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The Enigma of the United States, Base Erosion, and Global Tax Cooperation

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THE ENIGMA OF THE UNITED STATES, BASE EROSION, AND GLOBAL TAX COOPERATION

*Bret Wells**

The Organisation for Economic Co-operation and Development (OECD) frequently lauds its Pillar 2 project as a cooperative global effort to ensure that large multinational enterprises pay a minimum tax regardless of where they are headquartered and regardless of the jurisdiction where their operations are located. The United States and at least 137 other nations have all agreed that global tax cooperation is consistent with their fiscal interests and their fiscal priorities. However, one should remember the admonition that "the devil is often in the details." This Article dives into the details of the Pillar 2 model rules, identifying those areas where the model rules are deficient and where further reforms to the GloBE rules are necessary to ensure achievement of the agreed-upon aspirational goal. The Article also sets forth how the United States and other like-minded nations should respond during this interim period where design deficiencies remain in the Pillar 2 model rules.

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INTRODUCTION

The United States has at least three goals that, at times, can be in tension with each other: globalization, democracy, and tax competition.[1] The United States rightly engages in globalization because of the benefits globalization provides to its economy and to the peaceful comity among nations.[2] The United States also seeks to promote and sustain its democratic society, and in furtherance of that goal it must collect sufficient tax revenue[3] to fund the public goods and services its people need to compete in a globalized economy.[4] Finally, the United States utilizes tax incentives to attract investment and to modify economic behavior.[5] These three goals are not necessarily contradictory goals, but they can create conflicts if they are not carefully calibrated. Further, these goals can create incongruities with the tax collection and tax incentive goals of other nations. It is in the midst of these incongruities where multinational enterprises and rich individuals have

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1. *See* Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1575 (2000).

2. *See, e.g.*, JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS REVISITED: ANTI-GLOBALIZATION IN THE ERA OF TRUMP (2017); STEPHEN E. AMBROSE & DOUGLAS G. BRINKLEY, RISE TO GLOBALISM (9th rev. ed. 2011); JOSEPH E. STIGLITZ, MAKING GLOBALIZATION WORK (2017).

3. The Congressional Budget Office (CBO) has projected that the United States faces a challenging fiscal outlook. *See* CONG. BUDGET OFF., THE 2023 LONG-TERM BUDGET OUTLOOK 1 (2023).If current laws generally remained unchanged, budget deficits and federal debt would grow in relation to gross domestic product over the next three decades. *Id.*

4. *See, e.g.*, DANI RODRIK, THE GLOBALIZATION PARADOX: DEMOCRACY AND THE FUTURE OF THE WORLD ECONOMY (2011).

5. Tax expenditure theory is well enshrined in tax scholarship in the United States. *See* Martin J. McMahon Jr., *Taxing Tax Expenditures?*, 130 TAX NOTES 775, 776 (2011) (describing tax expenditure theory as "enshrined into law"); Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 705 (1970) (discussing whether tax incentives are useful or efficient in assisting particular industries, business activities, or financial transactions); STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 2 (1985); J. Clifton Fleming, Jr. & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and Its International Dimension*, 27 VA. TAX REV. 437, 446 (2008) (describing tax expenditure analysis as "the essence of simplicity"); Linda Sugin, *Tax Expenditure Analysis and Constitutional Decisions*, 50 HASTINGS L.J. 407, 410 (1999).

The Congressional Budget and Impoundment Control Act of 1974 requires the Office of Management and Budget to report tax expenditures annually. *See* Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, §§ 201–02, 88 Stat. 302–04 (1974). The Joint Committee on Taxation prepares an analysis of tax expenditures that is then used by the CBO. *See* JOINT COMM. ON TAX'N, JCS-22-22, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2022–2026 (2022); OFF. OF TAX ANALYSIS, U.S. DEP'T OF THE TREASURY, TAX EXPENDITURES (2023). The Congressional Research Service regularly prepares a committee print for Congress to aid it in evaluating the nation's tax expenditures. *See, e.g.*, CONG. RSCH. SERV., 116TH CONG., TAX EXPENDITURES: COMPENDIUM OF BACKGROUND MATERIAL ON INDIVIDUAL PROVISIONS 1 (Comm. Print 2022).

the opportunity, through complex business structures, to arbitrage tax incentives of various nations and shift profits to low-tax environs.[6] The inability of nation states to tax the rich or to assert a minimum tax on the profits of multinational enterprises increases inequality and strains the fiscal resources needed to preserve democratic societies.[7]

Although incongruities have always existed to some extent, it has become increasingly clear in recent years that the digitalization of the global economy creates acute base erosion challenges that require collective action to ensure imposition of a global minimum tax on multinational enterprises. As a result, the challenge for the United States and other nations is to calibrate their international tax regimes so that the regimes are not placed into conflict with each other to the ultimate detriment of their shared fiscal interests.[8] The tip of the spear for this challenge can be posited in this question: should a minimum global tax be imposed even if a country desires to subsidize particular investment activities within its borders?[9] If the global agreement opens the

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6. The windfall of double nontaxation over income created through such examples of taxpayer ingenuity has been called a variety of names in the academic literature, including homeless income, stateless income, ocean income, and nowhere income, to name a few. *See* Bret Wells & Cym Lowell, *Tax Base Erosion and Homeless Income: Collection at Source Is the Linchpin*, 65 TAX L. REV. 535 (2012); Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 TAX L. REV. 99 (2011); *Offshore Profit Shifting and the Internal Revenue Code: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Security and Governmental Affairs*, 112th Cong. (2013) (statement of Stephen E. Shay, Professor, Harvard Law School); Don Griswold, *Innovative Principles for Multistate CIT Planning—Part 1*, 104 TAX NOTES ST. 729, 729 (2022); Diane M. Ring, *One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage*, 44 B.C. L. REV. 79, 79 (2005); Adam Rosenzweig, *Harnessing the Cost of International Tax Arbitrage*, 26 VA. TAX REV. 555, 557 (2007); Omri Marian, *The State Administration of International Tax Avoidance*, 7 HARV. BUS. L. REV. 1, 1 (2017); Allison Christians, *Avoidance, Evasion, and Taxpayer Mobility*, 44 WASH. U. J. L. & POL'Y 39, 39 (2014).

7. *See* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (Arthur Goldhammer trans., Harvard Univ. Press 2014) (2013); *see also* Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 667 (1994) (arguing that the income tax is the most efficient means to redistribute other policy instruments); George R. Zodrow & Peter Mieszkowski, *Pigou, Tiebout, Property Taxation and the Underprovision of Local Public Goods*, 19 J. URB. ECON. 356, 356 (1986). For a contrary view, see Tsilly Dagan, *The Global Market for Tax and Legal Rules*, 21 FLA. TAX REV. 148, 151 (2017); Brian Galle, *Is Local Consumer Protection Law a Better Redistribution Mechanism than the Tax System?*, 65 N.Y.U. ANN. SURV. AM. L. 525, 526 (2010).

8. *See* Avi-Yonah, *supra* note 1, at 1616–75; Yariv Brauner, *An International Tax Regime in Crystallization,* 56 TAX L. REV. 259, 259–65 (2003); *see also* Org. for Econ. Coop. & Dev. [OECD], *OECD/G20 Base Erosion and Profit Shifting Project: Explanatory Statement*, at 4 (2015) ("In a globalised economy, governments need to cooperate and refrain from harmful tax practices, to address tax avoidance effectively, and provide a more certain international environment to attract and sustain investment. Failure to achieve such cooperation would reduce the effectiveness of [corporate income tax] as a tool for resource mobilisation . . . .").

9. The tension between tax competition and tax harmonization has been a longstanding challenged discussed in the academic literature. *See, e.g.*, Julie Roin, *Competition and Evasion: Another*

door to the possibility that some investment tax incentives are worthy enough to supplant the goal of imposing a global minimum tax, how does one then draw the line as to which tax incentives take priority, and how does one then address the collateral disequilibrium created by strategic state actors that choose to engage in ongoing permissible tax competition?

This question has taken on added significance due to the recent enactment in 2022 of transferrable green energy tax credits in the United States as those tax subsidies have now become the main policy instrument to transition the U.S. economy to green energy alternatives, and other nations have announced their intent to adopt similar green energy tax subsidies.[10] Promoting carbon capture and transitioning the U.S. economy away from carbon-based energy sources may be laudable goals, but the use of tax subsidies as the means to achieve those green energy goals conflicts with the goal of imposing a global minimum tax.

Admittedly, the United States might have chosen other green energy policy instruments, such as carbon taxes[11] or regulatory mandates, to achieve its climate goals.[12] If it had done so, then the use of

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Perspective on International Tax Competition, 89 GEO. L.J. 543, 564 (2001); Ring, *supra* note 6, at 139 (discussing competition-harmonization debate and considering national and multilateral instruments to prevent unwanted tax arbitrage). For a further analysis of the game theory impacts of tax competition in the international tax context, see TSILLY DAGAN, INTERNATIONAL TAX POLICY: BETWEEN COMPETITION AND COOPERATION 120–41 (2018); John D. Wilson, *Theories of Tax Competition*, 52 NAT'L TAX J. 269, 269 (1999); John D. Wilson & David E. Wildasin, *Capital Tax Competition: Bane or Boon*, 88 J. PUB. ECON. 1065, 1065 (2004); Adam Rosenzweig, *supra* note 6, at 559 (analyzing how tax competition can benefit developing nations).

10. Erin Slowey, *Global Tax Rules to Unleash Billions in Clean Energy Investment*, BLOOMBERG TAX (July 31, 2023), https://news.bloombergtax.com/daily-tax-report/global-tax-rules-to-unleash-billions-in-clean-energy-investment [https://perma.cc/3C6X-H8FD]; Timothy Conley & Kimberley Botwright, *What Do Green Subsidies Mean for the Future of Climate and Trade?*, WORLD ECON. F. (Mar. 13, 2023), https://www.weforum.org/agenda/2023/03/what-do-green-subsides-mean-for-the-future-of-climate-and-trade-099a016307 [https://perma.cc/9JWY-53SK].

11. David Weisbach & Sam Kortum, *Climate Change Policy in the International Context: Solving the Carbon Leakage Problem*, 31 N.Y.U ENV'T L.J. 1065, 1065 (2023); Gilbert E. Metcalf & David Weisbach, *The Design of a Carbon Tax,* 33 HARV. ENV'L L. REV. 499, 500 (2009); Richard D. Morgenstern, Reducing Carbon Emissions and Limiting Costs, *in* U.S. POLICY ON CLIMATE CHANGE: WHAT'S NEXT? 165, 168 (John A. Riggs ed., 2002) (explaining how price instruments such as carbon taxes are superior to quantity targets for the abatement of GHG emissions); Shi-Ling Hsu, *A Complete Analysis of Carbon Taxation: Considering the Revenue Side*, 65 BUFF. L. REV. 857, 887–91 (2017); Roberta F. Mann, *The Case for the Carbon Tax: How to Overcome Politics and Find Our Green Destiny*, 39 ENV'T L. REP. 10118, 10118 (2009).

12. Michael Wara, *Instrument Choice, Carbon Emissions and Information*, 4 MICH. J. ENV'T & ADMIN. L. 261, 262 (2015); Victor B. Flatt, "*Offsetting Crisis?"—Climate Change Cap-and-Trade Need Not Contribute to Another Financial Meltdown*, 39 PEPP. L. REV. 619, 623 (2012); Victor B. Flatt, *C(r)ap and Trade: The Brave New World of Non-Point Source Nutrient Trading*

those alternative policy instruments could have been harmonized with the goal of imposing a global minimum tax on multinational enterprises. But alas, the United States found it more palatable to utilize tax subsidies (the carrot) over the use of carbon taxes or regulatory mandates (the stick), and so the collateral impact of its chosen policy instrument now conflicts with its goal of imposing a global minimum tax on multinational enterprises. So, the question then becomes how this tension is addressed in the Organisation for Economic Co-operation and Development's (OECD) Pillar 2 rules when a nation (like the United States) decides to engage in tax competition to promote other important policy goals in preference to the goal of imposing an actual global minimum tax.

As will be demonstrated in this Article, the OECD's Pillar 2 model rules, as interpreted by the OECD administrative guidance, subordinate the goal of imposing an actual minimum tax to the retained sovereignty of nations to engage in ongoing tax competition within prescribed parameters. Oh yes, it is true to say that the OECD frequently lauds its Pillar 2 project as a cooperative global effort to ensure that large, multinational enterprises pay a minimum tax regardless of where they are headquartered and regardless of the jurisdiction where their operations are located.[13] It is also true to say that the United States[14] and at least 137 other nations[15] have all publicly stated that

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and Using Lessons from Greenhouse Gas Markets to Make it Work, 52 HOUS. L. REV. 301, 301 (2014).

13. *See* Org. for Econ. Coop. & Dev. [OECD], *Tax Challenges Arising from the Digitalisation—Report on Pillar Two Blueprint*, at 14 (2020).

14. *See Statement by President Joseph R. Biden, Jr. on the Unprecedented OECD Agreement for a Global Minimum Tax*, WHITE HOUSE (July 1, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/08/statement-by-president-joseph-r-biden-jr-on-the-unprecedented-oecd-agreement-for-a-global-minimum-tax/ [https://perma.cc/4WK6-V4CJ]; *Statement from Secretary of the Treasury Janet L. Yellen on the OECD Inclusive Framework Announcement*, U.S. DEP'T TREAS. (Oct. 8, 2021), https://home.treasury.gov/news/press-releases/jy0394 [https://perma.cc/L72G-LPU6]; *Statement by President Joseph R. Biden, Jr. on Today's Agreement of 130 Countries to Support a Global Minimum Tax for the World's Largest Corporations*, WHITE HOUSE (July 1, 2021), https://www.whitehouse.gov/briefing-room/statements-releases (click search button; type in "Today's Agreement of 130"; click on statement) [https://perma.cc/J4CA-UXD6]; *Statement from Secretary of the Treasury Janet L. Yellen on Today's Agreement of 130 Countries to Support a Global Minimum Tax for the World's Largest Corporations*, U.S. DEP'T TREAS. (July 1, 2021), https://home.treasury.gov/news/press-releases/jy0255 [https://perma.cc/EB3M-5TKG].

15. *See* Org. for Econ. Coop. & Dev. [OECD], *Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, at 1 (July 11, 2023) [hereinafter *Outcome Statement*]; *see also* Org. for Econ. Coop. & Dev. [OECD], *Tax Challenges Arising from the Digitalisation of the Economy—Global Anti-Base Erosion Model Rules (Pillar*

the imposition of a global minimum tax on multinational enterprises is consistent with their shared collective fiscal interests. However, it is at this point that one should remember the admonition that "the devil is often in the details." One should not accept out-of-hand the OECD's writ large aspirations as dogma, even if the OECD's stated aspirations are quite pleasing to the ear. It is important to remember that one can agree with the OECD's aspirational statements and still believe that the OECD Pillar 2 model rules fail to deliver on their professed narrative. As one parses through the detailed OECD administrative guidance as it has evolved, it is now clear that a compliant top-up tax under the GloBE rules may not actually collect any meaningful minimum tax on low-taxed foreign income, notwithstanding the OECD's sweeping, aspirational statements to the contrary.[16]

This Article identifies those areas where the Pillar 2 model rules are deficient and where further reforms to the GloBE rules are necessary to ensure imposition of a global minimum tax. It is this author's hope and belief that the United States and many other like-minded nations will agree that they have shared fiscal interests in ensuring that tax competition does not create a renewed race to the bottom. Avoiding that outcome, however, requires adopting nations to agree to subordinate their tax competition sovereignty to the shared interests in preserving a minimum tax. At present, the OECD Pillar 2 model rules don't require that concession, and its failure to do so represents a fatal design flaw in the OECD Pillar 2 model rules that thwart attainment of its minimum tax goal.[17]

Two): Inclusive Framework on BEPS, at 3 (2021) [hereinafter *Global Anti-Base Erosion Model Rules*].

16. The OECD has claimed that its proposal would increase tax revenue by $220 billion. *See* Org. for Econ. Coop. & Dev. [OECD], *Secretary-General Tax Report to G20 Leaders*, at 7 (Sept. 2023). However, that report assumes countries do not engage in further tax competition and enact tax subsidies as allowed by the Pillar 2 model rules, which in turn undercuts the reliability of its assertions.

