Ending the Race to the Bottom: Analyzing A Recent Global Agreement on Corporate Taxation

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Abstract

Globalization has led to a race to the bottom in corporate taxation, with countries slashing tax rates in order to attract investments from multinational companies. However, the COVID-19 pandemic highlighted deep inequalities in countries across the globe, spurring a movement to fight corporate tax avoidance. In October 2021, the Organization for Economic Cooperation and Development (OECD) announced a global tax agreement that creates a territorial tax system and imposes a 15% global minimum tax. These measures, which were endorsed by more than 130 countries, are expected to help ensure that companies pay tax in countries in which they generate sales, regardless of whether they have a physical presence in those countries. In addition, the 15% minimum tax rate is the first of its kind in international taxation and may put pressure on jurisdictions with little to no taxes on corporations. This Comment analyzes the OECD agreement by using case studies of previous multilateral tax proposals to provide historical context and by delving into various criticisms of the agreement. While the Comment lauds the agreement as a groundbreaking first step in combatting tax avoidance, it stresses that more needs to be done to address its deficiencies, such as its political infeasibility and lack of developing country involvement. As OECD negotiators are currently working on creating rules to implement this agreement, this Comment is a timely addition to the ongoing discussion.

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I. INTRODUCTION

As globalization has pushed countries to attract investments from multinational corporations, governments have tried to lure businesses in a myriad of ways. One approach taken by several countries is to have little to no taxation on corporate profits.[1] Countries that have taken this approach and staked out a reputation for themselves as tax havens include, among others, Ireland and the Cayman Islands.[2]

Sheltering profits in a tax haven is a common mechanism for large multinational companies to engage in legal tax avoidance.[3] Companies[4] achieve this by creating complex corporate structures that allow for the funneling of payments, profits, and investments to subsidiaries located in countries with minimal or nonexistent taxation on corporate profits.[5] These subsidiaries are often shell companies with virtually no physical presence in the tax haven and exist largely on paper to facilitate the transfer of profits to the low-tax jurisdiction.[6]

For example, Apple—one of the world's most valuable companies[7]—had its Irish subsidiary license its valuable intellectual property and pay royalties on the licensed intellectual property.[8] Because most of Apple's profits are derived from its intellectual property, this structure allowed the company to avoid paying taxes in the U.S. and instead have most of its income be subject to the much lower Irish corporate tax rate.[9]

Although using low tax rates to attract business investment was once seen as a legitimate form of tax competition among economies,[10] low tax rates often come at the expense of the countries in which the profits are originally generated. Companies that engage in profit shifting are essentially free riding because they

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1 *See* Colleen Essid, *The Global Minimum Tax Agreement: An End to Corporate Tax Havens?*, 73 ST. LOUIS U. L. J. ONLINE, ¶ 1 (2021).

2 *See id.* ¶ 3.

3 *See* Will Fitzgibbon & Ben Hallam, *What Is a Tax Haven? Offshore Finance, Explained,* INTERNATIONAL CONSORTIUM OF INVESTIGATIVE JOURNALISTS (Apr. 6, 2020), https://perma.cc/W35M-NUMY.

4 For the purposes of this Comment, the terms "company" and "corporation" are used interchangeably. However, it is important to note that the agreement this Comment covers is focused exclusively on corporate taxation. Companies that are flow-through entities, like partnerships and certain limited liability companies, would not be affected by this agreement because they are not taxed at the entity level.

5 *See* Fitzgibbon & Hallam, *supra* note 3.

6 *See id.*

7 Hardika Singh, *Apple Is No Longer World's Most Valuable Company*, WALL ST. J. (May 21, 2022), https://perma.cc/8TLT-J9DG.

8 Kim Lyons, *Ireland's status as tax haven for tech firms like Google, Facebook, and Apple is ending*, THE VERGE (Oct. 7, 2021), https://perma.cc/EZ6X-LA3Z.

9 *See id.*

10 Bruce Zagaris, *The G7 agreement on a global minimum tax will further squeeze the Caribbean*, GLOBAL AMERICANS (Jun. 22, 2021), https://perma.cc/B6FC-DYEQ (quoting U.S. Secretary of the Treasury Paul O'Neill, who discouraged OECD interference with the tax architecture of other countries and characterized tax havens as merely engaged in "tax competition").

are able to access a country's consumer market without paying for the privilege of doing so in the form of taxation.[11] When Apple sells iPhones in the U.S. but pays very little American tax because it funnels profits to Ireland, that creates revenue that the U.S. misses out on. Estimates suggest that this kind of cross-border profit shifting costs governments $100 billion to $240 billion in tax revenue per year.[12]

In addition, a separate problem has resulted from the growing digitalization of the global marketplace. This had led to many multinational technological companies being able to earn significant profits in countries where they have little physical presence.[13] The lack of physical presence is crucial because traditional tax nexus rules allow a country to tax a business's profits only if it has a physical presence within that country's territory.[14] However, companies that primarily operate in the digital space, such as Google and Amazon, can generate large amounts of income in a given country despite lacking any tangible infrastructure or employees in that country.[15] Many countries have had to miss out on tax revenue they would have earned had the company operated under a more traditional business model.[16]

The prevalence of multinational companies with minimal physical presence has led to pushback, most notably from EU countries, many of which instituted digital services taxes.[17] The taxes are aimed at tech firms that earned significant profits in EU member states but paid little in taxes due to their lack of physical presence.[18] Due to the nature of the tech industry, these taxes largely affected American companies. As a result, during the administration of former President Donald Trump, the U.S. imposed retaliatory tariffs on certain European countries, such as France, that instituted digital services taxes.[19]

In the midst of this conflict over digital services taxes and broader discussion over ways to combat global tax avoidance, the COVID-19 pandemic struck in 2020. The pandemic upended the global economic order, forcing governments to spend more than $13 trillion to protect businesses and individuals suffering under

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11 *See* Tove Maria Ryding & Alex Voorhoeve, *Is the Organisation for Economic Co-operation and Development's 2021 Tax Deal Fair?*, 2 LSE PUBLIC POLICY REVIEW 4 (2022).

12 William Horobin & Christopher Condon, *The Global Tax Revolution for Tech Giants is Delayed to 2024*, BLOOMBERG (Jul. 11, 2022), https://perma.cc/R6ZB-NBSV.

13 Alan Rappeport, *U.S. agrees to drop tariffs on countries that imposed digital services taxes as a global tax overhaul moves ahead*, N.Y. TIMES (Oct. 21, 2021), https://perma.cc/T4BV-VQUK.

14 *See* Young Ran (Christine) Kim, *Digital Services Tax: A Cross-Border Variation of Consumption Tax Debate*, 72 ALA L. REV 131, 133 (2019).

15 *See id.* at 131–135.

16 *Id.*

17 *See* Rappeport, *supra* note 13.

18 *Id.*

19 The Trump Administration's retaliatory tariffs targeted French wine and cheese in particular. *See* Jim Tankersley et al., *U.S. Will Impose Tariffs on French Goods in Response to Tech Tax*, N.Y. TIMES (Jul. 10, 2020) https://perma.cc/G4AZ-LM32.

pandemic-induced lockdowns.[20] Lower-income and working-class individuals bore the brunt of the virus' deaths and infections, highlighting deep inequalities in societies across the globe.[21] This crisis spurred a consensus among many Western governments that additional spending was needed to address unequal wealth distributions.[22] But in order to spend more money, governments needed additional tax revenue.

In response to these trends, the Organization for Economic Cooperation and Development (OECD) which had already been leading discussions on efforts to coordinate global tax policy since 2016,[23] set out to negotiate a global agreement on tax avoidance. The agreement was meant to combat tax-shifting and prevent a global race to the bottom that would lead countries to slash tax rates in an effort to outcompete each other to attract foreign investment.[24] The agreement that resulted from these negotiations is the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework), which has thus far been endorsed[25] by more than 130 countries.[26] The agreement is broken up into two pillars that each seek to achieve different goals. Pillar One of the agreement creates a territorial tax system that changes *where* companies pay tax, and Pillar Two implements a minimum tax rate that changes *how much* tax companies pay.[27]

Under Pillar One of the agreement, companies with revenues exceeding €20 billion and a profit margin greater than 10% would be required to have a portion of their profits taxed in the jurisdictions in which they have sales.[28] The purpose of this pillar is to create a territorial tax system that ensures that companies pay taxes in jurisdictions in which they have sales, regardless of whether or not they

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20 *See The territorial impact of COVID-19: Managing the crisis and recovery across levels of government,* OECD (May 10, 2021), https://perma.cc/9YHP-UDUX.

21 *See* Francisco H. G. Ferreira, *Inequality in the Time of COVID-19,* IMF (2021), https://perma.cc/KA9Y-ZCFQ. *See also* Jim Tankersley et al., *Biden's Economic Team Suggests Focus on Workers and Income Equality*, N.Y. TIMES (Nov. 30, 2020), https://perma.cc/FMB4-Q4TA.

22 *Id.*

23 *See* Adinda Wisse, et al., *Report on the B.E.P.S. Inclusive Framework of the OECD*, CENTRE FOR RESEARCH ON MULTINATIONAL CORPORATIONS, 3–4 (2021).

