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**Potential United States Responses to a Broad International Implementation of Pillar 2**

**by**

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1. Introduction

Over the past ten years the United States has actively considered adopting several proposals to ensure that income earned by US-based multinational enterprises ("US MNEs) is taxed at a minimum global effective tax rate on a current basis. In 2017 Congress adopted as part of the Tax Cut and Jobs Act (the “TCJA”) the Global Intangible Low-taxed Income regime (the “GILTI”), a form of a global minimum tax, which sought to assure that US MNEs would be subject to a current global average effective tax rate on most income earned by their controlled foreign corporations ("CFCs"). More recently, the US Treasury has viewed the Pillar 2 negotiations at the OECD and the OECD/G20 Inclusive Framework as an opportunity to achieve international agreement on an even more robust global minimum tax regime, which would ensure a current minimum tax rate on income *earned in each country* in which *any* MNE operates, as compared with the operation of the GILTI regime, which applies only to US-based MNEs and only ensures that the minimum rate is paid on a global averaging basis.

During 2021 and 2022, the Treasury, working in close cooperation with Germany and France, succeeded in achieving a consensus in the Inclusive Framework to adopt as a global common approach the GloBE minimum tax regime, which allows the countries in which a MNE has operations to collectively impose additional tax if another country where the MNE operates fails to impose a 15% agreed minimum tax rate on income in its jurisdiction. The GloBE regime, as agreed by the Inclusive Framework, thus can operate to impose its minimum tax rate on the global income of MNEs based in countries that do not adopt the GloBE regime and on income earned within countries that do not adopt the GloBE regime, without regard to traditional tax nexus requirements.

Following the adoption of the GloBE regime as a common international standard in 2022, the Inclusive Framework has approved model rules for countries around the world to adopt as domestic legislation to implement the GloBE regime (the "Model Rules"). The Inclusive Framework agreement calls for the adoption of the Model Rules as domestic legislation during 2023, with different parts of the regime becoming effective in 2024 and 2025. Legislative activity to implement the GloBE has been proceeding apace across much of the world. The members of the European Union and most members of the OECD are actively legislating as well as many countries that historically have been low-taxed jurisdictions. It appears that, if present trends continue, there will be a sufficient “critical mass” of implementing countries to collect the GloBE minimum top-up tax globally, including with respect to MNEs based in, and income earned within, countries that do not implement.

A notable exception to this trend towards implementation is the United States. Having succeeded in convincing much of the rest of the world to adopt a global minimum tax that is more robust than the US GILTI regime, the current Administration has not succeeded in convincing Congress to conform the US tax rules to the new GloBE common standard. The Administration narrowly failed in 2022 to have Congress pass the Build Back Better Bill, which would have amended the GILTI regime to make it a “Qualified Income Inclusion Regime” (“IRR”) and would have thereby avoided having CFCs of US MNEs be subjected to GloBE taxation by countries other the United States under their IRRs and Under Taxed Profits Rules (“UTPRs”).

The chances of any significant international tax legislation in the United States before 2025 appear to be slim. The United States therefore faces the prospect of the GloBE regime coming into force across much of the world while US MNEs are subject to the current GILTI regime. US MNEs will likely be required to apply the GILTI regime, which is both highly complex and flawed, to the income of their CFCs. To the extent that a US MNE group's income in any country, including the United States, is subject to an effective tax rate below 15% as measured under the GloBE international standards, it will face “top-up” tax collected by other countries. Although this combination of overlapping regimes applicable to US MNEs could be made to work, it is clearly suboptimal both in terms of its complexity and its potential for double taxation. It is not an outcome anyone would have designed from the outset.

This paper will summarize the origins of Pillar 2 and the negotiations at the OECD and Inclusive Framework that produced the current GloBE Model Rules. It will then explore the implications for the United States and for US MNEs of maintaining the current US international tax rules while much of the rest of the world is implementing the GloBE. The balance of the paper will then explore policy options that the United States might pursue, including both current diplomatic options and potential legislative options if a window for tax legislation opens in 2025.

1. The Background and Negotiation of Pillar 2.

Although Pillar 2 and the GloBE regime were negotiated at the OECD and the Inclusive Framework during the period of 2019 through 2023, they derive largely from a series of legislative proposals and legislation in the United States, the most recent of which are minimum tax legislation proposed by the Obama Administration and the enactment of the GILTI regime under the Trump Administration in 2017.

* 1. The 2017 Obama Green Book Minimum Tax Proposals.

A clear intellectual antecedent of the GloBE regime is a revenue proposal in the Obama Administration's 2017 Budget to impose a 19% minimum tax on foreign income of US corporations and their CFCs.[[2]](#footnote-1) It would have imposed what today we would call a "top-up tax" on a per-country basis to bring the current effective tax rate on a US MNE's income earned in each country up to 19%. Income of a US MNE group would be sourced to each country and the foreign effective tax rate on such income would be calculated. In making this rate calculation, however, only 85% of the foreign income taxes paid would be counted to preserve an incentive for taxpayers to minimize foreign taxes. If this "residual foreign tax rate" was less than 19%, the US shareholder would be subject to tax in the United States equal to the excess of the 19% minimum rate over this residual foreign tax rate multiplied by the income earned by the MNE group in that country. The income base for this minimum tax would have been calculated using US tax principles to include, with respect to each country, (i) all income of CFCs sourced from such country other than subpart F income, (ii) all income of foreign branches in such country, and (iii) all income of a US corporation from providing services in such country. This tentative tax base would be reduced by an Allowance for Corporate Equity ("ACE Allowance") which was an amount equal to a risk-free return on equity invested in assets other than assets that produce foreign personal holding company income. The ACE Allowance was intended to provide an exemption from the minimum tax for a return on "the actual activities undertaken in a foreign country."[[3]](#footnote-2) Under this regime, distributions from CFCs would be exempt from tax, with the result that income of a CFC would either be taxed currently as earned or not at all. Subpart F income would continue to be taxed currently at the full corporate tax rate; the remaining income of a CFC other than the ACE Allowance would be currently subject to the 19% minimum top up tax; and the ACE Allowance would never be subject to US tax. The general US corporate tax rate at that time was 35%.

It is worth noting that the Obama administration also proposed to reform the interest expense allocation rules in connection with the adoption of its minimum tax. It proposed to implement global apportionment of interest expense under Code Sec. 864(f)[[4]](#footnote-3) to end the systematic overallocation of interest expense to foreign source income, but also proposed to allow interest allocated against foreign source income to be deducted only at the rate at which the income against which it is allocated is taxed. Interest expense allocated against subpart F income and directly earned foreign source income would be deductible against the full corporate tax rate, whereas interest expense allocable against income subject to the minimum tax would be deductible at a 19% rate, and interest expense allocable against the ACE Allowance would not be deductible at all.

These proposals were made by the Obama Administration at a time when the Republicans controlled Congress and were not enacted. The proposals were nevertheless a significant development in the policy discussion regarding international tax reform in their focus on using a minimum tax calculated on a per-country basis to limit the tax benefit to US MNEs of earning income in low-taxed jurisdictions. The policy focus was solely on US MNEs and further limiting perceived incentives for them to conduct activities outside of the United States. The proposals do not appear to have been drafted to provide the basis for an international agreement to impose a global minimum tax on all MNEs, both US- and foreign-based.

* 1. OECD BEPS Action Report 3 on Design of CFC Regimes.

While the Treasury was formulating its legislative proposal for a 19% minimum tax on foreign income of US MNEs, it was representing the United States in negotiations at the OECD/  
G20 Inclusive Framework (the "Inclusive Framework") to reach an international agreement on rules to limit base erosion and profit shifting ("BEPS"). In these negotiations the United States advocated for a broader implementation of robust CFC regimes as a measure to reduce the incentives to shift profits to low-tax countries. The United States failed, however, to attract meaningful support for such an approach. There appear to be several reasons for this lack of support. Some OECD and G20 countries, most notably the United Kingdom, were actively looking to make themselves competitive as headquarters jurisdictions by maintaining lax CFC regimes. In addition, EU jurisdictions faced limits under EU law on enacting robust CFC regimes following the decision of the European Court of Justice in *Cadbury Schweppes*.[[5]](#footnote-4) Following that decision it was understood that a CFC regime, to be consistent with EU freedom of establishment principles, needed to "specifically target wholly artificial arrangements which do not reflect economic reality and whose only purpose would be to obtain a tax advantage."[[6]](#footnote-5)

The outcome of the Inclusive Framework discussions regarding CFCs in the BEPS 1.0 negotiations was the Action 3 Final Report - Designing Effective Controlled Foreign Corporation Rules.[[7]](#footnote-6) This Report was little more than a general policy discussion of the design features countries should consider if they choose to adopt CFC regimes, with some recommended best practices. The Report did not affirmatively recommend that countries adopt CFC regimes, let alone mandate their adoption. It instead focused on the flexibility countries had in designing CFC regimes to meet their particular needs and priorities.

There was a specific discussion of how a country's adoption of a robust CFC regime could reduce its competitiveness as a headquarters jurisdiction and of the need to strike a balance between competitiveness and taxing foreign income under a CFC regime. In a paragraph that foreshadowed negotiations to come years later, however, the Report observed:

Another way to maintain competitiveness would be to ensure that more countries implement similar CFC rules. This is therefore a space where countries working collectively and adopting similar rules could reduce the competitiveness concerns that individual countries may have when considering whether to implement CFC rules.[[8]](#footnote-7)

* 1. US Enactment of the GILTI Regime in the TCJA in 2017.

When Republicans took control of Congress following the 2016 elections, they had ambitious plans for tax legislation, including lowering the corporate tax rate to 20% and reforming the taxation of international operations. They succeeded in passing the Tax Cuts and Jobs Act[[9]](#footnote-8) in December of 2017, which lowered the corporate tax rate to 21% and included the enactment of the Global Intangible Low-Taxed Income ("GILTI") regime.

The GILTI is a second CFC regime that operates in parallel with subpart F to tax currently most of the income of CFCs that is not already taxed under subpart F. Under the combination of subpart F and the GILTI, a US shareholder of a CFC is currently subject to tax in the United States on the large majority of its CFC income. Under subpart F, passive income and foreign base company income is taxed currently to the US parent at the full corporate tax rate. The GILTI regime taxes the US shareholder on "tested income," which consists of all other income earned by a CFC subject to very limited exceptions for (i) income effectively connected with a US trade or business (with respect to which the CFC directly pays US corporate income tax), (ii) dividend income received from related CFCs, and (iii) foreign oil and gas extraction income. Treasury regulations provide an election to exclude from tested income any CFC income which is subject to a current effective foreign tax rate of greater than 90% of the US corporate tax rate. A US shareholder of CFCs includes in income the sum of its pro rata shares of the tested income earned by each CFC, reduced by its pro rata shares of current losses incurred by CFCs it owns ("tested losses"), and further reduced by an allowance for a deemed 10% return on the qualified business assets investments ("QBAI") owned by its profitable CFCs.

The GILTI regime taxes US shareholders on inclusions of net tested income at the equivalent of a 10.5% rate by providing a deduction under Code Sec. 250 equal to 50% percent of the inclusion. This deduction is scheduled to be reduced to 37.5% for years after 2025, for an effective rate of 13.125%. Earnings of CFCs that have been taxed to a US shareholder under either subpart F or the GILTI regime constitute "previously taxed earnings and profits," which are excluded from the income of US shareholders under Code Sec. 959 when distributed. Earnings of CFCs that are not taxed under either subpart F or the GILTI regime can be distributed without tax based on a deduction under Code Sec. 245A for 100% of the amount of the distribution, with the result that such earnings are never subject to US corporate tax.

Double taxation is mitigated under the GILTI regime through a US foreign tax credit for 80% of the foreign taxes paid with respect to tested income. GILTI inclusions are treated as a separate limitation basket for foreign tax credit purposes, combining within a single basket all GILTI inclusions from all CFCs owned around the world by a US shareholder and the associated foreign taxes paid. Therefore, unlike under the Obama Administration minimum tax proposal, a single foreign tax rate on GILTI inclusions is calculated on a worldwide basis, averaging the rates on inclusions from CFCs in high-tax countries against inclusions from lower-taxed countries. Because a foreign tax credit is given for only 80% of the foreign taxes deemed paid with respect to GILTI inclusions, a US shareholder will pay marginal US tax on GILTI inclusions until this worldwide blended foreign effective tax rate is at least 13.125%, even though the US tax rate on GILTI inclusions is 10.5%. (i.e., 10.5%/80% = 13.125%). If a US shareholder has a blended foreign tax rate in its GILTI basket in excess of 13.125%, it will be in an excess credit position and will not have incremental US tax on its GILTI inclusions. As will be discussed below, being in an excess credit position can, however, have a tax cost resulting from the allocation of domestic expenses against the GILTI basket. Following the scheduled reduction of the Code Sec. 250 deduction for GILTI inclusions to 37.5%, which will raise the effective US tax rate to 13.125%, a US shareholder will need a blended foreign tax rate in its GILTI Basket of at least 16.4% to avoid a marginal US tax on its GILTI inclusions. It would be in an excess credit position if its blended foreign tax rate exceeds that rate. (i.e., 13.125%/80% = 16.40625%).

Calculating the foreign tax credit limitation in the GILTI basket on a world-wide basis results in the United States imposing sufficient tax on GILTI inclusions to bring the ***global*** effective tax rate on a US MNE's tested income earned through CFCs to 13.125%. Unlike the Obama Administration's minimum tax proposals, and, as we will discuss, the GloBE proposals, the GILTI regime does not assure that a US MNE will bear tax at a minimum rate on every additional dollar it earns in a low-tax jurisdiction. If a US MNE has substantial operations in higher taxed jurisdictions so that its global foreign effective tax rate in its GILTI basket exceeds 13.125%, it will be in an excess foreign tax credit position in the GILTI basket. It can therefore, at the margin, earn additional zero-taxed tested income in a tax haven and use its otherwise excess foreign tax credits to offset the marginal US tax on those additional GILTI inclusions from low-tax jurisdictions.

Congress appears to have chosen to use global blending within a single GILTI foreign tax limitation basket in part out of a desire for simplicity and based on other foreign tax credit limitation baskets being calculated on a globally blended basis. A second reason appears to have been a desire to mitigate the potentially harsh consequences of a second simplifying design choice - - the lack of any carryforward for excess credits within the GILTI basket. The Obama minimum tax proposals would have calculated the foreign effective tax rate for a given country based on a 60-month base period average to help mitigate the harsh effects that fluctuating profits and losses over multiple years could have on the rate computation. The drafters of the GILTI regime intended that the global rate blending within the GILTI foreign tax credit limitation basket, together with the netting of tested losses of CFCs against tested income of other CFCs, to have a similar mitigating effect by averaging out the effects of profit fluctuations over a geographically diverse portfolio of businesses.

Given that most US MNEs have extensive operations and earn much of their income in jurisdictions with effective foreign tax rates substantially in excess of 13.125%, the effect of global rate blending in the GILTI basket is that most US MNEs are in an excess credit position. Only a relatively small portion of US MNEs have a sufficiently large share of their income earned in jurisdictions with effective tax rates below 13.125% to be in an excess limitation position in the GILTI basket and to therefore incur residual US tax on their GILTI inclusions. As a result, most of the income raised by the GILTI regime has not been from residual US tax on GILTI inclusions. Most of the revenue has instead been from the effect of allocating domestic expenses of US MNEs against GILTI basket income where the US MNE has excess credits in the GILTI basket.

The allocation of domestic expenses against a basket of foreign source income that has excess foreign tax credits has an effect equivalent to the denial of the benefit of a deduction for those allocated expenses. Under the Code Sec. 904 foreign tax credit limitation mechanism, a taxpayer may credit only an amount of foreign taxes paid with respect to income earned in a foreign tax credit limitation basket equal to the US tax paid with respect to such income. A dollar of expense of a US taxpayer that is allocated against foreign source income reduces the foreign tax credit limitation in the relevant basket by an amount equal to the expense so allocated multiplied by the corporate tax rate (e.g., $0.21 at the current 21% tax rate). If the taxpayer has excess foreign tax credits in the relevant basket, the reduction in the amount of foreign tax that the taxpayer can credit ($0.21) is equivalent to denying the benefit of the $1 deduction at the 21% tax rate, even though the $1 expense is, in fact, deducted.

