# Failing to Further the OECD Agreement Would Be A Lose-Lose-Lose

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In this article, Gurule and O'Neil argue that Congress should advance international tax reforms in the Build Back Better Act, and those more recently proposed by President Biden in the 2023 green book, to discourage continued profit shifting, base erosion, and offshoring by multinationals.



Congress must continue to advance international tax reforms already passed by the House of Representatives as part of the Build Back Better Act (H.R. 5376), as well as carefully consider recent international tax proposals made in President Biden's budget.[1] By doing so, Congress can discourage continued profit shifting and offshoring by multinational enterprises and advance the OECD's once-in-a-generation accord[2] to reset the taxation of large MNEs. A U.S. failure to act would likely result in substantial revenue forfeiture to EU jurisdictions that appear likely to adopt the OECD deal, forgoing U.S. competitive advantage. Congress has a tremendous amount of flexibility to implement the deal in a way that ensures that U.S. MNEs pay taxes on U.S. income in the United States, as evidenced by green book proposals. The international tax provisions in the Build Back Better Act are a good starting point to ensure that happens.

## A Good Thing for the United States

A lot has happened since nearly 140 jurisdictions signed onto the historic October 8 framework negotiated under the auspices of the OECD to rework century-old international tax norms. The agreement establishes a global minimum tax on the profits of large corporations applied jurisdiction-by-jurisdiction (pillar 2). It also transforms more than 100 years of tax status quo by reallocating some taxing rights to "market" jurisdictions (pillar 1). In part because of pillar 2's revenue implications, and in part because its modular design allows it to be equally effective and beneficial when implemented unilaterally, adoption of pillar 2 is a straightforward starting point for jurisdictions to implement the agreement.

The big picture is that pillar 2 works like it is supposed to: Large MNEs pay at least a 15 percent effective tax rate in all jurisdictions in which they

[1] Treasury, "General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals" (Mar. 1, 2022) (green book).

[2] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy" (Oct. 8, 2021).

operate. Recent technical guidance regarding pillar 2 rules[3] highlights the Herculean task being undertaken in implementing the OECD agreement, as well as the importance of remaining focused on the big picture while navigating through the extremely important details.

Two different top-up taxes — the income inclusion rule and the undertaxed payments rule — are the principal mechanisms that ensure this result. The IIR gives priority to MNE headquarter jurisdictions to levy a minimum tax on low-taxed offshore profits. It is to be determined jurisdiction-by-jurisdiction. Low-tax "intermediary" or source countries — where offshore profits may be booked to reflect actual activities or to reflect strategic tax planning — can assert tax priority and deny top-up rights under the IIR by implementing a domestic minimum top-up tax. That tax is essentially an effective 15 percent alternative tax in these jurisdictions that is levied on profits earned or routed through the applicable country.

Combined with the substantive payroll and tangible assets carveout included in the OECD agreement, the incentive to book profits in tax havens solely based on tax rates — and not for actual investment[4] — is substantially decreased. Higher tax rates and lower tax competition from pillar 2 are expected to generate up to $150 billion annually in tax revenue for governments worldwide.[5] For the United States, which is likely continuing to lose $70 billion to $100 billion annually to profit shifting even after the Tax Cuts and Jobs Act,[6] cutting off the incentive for these accounting gimmicks is essential.

The most recent country-by-country data[7] confirm that hundreds of billions of dollars in highly mobile profits continue to be booked offshore. Destinations include jurisdictions like Switzerland, Luxembourg, and the Netherlands, offering an aggregated average effective cash tax rate of less than 4.3 percent; and the Cayman Islands and Bermuda, each with an effective cash tax rate of less than 1 percent. These numbers are consistent year-over-year (though profits in Bermuda have dropped materially since 2018). Regardless, these profits are not tied to real operations in those countries as the CbC data show, and a global 15 percent effective tax rate is more likely to encourage these mobile profits to be directly booked in the United States, where a large portion of real operations are occurring.