24 Alan Rappeport, *Pastries and Persuasion: How a Global Tax Deal Got Done*, N.Y. TIMES (Oct. 27, 2021), https://perma.cc/353K-MHE9.

25 Although the agreement has been agreed to by more than 130 countries, these countries have only endorsed a basic framework for the agreement. Because there are additional details relating to implementation that still need to be developed, no country has yet formally signed and ratified the agreement. The OECD originally planned to create a multilateral convention with a signing ceremony in 2022 followed by ratification in 2023. However, the signing ceremony has not yet occurred, and the organization announced in July 2022 that it is delaying the ratification process to 2024. *See Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy*, OECD (2021), https://perma.cc/E235-G3HD. *See also* Alan Rappeport, *A global deal to tax large corporations is delayed a year*, N.Y. TIMES (Jul. 11, 2022), https://perma.cc/GDV5-WTXK.

26 *See* OECD, *supra* note 25.

27 *See* Daniel Bunn & Sean Bray, *The Latest on the Global Tax Agreement*, TAX FOUNDATION (Jun. 13, 2023), https://perma.cc/E27R-WRH2.

28 *See* Grant Wardell-Johnson, *OECD's Pillar One and Pillar Two – A Question of Timing*, BLOOMBERG TAX (Jun. 14, 2022), https://perma.cc/D4GC-Y94E.

actually have a physical presence there.[29] Pillar One is meant to replace the digital services taxes that several European countries have imposed on American tech companies[30] which paid little taxes in European countries despite earning a significant amount of revenue in those jurisdictions.[31] Of the two pillars, Pillar One is the more complex and pivotal one because it more directly addresses the methods by which companies engage in global tax avoidance.[32]

The main proposal of Pillar Two is a global minimum tax rate of 15% that would apply to companies with revenues of more than €750 million.[33] Pillar Two also includes a provision that governs when the foreign income of a company should be included in the company's taxable income for domestic purposes.[34] Additionally, under Pillar Two, countries can increase taxes on a company if it has a related entity in a different jurisdiction that is being taxed at a rate less than 15%.[35]

This Comment seeks to analyze this agreement by answering two questions. First, how did the OECD agreement even come to fruition in an era where it has been increasingly difficult for countries to coordinate large-scale agreements on most issues? Is there something about tax avoidance or the OECD's unique negotiating framework that has allowed countries to bridge their differences? Second, how effective is the agreement likely to be in achieving its goals? Are there steps that endorsing countries can take in the implementation process to address various criticisms of the agreements that have arisen thus far? This Comment concludes that while tax avoidance had long been a concern of the OECD, the budgetary holes created by pandemic spending turbocharged the organization's efforts in this area. With regards to the agreement's effectiveness, this Comment highlights serious concerns with certain elements of the agreement, namely political feasibility and lack of developing country involvement, but provides suggestions to address those concerns.

The Comment is organized into several parts. Part II provides important context for the OECD agreement, particularly background on international corporate taxation and how globalization has led to different countries using tax incentives to attract investments from multinational corporations.

Part III provides an extended and thorough explanation of the agreement. Part III.A discusses how the negotiations for the agreement started and details the timeline of events that led to the agreement's adoption. This Part also provides an

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29 *See* Daniel Bunn & Elke Asen, *What European Countries Are Doing About Digital Services Taxes,* TAX FOUNDATION (Aug. 9, 2022), https://perma.cc/LS8E-ZV4Z.

30 *See id.*

31 *See id.*

32 *See* Wardell-Johnson, *supra* note 28.

33 *See Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two),* OECD (2022), https://perma.cc/E5F7-FHXH.

34 *See* Bunn & Bray, *supra* note 27.

35 *See id.*

update on the agreement's ongoing implementation process and when the agreement is expected to be finalized. Given the current worldwide economic downturn, inflationary pressure, and the Russia-Ukraine war, countries have been distracted and discussions around implementing this agreement have stalled.[36] Part III.B will discuss the substance of the Inclusive Framework, including both pillars of the agreement.

Part IV will use previous tax agreements or proposals as case studies to analyze the extent to which the Inclusive Framework can build on or improve upon previous attempts to address cross-border tax-shifting. Part IV.B. will examine digital services taxes that were implemented in the past few years by several countries, including India and various countries in Europe.[37] Part IV.B will also discuss a broader EU initiative proposed in 2018 that sought to improve the taxation of digital business activities.[38] Although the proposal was ultimately never adopted, it is important to understand because Pillar One of the Inclusive Framework is meant to replace these kinds of digital services taxes.[39]

Part IV.A of this Comment analyzes the Ruding Report and the lessons it provides for negotiators currently crafting the implementing rules for the Inclusive Framework. The Ruding Committee was created by the European Community in the 1990s to come up with proposals to harmonize corporate tax rates among its member states.[40] The Committee's proposed minimum corporate tax rate of 30% and maximum of 40%[41] was never adopted by the European Community—or the successor EU— because member states were unwilling to give up their sovereignty over fiscal policy.[42] Nonetheless, it is an important case study that teaches us that minimum tax rates that cover large numbers of countries are easier to implement when they are limited in scope and do not unduly interfere with individual countries' ability to set their own tax policy. This is a lesson that the OECD negotiators should keep in mind as they work to develop the implementing rules for the Inclusive Framework.

Part V of the Comment analyzes the various critiques of the Inclusive Framework that have emerged since it was first announced in 2021. This Part responds to these criticisms and suggests ways in which they can be addressed through the agreement's implementation. The four main criticisms are: the

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36 *See* Michelle Scott, *Global Corporate Minimum Tax*, INVESTOPEDIA (Aug. 24, 2022), https://perma.cc/96NS-VZ56.

37 *See* Bunn & Asen, *supra* note 30. *See also USTR Welcomes Agreement with India on Digital Services Taxes*, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE (Nov. 24, 2021), https://perma.cc/W684-4C2E.

38 *See Fair Taxation of the Digital Economy,* EUROPEAN COMMISSION, https://perma.cc/TF5J-8VAR.

39 *See* Bunn & Asen, *supra* note 30.

40 *See generally* Michael Deveruex, *The Ruding Committee Report: An Economic Assessment*, 13 FISCAL STUDIES 96 (1992).

41 *See id.* at 106–107.

42 *See* Byoung-Inn Bai, *The Code of Conduct and the E.U. Corporate Tax Regime: Voluntary Coordination without Harmonization*, 15 J. OF INT'L & AREA STUD. 115, 117–18 (2008).

agreement's political infeasibility; the many exceptions in the agreement that undermine its goals; the possibility that the proposed global minimum tax rate of 15% is too low to have any discernible impact; and lastly, the detrimental impact the agreement could have on developing economies.

Part VI concludes by heralding this agreement as a step in the right direction in the global effort to fight tax avoidance and urges the OECD to use the ongoing implementation process to address the genuine concerns that have been raised thus far.

II. BACKGROUND

A. How Globalization Has Led to a Race to the Bottom in Taxation

Globalization is characterized by the increased mobility of economic activity, with companies able to invest in many different countries in a short period of time.[43] This is partly because it has become much easier to shift capital between countries due to lessening restrictions on international trade and improvements in telecommunications.[44] However, the ease of moving capital globally has meant that companies have been able to reallocate capital for nonproductive reasons, such as to take advantage of a country's lower tax rate. This leads to economic distortions because companies are making decisions on where to invest based on relative tax rates as opposed to productive reasons such as whether the country has a large consumer market or a talented work force.[45]

Because countries know that companies are making investment choices based on tax rates, their governments then face pressure to lower tax burdens in order to not miss out on international investment.[46] International investment is key in the era of globalization, as it can lead to employment opportunities, increases in national productivity, and other positive externalities.[47] And foreign investors are sensitive to tax rates; studies have shown that a 10% tax reduction has been associated with a 6% increase in inbound foreign investment.[48]

This trend has made it difficult for governments to meet their countries' fiscal needs. Economic models have shown that international tax competition, when taken to its furthest extreme, has resulted in lower government revenue and

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43 *See* Jason Fernando*, Globalization in Business With History and Pros and Cons,* INVESTOPEDIA (Mar.28, 2023), https://perma.cc/4F3Y-4L5Y.

44 *See* James Hines & Larry Summers, *How Globalization Affects Tax Design*, NBER Working Paper No. 14664, 2 (2009).

45 *See id.* at 9.

46 *See id.* at 11.

47 *See id.* at 1.

48 *See id. at 7.*

expenditures.[49] While some governments are able to make up the shortfall in revenue through raising other kinds of taxes, such as those on consumption and goods and services,[50] such taxes tend to be regressive. This is because regressive taxes place a higher burden on lower income individuals who often spend a greater portion of their wages on goods that are subject to consumption taxes such as sales taxes. Other governments have had to reduce expenditures during a time when they face significant demands for social welfare to help their citizens adjust to job losses and economic displacement resulting from globalization.[51]

Data shows that the past four decades have resulted in a race to the bottom in taxation.[52] The average corporate tax rate in the OECD went from 40% forty years ago to just 23% today.[53] While there may be other explanations for this decrease in rates, the fact that it came at a time of increased tax competition suggests that there has been a race to the bottom in taxation.