Because Code Sec. 250 provides a deduction equal to 50% of the gross GILTI inclusion, a US shareholder needs to incur foreign taxes at only a 13.125% rate on tested income to be in an excess credit position in the GILTI basket, compared with needing a 21% foreign effective tax rate to be in an excess credit position in the general basket. The enactment of the GILTI regime therefore resulted in US MNEs being much more likely to be in an excess credit position with respect to a much larger portion of their foreign source income than under prior law. This profile then led to a substantially larger portion of their allocable domestic expenses, including interest expense and headquarters expenses, no longer being tax benefited. The enactment of the GILTI regime therefore raised substantial revenues to help fund the reduction of the corporate tax rate, even after the Treasury and IRS issued regulations adjusting expense allocation rules to reduce the amounts allocated to the GILTI basket.[[10]](#footnote-9)

The enactment of the GILTI regime as part of the TCJA in 2017 was landmark legislation in that it assured that US MNEs would bear substantial current tax at a 13.125% global average rate on their income from foreign operations, subject to only very limited exceptions. This result accomplished important political and tax equity goals of its drafters but currently taxes the international operations of US MNEs significantly more heavily than foreign competitors are taxed on their international operations by their headquarters jurisdictions. What the GILTI regime did not do, however, was to reduce, at the margin, the incentive for US MNEs conducting substantial business in high-tax foreign jurisdictions to earn income in low-tax jurisdictions. The GILTI regime is therefore a less effective response to base erosion and profit shifting than the Obama per-country minimum tax would have been. As the negotiating partners of the United States at the OECD closely followed the enactment of the GILTI regime in the United States, several of them concluded that the US adoption of the GILTI regime was important tax reform that could be further improved upon.

* 1. Origins of the Pillar 2 negotiations at the OECD.

The Pillar 1 and Pillar 2 negotiations at the Inclusive Framework grew out of a failure to reach a consensus at the OECD/Inclusive Framework Task Force on the Digital Economy on whether international tax reforms should be made to address the taxation of digital companies. The Interim Report of the Taskforce issued in March 2018 reflected that many members of the Inclusive Framework believed that countries should adopt digital services taxes (“DSTs”) to give market jurisdictions taxing rights over services provided into those jurisdictions over the internet. The Interim Report also reflected that the United States opposed the adoption of DSTs or any other new tax regime applicable only to the digital sector, but that the United States was willing to entertain discussions at the OECD and the Inclusive Framework regarding fundamental reforms of the international tax system that would be broadly applicable across industries. The ensuing negotiations have been an effort to negotiate specific changes to traditional nexus and income allocation rules to grant somewhat greater taxing rights to jurisdictions in which goods and services, both digital and non-digital, are consumed. The US Treasury believed that it was necessary and appropriate to initiate international negotiations to revise the international tax system because the controversies over digital taxation made it clear that the long-standing consensus over the allocation of taxing rights among countries was breaking down. These negotiations ultimately led to the Pillar 1 proposals.

As these negotiations were getting underway in early 2019, Germany and France jointly proposed that the negotiations also include a discussion of the international adoption of a global minimum tax regime derived from the recent GILTI legislation in the United States. Many countries had closely followed the international tax reform process in the United States culminating in the TCJA and the enactment of the GILTI regime. Although some EU countries had long wanted to adopt robust CFC legislation, their ability to do so was limited by the EU freedom of establishment principle as interpreted by European Court of Justice decisions following the *Cadburry* *Sweppes[[11]](#footnote-10)* case. Germany and France saw the negotiation of a broad international agreement on a robust CFC regime by the Inclusive Framework, together with an EU directive, as a means of implementing a CFC minimum tax regime throughout the EU notwithstanding existing EU jurisprudence. Germany and France therefore introduced a global minimum tax proposal as a second topic for negotiations (referred to as the Pillar 2 proposals) to complement the original negotiations on expanding the taxing rights of market jurisdictions (the Pillar 1 proposals).

From the beginning, Pillar 2 was envisioned as an approved “common approach”, which countries would agree to follow in domestic legislation if they chose to implement a global minimum tax. Countries would not be required to adopt a global minimum tax, but Pillar 2 could have a global impact if a "critical mass" of countries were to implement it. If a large majority of the countries where MNEs are headquartered were to implement Pillar 2, that result would subject the global profits of most of the world's MNEs to a global minimum tax. A broad adoption by headquarters jurisdictions would also give low-tax countries an incentive to raise their corporate tax rates to the agreed minimum tax rate to allow them to collect the corporate tax on MNEs operations in their jurisdictions that would otherwise be collected under Pillar 2 in the headquarters jurisdictions.

The United States welcomed the introduction of a Pillar 2 global minimum tax as a topic for negotiations. Having implemented its own GILTI regime with a 2018 effective date, the United States was the only country in the world that subjected its MNEs to a broad global minimum tax. The US Treasury viewed the negotiation and widespread adoption of a Pillar 2 global minimum tax as a means to help level the playing field for US MNEs vis-à-vis their foreign-based competitors. The negotiating position of the Trump Administration was, however, that the recently enacted GILTI regime would need to be treated as a qualified global minimum tax under any Inclusive Framework agreement and that the United States would not commit to amend its recently enacted GILTI regime to conform with any such agreement.

* 1. Negotiation of the October 2020 Pillar 2 Blueprint.

The framework for Pillar 2 negotiations centered around two primary operating rules, which together became known as the GloBE regime.[[12]](#footnote-11) The first was an Income Inclusion rule ("IIR"), inspired by the GILTI, under which the parent jurisdiction of an MNE would impose additional tax sufficient to bring the combined effective tax rate on income earned by foreign subsidiaries of the group up to an agreed minimum rate. The second was a "backup" rule to achieve a similar result where the IIR did not apply because the parent of a MNE group was a resident of a country which did not adopt Pillar 2. In negotiations during 2019 and 2020, which led up to the 2020 Report on Pillar 2 Blueprint,[[13]](#footnote-12) the backup rule that emerged was the Undertaxed Payments Rule ("UTPR").

While it is fair to say that the GILTI regime was the inspiration for the IIR, it was not the model. Most of the countries advocating for Pillar 2 concluded that it should rely on different design features than the GILTI regime, both to address the technical challenges of having it be applied by countries across the globe and to achieve a more ambitious policy objective than the GILTI regime. The negotiating position of the United States was, however, that its existing GILTI regime must be treated as a qualified IIR, so that other countries could not tax the CFCs of a US MNE under their own Pillar 2 legislation. The prospect that US MNEs would be operating under a materially different regime than that which applied to foreign-based MNEs raised issues about the relative impacts of the different regimes and whether such a "grandfathering" of the GILTI regime would be politically feasible given the greater ambitions of the Pillar 2 regime.

As negotiators began to hammer out what would become the GloBE rules, it was quickly apparent that there would need to be a common measure of the tax base and for the taxes imposed on that base for purposes of measuring the minimum tax rate. The GILTI regime operates using US income tax principles to measure income and foreign taxes of CFCs. This approach of relying on domestic tax rules to calculate the income and taxes of foreign subsidiaries is extremely rare outside of the United States, even among those countries that have CFC regimes. Most countries look to financial accounting income to measure the earnings of CFCs, and financial accounting principles are the only regime that comes close to providing a uniform global standard for measuring income and income taxes. Therefore, rather than attempting to draft a new GloBE definition of income and income taxes from scratch, the negotiators decided to base the GloBE rate computations on the income and income taxes reflected on a company's financial statements.

The GloBE rules therefore start with the financial accounting principles applicable to the financial statements of the Ultimate Common Parent ("UPE") of a MNE group in defining the income base. Separate entity financial accounts are prepared for each Constituent Entity within the group using the financial accounting principles that apply to its UPE's consolidated financial statement. A series of specified adjustments are made to the resulting separate entity financial statement income to arrive at GloBE income. These adjustments are intended to bring the result closer to common international practices in defining taxable income, including adding back income tax expense, eliminating related party dividend income, and eliminating gains and losses on dispositions of stock of related parties. Taxpayers are also permitted to applying local tax principles, rather than financial accounting principles, in calculating the expense of employee stock-based compensation and depreciation and cost recovery expense.

The GloBE regime provides "substance based carve outs" from its tax base designed to exempt from its minimum tax regime a deemed return on substantive business activities conducted within a country. Like the GILTI regime, it provides an exclusion from income for a deemed return on the carrying value of tangible assets of a Constituent Entity. Under the GloBE regime that deemed return is initially at a 8% rate, but it phases down to a 5% rate by 2033. Unlike the GILTI regime, the GloBE regime also provides an exclusion equal to a percentage of a Constituent Entity's payroll cost that starts at 10% and phases down to 5% by 2033.

In the negotiations leading up to the 2020 Blueprint, the definition of tax for purposes of the rate computation (a "Covered Tax") was the current amount paid as a "compulsory unrequited payment to general government" "on and entity's income or profits." Also included are taxes imposed "in lieu of taxes imposed on a generally applicable income tax" as well as taxes on retained earnings and corporate equity.

Because the GloBE definitions of income and tax differ from the US tax definitions used in the GILTI regime, these differences can contribute to differences in the effective tax rates computed for GloBE purposes versus GILTI purposes. Financial accounting revenue recognition rules operate differently from US tax income recognition principles. Income measured under US tax principles reflects gains and losses on stock of affiliates and the effect of basis step ups under Code Sec. 338, whereas GloBE income generally does not. The scopes of the substance based carve outs differ. Some of these differences will be temporary differences, while others are permanent. With respect to taxes, the definition of Covered Taxes under the GloBE rules is somewhat broader than the definition of creditable income taxes under the US foreign tax credit rules, which in some cases could tend to lower the effective rate measured under GILTI rules compared with the rate under GloBE rules.

Once the Covered Taxes and GloBE income is measured for each Constituent Entity within a MNE group, the next step is to compute the relevant effective foreign tax rate. As discussed above, under the GILTI regime, this rate measurement effectively occurs at the US shareholder level, where the US shareholder includes in its income its share of the tested income of all of its CFCs around the world and then credits the associated foreign taxes, subject to a foreign tax credit limitation calculated on a world-wide basis. Germany and France, as sponsors of Pillar 2, were sensitive to the fact that blending high- and low-taxed income within a single global basket allows US MNE's operating in high-tax jurisdictions to cross credit such taxes against GILTI tax on income earned in low-taxed jurisdictions. The effect was to give US MNE's with high-tax operations an incentive, at the margin, to earn income in low-tax jurisdictions. France and Germany therefore strongly favored a "jurisdictional blending"[[14]](#footnote-13) so that, under the GloBE, a marginal unit of income earned in a low-tax country would be subject to a global marginal tax at the agreed minimum rate, rather than potentially being sheltered from marginal tax by averaging the effective foreign tax rate on income earned in low-taxed jurisdictions against the tax rate on income earned in higher-taxed jurisdictions. The United States agreed under the Trump Administration to support a Pillar 2 regime based on jurisdictional rate blending on the condition that the US GILTI regime would be deemed to be a qualified IIR notwithstanding that it was based on global rate blending.

As described in the 2020 Blueprint and later incorporated into the Model Rules, the IIR with jurisdictional blending operates as follows. First, the GloBE Income amounts and Covered Tax amounts for each Constituent Entity from with a given country are aggregated, and the Covered Tax paid to the country is divided by the GloBE income earned in the country to calculate the jurisdictional effective tax rate ("ETR"). If this jurisdictional ETR is less than the GloBE minimum tax rate, the difference, expressed in percentage points, is the Top-Up Tax Percentage. This Top-Up Tax Percentage is then multiplied by the GloBE income of each Constituent Entity derived within the country to compute a Top-Up Tax amount with respect to that Constituent Entity, which is then taxed to the UPE under the IIR.

At the time the Blueprint Report was being negotiated, the GloBE minimum tax rate had not been finally agreed upon, so the Report does not specify the rate. There nevertheless appeared to be emerging consensus at the time, and it was widely anticipated, that the minimum rate would be 12.5%. If the minimum rate were 12.5%, for example, and a Constituent Entity had a ETR of 10% and GloBE Income of $1,000,000 with respect to a jurisdiction, its UPE would be subject to a top-up tax in its home jurisdiction equal to $25,000 (i.e., (12.5%-10%) x $1,000,000) with respect to the GloBE Income of that Constituent Entity.

As the consensus at the Inclusive Framework moved towards applying Pillar 2 on a jurisdictional blending basis, the issue of whether the US GILTI regime should be “grandfathered” as a qualified IIR gained importance. Concerns were expressed by some countries that US MNEs would be structurally favored over foreign-based MNEs if US MNEs could continue to cross credit under the GILTI regime taxes paid in high-tax jurisdictions against income earned in low-taxed jurisdictions. To help the Inclusive Framework evaluate these concerns, the OECD staff prepared a detailed study of the competitive implications of allowing US-based MNEs to remain on the GILTI while other MNEs would be required to apply a Pillar 2 IIR based on jurisdictional blending. The study observed that, although the GILTI was more favorable than the proposed Pillar 2 regime in allowing global rate blending, some of its other features were less favorable to taxpayers. At the time, it was widely assumed that the GloBE minimum tax rate would be 12.5%, whereas the GILTI rate was effectively 13.125% (taking into account the 20% FTC haircut) and the GILTI rate was scheduled to increase to an effective rate of 16.4% after 2025. The GloBE tax base was proposed to have a substance based carve out for a deemed return (at a rate not yet specified) on local payroll expense, whereas the GILTI base does not. Most significantly, US-based MNEs are subject allocation rules for domestic expenses that have an effect equivalent to disallowing the deduction for such expenses allocated against GILTI basket income where the taxpayer is in an excess credit position in the GILTI basket.

The OECD Staff Study concluded that the then-current Pillar 2 proposals were roughly equivalent on an overall competitiveness basis to the GILTI regime operating as a Qualified IIR. US-based MNE’s with excess credits in the GILTI basket and domestic expenses allocable to the GILTI basket could be worse off than foreign based competitors subject to the then-current Pillar 2 proposals. US-based MNE’s with substantial amounts of low-taxed income and excess limitation in the GILTI basket could be better off under GILTI than their foreign competitors would be under the then-current Pillar 2 proposals.

The October 2020 Pillar 2 Blueprint left open the issue of whether the GILTI regime would be treated as a Qualified IIR. The UK had been the most vocal opponent of “grandfathering” the GILTI regime. The UK, through most of 2019 and 2020 had been a reluctant supporter of Pillar 2, at best. It had conditioned its support of Pillar 2 on a simultaneous adoption of Pillar 1. At the time, US negotiators suspected that the UK’s opposition to treating the GILTI as a qualified IIR was calculated to slow progress on Pillar 2. The UK's lack of enthusiasm for Pillar 2 changed, however, when it decided to increase its corporate tax rate to 25%, returning it to the fold of higher-taxed jurisdictions. It became a solid supporter of a Pillar 2 minimum tax. As the 2020 elections approached in the United States, presenting the probability of a new Democratic administration with a campaign platform which included putting the GILTI on a per country basis, negotiating positions on Pillar 2 froze awaiting the outcome. In highly negotiated language, the Blueprint Report stated:

Given the pre-existing nature of the GILTI regime and its legislative intent there are reasons for treating GILTI as a qualified income inclusion rule for purposes of the GloBE rules provided that the coexistence achieves reasonably equivalent effects. This treatment would need to be reviewed if subsequent legislation or regulations in the US would have the effect of materially narrowing the GILTI tax base or reducing the legislated rate of tax. The Inclusive Framework recognizes that an agreement on the co-existence of the GILTI and the GloBE would need to be part of the political agreement on Pillar Two.[[15]](#footnote-14)

As negotiated during 2019 and 2020 and reflected in the 2020 Pillar 2 Blueprint Report, the second component of the GloBE rules was an Undertaxed Payments Rule ("UTPR") designed to "backstop" the IIR. Because Pillar 2 was being proposed as a common approach rather than as a mandatory regime, it was anticipated that not all the countries of the world would adopt an IIR to impose top up tax on the income of low-taxed foreign subsidiaries of MNEs headquartered in their jurisdictions. In addition, even in those countries that implement an IIR, that IIR would not apply a top-up tax to income earned in the UPE's own country of residence. In the absence some back-up rule, a country implementing Pillar 2 would be putting itself at a competitive disadvantage as a headquarters jurisdictions compared with countries that did not. It was feared that an incentive would be created for MNE's to redomicile from jurisdictions that implement an IRR to jurisdictions that do not.

