Rushed Multilateral Negotiations Caused Two-Pillar Tax Mess

By **Jefferson VanderWolk** (October 18, 2022)

Jefferson VanderWolk

Cracks are appearing in the two pillars of the global tax plan that more than 130 countries agreed to in October 2021.

The plan, designed by members of the Organization for Economic Cooperation and Development's inclusive framework on base erosion and profit shifting, and approved by the G20 leaders, was aimed at preventing a chaotic, uncoordinated scramble by countries to tax cross-border business through new unilateral measures such as digital services taxes.

The plan included a tight time frame for implementation of the agreed measures by 2023, and required an immediate "standstill and rollback" of digital services taxes that were already in place.

A little more than one year later, the consensus in the inclusive framework is unraveling. On Oct. 11, the Intergovernmental Group of 24 on International Monetary Affairs and Development, which includes five G20 members (Argentina, Brazil, India, Mexico and South Africa) and two OECD members (Colombia and Mexico), issued a communiqué with the following startling assertion:

> Going forward, building on the reform principles agreed upon in the Inclusive Framework, developing countries need to develop and implement tax measures, including withholding taxes, on digital and remote transactions involving their residents, or to configure a significant taxable economic presence in their jurisdictions to protect their tax base in ways that are tailored to their unique circumstances.

Later the same week, Colombia's Finance Minister José Antonio Ocampo, while speaking at an event connected with the International Monetary Fund and World Bank annual meetings in Washington, D.C., called for a new round of negotiations in order to enhance the taxing rights of developing countries with respect to multinational business income, noting that the two-pillar proposals are overly complex.

He also advocated transferring the global talks from the OECD to the United Nations. Given that Colombia is an OECD member country, this is surprising indeed.

Meanwhile, the European Union member states have been unable to reach unanimous agreement on the implementation of Pillar Two, due to opposition by Hungary. As for Pillar One, the timing of its implementation was delayed earlier this year by the entire inclusive framework to 2024 at the earliest.

Currently, it appears that the developing countries are at odds with the developed world over a fundamental issue: namely, whether withholding taxes should be taken into account in Pillar One's formulae that determine how much of a multinational's income is to be reallocated to market jurisdictions. It is hard to see how the issue can be resolved without a substantial renegotiation of Pillar One's design.

Readers may recall that the two-pillar process had reached an impasse during the final year of the Trump administration, and that the Biden administration breathed new life into the

talks in the spring of 2021 by proposing changes to Pillar One. The real goal of that resuscitation was to get agreement on Pillar Two's global minimum tax, which would line up nicely with the Biden administration's proposals to raise taxes on multinational corporate groups.

At the time, it was widely assumed that the proposals were likely to be passed by Congress through a budget reconciliation bill, since both the U.S. House of Representatives and the U.S. Senate were under Democratic control.

Of course, that didn't happen, but Congress did ultimately pass a new 15% corporate alternative minimum tax based on adjusted financial statement income in August this year.

Yet the new U.S. corporate alternative minimum tax does not constitute implementation of Pillar Two's 15% global minimum tax. Why? Because the inclusive framework had put the cart before the horse in the fall of 2021, and produced final model rules for the Pillar Two minimum tax, with very specific requirements for conforming domestic provisions, before the U.S. legislative process had played out.

The requirements of the model rules were not aligned with relevant U.S. rules already in place, such as the global intangible low-taxed income rules, but presumably the inclusive framework delegates — including U.S. Department of the Treasury officials — were assuming that the GILTI rules would be amended in short order to conform with the model rules.

They weren't. The corporate alternative minimum tax differs from the model rules in significant ways as well.

In this way the OECD-led inclusive framework, which had been led by the U.S. to the October 2021 agreement on the two-pillar plan, departed from the OECD's tradition of following U.S. international tax innovations.

Examples include the OECD's production of transfer pricing guidelines long after the U.S. had pioneered the use of detailed arm's length pricing rules in the 1970s and 1980s, and the OECD's inclusion of various U.S.-implemented measures in the 15-point base erosion and profit shifting action plan of 2013-2015.

However, in the wake of last year's October agreement, the OECD rushed ahead to produce model rules on the Pillar Two global minimum tax, issuing them in late December in final form, without the benefit of input from outside stakeholders in the accelerated drafting process.

Thus, we now have an odd situation in which the U.S. has implemented a 15% book-based minimum tax on the global income of large multinationals but has not implemented the 15% book-based global minimum tax of the Pillar Two model rules, and is not likely to do so anytime soon.

It is worth noting that this is not an outcome that the U.S. multinational business community was hoping for. Rather than being the result of lobbying efforts by business groups, the current impasse is the result of an overly rushed multilateral tax policy process driven by politics alone.

Jefferson VanderWolk is a partner at Squire Patton Boggs LLP. He is the former head of the OECD Centre for Tax Policy and Administration's tax treaty, transfer pricing and financial transactions division.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.