B. How Multinational Companies are Taxed

Countries tax multinational companies when they earn profits, either by selling products or services or generating income through investments.[54] However, countries can tax multinational companies only when the company's profits are sourced in the country or if the company is a resident of the country.[55] A company's profits are sourced in a country if it has physical presence or employs workers in the country.[56] A company is considered a resident of a country if the country is the company's primary location, which is generally where the company has its headquarters.[57] Depending on the country, a company's headquarters is either where it is incorporated or where its place of effective management is located.[58] Governments have increasingly questioned the relevance of sourcing or residency requirements for taxation in the context of digital markets, which is why many countries chose to adopt digital services tax regimes that tax companies that generated profits in their territory even if the company lacked a physical presence or was not a resident.[59]

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49 *See* Sam Bucovetsky, *Asymmetric tax competition,* 30 J. URB. ECON. 167 (1991).
50 *See* Hines & Summers, *supra* note 44.
51 *See generally* Dani Rodrik, *Why do more open economies have bigger governments?,* 106 J. POL. ECON. 997 (1998).
52 *See* Hines, *supra* note 44.
53 *See* Lily Batchelder, *Remarks by Assistant Secretary for Tax Policy Lily Batchelder on Global Corporate Tax at the Hutchins Center at Brookings Institute and the Urban-Brookings Tax Policy Center* (Apr. 15, 2022), https://perma.cc/R8GR-YQEG.
54 *See* Sebastian Beer et al., *International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots*, IMF Working Paper No. 168, 5–6 (2018).
55 *See id.* at 5.
56 *See id.*
57 *See id.*
58 *See* Steinar Hareide, *Where is a company Tax resident?*, PWC NORWAY'S TAX BLOG (Mar. 27, 2017), https://perma.cc/F34Q-K2GA.
59 *See* Kim, *supra* note 14, at 143.

There are two kinds of tax systems: territorial and worldwide. Understanding the difference between territorial and worldwide tax systems is important because Pillar One of the Inclusive Framework aims to create a territorial tax system that relaxes traditional rules requiring companies to be physically present or be a resident in order to be taxable in a particular country.[60]

In a territorial system, countries tax companies only if they have active business income in the country.[61] Suppose, for example, that a company is a resident of Country A and earns income in both Country A and Country B. In a territorial system, Country A would only tax the company's earnings that are generated from sales and other revenue generating activities within A's borders. Country A would not tax the company's Country B earnings. This ensures that the company would not be double taxed on the same stream of income in both Country A and Country B because income streams are separated based on the country in which they are derived from. This system is used in Europe and Japan.[62]

In contrast, countries that have adopted a worldwide system tax a company's profits even if those profits were generated in another country, so long as the company is a resident of that country.[63] Countries using worldwide systems avoid double taxation by providing companies with a foreign tax credit for however much tax the company paid abroad.[64] Countries with worldwide tax systems also often defer taxing a resident company's offshore profits, waiting to tax it once the company repatriates it back.[65]

As an example of a worldwide tax system, suppose that a company is based in Country C, which used a worldwide system, and the company generated income in both Country C and Country D. Country C would be able to tax the company's income in both Country C and Country D. However, Country C would likely provide the company with a foreign tax credit that would reduce the company's Country C tax by the amount of tax the company paid in Country D. In addition, Country C may also refrain from taxing the company's Country D profits until the company actually brings the profits back to the company's resident entities in Country C. This system is used in Brazil, Russia, India, China, and South Africa, among other countries.[66] The U.S. has historically used a worldwide tax system, but following the passage of the Tax Cuts and Jobs Act in 2017, the U.S. has

60 *See Fact Sheet Amount A: Progress Report on Amount A of Pillar One*, OECD (2021), https://perma.cc/H9VK-V7JE.
61 *See* Beer et al., *supra* note 54, at 5–6.
62 *See id.* at 5.
63 *See id.* at 6.
64 *See id.*
65 *See id.*
66 *See id.*

adopted a hybrid model that includes elements of both the territorial and worldwide tax systems.[67]

C. How Multinational Companies Avoid Tax Through International Profit-Shifting

The International Monetary Fund has identified six major ways in which companies avoid paying taxes in their resident country: (1) transfer mispricing, (2) locating intellectual property in low-tax jurisdictions, (3) debt shifting, (4) treaty shopping, (5) tax deferral, and (6) strategically locating their headquarters.[68] The following sections explain each of these methods and how the Inclusive Framework aims to combat them.

1. Transfer mispricing.

Multinational corporations complete various transactions between their entities in various jurisdictions, often for legitimate purposes.[69] As supply chains become increasingly global and complex, multinational companies often have to engage in transactions with subsidiaries in different locations in order to manufacture and sell products.[70] For example, a company may have an entity in one country that produces the goods that are sold by a different entity in another country.[71]

Transfer pricing rules require that when a multinational company engages in transactions between entities in different countries, the company must price the transactions at an arm's length price that it would have charged were the entity an unrelated third-party.[72] The idea is that if the company were to engage in that same transaction in the marketplace, it would still charge the same price that it charged for the transaction between its two entities.

In practice, transfer pricing enforcement is difficult.[73] Determinations of what constitutes an arm's length transaction are subjective.[74] It is often difficult to determine what the "correct" price would have been had the company transacted with a third-party. Therefore, companies with entities in both low-tax and high-tax jurisdictions are often able to take advantage of the difference in tax rates by artificially charging low prices for exports from high-tax to low-tax jurisdictions.[75]

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67 *What is a Territorial Tax and Does the United States Have One Now?,* TAX POLICY CENTER (2020), https://perma.cc/WR47-X9UU.

68 *See* Beer et al., s*upra* note 54, at 6–10.

69 *See United Nations Practical Manual on Transfer Pricing for Developing Countries 2021*, UN (2021), https://perma.cc/MDH2-Q6WS.

70 *See id.* at 2–3.

71 *See id.*

72 *See id.* at 37–39.

73 *See* Beer et al., *supra* at note 54, at 7.

74 *See id.*

75 *See id.*

Pillar One of the Inclusive Framework has extensive provisions to address transfer pricing. For example, OECD negotiators currently drafting the agreement's implementation provisions have stated that they are working to make sure that Pillar One helps eliminate transfer pricing disputes.[76] Transfer pricing disputes often arise when companies engage in related party transactions for distribution arrangements, such as when one entity supplies inventory to another entity.[77]

Tax authorities in different countries use varying methods to determine whether such transactions were priced properly and were conducted for legitimate business purposes as opposed to for tax avoidance.[78] This can lead to extensive disputes, creating administrative headaches for governments and compliance burdens for taxpayers. While OECD negotiators are working out the details, Pillar One aims to create a simplified and streamlined process for transfer pricing transactions that is applied consistently across jurisdictions.[79] Given that negotiators are still working out the details,[80] it remains to be seen how effective Pillar One will be in simplifying the transfer pricing system.

2. Locating intellectual property in low-tax jurisdictions.

While a company may conduct its research and development in a high-tax jurisdiction, it can still avoid taxes on the intellectual property resulting from its research by transferring ownership of the intellectual property to an entity in a low-tax jurisdiction.[81] Once ownership of the intellectual property has been transferred to a low-tax jurisdiction, any income resulting from those intangible assets would be taxed at the lower rate.[82] This is often used by tech companies because intellectual property is usually just a formula or lines of code, making it easy to shift between jurisdictions.[83]

Pillar One and the digital services taxes that various European countries have implemented address this form of tax avoidance by taxing companies on the profits they earn in a particular country, even if the company holds its intellectual property elsewhere.[84] This means that even if a company has transferred its intellectual property to a low-tax jurisdiction, if it has earned profits in a high-tax jurisdiction, it will still be subject to taxation in that high-tax jurisdiction. This is a major change from the previous system, which allowed companies to use the

76 *See Pillar One Public Consultation Document*, OECD 7 (2022), https://perma.cc/UQQ2-KG8L.
77 *See id.*
78 *See id.*
79 *See id.*
80 *See id.* at 4–5.
81 *See* Beer et al., *supra* note 54, at 8.
82 *See id.* at 7.
83 *See* Daniel Bunn, *Intellectual Property Came Back to U.S. After Tax Reform, but Proposals Could Change That*, TAX FOUNDATION (July 21, 2021), https://perma.cc/GLE8-HB84.
84 *See Fact Sheet Amount A: Progress Report on Amount A of Pillar One*, *supra* note 60.

placement of intellectual property in low-tax jurisdictions to avoid paying tax in countries that charged higher tax rates.

The rise of highly lucrative tech companies that earn immense profits in regions where they do not have a physical presence has greatly exacerbated tax avoidance globally. It has incentivized countries, such as Ireland, to establish themselves as tax havens.[85] Firms that mostly derive their profits from intellectual property then shift to these low-tax jurisdictions to take advantage of their lower tax rates, thereby pushing down global corporate tax rates.[86] That is why Pillar One's focus on eliminating the use of intellectual property to avoid taxes is crucial. When the benefit to shifting intellectual property to low-tax jurisdictions is eliminated, the incentive for countries to market themselves as tax havens also decreases. This means that companies will instead make investment decisions based on factors other than the ability to engage in tax avoidance, such as a country's ease of doing business or presence of an educated workforce. Therefore, it is likely that Pillar One will go a long way in supporting the Inclusive Framework's goal of ending the race to the bottom in corporate taxation.