17. It is true that many countries are moving forward with legislation to adopt Pillar 2 notwithstanding these design flaws. *See, e.g.*, *The Latest on BEPS and Beyond*, ERNST & YOUNG (Nov. 21, 2023), https://www.ey.com/en_gl/tax-alerts/the-latest-on-beps-and-beyond---november-2023-edition [https://perma.cc/X449-K2ZL]; KPMG, BEPS 2.0—PILLAR TWO STATE OF PLAY (2024), https://kpmg.com/kpmg-us/content/dam/kpmg/pdf/2023/beps2-state-of-play-summary.pdf [https://perma.cc/WD2W-ZQSP]. However, the failure to prevent tax competition allows an adopting nation to engage in strategic actions to garner an advantage over other nations. Unless that strategic behavior is disallowed or sanctioned, the result would be that other nations will likely respond in kind in subsequent rounds, addressing the strategic disadvantage by leveling the playing field. Thus, the ultimate success of the adoption of the OECD Pillar 2 model rules is not at the time of initial adoption but rather on the sustainability of those rules in imposing a minimum tax in light of the very real tax competition opportunities for strategic adopters.

Even if many nations in their initial adoption of the OECD Pillar 2 rules do so without infusing tax competition elements into their laws, the model rules provide a competitive advantage in favor of strategic state actors that do engage in permissible tax competition. The resulting disequilibrium after the initial adoption phase is untenable. Once the competitive advantage garnered by strategic state actors is broadly understood, the disadvantaged nations will have an incentive to then adopt their own countervailing tax competition countermeasures in an effort to re-level the playing field. In Sections I.A and I.B, this Article analyzes the design defects in the OECD Pillar 2 model rules that foster this dynamic and the foreseeable race to the bottom.

If one accepts the observation that the OECD Pillar 2 model rules fail to ensure a stable global minimum tax equilibrium, notwithstanding the OECD's aspirational assertions to the contrary, then the United States (and perhaps other like-minded nations) are presented with a conundrum in the here and now. By failing to ensure imposition of a stable global minimum tax in all events, the OECD Pillar 2 model rules set forth a decidedly second-best world[18] where global tax competition and a race to the bottom is perpetuated, albeit under slightly different metrics from those of the past. If this is the current reality, then the most salient question becomes how the United States (and perhaps other like-minded nations) should design their international tax laws in light of this unfortunate reality. To that end, this Article seeks to demonstrate that the best course of action for the United States is for it to partially, but not fully, adopt Pillar 2 along the following lines.

Action Item #1

The United States should not adopt a compliant income inclusion rule (IIR) regime[19] but instead should stand pat with its existing U.S. global intangible low-taxed income (GILTI) regime.[20] For the reasons discussed in Section I.C of this Article, continued reliance on the U.S.

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18. Under the general theory of the second best, when an agreement fails to achieve the Pareto-optimal conditions for achieving the optimum outcome, then departure from the other conditions is required even if attainment of those conditions were possible on a stand-alone basis. *See* R.G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11, 11 (1956).

19. The IIR was formerly known as the income inclusion rule but now is simply defined using the above acronym. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 11. The design features of a compliant IIR and its weaknesses are discussed later. *See* discussion *infra* Sections I.A and I.B.

20. The U.S. GILTI regime is set forth in I.R.C.§ 951A.

GILTI regime best preserves the opportunity for the United States to collect an actual minimum tax on low-taxed foreign income in comparison to what the United States might collect under a compliant IIR regime. If a particular nation (generically designated as "Country #1" in this Article) adopts an adequately compliant qualified domestic minimum top-up tax (QDMTT) regime,[21] then the OECD Pillar 2 model rules require all other nations to have their top-up tax regime supplanted.[22] Moreover, under the Pillar 2 model rules, as interpreted by the OECD administrative guidance, it is now possible for a jurisdiction in the posture of Country #1 to maximize substance-based carve-out income exclusions[23] and also to grant qualified refundable tax credits and marketable transferrable tax credits to eliminate any actual tax on the Country #1 income without violating the Pillar 2 minimum tax design guidelines.

It is entirely reasonable to expect a nation in the posture of Country #1 to utilize its super-priority status to enact a so-called adequately compliant QDMTT regime that provides "a friendly safe haven" for multinational enterprises where no meaningful actual minimum tax is collected but it nevertheless serves as a golden talisman that prevents all other nations from stepping-in to collect a minimum tax. This state of affairs gives an awful lot of power to a country in the posture of Country #1 and presupposes that it will "play nice."[24] This is a fool's bargain for a jurisdiction like the United States that is the ultimate residency jurisdiction for many multinational enterprises within the scope of the Pillar 2 model rules.

Instead of adopting a compliant IIR regime, the United States should retain its U.S. GILTI regime to collect an actual controlled foreign corporation (CFC) tax on low-taxed foreign income (computed under U.S. principles) whenever a so-called adequately compliant QDMTT regime fails to collect an actual minimum tax. An analysis of

21. The QDMTT was formerly known as the qualified domestic minimum top-up tax. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 64.

22. The QDMTT supplants the application of other top-up taxes to claim the highest priority top-up tax. *See id.* at 29.

23. *See id.* at 30.

24. It is true that many countries are moving forward with legislation to adopt Pillar 2 notwithstanding these design flaws. *See The Latest on BEPS and Beyond*, *supra* note 17; KPMG, *supra* note 17. However, the ultimate success of the OECD Pillar 2 model rules is dependent upon whether strategic actors are sanctioned when those nations circumvent an actual minimum global tax. The failure of the OECD Pillar 2 model rules to prevent such strategic actions is a fatal design flaw that affords an opportunity for strategic actions by nations to garner a competitive advantage by adopting adequately compliant regimes that do not actually impose a global minimum tax.

the superiority of the U.S. GILTI regime in this second-best world where tax competition is prioritized is more fully discussed in Section I.C.

Action Item #2

In the short-term, the United States should demand that the OECD, through its administrative guidance, stipulate that the U.S. corporate alternative minimum tax (U.S. CAMT) regime[25] is an adequately compliant QDMTT regime in its own right, so that all other top-up taxes are supplanted with respect to U.S. country income for those U.S. multinational enterprises subject to the U.S. CAMT regime. Such a concession by the OECD would ensure that U.S. multinational enterprises subject to the U.S. CAMT are not subjected again to a third-country under-taxed profits rule (UTPR) regime[26] on U.S. country income. For those U.S. multinational enterprises that are not subject to the U.S. CAMT regime but are within the scope of the Pillar 2 model rules, the United States should demand that the OECD, through its administrative guidance, confirm that critical U.S. business tax credits (such as the research credit) are afforded the same treatment as qualified refundable tax credits[27] under the OECD model rules. As a longer-term strategy, the United States should negotiate to have all tax credits treated as a reduction of tax expense regardless of whether they are refundable or nonrefundable, at which time the United States would then reform its own U.S. CAMT regime to take out its own tax competition elements when the OECD Pillar 2 model rules do so in a corresponding fashion. The rationale for this multi-phased approach is discussed more fully in Part II.

Action Item #3

The United States should expand the scope of its base erosion anti-abuse tax in Internal Revenue Code (I.R.C.) section 59A to further protect the U.S. tax base from inbound base erosion. The United States has an interest in not allowing significant shifting of U.S. origin

25. The U.S. corporate alternative minimum tax (or "U.S. CAMT") is set forth in I.R.C. section 55(b)(2) and imposes a 15 percent minimum tax on adjusted financial statement income as defined in I.R.C. section 56A. The U.S. CAMT is discussed more fully in Part II of this Article.

26. The UTPR was formerly known as the under-taxed profits rule or the under-taxed payment rule. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 12–14.

27. *See id.* at 16, 22. In contrast, all other credits are called "nonqualified refundable tax credit" and are not treated as additional income but instead as a reduction of income tax expense. *Id.*

profits to a QDMTT compliant jurisdiction when it does not have adequate assurance that an actual minimum tax will be imposed on those shifted U.S. origin profits. To address this legitimate interest, the United States should bolster the effectiveness of its base erosion anti-abuse tax in I.R.C. section 59A. A discussion of where further reform is necessary to bolster the effectiveness of I.R.C. section 59A is discussed in Part III.

I. DO NOT ADOPT PILLAR 2 FOR THE UNITED STATES

A. Unilateral Solutions Versus Global Cooperative Solutions to the Low-Tax Income Phenomenon

The OECD Pillar 2 model rules contain two flawed design features that perpetuate tax competition: (1) the Pillar 2 model rules afford a super-priority status to a jurisdiction (generically designated as Country #1 in this Article) that adopts a so-called adequately compliant QDMTT regime that completely supplants the top-up tax regimes of all other nations; and then (2) the Pillar 2 model rules allow Country #1 to retain discretion to infuse significant tax competition elements into its so-called adequately compliant QDMTT regime.

To see this reality, one needs to work through the three inter-connected top-up taxes (referred to collectively as the Global Anti-Base Erosion rules or "GloBE" rules) comprised of a QDMTT, an IIR, and a UTPR. The first-in-line top-up tax is a QDMTT, which is defined to be a minimum tax included in the domestic law of a jurisdiction that: (a) determines the excess profits of the constituent entities located in the jurisdiction (referred to as domestic excess profits); and (b) operates to increase the taxpayer's domestic tax liability with respect to domestic excess profits up to the minimum rate for the jurisdiction.[28]

The next-in-line top-up tax is the IIR, which is a top-up tax applied by the residency jurisdiction of the owner of the underlying constituent entity.[29] Because the IIR is asserted by the residency jurisdiction of the entity's owner, when it applies, it imposes a minimum tax on the parent entity and not on the constituent entity.[30] Said

28. *Id.* at 64. Such a QDMTT is also implemented and administered in a way that is consistent with the outcomes provided for under the GloBE rules. *Id.* The QDMTT is given priority over the IIR in model rule 5.2.3. *Id.* at 29.

29. *See id.* at 11.

30. In most cases, the jurisdiction applying the IIR is the jurisdiction of the ultimate parent entity, but if that jurisdiction were not to apply their own IIR then a jurisdiction of an intermediate holding company could apply its IIR.

differently, when the IIR is applied, the jurisdiction of residence of the parent entity imposes a minimum tax on the parent entity's share of income earned by a constituent entity owned directly or indirectly by the parent entity when the income is low-tax.[31]

The last-in-line top-up tax is the UTPR, which seeks to impose a top-up tax on a constituent entity by a jurisdiction other than the jurisdiction of the constituent entity or the jurisdiction of the owner of the constituent entity.[32] If an adequate minimum tax is collected under a QDMTT regime, then a further top-up tax cannot be imposed under a compliant IIR regime or UTPR regime as the QDMTT regime is given the highest priority.[33] If a QDMTT regime has not been imposed, then the IIR is allowed to impose a top-up minimum tax.[34] The UTPR acts as a backstop that can be triggered into operation if and only if a sufficient QDMTT or a sufficient IIR top-up tax were not assessed, such that the low-taxed country income has not borne a minimum rate of tax.[35] Thus, the GloBE rules set forth a pecking order. The QDMTT regime is in the front of the queue. The IIR regime is in the middle position. And the UTPR regime is the last in the queue.[36]

However, the QDMTT, the IIR, and the UTPR apply only after covered taxes are assessed, and importantly a covered tax includes taxes imposed by a CFC tax regime.[37] The U.S. GILTI regime is a CFC tax regime,[38] so it can be assessed whether or not a QDMTT, IIR, or UTPR were also potentially applicable. Furthermore, the OECD administrative guidance provides a means to allocate the U.S. GILTI taxes on a country-by-country basis.[39] Thus, whereas an adequately compliant QDMTT regime squeezes out any applicability of an IIR regime, it does not supplant the potential application of a CFC tax regime—albeit, a CFC tax regime should provide foreign tax credit

31. *See id.* at 11–12.

32. *See id.* at 12–14.

33. *See id.* at 29.

34. *Id.* at 101.

35. *See* OECD*, supra* note 13, at 14.

36. OECD, *Tax Challenges Arising from the Digitalisation of the Economy—Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, at 106 (Dec. 2023); OECD, *supra* note 13, at 14.

37. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 23–24. A qualified domestic minimum tax applied by the jurisdiction of the constituent entity would appear to also be a covered tax because it is recorded on the financial statements of the constituent entity per Model Rule 4.2.1(a) and is not excluded by Model Rule 4.2. *See id.*

38. *See id.* at 23; *see* OECD, *supra* note 36, at 67.

39. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 7; OECD**,** *supra* note 36, at 106; OECD, *supra* note 13, at 68.

relief for any actual QDMTT tax imposed, effectively minimizing double taxation. Even so, the important learning here is that the U.S. GILTI regime could still collect a minimum tax if in fact an adequately compliant QDMTT regime did not impose one.

The OECD's decision to give a QDMTT regime a super-priority status over all other top-up taxes conflates two separate but interconnected elements. First, the QDMTT regime is given a first-priority status over all other top-up taxes in terms of their application to its own country income.[40] This is not a surprising or controversial outcome.[41] However, the Pillar 2 model rules then provide that an adequately compliant QDMTT regime also has the authority to turn-off residual taxation of all other top-up tax regimes of other nations.[42] Jurisdictions that endorse a territorial tax system may find this second element acceptable, but it represents "a bridge too far" for jurisdictions that ascribe to a residency-based worldwide taxation regime.[43] The U.S. tax system, in particular, retains elements of a worldwide taxation regime through its GILTI regime, and so this second required element of a compliant IIR regime fails to effectuate the historic residency-based fiscal interest of the United States over income earned in controlled foreign corporations.

The QDMTT's super-priority becomes acutely problematic when a jurisdiction utilizes its QDMTT status to then engage in ongoing tax competition, because once an adequately compliant QDMT regime exists it then supplants the applicability of all other top-up tax regimes of other nations.[44] As will be further explored in Section I.B, under the

40. OECD, *supra* note 36, at 106.

41. The U.S. foreign tax credit regime recognizes the priority status of a foreign jurisdiction to have the first-priority right to tax foreign income by affording a tax credit against the ultimate U.S. tax liability for any foreign income taxes actually paid on such income. *See* I.R.C. §§ 27, 901(b). Accordingly, the Treasury Department has issued guidance to indicate that forthcoming regulations would generally afford foreign tax credit relief for taxes imposed by a source jurisdiction under a QDMTT regime. *See* I.R.S. Notice 2023-80, 2023-52 I.R.B. 1583.

42. *See* Org. for Econ. Coop. & Dev. [OECD], *Tax Challenges Arising from the Digitalisation of the Economy—Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, at 77–88 (July 2023). The administrative rules envision that a peer review process would be employed to determine whether a jurisdiction's asserted QDMTT is sufficiently compliant so as to qualify for the compliant QDMTT safe harbor. *See id.* at 88. Thus, a jurisdiction that wanted to retain tax competition elements could do so as long as the tax competition elements fell within the framework of the substance-based safe harbor and the loophole afforded to qualified refundable tax credit and marketable tax credits.

43. For others who have noted that the GloBE rules appear to have been principally authored by persons with a territorial tax mindset, see Kimberly S. Blanchard, *Can U.S. Worldwide Taxation and Pillar 2's Minimum Tax Peacefully Coexist?*, 180 TAX NOTES FED. 949 (2023).

44. *See* OECD, *supra* note 36, at 106.

OECD Pillar 2 model rules, a QDMTT regime can and likely will be designed to engage in ongoing tax competition and thus undercuts the goal of imposing an actual minimum tax.

In a sense, the conclusion that the Pillar 2 model rules, as interpreted by the subsequent OECD administrative guidance, provide for ongoing tax competition is unsurprising once one considers the longstanding track record of the OECD.[45] The root cause for why global tax cooperation historically has failed to impose a minimum tax on multinational enterprise income remains the subject of rigorous scholarly debate.[46] In earlier articles, this author argued that in the twentieth century it was in fact the OECD, along with the League of Nations, that spearheaded efforts to shift residual profits away from

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45. A strong, intuitive argument can be made that states should ultimately agree to collective cooperative actions when defections are punished in an infinitely repetitive game. *See* ROBERT M. AXELROD, THE EVOLUTION OF COOPERATION 27, 54 (1984). But this outcome is premised on the assumption that each member understands that a defection by one member from cooperation will be met with punishment leveled against the defecting member. *See* MARTIN J. OSBORNE & ARIEL RUBINSTEIN, A COURSE IN GAME THEORY 133 (1994). In contrast, in the international tax arena, there has not been clarity on the parameters for cooperation, and when a country has engaged in a defection, isolating a binary result as a defection is difficult if not impossible. *See* DANIEL N. SHAVIRO, FIXING U.S. INTERNATIONAL TAXATION 138–39 (2014). Given these constraints and given that countries have been unwilling to agree to relinquish their sovereignty to engage in tax cooperation, a strong case can be made that global tax cooperation is unlikely to result in a sustainable minimum tax. *See* DAGAN, *supra* note 9, at 68–71, 120–84.