The Undertaxed Payments Rule as described in the 2020 Pillar 2 Blueprint Report was designed to backstop the IIR by requiring countries that adopt Pillar 2 to deny deductions to Constituent Entities operating in their jurisdictions for payments made to related parties that are not subject to being topped up under an IIR. This design was based on the observation that even if the UPE jurisdiction for a MNE group does not implement Pillar 2, the group would likely have significant operations in other countries that do implement Pillar 2. Under the 2020 Blueprint UTPR, a top-up tax amount would be calculated for every Constituent Entity within a MNE group that was not subject to topping up under an IIR under the same methodology used for the IIR. This top-up amount would then be allocated for collection to Constituent Entities within the MNE groups that are resident in countries that do implement Pillar 2 and the UTPR (such affiliates are referred to as "UTPR Taxpayers"). This allocation would be made among the UTPR Taxpayers within the group in proportion to the amounts of the deductible payments made by all UTPR Taxpayers to the low-taxed Constituent Entity being topped up. The Blueprint UTPR would have therefore operated as an anti-base erosion regime, denying deductions in higher-taxed jurisdictions for related party payments made into low-tax jurisdictions. Each UTPR Taxpayer would be denied a deduction in its residence jurisdiction for an amount of its payments to the low-tax Constituent Entity sufficient to collect additional tax equal to its allocable share of the top-up tax for the low-taxed Constituent Entity.

If the related party payments made by UTPR Taxpayers in the group directly to the low-taxed Constituent Entity were not sufficient in the aggregate for the disallowance of deductions for them to produce an additional tax equal to the top up amount, a second allocation of the remaining top-up amount would be made. This second allocation would be made among all UTPR Taxpayers within the group that had net related party expenditures, i.e. that had made deductible payments to related parties in excess of related party income received. Deductions for an amount of gross related party payments made to any member of the group would be denied in an amount sufficient to produce an additional tax liability equal to any top-up amount not absorbed in the first allocation. This second allocation was intended to prevent the manipulation of the first allocation through the use of back-to-back payments without the complexity of conduit tracing rules. The two-step allocation methodology was designed to impose sufficient top-up tax to neutralize the tax benefit of base erosion into low-tax constituent entities not subject to an IIR. It did not, however, assure in all cases that the full amount of top-up tax calculated for all low-tax Constituent Entities would be collected, because in some cases the denial of a group's aggregate tax benefit from deductions for intergroup payments might not produce a marginal tax equal to the top-up amount for all of the group's low-tax Constituent Entities.

The Blueprint specifically applied the UTPR to collect top-up amounts with respect to a UPE and entities operating in the UPE's jurisdiction. If a MNE's operations in its UPE's jurisdiction had a GloBE effective tax rate of less than the minimum rate, a top-up amount would be calculated for income earned by the group in the parent jurisdiction. This top-up amount would then be allocated among the foreign subsidiaries of the group that operated in countries that implemented Pillar 2, i.e., that were UTPR Taxpayers. The allocation would be made in proportion to the deductible payments made by UTPR Taxpayers to affiliates in the parent jurisdiction and top-up tax would be collected by denying deductions to the UTPR Taxpayers in their operating jurisdictions for such payments. The maximum top-up tax that could be collected with respect to operations in a UPE jurisdiction would have been the aggregate of the local tax benefits to the UTPR taxpayers from deductible payments made to UPE jurisdiction affiliates. This mechanism did *not* assure that the income earned *in the UPE jurisdiction* would be taxed at the minimum tax rate. It was instead designed to assure that an MNE group based in a jurisdiction that did not adopt Pillar 2 would have an amount taxed at a rate of at least the minimum rate equal to the sum of (i) its foreign source related party income and (ii) the income of its foreign operations.

In the negotiations leading up to the 2020 Blueprint Report, the US Treasury supported this operation of the UTPR while understanding that it could in some cases produce a top-up tax with respect to the domestic income of a US-parented MNE. Briefings of the Treasury Secretary specifically covered the possibility that domestic income of a US MNE with substantial R&D credits could have a GloBE minimum tax rate of less than the then assumed minimum rate of 12.5%, resulting in a top-up amount, as well as the possibility of a top-up tax arising with respect to income of foreign branches of US corporations due to cross crediting within the separate foreign tax credit limitation basket for branch income. It was concluded that this outcome was acceptable given the importance of the UTPR in reducing incentives to invert into non-Pillar 2 jurisdictions and given that the Blueprint UTPR was proposed to operate as an anti-base erosion rule, denying deductions for related party payments in a manner similar to existing base erosion rules of the US and many other countries. In hindsight, the Treasury probably underestimated how frequently a UTPR might apply to domestic profits of a US corporation and may have had an eye on tax proposals in the Biden campaign platform that would have made a top-up tax labiality on domestic profits even less likely.

* 1. Negotiation of the Pillar 2 Model Rules.

Leading up to the 2020 Presidential elections, the Biden campaign platform proposed to increase taxes on returns on capital. Consistent with that theme, the campaign platform proposed to significantly raise corporate taxes generally and to tax more heavily the income from the foreign operations of US MNEs. Following the election, these proposals were included in the Biden Administration's 2022 Green Book. As will be discussed in more detail in section 4.d., below, the 2022 Green Book proposals would have increased the corporate tax rate to 28% and substantially reformed the GILTI regime. All income earned by CFCs of US MNEs would have been made currently subject to US tax by eliminating all exceptions to tested income (including the QBAI exemption) other than for subpart F income and effectively connected inomce (which are otherwise subject to current US tax at the full corporate rate). The Code Sec. 250 deduction against GILTI inclusions was to be reduced from 50% to 25%. Global blending within the GILTI foreign tax credit limitation basket would have been repealed by putting GILTI inclusions and branch income on per-country foreign tax credit limitations. The combined effect of these changes would have been to tax US MNEs currently on all taxable income earned anywhere in the world. Income of domestic group members, subpart F income, and effectively connected income of CFCs would be taxed currently at the new 28% corporate rate. Tested income of CFCs would be taxed at a rate equivalent to 21% (resulting from the increase of the corporate rate to 28% and the decrease of the Code Sec. 250 deduction to 25%). After taking into account the 20% haircut on GILTI foreign tax credits, however, a US MNE would need to pay foreign tax in a given foreign country at a rate of at least 26.25% to avoid having residual US tax on a GILTI inclusion from that country. As a result of the application of a per-country foreign tax credit limitation for both GILTI and branch basket income, a US MNE would be subject to a minimum combined foreign and US tax rate on income in each country where it does business of 28% in the case of subpart F income or ECI, or in the case of tested income, of between 21% and 26.25%.

The 2022 Green Book would have also provided significant additional limitations on the tax benefit of domestic expenses allocable to foreign source income, including domestic interest expense and headquarters expense. It proposed a new Code Sec. 163(n) to disallow a deduction for domestic interest expense to the extent domestic members of an MNE group are overleveraged compared with the worldwide group. It also proposed to amend Code Sec. 265 to directly disallow any deduction of expenses allocatable to dividend income qualifying for the Code Sec. 245A deduction or to the portion of GILTI inclusions offset by the Code Sec. 250 deduction. A 15% corporate alternative minimum tax based on financial statement income was also proposed.

The 2022 Green Book proposals reflected the Biden Administration's political and policy objectives of raising more revenue from the international operations of US MNEs and reducing perceived incentives for US MNEs to earn income outside of the United States. The Biden Administration was aware, however, that these proposals would further erode the competitiveness of US-based MNEs compared with foreign-based MNEs, which are not subject to minimum tax rates on their global income. The Biden Administration viewed the negotiations at the Inclusive Framework on Pillar 2 as an opportunity to mitigate theses effects of its tax proposals on the international competitiveness of US MNEs. A robust Pillar 2 regime imposing on foreign-based MNEs a minimum rate of current tax on a per country basis could narrow, but would not eliminate, the difference between the treatment of US MNEs under the Biden Administration proposals and the taxation of the international operations of foreign-based MNEs.

On assuming the role of negotiating on behalf of the United States the Inclusive Framework, the Biden Treasury immediately pushed for agreement on the highest GloBE minimum tax rate that could be negotiated. It eventually achieved agreement on a 15% minimum rate, whereas it had been widely assumed previously that the minimum rate would be 12.5%. The Biden Treasury represented to the Inclusive Framework that the US would amend its GILTI regime, consistent with its 2022 Green Book proposals, to put the GILTI on a per-country foreign tax credit limitation to make it a qualified IIR, ending any discussion of “grandfathering” the existing GILTI regime. As will be discussed in more detail in section \_\_, below, the Biden Treasury also supported the redrafting of the 2020 Blueprint Undertaxed *Payments* Rule into the considerably more ambitous Undertaxed *Profits* Rule.

An outgrowth of the negotiation of the higher 15% GloBE minimum rate was an agreement on a “qualified domestic minimum top-up tax regime (“QDMTT”). The QDMTT allows an otherwise low-tax jurisdiction to adopt a targeted top-up tax on local profits of MNEs subject to the GloBe to collect the minimum tax amount that would otherwise be collected by third countries under an IIR or a UTPR. A QDMTT therefore allows a local taxing jurisdiction to keep for itself the tax revenue with respect to income earned within that jurisdiction that would otherwise be collected by other countries under Pillar 2 without raising its corporate tax across the board.

3. International Implementation of the GloBE Regime and Continued Administrative Guidance.

The agreements reached in the Inclusive Framework have been incorporated into Model Rules[[16]](#footnote-15) and Commentary on the Model Rules[[17]](#footnote-16) to guide domestic legislation by Inclusive Framework countries wishing to implement Pillar 2. Negotiations continue at the Inclusive Framework over the issuance of further administrative guidance with respect to the application of the Model Rules, with two major tranches of administrative guidance issued to date.[[18]](#footnote-17)

The Inclusive Framework agreed on target dates for countries to implement the GloBE regime effective in 2024 for the IIR and effective in 2025 for the UTPR. Legislative processes are under way in much of the world to implement the rules. In December 2022 the EU Council adopted a directive incorporating the Model Rules and requiring EU member countries to transpose them into their domestic laws by the end of 2023. This process is going forward. Many major commercial and headquarters jurisdictions outside of the EU are also in various stages of the legislative process, including Japan, South Korea, Canada, Australia, New Zealand, Indonesia, and Viet Nam. It is significant that many jurisdictions that have historically offered low effective tax rates are in the process of implementing Pillar 2 rules or QDMTTs, including Ireland, Luxembourg, Switzerland, Gibraltar, Cyprus, Singapore, the United Arab Emirates, and Hong Kong. While the situation remains dynamic and a number of major jurisdictions, including China and India, have not announced implementation plans, it appears that the implementation of Pillar 2 will likely be sufficiently broad to achieve the "critical mass" needed to be effective. The OECD has estimated that, based on implementation processes currently underway, at least \_\_% of the global profits of large MNEs will be subject to minimum taxation under either the GloBE or the GILTI.[[19]](#footnote-18)

Following its success in negotiating a more robust Pillar 2 at the Inclusive Framework, the Biden Administration has not succeeded in having its tax agenda enacted by Congress. Working with slim Democratic majorities in the House and Senate, the Administration was not able to incorporate its ambitious 2022 Green Book proposals into a bill. What emerged from the Ways and Means Committee and passed the House were the more limited tax measures in the Build Back Better Bill (the "BBB Bill"),[[20]](#footnote-19) which will be discussed in more detail at 4.e., below. These proposals did not include the more general tax increases of the 2022 Green Book but did include provisions to amend the GILTI regime to make it a Qualified IIR by putting it on a per-country foreign tax credit limitation, and to amend the BEAT to make it function more like the UTPR. The BBB Bill, however, narrowly failed to pass the Senate in early 2022, and it appears unlikely that there will be another legislative opportunity to enact international tax legislation before 2025. The Administration did succeed in having Congress enact a new 15% corporate alternative minimum tax based on financial statement income (the "CAMT") as part of the Inflation Reduction Act in 2022. The interaction of the CAMT with GloBE rules adopted outside of the United States will be discussed at 4.a.ii, below.

4. Potential United States Responses to Foreign Implementation of Pillar 2

As discussed above, many of the most significant trading partners of the United States are in the process of implementing GloBE Model Rules, which give them expanded taxing powers over both the international and domestic profits of US MNEs that are not constrained by traditional concepts of tax nexus. The United States must decide whether it will respond, either legislatively or diplomatically, and if so how. The remainder of this paper will discuss alternative approaches that might be considered.

a. Option 1: Do Nothing - The Interaction of GloBE with the Current US International Tax Provisions.

It appears likely that the IIR will be implemented by a significant number of countries effective for 2024 and the UTPR is scheduled to be implemented effective for 2025. It is widely believed that Congress is unlikely to enact significant US international tax legislation before 2025. It therefore appears likely that the GloBE regime will coexist with the current US international tax rules for at least some period, although that co-existence will eased somewhat by favorable GloBE administrative transition provisions for several years.[[21]](#footnote-20) This section will explore the interaction of the GloBE rules with the current US tax rules, assuming that the US rules remain unchanged after the transitional administrative relief has expired.

i. Income of CFCs of US MNEs: Interaction of current GILTI Regime with GloBE.

The Model Rules and administrative guidance negotiated at the Inclusive Framework specifically contemplate the possibility that the current GILTI regime will not be amended and that it will coexist with the GloBE regime. These provisions provide that the current GILTI regime is not a Qualified IIR and that both the UTPR and the intermediate IIRs can apply to CFCs of US MNE groups. The GILTI and subpart F regimes are, however, treated as controlled foreign corporation regimes for purposes of the Model Rules, with the result that GILTI and subpart F tax liability paid by a US shareholder can be attributed down to the jurisdictions of its CFCs for purposes of the top-up tax computation under the UTPR and under intermediate IIRs, but not for purposes of the top-up tax computation under QDMTTs.

* + - 1. Ordering Rules for Application of GILTI and GloBE.

The interaction of the GlLTI regime and the GloBE rules is therefore essentially a four-step process. First, the local corporate income tax in each operating jurisdiction is calculated. This tax could be imposed under the country's regular corporate income tax, under a QDMTT or under a combination of both. Such taxes will presumably be creditable foreign taxes for US foreign tax credit purposes. Next, the US UPE computes its US tax liability. As a US shareholder of its CFCs, a US UPE includes in its taxable income the tested income of its CFCs, net of allocable domestic expenses. This net GILTI income is taxed at an effective rate of 10.5% after the 50% Code Sec. 250 deduction. Double taxation is partially relieved by calculating a foreign tax credit for 80% of the creditable foreign taxes imposed on the included tested income of the CFCs.[[22]](#footnote-21) Because the GILTI foreign tax credit limitation is calculated using a single global basket, the US UPE will have marginal GILTI tax on its net GILTI income if the average rate of foreign tax, calculated on a base of its GILTI inclusion net of allocable expenses, is less than 13.125% (i.e., 10.5%/.8). If this average rate of foreign tax is greater than 13.125%, the US UPE will be in and excess foreign tax credit position in the GILTI basket and will not have marginal tax on its GILTI inclusion, but typically will have additional corporate tax liability resulting from the effective loss of the tax benefit of deductions for domestic expenses allocable to this excess credit basket.