3. Debt shifting.

As with transfer pricing, a company can avoid taxes by having its entities in low-tax countries issue loans to its entities in high-tax countries.[87] This generates tax benefits because an entity in a high-tax jurisdiction can deduct the interest on the loan from the low-tax country, thereby reducing its tax burden. And although the entity in the low-tax jurisdiction would have to report interest income, it would not be significantly affected precisely because the taxes in its jurisdiction are minimal.

The Inclusive Framework does not explicitly address debt shifting. However, debt-shifting is functionally similar to transfer pricing. The only difference is that in transfer pricing, a company's entities are trading goods and services with each other as opposed to lending and borrowing from each other. Therefore, Pillar One's transfer pricing considerations discussed above largely apply to debt shifting as well. The OECD will need to make sure its efforts to eliminate transfer pricing disputes and simplify the process address similar issues that arise when a company's various international entities shift debt to each other.

4. Treaty shopping.

Treaty shopping typically occurs when a company indirectly accesses the benefits of a tax treaty between two countries without being a resident of either country.[88] There are a large variety of corporate tax rates across countries and a

85 *See* Lyons, *supra* note 8.
86 *See id.*
87 *See* Beer et al., *supra* note 54, at 9.
88 *See BEPS Action 6*, OECD, https://perma.cc/BHY4-4T6W.

significant number of tax treaties between countries.[89] This means that companies, depending on where they are located, can shop between countries that have favorable tax treaties. According to a study published in 2018, such treaty shopping has reduced tax revenues in Sub-Saharan African countries by 15%.[90]

Bilateral tax treaties may become less important under the Inclusive Framework because the agreement's negotiators plan to form a multilateral convention that would allow all countries to join regardless of whether they have tax treaties with each other.[91] Although bilateral tax treaties will continue to apply to company profits that fall outside the scope of the Inclusive Framework,[92] their reduced importance could lead to less treaty shopping by multinational companies.

In addition, the Inclusive Framework has created a minimum standard on treaty abuse that countries have committed to include in their tax treaties.[93] The minimum standard requires jurisdictions to include an express statement prohibiting non-taxation and have language that addresses treaty shopping.

The goal is that by including such provisions, it will be more difficult for companies to try to game the system by taking advantage of different tax treaties. It is unclear how effective this solution will be—the OECD has said that the minimum standard would be adapted to each country's specific circumstances,[94] thereby creating a risk that countries may opt for weak language that does little to solve the problem. While it is admirable that the OECD is sensitive to the pitfalls of creating broad rules that do not consider individual countries' circumstances, the OECD will need to stay vigilant against creating a minimum standard that is ultimately rendered meaningless.

5. Tax deferral.

As discussed in Part II, countries that use a worldwide taxation system generally only tax a resident company's foreign earnings once those earnings are repatriated to the resident country.[95] This means that companies can avoid paying taxes on foreign earnings as long as they continue to defer repatriation and keep the earnings in assets abroad. For example, prior to 2018, Apple had $252.3 billion of earnings in cash overseas that it never brought back to the U.S. in order to

89 *See id.*
90 *See* Sebastian Beer & Jan Leprick, *The Cost and Benefits of Tax Treaties with Investment Hubs, Findings from Sub-Saharan Africa* 2 (World Bank Group Policy Rsch., Working Paper No. 8623, 2018).
91 *See Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy*, *supra* note 25.
92 *See id.*
93 *See* BEPS Action 6, *supra* note 88.
94 *See id.*
95 *See* Beer et al., *supra* note 54, at 10.

avoid paying U.S. income tax.[96] However, the Tax Cuts and Jobs Act, which went into effect in the U.S. in 2018, imposed a 15.5% repatriation tax that was much lower than the previous corporate tax rate of 35%.[97] This led Apple to then bring roughly $245 billion of the overseas cash back to the U.S.[98]

Given that Pillar One of the Inclusive Framework is pushing countries towards more territorial tax-based systems, tax deferrals may become less advantageous for multinational companies. Tax deferrals are only relevant in worldwide tax systems—countries that have territorial tax systems do not tax a company's income earned outside their borders. Therefore, companies will have less incentive to keep their foreign-earned income abroad and will be more likely to repatriate that money domestically.

6. Strategically locating headquarters.

Multinational companies can also reduce their tax burden by strategically locating their headquarters in countries with lower tax rates.[99] Some U.S. companies have done this through what are called corporate inversions. Corporate inversions occur when a company changes the U.S. parent to become a subsidiary and makes a foreign subsidiary in a low-tax jurisdiction the new parent entity.[100] Studies have shown that companies that have done such inversions have on average saved around $45 million in the year after the inversion.[101] While the Inclusive Framework does not specifically target corporate inversions, under Pillar One's territorial taxation system, it matters less where a company's headquarters is. Regardless of where the company is based, it will be taxed on the income it earns in each jurisdiction. Therefore, corporate inversions may become less valuable from a corporate tax avoidance perspective.

By making corporate inversions less beneficial, companies may start to choose their headquarters' location based on business needs unrelated to tax considerations, such as access to a talented workforce. This is a positive ancillary benefit of Pillar One because, as with many other parts of the Inclusive Framework, it incentivizes companies to make business decisions based on factors other than the ability to engage in tax avoidance.

III. Overview of Global Tax Agreement

The Inclusive Framework is meant to address many of the tax-shifting problems discussed in Part II.C. The agreement, which is the first of its kind, was

96 Tae Kim, *It Looks like Apple is Bringing Back Home Nearly All of its $250 Billion in Foreign Cash*, CNBC (Jan. 17, 2018), https://perma.cc/DHM3-89V6.

97 *See id.*

98 *See id.*

99 *See* Beer et al., *supra* note 54, at 10.

100 *See id.*

101 *See id.*

formally endorsed by members of the OECD on October 8, 2021[102] and has thus far been endorsed by more than 130 countries worldwide.[103] This Part discusses the history and timeline of the agreement's creation and the substantive provisions that countries have agreed upon.

A. Timeline of the Development of the Agreement

The OECD first adopted the Base Erosion and Profit Shifting (BEPS) Action Plan in 2013 to address the problems associated with global tax avoidance that countries were starting to recognize.[104] While the BEPS process was ongoing, the U.S. and EU took their own steps to address tax-shifting behavior.

The 2017 U.S. Tax Acts and Jobs Act had several provisions targeting companies that shifted profits overseas through tax avoidance mechanisms, such as moving intellectual property to low-tax jurisdictions like Ireland.[105] In 2018, the European Commission proposed a framework for digital services taxes that allowed EU member states to tax companies that generated profits in the country even if the company did not have a physical presence there.[106] Although the proposal was ultimately not adopted, several EU member states, such as Austria, France, Hungary, and Portugal, implemented their own digital services taxes that taxed companies based on their digital presence.[107]

The impact of these European digital services taxes was largely felt by U.S. technological firms, leading the Trump Administration at one point to impose retaliatory tariffs on countries, such as France, that imposed digital services taxes.[108] While the taxes were originally only meant to target tech companies, more and more non-tech businesses have been increasingly digitizing their sales operations.[109] This led to concerns within the U.S. government that a larger number of industries would fall under the ambit of digital services taxes, thereby paying more taxes in foreign jurisdictions.[110]

As discussed earlier, the COVID-19 pandemic, along with the election of Joe Biden as U.S. president in 2020, led to a renewed push for a global agreement

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102 Alan Rappeport & Liz Alderman, *Global Deal to End Tax Havens Moves Ahead as Nations Back 15% Rate*, N.Y. TIMES (Oct. 8, 2021), https://perma.cc/LNV9-T3NV.

103 *See Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy*, *supra* note 25.

104 *See OECD/G20 Inclusive Framework on BPA Progress Report September 2021 – September 2022*, OECD (2022), https://perma.cc/3K68-7Q79.

105 Cliff Taylor, *Trump's U.S. Tax Reform a Significant Challenge for Ireland*, THE IRISH TIMES (Nov. 30, 2017), https://perma.cc/55H5-PANT.

106 *See Fair Taxation of the Digital Economy*, *supra* note 38.

107 *See* Bunn & Asen, *supra* note 29.

108 *See* Rappeport, *supra* note 13.

109 *See* Batchelder, *supra* note 53.

110 *See id.*

on taxation. Many developed nations recognized the need to raise additional tax revenue to pay for social programs to address income inequality.

To further this goal, U.S. Treasury Secretary Janet Yellen in July 2021 met with Irish Finance Minister Paschal Donohoe to lobby Ireland to join efforts to combat tax-shifting.[111] Getting Ireland on board with the agreement was key because Ireland is a major tax haven, particularly for American tech companies. In addition, as an EU member, Ireland's support was crucial to ensuring all twenty-seven member states of the EU were on board with the agreement.[112]

Three months after the meeting between Yellen and Donohoe and after several rounds of negotiations, a final consensus on the basic outlines of the agreement was announced at the G20 meeting in Rome on October 8, 2021.[113] The consensus, which is essentially a kind of agreement to agree, is broken into two pillars, with Pillar One creating a territorial taxation system and Pillar Two enacting a minimum tax on corporate profits. The next two sections will discuss the substance of each pillar.