46. *See generally* Carlo Garbarino, *The Architecture of the Country-By-Country Minimum Tax Regime Proposed by the United States*, 25 FLA. TAX REV. 835 (2022) (detailing history of tax competition and the race to the bottom and expressing optimism that the current initiative will deliver on the promise to change the international paradigm); Reuven S. Avi-Yonah, *supra* note 1, at 1573 (persuasively arguing that the race to the bottom is a natural consequence of tax competition and that this outcome hurts both developing and developed countries and then arguing that cooperation among nations is the only viable path for improvement for all). Other scholars, while acknowledging the benefits of global tax cooperation, have set forth pointed critiques that challenge the OECD narrative that its process was intended to be "inclusive" and observed that the opacity of the OECD decision-making process hinders attainment of any real inclusivity and of the benefits of global tax cooperation. *See* Allison Christians & Laurens van Apeldoorn, *The OECD Inclusive Framework*, 72 BULL. INT'L TAX'N. 226 (2018).

Other scholars have looked at this OECD record of failure in outcomes and attributed it to the cartel nature in which developed nations dominate these global tax cooperation initiatives and have then argued that developing nations should eschew these unbalanced international global tax cooperation agreements and instead seek their own independent policy prescriptions. *See* DAGAN, *supra* note 9 (setting forth the thesis that tax competition and individualized tax base protection solutions are in fact a better approach for developing nations over international tax cooperation due to the cartelistic power that the richest countries have over international tax cooperation efforts and questioning whether a centralized institution in this existing reality can ever forge balanced outcomes). The United Nations has recently made its own assessment that the OECD process benefits developed nations over developing nations and has been described as an opaque decision-making process that lacks transparency. *See* U.N. Secretary-Gen., *Promotion of Inclusive and Effective International Tax Cooperation at the United Nations*, ¶¶ 33–44, U.N. Doc. A/78/XXX (Aug. 8, 2023).

developing source nations in favor of developed residency-based jurisdictions.[47] That profit-shifting objective, which favored residency jurisdictions over source jurisdictions, was in fact the foundational premise for the international taxation paradigm in the post-colonial period.[48] After constructing a consensus on this foundational premise, the stage was then set for inappropriate base erosion of source jurisdictions. It was only later in time, after the foundational premise was well entrenched, that developed nations realized it afforded multinational enterprises with the means to create intermediate holding companies, located in a low-tax jurisdiction, to base erode all jurisdictions (including the ultimate residency jurisdiction of the parent company) and thus ironically hoisted developed nations on a profit-shifting petard of their very own making.[49]

In 1962, the United States responded to this systemic base erosion phenomenon in a unilateral fashion by enacting its own subpart F regime as a backstop against the most obvious forms of profit shifting.[50] Even so, a key failure of the U.S. subpart F regime is that it seeks to affirmatively define specific profit-shifting transactions of interest, which in turn creates a roadmap for taxpayers to structure around the regime. In 2017, the U.S. Congress again chose to act in a unilateral fashion to address low-taxed foreign income earned in the controlled foreign corporation environment by enacting I.R.C. section 951A to provide for a minimum tax on "global intangible low-taxed income,"[51]

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47. *See* Wells & Lowell, *supra* note 6.

48. *Id.* at 537.

49. *Id.*

50. *See* Internal Revenue Code Amendments of 1962, Pub. L. No. 87-834, § 12, 76 Stat. 960, 1006–1027 (1962). The subsequent history of that subpart F regime has indicated that it has been largely relegated to protecting against earning passive income outside the United States, to shifting sales income and service income to base companies through related party transactions and providing punitive taxation for income earned in certain sanctioned nations. *See* Bret Wells, *Territorial Taxation: Homeless Income is the Achilles Heel*, 12 HOUS. BUS. & TAX L.J. 1 (2012). For a review of the detailed mechanics of the U.S. subpart F regime, see JOSEPH ISENBERGH AND BRET WELLS, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN PERSONS AND FOREIGN INCOME, ch. 70–75 (6th ed. 2023).

51. I.R.C. section 951A identifies global low-taxed income by subtracting from total net CFC tested income the deemed tangible income return. *See* I.R.C. § 951A(b)(1)(B). The idea is that a CFC that earns income far in excess of its economic factors of production is suspicious and may indicate profit shifting. Congress decided it was a fool's game to try to identify the transactions that created the migration of profits and simply said if profits in a CFC exceed a routine profit, then it is per se subject to U.S. tax because it believes that profit shifting is occurring. I.R.C. section 951A is best seen as a backstop to what should have been the right normative result under I.R.C. section 482 and gets to that outcome without having to go through the fact findings of a trial. Res ipsa loquitur: the unexplainable existence of residual profits in the CFC far above its factors of production is the thing that speaks for itself.

regardless of what type of transaction generated those excessive offshore residual profits.

The OECD had an opportunity to prioritize collecting a minimum tax over unchecked ongoing tax competition at the end of the last century but failed to make meaningful progress at that time. In 1998, the European Commission,[52] and then thereafter the OECD,[53] identified harmful tax competition as a significant threat to all developed countries. However, notwithstanding the OECD's assertion that tax competition was harmful, the actual policy prescriptions endorsed by the OECD allowed jurisdictions to continue to engage in "nonharmful tax competition" as long as their tax competition did not cross an opaque line that caused the jurisdiction to get blacklisted with a tax haven moniker.[54] In that era, the OECD was able to profess opposition to "harmful tax competition," even while it did not meaningfully impact base erosion and profit shifting among non–tax haven jurisdictions.

In 2010, due to the fiscal budgetary pressures created by the bailout of large multinational enterprises, governments were moved again to address ineffective taxation of multinational enterprises.[55] In response, in 2012, the OECD commenced its base erosion and profit shifting (BEPS) work, and by 2015 it had issued reports on fifteen "actions items" that countries could undertake to reduce base erosion and profit shifting.[56] These action items in the BEPS 1.0 initiative sought to affirmatively identify situations susceptible to profit shifting. The OECD BEPS 1.0 initiative resulted in changes to tax treaties, including the adoption by over 130 countries of the first multilateral tax treaty, and the OECD also set forth a recommendation for country-

52. *See* EUR. COMM'N, GROWTH FRIENDLY TAX POLICIES IN MEMBER STATES AND BETTER TAX COORDINATION IN THE EU 10 (2011).

53. *See* Org. for Econ. Coop. & Dev. [OECD], *Harmful Tax Competition: An Emerging Global Issue*, at 14 (1998).

54. *See* Andrew P. Morriss & Lotta Moberg, *Cartelizing Taxes: Understanding the OECD's Campaign Against "Harmful Tax Competition,"* 4 COLUM. J. TAX L. 1 (2012). For a critical review of the OECD's handling of its "harmful tax competition" project, see Allison Christians, *Sovereignty, Taxation, and the Social Contract*, 18 MINN. J. INT'L L. 99 (2009); Christians, *supra* note 6.

55. *See* Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L LAW 353, 355 (2020).

56. *See BEPS Actions*, ORG. FOR ECON. COOP. & DEV., https://www.oecd.org/tax/beps/beps-actions/ [https://perma.cc/YP4J-DKX3] (describing fifteen actions that the OECD/BEPS Project set forth to "equip governments with domestic and international rules and instruments to address tax avoidance").

by-country reporting.[57] However, significant scholarship argues that this BEPS 1.0 process did not fundamentally alter the nature of tax competition or the international tax paradigm.[58]

In 2018, the OECD re-engaged in its effort (its so-called BEPS 2.0 initiative), and the result of its BEPS 2.0 work was an inclusive framework comprised of two pillars: Pillar 1 and Pillar 2.[59] The OECD Pillar 1 project sets forth a proposed grant of jurisdictional nexus to source jurisdictions to tax ongoing electronic commerce activities that do not rise to the level of a traditional permanent establishment. At the time of the writing of this Article, the Pillar 1 process is ongoing, and so further comment on its outcomes and the U.S. response to Pillar 1 is a topic for another day. In contrast, the Pillar 2 consensus is further along, and so that is the topic of this Article.

B. Pillar 2's Allowance of Tax Competition Makes a Compliant IIR Ineffective

The OECD Inclusive Framework does not remove the tension between collecting a minimum tax and tax competition. In fact, Pillar 2 elevates the tension and gives a distinct preference and priority in favor of ongoing tax competition. On the one hand, the GloBE rules introduce the aspirational goal of a minimum 15 percent top-up tax applied to multinational enterprises. But, after stating this aspirational goal, and after articulating the three interlocking top-up taxes that are designed to accomplish that outcome, the GloBE rules then provide multiple exit ramps to erode (or unlock) the actual collection of a global minimum tax under the interlocking top-up tax regimes.[60]

To begin with, the Pillar 2 model rules envision that a concessionary rate below the 15 percent minimum is allowed for income arising from activities that satisfy a substance-based carve-out income exclusion.[61] An adequately compliant QDMTT is not required to have a

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57. *See* Yariv Brauner, *Serenity Now! The (Not So) Inclusive Framework and the Multilateral Instrument*, 25 FLA. TAX REV. 489 (2022).

58. *See id.*; *see also* Yariv Brauner, *Treaties in the Aftermath of BEPS*, 41 BROOK. INT'L L. REV. 973, 976–77 (2016) (demonstrating that BEPS 1.0 introduced only few changes to the substance of the international tax norms, leaving the division of tax bases among nations essentially intact); Yariv Brauner, *What the BEPS?*, 16 FLA. TAX REV. 55, 61–67 (2014) (noting that increased mobility of multinational enterprises to avoid state regulatory powers makes ultimate success doubtful under the current paradigm).

59. *See International Collaboration to End Tax Avoidance*, ORG. FOR ECON. COOP. & DEV., https://www.oecd.org/tax/beps/ [https://perma.cc/JK92-W3B2].

60. *See Global Anti-Base Erosion Model Rules*, *supra* note 15.

61. *See id.* at 30.

substance-based carve-out income exclusion, but countries are allowed to provide for one if they desire to engage in tax competition.[62] The substance-based carve-out income exclusion safe harbor thus allows a country to enact an adequately compliant QDMTT and then provide tax incentives for local investment and jobs that erode the imposition of a true global minimum tax. After giving explicit recognition to this substance-based carve-out income exclusion safe harbor, the OECD model rules then state that the exclusion cannot be broader than the substance factors set out in the OECD model rules, which in turn are based on tangible asset investment and payroll.[63] Even so, significant discretion is afforded for creating local tax incentives under this concession to generate zero-tax income that is excluded from the minimum tax computation. This is a design failure that should be removed if in fact the goal is to ensure imposition of an actual global minimum tax.

Whereas the OECD model rules at least purport to contain outer limits on tax competition that could be employed under the substance-based carve-out income exclusion safe harbor, the same cannot be said about the OECD's treatment of so-called qualified refundable tax credits, as those governmental subsidies are not treated as tax refunds regardless of amount.[64] The financial equivalency of a governmental payment made in the form of a grant scheme versus a tax subsidy scheme (the latter known as a tax expenditure in U.S. nomenclature) has long been recognized in the tax literature.[65] The OECD model

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62. In a recent letter by the National Foreign Trade Council (NFTC) to the Ministry of Finance in Bulgaria, the NFTC argued that Bulgaria should modify its draft QDMTT legislation to include a substance-based carve-out exclusion because without it, "Bulgaria would be the only country to adopt" a QDMTT without a substance-based carve-out exclusion in the European Union, and thus the failure to do so would place Bulgaria at a competitive disadvantage versus other EU member states. *See* Letter of the National Foreign Trade Council to Ministry of Finance of Bulgaria (Oct. 26, 2023).

63. *See* OECD, *supra* note 36, at 107. The scope and measure of tangible assets and payroll must not be broader than the GloBE rules, but the QDMTT carve-out could provide for an applicable percentage lower than the GloBE rules.

64. A qualified refundable tax credit is treated as additional income but not a reduction of income tax expense. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 16, 22. In contrast, all other credits are called "nonqualified refundable tax credit" and are not treated as additional income but instead as a reduction of income tax expense. *See id.* at 16, 23. For an illustration of the divergence afforded to qualified refundable credits and non-nonrefundable credits, see OECD, *supra* note 36, at 83, 85.

65. *See* Noam Noked, *From Tax Competition to Tax Subsidy*, 42 U. PA. J. INT'L L. 445, 451 (2020); David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 961 (2004); Jacob Nussim & Anat Sorek, *Theorizing Tax Incentives for Innovation*, 36 VA. TAX REV. 25, 58 (2017).

rules fail to rein in a jurisdiction from returning tax payments back to a multinational enterprise in the form of a qualified refundable tax credit, and this design failure in the OECD model rules allows jurisdictions to construct an adequately compliant QDMTT regime that does not retain a minimum tax and yet turns off all other top-up tax regimes of other nations. This is another critical design failure of the OECD Pillar 2 model rules that should be eliminated if in fact the goal is to ensure imposition of an actual global minimum tax.

The OECD Pillar 2 model rules should treat any governmental grant as a per se reduction of any imposition of an income tax for purposes of determining whether or not a multinational enterprise has incurred a minimum tax in that particular jurisdiction. An example of the OECD treatment of qualified refundable tax credits is set forth in the following illustrative example:

> Taxpayer has $100x of country income in Country #1 apart from any government payments. The taxpayer is subject to a Country #1 income tax of $18x on its Country #1 income apart from any government payments. The taxpayer, however, is also entitled to claim a $18x refundable research tax credit from Country #1 that is based on the taxpayer's investment in research activities in that country. The $18x of research credit is allowed regardless of the taxpayer's taxable income, is computed based on metrics other than the taxpayer's taxable income, and is fully payable regardless of the income tax liability of the taxpayer. Under the OECD approach, the $18x refundable research credit is treated as additional gross income earned in Country #1 and not as a reduction of the Country #1 income taxes paid. The result of this treatment is that the taxpayer has an effective tax rate of 15.25 percent as indicated in the following calculation:

$$\frac{\text{18x of foreign income tax paid}}{\text{100x of business profits + 18x of refundable tax credit}} = 15.25\%$$

So, even though the taxpayer has made no net payment to the foreign jurisdiction (i.e., its $18x of income tax liability and its $18x of refundable tax credit effectively offset), the taxpayer's tax rate is 15.25 percent in this scenario under the OECD model rules, which is higher than the prescriptive 15 percent minimum tax threshold that the OECD

model rules require. Thus, it is entirely possible for a jurisdiction to purport to collect $18x of income taxes and then return all of those funds right back to the taxpayer as governmental grants and yet have an adequately compliant minimum tax regime.

Curiously, after providing for a qualified refundable tax credit exception to the global minimum tax, the OECD model rules then set forth a stark distinction for how nonrefundable tax credits are treated. In this regard, under the OECD model rules, a nonrefundable tax credit is generally treated as a reduction of tax expense.[66] Thus, by way of comparison, the effective tax rate on a government refund that is provided in the form of a nonrefundable tax credit would be treated as follows in the calculation:

$$\frac{\text{0x of foreign income tax paid}}{\text{100x of business profits}} = 0\%$$

The above treatment of nonrefundable credits causes the effective tax rate to be zero, which is below the minimum global tax rate of 15 percent, so top-up taxes would then be potentially applicable in this scenario.

This dichotomy creates a line-drawing problem between refundable and nonrefundable tax credits, and the subsequent guidance issued by the OECD has refashioned this boundary line to further expand tax competition opportunities. To begin with, the OECD administrative guidance has provided that nonrefundable marketable transferrable tax credits are treated in the same manner as qualified refundable tax credits for the originator of the credit if the credit's originator utilizes the marketable credit with the consequence that its usage is not treated as a reduction of tax expense but instead as the receipt of additional income by way of a government grant.[67] If the credit originator instead assigns the marketable credit to a buyer, then

66. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 16, 22.

