EU CORPORATE TAXATION IN THE DIGITAL ERA

THE ROAD TO A NEW INTERNATIONAL ORDER

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The views expressed in this report do not necessarily reflect the views and positions of the Chair or the members of the Task Force, or the views of their respective companies. The members do not necessarily agree with all the positions put forward, and do not necessarily endorse the references to academic and independent studies. A robust and clear set of principles have guided the drafting process in order to preserve a balanced approach to a variety of views. All members were given ample opportunity to express their views. The content of the report and any remaining errors, however, can be attributed only to the rapporteur.

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Foreword

The current system of international coordination of corporate income tax is based on the individuation of separate entities (subsidiaries or permanent establishments), reference to intra-group transactions, and the 'arm's length principle' for transfer pricing among related parties. It is increasingly showing its inadequacies in dealing with today's economy, which is highly integrated and digitalised. This obsolescence is not a surprise. The system follows the criteria set by the Organisation for Economic Co-operation and Development (OECD) in the 1960s, inherited from those developed by the League of Nations in the 1920s, roughly a century ago.

Basing taxing rights on physical presence in a specific jurisdiction becomes inadequate when economic activity in a market does not require such presence. Also, the system does not properly consider the value of data collected from customers. Applying the transfer pricing rules to intra-group transactions has become a formidable endeavour in the highly globalised and integrated economy, especially when a comparison with similar transactions between unrelated parties is difficult or impossible. Moreover, transfer pricing has become an 'art' that requires great expertise and involves delicate choices between different methods, with high administrative costs and tax risks. The goal of setting a new coordination framework in international corporate taxation emerges as the answer to the shortcomings of the current system.

Furthermore, public opinion has become increasingly aware that multinational enterprises (MNEs), through aggressive tax planning, are able to reduce their tax liabilities to levels that are considered unacceptably low. Political pressure has mounted on governments to take action, at both national and international level.

The Base Erosion and Profit Shifting (BEPS) project was the beginning of the process of revising international coordination on tax matters. Its Action Plans were approved in 2015, and most countries started to implement them. With the Anti-Tax Avoidance Directive, the EU set new rules for controlled foreign companies, exit taxes on assets moved abroad, limitations on the deductibility of interest payments, measures to contrast non-taxation due to mismatches with third countries, and a general anti-abuse clause.

Under the Trump Administration, the United States showed its unwillingness to cooperate internationally by neither signing the multilateral agreement on BEPS, nor changing the definition of permanent establishment, nor participating in public country-by-country reporting. The introduction of the Tax Cuts and Jobs Act (TCJA) aimed to increase the competitiveness and attractiveness of the US tax system, while contrasting the tax avoidance of US MNEs, and guaranteeing a minimum level of taxation in the country. Although on some issues the TCJA was aligned with the BEPS approach, on others (i.e. Foreign Derived Intangible Income, Global Intangible Low-Taxed Income (GILTI), and Base Erosion and Anti-Abuse Tax (BEAT)) there was significant divergence. However, GILTI and BEAT were innovative in combating international tax avoidance, and aroused interest from other governments: they have been a stimulus for the definition of the global minimum tax of Pillar Two.

After the TCJA, and with the new stance of the US Administration on international trade, tensions (re-) emerged between the US and other (particularly European) countries. These focused on the taxation of the digital economy. The main point of contention was whether the new criteria should apply only to MNEs active in the digital economy, or to all MNEs. In this context, in March 2018 the European Commission put forward a package consisting of two proposals for directives on the digital economy: i) a *comprehensive solution* of a systemic nature; and ii) a *targeted solution* conceived as a bridge solution, a digital services tax (DST). Neither directive was approved, also due to the firm opposition of the US.

In the US, Biden's Administration turned towards a multilateral coordination approach, with a pledge to review some aspects of the TCJA. This was met with positive reactions among the G7. The momentum picked up in December 2021, with a 'historic' agreement on a two-pillar solution. Pillar One, which is mandatory for all participating jurisdictions and requires a multilateral convention, regards a revision of the allocation among participating jurisdictions of the right to tax large MNEs. It applies to all MNEs, not only to the digital economy. The existing DST will be repealed, and no further DST will be introduced. Pillar Two, which is not mandatory and simply reflects a 'common approach' (meaning that countries that adopt it must accept application by other countries, and that any implementation must be consistent with the agreed rules), introduces a 15 % minimum effective tax rate (ETR) on profits exceeding a substance-based income exclusion (SBIE) in each jurisdiction where an MNE operates. Both pillars have innovative aspects: in addition to traditional methods, they introduce consolidation of profits and formulary apportionment. While Pillar Two is well ahead, Pillar One is lagging behind and facing some resistance: the draft multilateral convention has not yet been finalised, and its implementation is subject to the achievement of a 'critical mass' of countries that will adhere.

At EU level, following unanimous approval by Member States in December 2022, Pillar Two has been translated into the EU Minimum Tax Directive, which will enter into force in January 2024. Though closely aligned with the model rules of the OECD, the EU Directive differs in some aspects. More importantly, its application is mandatory for all Member States, thus departing from the OECD 'common approach', and it also covers purely domestic groups.

In the US, Biden's Administration met resistance in Congress, with the Build Back Better Act (BBBA) failing to pass. However, in August 2022 the Inflation Reduction Act (IRA) was approved, introducing (inter alia) the Corporate Alternative Minimum Tax (CAMT), a worldwide minimum tax on US MNEs. CAMT pursues the general objectives of Pillar Two but diverges from its rules. At present, it is unlikely that the US will implement the rules of Pillar Two, mainly due to strong opposition by the Republican majority in Congress. There is also opposition to the US allowing other countries to apply Pillar Two rules to US MNEs.

The agreement on the two pillars and the progresses made in their implementation, albeit slower than hoped, mark a great progress and a step forward in international tax cooperation. With roughly 140 jurisdictions committed to such an important and innovative project, this has a truly historic dimension.

Nevertheless, several concerns have been raised with regard to Pillar Two. The business sector has denounced the complexity of the new rules, which involve complicated calculations requiring information from financial reporting and fiscal returns on all entities of an MNE group; information that at present is unavailable and needs to be collected with a new dedicated framework. Moreover, the complexities cast doubts on the capacity of national tax administrations, not only the less technically advanced, to manage the new commitments properly. There is also the risk of diverging application of the rules across countries, of litigation cases with taxpayers, and of contrasts between tax administrations. The lamented lack of dispute resolution mechanisms in both the OECD rules and the EU Directive worsens this scenario.

Another point of concern is the lack of consistency between the EU Directive, which is legally binding, and the OECD rules, especially if the OECD Inclusive Framework approves documents that are intended to provide interpretations and application guidelines, but in fact change the basic rules. The consistency of Pillar Two rules (in particular the Undertaxed Profits Rule) with existing treaties and national principles has also been questioned.

As for tax competition, which Pillar Two intended to curtail, it is likely that this will move to other obligatory contributions different from the CIT, or exploit the possibilities offered by the new rules: some tax incentives might be transformed into 'refundable tax credits' (or 'transferable tax credits) to improve the ETR.

Finally, there is some evidence that the revenues may fall short of what was originally expected. In conclusion, Pillar Two is a great step forwards in international tax cooperation, but is very complicated, does not curb tax competition and may raise less revenue than expected.

In the face of these shortcomings, corporate taxation in the EU could achieve substantial gains in simplification, reduction of tax competition and revenue collection with the implementation of the Business in Europe: Framework for Income Taxation (BEFIT), an ambitious comprehensive approach to harmonising business taxation. A draft directive is expected in the third quarter of 2023. This will replace the Common Consolidated Corporate Tax Base presented in 2010 and revised in 2016, maintaining the two fundamental characteristics: i) a set of common rules for the determination of a consolidated tax base; and ii) formulary apportionment of the tax base to the Member States, which will be free to establish the tax rate. BEFIT will build on Pillar Two, in the sense that it will be mandatory for groups of companies (MNEs and large-scale domestic groups) that fall within its scope; while other groups failing outside the scope of Pillar Two might voluntarily opt in. In addition, the tax base will be computed from financial accounts, with very limited adjustments.