The third step in the interaction of the GloBE and GILTI regimes is the attribution of the US shareholder's GILTI tax liability down to the operating jurisdictions of its CFCs. This allocation is necessary because the current GILTI regime is not a Qualified IIR. The profits of low-tax CFCs of US MNEs, already subject to the GILTI regime, remain subject to top-up tax under the IIR of an intermediate holding company jurisdiction or to a UTPR top-up tax collected from affiliates that are UTPR Taxpayers. Attributing GILTI tax paid in the United States down to CFCs increases the GloBE effective tax of those CFCs to reduce their top-up amounts and to thereby mitigate double taxation. Under temporary administrative guidance approved[[23]](#footnote-22) by the Inclusive Framework in February 2023, this attribution of US GILTI tax down to CFC operating jurisdictions is **not** made for purposes of the QDMTT top-up tax imposed by an operating jurisdiction so as to leave primary taxing rights with that country where the income is earned. Therefore, this attribution of tax is made only for purposes of calculating UTPR and IIR top-up taxes, which are collected by third countries.

The rules in the temporary administrative guidance for attributing GILTI tax to CFCs are notable in two respects. First, in defining the GILTI tax to be attributed downward, the rules include both (i) the tax imposed on GILTI inclusions where the US shareholder does not have sufficient GILTI foreign tax credits to fully cover the tax on the inclusions ("excess limitation shareholders"), and (ii) the marginal corporate tax of a US shareholder in an excess credit position in the GILTI basket resulting from the allocation of domestic expenses against that basket. This second category is particularly significant because it benefits a US MNE group that has substantial operations in high tax jurisdictions that result in a global average foreign effective tax rate on its CFCs in excess of 13.125%. Although such a group may not pay any tax net of foreign tax credits directly on its GILTI inclusions, it can bear substantial marginal tax as a result of the allocation of domestic interest and headquarters expenses to the GILTI basket, because that allocation effectively eliminates the tax benefit of the deduction for the expenses so allocated. The temporary administrative guidance can provide a degree of double tax relief by counting such marginal taxes as taxes paid in a low-tax jurisdiction for purposes of calculating the UTPR or IIR top up tax amount for that jurisdiction.

The operative language in the temporary administrative guidance providing this treatment is somewhat opaque in that it does not specifically describe allocations of domestic expenses. The language is relatively specific, however, and was presumably intentionally negotiated:[[24]](#footnote-23)

Allocable Blended CFC Tax is the amount of tax charge incurred by the Constituent Entity-Owner under the Blended CFC Tax Regime. For instance, in the case of GILTI, the Allocable Blended CFC Tax can be determined from the US shareholder's US federal income tax return and in the absence of a domestic loss is equal to the amount of GILTI (reduced by the GILTI deduction) multiplied by 21%, less the foreign tax credit allowed in the GILTI basket.

The general rule in the first sentence quoted above is ambiguous as applied to the GILTI because it is not entirely clear whether the loss of the tax benefit of domestic expenses allocated to a GILTI basket in an excess credit position is part of "the Blended CFC Tax Regime." The following sentence resolves that ambiguity by providing a specific computation in the case of the GILTI regime. The tax amount to be attributed down equals the amount of the GILTI inclusion (presumably after the Code Sec. 78 gross up) net of the Code Sec. 250 deduction taxed at the 21% corporate tax rate, less the foreign tax credit "allowed" in the GILTI basket. Presumably the "allowed" credit is the amount of foreign taxes allowed to be credited after the application of the Code Sec. 904 foreign tax credit limitation.

The following example illustrates how this computation works in the case of a US shareholder that is in an excess credit position in the GILTI basket and has material amounts of domestic expense allocated against the GILTI basket for purposes of the foreign tax credit limitation. Assume that a US shareholder's CFCs earn an aggregate of 100 of tested income on which they pay 25 of foreign income tax. After grossing up under Code Sec. 78, the US shareholder will have an inclusion of 100 in its GILTI basket against which 50 will be deducted under Code Sec. 250 GILTI deduction. The first part of the calculation per the temporary administrative guidance is therefore (100-50) x 21% = 10.5 of tax, which must then be reduced by "the foreign tax credit allowed in the GILTI basket."

The US shareholder will be deemed to have paid 20 of taxes in that basket (i.e. 80% of 25), but the amount "allowed" to be credited is limited by the Code Sec. 904 foreign tax credit limitation. Assume that the taxpayer has 40 of domestic interest and headquarters expense that is allocable to the GILTI basket. Its foreign tax credit limitation will then be its net income in the GILTI basket of 10 (i.e., 100-50-10) multiplied by the corporate tax rate of 21%, which equals 2.1. Completing the calculation prescribed by the temporary administrative guidance, the pre-credit amount of 10.5 is therefore reduced by the GILTI foreign tax credit "allowed" of 2.1 for a remaining Allocable Blended CFC Tax of 8.4. Note that this amount is not in the nature of a residual tax on the GILTI inclusion because the foreign taxes deemed paid in the GILTI basket are more than sufficient to cover the US tax liability on the GILTI inclusions. The 8.4 amount is instead a function of the loss of the benefit, at the 21% corporate tax rate, for the domestic deductions allocable against the GILTI basket (i.e., 21% x 40 = 8.4).

The second notable provision in the temporary administrative guidance relates to the methodology to be used for allocating GILTI tax paid by a US shareholder down among CFCs. The entire amount of Allocable Blended CFC Tax, which in the case of the GILTI includes the marginal tax resulting from expense allocation, gets allocated among only those CFC in jurisdictions that have GloBE jurisdictional ETRs below the applicable GILTI rate of 13.125%. This allocation among the low-taxed jurisdictions is made in proportion to income amounts in those jurisdictions weighted by the spread between the 13.125% GILTI rate and each jurisdiction's GloBE effective tax rate. The effect of this allocation key is to allocate GILTI tax amounts to those CFC where it is most likely to provide reductions of top-up tax liability.

The fourth and final step in the interaction between the GILTI regime and the GloBE rules is to calculate what amount, if any, of top-up tax is due with respect to the income of the CFCs of a US MNE under GloBE principles. This top-up computation will reflect the effect of the attribution of GILTI taxes paid in the United States down to the CFCs. If a CFC has a GloBE effective tax rate of less than 15%, taking into account any attributed GILTI taxes, the resulting top-up amount could be paid under the IIR of an intermediate holding CFC in a jurisdiction that implements Pillar 2 if there is such an intermediate holding company. If not, the top up amount would be paid under the UTPR by affiliated CFCs in Pillar 2 jurisdictions ("UTPR Taxpayers"), allocated in proportion to their employee head count and tangible assets.[[25]](#footnote-24) UTPR taxes paid would not qualify for as creditable foreign income taxes under current treasury regulations. As will be discussed below, the operation of these allocation rules in the temporary administrative guidance could operate to substantially reduce GloBE top-up amounts with respect to low-taxed operating jurisdiction of a US MNE that is in an excess credit position in its globally blended GILTI basket and has substantial domestic expenses allocated against the GILTI basket.

* + - 1. Probable Tax Profiles of US MNEs

The outcomes of this four-step interaction between the GILTI regime and the GloBE rules will vary depending on multiple factors. The main drives appear to be (i) whether the US MNE is in an excess credit position with respect to its GILTI basket, (ii) whether the US MNE has substantial domestic expenses allocable against its GILTI basket, and (iii) whether, under the taxpayer's facts, there is a material difference in the computation of the tax base and relevant taxes under US tax principles compared with the GloBE rules.

Most US MNEs are today in an excess credit position in the GILTI basket. Given that statutory corporate tax rates are well above 13.125% in most countries, most MNEs that have extensive operations around the world tend to have a blended global effective tax rate on their CFC income in excess of that rate. Those that currently have a blended global effective tax rate of less than 13.125% in the GILTI basket, and are therefore in an excess limitation position, generally earn disproportionately large amounts of income in very low-taxed jurisdictions or in jurisdictions in which they benefit from favorable base differences. For example, they may have had a step up in basis of amortizable assets for foreign tax purposes, thereby increasing local amortization deductions, but did not have a corresponding step up and increase in amortization deductions for US tax purposes. The foreign tax savings from the reduced foreign tax base reduces the foreign effective rate as measured for GILTI purposes where there is no corresponding tax base reduction under US tax principles.

It appears that even those US MNEs that are currently in an excess limitation position will likely trend into an excess limitation position in the coming years. If Pillar 2 achieves its "critical mass" and incentivizes currently low-taxed countries to adopt QDMTTs, there will be fewer countries in the world in which to earn enough low-tax income to pull the global effective foreign tax rate on a US MNE's GILTI income below 13.125%. Ireland, Switzerland, Luxembourg, and Singapore, all of which are major jurisdictions in which US MNEs have been earning low-taxed income, are in the process of implementing QDMTTs. Although sub-13.125% effective tax rates measured under US tax principles may continue to persist in such jurisdictions for a number of years following the implementation of QDMTTs due to the lingering effects of pre-effective date basis step ups, these effects should diminish over time as these basis amounts area amortized.

If a US MNE is subject to GloBE top-up tax to a rate of 15% on income in virtually every jurisdiction where it earns substantial amounts, it is hard to imagine that such a US MNE will not have an global effective foreign tax rate in its GILTI basket of at least 13.125%, even before allocation of domestic expenses, unless the computation of ETRs under the GloBE rules systematically produces a lower rate than the computation under US tax principles. The impact of differences between the ETR computation under GloBE and GILTI will be discussed at 4.a.i.4, below.

Another scenario that might leave some US MNEs in an excess limitation position in the GILTI basket would be if QDMTTs are not widely adopted and much of the top-up tax with respect to low-tax jurisdictions is collected through the UTPR regime. Given that UTPR taxes would not be creditable taxes under current US foreign tax credit regulations, such foreign tax amounts would not be included in the GILTI rate computation, potentially leaving a taxpayer in an excess limitation position in the GILTI basket. The result would be taxation of the same income by both the United States under GILTI and by UTPR jurisdictions under the GloBE.

For the reasons discussed above, it appears likely that US MNEs will be in an excess credit position with very few exceptions if the GloBE rules are widely implemented. These US MNEs would not bear incremental US tax under GILTI on income of their CFCs because the incremental income would be covered by their excess foreign tax credits. Most US MNEs would, however, have substantial domestic interest and headquarters expenses that are allocable against the GILTI basket, and they would therefore bear additional US tax as a result of the effective loss of a US tax benefit for the deductions for the expenses so allocated. Such expenses allocable to foreign source income will be deductible neither in the US nor in a foreign country. Such MNEs will therefore continue to be taxed on an amount in excess of their global economic income.

* + - 1. Numerical Examples Illustrating the Interaction of Current GILT with GloBE.

The following simplified examples illustrate the overall tax impact on US MNEs under a combination of the current GILTI regime and GloBE rules as compared with the overall impact of the GloBE rules on MNEs with a UPE resident in a jurisdiction that implements the IIR. The first example, for simplicity, assumes that the US MNE has no domestic expenses allocable to the GILTI basket. The second example assumes the US MNE has substantial allocable expenses. Both examples also make the simplifying assumption that the ETRs calculated under the GloBE and GILTI are the same.

Example 1: US Parent has three CFCs. CFC A, operating in Country A, earns 100 of income which is taxed at a 25% rate. Country A has implemented Pillar 2 and CFC A is therefore a UTPR taxpayer. CFC B, operating in Country B, earns 100 of income which is taxed by Country B at 15% under a QDMTT. Country B has implemented Pillar 2 and CFC B is therefore a UTPR taxpayer. CFC C, operating in Country C, earns 100, which is taxed by Country C at a 0% rate. Country C has not implemented Pillar 2nd and CFC C is therefore not a UTPR Taxpayer.

Under the first step of the ordering rules, the amount of tax imposed by the local operating jurisdictions is calculated: 25 in A, 15 in B and 0 in C. Next, USP's GILTI tax liability is calculated. Given that there are no allocable domestic expenses in this example, USP's effective GILTI ETR will be 13.33%, (i.e., (25+15+0)/300)), which is more than 13.125%,with the result that USP is in an excess credit position.[[26]](#footnote-25) Because USP is in an excess credit position and has suffered no tax as a result of allocation of domestic expenses against the GILTI basket, the amount of Allocable Blended CFC Tax to be allocated down to CFCs under the temporary administrative guidance is zero. Therefore, there is nothing to allocate down to CFC 3 in the third step. The fourth step is to apply the GloBE rules to the CFCs. There is no top-up amount with respect to CFC A or CFC B because each is taxed locally at a 15% or greater rate. There is a top-up amount with respect to CFC C of 15. Because both CFC A and CFC B are UTPR Taxpayers, this top-up amount will be allocated between them and taxed to them in proportion to their relative number of employees and values of tangible assets. The overall result is that the USP group will pay zero tax under the GILTI regime, and with respect to the income of each CFC, it will bear the higher of 15% or the tax rate in the CFC's jurisdiction of residence, for a total of 55 (i.e., 0+25+15+15).

Example 1:

USP

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

100@25%

100@15%

100@ 0%

Step 1: Countries Impose Local Corporate Tax

A=25 B=15 C=0

Step 2: Compute USP’s GILTI Tax

Blended Rate if no allocable domestic expenses = 40/300 = 13.33%

- no GILTI tax

Step 3: Allocate GILTI tax to CFCs

-none to allocate

Step 4: Apply UTPR in Countries A and B

-A & B together pay top-up tax of 15 w/r/t income of C

Total Tax on CFC income in countries

25 w/r/t A + 15 w/r/t B + 15 w/r/t C = 55

To compare this result with the treatment of a foreign-parented MNE, we assume the same facts except that the parent of the group, FP, is a resident of a country that has implemented the IIR. The first step in the computation is again to calculate the local corporate tax imposed on each CFC: again 25 on CFC A, 15 on CFC B, and 0 on CFC C. Under step 2, FP applies the IIR, rather than the GILTI, calculating the top up amounts of 0 for CFC A, 0 for CFC B and 15 for CFC C. Because all three CFCs are subject to topping up under the IIR, they are not subject to the UTPR and there are not further steps in the calculation. The overall tax collected is the same as in the case of the US-parented group, above, in that the amount of tax collected with respect to income in each of the three countries is at the higher of the local ETR or 15%, for a total tax of 55. The difference between the two cases is that the top-tax of 15 with respect to CFC C is paid by FP, whereas the top-up tax of 15 with respect to CFC C was collected from CFC A and CFC B in the case of the US-parented group.

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

FP

100@25%

100@15%

100@ 0%

Step 1: Countries Impose Regular Corp. Tax

A=25 B=15 C=0

Step 2: UPE Pays Top Up Tax under IIR

A=0 B=0 C=15

Total Tax on Income by Country

25 w/r/t A + 15 w/r/t B + 15 w/r/t C = 55

This example is not realistic, however, because it assumes that USP does not have any domestic expenses allocable against the GILTI basket. Almost all US MNEs have substantial amounts of allocable interest and headquarters expenses, notwithstanding regulations issued during the Trump Administration reducing amounts allocable against GILTI income generally, and specifically providing that no R&D expenses are to GILTI.[[27]](#footnote-26) For Example 2, we assume the same facts as Example 1, except that USP has 100 of deductible interest expense allocable to the GILTI basket. For purposes of the comparison with a foreign parented MNE, we will assume that FP has a comparable amount of interest expense, but that FP gets the full benefit of a deduction for such expense under the law in its jurisdiction.

Example 2: Same facts as Example 1, except that USP has 100 of interest expense allocable to the GILTI basket. Under Step 1, the same amounts of local tax are computed for each CFC: 25 for CFC A, 15 for CFC, B and 0 for CFC C. When the Allocable Blended CFC Tax with respect to GILTI is computed under step 2, US P is still in an excess credit position in the GILTI basket so there is no tax on the GILTI inclusion itself, but this time it bears additional US tax of 21 from the loss of the tax benefit of the deduction for its 100 of interest expense. Therefore, under the temporary administrative guidance, the Allocable Blended CFC Tax amount is 21,[[28]](#footnote-27) which is the allocated entirely to CFC C in step 3. When the top-up amount for CFC 3 is then calculated in Step 4, the amount is 0 because CFC C has 21 of covered taxes against income of 100. The total amount of tax paid is 61 (i.e., 21 in the US; 25 in Country A, 15 in Country B and zero in Country C). As shown in Example 1, a foreign parented group subject to an IIR pays 55 on the same facts.