67. A "marketable transferable tax credit" means a tax credit that can be used by the holder of the credit to reduce its liability for a Covered Tax in the jurisdiction that issued the tax credit and that meets the legal transferability standard and the marketability standard in the hands of the holder. The OECD rules provide guidelines for each of these elements. Further, if the marketable transferrable tax credit does in fact sell the credit, then the seller of the marketable transferable credit must treat the face value of the credit (or transfer price, if sold at a discount) as an increase to its income for Pillar 2 purposes instead of a reduction to covered taxes. Because this amount is treated as GloBE income, the discount is not treated as taxable income in the United States. *See* I.R.C. § 6418(b). The effect of selling the credit is to create low-taxed income to the extent of the sales price. *See* OECD, *supra* note 42, at 31–39.

the credit originator (seller) must treat its sales proceeds as gross income for purposes of the OECD Pillar 2 rules.[68] For U.S. tax purposes, these sales proceeds are nontaxable,[69] so the receipt of the sales proceeds can reduce the effective tax rate of the seller of the credit in that scenario.[70]

The purchaser of the transferrable green energy credit may treat the purchase price paid for the transferrable credit (not the full face amount of the credit) as a payment of covered taxes.[71] The consequence of this treatment is that the covered taxes paid by the purchaser of the marketable transferrable credit is reduced to the extent of any purchase discount enjoyed by the buyer in its purchase of the transferrable credit.[72] The tax press has already reported that this beneficial treatment afforded to marketable transferrable tax credits "is a game-changer for the [green energy subsidy] market."[73] As a further concession, the OECD has also advised that nonrefundable low-income housing credits are worthy credits (called "qualified flow-through tax benefits" under the administrative guidance) that in turn are afforded the same treatment as qualified refundable tax credits.[74] Commentators have already noted that these OECD "concessions" are devoid of any

68. *See* OECD, s*upra* note 42, at 33.

69. *See* I.R.C. § 6418(b).

70. For a discussion of the effective tax rate reduction that this exempt income implicates under the OECD Pillar 2 model rules, see generally Jason Yen et al., *Top 10 Most Common Pillar 2 Surprises for U.S.*, 112 TAX NOTES INT'L 1201 (2023) (discussing tax credits and rate deductions implicated under the OECD Pillar 2 model rules). *See also* Jason Yen et al., *Commentary, Top 10 Most Common Pillar 2 Surprises for U.S. Multinationals*, 181 TAX NOTES INT'L 1615, 1620–21 (2023) (providing commentary to the discussion on tax credits and rate deductions implicated under the OECD Pillar 2 model rules).

71. Because the credit, once purchased, is not re-transferrable, the green energy credit in the hands of the purchaser appears to become a non-marketable transferrable tax credit. But even so, the model rules treat the purchase price paid for a non-marketable transferrable credit as in effect a payment of covered taxes so that the purchaser is only required to reduce its adjusted covered taxes by the purchase discount and not by the entire face value of the credit used. *See* OECD, s*upra* note 42, at 36. This treatment is significantly more favorable than treating the purchaser's use of the purchased credit as a reduction of the purchaser's covered tax by the entire face value or by the purchase price of the credit as the purchaser is treated as having paid covered taxes equal to the discounted purchase price paid to the seller for the green energy credit.

72. For a discussion of the effective tax rate reduction that this exempt income implicates under the OECD Pillar 2 model rules, see generally Yen et al., *supra* note 70 (discussing tax credits and rate deductions implicated under the OECD Pillar 2 model rules). *See also* Yen et al., *supra* note 70, at 1621 (providing commentary to the discussion on tax credits and rate deductions implicated under the OECD Pillar 2 model rules).

73. Slowey, *supra* note 10.

74. OECD, s*upra* note 36, at 61–66. The rule would appear to apply to common U.S. tax equity investment structures used to finance projects eligible for renewable energy credits and the low-income housing tax credit (LIHTC), in which the tax credit is an essential component of the expected return on the equity investment.

compelling normative policy rationale.[75] The reality is that all government grants should be treated as a per se refund of the income tax payments for purposes of determining the net amount of the multinational enterprise's tax payment to a particular country. A rule that seeks to create a middle ground elevates formalistic distinctions in how governmental grant programs are designed above their true economic substance.

In substance, a government's return of funds back to the taxpayer through refundable or nonrefundable tax credits should in all events be treated as a refund of the income tax payment if in fact the goal of the OECD Pillar 2 model rules is to ensure imposition of a global minimum tax, but the OECD Pillar 2 model rules fail to do so. At present, U.S. research credits would be disadvantaged under the GloBE rules as they are nonrefundable credits,[76] whereas the research credits offered in many European jurisdictions are refundable credits that are more favorably treated under the OECD Pillar 2 model rules. U.S. Treasury officials have publicly indicated that they continue to negotiate with the OECD to require the Pillar 2 model rules to expand the qualified refundable tax credit exception to allow nonrefundable U.S. research credits to be given equivalent treatment under the model rules to level the tax competition playing field, as the U.S. research credits are a "similarly worthy incentive."[77] The ongoing negotiation highlights that the OECD's creation of a qualified refund tax credit loophole represents a slippery slope, as there is no compelling normative reason to make these drastic differentiations. Moreover, the administrative guidance has no restriction on whether or not the amount of the

75. There already have been calls for the OECD to provide carve-outs for "non-harmful" nonrefundable tax credits so that they are treated in the same manner as refundable tax credits under the OECD administrative guidance. *See* Peter R. Merrill et al., *Where Credit Is Due: Treatment of Tax Credits Under Pillar 2*, 109 TAX NOTES INT'L 1627, 1639–40 (2023); Noked, *supra* note 65, at 484–85.

76. *See generally* Martin Sullivan, *Some Simple and Overlooked Economics of the OECD's Pillar 2*, 180 TAX NOTES FED. 491, 493 (2023) (discussing American competition as it pertains to taxing U.S. companies). It has been estimated that the cost of converting nonrefundable credits to refundable credits would be $193 billion over ten years. Merrill et al., *supra* note 75, at 1641.

77. Representatives of the Treasury Department have indicated that the U.S. Treasury continues to press the OECD on altering the treatment of U.S. research credits under Pillar 2. *See* Sarah Paez, *Treasury Wants Different Pillar 2 Treatment for Research Credit*, 112 TAX NOTES INT'L 865, 865–66 (2023); Stephanie Soong Johnston, *U.S. Working with OECD on Pillar 2 Clarifications on Tax Credits*, 175 TAX NOTES FED. 939, 940 (2022); Dylan Moroses, *US Scrambles to Save R&D Credit Under Globe Min. Tax*, LEXIS LAW360 (Nov. 22, 2023), https://www.law360.com/tax-authority/articles/1769507/us-scrambling-to-save-r-d-credit-under-global-min-tax [https://perma.cc/84PZ-TNEZ].

marketable transferrable tax credit is constrained by any actual expenditure for amounts paid into the jurisdiction, but it can be restricted to be used only against income tax liability or sold to offset income tax liability of a company.

Thus, when the rubber meets the road, the OECD Pillar 2 model rules, as interpreted by the OECD administrative guidance, provide strategic state actors with multiple exit ramps for tax competition, supplanting the aspirational goal of collecting an actual minimum tax. A strategic state actor can claim to adopt an adequately compliant QDMTT regime and broadcast that it has a headline minimum tax rate of 18 percent (above the 15 percent minimum tax rate and thus compliant under Pillar 2) to other GloBE adopting jurisdictions, but then that strategic state actor could then grant a properly designed tax incentive in the form of a qualified refundable tax credit or nonrefundable marketable transferrable credits,[78] or provide substance-based income exclusion carve-outs, or provide a combination of these features so that no net tax payment (post-subsidy and post-carve-out) is retained.[79] Yet, other jurisdictions would be foreclosed from imposing any actual global minimum top-up tax once an adequately compliant QDMTT regime has placed its "seal of approval" on low-tax Country #1 income.[80] Jurisdictions in the posture of Country #1 could then notify the largest multinational enterprises that it stands ready to serve as a "reliable and friendly safe haven" that can inoculate income shifted

78. The calculation is as follows: 18 of tax / (100 business profits + 18 of tax incentive) = 15.2 percent.

79. The Joint Committee on Taxation stated as follows:

> The adoption of Pillar 2 is likely to encourage countries (especially ones with low tax rates) to seek to attract local investment in new ways. For example, countries may choose to raise more tax revenue (through Pillar 2 compliance) and then to return the revenue (perhaps to the same [multinational enterprises] paying the tax) in the form of (tax and nontax) incentives. In theory, such incentives could offset the cost of any additional tax liability under Pillar 2. In this case, there would be less reason for U.S. [multinational enterprises] to shift income into the United States and more reason to shift profits to Pillar 2 compliant jurisdictions offering incentives.

STAFF OF THE JOINT COMM. ON TAX'N, 118TH CONG., POSSIBLE EFFECTS OF ADOPTING THE OECD'S PILLAR 2, BOTH WORLDWIDE AND IN THE UNITED STATES 8, n.17 (Comm. Print 2023).

80. *See* OECD, *supra* note 42, at 77–88. The administrative rules envision that a peer review process would be employed to determine whether a jurisdiction's asserted QDMTT is sufficiently compliant so as to be determined to satisfy the safe harbor status as a compliant QDMTT. *See id.* at 88. Thus, a jurisdiction that wanted to retain tax competition elements could do so as long as the tax competition elements fell within the framework of the substance-based safe harbor and the qualified refundable tax credit exemption as those rules have evolved for transferrable credits.

into its jurisdiction against the Pillar 2 minimum top-up taxes of other nations. This state of affairs promotes ongoing tax competition.[81]

In recognition of this tax competition reality, the International Monetary Fund (IMF) has urged nations to redesign their tax competition into the lanes demarcated by the new rules.[82] The World Bank has also recognized tax competition remains part of the Pillar 2 model rules, although it then expressed a desire for a different reality as the following quote indicates:

> While certain incentives will no longer be [global minimum tax] compliant, countries will have the scope to introduce Pillar Two compliant incentives. These can include unlimited loss carry-forward, accelerated depreciation, and [global minimum tax] compliant refundable tax credits. Countries can look to optimize their tax incentive offering within the parameters of the new regime, recognizing that it incentivizes real investment; however, it would be prudent for countries to carry out cost-benefit analysis on such tax expenditures to ensure they have a clear policy rationale, are effectively designed to deliver intended policy objectives, and are reviewed periodically.
>
> Despite the growing global prevalence of tax incentives, empirical evidence finds they play a limited role in influencing investor decisions and often lead to fiscal losses, especially in low-income countries already struggling with revenue mobilization. The World Bank and other development partners, have long advocated that countries consider non-tax factors to strengthen their attractiveness for investment, including the general business environment, investment in infrastructure and people, and strong public administration.[83]

81. For a current overview of this evolving state of affairs by strategic state actors, see generally Mindy Herzfeld, *QDMTTs: Pillar 2's Minimum Tax Trendsetter*, 112 TAX NOTES INT'L 1353 (2023) (discussing different tax regimes in the post-QDMTT landscape).

82. *See* IMF, *International Corporate Tax Reform*, International Corporate Tax Reform 5, 27–28 (Feb. 6, 2023) ("[Countries] need to undertake comprehensive evaluations of their investment promotions and potentially redesign incentives to maximize their effectiveness . . . .").

83. World Bank Group [WBG], *The Global Minimum Tax: From Agreement to Implementation*, at 18–19 (2022). The World Bank then dedicates the entirety of Chapter 5 of its report to how tax incentives can be reformulated to continue tax competition and remain in compliance with the Pillar 2 rules. *See id.* at 33–35.

The Tax Foundation, which publishes an International Tax Competitiveness Index, has stated that "the rules of tax competition [by reason of the OECD Pillar 2 model rules] are changing, but that does not mean the contest is over," and further observed that the world is simply entering "a new phase of tax competition."[84] This observation is a far cry from what the OECD's aspirational statement would lead one to believe, but the true implication of the tax competition design defects in the OECD Pillar 2 model rules are irreconcilable with the desire to impose an actual global minimum tax. The OECD should have removed these tax competition elements from its Pillar 2 model rules, but instead of doing so, it has claimed a "minimum tax victory" while allowing jurisdictions to retain sovereign authority to engage in tax competition that hinders the actual imposition of any real global minimum tax.

The U.S. Joint Committee on Taxation has made a similar observation:

> In general, jurisdictions that comply with Pillar Two may offer tax credits at the same time to preserve their competitiveness (i.e., offset the top up taxes that an MNE located in their jurisdiction must pay). Thus, the effectiveness of Pillar Two might be weakened by the introduction of such forms of tax credits by low-tax jurisdictions. The country that introduces them thereby preserves its fiscal competition feature without visibly having a low tax rate. This might lead to a tax credit competition, particularly with respect to refundable tax credits . . . among countries who would like to compete over attracting [multinational enterprises]. Therefore, some jurisdictions that desire to attract real activity might adopt a combination of QDMTTs and investment attracting provisions. In general, even though Pillar Two may reduce base erosion profit shifting, Pillar Two may also increase tax competition over other factors.[85]

In recent U.S. Congressional hearings, it was posited that this state of affairs gave a competitive advantage to jurisdictions that have state-owned companies and controlled economies, as governments of those

84. Daniel Bunn, *What's Next for Tax Competition?*, TAX FOUND. (Nov. 8, 2022), https://taxfoundation.org/blog/tax-competition/ [https://perma.cc/V85Z-WMGF].

85. *See* JOINT COMM. ON TAX'N, JCX-35-2, BACKGROUND AND ANALYSIS OF THE TAXATION OF INCOME EARNED BY MULTINATIONAL ENTERPRISES 64 (2023).

jurisdictions can more easily arrange their contractual tax incentives to navigate the Pillar 2 loopholes.[86] In fact, existing U.S. case law addressing the meaning of an "indirect tax subsidy" reinforces this belief, as courts have found it difficult to ferret out a tax subsidy between a foreign government and its state-owned enterprise.[87] However, it would be wrong to believe that this refundable tax credit loophole provides tax competition opportunities only for countries with controlled economies.

It is now clear that many western developed nations, including the United States itself, are implementing tax incentives that capture the tax competition benefits of the Pillar 2 loopholes. This is an evolving and accelerating trend. In the Inflation Reduction Act of 2022,[88] Congress authorized green energy credits to be both direct pay credits for tax-exempt investors[89] and transferrable credits for taxable investors.[90] The Joint Committee on Taxation estimated that these transferrable and direct pay credits represented tax subsidies of $216 billion over a ten-year period,[91] but others have estimated that the true U.S. tax expenditure cost is in the range of $1 trillion to $1.2 trillion over a ten-year period.[92] The use of tax subsidies to incentivize green energy

86. In hearings before the House Ways and Means, it was posited that Chinese companies would be particularly advantaged. *See Tax Subcommittee Hearing: Biden's Global Tax Surrender Harms American Workers and Our Economy*, U.S. COMM. ON WAYS & MEANS (July 19, 2023), https://gop-waysandmeans.house.gov/event/39854592/ [https://perma.cc/2FUG-QCKB]. But, more broadly, any company this is state-owned is particularly susceptible to this type of manipulation to preserve a minimum tax even though no net payment is made to the foreign government. For recent commentary that echoes these concerns, see Mindy Herzfeld, *Pillar 2, State Aid, and Industrial Policy*, 112 TAX NOTES INT'L 329, 331 (2023).

87. Amoco Corp. v. Comm'r, 138 F.3d 1139 (7th Cir. 1998), *aff'g* 71 T.C.M. (CCH) 2613 (1996). For a further analysis of this case, see ISENBERGH & WELLS, *supra* note 50, ¶ 56.16.2.

88. Inflation Reduction Act, Pub. L. No. 117-169, § 13801, 136 Stat. 1818, 2003–2013 (2022).

89. I.R.C. § 6417. The direct pay credit allows tax-exempt entities to obtain direct federal funding if the tax-exempt entity otherwise meets the requirements for claiming a tax credit.

