taxnotes® international

Volume 110, Number 22 ■ May 29, 2023

Pillar 1, Amount A: Will the Zombie Arise?

by Jefferson VanderWolk

Reprinted from *Tax Notes International*, May 29, 2023, p. 1181

Pillar 1, Amount A: Will the Zombie Arise?

To the Editor:

Since 2021, when the OECD's two-pillar global tax plan was signed by more than 130 countries in the inclusive framework on base erosion and profit shifting, the implementation of pillar 2's global minimum tax regime has made considerable progress (although the United States and some other large economies have not yet taken any steps). In contrast, pillar 1 implementation is in limbo, as the inclusive framework members disagree about important questions, like whether taxes collected by withholding should be taken into account under the pillar 1 rules to determine how much tax a company has paid on its profits.

Moreover, the United States is clearly not ready (and may never be ready) to implement an agreement on pillar 1's amount A regime, which would reallocate for tax purposes a portion of the profits of 100 or so of the world's largest and most profitable multinational enterprises. Most of the reallocated profits would come from U.S. MNEs. The idea of reallocating profits of U.S. MNEs to other countries, thereby shrinking the U.S. corporate income tax base, does not appeal to legislators in Congress despite the key role played by the Biden administration in pushing the two-pillar deal in the G-7 and G-20 in 2021.

The proposed reallocation of profits to market countries involves a radical departure from established notions of income taxation. The amount A rules would treat a controlled group of companies as a single taxpayer for the allocation formula and would rely on a group's consolidated financial statements to determine the amounts to be reallocated. The formula would allocate a portion of profits to market countries based on gross revenue derived from those countries (or possibly based on relative GDP), with tax payable there regardless of whether the MNE has employees, agents, or assets in the jurisdiction.

Amount A implementation would require a critical mass of countries to sign and ratify a multilateral treaty containing the reallocation formula and all rules related to it. The head of the OECD's Centre for Tax Policy and Administration, Manal Corwin, recently said that she expects the inclusive framework to publish the new treaty, called the multilateral convention (MLC), by the end of July. Member countries will then be expected to sign it and take whatever steps are necessary under their domestic laws to ratify it. Enactment of new legislation to implement each country's obligations under the MLC will be necessary as well. However, what constitutes a "critical mass" of implementing countries is not yet clear.

Some assume that other countries could not implement the global reallocation scheme, as a practical matter, without the United States' participation. Since the United States is home to more than half of the MNEs to which the amount A rules would apply, U.S. participation appears essential. A former head of the OECD's tax centre, Pascal Saint-Amans, said repeatedly during his tenure that the proposed amount A plan would not fly if the United States did not participate. It is worth considering, however, whether the rules could be applied to U.S.-based MNEs even if the United States did not implement them — particularly because pillar 2 implementation is proceeding in many countries while the United States sits on the sidelines.

Let's assume that a significant number of countries — say, the EU member states plus Australia, Canada, India, New Zealand, the United Kingdom, and the larger Southeast Asian and Latin American economies — proceed to ratify the MLC and enact the necessary amount A rules in their domestic legislation. Any MNE with a subsidiary located in any of those countries could be required by the local tax authorities, under local law, to provide a computation of, and pay tax on, the group's amount A allocation to the

country based on the group's consolidated financial statements for its global business and the amount A formula for global reallocation of the relevant portion of the MNE's global profits.

In this case, several issues would arise, including:

- *Double taxation relief.* To the extent that the amount A allocation to a given country was considered under the rules to be surrendered by a different country where the profits were reported as taxable under the normal tax rules of the surrendering country, the MNE could expect to receive corresponding tax relief in the surrendering country, assuming that it had implemented the amount A regime in its laws. If a surrender jurisdiction did not implement the amount A rules, however, no relief could be expected, and double taxation would result. Double taxation would be contrary to the express intention of the inclusive framework in its agreement on the two-pillar plan.
- *Treaty conflicts and international law questions.* If a taxing country's enactment of amount A legislation did not override the provisions of existing bilateral tax treaties between that country and surrendering countries, the MNE might be able to mount a treaty-based challenge to taxation of the amount A allocation. Many arguments regarding possible treaty-based challenges to taxation under pillar 2's UTPR would be applicable regarding amount A taxation. Similarly, aggrieved taxpayers might invoke general or customary international law to challenge the validity of amount A taxation.
- *Consistency of interpretation and application of revenue sourcing rules.* The rules for sourcing revenue to a jurisdiction for amount A purposes would be very difficult for MNEs and tax administrations to apply consistently. Inevitably, taxing jurisdictions and surrendering jurisdictions would disagree about the correct formulary apportionment of a given MNE's profits. Absent an effective dispute resolution mechanism, double taxation would result from these disagreements.
- *Constitutionality of legislation surrendering taxable income to other jurisdictions.* In many jurisdictions there are constitutional constraints requiring the government to use tax revenue for government purposes only. Amount A implementing legislation would, in some countries, effectively give away tax revenue to other countries, arguably violating the constitutional limitation.
- *Application of the marketing and distribution profits safe harbor.* The OECD's public consultations on the amount A rules in 2021 proposed a safe harbor mechanism aimed at preventing double taxation of profits in market countries where an MNE is already paying tax on nonroutine profits. The proposal was complex, and the inclusive framework has continued to negotiate the design of the mechanism. How it would work in practice is an open question.

Additionally, MNEs will be concerned about whether countries participating in the amount A process will live up to their commitment to refrain from imposing unilateral measures like digital services taxes. The OECD's public consultation on the definition of these measures last year appeared to give countries some wiggle room in this regard.

It seems that, although pillar 2's global minimum tax will continue to receive a great deal of attention as it is rolled out in various countries, MNEs and tax policymakers in the United States and elsewhere will also need to keep an eye on whether, and how, the pillar 1 amount A regime is implemented. ■

Jefferson VanderWolk
Senior Partner
Squire Patton Boggs
Washington, D.C.
May 19, 2023