B. Pillar One – Territorial Taxation

The purpose of Pillar One of the Inclusive Framework is to create a territorial tax system that ensures that companies pay taxes in jurisdictions in which they have sales, regardless of whether they actually have a physical presence there.[114] As discussed earlier, this pillar is a response to the digital services taxes that were proposed by the European Commission and actually implemented by several European countries. These countries have agreed to eliminate their digital services taxes once Pillar One of the agreement goes into effect.[115] Pillar One is largely the result of compromise—the U.S. dropped its proposal to make it voluntary, and European countries agreed to limit Pillar One to only the most profitable companies in the world.[116]

Pillar One's implementation is expected to occur in five steps: (1) determining whether the company is within the scope of Pillar One, (2) determining which countries can tax the company, (3) determining which jurisdictions can tax the company, (4) determining taxable profit, and (5) eliminating double taxation.[117]

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111 *See* Rappeport, *supra* note 24.

112 *See id.*

113 *See id.*

114 *See Fact Sheet Amount A: Progress Report on Amount A of Pillar One*, *supra* note 60.

115 *See Joint Statement from the United States, Austria, France, Italy, Spain and the United Kingdom, Regarding a Compromise on a Transitional Approach to Existing Unilateral Measures During the Interim Period Before Pillar 1 is in Effect*, U.S. Department of the Treasury (October 21, 2021), https://perma.cc/TTR3-MGUS.

116 *See* Batchelder, *supra* note 53.

117 *See Fact Sheet Amount A: Progress Report on Amount A of Pillar One*, *supra* note 60.

1. Determining whether the company is within the scope of pillar one.

For a company to fall within the scope of Pillar One, it would need to have revenues in excess of €20 billion and have a profit margin exceeding 10%. If the tax period of the company is less than twelve months, the €20 billion revenue requirement is proportionally reduced by the length of the period. Pillar One includes exceptions that place companies that engage in extractive activities, such as mining and oil and gas, outside the scope of the Inclusive Framework.[118]

2. Determining which countries can tax the company.

A country can tax a company that falls under Pillar One if the company generated revenue of more than €1 million from that country.[119] For countries that have a GDP of less than €40 billion, the minimum threshold above which a company falls under Pillar One is €250,000.[120] Both the revenue scope and country restrictions make sense because the Inclusive Framework is meant to only target the world's most lucrative companies. Expanding this initiative to cover all manner of companies would likely prove too burdensome.

3. Determining which jurisdictions can tax the company.

Companies will need to determine which countries they will need to pay taxes to under Pillar One. There are two methods to determine a company's tax base: (1) the nexus test and (2) revenue sourcing rules.[121] Under the nexus test, a company is said to have a tax base—otherwise known as nexus—in a particular jurisdiction if it has generated more than €1 million in that country. If the country's gross domestic product is less than €40 billion, then the €1 million requirement is reduced to €250,000.[122]

The nexus test relies on a company's revenues in specific jurisdictions, and so the revenue sourcing rules are key to determining when a company's revenues are said to be generated in a particular jurisdiction. Revenue can be classified as coming from a specific country if it is derived from the sale of a finished good to a customer in that country, location specific services to customers in that country, and licensing of intangible property that relates to finished goods sold in the country, among many other categories.[123]

Pillar One's nexus test and revenue sourcing rules ensure that companies that generate a significant amount of revenue in a country cannot avoid taxation,

118 *See Progress Report on Amount A of Pillar One: Two-Pillar Solution To the Tax Challenges Of the Digitalization Of the Economy,* OECD (2022), https://perma.cc/Q67V-XNA6.

119 *See Fact Sheet Amount A: Progress Report on Amount A of Pillar One*, *supra* note 60.

120 *See id.*

121 *See Progress Report on Amount A of Pillar One: Two-Pillar Solution To the Tax Challenges Of the Digitalization Of the Economy*, *supra* note 118.

122 *See id.*

123 *See id.*

while at the same time protecting companies from burdensome taxation in jurisdictions in which they have little presence. These rules are a core component enabling Pillar One's primary goal of ensuring that companies pay tax in the jurisdictions in which they generate revenue, regardless of whether they have a presence there.

4. Determining taxable profit and how to allocate among jurisdictions.

A company's taxable profit is calculated by taking its profit as reported on its financial statements, then modifying the profit by a variety of book-to-tax adjustments.[124] Adjustments include excluding tax expenses and dividends and making changes for gains and losses resulting from the sales of assets, among others.[125] Once the profit is calculated, it is then allocated among the jurisdictions that were identified in Step Three as jurisdictions that can tax the company. This allocation is done using a formula that considers profit before taxes and the proportion of the company's revenues that come from each taxable jurisdiction.[126]

5. Eliminating double taxation.

After Step Four allocates a company's taxable profit among various jurisdictions, Step Five of the Inclusive Framework eliminates double taxation through a variety of mechanisms that apply in situations when a company is overtaxed on the same stream of taxable income in multiple jurisdictions.[127]

The OECD has noted that this step is still currently being developed and that work is on-going to make sure that it truly does help ensure that companies are not subject to double taxation.[128] It is important that the OECD gets this step right, because Pillar One's territorial tax approach involves trade-offs. Governments must relinquish their right to tax the worldwide profits of their domestic companies in return for being able to tax companies that generate profits in their border regardless of their physical presence. These trade-offs become unsustainable if companies end up being double taxed because it could lead to pressure on governments to abandon the Pillar One system.

C. Pillar Two – Minimum Tax

Pillar Two of the agreement is designed to ensure that companies pay a minimum level of tax in the jurisdictions in which they operate. This pillar imposes a 15% minimum tax that only applies to companies that have more than €750

124 *See id.*
125 *See id.*
126 *See id.*
127 *See Fact Sheet Amount A: Progress Report on Amount A of Pillar One*, *supra* note 60.
128 *See Progress Report on Amount A of Pillar One: Two-Pillar Solution To the Tax Challenges Of the Digitalization Of the Economy*, *supra* note 118.

million in revenue.[129] Taxpayers below that revenue threshold, governmental entities, international organizations, and nonprofit charities are not subject to the minimum tax rate.[130]

The minimum tax rate is implemented by first having the company calculate its effective tax rate in every jurisdiction in which it operates.[131] If there is a jurisdiction in which the company's effective tax rate is lower than the 15% minimum rate, the company pays a top-up tax that covers the difference between the effective rate and the minimum rate.[132] The revenue from this top-up tax would go to the country in which the company has its parent entity.

Pillar Two also has an international coordination mechanism to enforce the minimum tax rate. Countries that are part of the agreement have agreed to impose additional taxes on companies in their jurisdiction if those companies have effective tax rates below 15% in any jurisdiction.[133] This means that if a country has a tax rate lower than 15%, it is missing out on revenue that instead gets siphoned by other countries that have endorsed the agreement.[134]

In addition, the OECD plans to create a standardized information return that companies would need to fill out to report the tax rates they fall under in each country they pay taxes in.[135] This means that countries will be able to see the different tax rates a company is subject to and can make sure that a company is not shortchanging any country that is party to the agreement.

The OECD is also considering ways to make sure that implementing Pillar Two does not pose an administrative burden for governments. For example, it plans to add provisions to Pillar Two that would make certain companies automatically subject to taxation above a minimum rate. This means that for those companies, governments will not have to engage in significant effort to determine whether the company falls within the scope of Pillar Two.[136]

Pillar Two's 15% minimum tax rate is a good first step to setting a benchmark floor for corporate tax rates. But as will be discussed in Part V.C, there are valid concerns that the rate is too low and should leave room for increases in the future.

D. Ongoing Negotiations for the Agreement's Implementation

129 *See Tax Challenges Arising from the Digitalization of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*, *supra* note 33.
130 *See id.*
131 *See id.*
132 *See id.*
133 *See* Batchelder, *supra* note 53.
134 *See id.*
135 *See Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*, *supra* note 33.
136 *See id.*

Negotiations over how to implement the agreement are ongoing, but the details discussed above are the main agreed-upon elements thus far. While the agreement was originally targeted to be enacted by 2023, the timeline has been pushed by a year.[137] In a report to G20 finance ministers, OECD Secretary General Mathias Cormann said the organization needed more time to design the implementation rules given that the agreement is expected to last for decades.[138] While this is ongoing, the EU and several G20 countries have scheduled time in their legislative calendars to make changes to their tax laws so that they comport with the Inclusive Framework.[139]

Cormann also noted that the OECD is trying to include developing countries in the rule development process, for example, by electing a Jamaican official as the Inclusive Framework's co-chair.[140] The organization also plans to prepare materials that address the concerns developing countries have about international tax issues more broadly.[141] Part V.D. will go into more detail on developing countries' concerns about the agreement and steps the OECD can take to address their objections.