BEFIT has great potential in terms of simplifying compliance requirements, reducing related costs and ensuring uniformity within the EU. The adoption of a single corporate tax rulebook instead of 27 national sets of rules, and the use of consolidation and apportionment instead of transfer pricing rules, would bring greater stability and tax certainty, and would also curtail tax competition among Member States. Moreover, BEFIT would reduce the scope for tax arbitrage and tax planning that exploit inconsistencies between national legislations. Hence, it could bring increased revenues and provide a solid base for the EU budget's own resources. In conclusion, building on Pillar Two, BEFIT goes beyond and may greatly improve the scenario of corporate taxation in the EU.

This report highlights the main developments in corporate taxation in the last decades in both the EU and the US. It then dives into the data and tries to analyse MNEs' activity and profit shifting, as well as the impact of a 15 % minimum corporate tax on revenues. The report continues by discussing the critical points in the design of Pillar Two that raise concerns and require careful calibration, before putting forward recommendations on improving the functioning of Pillar Two, and on the implementation of BEFIT, stressing the importance of simplicity and uniformity.

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Executive summary

International coordination of corporate income tax has traditionally been based on the individuation of separate entities that perform economic activities within a multinational group: taxation is linked to the place where all or part of a company's business activities are physically carried out, either through a legal entity or through a permanent establishment. Over recent years, however, growing internationalisation – partly due to digitalisation – and the arrival of big-tech companies, have resulted in changes in companies' business models. This includes their ability to provide digital services and create value without being physically based in a certain tax jurisdiction, and to recoup it through intellectual property rights for digital users. This has raised concerns about tax avoidance, brought challenges to the rules for taxing international business income, and sparked the debate on whether such rules are still fit for purpose.

In an effort to avoid taxes, multinational enterprises (MNEs) exploit the inadequacies of international tax rules and shift profits to low or non-tax jurisdictions. Although the share of corporate profits in global income increased from 14 % to 20 % between 1975 and 2019, the share of MNEs' profits in global income quadrupled (from 4 % to 18 %) over the same period. On top of that, about 40 % (or EUR 193 billion) of these profits were shifted to low-tax jurisdictions, particularly low-tax EU Member States.

Aiming to ensure that profits are taxed where economic activities take place and value is created, on 1 July 2021, the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) agreed a two-pillar solution. Pillar One focuses on re-allocating the profits of the largest and most profitable MNEs to countries worldwide, in favour of market jurisdictions where goods or services are used or consumed. Pillar Two introduces a minimum corporate tax rate of 15 % for large MNEs in an effort to create a level playing field through a minimum worldwide level of taxation.

Following the OECD agreement on Pillar Two Model Rules, in December 2021 the European Commission proposed a directive to implement Pillar Two in the European Union. In a historic moment, after several attempts and initiatives to harmonise taxes in the EU that date back to 1960, Member States agreed unanimously in December 2022 to adopt the Directive ensuring a global minimum level of taxation for MNEs. With this agreement, the EU strengthens its commitment to be among the first to implement the OECD's tax reform. EU Member States are now required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 31 December 2023.

Although efforts have been made to estimate the increase in corporate tax revenue from the introduction of a 15 % minimum effective tax rate, these should be treated cautiously due to the complexity of the rules, the uncertainty on how they will be applied, the behavioural responses of firms to the new rules, and the availability of data. On a global scale, a minimum corporate tax rate could result in annual revenue gains in the range of EUR 150 billion to EUR 200 billion, representing an increase in global corporate tax income of about 6 % to 12 %. For the EU, these numbers range between EUR 55 billion and EUR 85 billion, or between 16 % and 25 % of current corporate tax revenue. Low-tax countries like Belgium, Ireland and Luxembourg would benefit significantly, while in others such as France, Germany, Italy and Spain, the increase in corporate tax revenue would be lower.

The breadth and complexity of the new rules, especially in light of the very short timeframe for their entry into force, have raised concerns and discomfort in both MNEs and tax administrations. Implementation of the rules may be problematic, leading to differing interpretations and application across jurisdictions, coordination and compatibility challenges with other current or ongoing international tax standards and initiatives, more intense tax competition or new forms of it, possible disputes between companies and authorities or between authorities, double taxation issues, administrative burden and legal uncertainties, as well as increased tax risks.

In order to eliminate such concerns, there should also be consistency between the sequencing of the Global Anti-Base Erosion (GloBE) rules in the EU Directive and the OECD's Administrative Guidance. This will require improved coordination between changes in the GloBE rules and the EU legislation. Moreover, and within the EU, the principles of the single market must be fulfilled, while the constant streamlining of national rules should be promoted.

Despite the fact that safe harbours should bring stable and substantial simplifications to the GloBE rules, if the definition process is prolonged, it may be worthwhile considering an extension of the transitory country-by-country safe harbour rules. The agreement and implementation of rules for the settlement of litigation should be highly prioritised within the Inclusive Framework, and special rules at EU level should be envisaged.

As for the Business in Europe: Framework for Income Taxation (BEFIT), which aims for simplification, a reduction in compliance costs and uniformity within the EU (e.g. through the provision of a one-stop shop), this should build on Pillar Two rules, as much as possible. The European Commission proposes that the rules should be mandatory for MNEs that fall within the scope of Pillar Two and optional for all other groups. However, businesses ask for optionality for all. This solution could be considered, at least on a temporary basis, to test the appropriateness and attractiveness of BEFIT. After all, the 'success' of BEFIT would be measured by the number of businesses that opt for it on a voluntary basis.

Furthermore, BEFIT should be based on a strict derivation from financial reporting, with very few corrections. For the sake of simplification and uniform application within the EU, International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) rules should apply and, contrary to the GloBE rules, the use of national accounting rules (i.e. local GAAP) should not be allowed. However, as a subordinate solution, the use of national accounting standards might be left optional for businesses.

Finally, given the strict timing of implementation, and in order to avoid overburdening tax administrations and taxpayers, an adequate timespan in relation to the implementation of the GloBE rules should be granted.

1. Introduction

The fight against international corporate tax avoidance has been on the agenda of both the Organisation for Economic Co-operation and Development (OECD) and the European Commission (Commission) for many years. However, it has intensified since the 2008 global financial crisis and the subsequent fiscal pressures faced by many developed countries, as well as the recent scandals of Lux Leaks and the Panama Papers, among others, that have attracted international attention. Thus, significant public and political scrutiny has come to bear on the extent of tax avoidance by the world's leading multinational enterprises (MNEs) (Cobham *et al*., 2021).

Broadly speaking corporate tax avoidance can be defined as 'acting within the law, sometimes at the edge of legality, to minimise or eliminate tax that would otherwise be legally owed' (European Commission, 2016)[1]. More specifically, tax avoidance strategies cover a wide variety of behaviours such as debt-shifting across countries (Desai and Dharmapala, 2015; Bilicka *et al*., 2021), the manipulation of transfer prices (Klassen *et al*., 2016; Liu *et al*., 2020), the location of physical activities of companies or some of their assets (notably intangible assets such as patents) (Hines and Rice, 1994; Carpentieri *et al*., 2019), the use of mismatches between tax regimes (OECD, 2012; CEPS, 2019), the inversion of corporate structures between parents and affiliates (Gao, 2012; Beer *et al*., 2020), deferral in the repatriation of profit generated in low-tax jurisdictions, and the use of treaty networks (Azémar, 2010; IMF, 2014). All of these different channels are not only difficult to measure (partly because MNEs do not publicise their use of specific tax planning schemes and tools), but can often be used simultaneously in complex tax planning structures.

Despite the fact that tax avoidance has been on the agenda for many years, policy actions have only recently stepped up. In 2012, the G20 began to develop a response, which eventually led to the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan in July 2013 (OECD, 2013). The plan, through its 15 proposed actions, aimed to tackle tax avoidance strategies that exploit gaps and mismatches in tax rules between different countries to artificially shift profits to low or no-tax locations around the world. Two years later, in October 2015, 15 final reports were published outlining consensus recommendations and concrete measures to help countries tackle BEPS.