90. I.R.C. § 6418. Credits eligible for transferability are set forth in I.R.C. section 6418(f)(1) and include investment tax credit for alternative fuel property, the renewable electricity production tax credit, the carbon capture credit, the zero-emission nuclear power credit, the clean hydrogen production credit, the advanced manufacturing production credit, the clean electricity production credit, the clean fuel production credit, the energy credit, the advanced energy credit, and the clean electricity investment credit. *See* I.R.C. §§ 30C, 45(a), 45Q(a), 45U(a), 45V(a), 45X(a), 45Y(a), 45Z(a), 48, 48C, 48E (respectively).

91. *See* STAFF OF THE JOINT COMM. ON TAX'N, 118TH CONG., ESTIMATED REVENUE EFFECTS OF H.R. 3938 (2023); STAFF OF THE JOINT COMM. ON TAX'N, 118TH CONG., ESTIMATED REVENUE EFFECTS OF TITLE III OF H.R. 2811 (2023).

92. *The US Is Poised for an Energy Revolution*, GOLDMAN SACHS (Apr. 17, 2023), https://www.goldmansachs.com/intelligence/pages/the-us-is-poised-for-an-energy-revolution.html [https://perma.cc/9NBN-HF9R]; *see* John Bistline et al., *Economic Implications of the Climate Provisions in the Inflation Reduction Act*, 2023 BROOKINGS PAPERS ON ECON. ACTIVITY 1, 18; *Update: Budgetary Cost of Climate and Energy Provisions in the Inflation Reduction Act*, PENN WHARTON

projects may be a worthy goal,[93] but it is in conflict with the goal of ensuring that a global minimum tax is actually collected.

The European Union historically attempted to address climate change through the adoption of various carbon taxes or through regulatory mandates on carbon emissions.[94] Those policy tools that have been the historical choice utilized in Europe for reducing greenhouse gas emissions can be harmonized with the goal of also imposing a global minimum tax. However, in 2023, a marked shift in the European Union's approach to climate change legislation occurred, perhaps due to the United States's enactment of substantial green energy tax subsidies the prior year.[95] In this regard, the European Commission released its "Green Deal Industrial Plan for the Net-Zero Age"[96] in

(Apr. 27, 2023), https://budgetmodel.wharton.upenn.edu/estimates/2023/4/27/update-cost-climate-and-energy-inflation-reduction-act [https://perma.cc/W5Q3-VYCB].

93. Of course, "worthy" is in the eye of the beholder, and the OECD does not limit the types of tax credits eligible for qualified refundable tax credit status to only green energy credits.

94. *See* Kimberly A. Clausing & Catherine Wolfram, *Carbon Border Adjustments, Climate Clubs, and Subsidy Races When Climate Policies Vary*, 37 J. ECON. PERSPS. 137, 152 (2023); Press Release, Eur. Comm'n, European Green Deal: Agreement Reached on the Carbon Border Adjustment Mechanism (CBAM) (Dec. 13, 2022); Shantayanan Devarajan et al., *How Carbon Tariffs and Climate Clubs Can Slow Global Warming* 2 (Peterson Inst. for Int'l Econ., Working Paper No. 22-14, 2022); World Bank Group [WBG], *State of Trends of Carbon Pricing*, at 61 (2023); *see also* Nana Ama Sarfo, *Greening the ESG and Tax Debate*, 110 TAX NOTES INT'L 838, 838 (2023) (quoting Kristalina Georgieva with the IMF who stated at the 2022 U.N. Climate Change Conference that a carbon price of $75 per ton may be needed to blunt damaging carbon emissions); Theophilus Tawiah, *Tax Strategies to Fight Global Warming: What Is the Answer*, 110 TAX NOTES INT'L 1337, 1338–39 (2023); Frédéric Branger & Philippe Quirion, *Would Border Carbon Adjustments Prevent Carbon Leakage and Heavy Industry Competitiveness Losses? Insights from a Meta-Analysis of Recent Economic Studies*, 99 ECOLOGICAL ECON. 29, 30 (2014); Christoph Böhringer et al., *The Role of Border Carbon Adjustments in Unilateral Climate Policy: Overview of an Energy Modeling Forum Study (EMF 29)*, 34 ENERGY ECON. 97, 108 (2012); Christoph Böhringer et al., *The Strategic Value of Carbon Tariffs*, 8 AM. ECON. J. 28, 29 (2016); Christoph Böhringer et al., *Embodied Carbon Tariffs*, 120 SCANDINAVIAN J. ECON. 183, 207 (2018); Christoph Böhringer et al., *Potential Impacts and Challenges of Border Carbon Adjustments*, 12 NAT. CLIMATE CHANGE 22, 29 (2022); Joseph E. Aldy & William A. Pizer, *The Competitiveness Impacts of Climate Change Mitigation Policies*, 2 ASS'N ENV'T & RES. ECONOMISTS 565, 591 (2015); Meredith Fowlie et al., *Border Carbon Adjustments When Carbon Intensity Varies Across Producers: Evidence from California*, 111 AEA PAPERS & PROC. 401, 401 (2021); Michael Grugg et al., *Carbon Leakage, Consumption, and Trade*, 47 ANN. REV. ENV'T & RES. 753, 770 (2022).

95. *See* Keith Goldberg, *The IRA Has Europe Upping Its Clean Energy Game*, LAW 360 (Aug. 25, 2024), https://www.law360.com/articles/1714942/ [https://perma.cc/4RTK-CZWF] (quoting Elina Teplinksy of Pillsbury Winthrop Shaw Pittman LLP as follows: "[T]he IRA has completely changed the landscape. Now you're seeing other jurisdictions trying to pass new incentives.").

96. *See Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Region, A Green Deal Industrial Plan for the Net-Zero Age*, COM (2023) 62 final (Jan. 1, 2023) ("The Commission strongly encourages Member States to include in their modified RRPs simple and effective measures to provide immediate support to companies and boost their competitiveness [by] . . . tax breaks or other forms of support for green net-zero technologies investments

which it endorsed the use of incentive tax credits as part of Europe's green energy transition. Shortly thereafter, the European Commission announced a temporary exclusion from state aid restrictions for tax subsidies designed to transition European nations to a net-zero carbon emission goals.[97] In addition, several nations that have been the most ardent supporters of a Pillar 2 minimum top-up tax have nevertheless recently announced their own plans to utilize refundable tax credits as a means to incentivize their own transition to green energy infrastructure projects.[98]

Ironically enough, the OECD, even while it has been engaged in developing the Pillar 2 global minimum tax rules, has established its own Inclusive Forum on Carbon Mitigation Approaches to advance the global green energy transition.[99] Thus, the goals of the OECD BEPS initiatives, on the one hand, and the goals of utilizing tax subsidies to promote green energy projects, on the other hand, have been placed in opposition to each other. And, at present, the OECD model rules give a clear priority to tax competition over the goal of imposing a global minimum tax. The United States and European jurisdictions are moving forward with tax credits to subsidize the transition into green energy projects along the tax competition parameters sanctioned by the OECD Pillar 2 model rules. The efficacy of imposing a

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undertaken by businesses, taking the form of either a tax credit, an accelerated depreciation or a subsidy linked to the acquisition or improvement of green investment assets."). The OECD has established an Inclusive Forum on Carbon Mitigation Approaches, but as of now it has not set forth definitive recommendations. *See Inclusive Forum on Carbon Mitigation Approaches*, ORG. FOR ECON. COOP. & DEV., https://www.oecd.org/climate-change/inclusive-forum-on-carbon-mitigation-approaches/ [https://perma.cc/CAY4-ANM7].

97. Press Release, Eur. Comm'n, State Aid: Commission Adopts Temporary Crisis and Transition Framework to Further Support Transition Towards Net-Zero Economy (Mar. 9, 2023).

98. *See, e.g.*, William Horobin, *France Fights Back Against US with Aid for Green Transition*, BLOOMBERG TAX (May 16, 2023), https://news.bloombergtax.com/daily-tax-report-international/france-presents-bill-to-rival-us-support-for-green-industry [https://perma.cc/GLJ8-KJEE] (indicating that the French government presented a green industry bill including tax credits for electric vehicles); *see also* Brian Platt & Gabrielle Coppola, *Stellantis Plant Likely to Top $10 Billion*, BLOOMBERG TAX (May 31, 2023, 2:39 PM), https://news.bloombergtax.com/daily-tax-report/stellantis-subsidy-likely-to-exceed-what-trudeau-gave-volkswagen [https://perma.cc/RWW6-N8VE] (announcing Canadian tax subsidies for an electric-vehicle battery plan of $19 billion); David Kleimann et al., *How Europe Should Answer the US Inflation Reduction Act*, BRUEGEL (Feb. 23, 2023), https://www.bruegel.org/policy-brief/how-europe-should-answer-us-inflation-reduction-act [https://perma.cc/P9ZX-YSRF]; BRUNO LE MAIRE & ROBERT HABECK, FOR A EUROPEAN GREEN INDUSTRIAL POLICY (2022), https://www.bmwk.de/Redaktion/DE/Downloads/F/for-a-european-green-industrial-policy.pdf?__blob=publicationFile&v=4 [https://perma.cc/85A7-FBCM] (announcing proposal to now experiment with targeted subsidies and tax credits on a fast-track basis as a response to the U.S. green energy tax credits).

99. *See Inclusive Forum on Carbon Mitigation Approaches*, *supra* note 96. However, at present the OECD has not yet provided specific recommendations.

minimum tax under the model rules is being dismantled at the very same time that they are being adopted around the world.

However, this tax subsidy loophole supplanting the imposition of an actual minimum tax is not confined to green energy incentives. Even though many may support the goals of utilizing tax subsidies to transition economies to green energy sources, the reality is that the qualified refundable tax credit loophole, as currently constructed, is available for any and all qualified refundable tax or marketable transferrable tax credits, as all credits structured along these parameters are afforded the same treatment.[100] Thus, at the very moment that nations are implementing the Pillar 2 model rules, the United States and other European jurisdictions are highlighting the path for how the tax subsidy loopholes in those Pillar 2 model rules can be strategically utilized to undercut the efficacy of the global minimum tax. And, what is more, the OECD Pillar 2 model rules provide a clear roadmap for doing so.

As a final comment, it should be noted that the current dichotomy in how refundable and nonrefundable credits are handled under the OECD Pillar 2 model rules advantages wealthy countries, which can better afford to grant them, versus developing nations that cannot.[101] Developing nations find it more difficult to grant open-ended subsidies that span economic downturns.[102] So, the design features of the OECD's Pillar 2 model rules have another negative consequence: those rules provide a path for developed nations to engage in ongoing tax competition that will be costly for developing nations to

100. Lauren Vella & Danish Mehboob, *Tax Havens Race to Lure Companies as 15% Global Levy Looms*, BLOOMBERG TAX (Dec. 6, 2023, 1:45 AM), https://news.bloombergtax.com/daily-tax-report-international/tax-havens-race-to-lure-companies-as-15-global-levy-looms [https://perma.cc/4EWC-WUKR] (stating that several countries are considering tax relief as qualified refundable tax credits to garner a tax competition advantage).

101. *See, e.g.*, Stephanie Soong, *ASEAN Investment Ministers Call for Global Minimum Tax Review*, 111 TAX NOTES INT'L 1151, 1151 (2023) (quoting Indonesia's Minister of Investment as stating that the global minimum tax rules don't give equitable treatment to developing nations and that more room must be given to developing nations to attract investment).

102. Natalie Olivo, *Profit Shifting Worries Continue Under Global Min. Tax Deal*, LAW 360 (May 10, 2023, 1:47 PM), https://www.law360.com/tax-authority/articles/1606122/profit-shifting-worries-continue-under-global-min-tax-deal [https://perma.cc/4J65-HZP5] (quoting Christian Hallum, tax policy lead at Oxfam, for this stated concern). The institutional and societal issues that disadvantage developing nations in successfully imposing a minimum tax have been the subject of significant study. *See e.g.*, Timothy Besley & Torsten Persson, *Why Do Developing Countries Tax So Little?*, 28 J. ECON. PERSPS. 99, 99 (2014) (setting forth empirical analysis of the deficiencies and reviewing economic literature on this topic).

emulate.[103] With that said, the recent concession by the OECD to treat nonrefundable marketable transferrable tax credits in the same manner as refundable tax credits, whether or not such credits are actually transferred, expands the universe of potential subsidy regimes that can be put into place. This favorable status for nonrefundable marketable transferrable credits under the OECD model rules thus provides a roadmap for developing nations to conform their tax subsidies so as to fit within the marketable transferrable credit designation and avail themselves of the favorable refundable tax credit loophole.

Faced with these prospects, some still argue that even if most or all of the minimum tax is replaced dollar-for-dollar by governmental grants, the net effect of the GloBE rules "should be to increase social welfare."[104] That conclusion, at least to this author, is problematic as it seeks to justify the OECD Pillar 2 project on grounds that are different from its stated aspirational goal of setting forth rules that ensure imposition of a global minimum tax. If the OECD has in fact shifted away from its goal of imposing an actual global minimum tax in order to provide a pathway for ongoing tax competition for "worthy incentives," then more debate over this shifted policy goal should occur in an open and transparent manner. In the meantime, the United States and other like-minded nations need to recognize that the OECD Pillar 2 model rules set forth a series of loopholes that frustrate attainment of the OECD's aspirational goals and provide strategic state actors with tax competition advantages.

So, what should be the United States's response given the reality that a so-called adequately compliant QDMTT regime can avoid collecting any actual minimum tax and yet shut off all other top-up taxes around the world? It is here that the United States should remember its longstanding historic rejection of tax-sparing credits.[105] A QDMTT regime that nominally imposes a local tax and then returns the

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103. By way of comparison, it is estimated that the governmental cost to the United States to convert its own nonrefundable tax credits into refundable tax credits would cost approximately $193 billion over a ten-year period. *See* Merrill et al., *supra* note 75, at 1627, 1641, 1644 (providing a compelling argument that "questions whether governments should be forced to make income tax credits refundable or, alternatively, convert them into direct grants, to preserve their efficacy").

104. *See* Michael C. Durst, *BEPS, Pillar 2, and the Replacement of Tax-Based Incentives with Nontax Incentives*, 110 TAX NOTES INT'L 349, 449 (2023).

105. For a discussion of the U.S. hostility towards tax-sparing provisions and the impact this resistance has had on the enactment of U.S. treaties with developing nations, see Howard M. Leibman, *A Formula for Tax-Sparing Credits in U.S. Tax Treaties with Developing Countries*, 72 AM. J. INT'L L. 296, 296 (1978); Charles I. Kingson, *The Coherence of International Taxation*, 81 COLUM. L. REV. 1151, 1263 (1981).

collected funds right back to a multinational enterprise has all the same hallmarks of a traditional tax-sparing regime where tax relief is provided for hypothetically paid taxes. Given the United States's longstanding refusal to grant tax-sparing credits to any other nation's tax subsidy regimes, the United States should in like manner refuse to give any tax deference to a so-called adequately compliant QDMTT regime that utilizes refundable or marketable transferrable tax credits or utilizes a substance-based income exclusion.

Said differently, if the United States adopts a compliant IIR regime as formulated by the OECD Pillar 2 model rules, then the United States must disclaim its right to tax its resident companies whenever the other host jurisdiction adopts an adequately compliant QDMTT regime, whether or not taxes are actually imposed under the QDMTT compliant regime. This abdication of any further U.S. taxation of U.S. multinational enterprises is required even if the amount of actual tax assessed and collected by the QDMTT compliant regime is less than a 15 percent tax rate, as calculated under U.S. tax principles, because a QDMTT regime can be based on international financial reporting principles and can utilize substance-based income exclusion carve-outs and refundable or marketable tax credits.[106] These features of the OECD Pillar 2 model rules are inconsistent with the longstanding position of the United States that it reserves the right to tax its U.S. resident companies on a residual basis under the savings clause of all existing U.S. tax treaties.[107] Admittedly, the United States would give appropriate foreign tax credit relief to its U.S. resident companies if actual taxes were paid to the host jurisdiction,[108] but again, the United States has always reserved the right to assert residual taxation over its U.S. resident companies when actual taxes are not paid to the other jurisdiction.

In contrast, the OECD Pillar 2 model rules, as interpreted by the administrative guidance, envision that a compliant IIR regime must appropriately interlock and afford deferential priority to the QDMTT regime under the OECD Pillar 2 model rules. That envisioned interaction may work well for a jurisdiction that favors a territorial tax policy approach, but the OECD Pillar 2 model rules do not promote the

106. *See supra* text accompanying notes 22–26.