A draft of the Inclusive Framework task force's most recent consensus on Pillar One was released in October of 2023.[142] The OECD noted that there are still differences on various issues among member nations, and that the agreement is still not ready for signature.[143]

IV. Case Studies of Previous Similar Agreements

There are two main European proposals and existing agreements that this Part will discuss to better understand the current global tax agreement: the European Commission's 1992 proposal for a minimum corporate tax rate[144] and the EU's push for a digital services tax in recent years.[145] Both these agreements provide historical context for the Inclusive Framework and can help illuminate potential obstacles it may face to get implemented.

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137 *See* Rappeport, *supra* note 25.

138 *See OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors*, OECD (2022), https://perma.cc/DS3V-W268.

139 *See id.* at 4.

140 *See id.*

141 *See id.*

142 *See International Tax Reform: Multilateral Convention to Implement Amount A of Pillar One*, OECD (2023), https://perma.cc/8683-YQWN.

143 *See id.*

144 *See* Bai, *supra* note **Error! Bookmark not defined.**, at 118.

145 *See* Blum & Asen, *supra* note 29.

A. Ruding Report

During the late 1980s, as the European Community moved to expand the common market and further liberalize the movement of capital between member states, members states looked at ways to harmonize tax rates between each other.[146] The idea was that with a single common market, it would be much easier for companies to move capital between European countries. Therefore, having a minimum tax rate that applied to all the countries that participated in the common market would prevent high-tax jurisdictions from losing out on capital.[147]

To address this concern, the European Commission in 1990 appointed a panel of experts led by Onno Ruding, a former Dutch finance minister, to consider ways to harmonize tax rates across the European Community.[148] The panel was tasked with answering the following three questions.[149] First, do differences in tax rates between European Community member states cause distortions in the common market in terms of investment decisions by companies?[150] Second, if there are distortions, are free market forces and tax competition between European Community member states sufficient to address these distortions?[151] And lastly, what steps should the European Community as a whole take to address these distortions?[152] The Ruding Committee's answers to these questions and the European Community's subsequent response to their recommendations provide important insights on the possibilities and perils of multinational cooperation against tax avoidance. The outcome of the Committee's proposals seems to indicate that multinational solutions that do not unduly interfere with individual country's tax systems are more likely to get implemented in the long-term.

1. Effect of tax rates on economic distortions.

The panel found that differences in taxes among European Community members were causing distortions in the common market. It found that companies were making investment decisions based on a country's tax rate as opposed to productivity related reasons, such as whether the country has a talented workforce. This is important because the European Community at the time had large range of tax rates—with Ireland having a 10% rate and Germany having a top marginal rate of 50%.[153]

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146 *See* Devereux, *supra* note 40, at 97.
147 *See id.* at 96.
148 *See* Bai, *supra* note **Error! Bookmark not defined.**, at 118.
149 *See* Devereux, *supra* note 40, at 96.
150 *See id.*
151 *See id.*
152 *See id.*
153 *See* Franz Vanistendael, *The Ruding Committee Report: A Personal View*, 13 FISCAL STUD. 85, 86 (1992).

The Ruding Committee's modeling suggested that withholding taxes on cross-border dividends caused the most economic distortions between member states.[154] This is because each of the different member states had quite varied tax rates on dividend income and different views on what was considered dividend income in the first place.[155] This detail is important because, as will be discussed later in Part IV.A.4, the EU did eventually implement a standardized system for withholding taxes.

2. Ability of tax competition to address economic distortions.

Given that tax rate differentials could lead to economic distortions, the panel found that competition for physical capital—like factories and equipment—would likely not be affected by tax competition because it is difficult to move such types of assets across borders. However, because paper capital such as equity or debt is highly mobile, it would be strongly impacted by tax competition between different countries.[156]

The panel also noted that tax competition could lead to substantive decreases in tax rates that would not necessarily lead to an equilibrium minimum tax rate.[157] Declines in corporate tax rates could lead to distortions because countries would then be forced to raise revenue from other kinds of taxes, such as consumption taxes. This could lead to higher tax burdens on labor, as opposed to holders of capital, since workers usually spend a higher share of their income on regular consumption of goods and services.

3. Proposed steps to address economic distortions.

The Ruding Committee found three ways in which economic distortions could result from differences in tax rates between member states: (1) variation in withholding taxes on dividend payments between countries, (2) the way in which countries tax corporations' foreign source income, and (3) differences in the domestic structure of different countries' tax systems.[158]

To address these concerns, the committee proposed a minimum community-wide tax rate of 30% and a maximum of 40%.[159] The committee argued that a minimum tax rate could prevent countries from fighting over paper profits like debt and securities that are highly mobile.

Although the biggest proposal was the minimum tax rate, the committee also proposed other tax measures, including establishing a commission to review transfer pricing issues, developing a European Community-wide policy on how to

154 *See id* at 89.
155 *See id.*
156 *See* Devereux, *supra* note 40, at 100.
157 *See id.* at 102.
158 *See id.* at 103–04.
159 *See id.* at 105.

address tax issues with non-European countries, and fostering bilateral tax treaties between member states.[160]

4. Legacy of the Ruding Report.

While the European Community never adopted a minimum corporate tax rate, the EU did pass a measure in 2003 to improve information sharing between member states on interest and dividend payments.[161] The EU did not actually collect any taxes under this initiative, however. The idea was that member states could use this information on interest and dividend payments to make sure their taxpayers were paying the appropriate amount of tax in their respective jurisdictions. This addressed the concern that the Ruding Committee raised regarding gaps in withholding taxes on interest and dividend payments between individuals in different countries. The 2003 directive was replaced in 2014 by a program that made it easier for member states to report dividend and interest payment information to each other.[162]

The legacy of the Ruding Report is that while countries are willing to make changes to address tax distortions, they are unwilling to substantially give up their autonomy over fiscal policies. Because the withholding tax was limited to information sharing and targeted a specific subset of income, it was much easier to adopt. In addition, the Ruding Report noted that the lack of coordination on withholding taxes caused the greatest amount of economic distortion, and so was a greater priority than some of the committee's other proposals.[163]

Although the European Community—and later the EU—was unable to successfully push for a wider minimum tax rate that applied across member states, the European Commission instead created a Code of Conduct for member states to follow.[164] The Code of Conduct encourages member states to "refrain from engaging in harmful forms of tax competition" and was designed to "curb those business tax measures which affect, or may affect, in a significant way the location of business activity within the Community."[165]

The challenges that the European Community faced in going from the Ruding Report to actually implementing a minimum tax in practice are lessons that the implementers of the OECD's Inclusive Framework can learn from. The European Community struggled to convince member states to relinquish their autonomy to set tax rates, an effort made more difficult by the fact that the

160 *See id.* at 104.
161 *See* Council Directive 2003/48/EC, on Taxation of Savings Income in the Form of Interest Payments, 2003 O.J. (L 157).
162 *See* Council Directive 2014/107/EU, Amending Directive 2011/16/EU as Regards Mandatory Automatic Exchange of Information in the Field of Taxation, 2014 O.J. (L 359).
163 *See* Vanistendael, *supra* note 153.
164 *See* Bai, *supra* note **Error! Bookmark not defined.**, at 128.
165 *See id.* at 119.

organization had a unanimous voting rule on tax matters.[166] Many of the member states in the European Community had starkly different views on the role of taxation, which stemmed from their respective political and cultural norms.[167] In addition, countries often structured their tax systems to favor domestic companies.

For example, most Dutch companies tended to have multinational corporate structures because the Netherlands has a relatively small domestic market.[168] Therefore, the Netherlands's tax system was designed to be favorable to companies with subsidiaries abroad. This is unlike countries like Germany, which tended to use their tax systems to disincentivize domestic companies from investing abroad.[169] In addition, some countries like Luxembourg—which saw themselves as major financial centers—structured their tax systems to favor banks and other financial institutions.[170]

The difficulties faced by the European Community in implementing the Ruding Committee's recommendations shows that one potential reason why the Inclusive Framework was able to obtain buy-in from a large number of countries is because it does not unduly interfere with countries' ability to set their own tax policies. The global minimum rate of 15% introduced by Pillar Two is lower than the corporate tax rates of most countries, and the territorial system mandated by Pillar One is something that many countries have gradually been moving towards anyway in the form of digital services taxes and other mechanisms. However, the devil is in the details, and the negotiators working on developing rules for the agreement will have to be careful to not step on governments' toes and avoid restricting countries' autonomy to set their own tax policies.

B. Digital Services Taxes

The current existing digital services taxes are important to understand because Pillar One of the Inclusive Framework was expressly created to address this issue.[171] In a digital services tax, a country taxes a company based on its digital presence in that country, regardless of whether or not the company actually has any physical assets or labor in that country.

This is a divergence from international norms of taxation because, for a company to typically be taxed in a country, it is required to have nexus in that country.[172] Nexus generally refers to whether the company has physical presence

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166 *See* Vanistendael, *supra* note 153, at 93.
167 *See id.* at 94.
168 *See id.*
169 *See id.*
170 *See id.*
171 *See* Bunn & Asen, *supra* note 30.
172 *See Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint : Inclusive Framework on BEPS*, ¶ 186–215 (2020), https://perma.cc/9EZC-UDWZ.

or employees in the country.[173] However, with these digital services taxes, if a firm made sales from customers in a particular country, it would still have to pay tax, even without nexus.[174]

Unlike income taxes, digital services taxes are often based on revenue alone.[175] This is because it is not possible for a company to calculate income in a country where it does not have some kind of physical presence. Roughly speaking, income is calculated as revenue minus expenses. If a company does not have a physical presence in a country, it likely does not have any expenses because it does not spend any money on operations, such as by paying rent on facilities or wages to workers. Therefore, it only has revenue to report.