Consistent with BEPS, in 2016 the EU adopted its Anti-Tax Avoidance Directive (ATAD). In 2017, the United States – the first mover in implementing a minimum tax – adopted its Tax Cuts and Jobs Act (TCJA) that pursued the goals of BEPS in an innovative way. Different from the BEPS Action Plan, the TCJA aimed to ensure a minimum global level of taxation for US multinationals, and pursued the general objective of increasing the competitiveness and attractiveness of the US tax system.

In the meantime, further steps have been undertaken on many of the BEPS actions through the BEPS Inclusive Framework, which brings together a much larger group of countries than those involved in agreeing the recommendations published in 2015. In particular, discussions restarted on the treatment of the digital economy, an issue on which BEPS had been unable to find an agreement and had left unresolved. A general consensus started to emerge on the fact that the traditional criteria had to be revised. The international division of taxing rights is based on physical presence in a jurisdiction, either through a legal entity or permanent establishment (PE), but the digital economy is able to operate in a jurisdiction without any physical presence. Furthermore, the digital economy extracts profits from the

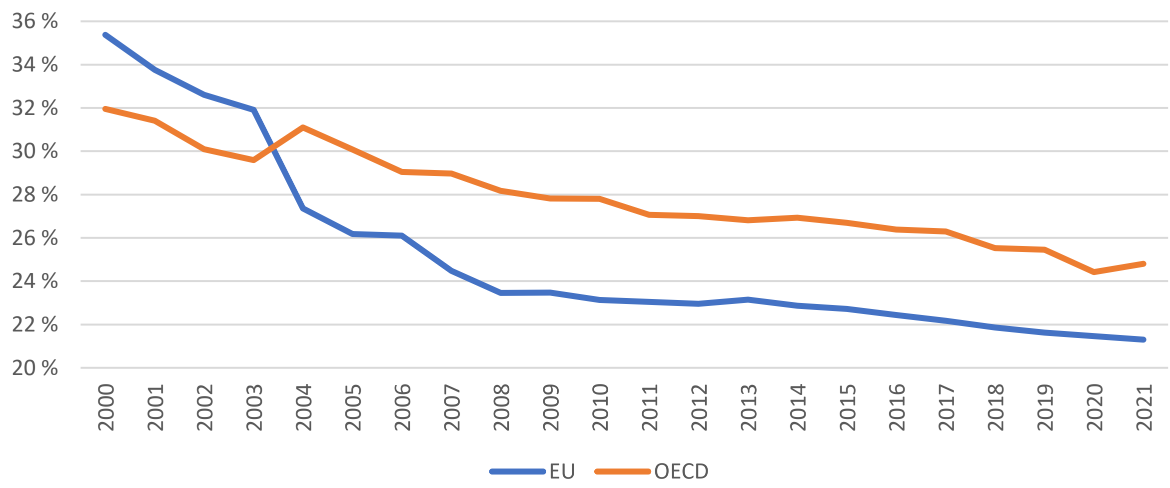
[1] There is a vast amount of literature examining what constitutes tax avoidance within the context of corporate behaviour, and whether it fits with the corporate social responsibility issue (Hasseldine and Morris, 2013, 2018; Col and Patel, 2019; Goerke, 2019; Zeng, 2019).

information provided by its customers, without remuneration. Therefore, the idea of abandoning the traditional criteria and devising new forms of international coordination with the right to taxation in the destination country, irrespective of physical presence, began to gain support. A contrast emerged between many destination countries (among them, large European countries) and the US on whether this destination principle should apply only to the digital economy, or to all economic activities.

The Biden Administration gave new momentum to international efforts to establish a minimum global tax[2]. In May 2019, the Inclusive Framework agreed on a two-pillar programme to address tax challenges arising from the digitalisation of the economy (OECD, 2019a). Pillar One addresses the allocation of taxing rights of business profits between jurisdictions (OECD, 2019b), while Pillar Two (also referred to as the Global Anti-Base Erosion (GloBE) proposal) calls for the development of a co-ordinated set of rules to address ongoing risks arising from multinational structures that allow profit shifting to jurisdictions where income is not taxed, or is taxed at a very low level (OECD, 2019b), and imposes an effective global minimum tax.

On the European front, EU Member States are currently free to set their corporate tax base and rates. This has resulted in a 'race to the bottom' in terms of corporate tax rates over the last 30 years, and has been accompanied by an increase in the size of the corporate tax base. Ever since the completion of the European single market, tax competition has been on the rise (see Figure 1). One contributing factor is the EU's limited competence to act and legislate in the field of taxation. In 1988, following the adoption of the Single European Act in 1987, the Commission made its first attempt to harmonise the corporate tax base, which was unsuccessful due to the reluctance of most Member States to support the harmonisation[3]. In the early 1990s, the EU introduced limited measures to abolish double taxation between related enterprises. In November 1999, the Primarolo Report, whose purpose was to assess tax measures that may fall within the scope of the Code of Conduct for Business Taxation, identified several harmful tax regimes implemented in Member States, and concluded to stop such practices.

Figure 1. Corporate income tax statutory rates (EU and OECD countries, 2000-2021)



[2] President Biden's efforts build on an initial proposal from France and Germany, which in turn was inspired by Global Intangible Low-Taxed Income (GILTI) and the Base Erosion and Anti-Abuse Tax (BEAT) introduced by the previous US Administration.

[3] In fact, the Commission's draft proposal on harmonising the tax base for enterprises was never officially presented to the Council. The document has never been published: it is in the Commission's archives and available only in French (European Commission, 2001; Chelyadina, 2019).

Notes: The figure shows the basic combined central and sub-central (statutory) corporate income tax rate given by the central government rate (minus deductions for sub-national taxes) plus the sub-central rate. For the EU, Member States are included only after each enlargement. This means that the sample from 2000 to 2003 includes: AT, BE, DE, DK, EL, ES, FI, FR, IE, IT, LU, NL, PT, SE and UK. In 2004, the following countries are added: CY, CZ, EE, HU, LT, LV, MT, PL, SI and SK. In 2007, BG and RO are added, and HR in 2013. The UK is excluded in from the EU sample from 2020 onwards. The sample of OECD countries includes European countries before (or after) they join (or leave) the EU. From 2000 to 2003, the countries included are: AU, CA, CH, CZ, HU, IS, JP, KR, MX, NO, NZ, PL, SK, TR and US. In 2004, given that CZ, HU, PL and SK joined the EU, they are excluded from the OECD sample. In 2010, CL and IL became OECD members and are added to the sample. In 2020, CO and UK are added, and CR in 2021.
Source: Author's calculations based on data from the OECD Tax Database.

Most of the focus so far has been on the convergence of European tax legislation regarding value-added tax (VAT) or excise duties, and cooperation between tax administrations[4]. Thus, direct taxation remains the prerogative of individual Member States[5]. Disputes between Member States – for example due to the spillover effects of individual Member States' tax policies on other Member States – can only be addressed within the official EU framework if they distort competition within the common market (Article 116 of the Treaty on European Union and the Treaty on the Functioning of the European Union (TFEU))[6]. This has led to actions by the Commission's Competition Directorate under the EU's state aid rules against distortive tax deals by Member States, mainly in the period 2010 to 2020. Several of these cases have since been annulled by the European Court of Justice (ECJ), which judged that the Commission had exceeded its competence and unduly interfered in the Member States' tax autonomy.

[4] Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC 1), Directive 2014/107/EU amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (DAC 2), Directive 2015/2376/EU on mandatory automatic exchange of information on advance tax rulings with a cross-border dimension (DAC 3), Directive 2016/881/EU on country-by-country reporting (DAC 4), Directive 2016/2258/EU on access to anti-money-laundering information by tax authorities (DAC 5), Directive 2018/822/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (DAC 6), Directive 2021/514/EU on the automatic exchange of information of digital platform operators (DAC 7). Or Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax. But also the latest proposal on the misuse of shell entities for tax purposes (ATAD 3).
[5] Subject to the fundamental freedoms set out in the TFEU.
[6] For example, the Commission has scrutinised several Member States' corporate tax practices within the framework of state aid investigations (European Commission 2017a, 2017b).

