A Country-by-Country Global Minimum Tax (like Pillar Two) Can Create a Stronger Incentive for Profit Shifting and Tax Competition than an Aggregate System (like GILTI)

- The Biden Administration played a key leadership role in reaching an agreement in 2021 with 135 countries that would establish a 15% global minimum tax ("Pillar Two"). The OECD's global minimum tax would be imposed on a country-by-country basis; by contrast, the U.S. global intangible low-taxed income ("GILTI") tax is imposed on an aggregate (overall) basis.
- Former Biden Administration Deputy Assistant Secretary for Tax Analysis, Kimberly Clausing, expressed the Administration's strong preference for a country-by-country minimum tax in a *Foreign Affairs* article.[1] Clausing argues that as compared to an aggregate approach, a country-by-country minimum tax more effectively reduces profit shifting and would "put an end to the destructive race to the bottom in corporate taxation."
- However, contrary to Clausing's views, recent analyses by Chris Sanchirico, a tax professor at the University of Pennsylvania Law School, and Martin Sullivan, Chief Economist at Tax Analysts and former member of the staffs of the Treasury Office of Tax Analysis and the Joint Committee on Taxation, reach exactly the opposite conclusion, i.e., a per-country minimum tax perversely can result in *more* profit shifting and *more* tax competition than an aggregate minimum tax imposed at the same rate.[2]
- As pointed out by Professor Sanchirico, even assuming other countries enact Pillar Two minimum taxes, the country-by-country design gives companies an incentive to move all income subject to Pillar Two out of any jurisdiction with an effective tax rate above 15% to jurisdictions with lower tax rates. By contrast, under an aggregate system, any incentive to shift investment stops when the average effective tax rate reaches 15%.
    - **Example 1—Aggregate minimum tax.** A U.S. company earns $100 of pretax income in Country H, which imposes income tax at a rate of 25% and also earns $100 of pretax income in Country L, which imposes income tax at a rate of 5%. The company pays $25 of tax to Country H, and $5 of tax to Country L for an average global effective tax rate of 15% ($30/$200). Assume the U.S. company faces an aggregate minimum tax on foreign earnings at a rate of 15%. The U.S. company would pay no additional tax under the aggregate minimum tax because its average foreign tax rate is equal to the minimum tax rate. Moreover, it has no incentive to shift income from high-tax Country H to low-tax Country L as its total tax liability would not be reduced.[3]
    - **Example 2—Per-country minimum tax.** Assume the same facts as in Example 1, except now the U.S. company faces a global minimum tax on foreign earnings under a country-by-country system at a rate of 15%. The company still pays $25 of tax to Country H and $5 of tax Country L, but it would pay $10 of per-country minimum tax on income earned in Country L (15%-5%=10%*$100=$10). Total tax on foreign income is $40 ($25+$5+$10). If the company shifts all its pretax income ($100) from Country H to Country L, it can reduce its tax on foreign income to $30 (15%*$200), saving $10.
- **Conclusion**. These examples show a per-country minimum tax (like Pillar Two) increases pressure to shift *more* profits to low-tax countries than does an aggregate minimum tax (like GILTI) if both are levied at the same rate. For this reason, a high-tax country can face *more* pressure to compete on corporate tax rates under a per-country minimum tax than under an aggregate minimum tax.
- **GILTI coexistence**. The OECD Blueprint acknowledged reasons for treating GILTI as equivalent to the Pillar Two global minimum tax, noting its pre-existence, legislative intent, and frequently less permissive results; nevertheless, the Administrative Guidance rules out equivalent treatment because GILTI is not imposed on a per-country basis. As explained above, imposition of a minimum tax on an aggregate basis (vs. per-country) should not bar GILTI coexistence, as an aggregate minimum tax is more consistent with the objectives of Pillar Two (i.e., to reduce profit shifting and tax competition).

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[1] Kimberly Clausing, "The Global Minimum Tax Lives On," *Foreign Affairs*, August 17, 2022.
[2] See, Martin Sullivan, "Pillar 2 Can Increase Tax Competition," *Tax Notes Federal*, Volume 180, August 7, 2023 pp. 887-8; Chris William Sanchirico, "Should a Global Minimum Tax Be Country-by-Country?" *Tax Notes Federal*, Vol. 175, April 25, 2022, pp. 549-558; and Chris William Sanchirico, "A Game Theoretic Analysis of Global Minimum Tax Design: Country-by-country vs. Global Averaging," University of Pennsylvania, Institute for Law and Economics Research Paper No. 22-19, March 25, 2022.
[3] If the company shifts all its pretax income ($100) from Country H to Country L, its total tax bill would be unchanged, as its total tax liability would still be $30 (5%*200+(15%-5%)*200=$10+$20).