Example 2:

USP

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

100@25%

100@15%

100@ 0%

100 of allocable interest

Step 1: Countries Impose Local Corporate Tax

A=25 B=15 C=0

Step 2: Compute USP’s GILTI Tax

Blended Rate pre allocable domestic expenses = 40/300 = 13.33%

- No GILTI top up

- Marginal US tax from allocation of 100 interest expense = 21

Step 3: Allocate 21 of "Allocable Blended CFC Tax" to CFC C

Step 4: UTPR Computation

Because GloBE rate in Country C is 21%, No top up for Country C

Total Tax on CFC income in countries

25 w/r/t A + 15 w/r/t B + 0 w/r/t C + 21 w/r/t US = 61

One can make several observations from these examples. First, in the absence of allocable domestic expenses, a US MNE that is in an excess credit position bears a comparable global tax burden with respect to the income of its CFCs as would a foreign-based MNE subject to a GloBE IIR. In both cases, the tax paid with respect to the income earned in each CFC is the greater of the local corporate tax imposed or 15% of GloBE income. In Example 1 the tax with respect to CFC C is topped up to 15 in both cases. The difference, however, is which country collects the top-up amount. In the case of a foreign-based MNE, it is the parent jurisdiction that collects the top-up amount. In the case of a US-based MNE, it is not the United States that collects the top up amount; it is the countries where the group has CFCs that are UTPR Taxpayers.

Where the US MNE has substantial domestic expenses allocable to the GILTI basket, as will typically be the case, the result is quite different. The loss of the domestic tax benefit to the US parent of the deduction for such expenses increases the US group's global tax expense, and there is typically not a corresponding tax cost to foreign-based groups. Example 2 shows the global tax burden to the US MNE of 61with respect to its international income, as opposed to a global tax burden of 55 on the international income of a comparable foreign-based MNE. This increased burden is the result of the US providing double tax relief for GILTI inclusions through a foreign tax credit mechanism that reduces the amount of foreign tax allowed to be credited by the amount of domestic expenses allocable against GILTI income multiplied by the corporate tax rate. The GloBE rules, in contrast, avoid double taxation by using a top-up mechanism that reduces the amount of the top-up tax by the full amount of foreign taxes paid. A central policy issue for the United States, both from a competitiveness perspective and from a revenue perspective, will be whether its current foreign tax credit regime is appropriate in a world with broad implementation of the GloBE rules.

It is worth observing that the difference between the global tax burdens shown in Example 2 of the US MNE and the foreign-based MNE is 6 (i.e., 61 vs. 55). This amount does not equal the full lost tax benefit in the United States of 21 (i.e., 100 @ 21%). This reduced difference results from the temporary administrative guidance with respect to Blended CFC Regimes specifically recognizing the lost tax benefit in the United States for allocable deductions as a tax burden on GILTI income. The guidance provides double tax relief by allocating that amount down to CFCs to reduce top-up tax under a UTPR on a dollar-for-dollar basis. In Example 2, 15 of the 21 of tax detriment in the United States is offset by eliminating the top-up amount of 15 that would have otherwise been collected in Countries A and B with respect to the income of CFC C. The US MNE is left worse off than the comparable foreign-based MNE by only the excess Allocable Blended CFC Tax amount of 6.

It is also significant to note that a US MNE in the position illustrated in Example 2 would have an increased marginal incentive to earn more income in Country C and less income in Country A or even Country B. Assume that in Example 2 CFC A makes a deductible payment of 50 to CFC C. The payment would be deducted in Country A against a 25% tax rate for a tax savings of 12.5. The US parent would still be in an excess credit position; therefore, no additional tax would be paid under the GILTI. There would now be a top-up amount of 1.5, with respect to CFC C, because the US parent's Allocable Blended CFC Tax Amount allocated down to CFC C of 21 is not sufficient to keep CFC C's GloBE ETR above 15%. The global tax paid with respect to the income of the CFCs would be 50, which is the same amount that would be paid by a comparable foreign-parented MNE group under the IIR. The steps of the calculations are shown in Example 3, as follows:

Example 3:

US MNE

USP

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

50@25%

100@15%

150@ 0%

100 of allocable interest

Step 1: Countries Impose Local Corporate Tax

A=12.5 B=15 C=0

Step 2: Compute USP’s GILTI Tax

Blended Rate post allocable domestic expenses =27.5/200 = 13.75%

- No GILTI top up

- Marginal US tax from allocation of 100 interest expense = 21

Step 3: Allocate 21 of "Allocable Blended CFC Tax" to CFC C

Step 4: UTPR Top-Up Computation for 150 income of CFC C

21/150=14%; Top-Up % = 1%; Top-Up Amount = 1% of 150 = 1.5

-Paid by CFC A and CFC B

Total Tax on CFC income in countries

12.5 w/r/t A + 15 w/r/t B + 1.5 w/r/t C + 21 w/r/t US = 50

Example 3, cont'd:

Foreign Based MNE under IIR

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

FP

50@25%

100@15%

150@ 0%

Step 1: Countries Impose Corp. Tax

A=12.5 B=15 C=0

Step 2: UPE Pays Top Up Tax under IIR

A=0 B=0 C=22.5

Total Tax on Income by Country

12.5 w/r/t A + 15 w/r/t B + 22.5 w/r/t C = 50

A foreign-based MNE subject to the IIR can achieve a rate arbitrage benefit from shifting income from a high-tax jurisdiction to a low-tax jurisdiction equal only to the excess of the effective tax rate in the high-tax jurisdiction over the 15% GloBE minimum rate. In Example 3, the foreign-based MNE achieves an overall tax savings 5 compared to Example 1. This savings equals the 50 of income shifted from Country A to Country C multiplied by the 10-percentage point difference between the ETR in Country A and the 15% rate to which income is topped up in Country C under the IIR.

In contrast, a US MNE that is subject to the current GILTI rather than the IIR and that has both excess credits in the GILTI basket and substantial amounts of allocable domestic expenses can achieve a global tax benefit from shifting income from a high-tax jurisdiction to a low-tax jurisdiction equal to the entire rate differential between the two jurisdictions. It can do so, however, only until it reaches the point that its Allocable Blended CFC Tax Amount is exhausted and it has no remaining capacity to prevent the existence of a GloBE top-up amount in the low-taxed jurisdiction. In Example 3, a total of 22.5 of tax would be required to be attributed to or be paid by CFC C to achieve a 15% GloBE ETR on its 150 of income. Given that the US shareholder's Allocable Blended CFC Tax Amount was only 21, a top up-tax of 1.5 with respect to the income of CFC C is collected from its sister CFCs. The group was able to achieve a rate reduction of 25% for the first 40 of income shifted from Country A to Country C (i.e., 25%-0%). At that point its Allocable Blended CFC Tax Amount was exhausted because 21 of tax is able to cover only 140 of income at a 15% rate (i.e. 21/15%=140). The remaining 10 of income in CFC C was therefore topped up to a 15% rate producing a top-up tax of 1.5, and the rate arbitrage benefit from shifting the last 10 of income was only 10%, the difference between the Country A rate and the 15% GloBE minimum rate. The US MNE's total tax savings of 11 from shifting 50 of income from CFC A to CFC B is therefore the sum of a 25% rate benefit with respect to the first 40 shifted (10) and a 10% rate benefit with respect to the last 10 shifted (10).

Under the current GILTI regime, US MNEs with excess GILTI credits and substantial allocable expenses can therefore have a greater incentive at the margin to shift income from high-tax jurisdictions to low-tax jurisdictions than the incentive for foreign-based MNEs subject to the IIR. Such income shifting cannot, however, put the US MNE in a *better* global tax position than a comparable MNE that is subject to the IIR. At the point where the amount of income shifted exhausts the Allocable Blended CFC Tax Amount, the tax detriment to the US MNE of the allocation of domestic expenses to the GILTI basket has been fully offset by the benefit of achieving a lower GloBE top-up tax liability than would otherwise be incurred. The US MNE is then in a comparable position to a foreign-based MNE subject to the IIR, and any further base erosion into a sub-15% jurisdiction will produce a benefit equal only to the difference between the tax rate of the jurisdiction being base eroded and 15%, as would be the case for the foreign-based MNE under an IIR.

These outcomes suggest that the rules in the temporary administrative guidance for the downward allocation of tax liabilities under CFC regimes work appropriately with respect to the current GILTI regime. The guidance recognizes that the tax detriment resulting from the allocation of domestic expenses against the GILTI basket is a tax cost associated with the tested income of the relevant CFCs and takes that tax into account for purposes of computing top-up amounts with respect to such CFCs. The combination of bearing the tax detriment from the allocation of domestic expenses and having CFC income topped up under UTPRs tends to subject US MNEs to a higher overall tax burden on their international income than foreign-based MNEs, because most foreign-based MNEs are not subject to a comparable loss of tax benefit of domestic deductions. The temporary administrative guidance addresses this issue in part by providing relief from top-up taxation at the CFC level in an amount up to the Allocable Blended CFC Tax Amount. While this relief can give a US MNE a greater incentive at the margin than a foreign-based MNE to shift income to a low-taxed jurisdiction, this relief can never put the US in a better position than a foreign-based MNE that is not subject to a comparable loss of domestic tax benefits.

The temporary administrative guidance expires in for fiscal years ending after June 30, 2027. It is uncertain whether it will be made permanent. One of the underlying goals of the GloBE regime is to reduce incentives at the margin to shift income between jurisdictions. Given the effect of the temporary guidance on the marginal incentives of US MNEs with excess GILTI credits and substantial allocable domestic expenses, the US could face resistance in the Inclusive Framework to making the rule permanent. There could also be a concern that making the rule permanent could give low-tax jurisdictions that seek to attract investment from US MNEs an incentive to not adopt QDMTTs. When deciding whether to retain the current rules for the allocation of domestic expenses against the GILTI basket, US policy makers should not assume that the GloBE regime will continue to provide some degree of double tax relief from the impact of such allocations indefinitely. It should also be noted that if essentially all low-tax countries adopt QDMTTs the Allocable Blended CFC Tax Amount guidance would become irrelevant and would provide no benefit.

* + - 1. Potential Impact of Differences in ETR Calculations under GloBE vs. GILTI.

The discussion thus far has assumed that the effective tax rate calculated under US tax principles for purposes of the GILTI regime will be the same as the effective tax rate calculated under GloBE principles for purposes of top-up amount calculations. This will clearly not be true, given (i) the differences in the computation of the tax base under GILTI and GloBE, (ii) the differences between the definitions of creditable taxes for US purposes and covered taxes for GloBE purposes, and (iii) the differences in the operations of the double tax relief mechanisms of the two systems. Will such differences be so material to affect how many US MNEs are in an

excess credit position in the GILTI basket? Will such differences produce an ETR measured under GILTI of less than 15% in some QDMTT jurisdictions? Could such differences produce anomalous outcomes for certain industries or business models?

A comprehensive discussion of the differences between the computation of ETRs under GloBE rules compared with the GILTI regime would be complex, highly technical, and is well beyond the scope of this paper. We will limit ourselves to a high-level review of some of the major computational differences that might drive differences in ETRs.

Starting with tax base, the GloBE computation starts with financial statement income, then requires or permits a number of adjustments designed to bring it closer to widely shared notions of taxable income. There will remain differences in the operation of financial accounting principles relating to income recognition and timing differences resulting from the use of deferred tax accounting under the Model Rules as compared with realization and payment principles under US tax accounting rules. Specific base differences between the two regimes include their different substance based carve outs. The GloBE regime provides an exclusion from income for a deemed return on the carrying value of tangible assets of a Constituent Entity that starts at a 8% rate and phases down to 5% by 2033. It also provides an exclusion equal to a percentage of a Constituent Entity's payroll cost that starts at 10% and phases down to 5% by 2033. The GILTI provides a substance based carve out under the QBAI rules equal to a 10% return on tangible assets of CFCs, although the definition of eligible tangible assets under QBAI appears to be somewhat narrower than under GloBE. Unlike the GloBE regime, the GILTI regime does not provide any substance based carve out for payroll expense of CFCs. Another base difference that could have a material impact in certain cases is that under US tax principles a corporation's taxable income includes both gains and losses from the disposition of stock of affiliates, whereas that will generally not be the case for Constituent Entities under the GlobE. Similarly, a US corporation may have a basis step up for assets under Code Sec. 338 for US tax purposes, but no corresponding basis step up for GloBE purposes. Conversely, a corporation may have a disregarded sale for US tax purposes which produces a basis step up for GloBE purposes. These are just a sample of base differences that will create differences in effective rates in one direction or the other.

Somewhat different amounts of taxes will be taken into account in the ETR calculation under the two regimes. For purposes of the GILTI, foreign taxes will be taken into account when paid or accrued under US tax principles, whereas the GloBE rules use deferred tax principles under financial accounting to determine the year taxes are taken into account. Although a given amount of tax liability may be taken into account in different years under the two regimes, the design of the GloBE regime assumes that these differences will reverse over time. A second difference is that the definition of creditable foreign income tax under US treasury regulations is somewhat narrower than the definition of Covered Tax in the GloBE Model Rules, which could tend to somewhat lower GILTI ETRs compared with GloBE ETRs.

One particular difference between the tax rate computations under the two regimes that will need to be monitored is the treatment of refundable tax credits. The GloBE regime has a beneficial treatment of Qualified Refundable Tax Credits ("QRTCs") which treats the amount of such credit as income rather than as a reduction of income tax. To be a QRTC, a tax credit must be payable in cash to the taxpayer within four years to the extent that it has not already been used to offset income tax liability. Characterizing the credit as income rather than a reduction of tax liability results in only a fraction of the reduction of a Constituent Entity's ETR compared with characterizing the credit as a direct reduction of tax liability. While negotiating the QRTC rules at the inclusive framework, the Treasury and Internal Revenue Service issued foreign tax credit regulations containing a similar, but perhaps somewhat narrower rule. Under Treas. Reg. Sec. 1.901-2(e)(2)(iii) a credit against foreign tax is treated as a reduction of foreign tax liability, rather than income, unless “the full amount of a tax credit is payable in cash at the taxpayer’s option."

If, for example, a local jurisdiction were to grant a credit that is payable in cash only at the end of four years the extent that the taxpayer had not had sufficient tax liability to absorb the credit, such a credit would appear to qualify as a QRTC for GloBE purposes. A question arises, however, as to whether "the full amount" of such a credit would be "payable in cash at the taxpayer's option" within the meaning of Treas. Reg. Sec. 1.901-2(e)(2)(iii). It is far from clear that it would be. If not, such a credit would reduce net taxes paid for purposes of calculating the foreign tax credit under the GILTI, at least to the extent the credit is applied against the tax liability rather than refunded in cash but would not reduce net tax paid under the GloBE regime. In such case the credit would have the effect of producing a higher foreign effective tax rate in a jurisdiction for GloBe purposes than for GILTI purposes. If the GloBE rate is being calculated for purposes of topping up under a QDMTT, the result could be that a CFC of a US MNE could end up with a effective rate for GILTI purposes in that jurisdiction of less than 13.125%.

QDMTT jurisdictions may well take the US foreign tax credit rules into account as they enact credits for purposes of their QDMTTs. A jurisdiction would avoid this issue if it instead chose to grant a credit that is immediately payable in cash at the option of the taxpayer, so that the credit would clearly get favorable treatment for both GloBE and GILTI purposes. It will be interesting to see what decisions end up being made in different QDMTT jurisdictions and how those decisions might be affected by expectations as to whether the GILTI regime will continue to operate on a blended foreign tax credit basis.