2. What is Pillar One?

Pillar One aims to resolve longstanding concerns that the international corporate tax framework has not kept in pace with the digital economy and the way in which highly digitalised businesses generate value from active interaction with their users. For this reason, it involves the partial reallocation of taxing rights over the profits of the largest and most profitable multinational businesses to the jurisdictions where customers/users are located. In other words, it is about reattribution/reallocation of taxing rights at a global level, in favour of market jurisdictions where goods and services are used or consumed. It is about where MNEs pay tax.

However, the scope of businesses covered under Pillar One has moved far from the original intention of highly digitalised business models. Although extractives and regulated financial services are excluded from the scope of Pillar One, other industries are generally not. Amount A of Pillar One will be applicable to MNEs with a global turnover above EUR 20 billion (the 'global revenue test') and profitability above 10 % (i.e. profit before tax (PBT)/revenues) (the 'profitability test').

Pillar One creates a new 'special purpose' nexus rule that results in the allocation of Amount A (or the 'residual profit') to any jurisdiction from which that MNE derives a certain amount of revenue. In particular, jurisdictions will only obtain taxing rights on Amount A if the MNE falling under the scope of Pillar One realises revenue derived from third parties in that jurisdiction during a certain period (normally a year) of at least: i) EUR 1 million for jurisdictions with an annual gross domestic product (GDP) of at least EUR 40 billion; or ii) EUR 250 000 for jurisdictions with an annual GDP of less than EUR 40 billion.

In addition, Pillar One introduces Amount B. This is fixed remuneration for certain baseline routine marketing and distribution functions taking place in the market jurisdiction. The purpose of Amount B is to standardise the remuneration of related party distributors that perform baseline marketing and distribution activities in market jurisdictions. In doing so, it benefits both entities and tax administrations by reducing the risk of double taxation and compliance costs, given the large number of tax disputes related to marketing and distribution functions under the current transfer pricing rules. Figure 2 summarises the basic steps under Pillar One.

Because Pillar One focuses on changing where profits are taxed, it would replace some existing norms for taxing multinationals that countries have put in place to tax digital companies in recent years. The most common form is a digital services tax (DST), which is a tax on selected gross revenue streams (i.e. turnover) of large digital companies. Under Pillar One, DST and other similar measures are to be repealed in a transition process that is expected to be completed by the end of 2023.

On Pillar One, work is progressing in the OECD on finalising the detailed framework for reallocating taxing rights. Implementing Pillar One requires the development of: i) a Multilateral Convention (MLC)[7]; ii) an Explanatory Statement to the MLC[8]; iii) Model Rules for Domestic Legislation for implementing Amount A; and iv) a Commentary to the Model Rules. The initial plan was to introduce Pillar One through

[7] An MLC introduces a multilateral framework for all jurisdictions that join, regardless of whether a tax treaty already exists between those jurisdictions. It contains rules necessary to determine and allocate Amount A, and ensures consistency and certainty in the application of Amount A.

[8] The Explanatory Statement describes the purpose and operation of the rules and processes.

an MLC that would have been available for signature in 2022, with the rules becoming effective in 2023. However, these deadlines have been extended by a year[9].

Figure 2. Basic steps under Pillar One Amount A

Step 1
- Perform threshold tests: i) global revenue test; and ii) profitability test.

Step 2
- Perform activities test: extractives and regulated financial services activities are excluded from the scope of Amount A.

Step 3
- Determine the tax base using an adjusted profit before tax (PBT) measure, derived from the consolidated financial accounts of in-scope MNE Groups.

Step 4
- Determine whether the MNE Group has to segment the PBT measure.

Step 5
- Determine whether the MNE Group has a loss or a profit, which will be carried forward to offset future profits or future losses respectively.

Step 6
- Perform a nexus test to identify market jurisdictions eligible for allocation of Amount A.

Step 7
- Determine the Amount A to be allocated to the eligible market jurisdiction.

Step 8
- Determine whether there is a potential safe harbour exemption for marketing and distribution activities.

Step 9
- Eliminate double taxation of profit allocated to market jurisdictions, and identify the entity or entities paying the Amount A tax liability.

Notes: This figure is based on the information currently available. Some of the key parameters are still subject to discussion and thus may still change. Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction through Amount A. Work on Amount B (which includes defining the in-country baseline marketing and distribution activities in scope) will be finalised by the end of 2023.
Sources: Author's compilation based on information currently available, and EY (2021).

Work on Pillar One at the OECD continued throughout 2022 (OECD, 2022b) and was set to intensify in 2023. On 11 July 2022, the OECD Secretariat presented and submitted for public consultation a report approved by the Inclusive Framework containing the technical rules for the implementation of Amount A. As for Amount B, a public consultation document was released on 8 December 2022, providing a

[9] See the Communication of the G20 meeting of the Finance Ministers and Central Banks Governors held in Bali on 15 and 16 November 2022.

simplified and streamlined approach to the application of the arm's length principle (ALP)[10] to in-country baseline marketing and distribution activities. A new public consultation on Amount B was launched on 13 July 2023.

With regard to the MLC, on 20 December 2022 the OECD launched a public consultation aimed at finalising it by mid-2023 for entry into force in 2024. On 11 July 2023, the OECD Inclusive Framework announced that the text of the Convention would be published 'once it has been prepared for signature, upon resolution of a small number of specific items about which a few jurisdictions have expressed concerns'.

The MLC, to be signed and ratified by the members of the Inclusive Framework, will establish the legal obligations to: i) implement Amount A in a coordinated and consistent manner, including its allocation to market jurisdictions; ii) eliminate double taxation; iii) establish tax harbours for marketing and distribution expenses falling under Amount B; and iv) establish the rules for a simplified administrative process, for the exchange of information and to ensure tax certainty. The MLC will also contain provisions requiring the abolition of all national taxes on digital services, as well as a commitment not to adopt similar provisions in the future. It will enter into force after ratification by a 'critical mass' of countries.

[10] The arm's length principle states that the price agreed in a transaction between two related parties must be the same as the price agreed in a comparable transaction between two unrelated parties. The ALP was agreed upon by all OECD member countries and adopted as an objective guideline for use by MNEs and tax administrations in international taxation. Its objective is to avoid the erosion of the tax base or the transfer of profits to low-tax jurisdictions.

3. What is Pillar Two?

In contrast to Pillar One, Pillar Two is not focused on the allocation of taxing rights, but on ensuring that multinationals pay a minimum rate of tax in every jurisdiction they operate in, through a framework of rules (i.e. GloBE rules). In other words, Pillar Two is about creating a level playing field through a minimum worldwide level of taxation. It is about how much tax MNEs pay.

Pillar Two requires the application of a minimum standard tax rate to a defined corporate income base. After reporting and paying the national taxes due in every jurisdiction where an MNE is present, the following year the MNE calculates the effective tax rate (ETR) as the ratio of 'in scope' taxes and 'in scope' profits. If the ETR is below 15 %, a top-up tax is due. Both the taxes and the profits are calculated from the financial reporting, with a number of corrections that ensure uniformity of definition and calculation among jurisdictions.

Pillar Two under the OECD rules is a coordination framework: its implementation is left to the discretion of each jurisdiction. Hence, jurisdictions signing up to the OECD deal are not obliged to introduce Pillar Two rules, but must accept their adoption by others. Moreover, if they do adopt the rules, they must follow the approach taken in the OECD Model Rules. With regard to implementation, it was originally planned that jurisdictions would introduce the Pillar Two rules into their domestic legislation by the end of 2022, with the Income Inclusion Rule (IIR) to be effective in 2023 and the Undertaxed Payments Rule (UTPR) coming into effect in 2024[11]. These deadlines have been postponed by one year.

By setting a global minimum corporate tax rate, Pillar Two not only reduces the incentive to shift profit to low- or no-tax jurisdictions, but also aims to place a floor on tax competition between jurisdictions. In doing so, it ensures the sustainability of corporate tax as a major source of government revenues, while leaving appropriate flexibility for countries to use corporation tax as a policy lever for supporting business investment and innovation.