The UTPR applies as a backstop, affording top-up tax rights (via denied deductions or otherwise) to operating jurisdictions if parent jurisdictions fail to appropriately tax MNE income, for example, by not including a qualifying IIR tax. The UTPR is essential to ensuring that MNEs don't play games like changing their headquarters address on paper — or "inverting" to a country without an IIR. Also, it removes the incentive for countries to opt out of enacting OECD-compliant reforms.

The UTPR is also necessary to ensure that common headquarter jurisdictions do not take steps to attract what otherwise might be foreign-source income. For example, the UTPR helps to prevent the incentive for a headquarter country to implement a qualified IIR on offshore income, while implementing preferential rates for income booked at "home." Today's profits are mobile. Lower rates for "domestic" intangible income (such as via a patent box) undermine the point of the deal. In other words, the OECD project ensures that MNEs are taxed and that there is no competitive advantage for booking profits through conduit or headquarter tax havens with tax rates near zero. That's a good thing for the United States, and it's an important principle of the deal, of which Congress must not lose sight.[8]

[3] OECD, "Tax Challenges Arising From the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)" (Dec. 20, 2021).

[4] Michael P. Devereux, John Vella, and Heydon Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," Oxford University Centre for Business Taxation Policy Brief (Jan. 14, 2022).

[5] IMF, "Fiscal Policy From Pandemic to War," Fiscal Monitor (Apr. 2022).

[6] Kimberly A. Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act," 73(4) *Nat'l Tax J.* 1233 (2020).

[7] IRS, "SOI Tax Stats — Country by Country Report" (last updated Apr. 28, 2022).

[8] The FACT Coalition has previously noted valid concerns raised by low- and middle-income countries regarding both the OECD process and the OECD results. Ryan Gurule, "Tremendous Opportunities and Legitimate Concerns," FACT Coalition blog (Oct. 5, 2021). This article does not address these concerns but stresses that they must be taken seriously and given ongoing consideration to promote greater revenue-raising autonomy for low- and middle-income countries and greater transparency in the OECD process.

### Deterring Profit Shifting and Offshoring

The competitiveness of U.S. multinational companies has not really been in question in recent years.[9] U.S. corporate profits continue to soar, despite global challenges like the COVID-19 pandemic, climate change, a land war in Europe, and mounting inflationary pressures. Arguments around tax competitiveness often neglect to compare hypothetical circumstances with realities. Still, advancing the 15 percent global minimum tax through the Build Back Better Act's international tax reforms, along with other reforms proposed by Biden, will improve U.S. MNE competitiveness from a tax basis — more than international tax aspects of the 2017 Trump tax cuts.

To see why, consider that Republicans created the first minimum offshore profits tax by adopting the global intangible low-taxed income regime. GILTI requires MNEs to pay a minimum tax on most offshore profits equal to 10.5 percent, subject to a carveout for 10 percent of offshore tangible investment and some foreign tax credit limitations — essentially half the U.S. domestic nominal rate of 21 percent. This results in two things:

- cementing the incentive for many MNEs to book profits offshore, and offshore factories and jobs; and
- creating a comparative tax-only "disadvantage" for U.S. MNEs on foreign profits equal to around 10.5 percent compared with the current 0 percent global minimum tax.

But international tax reforms contemplated in the Build Back Better Act and the green book, together with a global minimum effective tax rate of 15 percent, will reduce the competitive tax disadvantage for U.S. MNEs (if any) and weaken the incentive to book profits offshore. For example, international tax reforms in the Build Back Better Act would increase the GILTI rate to 15 percent and maintain the domestic nominal rate at 21 percent. That significantly lowers the incentive to book profits offshore. Similarly, with Biden's reforms, U.S. MNEs would be more competitive solely on a tax basis as it relates to booking domestic or foreign profits. The table is illustrative.

Two other key reforms — applying the minimum tax on a CbC basis and reforming the base erosion and antiabuse tax — are necessary to deter profit shifting and gamesmanship[10] available to domestic and foreign MNEs, while providing greater certainty to businesses. Fortunately, these reforms raise no competition concerns because each is part of the OECD deal. In fact, the BEAT reforms may reduce potential double taxation concerns related to FTC application that exist under current rules, and along with multiple other taxpayer friendly tweaks in the Build Back Better Act, these reforms are much more balanced than certain detractors may argue.