It remains to be seen how material the effect of ETR differences under the GILTI versus GloBE regimes turns out to be. In a world with a broad adoption of QDMTTs by formerly low-taxed jurisdictions, it seems unlikely that different measures of ETRs would be sufficient to change the conclusion that almost all US MNEs would eventually end up in an excess credit position in the GILTI basket. Because the GILTI minimum tax rate is currently calculated as a global average, different base and timing differences arising over a large portfolio of CFCs would likely tend to average out to some degree, and only structural differences, such the differences in substance based carve outs and differences in treatment of credits, would seem likely to have a sustained impact on relative ETRs. If a large number of QDMTT jurisdictions heavily utilized QRTCs that are not designed to be creditable in the United States, rate differences could be significant. In the case of service industries, the lack of a substance based carve out for payroll under the GILTI regime might be significant. Similarly, if few low-taxed jurisdictions adopt QDMTTs, with the result that the low-taxed income of CFCs of US MNEs ends up being topped up primarily through non-creditable UTPRs, rather than under creditable QDMTTs, some US MNEs might remain in a excess limitation position and suffer double taxation. None of these scenarios seems likely, however, and the outcomes illustrated by Examples 1 through 3 seem likely to remain directionally correct. The large majority of US MNEs likely would end up in an excess credit position; they would not have marginal tax on their GILTI inclusions; and they would continue to suffer the detriment of domestic expense allocation. In this case, US MNEs would face heavier global taxation with respect to income from their international operations than comparable foreign-based MNEs due almost exclusively to the impact of the US foreign tax credit expense allocation rules.

It is worth noting, however, that if the GILTI foreign tax credit limitation were put on a per country basis, potential ETR differences between the GILTI regime and the GloBE regime could become more important. Once a separate minimum GILTI rate is calculated for each country, the global blending effect on ETR differences would no longer apply. It is entirely possible that in a given QDMTT jurisdiction a US MNE would have a sub-13.125% rate for GILTI purposes notwithstanding the fact that the GloBE rate there was 15%. In such case, the US MNE would face marginal tax under GILTI with respect to such income, even though a foreign-based MNE would not under an IIR. A US MNE would effectively be topped up on a per-country basis to the higher of the 15% GloBE or the 13.125% rate under GILTI.

* + 1. Impact under Current US Law of GloBE Implementation on the Taxation of Domestic Profits of US Corporations.

More controversial than the application of the GloBE rules to CFCs of US MNEs is the application of the GloBE UTPR rule to the domestic profits of US corporations. In cases where the income of the US members of a US MNE group is not taxed by the United States at an effective rate of at least 15% as measured under GloBE principles, a top-up amount will be computed with respect to those domestic profits and the top-up tax will be paid by the group's CFCs that are UTPR taxpayers.

As summarized at 2.e, above, the UTPR that emerged as the "Undertaxed Payments Rule" from the negotiations leading up to the 2020 Blueprint was designed to collect top-up amounts with respect to Constituent Entitles to which an IIR did not apply by denying deductions for related party payments. It was specifically contemplated that the UTPR could apply with respect to low-taxed income earned in a UPE jurisdiction, but the amount of top-up tax collected by the rule was limited to the aggregate tax benefit denied to foreign affiliates by disallowing their deductions for related party payments they made to the UPE jurisdiction. The collection mechanism for the Undertaxed Payments Rule was therefore in the character of an anti-base erosion rule. During negotiations at the Inclusive Framework during 2021, the UTPR morphed into the simpler and more ambitous Undertaxed Profits Rule set forth in the Model Rules. Under this final UTPR, the top-up amount for every jurisdiction where a group operates, including the UPE jurisdiction, is simply allocated and taxed to the UTPR Taxpayer affiliates in other jurisdictions in proportion to their employee headcount and the carrying value of their tangible assets. In the case of a top-up amount with respect to a UPE jurisdiction, just as with the top-up amount for any other jurisdiction, the entire top-up amount is taxed to UTPR Taxpayer affiliates, regardless of the level of related party base erosion payments.

The UTPR was renegotiated with the active participation of the Biden Treasury for the purpose of increasing its reach and its incentive for countries to implement Pillar 2. By providing a mechanism to collect to the full-top amount with respect to every jurisdiction where an MNE operates, regardless of whether that jurisdiction implements Pillar 2, the Undertaxed Profits Rule maximizes the incentive for countries to adopt QDMTTs to collect the top-up amounts themselves.

At the time the Biden Treasury was renegotiating the UTPR at the Inclusive Framework, it was proposing in its 2022 Green Book domestic legislation that included raising the corporate tax rate to 28% and adopting a 15% corporate alternative minimum tax based on financial statement income. It may have assumed that, following the enactment of such legislation, relatively few domestic corporations would be left with a GloBE effective tax rate of less than 15% and that it would be politically acceptable to have those relatively few corporations subject to the UTPR. As events have transpired, however, the Biden Administration has not succeeded in raising the corporate tax rate. Although it did succeed in enacting a corporate alternative minimum tax (the "CAMT") in the Inflation Reduction Act, the CAMT does not function as a surrogate for a QDMTT. The CAMT does not treat general business credits, including the R&D credit, as tax preferences, whereas such credits do not qualify as QRTCs under the GloBE rules and directly reduce the GloBE ETR. It has become clear that a significant number of US corporations will have top-up amounts under the GloBE rules, notwithstanding the enactment of the CAMT, largely due to some combination of the tax benefits of the R&D credit and the 13.125% US effective rate on their FDII income.

* + 1. Competitiveness of US MNEs under Current Law with a Broad Implementation of Pillar 2

Based on the analysis above, it appears that a broad implementation of Pillar 2 may for some US MNEs mitigate to some degree their competitive disadvantage in relation to foreign-based MNEs, but it will seldom level the playing field. US MNEs will pay more foreign tax on their foreign operations following a widespread implementation of Pillar 2 as they pay tax at a GloBE rate of at least 15% each jurisdiction in which they operate, but the same will be true for the foreign-based MNEs with whom they compete. Today, prior to an implementation of Pillar 2, only MNEs that are based in the United States are subject to a global minimum tax in the nature of a GILTI regime, and most of their foreign-based competitors are not subject to the equivalent of the US expense allocation rules. Following a broad implantation of Pillar 2, competing foreign-based MNEs will be subject to a global minimum tax, but they will still not be subject to the equivalent of the US domestic expense allocation rules.

It appears that GloBE implementation will not significantly change the competitiveness of US MNEs that are today in an excess credit position in the GILTI basket under current global rate blending. They are today, like foreign-based MNEs, not bearing any marginal tax at the UPE level with respect to the tested income earned in foreign subsidiaries. After a broad implementation of the GloBE rules, they, like their foreign-based competitors, will bear a global Globe tax rate of at least 15% with respect to income earned in each jurisdiction. However, US MNEs are today, unlike most foreign-based MNEs, losing the tax benefit of domestic deductions allocable to the income of such foreign subsidiaries, and that will continue to be the case after implementation of Pillar 2. This detriment of the denial of US deductions for allocable expenses can be partially or wholly offset by the operation of the of the temporary administrative guidance on the allocation of Blended CFC Taxes, but it appears that this allocation can never put a US MNE in a better position than a comparable foreign-based MNE subject to the IIR.

In the case of US MNEs that are currently in an excess limitation position, they are currently paying a global minimum tax that in effect tops their global average tax rate on the tested income of their CFCs up to somewhere between 10.5% and 13.125%, which is not the case for their foreign competitors. Following an implementation of Pillar 2, both they and their competitors will be topped up to a 15% GloBE rate in each jurisdiction and this will tend to level the playing field. Paying this additional foreign tax, however, will likely tip them into an excess credit position, at which point they will start experiencing the loss of the tax benefit of allocable domestic expense deductions, which will not be the case for their foreign competitors.

Based on the above, it appears that the United States would need to re-think its expense allocation rules under the foreign tax credit limitation if it wanted to level the playing field for US MNEs following a broad implementation of Pillar 2. As discussed at 4.e, below, the failed Build Back Better Bill would have done so.

* + 1. Impact on US Tax Revenues

As discussed above, it appears likely that, following a broad implementation of Pillar 2 with QDMTTs, nearly all US MNEs that operate on a global basis would eventually end up in an excess foreign tax credit position in the GILTI basket. At that point, the United States would no longer be collecting material amounts of residual tax on the tested income of CFCs of US MNEs. Under the current foreign tax credit limitation rules, however, the United States would continue to collect very substantial amounts of revenue attributable to the operation of the expense allocation rules. In this case the revenue raised by the GILTI regime would essentially be limited to the effect of allocating domestic expenses against the GILTI basket, although this revenue could still be substantial. The revenue impact of the expense allocation rules would likely increase as nearly all taxpayers that are currently in an excess limitation position in the GILTI basket tip into an excess credit position as they pay more foreign tax under QDMTTs. Such a revenue increase from the broader operation of the expense allocation rules would offset to some degree the revenue loss from the disappearance of sub-13.125% rate GILTI inclusions.

It is worth noting that it is possible that some US MNEs would continue to have sub-13.125% effective rates in their GILTI baskets despite paying at least a 15% local GloBE rate in each country in which they operate due to differences in the way ETRs are computed under the GILTI and GloBE rules. One scenario in which this might be significant would be if it became common for jurisdictions that enact QDMTTs and grant QRTCs that are determined to be not creditable for US tax purposes because they are not immediately fully refundable. A second scenario might be if UTPRs are widely adopted around the world, but relatively few low-tax jurisdictions adopt QDMTTs, with the effect that the most top-up taxes paid are in the form of non-creditable UTPRs rather than creditable QDMTTs. In both scenarios the magnitude of the difference in ETR calculations would need to overcome the weight of the allocation of domestic expenses in driving up the GILTI effective rate. It also seems more likely that foreign jurisdictions will design their tax incentives to be beneficial to US MNEs and that they will choose to collect the top-up amounts with respect to income earned in their jurisdictions by enacting QDMTTs rather than allowing other jurisdictions to collect the top up under UTPRs and IIRs.

* + 1. Complexity and administrability issues.

A broad implementation of Pillar 2 combined with the current US international tax rules will significantly increase the compliance burdens and complexity faced by US MNEs and the administrative burdens on tax authorities. US MNEs today need to comply with the current GILTI and subpart F regimes and need to achieve double tax relief through the current foreign tax credit rules. These are among the most complex tax regimes in the world and require a US MNE to apply US tax principles in calculating the income and earnings of each CFC, wherever located. Following a broad implementation of the GloBE rules, US MNEs will need to follow the four-step process described above governing the interaction of the GILTI and GloBE rules. As today, they will start by calculating the regular local income tax liability of each CFC. Next, they will continue to perform subpart F and GILTI and foreign tax credit computations under current law to determine the US shareholder's US tax liability with respect to the income of the CFCs. Next, for the first time, they will need to attribute the US shareholder's Allocable Blended CFC Tax Amount to CFCs and perform GloBE top-up amount computations for each country in which the group operates, including the United States. These calculations require measuring GloBE income and GloBE covered taxes, which are a new and separate tax base and tax amount measured differently than under local law, financial accounting principles or US tax principles. The top-up amounts so computed must then be allocated to either UTPR Taxpayer jurisdictions or to an intermediary IIR jurisdiction to be paid.

While gathering the required information and performing the computations will be possible, the process will be highly complex, requiring the maintenance of multiple sets of books for each relevant entity and the parallel application of two complex set of rules. The Inclusive Framework is working on administrative rules intended to simplify the process under the GloBE rules. If QDMTTS are widely implemented, a robust QDMTT safe harbor could reduce the number of countries for which top up computations would need to be performed. On the administrative side, there is cause for concern whether implementing countries around the world will apply and enforce the GloBE rules consistently, applying a uniform set of top-up computations for each Constituent Entiy in a MNE group and uniform allocations among countries of Blended CFC Tax Amounts and of liability for payment of top-up amounts. It will require enormous effort and cooperation at the Inclusive Framework to achieve meaningful simplification and to assure a consistent application and enforcement of the GloBE rules by implementing countries. It remains to be seen if this is achievable.

* + 1. Allocative Efficiency and BEPS Issues.

The Pillar 2 negotiations arose out of ongoing OECD/Inclusive Framework negotiations focusing on Base Erosion and Profit Shifting ("BEPS") issues. In that context, one of the goals of Pillar 2 has been to reduce the marginal tax incentive to shift income from high-tax jurisdictions into low-tax jurisdictions. By assuring that all income wherever earned is currently taxed at a 15% minimum rate, one intended effect of Pillar 2 is generally to reduce the rate arbitrage achievable through profit shifting to the difference between the tax rate in the jurisdiction being base eroded and the 15% GloBE minimum rate. A broad implementation of the GloBE rules would appear to effectively advance that goal, although, as discussed above, in the case of a US MNE that goal might in some cases be fully achieved only when its Allocable Blended CFC Allocation Amount is fully utilized.

* + 1. Stability of the International Tax System.

The Pillar 1 and Pillar 2 negotiations grew out of a concern that the longstanding international consensus over the allocation of taxing rights among countries is the process of breaking down. The overarching goal of the negotiations has been to supplement and make appropriate adjustments to the existing rules to re-establish a renewed international consensus and to avoid the consequences of a potential collapse of an international consensus. The progress to date in agreeing to Pillar 2 Model Rules and in their implementation can be viewed as an important building block in supplementing existing international tax rules in a way to maintain international consensus. Progress on Pillar 1 has faltered, in large part due to lack of political support in the United States implement it. Although Pillar 2 can be implemented by other countries and become effective without any implementation or legislation by the United States, the failure of the United States to do so raises concerns about whether there will be sufficient international cooperation to assure that the GloBE rules will be consistently and uniformly applied. It could make more it more difficult to resolve remaining fundamental issues about the operation of the GloBE rules, including the interaction between existing tax treaties and the UTPR. The entire agenda of renewing an international consensus on the allocation of taxing rights among countries remains countries remains unresolved, and one might fear that a choice by the United States to do nothing could make matters worse.

**b. Option 2**: Reduce the Impact of the UTPR on Domestic Profits of US Corporations Through Administrative Guidance or US Legislation.

The aspect of Pillar 2 that has generated the most controversy is the imposition of the UTPR top-up tax on the domestic profits of a US corporation where its effective US tax rate, measured under GloBe rules, is less than 15%. As discussed above, a significant numbers of US corporations are anticipated to have effective GloBe tax rates of less than 15% under the current combination of US and GloBe rules despite the US statutory corporate tax rate of 21%. This result can arise from a number of US tax preferences, the most significant of which appear to be general business tax credits, including the R&D credit, which are not QRTCs for GloBE purposes, and the FDII regime, which taxes US corporations on foreign derived intangible income at a rate of 13.125%.

As the GloBE rules were being drafted by working parties of the Inclusive Framework, it was recognized that a line needed to be drawn distinguishing tax credits from direct cash subsidies. While both tax credits and direct cash subsidies are forms of incentives that governments can use to attract investments, negotiators believed that tax subsidies were within the scope of the Pillar 2 negotiations, but that other types of direct subsidies were not. The line between a cash subsidy and a tax credit blurs, however, when a tax credit is refundable in cash. Where a taxpayer has the option to immediately receive the full amount of the credit in cash, the substance of the credit is equivalent to a direct cash subsidy even if the taxpayer chooses to apply the credit against its tax liability rather than receiving the cash. Members of the working party looked for guidance to financial accounting principles which generally treat a tax credit as a subsidy, and therefore as income rather than a reduction of tax, if it is clear that the taxpayer will get the benefit of the credit regardless of whether it has a tax liability. The drafters and the Inclusive Framework ultimately settled on the definition of QRTC in the Models Rules, which treats a credit as income, rather than a reduction of tax, if it fully refundable within four years to the extent it has not previously been used to reduce tax liability. At the time it was understood that the rule for QRTCs would leave open the possibility of tax competition in granting such refundable credits, but it was hoped that there would be more transparency and political scrutiny with respect to granting refundable credits, which would to some degree inhibit their use. One might question whether this is in fact the case, but a line had to be drawn somewhere if the Inclusive Framework was not going to take on all types of government subsidies to businesses.

