The OECD Global Minimum Tax Raises Important Questions for U.S. Policymakers

Overview

- The Treasury Department unilaterally agreed to Model Rules proposed by the Organization for Economic Cooperation and Development ("OECD"), the so-called "Pillar Two" agreement, that are designed to ensure multinational companies ("MNCs") with annual revenue in excess of €750 million (~$800 million) pay at least a 15% tax rate on the income they earn in every country in which they operate. Pillar Two provides three ways to ensure this 15% minimum tax is paid.
  - First, a host country may impose a qualified domestic minimum top-up tax ("QDMTT") on income earned by the MNC in that country.
  - Second, if the host country does not impose a QDMTT, a parent country may impose an income inclusion rule ("IIR") on the MNC's income earned in the host country; and,
  - Finally, if the host country does not impose a QDMTT and there is no parent country that imposes an IIR, the undertaxed profits rule ("UTPR") allows every country where an MNC operates to collect a proportionate share of the global minimum tax not collected under the first two tax mechanisms.
- More than 30 countries have adopted Pillar Two; however, over half of the countries that signed on to the Pillar Two agreement have not announced an intention to implement it, including China, India, and Russia.

QDMTTs will cost the U.S. Treasury more than $100 billion over the next decade.

- Unlike the December 2021 Pillar Two Model Rules, the Administrative Guidance issued by the OECD in February 2023 allows QDMTTs to be imposed before IIRs, giving host countries first taxing rights ahead of parent countries (including ahead of the United States with its tax on global intangible low-taxed income ("GILTI") earned by U.S. MNCs).
- As a result, the Joint Committee on Taxation estimates that widespread adoption of first-in-line QDMTTs will reduce U.S. tax on GILTI, causing the U.S. Treasury to lose $122 billion in revenue over the next decade and, at the same time, requiring U.S. companies to pay more tax to foreign governments.

The GILTI regime should be treated as a qualified IIR.

- The OECD's IIR proposal is a secondary right to collect tax that bears some similarities to the U.S. GILTI regime. However, while the OECD's global minimum tax would be imposed on a country-by-country basis, the U.S. GILTI tax is imposed on an aggregate (overall) basis.
- In many cases, the GILTI regime imposes a greater tax burden on U.S. companies than would be the case under the Pillar Two rules developed by the OECD. For these reasons, the Pillar Two negotiators initially agreed that the tougher GILTI tax regime would be "grandfathered" or "coexist" as a compliant IIR until they suddenly and inexplicably altered course in late 2021.
- Treating the GILTI regime as a qualified IIR would 1) protect the international income of U.S. companies from foreign UTPRs and 2) reduce the risk of industrial espionage by eliminating the need to file global information returns with foreign governments who are known to collaborate with their national champions.

UTPRs target U.S. tax incentives and handcuffs U.S. policymakers.

- The UTPR applies to the home country income of domestic MNCs– meaning that a U.S. company could pay UTPR taxes to foreign governments on income earned solely in the United States if its U.S. tax rate drops below 15% due to incentives like the research tax credit.
- Consequently, the UTPR allows foreign governments to tax away the benefits of bipartisan tax incentives (including, but not limited to, the research credit, the tax exemption for state and local bond interest, and incentives for Opportunity Zones that are focused on economically and socially desirable domestic activities.
- Although the current Model Rules contemplate basing the UTPR on the 15% Pillar Two threshold, there is no limiting principle stopping countries from imposing this new tax at a higher rate or on broader activities to maximize the revenue they would collect from this unprecedented extraterritorial tax.
- Moreover, the UTPR handcuffs the ability of future Congresses to use tax policy to counteract a recession, accelerate recovery from a natural disaster or pandemic, or encourage domestic production of critical supplies for national security reasons.