### A Lose-Lose-Lose Situation

The United Kingdom and the EU have begun formal processes for adopting portions of the OECD agreement. While EU developments have been cited as proof that there is hesitation around the process, delays in implementing pillar 2 in Europe may be unrelated.[11] As of April, Poland remains a lone holdout on advancing pillar 2 at the EU,[12] and there is speculation that Poland's objections are tied to its demands on economic recovery and not the OECD deal itself. The EU's adoption of the 15 percent corporate minimum tax rate still seems more of a matter of "when" than "if"[13]: Jurisdictions globally are moving toward adopting pillar 2, with or without the United States.

There is no competitive advantage for the United States to fail to advance the Build Back Better Act's international tax reforms, or the president's green book reforms. That is the simple elegance of pillar 2. If the United States does not advance the Build Back Better Act's international

[9] Stephen Shay, "Comment on International Tax Reform Framework Discussion Draft by Senate Committee on Finance Chair Ron Wyden and Senators Sherrod Brown and Mark Warner," SSRN (Sept. 7, 2021).

[10] Clausing, "Fixing Our 'America Last' Tax Policy," *The Hill*, Apr. 11, 2019.

[11] Bjarke Smith-Meyer, "Poland Vetoes EU Tax Reform Again, Dismisses Ulterior Motives," *Politico*, Apr. 5, 2022.

[12] Elodie Lamer, "Linking Tax Pillars Would Undermine EU Sovereignty, France Says," *Tax Notes Today Int'l*, Apr. 6, 2022.

[13] Brian Faler, "Yellen: EU Will Adopt Global Minimum Tax This Spring," *PoliticoPro*, May 4, 2022.

**Comparison of Relevant Nominal and Effective Rates (%) in International Tax Regimes**

| | Current Law (from GOP tax cuts) | Current Build Back Better Act Draft (with OECD deal) | Biden's Green Book (with OECD deal) |
|---|---|---|---|
| Domestic profit tax rate (nominal) | 21 | 21 | 28 |
| Foreign profit (GILTI) tax rate | 10.5 | 15 | 20 |
| Global minimum rate (based on effective rate) | 0 | 15 | 15 |
| Difference between U.S. domestic rate and global minimum rate | 21 | 6 | 13 |
| Difference between GILTI and global minimum rate | 10.5 | 0 | 5 |

*Note*: The Financial Accountability and Corporate Transparency Coalition has also presented a similar table relying on effective tax rate analysis, taking into account FTC limitations under GILTI, including as modified by the Build Back Better Act. That analysis remains relevant; however, by converting GILTI to apply on a CbC basis (which must be prioritized and is in line with the OECD deal), this absolute comparison is particularly helpful given that low-tax jurisdictions likely won't run into FTC limitation issues under GILTI.

tax reforms, U.S. and foreign multinationals will still pay a 15 percent effective tax rate on global profits, but the U.S. fisc will not benefit.[14] This might put downward pressure on U.S. community and workforce investments that attract foreign investment and increase the desirability of the United States as an investment destination.

There is a risk that a U.S. failure to advance the OECD agreement might derail its adoption in other jurisdictions. However, the big picture is that the United States becomes a more attractive destination for investment and that profit shifting and offshoring are discouraged under the OECD deal. This should motivate Congress to act now. Even if other jurisdictions are delayed in implementing the OECD agreement, the incentive for MNEs to profit shift or otherwise erode the U.S. tax base via paper transactions is dramatically reduced with the international tax changes proposed in the Build Back Better Act, particularly when combined with the UTPR (as well as strengthened anti-inversion rules, like those previously put forward by the president).[15]