The Biden Treasury has had some notable success in negotiating favorable administrative guidance from the Inclusive Framework regarding both US low-income housing tax credits and transferable environment-related credits created by the Inflation Reduction Act. Under this guidance, low-income housing credits from investments held through tax-equity participation structures will typically not be treated as direct reductions of the investor's tax liability for GloBE purposes, and transferable credits that can be sold in an actively traded market will generally be treated as the equivalent of refundable credits and qualify as QRTCs. R&D credits and other general tax credits remain a major issue in that they are neither refundable nor transferable and are granted directly to the corporate taxpayer. It would seem to be a heavier lift to get agreement on administrative guidance treating R&D credits as QRTCs.

Congress could choose to amend the current R&D credit to make it sufficiently refundable to squarely fall within the definition of a QRTC under the Model Rules. While this legislation would come at a considerable revenue cost, such legislation, combined with the rise in the effective tax rate on FDII to 16.4% scheduled for 2026, would very significantly reduce the number of US corporations subject to top up under the UTPR. An alternative proposal which has been floated, and which would not have as significant a revenue cost, would be to amend the R&D credit to allow a taxpayer to elect to use in a given year only so much of its R&D credits as would reduce its GloBE ETR to 15%, and to then carry forward the remaining credits indefinitely. Presumably the same amendment could be made to apply to other general business credits. Taxpayers would have an incentive to make the election to preserve for future years the benefit of credits that would otherwise be taxed away by foreign jurisdictions under the UTPR. By amending US tax preferences to minimize or eliminate their impact on the GloBE ETR of US corporations, Congress could greatly reduce the number of US MNEs whose domestic profits could be subjected to the UTPR and greatly reduce the amounts at stake. Doing so, however, would be a political acknowledgement by Congress that its ability to grant tax benefits to US corporations has been effectively limited by the new taxing rights of foreign countries under their GloBE UTPRs.

**c. Option 3:** Attempt to Renegotiate the UTPR / Threaten Retaliation for the Application of UTPRs with Respect to Domestic Profits of US Corporations.

The application of the UTPR to the domestic profits of US corporations has become a serious political issue in Congress. There is a sense in some quarters that the Biden Treasury, by agreeing to the Undertaxed Profits Rule at the Inclusive Framework, has inappropriately ceded to foreign countries taxing jurisdiction over domestic profits of US corporations and negated the ability of Congress to grant tax benefits to US corporations as it sees fit. The gravity of the issue is compounded by the fact that this has occurred without the direct participation or consent of Congress.

The clearest manifestation of this displeasure in Congress is the introduction of a bill by Chairman Smith of the House Ways and Means Committee to add a new section 899 to the Code. This Defending American Jobs and Investment Bill would increase the US taxation of foreign corporations and individuals that are resident in a country that is determined to have an "extraterritorial" or "discriminatory" tax. The implementation of the Undertaxed Profits Rule is specifically targeted by the definition of extraterritorial tax as:

[A]ny tax imposed by a foreign country on a corporation . . . which is determined by reference to any income or profits received by any person . . . by reason of such person being connected to such corporation through any chain of ownership, . . . other than by reason of such corporation having a direct or indirect ownership interest in such person.

A broad definition of discriminatory tax would include digital services taxes.

Once a country is determined to have imposed an extraterritorial or discriminatory tax, the rate of US tax on residents of that country under Code Sec. 871, 881, 884, and 1441 et. seq. would be increased by 5% points in the first year, and by an additional 5% points in each year thereafter during which the country continues to impose the tax, until the total increase reaches 20% points. Although it is unlikely that the Defending American Jobs Bill will be become law while President Biden is in the White House, the bill is clearly intended to chill the implementation of UTPRs by other countries and potentially to strengthen the hand of the US Treasury if it chose to attempt to renegotiate the terms of the UTPR at the Inclusive Framework.

Renegotiating the terms of the UTPR at the Inclusive Framework would be difficult. The United States was active in designing the UTPR and was ultimately the leading proponent of a robust GloBE regime at the Inclusive Framework negotiations. The terms of the UTPR have been agreed by [138] countries around the world. The implementation of the rules is underway, although the effective date for the UTPR is not until 2025. Implementation is far advanced in the European Union in particular, where the member states have by unanimous agreement obligated themselves to implement the Pillar 2 rules. It would be difficult for them to achieve the unanimous agreement that would be required to materially amend their implementation of the Model Rules. Furthermore, a US attempt to eliminate the UTPR, which it was active in drafting and supporting, and the threat of retaliation against countries that adopt the agreed rules, could put at risk the United States' reputation as a reliable negotiating partner. The ultimate goal of the OECD/Inclusive Framework negotiations, to renew and maintain an international consensus on the allocation of taxing rights among countries, could become more elusive that it already is.

That having been said, a case can be made that the Model Rules UTPR is so inconsistent with traditional concepts of sovereign taxing rights that it cannot provide a stable political basis for Pillar 2, or for a renewed international consensus on the allocation of taxing rights among countries. Under this view, a US effort to renegotiate the terms of the UTPR could be a constructive intervention to increase the stability of the international tax system. If a current or future administration were to attempt to renegotiate the UTPR, what might it ask for?

On possible approach would be to propose to revert to the 2020 Blueprint Undertaxed Payments Rule. As, discussed above at, 2.e., the mechanism by which the 2020 Blueprint UTPR collected top-up amounts with respect to a UPE jurisdiction was to deny deductions to foreign affiliates for payments they make to the UPE jurisdiction to the extent of the top-up amount. This mechanism might not be as offensive to traditional principles of tax sovereignty, because it is more in the nature of an anti-base erosion measure, preserving the tax base of the higher-tax affiliates in the UTPR jurisdictions. The mechanism is also self-limiting in that the total amount of top-up taxes collected with respect to a UPE jurisdiction could not exceed the tax benefit in the UTPR Taxpayer jurisdictions of the deductible payments made to the UPE jurisdiction being topped up. Reverting to the Blueprint Undertaxed Payments Rule would not eliminate the foreign taxation of top-up amounts with respect to income of US parented groups, but it could in many cases substantially reduce the amount paid. As described in the Blueprint report, the Undertaxed Payments Rule would have the effect of assuring that the GloBE effective tax rate on foreign source income of a US MNE group would be at least 15%, but it would *not* top-up for the purely domestic income of the US group.

Such a proposal could face at least two objections at the Inclusive Framework. The first is that the more robust Undertaxed Profits Rule of the Model Rules is needed to eliminate incentives for MNE groups to redomicile to jurisdictions that do not implement Pillar 2 and to give low-tax countries an incentive to implement QDMTTs. It is arguable, however, that the 2020 Blueprint Undertaxed Payments Rule would achieve these objectives to an adequate degree for the reasons laid out in the Blueprint Report. Redomiciliations do not appear to be driven by a desire to achieve low tax rates on income from sources within the new parent jurisdiction. They instead tend to be driven by a desire to base erode income from higher-taxed foreign affiliates into the new low-taxed UPE jurisdiction. This benefit would be neutralized by the Undertaxed Payments Rule. The second likely objection would be that headquarters jurisdictions are somehow favored over non-headquarters jurisdictions under the 2020 Blueprint UTPR. A UPE jurisdiction would essentially be given a free pass to reduce taxation on the domestic operating income of domestic members of MNE groups parented in its jurisdiction, whereas, it might be argued, profits from operations within jurisdictions that are not UPE jurisdictions would be fully subject to topping up under GloBE rules. The number of countries in the Inclusive Framework that are not headquarters jurisdictions is large compared to the number of major headquarters jurisdictions. This objection is not necessarily accurate, however, because the 2020 Blueprint UTPR is designed to operate by denying the benefit of base erosion into low-taxed jurisdictions by denying deductions to related UTPR Taxpayers for payments that end up, directly or indirectly, in the low taxed jurisdictions. It should be demonstrable that the overall effect is that a top-up amount will be collected with respect to a low-tax, non UPE jurisdiction's income that has been shifted to it from affiliates. The effect should be that purely domestic operating income of the low-tax, non-UPE jurisdiction should not end up being systematically topped up.

A second negotiating approach for the United States could be to propose amending the GloBE Rules to accommodate a broader range of domestic tax preferences as not reducing the GloBE ETR. For example, the United States could propose an amendment that would treat all research credits, whether or not refundable, as income rather than as a reduction of tax liability. Accommodating an increasing list of tax preferences, however, risks making the GloBE regime largely ineffective. We may already be on a slippery slope, given the broad ability of a QDMTT jurisdiction to give tax incentive through QRTCs without directly reducing the GloBE ETR. Re-opening negotiations to accommodate further tax preferences could exacerbate the situation.

One approach, however, that might both enhance the ability of countries to incentivize socially important investments and behaviors while potentially stabilizing the effectiveness of the GloBE regime might be to seek to negotiate a specific list of tax credits categories that promote agreed social goals, such as environmental credits, low-income housing credits and research credits. Credits to incentivize activities on the agreed list could be treated as income regardless of whether they are refundable, whereas other tax credits would be treated as a reduction of tax liability even if they are refundable. The concept would be that tax credits to incentivize general business activities or to lower overall tax liability would directly reduce GloBE ETR. Credits to incentivize research are a mixed case that could fit into this paradigm in that governments do see themselves as promoting a social good in encouraging research, even though businesses engage in research to profit from the results. Although ending the favorable treatment of refundable credits that do not promote an agreed list of social goals would likely push countries to substitute direct cash subsidies for such credits, a favorable treatment of credits that do promote social goals could address the objection that the Undertaxed Payment Rule limits the ability of governments to use their tax systems to address social needs.

Yet another approach that has been floated would be to advocate for a rule that treats limited categories of expenditure-based credits as income rather than as reductions in tax liability, and which scraps the QRTC rule. Expenditure-based credits would avoid the administrative issues and fraud potential inherent in having governments write checks to taxpayers. Because there would appear to be no natural limit on the ability of a QDMTT jurisdiction to reduce taxes through nonrefundable expenditure-based credits, the favorable GloBE treatment would need to be limited to well defined classes of credits to preserve the effectiveness of the GloBE rules. Issues would also need to be addressed as to whether tax credits for purchases of tangible assets or payments of payroll would be given favorable treatment under such a rule, given that the GloBE substance based carve outs already benefit such expenditures.[[29]](#footnote-28)

d. Option 4: Implement the Biden Green Book Proposals

As discussed above, while the Biden Administration was negotiating the final terms of the GloBE regime, it was planning to enact domestic tax legislation described in its 2022 Green Book that would both raise corporate taxes generally and qualify the GILTI regime as a Qualified IIR. Although only some of the Green Book proposals were incorporated into the Build Back Better Bill, which then failed to pass the Senate, the Green Book proposals remain a policy option that the Biden Administration could pursue in a second term.

By repealing all exceptions to the definition of tested income other than for subpart F income and income effectively connected with a US trade or business ("ECI"), the Green Book proposals would make all income earned by a US MNE anywhere in the world currently taxable by the United States. This repeal would include the QBAI exemption, leaving US MNEs with no substance based carve out from the GILTI regime, whereas foreign-based MNEs under the GloBE rules will have the benefit of substance based carve outs for both payroll and tangible assets. Subpart F income and ECI would be currently taxed at the new 28% corporate tax rate. Tested income of CFCs would be topped up on a per-country basis to a combined foreign and US tax rate of between 21% and 26.5%, with residual tax owed under the GILTI regime on the income of any CFC that is subject to a foreign effective tax rate, measured under US tax principles, of less than 26.5%.[[30]](#footnote-29) In comparison, under the GloBE rules, foreign-based MNEs will not be topped up above a 15% GloBE ETR.

The impact of these proposed rates under the Green Book is illustrated by Example 4, below, which assumes the same facts as Example 1. US Parent has three CFCs. CFC A, operating in Country A, earns 100 of income which is taxed at a 25% rate. Country A has implemented Pillar 2 and CFC A is therefore a UTPR Taxpayer. CFC B, operating in Country B, earns 100 of income which is taxed by Country B at 15% under a QDMTT. Country B has adopted Pillar 2 and CFC B is therefore a UTPR Taxpayer. CFC C, operating in Country C, earns 100, which is taxed by Country C at a 0% rate. Country C has not implemented Pillar 2, and CFC C is therefore not a UTPR Taxpayer. For simplicity, it is assumed that USP has no domestic expenses allocable against foreign source income.

After CFC A pays 25 of tax to Country A on its 100 of income, USP would have a residual GILTI tax with respect to the income of CFC A equal to 1 (i.e., (21% x 100) - (80% of 25) = 1). After CFC B pays 15 of tax to Country B under a QDMTT, USP would have a residual GILTI tax with respect to the income of Country B of 9 (i.e., (21%x100) - (80% of 15) = 9. CFC C pays no tax to Country C, leaving USP with a residual GLITI tax with respect to the income of Country C of 21 (i.e., (21% x 100) - (80% of 0) = 21). A total of 40 of foreign tax and 31 of US tax would be paid, for a global total tax burden of 71. This compares with the total global tax 55 that would be paid by a comparable foreign-based MNE under GloBE rules, comprised of 40 of local tax and 15 of IIR top up, as illustrated in Example 1 above.

Example 4:

USP

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

100@25%

100@15%

100@ 0%

Step 1: Countries Impose Regular Corp. Tax

A=25 B=15 C=0

Step 2: Compute Per Country GILTI Tax against 21% effective rate with 20% FTC haircut:

A= 1 B= 9 C= 21

No UTPR application because GILTI would be a Qualified IIR.

Total Tax on CFC income in countries

26 w/r/t A + 24 w/r/t B + 21 w/r/t C = 71

For simplicity, Example 4 illustrates how the Green Book proposals could result in materially more global tax being paid by a US MNE than a comparable foreign based MNE based solely on GILTI topping up on a per-country basis to an effective rate of 26.25% rather than 15%. The comparison between a 71 global tax cost to USP with a 55 global tax cost to a comparable foreign-based MNE under the GloBE rules ignores that a foreign-based MNE would benefit from substance based carve outs for payroll and tangible assets, whereas USP would not. By assuming that USP has no domestic expenses, the example also does not attempt to illustrate the further competitive disadvantage for US MNEs that would be created by the Green Book proposals with respect to allocable expenses. The benefit of domestic deductions allocable to separate per-country GILTI baskets that ended up in an excess credit position would continue to be lost, as under current law. The benefit of domestic deductions allocated to separate per-country GILTI baskets that ended up in an *excess limitation* position would be limited by amendments to Code Sec. 265. That section directly denies deductions for expenses allocable to tax exempt income. The Green Book proposals would treat the 25% portion of the GILTI inclusion that qualified for the Code Sec. 250 deduction as tax exempt income for purposes of Code Sec. 265.

The Biden Administration supported a robust Pillar 2 in negotiations at the Inclusive Framework to give it space to significantly increase the taxation of the international operations of US MNEs without materially eroding their competitiveness with respect to foreign-based MNEs. Under then existing and still current law, US MNEs are subject to a topping up to an effective 13.125% global average rate, whereas foreign-based MNEs are generally not subject to any global minimum tax regime. In addition, US MNEs in an excess credit position in the GILTI basket lose the US tax benefit of deductions for domestic expenses allocable against GILTI income, which is a much bigger detriment to US MNEs in the aggregate. Under the combination of the Green Book proposals and the GloBE rules, US MNEs would be subject to topping up to a 26.25% rate, calculated under US tax principles, in every jurisdiction with an effective rate below 26.25%, whereas foreign-based MNEs would be topped up to a GloBE rate of only 15%, and only with respect to the amount of income in those jurisdictions which have a tax rate below 15%. Under the Green Book proposals US MNEs would lose the benefit of tax deductions allocable not only to excess credit separate country GILTI baskets but also those allocable to excess limitation baskets. A very complex analysis would be required to conclusively determine whether US MNEs are in a better or worse competitive position under current law, before Pillar 2 implementation, than they would be in a world where both the Green Book and the GloBE proposals are implemented. It seems entirely possible, however, that US MNEs could end up in an even worse competitive position under a combination of the Green Book and GloBE proposals than they are today.