To achieve these two objectives, and as agreed by the Inclusive Forum, on 20 December 2021 the OECD published a framework of rules (the Model Rules) for Pillar Two. Further technical guidance with regard to the operation and intended outcomes under the rules became available on 14 March 2022 (OECD, 2022a). Under these rules, an adjusted accounting measure of profit needs to be calculated for a group's total operations in each jurisdiction. If the tax paid by the group on profit in a jurisdiction falls below the minimum 15 % level, the rules require countries to impose top-up taxes on certain entities within the group, in order to bring the overall taxation of jurisdictional profit up to the minimum level. Moreover, the rules include a detailed framework for determining where any required top-up tax should be imposed within the group, to ensure appropriate coordination between different jurisdictions and to prevent MNEs from restructuring outside of the rules.

Digging deeper, Pillar Two consists of four interlocking domestic rules:

- The first, the Qualified Domestic Minimum Top-up Tax (QDMTT), applies to low-tax profits within a jurisdiction's own borders.
- The second, the IIR, applies to low-tax profits of foreign subsidiaries of a jurisdiction's own companies.

[11] The name has since been changed to the Undertaxed Profit Rule, and is now called the UTPR without a precise definition.

- The third, the UTPR, applies to low-tax profits of a subsidiary of a foreign company that has low-tax profits not taxed under other top-up rules.
- The fourth, the Subject to Tax Rule (STTR), allows source country jurisdictions to impose a top-up withholding tax on certain types of outbound payments made between related parties that are not subject to a minimum tax rate.

In more detail, the QDMTT refers to a minimum tax regime that is implemented in the legislation of a jurisdiction and mimics the impact of the GloBE top-up tax on domestic companies. In other words, it allows jurisdictions to introduce a minimum corporate rate and maintain a competitive tax regime. This means that a QDMTT will effectively change the order in which jurisdictions are entitled to charge top-up taxes where the ETR of an entity within Pillar Two falls below the 15 % global minimum rate. The QDMTT is prioritised with the result that a jurisdiction with a QDMTT becomes the first in line to receive any top-up revenue from entities located in its jurisdiction. Without a QDMTT, that revenue would go to another country as determined by the Pillar Two rule order. For businesses, the effect of a QDMTT is to direct where any top-up tax is to be paid. There should be no change in the amount of top-up tax that is due.

The IIR imposes top-up tax on an ultimate parent entity (UPE) in respect of the low-tax income of a constituent entity (CE). If the country where the UPE is located has a qualifying IIR (i.e. at least 15 %), then if a subsidiary of an MNE is subject to a lower ETR in a country where it does business, the UPE's country collects the top-up tax to ensure that the 15 % minimum tax is paid. The IIR therefore imposes tax on a company in relation to the profits of its foreign subsidiaries and branches.

The UTPR denies deductions or requires an equivalent adjustment to the extent that the low-tax income of a CE is not subject to tax under the IIR. The UTPR is essentially a backstop to the IIR, and is intended to encourage all countries to adopt an IIR. Nevertheless, the adoption of Pillar Two is voluntary, meaning that there may be jurisdictions that do not apply the IIR rule. Hence, the UTPR is a necessary backstop to ensure the consistency of Pillar Two. For MNE groups whose ETR is less than 15 % after application of the IIR, the UTPR ensures that all other countries participating in Pillar Two where the MNE has a presence receive an allocation of the additional taxes. This is done by sharing the global residual top-up tax among the jurisdictions that apply the UTPR, using an apportionment formula[12].

To meet the needs of less developed countries with lower administrative capacity, Pillar Two also provides for the STTR, which allows these jurisdictions to impose withholding taxes on direct outgoing payments (interest, royalties and similar) to related parties that are subject to a tax rate of less than a minimum (set at 9 %) in their country of residence. The STTR will be based on the treaties: if requested, the destination countries of the payments that apply a corporate tax with a nominal rate lower than the minimum will allow the application of the STTR by the jurisdictions of origin of the flows, disapplying any more favourable conditions for the taxpayer provided for by the treaties in force.

The rate of withholding tax will have a limit: it cannot bring the overall tax on payments to exceed the minimum rate. Unlike the IIR and the UTPR, the STTR is independent of the size of the group: it will also apply to payments between related parties belonging to a group with revenues of less than EUR 750 million. The rate to be taken into consideration will be the nominal rate of the destination country of the payments, not the effective rate. The withholding tax will apply payment for payment, not on the profit determined at the end of the year. The STTR will apply before the IIR and the UTPR,

[12] Undertaxed profits are divided between group entities using an allocation key based on a jurisdiction's share of employees and tangible assets, weighted on a 50:50 basis.

while its payment will be taken into account in the calculation of the global minimum tax for the purposes of the IIR and the UTPR.

There is an order to the application of the rules. First comes the national tax legislation, including the STTR (in the country of origin of the payments) and controlled foreign company (CFC) rules (in the countries that apply these regimes to the headquarters of the multinational group). These rules must be recognised as 'eligible' for the application of Pillar Two. Then, after these taxes have been computed and included in the tax reporting of the CE and UPE, the level of ETR is calculated. If the ETR is below the minimum of 15 %, the jurisdictions that choose to do so may apply the QDMTT to the resident CE, and the QDMTT could absorb all the top-up tax. If a QDMTT is absent and a top-up tax is due, either the IIR or UTPR will apply. Both may apply if the IIR is insufficient or absent, and some residual top-up tax remains. Hence, the UTPR will be the last rule to be applied. This order is important to establish which jurisdictions will seize the revenues of the top-up tax. Most jurisdictions seem oriented towards applying the QDMTT and seizing the revenue of the top-up tax, while maintaining various tax incentives in their domestic tax legislation (i.e. their fiscal attractiveness).

Companies falling under the scope of Pillar Two are MNEs with an annual consolidated group revenue in excess of EUR 750 million in at least two of the four immediately preceding fiscal years. Exclusions apply to investment funds / real estate investment vehicles, pension funds, governmental entities, international organisations and non-profit organisations that are UPEs of an MNE group (or any holding vehicle used by such entities). Although these entities are not subject to the GloBE rules, the rules can apply to subgroups controlled by these excluded entities. Figure 3 summarises the basic steps involved under Pillar Two.

On 6 October 2022, the OECD published a new report on Tax Incentives and the Global Minimum Corporate Tax (OECD, 2022c) in an effort to assist emerging and developing countries to review the design of their tax incentives as they prepare for implementation of the GloBE rules. At the end of the year, on 20 December 2022, the OECD released an implementation package consisting of three elements: i) a guidance on safe harbours and penalty relief; ii) a public consultation document on the GloBE Information Return; and iii) a public consultation document on Tax Certainty for the GloBE Rules.

In February 2023, technical guidelines were released to assist governments with the implementation of the GloBE rules. The Administrative Guidance aims to ensure coordinated implementation in domestic legislation and provide greater certainty for businesses. It also includes guidance on recognition of the US minimum tax called Global Intangible Low-Taxed Income (GILTI) under the GloBE rules, and on the design of the QDMTT. Further Agreed Administrative Guidance will be released on an ongoing basis to ensure that the GloBE rules continue to be implemented and applied in a coordinated manner. In fact, in July 2023 a second Administrative Guidance document was released by the Inclusive Framework[13], while the OECD Inclusive Framework approved a document containing the model treaty on the STTR and a commentary explaining the purpose and operation of the STTR. Following the public consultation that took place in March 2023, a document on the GloBE Information Return was published, containing a standardised information return to facilitate compliance with, and administration of, the GloBE Rules.

[13] This includes guidance on: currency conversion rules when performing GloBE calculations; tax credits; the application of the substance-based income exclusion (SBIE); and the design of QDMTT. It also provides a QDMTT safe harbour and transitional UTPR safe harbour.

Figure 3. Basic steps in calculating the effective tax rate and the top-up tax payable under Pillar Two

Step 1
- Determine the entities that a group has in a particular jurisdiction.

Step 2
- Determine the profits of those entities.

Step 3
- Determine the taxes that relate to those profits (including those relating to timing differences).

Step 4
- Aggregate for each jurisdiction the profits and taxes found in Steps 2 and 3.

Step 5
- Calculate the group's ETR in that jurisdiction by dividing the aggregate taxes by the aggregate profits (i.e. Net GloBE Income).