107. *See* U.S. MODEL INCOME TAX CONVENTION art. 1(4) (U.S. DEP'T OF THE TREASURY, 2016).

108. *See* U.S. MODEL INCOME TAX CONVENTION arts. 1(5), 23 (U.S. DEP'T OF THE TREASURY, 2016).

residency-based fiscal policy interest of a jurisdiction like the United States, which historically has preserved residual taxation over low-taxed income of its U.S. multinational enterprises. Given that the OECD Pillar 2 model rules require compliant IIR regimes to disclaim residency-based taxation whenever an adequately compliant QDMTT regime is put into place by another jurisdiction that may or may not collect any actual minimum tax, the best currently available option for the United States is for it to continue to rely on a CFC tax regime (e.g., its GILTI and subpart F regimes) in lieu of adopting a compliant IIR regime, which is the topic of the next section.

C. Retention of the U.S. GILTI Regime Better Ensures Adequate Taxation of Low-Taxed Income that Otherwise Would Go Untaxed Under Adequately Compliant QDMTT Regimes

In 2017, Congress enacted the U.S. GILTI regime as a means to ensure that low-taxed foreign income is subjected to an actual minimum tax.[109] The legislative evolution that resulted in the enactment of the U.S. GILTI regime has been well documented,[110] so it is not repeated here except to highlight three important features of the regime. First, the U.S. GILTI regime departs from an IIR regime by not providing for timing differences, whereas the OECD Pillar 2 model rules set forth extremely nuanced and complex cut-offs for the treatment of deferred tax assets and deferred tax liabilities.[111] Thus, on this metric, the U.S. GILTI regime is harsher than a top-up tax regime envisioned under the Pillar 2 model rules.

Second, as a countervailing feature, the U.S. GILTI regime is computed on an aggregate CFC basis, so on that metric it is less rigorous than the country-by-country approach utilized by a compliant IIR regime, as the U.S. GILTI regime affords the potential for blending of high-tax and low-tax income among jurisdictions. But even so, the U.S. GILTI regime could be reformed to determine low-taxed income on a jurisdiction-by-jurisdiction basis.[112] However, one advantage of

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109. *See* Internal Revenue Code Amendments of 2017, Pub. L. No. 115-7, § 14201, 131 Stat. 2054, 2208 (2017).

110. *See* Dana L. Trier, *International Tax Reform in a Second Best World: The GILTI Rules*, TAXES: TAX MAG., Mar. 2019, at 39; Christopher H. Hanna, *The Rise of the Minimum Tax*, 100 TAX 55 (2022). For a further discussion of the detailed analysis of I.R.C. section 951A, see ISENBERGH & WELLS, *supra* note 50, ¶ 76.

111. *Global Anti-Base Erosion Model Rules*, *supra* note 15, at 25.

112. There have been proposals to reform the regime so that it is applied on a country-by-country basis and could be implemented if desired. *See* U.S. DEP'T OF THE TREASURY, GENERAL

a combined CFC approach is that it is less susceptible to country-by-country tax planning that seeks to arbitrage separate unconsolidated financial statements, whereas a combined CFC approach has both sides of the affiliated transaction in the combined statements and is thus less susceptible to arbitrages in the separate country financial reporting.[113] The OECD has recognized this design weakness in its reliance on country-by-country unconsolidated financial reports and has stated that "[it's] been told that there's a whole lot of tax planning around . . . how to leverage safe harbors to get benefits way beyond what was anticipated."[114] As a result, the OECD has announced the formation of a working group to develop anti-abuse rules to mitigate against the arbitrage of the reporting of transactions in the stand-alone financial statements of different countries.[115] At least to this author, this admission of the weakness of reliance on separate unconsolidated country-specific financial statements creates administrability concerns that are less apparent when a combined set of global consolidated financial statements are utilized where all sides of the transactions are reported under a common reporting standard, which is what the U.S. GILTI regime does.

Third, the U.S. GILTI regime applies regardless of whether or not there is a compliant QDMTT regime in place, so on this metric, it is more rigorous in its application in comparison to a compliant IIR regime, as a compliant IIR regime requires the ultimate residency jurisdiction to accept the tax subsidy loopholes that the QDMTT regime puts into place, whereas the U.S. GILTI regime (as a CFC tax regime) does not.

In 2013, an academic paper analyzed a global minimum tax on foreign income and determined that a country-by-country approach was the most precise means of imposing a global minimum tax, but that paper then stated that a minimum tax applied on an aggregate CFC basis deserved serious consideration given its administrability and

EXPLANATION OF THE ADMINISTRATION'S FISCAL YEAR 2024 REVENUE PROPOSALS 25–26 (2023).

113. It has been reported that Apple transferred intangible assets to Ireland and obtained a basis step-up and ongoing amortization deductions on that stepped-up basis that will substantially reduce its country income in Ireland, even though that transfer was tax-free. *See* Martin Sullivan, *supra* note 76, at 492.

114. *See* Stephanie Soong, *Pillar 2 Anti-Arbitrage Guidance in the Works, OECD Advisor Says*, 111 TAX NOTES INT'L 749, 749 (2023).

115. *See id.*

simplification features.[116] The ultimate enactment of I.R.C. section 951A in the United States can be seen as influenced by that policy paper.[117] In this regard, in order to determine the existence of "excessive amounts" of low-taxed profits, I.R.C. section 951A determines net CFC-tested income on a combined basis from all related controlled foreign corporations and then determines the extent to which that net CFC-tested income exceeds a "net deemed tangible income return" threshold.[118] This design feature of exempting the normal return of CFCs from U.S. tax achieves a measure of capital import neutrality, allowing U.S. companies to be competitive with their foreign competitors with respect to profits that relate to the investment decision, but then seeking to impose a minimum tax on the supernormal profits that arguably are less sensitive to tax rates.[119] If the aggregate earnings in the controlled foreign corporation context exceed a routine profit margin (or, in terms of the statute, exceed a normal net deemed tangible income return), then this excess profitability is within scope, but then a foreign tax credit is allowed for 80 percent of the creditable foreign taxes that are incurred with respect to that inclusion.[120] After 2025, this U.S. GILTI regime effectively applies a top-up tax if global low-taxed income is subjected to U.S. taxation and an actual foreign tax of less 20.5 percent.[121] The United States would provide a foreign tax

116. *See* Harry Grubert & Rosanne Altshuler, *Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax*, 66 NAT'L TAX. J. 671, 701 (2013).

117. *See* Julie Roin & Skubis Weber, *"Subpar" F? The Role of Anti-Deferral in a Post-GILTI (and Maybe Pillar Two) World*, TAXES: TAX MAG., Mar. 2023, at 26.

118. This deemed tangible income return has features that in a sense are similar to the substance-based carve-out income exclusion envisioned by the Pillar 2 model rules, but it is in fact narrower and utilizes a single tangible asset investment metric that is less susceptible to tax planning strategies. *See* OECD, *supra* note 36, at 107.

119. *See, e.g.*, Grubert & Altshuler, *supra* note 116, at 673, 675 ("[C]ompanies that make basic real investments that do not earn much more than a normal return probably have more intense foreign competition. Imposing a U.S. tax on such companies could put them at a competitive disadvantage even if they were more efficient than their rivals. A minimum tax with expensing therefore has the virtue of moving the system towards [capital export neutrality] for foreign investments with large excess returns and little competition, and towards [capital import neutrality] for more basic real investments that compete with close rivals in foreign locations for normal returns."). This argument was considered persuasive by those who crafted I.R.C. section 951A. *See* Christopher Hanna, Supernormal Returns and the Modern Cary Brown Theorem 34 (Apr. 14, 2023) (unpublished manuscript) (on file with author).

120. I.R.C. § 960(c)–(d).

121. In 2025, the I.R.C. section 250 deduction is reduced from 50 percent to 37.5 percent with the consequence that the implied GILTI rate becomes approximately 13.125 percent at that time. The calculation is 100 of GILTI less 37.5 of an I.R.C. section 250 deduction provides a resultant of 62.5 that is then subjected to a 21 percent U.S. tax rate for a U.S. tax of $13.125 before credits. Because only 80 percent of the tax credits are allowed under I.R.C. section 960(d), the effective tax

credit for payments under a QDMTT regime but as a general rule would not do so for top-up taxes paid under an IIR or UTPR regime.[122]

The determination of creditable foreign taxes allowed to offset a U.S. GILTI income inclusion is determined under I.R.C. section 901, and I.R.C. section 901(b) establishes the general rule that a credit is provided for the amount of foreign income taxes paid with respect to the income. Thus, the statute requires a determination of taxes "paid" in order to be entitled to a credit. A foreign tax that is refunded to the taxpayer—however impeccably the tax base might initially have reflected U.S. notions of net income—has clearly not been "paid" (one of the predicates of the foreign tax credit in I.R.C. section 901(b) and therefore cannot sustain the credit. A government subsidy paid directly to a taxpayer in the precise amount of taxes received from that taxpayer, being no more than a refund under an assumed name, can similarly be regarded as canceling the tax. The bare terms of I.R.C. section 901(b) have always been more than sufficient to deal with this pattern and could have treated all government grants as a per se refund of any formalistically paid tax, but the U.S. Treasury Department guidance has continued to evolve, and the U.S. financial statement reporting standards are even less precise.[123]

To begin with, it is true to say that prior administrative guidance of the U.S. Treasury Department had staked out a position consistent with the current OECD approach to refundable tax credits. Under that guidance, refundable tax credits were not treated as a refund of the foreign income taxes paid but instead were treated as a constructive receipt of additional income[124] (thus increasing the denominator by $18x, as indicated in the above example) followed by a constructive payment by the taxpayer of foreign income tax expense (thus allowing the "taxes paid" in the numerator to be unchanged as a result of the taxpayer's receipt of the government grant, as indicated in the above

rate on the foreign income needed to offset the $13.125 tax liability is 16.40625 percent (i.e., $16.40625 x .8 = $13.125).

122. *See* Notice 2023-80, 2023-52 I.R.B. 1583.

123. For financial statement presentation purposes, International Accounting Standard (IAS) 20 indicates that governmental grants related to income may be presented either as part of profit or loss as "other income' or alternatively may be reported as a deduction in reporting of the related expense. Both of those methods are considered acceptable. INT'L FIN. REPORTING STANDARDS FOUND., IAS 20: ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE A1216 (2021), https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/ias-20-accounting-for-government-grants-and-disclosure-of-government-assistance.pdf [https://perma.cc/HR4Q-8KYB].

124. Akin to the receipt of a governmental grant.

example).[125] The foreign income tax was not viewed as refunded because the governmental assistance received by the taxpayer was not directly or indirectly determined in accordance with the income tax base. In contrast, when the amount of the taxpayer's credit against its foreign income tax liability was limited and economically usable only to the extent of the income tax liability of the taxpayer, the Internal Revenue Service (IRS) treated the credit as a refund of the actual taxes paid by the taxpayer as its usage was determined by reference to the tax base.[126]

In 2022, the Treasury Department departed from its prior administrative practice and from the approach taken by the OECD to forge a new answer to this old question.[127] In Treasury Regulation section 1.901-2(e)(2)(ii) and (iii), the U.S. Treasury Department set forth a new standard for when a foreign tax payment is treated as a reduction of foreign income taxes paid for U.S. foreign tax credit purposes as indicated in the following provision:

> (ii) *Credits*. Except as provided in paragraph (e)(2)(iii) of this section, an amount of foreign income tax liability is not an amount of foreign income tax paid to the extent the foreign income tax liability is reduced, satisfied, or otherwise offset by a tax credit, including a tax credit that under the foreign tax law is payable in cash only to the extent it exceeds the

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125. *See* Rev. Rul. 57-106, 1975-1 C.B. 242; I.R.S. Tech. Advice Memoranda 2001146001 (Apr. 2, 2001) (providing that refundable French research credits were not a reduction of foreign tax expense); I.R.S. Field Serv. Advice Memoranda 519, at 39 (Dec. 8, 1997) (same); I.R.S. Field Serv. Advice Memoranda 520, at 3 (Aug. 19. 1992) (providing that refundable Canadian investment tax credit was not a reduction of foreign income taxes); I.R.S. Field Serv. Advice Memoranda 3697, at 2 (Dec. 22, 1994) (providing that the grant and usage of New Zealand investment tax credits were not a reduction in New Zealand income taxes paid because the tax credits were not determined, directly or indirectly, through reference to the income tax assessment nor the taxable base under the tax laws of New Zealand, so the credits were not treated as tax subsidies which reduce the amount of foreign taxes paid).

126. *See* Rev. Rul., 86-134, 1986-2 C.B. 104; Rev. Rul. 78-258, 1978-1 C.B. 239. In the context of the above example, treating the tax credit of $20x as a refundable tax credit caused the taxpayer to be viewed as having made no net tax payment and as having received no net governmental assistance. The taxpayer simply had $100x of income and no foreign income tax payment. *See supra* note 66 and accompanying text.

127. In the preamble to its final regulations, the Treasury Department articulated that the prior treatment of refundable credits had been inconsistent. *See* T.D. 9959, 2022-3 I.R.B. 312. In addition, the earlier proposed regulations offered another rationale, stating that the Treasury Department believed that a stricter standard was needed to prevent foreign government gamesmanship that was designed to maximize the amount of credits available to U.S. taxpayers. *See* Notice of Proposed Rulemaking, Reg. 101657-20, 85 Fed. Reg. 72,078, 72,093 (Nov. 12, 2020).

> taxpayer's liability for foreign income tax or a tax credit acquired from another taxpayer.
>
> (iii) *Exception for overpayments and other fully refundable credits.* An amount of foreign income tax paid is not reduced (or treated as constructively refunded) solely by reason of the fact that a credit is allowed (or may be allowed) for the amount paid to reduce the amount of a different separate levy owed by the taxpayer. . . . [I]f under the foreign tax law, the full amount of a tax credit is payable in cash at the taxpayer's option, the taxpayer's choice to apply all or a portion of the tax credit in satisfaction of a foreign income tax liability of the taxpayer is treated as a constructive payment of cash to the taxpayer in the amount so applied, followed by a constructive payment of the foreign income tax liability against which the credit is applied.[128]

This regulatory rule bifurcates the outcomes for refundable credits. If the refundable tax credit must first be applied to reduce the income tax payment of the taxpayer, then the Treasury regulations treat this "forced usage" of the refundable tax credit as a reduction of the income taxes paid by the taxpayer and only the excess payment above the tax liability is treated as additional gross income.[129] In contrast, Treasury Regulation section 1.901-2(e)(2)(iii) provides that if the taxpayer has the option to receive the governmental benefit as a cash payment in full but simply chooses to apply its right to a full cash payment as an offset to its own tax payment, then the taxpayer is not considered to have paid a reduced amount of foreign income tax.[130]

From a normative perspective, the U.S. foreign tax credit regulations should have treated all governmental grants as a per se refund of income taxes "paid," regardless of the formalistic manner in which the governmental subsidy is returned back to the taxpayer. Such a clear

128. Treas. Reg. § 1.901-2(e)(2)(ii)–(iii).

129. *See* Treas. Reg. § 1.901-2(e)(2)(ii); *see also* Treas. Reg. § 1.901-2(e)(2)(iv)(B) (refundable credits were refundable in cash only to the extent they exceeded the tax liability in the foreign country were held to be a reduction in income taxes paid to the extent the credit reduced income tax liability); Treas. Reg. § 1.901-2(e)(4)(ii) (conforming analysis under multiple levy rule).

130. *See* Treas. Reg. § 1.901-2(e)(2)(iii) ("[I]f under the foreign tax law, the full amount of a tax credit is payable in cash at the taxpayer's option, the taxpayer's choice to apply all or a portion of the tax credit in satisfaction of a foreign income tax liability of the taxpayer is treated as a constructive payment of cash to the taxpayer in the amount so applied, followed by a constructive payment of the foreign income tax liability against which the credit is applied.").

and distinct line would have removed the opportunity for tax competition via government subsidies in whatever form those subsidies are crafted, but it appears that the US Treasury Department was not immune to political lobbying on this point either.[131] However, even though the Treasury regulations depart from the normatively correct approach and thus create their own line-drawing problems, those regulations nevertheless are stricter and more narrowly tailored versus the more open-ended approach of the OECD Pillar 2 model rules.

