

Contemporary Overview of the US Position on Pillar 2

Piyush Baid B.Com(H), MA(Intl Tax),FCCA, MCSI, ACIARB, ADIT, FCTPr, CertBV

Priya Phulwani B.Com , MA (Intl Tax), FCA, DipIFRS

Pillar Two of the OECD/G20 Inclusive Framework's international tax reform package introduces the concept of a 15% global minimum corporate tax rate.¹ This provision aims to address the longstanding issue of base erosion and profit shifting (BEPS) by multinational enterprises (MNEs). In simpler terms, BEPS refers to practices employed by MNEs to artificially move profits to low-tax jurisdictions, reducing their overall tax burden. Pillar Two seeks to deter such practices by establishing a baseline tax rate that MNEs must pay globally, regardless of where they locate their subsidiaries.²

The United States, while initially a strong proponent of this concept, faces domestic challenges and technical issues in fully aligning its tax system with Pillar Two principles.³ However, the potential benefits of Pillar Two for the US economy are significant. There is a view in the democrat administration that by curbing BEPS, Pillar Two can help ensure that US-based MNEs pay their fair share of taxes, protecting the US tax base and promoting a more level playing field for domestic businesses.

¹ Overview of the Key Operating Provisions of the GloBE Rules <https://www.oecd.org/tax/beps/pillar-two-GloBE-rules-fact-sheets.pdf>

² What is BEPS ? <https://www.oecd.org/tax/beps/about/>

³ Pillar 2 and the United States: What's Next : Reuven S. Avi-Yonah : <https://www.taxnotes.com/featured-analysis/pillar-2-and-united-states-whats-next/2024/01/26/7j41s> , The Hill - Biden's global minimum tax plan faces challenges at home: <https://thehill.com/policy/finance/557249-ireland-loved-by-biden-is-obstacle-to-tax-deal/>

Additionally, a global minimum tax has the potential to generate additional tax revenue for the US government, which could be used to fund vital public services and infrastructure investments.⁴

Early Support for a Global Minimum Tax

The Biden Administration championed the idea of a global minimum corporate tax as a way to address several interconnected concerns within the international tax landscape.⁴ An important concern revolved around the depletion of the US tax base as a result of BEPS practices. Through the strategic allocation of profits to jurisdictions with lower tax rates, US-based multinational enterprises were effectively minimizing their tax obligations to the US government. This not only resulted in the loss of significant tax revenue for the US, but also gave these companies an unfair edge over domestic businesses that were unable to partake in similar tactics.

A second major concern was the concept of a "race to the bottom" in international corporate taxation.⁵ As countries vied for foreign investment, certain nations started reducing their corporate tax rates to levels that were becoming increasingly difficult to sustain. This trend has had a detrimental impact on tax bases worldwide and has also discouraged countries from making essential investments in public services and infrastructure as a result of decreasing tax revenues.

Ultimately, the Biden Administration viewed a global minimum tax as a means to foster increased equity and openness within the international tax system. By implementing a uniform tax rate for all multinational enterprises (MNEs), it would create a fair and equal environment where companies from any country would be obligated to pay their rightful portion of taxes in the regions where they conduct business and generate profits.

⁴ U.S. Treasury, "Made in America Tax Plan": <https://home.treasury.gov/news/press-releases/jy1832>

⁵ Yellen says U.S. pushing to end global 'race to the bottom' on corporate taxes
<https://www.cnbc.com/2021/05/04/yellen-us-pushing-to-end-race-to-the-bottom-on-corporate-taxes.html>

Challenges to US Implementation

Despite these advantages, the path to Pillar Two implementation in the US is not straightforward:

