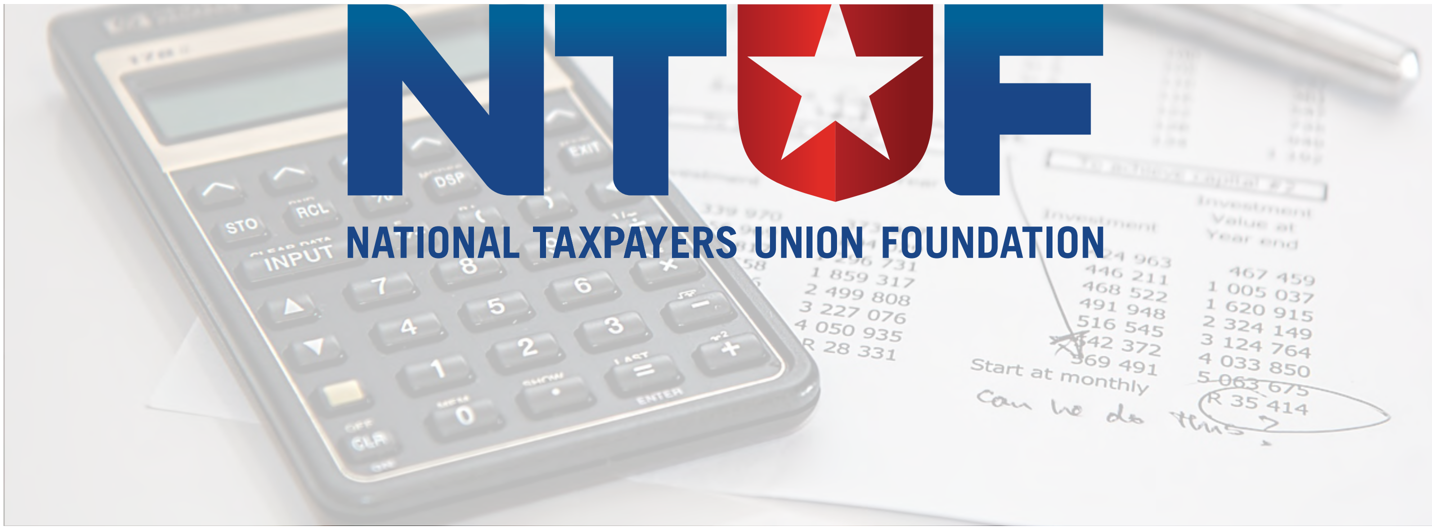

No Solution Yet for the "Two-Pillar Solution"

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Key Takeaways

- Pillar One and Pillar Two of the OECD agreement are currently at different stages and require different paths forward. Realistically, the two do not depend on each other for implementation, but are tied together for the political purpose of different countries wanting the pillars to different degrees.

- There are many reasons to doubt the success of the "Two-Pillar Solution." The timeline for Pillar One has been continuously delayed while Pillar Two faces technical challenges in its scope and administration.

- Congress has wisely decided not to enact elements of either pillar thus far. Meanwhile, other countries eager to take a share of U.S. tax revenue have continued with discriminatory digital services taxes and moved towards enacting a global minimum tax. Congress must receive more information to ensure that any tax changes preserve U.S. competitiveness.

Introduction

The global tax deal negotiated by the Organization for Economic Cooperation and Development (OECD) continues to move forward even as uncertainty around the proposal's effects remains. A crucial step towards implementation is due to take place by the end of this month. As the tax overhaul draws increased scrutiny from Congress and its consequences begin to play out, Congress should avoid rubber-stamping a proposal that could harm the country's international competitiveness.

How Did We Get Here?

The current negotiations come on the heels of the Base Erosion and Profit Shifting (BEPS) Project, which was finalized in 2015 to reconfigure the global tax system specifically in terms of the pricing of intangible assets. BEPS was negotiated and agreed to by the OECD and G20 as part of the "Inclusive Framework," which is the same structure being used to negotiate the new deal.

As early as 2019, the OECD began considering the current global tax deal known as the "Two-Pillar Solution," which some refer to as BEPS 2.0, to address questions of taxation in the digital economy that countries felt were not adequately addressed by the original BEPS. In October 2020, the OECD released official blueprints for Pillar One and Pillar Two. Pillar One would reapportion the taxing power over profits of large multinational companies, mostly U.S.-based tech companies. Pillar Two would impose a global minimum tax, allowing countries to impose additional taxes on either domestic or foreign earnings that are not taxed at the minimum threshold of 15 percent.