Further, if the EU advances pillar 2 and the United States does not (including failing to enact international tax provisions in the Build Back Better Act and the president's 2023 budget), much of the revenue that would come to the United States under the agreement will likely end up in EU coffers. In the latest estimations based on reforms in the Build Back Better Act and green book, that would be the equivalent of the United States handing a big portion of roughly $550 billion over the 10-year budget window to the EU. This is revenue generated not just as a result of increasing GILTI rates, but also as a result of the decreased incentive to move profits through conduit countries, as well as U.S. taxes from relocation of economic activity (back) to the United States. That revenue could fund critical investments in U.S. communities, combat inflation, improve long-term U.S. competitiveness, or go toward budget deficit reduction. The United States has every incentive to push pillar 2 through international tax reforms. Failing to do so is a lose-lose-lose and an inexcusable policy choice.

[14]Notably, this article does generally assume that GILTI will be deemed to be a qualifying IIR tax to the extent international tax reforms included in the Build Back Better Act are enacted by Congress, as appears to be reasonably expected by Treasury; however, these points are likely true even if GILTI is not a qualifying IIR as GILTI is currently structured as a controlled foreign corporation tax, which appears to have some preference in OECD ordering rules. The technical treatment of GILTI as a CFC tax without Build Back Better Act reforms is more challenging, though still a possibility. *See* Andrew Velarde, "Treasury Defends GILTI as Good Pillar 2 Regime," *Tax Notes Int'l*, May 23, 2022, p. 1094; *cf.* Mindy Herzfeld, "More on GLOBE Ordering: CFC Rules," *Tax Notes Int'l*, May 2, 2022, p. 603.

[15]Treasury, "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals" (May 2021).

## The Exaggeration of Concerns

Rewriting 100 years of global tax policy is not easy. Technical difficulties continue to arise. But so too will solutions. This is not too dissimilar from the creation of GILTI in the first place. It was flawed in its conception, but the Build Back Better Act and the OECD deal improve GILTI and make it an international norm — thereby advancing what might be considered a nonpartisan solution to real-time issues.

The president's green book directly addresses concerns about where U.S. MNE revenue may be taxed in light of the UTPR and some highly political U.S. tax credits: renewable energy credits, low-income housing tax credits, and research and development tax credits. The president has recommended adopting a domestic minimum top-up tax, and suggested flexibility to preserve preferred credits to ensure that U.S. MNEs pay an effective U.S. tax rate equal to 15 percent, while avoiding foreign application of the UTPR on U.S. MNE income. Increasing the U.S. domestic nominal rate, as proposed by the president, may also decrease the incidence of UTPR application.

The president's proposed solution is just one possible outcome. This highlights the tremendous flexibility Congress has in making sure that U.S. and foreign MNEs play by the same rules and face a stable tax regulatory environment. Better-tailored approaches to addressing underlying concerns about low-income housing, climate change, and encouraging R&D may be available (or already partially addressed in other Build Back Better Act reforms).

Treasury has indicated that a new process is being created at the OECD that will work toward clarification of the pillar 2 treatment of some credits, like low-income housing and renewable energy credits.[16] This may entirely preserve the benefit of these credits. What cannot be lost in the debate, however, is investments that can be funded by these reforms would further U.S. competitiveness and create a feedback loop that benefits local communities instead of leading to profit shifting and offshoring.

## Conclusion

The time to pass international tax reforms included in the Build Back Better Act is now. If Congress fails to pass these reforms it would be a lose-lose-lose: encouraging continued profit shifting and offshoring of investment and jobs, while yielding no competitive benefit for U.S. MNEs, and potentially contributing to the failure to invest in solutions to some of our biggest long-term competitive concerns. In contrast, these reforms can advance the OECD minimum tax agreement and create a more competitive tax environment for U.S. MNEs, deterring the incentive to shift profits and offshore factories and jobs, while funding critical investments toward more sustainable and equitable growth. ■

[16]Remarks by Assistant Secretary for Tax Policy Lily Batchelder for the D.C. Bar Association (May 5, 2022). *See also* Stephanie Soong Johnston, "U.S. Working With OECD on Pillar 2 Clarifications on Tax Credits," *Tax Notes Int'l*, May 9, 2022, p. 817.