- **Legislative Hurdles:** Implementing a global minimum tax requires modifications to the US tax code, which may encounter opposition and potential delays in a politically polarized Congress.⁶
- **GILTI Interaction:** The current US Global Intangible Low-Taxed Income (GILTI) regime has a tax rate that closely resembles the suggested minimum. There are concerns about the complexity of harmonizing or replacing GILTI with Pillar Two, as it could potentially lead to double taxation and place undue burdens on US businesses.⁷
- **Potential Constitutional Issues:** There have been concerns raised regarding the US government's constitutional authority to impose a tax based on the actions of foreign jurisdictions.⁸
- **Attempts at Harmonisation :** Although there is another proposal to replace the BEAT with 10% of the UnderTaxed Payments Rule and a “qualified domestic minimum top-up tax” (a “QDMTT”), it still remains a proposal for 2025, with the outcome to be determined by the US Elections.⁹

Parallely the Biden Administration and the US Treasury Department are actively involved in ongoing OECD discussions to find practical solutions that address US concerns while maintaining the fundamental principles of Pillar Two.

⁶ The Hill - Biden's global minimum tax plan faces challenges at home: <https://thehill.com/policy/finance/557249-ireland-loved-by-biden-is-obstacle-to-tax-deal/>

⁷ KPMG - Considerations on the potential interplay between GILTI and Pillar Two: <https://kpmg.com/us/en/webcasts/2023/pillar-two-administrative-guidance.html>

⁸ Forbes - Is Biden's Global Minimum Tax Unconstitutional? : <https://www.forbes.com/sites/taxnotes/2022/08/23/analyzing-the-corporate-alternative-minimum-tax/>

⁹ EY Tax News Update, March 15, 2024 <https://taxnews.ey.com/news/2024-0618-us-fy2025-budget-contains-international-tax-proposals-mainly-stemming-from-prior-budgets#:~:text=The%20Budget%20would%20repeal%20the,as%20proposed%20in%20the%20Budget.>

Pathways for US Adoption

Potential approaches for US implementation of Pillar Two include:

- Modifications to GILTI: Adjusting GILTI provisions (deductions, exemptions, etc.) could help align it with Pillar Two, making it a potential implementation mechanism. ¹⁰
- Qualified Domestic Minimum Top-Up Tax (QDMTT): The US could introduce a QDMTT specifically designed to collect the difference between an MNE's effective tax rate in a low-tax jurisdiction and the 15% minimum. This aligns conceptually with Pillar Two. ¹¹
- The Undertaxed Profits Rule (UTPR): The UTPR allows the jurisdiction where the MNE subsidiary is located to collect the 'top-up' tax. US-based MNEs may face such taxes abroad even if the US doesn't implement its own rule, creating pressure for domestic reform. ¹²

Evolving Outlook

The ultimate form Pillar Two implementation takes within the US will depend heavily on:

- International Negotiations: The ongoing OECD discussions will play a crucial role in determining the final rules and may offer some flexibility to address US concerns.

¹⁰ Baker McKenzie - Client Alert on Pillar Two:

https://insightplus.bakermckenzie.com/bm/attachment_dw.action?attkey=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQJsWJiCH2WAXENnrNzNVLu

¹¹ EY - Qualified Domestic Minimum Top-up Tax: https://www.ey.com/en_gl/tax-alerts/us-irs-releases-interim-guidance-on-15--corporate-alternative-mi

¹² OECD - Pillar Two Undertaxed Payment Rule: <https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm>

- Legislative Landscape: The fate of a minimum tax will depend on the dynamics within Congress and whether it garners enough support.
- US Tax Policy Alignment: It is crucial to find ways to harmonize existing policies like GILTI and potential new mechanisms with Pillar Two in order to prevent any unintended consequences.

The US approach to Pillar Two reflects a delicate balancing act. The Biden administration is committed to the principle of a global minimum tax in principle, recognizing its potential to level the playing field and generate additional revenue. However, navigating domestic legal and political complexities necessitates a nuanced strategy. Added to this, with the uncertainty of the impending US elections, and the republican stance against the two pillar solution, it remains to be seen whether the incumbent US administration would at all even provide a semblance of green light to the Pillar 2.