

# The UTPR Is Far From Becoming Part of Customary International Tax Law

by Jefferson VanderWolk

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To the Editor:

Reuven Avi-Yonah's recent letter to the editor maintains that customary international tax law (CITL) is dynamic, changing to reflect the "general and consistent practice of states."<sup>1</sup> I am happy to say that I fully agree with him on that point, and I thank him for his kind words about my earlier letter<sup>2</sup> arguing that the UTPR (now known as the undertaxed profits rule) is inconsistent with CITL. Avi-Yonah proceeds to give three reasons why he thinks that the UTPR is consistent with CITL, even though the UTPR would break new ground in the international taxation of business profits by allowing a country to impose tax on a resident company with respect to low-taxed profits of uncontrolled foreign affiliates, not because of any economic or transactional connection that the affiliates have to the taxing country, but rather because — and only because — the affiliates are part of the same multinational group.

First, he says, CITL permits a country to use controlled foreign corporation rules to tax a resident controlling parent company on the profits of foreign affiliates simply because of the legal relationship between the taxpayer and the affiliates. My answer is that the economic rationale for attributing profits of a controlled affiliate to the parent company under CFC rules — namely, that the parent has the power to obtain the affiliate's profits and indeed to control every aspect of the affiliate's business — is lacking in the case of the UTPR.

Avi-Yonah's second point is that CITL can now be seen as permitting a country to impose tax on

gain realized by a nonresident company from an indirect offshore transfer of ownership of an asset located in the taxing country. Again, in my view there is a rationale here for the exercise of tax jurisdiction that is lacking in the case of the UTPR. The income being taxed in the case of an offshore indirect transfer is clearly attributable to property in the taxing jurisdiction. In contrast, the UTPR allows the taxing state to collect tax on profits that have no economic or transactional connection to the state and are not under the control of the taxpayer.

The third argument made by Avi-Yonah is that 137 member countries of the inclusive framework on base erosion and profit shifting agreed to the two-pillar plan that included the UTPR, thereby making the UTPR part of CITL. Can it really be said that the UTPR has become, by virtue of the events of last fall, a general and consistent practice of states as required by CITL? The UTPR has not yet been implemented by a single country. It is not even clear what type of agreement, if any, was made by the inclusive framework countries, because the delegates to the inclusive framework were not authorized to bind their governments. The October 2021 statement cannot be viewed as a conscious agreement on a UTPR that broke new ground in international taxation by requiring nothing more than common ownership for imposing tax on a resident company regarding profits of an uncontrolled foreign affiliate. The UTPR, with its new design, disconnected from deductible intragroup payments, was not finalized until after the October statement and was not revealed to the public until the issuance of the global anti-base-erosion model rules in late December 2021. Further, the rushed approval of the model rules does not appear to have involved a conscious decision by the inclusive framework to change accepted principles regarding the need for a transactional or other economic nexus for a

<sup>1</sup>Reuven S. Avi-Yonah, "UTPR's Dynamic Connection to Customary International Tax Law," *Tax Notes Int'l*, Nov. 21, 2022, p. 951.

<sup>2</sup>Jefferson VanderWolk, "Much Ado About Pillar 2," *Tax Notes Int'l*, Nov. 14, 2022, p. 821.

country to impose tax on profits of an uncontrolled nonresident. If such a change had been intended, surely something would have been said about it when the model rules were published.

In order for the UTPR to become part of CITL, it seems necessary for it to become a general and consistent practice of states through actual implementation of the model rules in the domestic laws and administrative practices of a sufficiently large number of countries. Maybe that will happen, but it certainly hasn't happened yet. ■

Sincerely,  
Jefferson VanderWolk  
Squire Patton Boggs  
Nov. 21, 2022



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