If, following a broad international implementation of Pillar 2, the United States enacted the Green Book proposals to amend the current GILTI, the effect on compliance and administrative burdens would be mixed. The Green Book would add the additional complexity of a per-country foreign tax credit limitation for GILTI compared with global blending. On the other hand, the Green Book would make the GILTI regime a Qualified IIR with the result that only GILTI calculations would need to be performed with respect to each CFC, rather than both GILTI and UTPR top-up computations.

Enacting the Green Book proposals would clearly raise more revenue for the United States than current law in that it would raise the residual US tax rate that the US imposes on CFC income and would deny additional deductions allocable to foreign source income. It would likely also raise more revenue for the United States than would the alternatives of implementing the Build Back Better Bill or the US adopting the Globe Model Rules as its international tax regime, as discussed more fully below.

The effects of enacting the Green Book proposals on allocative efficiency and the incentives to shift income would be mixed. A Green Book version of the GILTI regime would arguably be better than the current GILTI or the Build Back Better proposals in reducing the rate incentive to shift income and operations out of the United States. On the other hand, by creating higher overall effective tax rates on the international operations of US MNEs than apply to foreign-based MNEs, it would further skew the bidding for assets in the global market.

Adopting the Green Book proposals would contribute more to the stability of the international tax system than the United States doing nothing. The current political impasse in the United States over Pillar 2 raises serious issues about whether the United States is committed to the agreements it negotiated at the Inclusive Framework and makes more difficult the ongoing negotiations and peer review that will be required for the GloBE rules are to be administered in a uniform, consistent and reasonable fashion. Although the Green Book would continue the tradition of American exceptionalism by imposing more burdensome and complex tax regime on US MNEs, it would demonstrate the commitment of the United States to the Pillar 2 agreements by better aligning US law with GloBE principles.

e. Option 5: Implement the Build Back Better Bill Proposals.

As described at 3., above, during 2021 and 2022 Congress considered, but failed to enact, the Build Back Better Bill, which would have better aligned the US international tax rules with Pillar 2, and would have done so while placing US MNEs on a much more competitive basis. To briefly recap, the BBB Bill would put the GILTI regime on a per-country foreign tax credit limitation, making it a Qualified IIR. It would not change the current 21% corporate tax rate but would reduce the Code Sec. 250 deduction to 28.5% and reduce the GILTI haircut to 5%. The effective tax rate on GILTI would therefore be 15.015% (i.e., 71.5% of 21%). CFC income earned in a given country would incur marginal GILTI tax unless the foreign effective tax rate there is at least 15.8% (i.e., 15.015%/.95). The BBB Bill would provide a 5-year carryforward for excess GILTI foreign tax credits by separate country basket and would also provide for the carryforward of tested losses with respect to each country. The BBB Bill also proposed to reduce the QBAI exclusion by reducing the deemed return on tangible assets from 10% to 5%, to make the return more consistent with the substance based carve out for tangible assets under the GloBE rules. US MNEs would continue to lack a substance based carve out based on payroll expenses comparable to that provided under the GloBE rules.

Perhaps most significantly, in drafting the BBB Bill, the Congressional committees proposed to give relief from the allocation of domestic expenses to the GILTI basket rather than put further limitations on the deduction of allocable expenses. The bill provides that domestic interest and headquarters expenses that would otherwise be allocated to the GILTI basket would instead be allocated to, and deductible against, US source income. It did not propose to amend Code Sec. 265 to deny deductions allocable to the portion of GILTI that is offset by Code Sec. 250 deductions. The bill would instead enact new Code Sec. 163(n), which would limit a MNE group's interest deduction in the United States to the extent the group's US operations are over leveraged compared with its global leverage ratio.

The impact of enacting the BBB Bill proposals is illustrated in Example 5, below. The facts are the same a in Example 4. After CFC A pays 25 of tax in Country A, USP has no residual GILTI tax on that income. After CFC B pays a total of 15 tax in Country B under a QDMTT, USP has a residual GILTI tax of 0.77 (i.e., (100 @ 15.015%) - (15 x .95)). After CFC C pays zero tax in Country C, USP has a residual GILTI tax of 15.02 (i.e., (100 @ 15.015) - (0 x .95)). The combined local and US tax by country is therefore 25 with respect to Country A, 15.77 with respect to Country B, and 15.02 with respect to Country C, for a total tax on CFC income of 55.79. This compares with a total of 55 for a similarly situated foreign-based CFC, as illustrated in Example 2.

Example 5:

USP

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

100@25% 100@15% 100@ 0%

Step 1: Countries Impose Regular Corp. Tax

A=25 B=15 C=0

Step 2: Compute Per Country GILTI Tax at 15.015% effective rate with 5% FTC haircut

A= 0 B= 0.77 C= 15.02

No allocation of domestic expenses against GILTI

No UTPR application because GILTI is a Qualified IIR

Total Tax on CFC income in countries

25 w/r/t A + 15.77 w/r/t B + 15.02 w/r/t C = 55.79

Example 5 illustrates how implementing the BBB Bill proposals would put US MNEs on an approximately level playing field with foreign-based MNEs subject to the GloBE rules. Although the 15.015% GILTI rate and the remaining 5% GILTI foreign tax credit haircut produces a slightly higher tax burden than the simple 15% top-up rate under GloBE, ignoring base differences, the difference is small. Although Example 5, for simplicity, assumes that UPE has no domestic expenses that would be allocable to foreign source income, this assumption is no longer material because, under the Build Back Better Bill proposals, no domestic interest or headquarters expenses would be allocated against GILTI baskets, preserving the benefit of the deductions for those expenses. As illustrated in Example 2, above, under current law a US MNE in an excess credit position with 100 of domestic expenses allocable against its GILTI basket would face a tax detriment of 21 unless and until some portion of that detriment is effectively offset against a UTPR top-up liability through the Allocable Blended CFC Tax Amount mechanism the GloBE rules. Under the BBB Bill, the entire deduction for 100 of allocable expenses would be preserved. The overall result is that US MNEs would be on an approximately level playing field with foreign-based MNEs and would be at much less of a competitive disadvantage than they are today prior to the implementation of the GloBE rules. They would also be in a better competitive position than they would be under combination of current US law and the GloBE rules.

With respect to compliance and administrative burdens, moving the GILTI regime to a per country foreign tax credit limitation and adding carryforwards for excess credits and tested losses by country would add complexity compared with the current GILTI regime. The effect would be offset to some degree by the fact that, because the GILTI regime would be a Qualified IIR, the UTPR would not apply to CFCs of US MNEs. GloBE top-up calculations would have to be done only for purposes of local QDMTTs.

Assuming a broad international implementation of the GloBE rules, the BBB Bill proposals would likely raise considerably less revenue for the United States than would the current GILTI or the Green Book proposals. As discussed above, most of this difference would be attributable to the more favorable treatment of domestic expenses in the BBB Bill.

With respect to allocative efficiency and the effect on incentives to shift income between jurisdictions, the BBB Bill proposals would be more effective at limiting the rate arbitrage from income shifting to the difference between the rate in the payor jurisdiction and 15%, because the Allocable CFC Blended Tax Amount mechanism discussed above would no longer come into play because the UTPR would not apply to CFCs of US MNEs. The Green Book proposals would likely reduce incentives to shift income between CFCs even further, however, by establishing for US MNE groups a minimum tax rate of 21% to 26.25% on the income shifted. The Green Book proposals would for the same reason go further in eliminating the incentive to shift income out of the United States. It is also significant, however, that by approximately equalizing the overall tax burden on the international operations of US MNEs and foreign-based MNEs, the BBB Bill proposals would reduce tax distortions in the bidding for assets in the global market.

The BBB Bill proposals, like the Green Book proposals, if enacted would contribute to the stability of the international tax system by resolving the current uncertainty regarding US commitment to the Pillar 2 agreements. This would in turn facilitate the ongoing efforts at the Inclusive Framework to provide administrative guidance and to peer review to promote the consistent application and administration of the GloBE rules.

f. **Option 6:** United States Implements the GloBE Model Rules and a QDMTT to Replace its Current Corporate International Tax Rules.

If the primary policy goals of the United States were to provide a level competitive playing field for US MNEs and to simplify its tax system, the United States could adopt the GloBE Model Rules and a QDMTT as its international tax regime. The GILTI, the BEAT, and the CAMT could be repealed, as could the foreign tax credit regime as it applies to income earned through CFCs and foreign branches. Income of CFCs and foreign branches would be taxed only to the extent that there was a top-up amount to be collected by the United States under its IIR based on the GloBE 15% minimum tax rate. CFC and branch earnings could otherwise be distributed back to the United States free of US tax. The United State could adopt a full territorial system for corporate tax purposes, including excluding from income both gains and losses from the disposition of stock of CFCs. Such an approach would be consistent with the stated premise of the TCJA in its legislative history, if not the drafting of its statutory language, of putting the United States on a territorial basis with respect to income earned through CFCs if that income is subjected to an acceptable minimum rate of foreign tax.

Such an approach would truly level the playing field for US and foreign-based MNEs in that US MNEs would be taxed on their international operations under the same rules as would apply to their foreign competitors. They would be subject to the same minimum tax rate, calculated on the same tax base, using the same top-up mechanism. US MNEs would no longer include in their current US taxable income most of their foreign operating income and then receive only partial relief from double taxation under the US foreign tax credit regime. The conclusion that applying the same rules to both US and foreign based MNEs levels the playing field is probably sufficiently obvious that no computational example is required. Nevertheless, for the sake of consistency, Example 6 is provided below. It assumes the facts of Example 1 and produces the same outcome as that shown for the foreign-parented MNE in Example 1:

Example 6:

USP

A

QDMTT

UTPR TP

B

QDMTT

UTPR TP

C

LOW TAX

100@25%

100@15%

100@ 0%

Step 1: Local Countries Impose Corp. Tax

A=25 B=15 C=0

Step 2: USP pays Top-Up Tax under GloBE IIR

A= 0 B= 0 C= 15

Total Tax on CFC income in countries

25 w/r/t A + 15 w/r/t B + 15 w/r/t C = 55

The adoption of the GloBE rules by the United States to replace its existing corporate international tax regime would represent a substantial simplification of the US tax system. US MNEs would need to apply only a single set of tax rules, the GloBE rules, to measure and tax the income of CFCs, rather than performing simultaneous calculations under both the GloBE rules and the GILTI and foreign tax credit rules. The enormously complex foreign tax credit and foreign tax credit limitation rules could be eliminated as applied to the foreign operating income of corporations, as would the need to track previously taxed earnings and profits and to make basis adjustments under section 961. The Code Sec. 367 regulations could be greatly simplified. Enacting the BBB Bill proposals achieve almost as much in terms of leveling the competitive playing field as simply adopting the GloBE rules outright. The BBB Bill proposals would, however, retain the much more complex tax architecture of including tested income in the income of the US parent and providing double tax relief through the foreign tax credit mechanism.

It is worth observing that this dramatic simplification could be achieved even if Congress chose to perpetuate American exceptionalism by continuing to tax US MNEs more heavily on their international operations than foreign-based MNEs are taxed. If Congress wanted to continue to collect some amount of residual tax on the income of CFCs of US MNEs, it could set the top-up tax rate under a US-implemented IIR at a rate above 15%. Presumably, however, the United States would be barred in principle by the agreement at the Inclusive Framework from setting a minimum rate for purposes of its UTPR above 15%. Similarly, the United States would be free to amend Code Sec. 265 to limit the deductibility of domestic expenses allocable to CFC income even in the context of an IIR top up regime. While such an approach would not level the playing field or be as favorable to US MNEs as adopting the BBB Bill proposals or the GloBE rules with a 15% IIR rate, it would nevertheless produce a simpler international tax regime.

If the US were to adopt the GloBE Model rules, it would significantly contribute to the stability of the international tax system. It would demonstrate the commitment of the United States to making the Pillar 2 regime work as an internationally agreed minimum tax regime around the world. It would facilitate ongoing administrative guidance and peer review. It would also make realistic the possibility of implementing the GloBE regime through a multilateral instrument, which would likely be necessary if effective dispute avoidance and dispute resolution mechanisms are to be provided and if countries are to be to legally obligated to keep their implementation of Pillar 2 consistent with the Model Rules.

* 1. **Option 7**: Radical Tax Reform?

Pillar 2 is designed to operate essentially as a cartel among nations with relatively high corporate tax rates to limit the degree to which other nations can engage in competitive reductions of corporate taxes. It has long been observed that the corporate income tax is an economically inefficient way to raise revenues, and that the economic incidence of the corporate income tax is uncertain. From time to time there have been discussions of the United States replacing its corporate income tax with, for example, a destination-based cash flow tax or transitioning to a fully destination-based corporate tax or a consumption tax. Although such approaches remain at least conceptual alternatives for the United States, implementing them in a world where most jurisdictions have implemented Pillar 2 would be extremely challenging. One significant result of the negotiation of Pillar 2 and the move towards its widespread implementation outside of the United States appears to be the creation of serious constraints on the ability of United States to replace or to materially reduce its corporate income tax.

1. L.G. "Chip" Harter is a retired international tax professional. From 2017 through 2020, he served as Deputy Assistant Secretary of the Treasury for International Tax Affairs. While at the Treasury, he represented the United States at the OECD/G20 Inclusive Framework negotiations on Pillar 1 and Pillar 2 and he oversaw the drafting of regulations implementing the international provisions of the Tax Cut and Jobs Act. [↑](#endnote-ref-1)
2. General Explanation of the Administration's Fiscal Year 2017 Revenue Proposals, pp. 9-12 (2016). [↑](#footnote-ref-1)
3. Id. at 11. [↑](#footnote-ref-2)
4. [↑](#footnote-ref-3)
5. Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, C-196/04 (2006). [↑](#footnote-ref-4)
6. Haribo Lakritzen Hans Riegel BetriebsgmbH and Osterreichische Salinen AG v. Finanzamt Linz, Joined Cases C-436/08 and C-437/08, paragraph 165. [↑](#footnote-ref-5)
7. OECD (2015), Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. [↑](#footnote-ref-6)
8. Id. Section 1.2.1.1 paragraph 16. [↑](#footnote-ref-7)
9. [↑](#footnote-ref-8)
10. [↑](#footnote-ref-9)
11. [↑](#footnote-ref-10)
12. [↑](#footnote-ref-11)
13. [↑](#footnote-ref-12)
14. Under jurisdictional blending, an effective rate is computed with respect to all income earned by the MNE group within a single country by combining the income earned by all group members within the country with the taxes paid by all group members to the country. [↑](#footnote-ref-13)
15. Pillar 2 Blueprint Report, para. 29. [↑](#footnote-ref-14)
16. [↑](#footnote-ref-15)
17. [↑](#footnote-ref-16)
18. [↑](#footnote-ref-17)
19. [↑](#footnote-ref-18)
20. [↑](#footnote-ref-19)
21. [↑](#footnote-ref-20)
22. [↑](#footnote-ref-21)
23. *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Inclusive Framework on BEPS, Sec. 2.10, p. 67-69, OECD, Paris. [↑](#footnote-ref-22)
24. The issue of whether the marginal tax resulting from expense allocation to the GILTI basket should be treated as Allocable Blended CFC Tax Amount was well understood and discussed at the time the administrative guidance was being considered. See, e.g. Heydon Wardell-Burrus, GILTI and the Globe (February 2, 2023). [↑](#footnote-ref-23)
25. [↑](#footnote-ref-24)
26. This computation is simplified for ease of presentation by building the Code Sec. 250 deduction and the 20% GILTI haircut into the rate. The actual ETR computation would be (80% x40)/(300 - 150) = 21.33% which would be compared with the 21% corporate tax rate. [↑](#footnote-ref-25)
27. [↑](#footnote-ref-26)
28. i.e., (300 - 150) x 21% - ((300-150-100) x 21%) = 21 [↑](#footnote-ref-27)
29. The concept of replacing the QRTC rule with a rule favoring expenditure-based credits was floated by Danielle Rolfes at a Washington International Tax Study Group meeting. [↑](#footnote-ref-28)
30. [↑](#footnote-ref-29)