1. European Commission proposal for digital services taxes.

In 2018, the European Commission proposed new rules meant to tax earnings from companies that earned sales from digital businesses in the EU.[176] The two proposals the commission introduced were: (1) allowing member states to tax profits generated by a company in its territory, even if the company does not have a physical presence there, and (2) levying an interim tax to cover digital activities that were currently not being taxed.[177]

a) Proposal One

Under the first proposal, a company was said to have a digital presence if it fulfills one of the following three criteria: (1) exceeds €7 million in annual revenues generated in the member state, (2) has more than 100,000 digital users in the member state, and (3) has over 3,000 business contracts with business users in the member state.[178]

In addition, the proposal allocated profits to member states based on where the customer was when they used the company's digital service. When allocating profits, the Commission would have taken into account the market value of the user data the company obtains in the member state, the company's services connecting users in the country, and other digital services provided by the company, such as subscriptions, used by customers in the jurisdiction.[179]

b) Proposal Two

The interim tax to cover digital activities not currently being taxed was proposed as an interim measure while the member states worked out how to implement Proposal One. The tax would have been levied on 3% of revenues for

173 *See id.*
174 *See* Bunn & Asen, *supra* note 30.
175 *See id.*
176 *See* Fair Taxation of the Digital Economy*, supra* note 38.
177 *See id.*
178 *See id.*
179 *See id.*

companies with worldwide revenues of €750 million and EU revenues of €50 million. The tax would have been focused on companies that generated revenue from online placement of advertising, sales of data collected on users, and digital platforms that connected users with each other.[180]

The Commission was likely concerned that without this interim tax, EU member states would institute their own unilateral digital services taxes. This could lead to the emergence of a medley of varied regulations that would undermine the EU's Common Market by having companies be subject to different rules in different member states.

c) Takeaways from European Commission Proposals

Ultimately, the European Commission's fear of countries implementing their own digital services taxes was borne out because the EU failed to adopt these two proposals. Instead, various EU member states, such as Austria, France, Italy, and Spain, passed their own digital services taxes. And as predicted by the European Commission, many of the member states with digital services taxes have different requirements. For example, the Austrian digital services tax kicks in when a company earns more than €25 million in domestic revenue, while the Italian tax applies at a much lower threshold of €5 million in domestic revenue.[181]

Understanding the EU proposal and the current digital services taxes is important because the logic underlying these proposals and taxes are a core part of Pillar One of the Inclusive Framework. As discussed in Part III, Pillar One's territorial tax system is designed to ensure that companies pay tax in a jurisdiction regardless of their lack of physical presence. Much like the digital services taxes currently in place, a key motivation behind Pillar One is to target tax avoidance by tech companies.

Various countries have agreed to delay imposing their digital services taxes until December 31, 2024.[182] However, if the implementation of Pillar One continues to be delayed beyond that date, these digital services taxes may come back into effect.[183]

V. Analysis of Critiques of the Agreement Including Recommendations to Address Those Critiques

Various criticisms of the Inclusive Framework have emerged, including that the agreement is not politically feasible, the agreement is undermined by the many exceptions and carve outs contained in its text, the agreement's minimum tax rate

180 *See id.*
181 *See* Bunn & Asen, *supra* note 30.
182 *See* Josh White, *OECD extends pillar one timeline in outcome statement,* INT'L TAX REV. (July 12, 2023), https://perma.cc/R6WK-8DD8.
183 *Id.*

of 15% is too low, and that the agreement has a detrimental impact on developing economies.

This Part of the Comment analyzes these various critiques and provides possible solutions or responses to them that could be taken into account by negotiators as they work through developing the rules for the agreement. And given that implementation for the agreement has been pushed back until 2024,[184] negotiators do have the time to be thorough and listen to the various stakeholders who have publicly provided feedback on the agreement.

A. Is the Agreement Politically Unfeasible?

The agreement is facing domestic pushback from several major players who are key to its success. For example, the U.S. Senate has thus far been unable to come together to pass the spending proposals that would be necessary to implement the agreement.[185] And in the EU, Poland has expressed technical concerns about the agreement.[186]

The implementation of the agreement largely relies on countries to pass laws domestically, which could run into trouble in countries with federal systems that often have multiple jurisdictions imposing various different taxes.[187] This includes not only the U.S., but also countries like Germany, Japan, and Switzerland.[188]

While there are some concerns about Poland, the EU is likely to move forward with the agreement. Some analysts have suggested that Poland's current intransigence on the agreement has more to do with other concessions it would like that are not related to the Inclusive Framework.[189]

With regards to the U.S., it does seem unlikely that its Congress would be able to pass the necessary legislation. This is primarily because the 2022 midterm elections gave the Republicans control of the House of Representatives.[190] This would make it even less likely for the U.S. to pass the needed legislation because Republican leaders in Congress have consistently stated their opposition to the Inclusive Framework.[191]

Even if the agreement were to potentially lose the U.S., the fact that the EU and many other large economies, such as China and India, have signed on to the

184 *See* Rappeport, *supra* note 24.
185 Alan Rappeport, *A Tax Deal, in Trouble,* N.Y. TIMES (June 7, 2022), https://perma.cc/35YW-QTSZ.
186 *See id.*
187 Joseph W. Sullivan, *A Global Minimum Corporate Tax Is a Bad Idea Whose Time Hasn't Come*, FOREIGN POL'Y (April 12, 2021), https://perma.cc/7F8R-J7WK.
188 *Id.*
189 *See* Rappeport, *supra* note 185.
190 *See* German Lopez, *Still Undecided*, N.Y. TIMES (Nov. 9, 2022), https://perma.cc/99FD-VYAZ.
191 *See Brady: OECD/G20 Global Minimum Tax is a Dangerous Economic Surrender*, G.O.P. HOUSE WAYS AND MEANS (Jul. 1, 2021), https://perma.cc/G6M6-A764.

agreement makes it more likely that it will move forward.[192] In addition, the U.S. would lose out significantly if other countries move forward with the agreement because that means American companies would be double taxed in both the U.S. and other countries due to the agreement's Pillar One territorial taxation provisions.

To make matters worse, Pillar Two has an enforcement mechanism that ensures that if a company pays an effective tax rate lower than 15% in any country, including the U.S., it will have to pay top-up taxes to other countries to make up the difference.[193] This means that the U.S. would be missing out on revenue that instead goes to countries that are part of the agreement.

Given these points, despite the obstacles that the Inclusive Framework faces from certain countries that have domestic opposition to it, it is likely that they can be resolved. There may be additional delays in implementation due to the various global issues that are distracting countries, such as the Russia-Ukraine War. But one way or another, this agreement will come to fruition.

B. Does the Agreement Have Too Many Exceptions and Carve-Outs?

The Inclusive Framework has a variety of exceptions and carve-outs, including for financial services and extractive industries. The financial services exclusion was reportedly added following lobbying from countries with large financial systems, such as the U.K.[194] And the exemption for extractive industries was pushed for by various African countries that rely on such industries for their economic output.[195]

Under the Inclusive Framework's Financial Services Exclusion, regulated financial institutions such as deposit institutions, mortgage institutions, investment banks, insurance companies, and asset managers are exempt from Pillar One's territorial taxation requirements.[196] In order for an entity to be considered a regulated financial institution that qualifies for this exception, it has to have appropriate licensing from its country's government and it has to be subject to a capital reserve requirement, among other qualifications.[197]

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192 *See Members of the OECD/G20 Inclusive Framework on BEPS*, OECD (July 9, 2023), https://perma.cc/Z3VD-PYVV.

193 *See* Batchelder, *supra* note 53.

194 Jeff Stein, *As Wealthy Nations Back Yellen's Call for Global Taxation, Fears About National Differences Quietly Persist*, WASH. POST (Oct. 31, 2021) https://perma.cc/347P-G2LA.

195 *See id.*

196 *See Pillar One – Amount A: Regulated Financial Services Exclusion*, OECD (2022) https://perma.cc/PU4V-4X6J.

197 *Id.*

For the agreement's Extractive Exclusion to apply, the company has to meet the exclusion's product test and activities test.[198] A company qualifies under the product test if it derives revenues from the sale of extractive products such as oil and gas, minerals, and hydrocarbons.[199] If the company's activities include exploration, development, or extraction, then it meets the activities test. Companies that fall under this inclusion are exempt from Pillar One of the Inclusive Framework—much like the financial services companies discussed earlier.[200]

It is unclear whether these two exclusions will lead to any significant reductions in revenue for countries that are participating in the agreement. However, it does appear that there are legitimate economic reasons behind these exceptions. For example, the OECD notes that financial institutions are subject to unique forms of regulation, such as capital reserve requirements, that help make sure that profits are aligned with the market they are generated in.[201] The discrepancy between where profits are generated and where they are recognized is the core issue that Pillar One is attempting to address. Because banks are generally taxed in the jurisdictions in which they operate due to regulatory constraints, there is a strong argument that there is no need for Pillar One to apply to them.[202]

Similar reasoning underpins the Extractive Exclusion. Most extractive industries are location specific, and due to the nature of the industry it is relatively easy for a country to make sure the tax on the extracted resource is paid in the source jurisdiction.[203] The OECD also notes that the Extractive Exclusion does not apply to companies that engage in production and manufacturing with natural resources long after they have been extracted, rendering the exclusion limited in scope.[204]

While it is generally inadvisable for an agreement to have excessive carve-outs that ultimately render the agreement useless, that does not appear to be the case here. Both of these carve-outs seems to have legitimate industry-specific justifications and would likely not unduly undermine the agreement.