At the time that the Two Pillar Solution was rolled out, the United States was the only country in the world with a global minimum tax. In 2017, the Tax Cuts and Jobs Act (TCJA) established the Global Intangible Low-Taxed Income (GILTI) tax. GILTI targets foreign income from intangible assets such as intellectual property and imposes a minimum tax of 10.5 percent, which, when combined with only partially creditable amounts of foreign tax credits, results in an effective GILTI tax rate of 13.125 percent. The TCJA paired GILTI with a separate Foreign-Derived Intangible Income (FDII) tax of 13.125 percent on export income from U.S.-based intangible assets, reducing the incentive for profit-shifting and increasing somewhat the incentive to retain or bring back to the U.S. intellectual property-related economic activity.

What Are the Two Pillars?

Pillar One includes two main components: Amount A and Amount B. Amount A is the most critical element of Pillar One, as it reapportions the profits of multinational enterprises (MNEs) to other market jurisdictions if the MNE has more than 20 billion Euros ($21.3 billion) in global revenue and a profit margin greater than 10 percent. Amount A would reallocate 25 percent of the company's profits in excess of the 10 percent profit margin. Amount B deals with transfer pricing rules for marketing and distribution activities. In exchange for implementing Pillar One, countries had agreed to eliminate Digital Services Taxes (DSTs), which are discriminatory taxes enacted to tax mainly U.S.-based tech companies.

Pillar Two is a country-by-country global minimum tax of 15 percent on the foreign income of multinational companies that have annual revenues above 750 million Euros. Pillar Two allows for a "top-up tax" to bring the MNE's effective tax rate up to 15 percent in each jurisdiction it operates in and has several components. The Income Inclusion Rule (IIR) allows for the global minimum tax to be applied to the foreign income of a country's MNEs. The Undertaxed Payments Rule (UTPR) would allow a country to impose a tax on the local subsidiary of a multinational company if the company had an effective tax rate of less than 15% in any other country where it operates.

Where Does the Deal Stand Now?

The two pillars are currently at different stages and require different paths forward. Realistically, they do not depend on each other for implementation but are tied together for the political purpose of different countries wanting the pillars to different degrees.

Pillar One is currently not in force, as it cannot go into force unless the United States ratifies the agreement. This is because Pillar One's rules for entry into force currently require ratification by the U.S. since the U.S. has taxing powers for a significant share of global profits to be reallocated under Amount A.

Per the agreement, countries are not required to implement Pillar Two. Because of this, there are still questions as to whether China will fully enact Pillar Two. Various countries have now independently started implementing global minimum taxes.

Pillar One Next Steps

The next step in the current timeline for Pillar One is for countries to sign the agreement by the end of June, allowing for Pillar One to go into force once countries adopt the rules domestically. However, there are several reasons to doubt speedy implementation, the first being its delayed timeline thus far. Preceding the June signing deadline, the OECD was due to release the agreement's final text by March 31, a deadline that has now passed, with no final text. U.S. Treasury Secretary Janet Yellen points to a lack of engagement by China and India, as well as concerns about Amount B. Despite evidence suggesting otherwise, the OECD continues to claim that Pillar One is still on track for implementation. To put Pillar One's timeline into perspective, the OECD originally expected global consensus on the agreement in 2020 and has pushed this deadline back several times to now arrive at June 2024.

The second reason to doubt Pillar One's timeline is due to the process by which it must enter into force. Pillar One's Amount A is structured as a multilateral convention, which most presume to be an international treaty. The U.S. Constitution provides that treaties must be approved by two-thirds of the Senate for ratification, leaving the fate of Pillar One squarely with Congress. The Department of the Treasury has occasionally suggested that the U.S. can sign on via congressional-executive agreement, which requires only a simple majority of both houses of Congress. However, Secretary Yellen recently conceded that Pillar One will need Senate approval during a Senate Finance Committee hearing. Of note, Amount B of Pillar One is not due to be included in the treaty language.

Overall, it has become clear that Congress still has a lot of questions about the proposal that will need to be answered before a treaty is agreed to. Several Senators took time during the hearing with Secretary Yellen to ask about the global tax deal, and just two weeks prior, the House Ways and Means Committee held a hearing specifically focused on Pillar One. Lawmakers abroad also have unresolved questions about Pillar One that will likely need to be addressed before their full implementation. Some countries are still debating technical issues, and frustration with the OECD has recently led 145 countries to back a United Nations resolution to convene a new international tax forum.