Step 6
- If the ETR in Step 5 is less than 15 %, calculate the group's 'top-up percentage' for the jurisdiction, which is 15 % less the jurisdictional ETR.

Step 7
- Calculate the jurisdictional top-up tax by multiplying the profit calculated in Step 2 by the 'top-up percentage' in Step 6, and deducting the QDMTT in that jurisdiction.

Step 8
- Attribute that jurisdictional top-up tax to the group's individual entities in that jurisdiction based on their relative contribution to total profit.

Step 9
- The top-up tax attributed to an entity is first charged under the IIR, which charges this tax on the entity's parent entity[1].

Step 10
- Any remaining top-up not collected under the IIR will be charged upon other group entities under UTPR[2].

Notes: [1] The IIR is charged on a top-down basis, which means that the ultimate parent will generally be charged the top-up when it is located in a jurisdiction that has introduced Pillar Two. This means that the IIR will only be charged at an intermediate parent level if the UPE is not subject to Pillar Two (or if the low-taxed entity is more than 20 % owned by minority investors). These parents will be charged a top-up based on their ownership share in the low-taxed entity. [2] The total amount to be collected from group entities in a jurisdiction under the UTPR will be based on the tangible assets and employees of those entities as a proportion of tangible assets and employees in all jurisdictions that have implemented the UTPR.
Sources: Author's compilation based on information currently available, and HMRC (2022).

4. European corporate tax system

The common market in the EU and the close economic relations with non-EU countries (e.g. Norway, Switzerland and the United Kingdom) have resulted in European economies being deeply interconnected with significant trade, investment, financial and economic benefits among them. This strong connection influences each country's corporate income tax (CIT) base and rate, and affects those of other countries (Crivelli *et al*., 2021). Given the sovereignty of Member States in setting their own corporate tax policy, European coordination with regard to CIT rates has been very limited (Flamant *et al*., 2021)[14]. Moreover, as we analyse below, there has been a fundamental shift in European (political) attention from harmonisation efforts aiming to reduce the double taxation of corporate activities (particularly cross border) in the 1980s and 1990s, to harmonisation efforts towards reducing tax avoidance in the 2000s and 2010s.

The average statutory tax rate in the EU has declined significantly over the last decades, from approximately 35 % at the end of the 1990s to 23 % in 2008 and 21 % in 2021. Despite the modest decline observed since the global financial crisis, tax competition seems to have become more intense in Europe[15]. Although there may be country-specific determinants of tax rate decreases (Rodrik, 1997; Winner, 2005; Overesch and Rincke, 2011; Mourmans, 2016), one reason for a 'race to the bottom' is tax competition triggered by production factors, in particular capital, becoming increasingly mobile. Another factor that has exacerbated such competition is the successive enlargements that took place in the EU. Evidence shows that tax competition depends on EU membership, with EU Member States already responding more competitively to corporate tax cuts made by other EU Member States than those introduced by non-members (Davies and Voget, 2011). In addition, bilateral trade integration has given rise to significant interaction between European countries with respect to effective average tax rates, thus pushing corporate tax rates downwards (Crabbé, 2013; Exbrayat, 2017).

4.1 From the Neumark Report to the Anti-Tax Avoidance Directive

Several factors justify much closer cooperation of corporate tax policies in the EU: i) high compliance and administration costs due to the existence of 27 different national tax systems across Member States; ii) differences in effective tax burdens within the EU; iii) difficulties in collecting corporate tax based on separate accounting systems (especially for MNEs); and iv) conflicts between national tax policies and EU laws.

Proposals to harmonise taxes in the EU are not a new phenomenon, and are mainly driven by the commitment to create a single market (EEC, 1963; ECIS, 1968; Alworth, 1987; Kopits, 1992; Bettendorf *et al*., 2010). However, the harmonisation process is complicated by the widely diverging interests of the individual Member States and the unanimity principle in tax matters imposed by Article 113 (for indirect taxes) and Article 115 (for direct taxation) of the TFEU.

In 1960, the Commission set up the Fiscal and Financial Committee (FFC), chaired by Professor Fritz Neumark and tasked with examining taxation and public expenditure with a particular focus on those aspects that might distort the achievement of a common market. The outcome of this committee, the

[14] In contrast to other taxation areas (e.g. consumption taxes) where EU coordination efforts are more advanced.
[15] At least for certain tax-base-narrowing measures, including expenditure-related investment incentives, research and development (R&D) incentives, and other exemptions and deductions specifically targeting the most mobile parts of corporate tax bases (i.e. MNE's profits). For example, Malta and Cyprus allow returns of up to 5 % of new equity, or even total equity, to be excluded from the corporate tax base (Flamant *et al*., 2021).

Neumark Report, recommended the harmonisation of taxation in a general sense using a three-stage approach. This first stage was about turnover taxes, withholding taxes on dividends and interest, and double taxation agreements. The second stage focused on the harmonisation of personal income taxes and corporate taxation, while the third stage included a common information system and the establishment of a Community tax court. Although the report put forward a fundamental set of proposals, sixty years later they are still a long way from being implemented in full.

A few years later, the Segre Committee focused on the establishment of an integrated capital market within the Community and the free movement of capital. The 1966 Segre Report concluded that tax considerations should not influence the choice of location of investments or transactions, nor investor choices between direct investment and investment through an intermediary. Among the recommendations put forward was the replacement of bilateral double tax treaties with a multilateral Community convention, as well as the extension of credits for company tax paid to non-resident shareholders.

In the 1970s, the discussion focused on the dilemma between classical and imputation systems of cross-border dividends[16]. Although the Van den Tempel Report advocated that the former system was preferable in view of harmonisation, this was not followed up by the Commission's 1975 proposal recommending a partial imputation system, which was eventually withdrawn. Other draft proposals on loss relief rules[17] and on the harmonisation of the tax base of enterprises were also withdrawn.

In an effort to better understand the level of distortion that differences in taxation between Member States cause in the internal market and particularly to investment decisions and competition, the Commission charged the Ruding Committee with coming up with recommendations and long-term measures to be implemented. The Ruding Report highlighted that priority should be given to: i) removing discriminatory and distortionary features of countries' tax arrangements that impede cross-border business investment and shareholding; ii) setting a minimum level for the statutory corporation tax rate and common rules for a minimum tax base[18]; and iii) encouraging the maximum transparency of any tax incentives granted by Member States to promote investment.

Regarding the harmonisation of the CIT base, several proposals were put forward[19] before the Commission made a concrete proposal in 2011 for the introduction of a common consolidated

[16] Systems that tax both companies and shareholders on corporate profits (i.e. double taxation of company profits) – companies when profits are derived, and shareholders when profits are distributed as dividends – are referred to as classical systems. On the other hand, systems that mitigate such distortionary effects include split rate and imputation systems. A split rate system adopts different rates of corporation tax for retained and distributed company profits, while an imputation system entails at least part of the tax paid by the corporation being imputed to shareholders and set against their liability to income tax on their dividends.

[17] Such as the 1984 Proposal for a Council Directive on the harmonisation of the laws of the Member States relating to the tax arrangements for the carryover of losses of undertakings, or the 1991 Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States.

[18] In an effort to limit excessive tax competition between Member States, intended to attract mobile investment or taxable profits of multinational firms.

[19] One of these was the common base taxation under which two or more Member States would harmonise their rules for computing taxable profits in respect of MNEs with cross-border operations (national rules would be maintained for MNEs with purely domestic operations). Another proposal was home state taxation, under which participating Member States would maintain their own profit determination rules, but MNEs with cross-border operations would be taxed in the Member State in which their headquarters were located (exemplifying the principle of mutual recognition). Other more far-reaching proposals included a European corporate tax (operating

corporate tax base (CCCTB), which was later relaunched in 2016. The proposal is based on a two-step approach, where the first step introduces common rules for determining EU corporate tax bases (CCTB), and the second leads to consolidation and the adoption of a CCCTB[20]. Despite lack of progress on these proposals in recent years – also because of the intervening discussions in the context of the OECD Inclusive Framework – they remain on the Commission's agenda. Most recently, a renewed commitment to a system of a common tax base with formulary apportionment was published, the so-called 'Business in Europe: Framework for Income Taxation (BEFIT)'. This has resulted in the CCTB proposal being withdrawn and replaced by BEFIT.