Moreover, the Treasury regulations also make clear that transferrable credits are not entitled to foreign tax credit relief, as they provide an indirect subsidy to another party in prohibition of I.R.C. section 901(i).[132] Again, this outcome for transferrable credits is significantly more restrictive than the OECD approach, as the OECD administrative guidance treats all transferrable credits the same as qualified refundable tax credits. In addition, the OECD administrative guidance affords nonrefundable low-income housing credits the same treatment as qualified refundable tax credits,[133] whereas the U.S. Treasury regulations would not afford this outcome. Thus, when evaluated in their totality, the U.S. foreign tax credit regulations provide for a narrower definition of taxes "paid" versus the current OECD approach.

131. In the preamble to proposed regulations, after acknowledging its prior administrative guidance, the Treasury Department expressed concern that if the use of tax credits can be treated as a means of payment of a foreign income tax for foreign tax credit purposes, then foreign countries, rather than reducing their tax rates, could instead offer tax credits that would have the same economic effect without reducing the amount of foreign income tax that is treated as paid by taxpayers for purposes of the foreign tax credit. *See* Notice of Proposed Rulemaking, Reg. 101657-20, 85 Fed. Reg. 72,078, 72,093 (Nov. 12, 2020). At that time, the Treasury Department proposed to treat all refundable credits as a reduction of income tax expense. *See* Prop. Treas. Reg. § 1.901-2(e)(2)(ii), 85 Fed. Reg. 72,078, 72,134 (Nov. 12, 2020). However, this proposed absolute approach to refundable credits elicited significant negative comments. *See, e.g.*, N.Y. STATE BAR ASS'N, REP. NO. 1448, REPORT ON PROPOSED REGULATIONS PROVIDING GUIDANCE RELATED TO THE FOREIGN TAX CREDIT 33–34 (2021) (discussing options and also recommending an approach that appears to have been adopted in the final regulations). The final regulations referenced these comments as the basis for the exception in Treas. Reg. § 1.901-2(e)(2)(iii) that does not treat a fully refundable credit as a reduction of foreign income taxes paid when the refundable credits are fully refundable in cash at the taxpayer's option. *See* T.D. 9959, 2022-3 I.R.B. 328.

132. *See* Treas. Reg. § 1.901-2(e)(2)(ii). The preamble to its final regulations explains this restriction by stating that an amount must be both owed and remitted to the foreign country and not used to provide a benefit to any other party per I.R.C. § 901(i) in order to be eligible for foreign tax credit relief. *See* T.D. 9959, 2022-3 I.R.B. 301.

133. The OECD did provide a concession for energy credits earned through a tax equity partnership investment structure such that the tax credits that flow up to the company can be added to the numerator of the effective tax rate calculation to the extent necessary to offset the reduction to financial accounting tax expenses. *See* OECD, *supra* note 36, at 61. However, the OECD administrative guidance has not addressed how transferrable credits under I.R.C. § 6418 should be handled under the OECD framework.

In summary, the U.S. Treasury regulations treat all nonrefundable tax credits, all transferrable credits, and certain refundable tax credits (if required to be applied against an income tax liability first) as a refund of taxes "paid" and thus ineligible for tax credit relief. In contrast, the OECD Pillar 2 model rules, as interpreted by the OECD administrative guidance, generally *do not* treat refundable tax credits, marketable transferrable credits, and certain nonrefundable credits as a refund of the income taxes paid, even though the funds are paid back to the taxpayer. In the below table, a comparison is provided in terms of the tax incentives that are allowed to be used in tax competition (designated with a "✓ No Tax Refund") compared with where a tax incentive is treated as a refund of the income tax expense (designated as "✘ Tax Refund").

Type of Tax Incentive	**U.S. FTC Regulations**	**OECD Pillar 2 Model Rules**
Refundable Credits (Paid in Cash in Full at Taxpayer Option)	✓ No Tax Refund	✓ No Tax Refund
Refundable Credits (Applied to Income Tax Liability First)	✘ Tax Refund	✓ No Tax Refund
Transferrable Credits	✘ Tax Refund	✓ No Tax Refund
Qualified Flow-Through Tax Benefits	✘ Tax Refund	✓ No Tax Refund
Nonrefundable Research Tax Credits	✘ Tax Refund	✘ Tax Refund (but negotiation ongoing)
All other Nonrefundable Tax Credits	✘ Tax Refund	✘ Tax Refund

Even though the above table indicates that the U.S. foreign tax credit regulations are more narrowly tailored in comparison to the OECD Pillar 2 model rules, the Treasury Department nevertheless should revise its existing regulations to adopt its original regulatory proposal to disallow all refundable tax credits as a per se refund of the country income taxes paid in all events. That regulatory reform would expunge the potential for tax competition through refundable credits under the U.S. GILTI regime entirely. But even prior to such a regulatory change, the Treasury regulations provide a more narrowly tailored scope for the tax refund loophole that better protects the United

States's fiscal interest than the approach taken by the OECD Pillar 2 model rules, which allow for a much larger loophole for tax avoidance.

II. CORPORATE ALTERNATIVE MINIMUM TAX SHOULD BE DESIGNATED AS A QDMTT

The U.S. CAMT is based on book income, which means that it includes the income of the U.S. parent and its CFCs.[134] Once that income is included, a tentative tax at 15 percent is applied,[135] but it is offset by a credit for regular corporate tax,[136] credits for foreign taxes,[137] and various domestic credits.[138] The resulting tax is then compared with the regular corporate tax, and the higher tax is payable. As to the portion of the U.S. CAMT attributable to foreign income, it seems reasonable to believe that it should be allocated in the same manner as covered taxes are allocated under the Pillar 2 model rules,[139] but this conclusion is not free from doubt.[140] As to the portion of the U.S. CAMT liability attributable to U.S. country income, the Treasury Department should argue that the allocable portion of the U.S. CAMT liability attributable to U.S. country income should be treated as an adequately compliant QDMTT regime.

The OECD model rules define a QDMTT as a minimum tax that: (1) determines the excess profits[141] of the constituent entities located in its jurisdiction in a manner that is equivalent to the GloBE rules; (2) operates to increase domestic tax liability for domestic excess profits to the minimum rate for the jurisdiction and constituent entities for a fiscal year; and (3) is implemented and administered in a way that is consistent with the outcomes provided for under the GloBE rules.[142]

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134. I.R.C. §§ 56A(a)(2)(A), 59A(c)(3)(A).

135. *Id.* § 55(b)(2)(A)(i).

136. *Id.* § 55(a)(2).

137. *Id.* § 55(b)(2)(A)(ii).

138. *Id.* § 38(c)(1).

139. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 22–27; Org. for Econ. & Dev. [OECD], *Tax Challenges Arising from the Digitalisation of the Economy—Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, at 88 (Mar. 2022). For a more detailed discussion of this proposal, see Reuven S. Avi-Yonah & Bret Wells, *Pillar 2 and the Corporate AMT*, 107 TAX NOTES INT'L 693 (2022).

140. This is the assumed position of the Joint Committee on Taxation in its analysis, but it recognized that this outcome is not free from doubt. *See* STAFF OF THE JOINT COMM. ON TAX'N, *supra* note 79, at 6.

141. Excess profits are defined as GloBE income minus the substance-based carve-out income exclusion. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 30.

142. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 64; OECD, *supra* note 139, at 212. The QDMTT is given priority over the IIR in model rule 5.2.3. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 29

A QDMTT may compute excess profits based on an acceptable financial accounting standard permitted by the authorized accounting body or an authorized financial accounting standard rather than the financial accounting standard used in the consolidated financial statements.[143] Because the U.S. CAMT will be based on applicable financial statements, it will be possible to determine the portion of the U.S. CAMT related to the U.S. segment reporting unit. The OECD model rules envision more adjustments and more carve-outs from a minimum tax than is envisioned by the U.S. CAMT.[144] The GloBE rules also contain significant adjustments on deferred tax assets and deferred tax liabilities.[145] Even so, the OECD model rules envision that a minimum tax on the income located in the United States that is "equivalent" to the GloBE rules should be treated as a QDMTT. Given that the segment reporting on the financial statements will make it clear what portion of the CAMT relates to U.S. operations, the variances between the U.S. CAMT and the GloBE rules should be viewed as minor, and the CAMT should be viewed as substantially equivalent to the GloBE rules, at least in their practical operation vis-à-vis the U.S. jurisdiction.

This author views this action item as an intermediate step. Even though the U.S. CAMT should reasonably be considered as "equivalent" to the GloBE rules and thus adjudged as an adequately compliant QDMTT regime, the reality is that both the design parameters for an adequately compliant QDMTT regime and the U.S. CAMT regime allow for significant tax credits that can reduce if not eliminate imposition of an actual minimum tax. If and when the United States, the OECD, and other nations agree to remove the design deficiencies in the OECD Pillar 2 model rules in the manner set forth in this Article, then they should remove the tax competition elements in their respective laws within an agreed-upon timeframe so that the playing field is level for all nations throughout the transition period.

III. BEAT REFORMS

When "excessive" amounts of related party transactions are able to be piled on top of each other, the potential for significant earning-stripping of U.S.-origin profits to another jurisdiction becomes a real concern. For the reasons discussed in Part I, design deficiencies of the

143. *See Global Anti-Base Erosion Model Rules*, *supra* note 15, at 64.
144. *See id.* at 30–31.
145. *See id.* at 25.

OECD's Pillar 2 model rules create the real possibility that profits shifted to another jurisdiction may not bear an actual minimum tax given the tax competition elements that can be infused into the QDMTT regime of the other jurisdiction. Thus, the United States retains a fiscal interest in ensuring that shifted profits from the U.S. economy are adequately taxed and not excessively shifted out of the U.S. tax base, as that outcome creates a revenue loss for the United States and creates competitiveness concerns for domestic multinational enterprises in the U.S. economy. I.R.C. section 59A is the most comprehensive expression of the U.S. response to these concerns, and the legislative history accompanying the enactment of I.R.C. section 59A explains its rationale as follows:

> Foreign-owned U.S. subsidiaries are able to reduce their U.S. tax liability by making deductible payments to a foreign parent or foreign affiliates. This can erode the U.S tax base if the payments are subject to little or no U.S. withholding tax. Foreign corporations often take advantage of deductions from taxable liability in their U.S. affiliates with payments of interest, royalties, management fees, or reinsurance payments. This provision aims to tax payments of this kind. This type of base erosion has corroded taxpayer confidence in the U.S. tax system.
>
> Moreover, the current U.S. international tax system makes foreign ownership of almost any asset or business more attractive than U.S. ownership. This unfairly favors foreign-headquartered companies over U.S. headquartered companies, creating a tax-driven incentive for foreign takeovers of U.S. firms. Furthermore, it has created significant financial pressures for U.S headquartered companies to redomicile abroad and shift income to low-tax jurisdictions. Since 2000, the number of U.S.-headquartered multinationals among the 500 largest public companies has decreased by over 25 percent.
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> The Committee is also concerned about U.S. and foreign corporations outsourcing their U.S. business operations to foreign jurisdictions at the expense of the American worker. In certain circumstances, this may have the additional effect of reducing the U.S. income tax liability on such companies' profitable operations in the United States.

> This provision aims to level the playing field between U.S. and foreign-owned multinational corporations in an administrable way. To the extent that corporations with significant gross receipts are able to utilize *deductible* related party payments to foreign affiliates to reduce their U.S. corporate tax liability below l0-percent, the Committee intends that the base erosion and anti-abuse tax function as a minimum tax to preclude such companies from significantly reducing their corporate tax liability by virtue of these payments.[146]

What amount of U.S. profits should one be able to shift out of the U.S. tax base through related-party earnings-stripping transactions before those base erosion benefits are curtailed? The U.S. Congress answered this question by providing that very large companies can claim base erosion benefits through related-party earnings-stripping transactions for approximately one-half of its pre-base erosion profits. I.R.C. section 59A achieves this outcome by imposing a base erosion anti-abuse tax (BEAT) equal to the excess of a minimum tax rate of 10 percent (which is 10/21st of the regular 21 percent rate specified in I.R.C. section 11)[147] but applies this concessionary rate of tax on *modified taxable income*. The U.S. payor corporation is then required to remit an additional tax if the base erosion minimum tax liability exceeds the corporation's regular tax liability.[148] I.R.C. section 59A(b) computes the minimum tax amount required under I.R.C. section 59A(a) without the benefit of U.S. foreign tax credit relief because U.S. foreign tax credits are allowed under I.R.C. sections 27 and 901 and thus are not included in the list of credits allowed under I.R.C. section 59A(b)(4).[149]

However, the BEAT applies only to the very largest multinational enterprises—namely those that have average annual gross receipts of $500 million or more over a three-year period.[150] The U.S. Treasury Department has estimated that only 3,500 to 4,500 taxpayers are

146. S. REP. NO. 115-20, at 396 (2017).

147. In 2025, the minimum tax rate will be increased from 10 percent to 12.5 percent. Further, prior to 2025, the taxpayer's regular tax liability (the starting point for the provision's calculation) is determined before allowance of certain credits. *See* I.R.C. § 59A(b)(1)(b). After 2025, regular tax liability is computed after allowance of all credits. *See id.* § 59A(b)(2).

148. *Id.* § 59A(a); Treas. Reg. § 1.59A-5(b)(1).

149. A cogent argument can be made that the foreign tax credit should be allowed to reduce the extent such credits are allowed under the I.R.C. section 904 limitation regime. For further discussion of that issue, see Bret Wells, *Get with the BEAT*, 158 TAX NOTES 1023, 1031–32 (2018).

150. I.R.C. § 59A(e)(1)(B).

potentially subject to I.R.C. section 59A,[151] and as a result, I.R.C. section 59A was estimated to collect only $149.6 billion over a ten-year period due to this scope limitation.[152] Yet, base erosion and profit shifting create competitiveness concerns beyond simply the revenue effects, and thus this provision should not have its applicability limited to only the largest multinational enterprises. Instead, Congress should expand the reach of I.R.C. section 59A so that it applies to mid-size corporations in order to raise much needed revenue and also to better ensure a level playing field. However, expanding its scope of coverage is not the only reform measure, as I.R.C. section 59A contains several design deficiencies of its own that inhibit its effectiveness, discussed further below.

The category of payments that are added back to arrive at "modified taxable income" are payments that constitute a "base erosion payment" that results in a "base erosion tax benefit" to the U.S. payor corporation.[153] Thus, the key concept for unpacking the BEAT is "base erosion payment." A base erosion payment means any amount paid or accrued by a taxpayer to a foreign person that is a *related* party (defined as a 25 percent or more common ownership)[154] and with respect to which a deduction is *allowable*.[155] Thus, a related party payment of interest, rents, royalties, services, or other amounts that provide an immediate deduction is a base erosion payment. Furthermore, the amount of a base erosion payment is determined on a gross basis even if contractual arrangements provide that payments are to be netted.[156] From the above general definition, several important exceptions are made to

151. T.D. 9910, 2019-1 I.R.B. 235.

152. *See* JOINT COMM. ON TAX'N, JCX-67-17, ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT" (2017). At least for its first year of implementation, it appears that the actual revenue receipts for I.R.C. section 59A are above the initial revenue estimate. *See* Andrew P. Duxbury et al., *Have the TCJA International Provisions Met Revenue Estimates?*, TAX NOTES FED. 741, 761 (2023).

153. I.R.C. § 59A(c)(1)(A).

154. Related party means: (i) any 25-percent owner of the taxpayer; (ii) any person who is related to the taxpayer or any 25-percent owner of the taxpayer, within the meaning of I.R.C. sections 267(b) or 707(b)(1); and (iii) any other person related to the taxpayer within the meaning of I.R.C. section 482. For these purposes, I.R.C. section 318 regarding constructive ownership of stock applies to these related party rules, except that 10 percent is substituted for 50 percent in I.R.C. section 318(a)(2)(C), and for these purposes I.R.C. section 318(a)(3)(A), (B) and (C) do not cause a U.S. person to own stock owned by a non-U.S. person.

155. Treas. Reg. § 1.59A-3(b)(1)(i).

156. *Id.* § 1.59A-3(b)(2)(iii).

the base erosion payment category,[157] and it is with respect to these exceptions that the effectiveness of I.R.C section 59A is curtailed.