C. Is the Agreement's Minimum Tax Too Low?

This agreement has for the first time in history set a minimum global corporate tax rate. Critics argue that by setting the rate at 15%, it does not really force already low-tax jurisdictions, such as Ireland and Singapore, to drastically

198 *See id.*
199 *Id.*
200 *Id.*
201 *See id.*
202 *See Pillar One – Amount A: Extractives Exclusion*, *supra* note 196.
203 *See id.*
204 *Id.*

change their tax systems. For reference, Singapore's corporate tax rate is 17%,[205] while Ireland's is 12.5%.[206] Some nonprofit groups have strongly criticized the 15% rate,[207] noting that a United Nations panel in 2021 recommended a 20 to 30% global minimum tax on corporations.[208]

Although there are criticisms that the tax rate is too low, the agreement is still a major blow[209] for zero-income tax jurisdictions which impose no corporate income taxes, such as the Bahamas.[210] In addition, several countries are being forced to raise tax rates, with Ireland having to raise its 12.5% rate to at least 15%. Accordingly, worries that the 15% tax rate is too low overlook the important fact that a 15% minimum rate is still a step in the right direction.

To the extent that 15% is still too low, a possible solution is for the agreement to clarify that the minimum tax rate should be *at least* 15%. That was what the original language in the agreement was going to be, but the words "at least" were removed at Ireland's insistence.[211] In addition, the agreement could include a mechanism to review the minimum rate every couple of years and increase the minimum rate as necessary. Leaving the door open to raising this minimum rate can help ensure that in its efforts to end the race to the bottom, the Inclusive Framework does not inadvertently promote a race pushing countries downward to the 15% rate.

D. Does the Agreement Have a Detrimental Impact on Developing Economies?

A major critique of the agreement is that it leaves out the Global South, with some estimates suggesting that 60% of the additional tax revenue that would be generated by this agreement would go to the G-7 developed economies.[212] In addition, the global tax is premised on digital services taxes coming to an end, which could potentially detrimentally affect developing countries.[213] This could harm developing countries because some analysts have argued that Pillar One's allocation system disadvantages developing economies.[214]

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205 *See Singapore Taxes on Corporate Income*, PWC, LLP (May 4, 2023), https://perma.cc/YF2A-QPCH.

206 *See Ireland Taxes on Corporate Income*, PWC, LLP (Jul. 18, 2023), https://perma.cc/F3HD-N5WV.

207 *See* Press Release, OXFAM, OECD tax deal is mockery of fairness (Oct 8. 2021), https://perma.cc/Q58Y-4FXV.

208 *See Financial Integrity for Sustainable Development,* FIN. ACCOUNTABILITY TRANSPARENCY & INTEGRITY PANEL, 25 (2021), https://perma.cc/3THN-R7JU.

209 Gary Silverman*, Bermuda Digs in Against Global Corporate Tax Deal*, IRISH TIMES (June 22, 2021), https://perma.cc/P836-QPA5.

210 *See Bermuda Taxes on Corporate Income*, PWC, LLP, (Jun. 29, 2023), https://perma.cc/7C5H-UYXY.

211 *See* Rappeport, *supra* note 24.

212 *See* Julie McCarthy, *The New Global Tax is Bad for Development*, BROOKINGS INST. (May 16, 2022), https://perma.cc/7C5H-UYXY.

213 *See id.*

214 *See* Carlos Mureithi, *Why Kenya and Nigeria Haven't Agreed to a Historic Global Corporate Tax Deal,* QUARTZ (Nov. 2, 2021), https://perma.cc/5ZF7-JF3V.

Oxfam, a charity that focuses on global poverty, conducted an impact assessment of the Inclusive Framework's Pillar One and found that developing countries would earn $1.66 billion less from Pillar One than they would have earned from a 3% digital services tax.[215]

Tax authorities in Kenya and Nigeria have expressed skepticism as to whether the allocations they would get under Pillar One would be the same or greater than what their countries could earn under their own digital services taxes.[216] The African Tax Administration Forum (ATAF), a network of tax systems on the continent, has also argued that the Pillar One system for territorial taxation reallocates too little of a company's profits. Under the proposed model, 20% to 30% of a company's profits exceeding a 10% profit margin would be reallocated, while the ATAF has argued for 35% of a company's profits to be reallocated.[217]

Developing countries have also criticized Pillar Two of the Inclusive Framework. Some analysts have argued that developed countries get priority in levying top up taxes on companies that countries can collect when a company pays below a 15% effective tax rate in a particular jurisdiction.[218] In addition, the ATAF has argued that a 20% minimum global effective rate would have done a better job of fighting profit shifting out of African countries since most countries in the region have tax rates between 25% and 35%.[219]

A more fundamental criticism of the Inclusive Framework, apart from its substantive provisions, is that the process by which it was created was undemocratic and lacks legitimacy.[220] It was mainly drafted by developed countries that were part of the G20 with little input from most developing countries.

The OECD defends this because the G20 represents 85% of global gross domestic product and 75% of world trade.[221] However, the G20 has only one African country—South Africa—and very little representation from most other regions that constitute the Global South.[222] In fact, the EU has significantly more representation in the G20 than any other global region.

One remedy to address the lack of representation for developing countries in the creation of the global tax agreement is to convene a United Nations convention on the topic.[223] This was actually suggested by the United Nation's

215 *See id.*
216 *See id.*
217 *See The Effect of the OECD's Pillar 1 Proposal on Developing Countries – An Impact Assessment*, OXFAM (2022), https://perma.cc/DB84-EB82.
218 *See McCarthy, supra* note 212.
219 *See A New Era Of International Taxation Rules – What Does This Mean For Africa?*, AFR. TAX ADMIN. F. (2021), https://perma.cc/M2FY-3GJZ.
220 Sissie Fung, *The Questionable Legitimacy of the OECD/G20 BEPS Project*, 2 ERASMUS L. REV. 76 (2017).
221 *See About the G20*, G20, https://perma.cc/P2RR-VK52.
222 *Id.*
223 *See* Mccarthy*, supra* note 212.

Financial Integrity for Sustainable Development panel in early 2021, several months before the OECD agreement was announced.[224]

Despite the fact that a U.N. convention could address the concerns that developing countries have and provide them a voice in the discussion, it is ultimately unrealistic and would unnecessarily extend the time it takes to actually implement the agreement. Instead, the OECD should make it easier for developing countries, such as those represented by ATAF, to bring up their concerns regarding Pillar One's allocation system and Pillar Two's low minimum tax rate. This can be done by more actively integrating developing country officials into the ongoing negotiations over the Inclusive Framework's implementation. The consensus on the agreement that was announced in 2021 was just a broad outline; this means that developing countries can have a much larger impact on the Inclusive Framework by shaping how it is eventually implemented.

VI. Conclusion

The OECD's Inclusive Framework is a historic agreement that has the potential to change the way countries approach international tax issues. The territorial taxation system implemented by Pillar One and the 15% global minimum tax mandated by Pillar Two are groundbreaking proposals that have the potential to help many countries recover revenue lost to tax avoidance. However, the devil is in the details. As OECD negotiators continue to work on developing the implementing rules for the agreement, they will have to keep in mind several important issues.

First, as demonstrated by the obstacles faced by the Ruding Committee in the European Community in the 1990s, countries will always be hesitant to give up their autonomy over tax issues. Therefore, negotiators will have to tread a fine line in creating rules that are actually effective and yet do not unduly step on governments' toes.

Second, there are serious concerns that major players in the agreement, such as the U.S., do not have the political support to pass the domestic legislation needed to implement the agreement. Negotiators will have to figure out if the agreement's top-up mechanism is enough to make the non-participation of major economies irrelevant to the agreement's success. If not, negotiators will have to work hard to keep other countries in line and come up with alternative mechanisms to ensure the agreement can still achieve its goals with regards to tax avoidance.

Third, developing countries have raised legitimate concerns regarding their lack of involvement in the creation of the agreement, and negotiators should either modify the agreement to address their concerns, or acquiesce to the creation of a

224 *See Financial Integrity for Sustainable Development*, *supra* note 208.

U.N. convention on tax. Given the unrealistic nature of a U.N. convention, the OECD should engage in genuine efforts to make the Inclusive Framework more legitimate in the eyes of developing countries and ensure that developing countries' interests are protected.

All in all, we will see how the finalized agreement looks in 2024. But regardless of the final outcome, the fact that all of these countries have been able to come together on this issue, in a time when it has been quite difficult to pursue multilateral agreements, is a success in and of itself.