During more recent decades, several aspects of CIT have been coordinated across Member States through directives. In particular, greater attention has been given to removing obstacles to cross-border activities and limiting profit shifting by MNEs. For example, the Merger Directive of 1990 and its amendment in 2005[21] rule out additional taxes on cross-border transfers of assets in the case of a merger between two companies in different Member States, and provide for a common system of deferral for taxation of capital gains and tax-free reserves. The Parent-Subsidiary Directive of 1990 and its 2003 amendment eliminate withholding taxes on payments and double taxation of dividends for parent companies and subsidiaries in different Member States. Finally, the 2003 Interest and Royalty Directive provides for a withholding tax exemption on interest and royalty payments between associated companies within the EU.

Whilst some of the earlier recommendations and directives sowed the seeds for the system that Europe has today, some of the important legislative measures adopted recently were precipitated and facilitated by political developments affecting the international tax community at large, such as the OECD/G20 BEPS project. Two such directives are the 2016 ATAD I and the 2017 ATAD II, which make some of the BEPS outcomes mandatory for EU Member States (e.g. on limiting interest deductibility) and introduce anti-abuse measures against tax avoidance practices. In addition, directives have been passed to implement BEPS recommendations in EU law, including on administrative cooperation in taxation and on tax dispute resolution mechanisms in the EU.

4.2 The EU's Digital Taxation Package

In March 2018, the Commission presented its communication 'Time to establish a modern, fair and efficient taxation standard for the digital economy', which included not only a proposal for a long-term solution in the form of a significant digital presence (SDP), but also a short-term proposal for a DST.

The SDP proposal, which extends the treaty concept of PE, entails a common reform of national CIT systems and the introduction of rules for attributing profits to digital businesses. It applies to any company in a Member State if, in a given tax period:

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alongside national rules with revenues to be paid into the EU budget), or an EU-wide corporate tax base replacing national tax bases (but to be allocated to Member States, which could apply their own rates). For a more detailed explanation, see Gnossen (2001), Pîrvu (2012), Chelyadina (2019), and Crivelli *et al*. (2021).

[20] The CCCTB aims to eliminate mismatches between national systems and remove the possibility of using preferential regimes for profit shifting or manipulating transfer pricing. This is because intra-group transactions would be ignored, and the consolidated group profits would be shared by an apportionment formula. In addition, the CCCTB would introduce complete transparency on the ETR of each jurisdiction, thereby reducing the scope for harmful tax competition, while it could also be a useful instrument to address the debt bias.

[21] The first discussions on cross-border dividends and corporate restructurings were held in 1967 ('Programme d'harmonisation des impôts directs'). However, the Directive was only enacted in 1990, 23 years later.

i) the revenues from providing digital services to users in that Member State exceed EUR 7 million;
ii) the number of users of one or more of those digital services located in the Member State exceeds 100 000; or
iii) the number of contracts for supplying digital services concluded by company users located in the Member State exceeds 3 000.

In addition, there is a range of activities (economically significant activities as defined by Article 5(5)) pursued by a business in connection with an SDP that would justify profit attribution to the SDP jurisdiction (even though the activities are physically carried out outside the jurisdiction).

With regard to DST, which would have been an interim/temporary solution for the taxation of digital activities in the EU (until an agreement is reached at the OECD level), its main rationale is the misalignment between where value is created for certain digital platform companies and where taxing rights are allocated. The DST would be applied at a rate of 3 % on gross annual revenues stemming from:

i) selling online advertising space;
ii) digital intermediary activities that allow users to interact with other users and can facilitate the sale of goods and services between them; and
iii) the sale of data generated from user-provided information.

However, both of these proposals (i.e. SDP and DST) fell short of securing consensus in the Council, as unanimity was not achieved. Similar was the outcome on the Commission's effort to propose a 'reduced' approach focusing on targeted advertising (Digital Advertising Tax). The rejection of the package presented by the Commission was also influenced by the position taken by the US government, which strongly opposed solutions related to the taxation of large digital companies (almost all with headquarters in the US) in the country of 'consumption' of digital services. Such web taxes were considered discriminatory against US companies, and countervailing custom duties were threatened. There was also a widespread sentiment that national solutions could not properly address problems with a global dimension, and that a globally agreed solution would be preferable.

Nevertheless, pending overall agreement, many Member States (e.g. Austria, France, Hungary, Italy, Poland, Portugal and Spain) and third countries (e.g. Brazil, Canada, Turkey and the UK) have adopted national web taxes. Others have put forward proposals to enact (e.g. Belgium, Czech Republic and Slovakia) or have expressed their intention to introduce (e.g. Latvia, Norway and Slovenia) unilateral DSTs with various scopes and thresholds (KPMG, 2022). For example, while some countries only tax revenues from online advertising (e.g. Austria and Hungary), others such as France use a much broader tax base, including revenues from the provision of a digital interface, targeted advertising and the transmission of data collected about users for advertising purposes. The tax rates range from 1.5 % in Poland to 7.5 % in Hungary (although it has been temporarily reduced to 0 %).

Eventually, in the framework of the general agreement on Pillar One, it was agreed to put the adoption of new national web taxes on hold, while those already implemented will be abolished when Pillar One is effectively finalised.

4.3 The EU Directive on Pillar Two

The discussion on a minimum effective level of taxation of MNEs in Europe was revived in 2019 by a French-German proposal. The proposal advocated for schemes that would ensure that the profits of

MNEs were subject to some minimum overall level of taxation that would apply to both outbound and inbound foreign direct investment (FDI):

i) A minimum tax on outbound investment would tax foreign earnings of MNEs at a reduced rate with credit for source-based taxes. This is similar to the US GILTI, introduced in 2017.

ii) A minimum tax on inbound foreign investment would impose a minimum tax on operations in source countries or deny tax-reducing deductions. This is similar to the base erosion and anti-abuse tax (BEAT) introduced in 2017 in the US. Different variants of these measures were also discussed under Pillar Two of the OECD Inclusive Framework.

Following the OECD agreement of 20 December 2021, two days later the Commission proposed a directive to incorporate Pillar Two rules into EU law. On 22 December 2022, Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, was published in the Official Journal of the European Union. EU Member States are now required to bring into force the laws, regulations and administrative provisions necessary to comply with this directive by 31 December 2023. Although it will implement most of the OECD Pillar Two rules, and thus follows the OECD GloBE rules closely, there are few deviations worth mentioning.

First, it is a directive, meaning that Europe is creating a legislative act that is binding on the 27 Member States[22], which is different from the status of 'common approach' of the OECD rules. Due to the way in which the single market operates, it will be almost impossible for Member States to apply their own rules. On top of that there is the ECJ jurisprudence, which would make it impossible to treat foreign and national companies differently, as well as to introduce isolated measures that could distort the single market and go against EU law.

Second, to ensure compliance with EU law, the Directive extends the scope of the GloBE rules. This means that the EU proposal includes large-scale domestic groups with a combined annual group turnover of at least EUR 750 million based on consolidated financial statements. Therefore, the adjusted scope also takes into account purely domestic groups, which is necessary for complying with the EU fundamental freedoms.

Third, on the application of the IIR, the Directive requires Member States to ensure that the entity applying the IIR (i.e. the UPE) also meets the minimum ETR domestically (meaning that the IIR principles apply to the UPE as well as to its domestic subsidiaries). This differs from the OECD GloBE rules, which provide that the jurisdiction applying the IIR only takes into account the ETR of foreign CEs.

Fourth, and in addition to the GloBE rules, the Directive obliges Member States to implement penalties that will apply to entities that breach the national rules implementing the Directive (i.e. those that do not comply with their obligation to file the GloBE information return and pay their share of top-up tax).

Regarding implementation, and in contrast to the OECD rules (the implementation of which is left to the discretion of each jurisdiction), the Directive obliges all Member States to implement Pillar Two and adopt common rules, closely in line with the OECD ones. However, the Directive needs to be transposed into the national laws of each Member State, so some differences in its implementation may still arise.