To begin with, a base erosion payment generally does not include payments made to purchase inventory because such a payment is made to acquire property that is not of a character subject to depreciation.[158] In 2021, there was a proposal to remove this inventory safe harbor, but that legislative proposal has not been acted upon.[159] Until removed, this inventory safe harbor represents a significant loophole that limits the effectiveness of I.R.C. section 59A.[160]

I.R.C. section 59A also excludes from the definition of a base erosion payment any qualified derivative payments.[161] On its face, the section provides that no payment is treated as a qualified derivative payment for any taxable year unless the taxpayer identifies the payments as such as part of the reporting requirements under I.R.C. section 6038A(b)(2).[162] However, the Treasury Department has announced that it has deferred the need for taxpayers to make this required reporting until taxable years that begin after January 1, 2025.[163] This broad exemption was done without statutory authority and should be rescinded. What is more, the Treasury Department should consider stricter anti-abuse rules and clearer standards for satisfying this safe harbor exception, particularly if derivatives are not exchange-traded.[164]

The U.S. Treasury Department provided a further exception to a base erosion payment for any payments that represent effectively

157. I.R.C. § 59A(d)(3).

158. Treas. Reg. § 1.59A-3(b)(2)(viii). This carve-out for inventory was explicitly contemplated in the legislative history. H.R. REP. NO. 115-466, at 657 (2017).

159. H.R. 5376, 117th Cong. § 138131(b)(1), 167 Cong. Rec. 6549 (2021).

160. However, this cost of goods sold exception does not apply to a payment that reduces the gross receipts of a taxpayer and is paid to a surrogate foreign corporation (or a member of the expanded affiliate of a surrogate foreign corporation) that became a surrogate foreign corporation after November 9, 2017. A surrogate foreign corporation has the meaning given in I.R.C. section 7874(a)(2) but does not include a foreign corporation treated as a domestic corporation under I.R.C. section 7874(b). The definition of expanded affiliated group follows the definition in I.R.C. I.R.C. section 7874(c)(1), under which an expanded affiliated group is an affiliated group, as defined in I.R.C. section 1504(a), but without regard to the exception for foreign corporations and applied by substituting "more than 50 percent" for "at least 80 percent" each place it appears.

161. I.R.C. § 59A(h)(1); Treas. Reg. § 1.59A-3(b)(3)(ii).

162. I.R.C. § 59A(h)(2)(B).

163. Notice 2022-30 2022-29 I.R.B. 70.

164. In I.R.C. section 59A(i)(2), the Treasury Department was given broad authority to prevent avoidance of the usage of the qualified derivatives exception from undermining the goals of the enactment of I.R.C. section 59A. It has not exercised that authority notwithstanding Congress's expression that it should do so.

connected income of the foreign payee.[165] This newfound regulatory exception contravenes clear statutory language of I.R.C. section 59A. In this regard, I.R.C. section 59A(f) and 59A(g) make clear that a base erosion payment includes any payment to a foreign-related person (as defined in I.R.C. section 6038A(c)(3). The only relevant statutory carve-out from a base erosion payment is provided in I.R.C. section 59A(d)(2)(B), where U.S. withholding tax was imposed on the payment.[166] No exception is provided for effectively connected income.[167] However, after recognizing the lack of statutory authority, the U.S. Treasury Department simply stated as follows:

> [The U.S. Treasury Department has] determined that it is appropriate in defining a base erosion payment to consider the U.S. tax treatment of the foreign recipient. In particular, the Treasury Department and the IRS have determined that a payment to a foreign person should not be taxed as a base erosion payment to the extent that payments to the foreign related party are effectively connected income.[168]

I.R.C. section 59A provides authority to the U.S. Treasury Department to ensure that it is not avoided, but nowhere does the statute grant authority for the Treasury Department to create new exceptions to the scope of I.R.C. section 59A's application.[169] Yet, notwithstanding that the Treasury Department was not granted explicit authority in I.R.C. section 59A(i) to curtail the scope of I.R.C. section 59A, it has used its regulatory authority under that provision to do exactly that.

Moreover, the effectively connected income exception affords clear planning opportunities, as a base erosion payment made to a foreign related party that is treated as effectively connected income is excluded whether or not that base erosion payment actually suffers any meaningful net basis U.S. taxation. All that is required is that the base erosion payment be included in the computation of effectively

165. Treas. Reg. § 1.59A-3(b)(3)(iii).

166. *Id.* § 1.59A-3(c)(4)(C)(2).

167. *See id.* § 1.59A-3.

168. Notice of Proposed Rulemaking, Reg. 104259-18, 83 Fed. Reg. 65,956, 65,963 (Dec. 21, 2018); *see* T.D. 9910, 2019-1 I.R.B. 235; T.D. 9910, 2020-44 I.R.B. 915.

169. In this regard, I.R.C. section 59(i) limits the U.S. Treasury Department's authority to provide rules to prevent the avoidance of I.R.C. section 59A through: (1) the use of unrelated persons, conduit transactions, or other intermediaries; or (2) transactions or arrangements designed in whole or in part: (A) to characterize payments otherwise subject to this provision as payments not subject to this provision; or (B) to substitute payments not subject to this provision for payments otherwise subject to this provision. I.R.C. § 59A(i)(1).

connected income.[170] The creation of an effectively connected income exception out of whole cloth signals a significant ambivalence on the part of the Treasury Department towards the efficacy of this provision in actual practice.

The U.S. Treasury Department also provided that foreign currency exchange losses subject to I.R.C. section 988 are categorically excluded from the scope of a base erosion payment.[171] The Treasury Department, in cursory fashion, said that it had "determined that these losses do not present the same base erosion concerns as other types of losses that arise in connection with payments to a foreign related party."[172] This unilateral concession also represents another instance where the Treasury Department has curtailed the scope of I.R.C. section 59A, notwithstanding that it was not been granted the authority to do so.

The Treasury Department also utilized its regulatory authority to exclude from base erosion payments any related-party interest-stripping transaction that relates to total loss-absorbing capacity (TLAC) securities[173] that apply to regulated banks.[174] Again, there is no legislative support for such an exclusion, and the Treasury Department again asserted:

> [The U.S. Treasury Department has] determined that because of the special status of TLAC as part of a global system to address bank solvency and the precise limits that Board regulations place on the terms of TLAC securities and structure of intragroup TLAC funding, it is necessary and appropriate to include an exception to base erosion payment status for interest paid or accrued on TLAC securities required by the Federal Reserve.[175]

170. Notice of Proposed Rulemaking, Reg. 104259-18, 83 Fed. Reg. 65,956, 65,963 (Dec. 21, 2018).

171. Treas. Reg. § 1.59A-3(b)(3)(iv).

172. Notice of Proposed Rulemaking, Reg. 104259-18, 83 Fed. Reg. 65,956, 65,963 (Dec. 21, 2018).

173. *See* Treas. Reg. § 1.59A-3(b)(3)(v). A "TLAC security" is a security that ensures "total loss absorption capacity" for a regulated bank. Total loss-absorbing capacity is an international standard, finalized by the Financial Stability Board that is intended to ensure that global systemically important banks have enough equity and bail-in debt to pass losses to investors and minimize the risk of a government bailout.

174. *Id.*; *id.* § 1.59A-1(b)(4) (defines bank); *id.* § 1.59A-1(b)(18)–(20) (defining TLAC specific terms).

175. Notice of Proposed Rulemaking, Reg. 104259-18, 83 Fed. Reg. 65,956, 65,963 (Dec. 21, 2018).

This statement is astonishing. Certainly, banks could meet their solvency requirements through related party arrangements that would be treated as equity for U.S. tax purposes. The fact that regulatory capital is needed is not an explanation as to why that regulatory capital should preserve its base erosion tax benefits when Congress explicitly adopted I.R.C. section 59A to curtail base erosion benefits. Again, the U.S. Treasury Department was given authority under I.R.C. section 59A to *prevent* the avoidance of that section, but it has used its regulatory authority to *create* avoidance of I.R.C. section 59A in ways that significantly restrict its statutorily enacted scope.

The Treasury Department provided in its regulations that taxpayers can elect to waive the benefits of a deduction, and if so, then the portion of the payment to which a deduction is waived is not treated as a base erosion payment that gives rise to a base erosion tax benefit.[176] A taxpayer makes the election on an annual basis and does not need the consent of the Commissioner if the taxpayer chooses not to make the election for a subsequent taxable year.[177] The waived deduction is treated as a nondeductible, noncapital expense under Treasury Regulation section 1.1502-32(b)(2)(iii).[178] Here again, the Treasury Department has exercised its regulatory authority to create an opportunity to side-step the application of I.R.C. section 59A in ways that significantly restrict its statutorily enacted scope, even though the statute did not authorize it to have such authority.

Given that other countries may not impose an adequate tax on income shifted out of the United States into that other jurisdiction, the United States should retain and enhance its own base erosion protections along the lines indicated in the above analysis so that profit-shifting through related-party transactions do not escape a minimum tax. What is more, until such time as the OECD model rules are purged of their tax competition elements, other nations should consider their own adoption of a base erosion anti-abuse tax for similar reasons.[179]

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176. Treas. Reg. § 1.59A-3(c)(6)(i).

177. *Id.* § 1.59A-3(c)(6)(ii)(A). The election is made on Form 8991 and the regulations set forth the information needed to make the election. *See id.* § 1.59A-3.

178. *Id.* § 1.59A-3(c)(6)(iii)(A)(4).

179. *See* Wells, *supra* note 149, at 1032 (making this recommendation); VIERI CERIANI & APOSTOLOS THOMADAKIS, EUR. CAP. MKTS. INST., EU CORPORATE TAXATION IN THE DIGITAL ERA: THE ROAD TO A NEW INTERNATIONAL ORDER 16–17 (2023) (discussing a French-German proposal circulated in 2019 that would have utilized a similar base erosion anti-abuse tax as the one enacted by the United States in I.R.C. section 59A).

CONCLUSION

This Article delivers a somber message—one the author and many others would prefer not to hear. It is true to say that collective action is needed to implement a global minimum tax. It is also true to say that a global minimum tax agreement, if properly structured, promotes globalization and preserves the ability of democratic states to collect the revenue needed to preserve their democratic societies. Moreover, it is true to say that such an agreement need not prevent attainment of climate change goals because the United States and other nations could adopt other policy instruments (such as carbon taxes or regulatory emission caps) to achieve their climate change goals, and doing so could be harmonized with a global minimum tax agreement. However, having said all of that, it also remains true to say that a global minimum tax agreement requires each nation, by necessity, to disavow its use of tax competition—competition that would erode and circumvent the imposition of the agreed-upon global minimum tax. The OECD Pillar 2 model rules fail to require such a disavowal of tax competition, and that failure represents a fatal design flaw in the GloBE rules. Moreover, the recent OECD administrative guidance has further exacerbated the means by which tax competition can be employed to supplant the minimum tax through a broadening of the qualified refundable tax credit loophole and by further detailed guidance on the substance-based income carve-out exclusion loophole. Thus, in the end, the OECD Pillar 2 model rules, as interpreted by the existing OECD administrative guidance, fall far short of attaining their aspirational goal of imposing an actual global minimum tax because they fail to prioritize a global minimum tax over tax competition. The OECD contrary aspirational statements represent mere cant.

Failure is not inevitable, but it is foreseeable if the design flaws are not addressed, as they allow strategic state actors to engage in tax competition that subverts the imposition of a global minimum tax. It may be that many nations may not engage in tax competition in their initial adoption phase,[180] but that is not the end of the story. Strategic state actors can garner an advantage by engaging in tax competition under the OECD Pillar 2 model rules as currently constructed, and their actions foreseeably create competitive pressures on other nations to respond strategically with countervailing tax competition

180. *See* sources and discussion *supra* note 17.

countermeasures to re-level the playing field. As this is played out over time, a race to the bottom is not only foreseeable but likely. In order for a sustainable minimum tax equilibrium to exist, all adopting nations must disavow their use of tax competition as a means to circumvent the imposition of an actual global minimum tax. To that end, perhaps the OECD will remove the refundable tax credit loophole. Perhaps the OECD will remove the substance-based carve-out income exclusion safe harbor. What is more, perhaps the OECD will rethink its decision to allow Country #1 to decide for everyone else what a minimum tax means with respect to its own country's income and will instead recognize that the ultimate residency jurisdiction has an interest in residual taxation over income earned by CFCs, adjudged by its own tax principles. The United States should continue to negotiate with the OECD and with its major trading partners to reform the design deficiencies identified in the Pillar 2 model rules. The optimum result would be to forge an international tax agreement purged of tax competition elements, and so notwithstanding the historic failure to achieve such an agreement, one should remain committed to its attainment.[181] However, if this tax competition design flaw is not fixed, then one should expect that the OECD Pillar 2 model rules will perpetuate ongoing tax competition.

Until it is determined what course the global community ultimately takes in terms of correcting the fatal design flaws in the OECD Pillar 2 model rules, the United States and other like-minded nations should enact unilateral measures. In this regard, the United States should continue to rely on CFC tax regimes, such as the U.S. GILTI regime, and should not adopt a compliant IIR regime so that strategic state actors engaging in tax competition do not circumvent imposition of a global minimum tax on multinational enterprises. Yes, the United States should give foreign tax credit relief for actual foreign taxes paid to another county under a compliant QDMTT regime, but the United States deference should end there. If the U.S. wanted to tax broader notions of income arising from Country #1 than what is recorded on Country #1's local financial statements, or if the United States wanted to tax the income of its CFC at a higher tax rate than the minimum tax, or if the United States believed that the Country #1 taxes were

181. When faced with ongoing futility, one is reminded of the admonition by Albert Camus that one nevertheless must imagine Sisyphus happy. *See* ALBERT CAMUS, THE MYTH OF SISYPHUS (Justin O'Brien trans., Vintage Books 1991) (1942).

refunded by a broader understanding of governmental grant subsidies, then the United States should retain the sovereign right to re-impose its own minimum tax as the ultimate residency jurisdiction with or without the permission of any other country. Until the OECD Pillar 2 model rules are reformed to recognize the legitimate fiscal interest of the ultimate residency jurisdiction in assuring such minimum tax outcomes, the United States should not replace its existing U.S. GILTI regime with a compliant IIR regime, as doing so would cause the United States to lose too much control over the taxation of CFCs of U.S. multinational enterprises without adequate assurance that those CFC earnings are in fact subjected to an actual minimum tax.

As to the U.S. country income of U.S. multinational enterprises, the United States should argue that it has done enough to ensure a minimum tax for purposes of the GloBE rules given its enactment of the U.S. CAMT, and as such the OECD and peer nations should designate the U.S. CAMT as an adequately compliant QDMTT regime in its own right. When the OECD and other nations agree to eliminate the tax competition elements in the Pillar 2 model rules, the United States should at that time reform its own U.S. CAMT regime to remove its equivalent tax competition elements as the OECD Pillar 2 model rules are reformed in an agreed-upon timeframe. This staged approach provides a path for further needed reforms to remove the tax competition elements in the model rules and U.S. law while maintaining a level playing field during the transition period when tax competition remains a design flaw in all of these rules, including the OECD Pillar 2 model rules.

Finally, the United States continues to have an interest in preventing base erosion and profit-shifting of U.S.-origin profits out of the U.S. tax base. The OECD Pillar 2 model rules do not ensure that shifted profits out of the United States will in fact be subjected to a minimum tax in the other jurisdiction. As a result, the United States should further strengthen its base erosion anti-abuse tax set forth in I.R.C. section 59A, and it should encourage other jurisdictions to adopt similar inbound base erosion anti-abuse tax regimes in this interim period to ensure a minimum tax is imposed on profits shifted from its jurisdiction. If and when the United States gains confidence that profits shifted out of the United States are subject to sufficient taxation in the other jurisdiction, then the United States can revisit the need for this provision. But until then, the United States has a fiscal interest in protecting against profit-shifting that creates an unlevel

playing field in favor of inbound multinational enterprises in the U.S. economy.

With reform, perhaps the OECD Pillar 2 model rules could evolve towards a workable global agreement that prioritizes the imposition of an actual minimum tax over tax competition. But until then, the United States and other like-minded nations should address the tax competition design deficiencies in the OECD Pillar 2 model rules through unilateral measures that protect their own fiscal interests, given that tax competition and profit-shifting to low-tax environs remains a pernicious reality under the OECD Pillar 2 model rules.