There remains uncertainty as to whether the U.S. will actually get its desired result from Pillar One. The delay of Pillar One has led countries to consider discriminatory DSTs again, despite an extension of the agreement to pause DST implementation until the proposed June 2024 signing of Pillar One. While DSTs have mainly been proposed in Europe, Canada has proposed a retroactive DST going back to 2022. Even more troubling is the possibility that even if Pillar One went into force, not all DSTs would be eliminated.

Pillar Two Next Steps

Pillar Two is seemingly on a less rocky path to global implementation. Several countries have already enacted or introduced legislation for a global minimum tax to comply with Pillar Two rules. This comes after initial resistance to the tax in Europe, which requires unanimity for tax changes, as lower-tax countries like Ireland and Hungary initially opposed the agreement because it would make their jurisdictions less competitive. Implementation by various countries has now led the OECD to call for the development of dispute-resolution mechanisms. In the U.S., Pillar Two would require Congress to implement a 15 percent global minimum tax.

The question of how dispute resolution and other administrative safeguards under the Pillars would function has been a persistent one. A recent compendium of these problems surrounding just one area of OECD's project was published in May 2024 by Jones Day, entitled "Dispute Resolution Under OECD's "Pillar Two" 15% Global Minimum Tax Remains Unclear." An example provided in the White Paper vividly illustrates the myriad challenges that are still ahead:
[W]hile the OECD Consultation Document points to existing mechanisms including the Convention on Mutual Administrative Assistance in Tax Matters ("MAAC") and bilateral double taxation treaties, it is unlikely that the MAAC would constitute an effective dispute resolution mechanism because it does not entitle taxpayers to request that a competent authority review the tax policy that they claim is harming their investment. Rather, it is primarily intended to facilitate the exchange of information between States' respective competent authorities. Nor does the option of using the MAP [Mutual Agreement Procedure] provisions to resolve GloBE disputes in existing double taxation treaties sound particularly promising. Not all jurisdictions that implement the GloBE rules will have treaties in force with each other. In addition, many double taxation treaties contain limitations allowing taxpayers to initiate a MAP case only where there is "taxation not in accordance with" a tax treaty, and as of now, it is not clear if disputes concerning the GloBE rules will necessarily involve "taxation not in accordance with" a tax treaty.

It bears mentioning again that this complex matter is but one of dozens, if not hundreds, of considerations in one area of administration surrounding one of the Pillars.

An additional remaining concern about Pillar Two is the effect it would have on U.S. revenue. Senate Finance Committee Ranking Member Mike Crapo (R-ID) recently called attention to the fact that even according to the Biden Administration's estimates, as more countries adopt Pillar Two, U.S. tax revenue declines dramatically. The Joint Committee on Taxation (JCT) estimated in June 2023 that the U.S. stands to lose $122 billion in revenue over a ten-year window if the U.S. does not enact Pillar Two and the rest of the world does. JCT also estimated that even if the U.S. enacts Pillar Two with the rest of the world, the potential U.S. revenue loss amounts to $56 billion over ten years.

Other outstanding questions surround Pillar Two's treatment of U.S. tax credits. Under the proposed rules, qualified refundable tax credits are treated as income rather than as a reduction in tax. This is significant as refundable tax credits are more common in Europe, whereas important nonrefundable U.S. tax credits, such as the research and development (R&D) tax credit, would be treated unfavorably compared to more generous refundable credits offered in other jurisdictions. Some countries, such as Bermuda, are now proposing new refundable tax credits that would be allowable under Pillar Two, raising concerns that governments will now compete for business via costly subsidies.

Conclusion

As noted above, Pillar One and Pillar Two do not have any mechanical link conditioning their implementation to one another. The main condition of implementation within the agreement is the need for the U.S. to agree to Pillar One before it can be entered into force globally. Therefore, it is necessary to consider both pillars separately in terms of their own merits.

Given the technical uncertainty around both pillars, the likelihood that the U.S. will lose revenue from both pillars, and the potential that the deal will fail to achieve important U.S. policy goals such as the elimination of DSTs, Congress has wisely decided not to enact elements of either Pillar thus far. Meanwhile, other countries eager to take a share of U.S. tax revenue have continued with discriminatory DSTs and moved towards enacting a global minimum tax.

Congress must receive more information to ensure that any tax changes preserve U.S. competitiveness. International tax competition encourages innovation in tax policy, economic growth, and efficient use of global resources. Handing over our country's tax laws and revenues to international actors eliminates the ability to determine which policies would be best suited for U.S. taxpayers.

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