[22] The Directive is binding on the Member States with regard to the result to be achieved, while leaving to national authorities the competence to decide on the form and means to achieve it. Thus, the 'binding' should rather be interpreted in a teleological sense.

Moreover, in the EU, the OECD and the G20 initiatives must be framed in the BEFIT framework, which aims to harmonise business taxation in Europe by providing a single corporate tax rulebook.

From early on, all 27 EU Member States stated in principle that they supported the deal on Pillar Two, resulting in the draft directive on the global minimum tax being presented quickly after the issuance of the Model Rules. However, EU legislation on tax issues requires unanimity, which at the beginning of the dialogue seemed difficult to achieve, as a handful of Member States were not willing to support the Directive as first drafted. As a result, on 12 March 2022 an amended draft compromise text of the proposed directive was published, including several amendments compared to the 22 December 2021 version. Although some of these are essentially semantic, others appear to be more fundamental.

A major point of concern for Member States (e.g. Estonia, Malta, Poland and Sweden) was the initial short implementation timeline. The 12 March compromise text referred to a transposition deadline of 31 December 2023 and an option for Member States to defer the application of the IIR and the UTPR until 31 December 2025, where no more than 10 UPEs of in-scope MNE groups are located in those Member States (optional IIR and UTPR deferral)[23]. On 28 March 2022, a revised compromise text was published, extending the maximum deferral period that Member States can opt from two to six months, and increasing the minimum number of UPEs of in-scope groups located in a given Member State from 10 to 12, under which that Member State may choose not to apply the IIR and UTPR until 31 December 2029. In addition, the principle of the link between Pillar Two and Pillar One was reaffirmed and the commitment to present a solution on the taxation of the digital economy in the course of 2023 was announced.

The Polish government, which had initially declared its opposition to the Directive – also for general political reasons related to access to the Next Generation EU funds – declared itself satisfied with the revised compromise[24]. However, the Hungarian government vetoed it, denouncing delays in the work on Pillar One (on the basis of the agreement that the two Pillars form a package) and deeming the approval of the Directive premature in the current geopolitical and economic context. The French presidency tried unsuccessfully to obtain unanimity, until the last Economic and Financial Affairs Council of its semester in June 2022. The subsequent Czech presidency (from 1 July until 31 December 2022) resumed the negotiations, and a political agreement was reached on 15 December 2022[25], leading to the approval of the Directive.

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[23] In particular, Estonia and Malta requested a broader scope and timeframe in respect of the optional IIR and UTPR deferral. On the other hand, Poland's concern was related to the adoption of the Directive independent of Pillar One, while Sweden maintained a parliamentary scrutiny reservation.

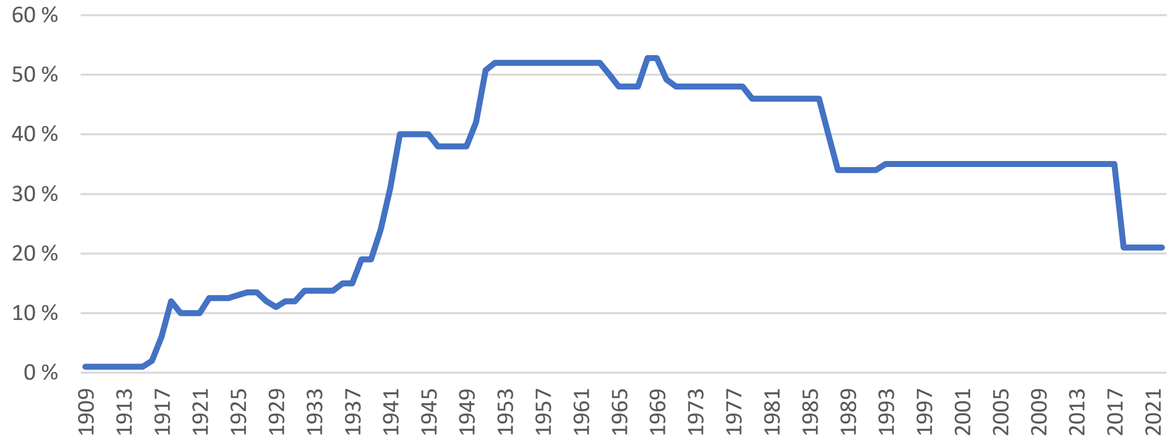
[24] In particular, Poland's concerns were related to the link between Pillar One and Pillar Two. This has now been addressed with Article 57, which required the Commission to submit a report to the EU Council by June 2023 assessing the implementation of Pillar One, 'and, if appropriate, submit a legislative proposal to address these tax challenges in the absence of the implementation of the Pillar One solution'. The report, published on 30 June, takes note of the work on the draft multilateral convention on Pillar One and looks ahead to an imminent solution to the outstanding problems.

[25] Although Hungary abstained from voting, the required unanimity was reached. According to Article 235 TFEU, 'abstentions by members present in person or represented shall not prevent the adoption by the European Council of acts which require unanimity'. This means that Hungary is bound by the Pillar Two Directive and will implement it according to the agreed timeline. Failure to do so, may result in Hungary being brought before the ECJ by the Commission.

5. US tax reforms

US CIT has increased from just 1 % in 1909 to its peak of 52.8 % in 1968, before declining to 35 % in 1995 (see Figure 4). In December 2017, Congress passed the TCJA, which made significant changes to the CIT and taxes on pass-through businesses[26]. In particular, and among other changes to the CIT base: i) the federal CIT was reduced from 35 % to 21 %[27]; ii) investment in short-lived assets was provided bonus depreciation (also known as full expensing); and iii) the treatment of foreign income was completely overhauled (a move from worldwide to territorial taxation).

Figure 4. Historical federal corporate income tax rate in the US (1909-2022)



Notes: Data refer to the top marginal tax rate on corporations. This is the tax rate applicable at the federal level on domestic companies. Different rates apply on non-resident/foreign-owned companies. Provincial and local governments may levy additional taxes.
Source: Author's calculations based on data from the Tax Policy Center.

The high US corporate tax rate prior to the TCJA reduced US companies' competitiveness, and encouraged them to shift profits abroad and move their headquarters to foreign jurisdictions in order to avoid the US tax liability[28]. By lowering the corporate tax rate and moving closer to a territorial tax system[29], the TCJA reduced the incentives for US corporations to invert and engage in other methods of profit shifting. On top of that, it made the US economy more competitive with other industrialised countries, and introduced incentives to invest in the country.

[26] Pass-through businesses are not subject to CIT, but instead report their income on the individual income tax returns of owners.
[27] On top of the federal CIT of 21 %, corporations operating in the US face another layer of CIT levied by states (44 out of the 50 US states). The state corporate tax rate ranges from 3 % in North Carolina to 12 % in Iowa, with the average (weighted by population) being about 6 %. As such, the statutory CIT rate in the US, including an average of state CITs, is 25.7 % (38.9 % before the TCJA). This rate is in line with the OECD average of 24 %.
[28] Inversions were due to the high tax rate and the worldwide system of corporate taxation, which required corporations to pay US tax on worldwide profits after receiving a credit for foreign taxes paid (Watson and McBride, 2021).
[29] In a territorial tax system, foreign profits are generally exempt from US taxes. In practice, such a system usually has anti-avoidance provisions to prevent firms from shifting their domestic profits abroad.

5.1 Global Intangible Low-Taxed Income

The TCJA introduced three key provisions aimed specifically at influencing the behaviour of multinationals. The first one is the Global Intangible Low-Taxed Income (GILTI) provision, which intends to approximate income from intangible assets (e.g. patents, trademarks and copyrights) held abroad.

The worldwide system of corporate taxation applicable before 2017 required multinational corporations to pay taxes twice, first to the foreign country in which they did business, and then to the Internal Revenue Service (IRS) after they repatriated their profits. If foreign profits were not repatriated (e.g. reinvested in ongoing activities of their foreign subsidiaries), US firms could delay paying the additional US tax on their foreign profits (i.e. deferral). After the TCJA, the US exempted earnings from active businesses of US firms' foreign subsidiaries, even if the earnings were repatriated.

Worrying that this complete exemption of US multinationals' foreign earnings could incentivise profit shifting to low-tax jurisdictions abroad, Congress added a new minimum tax on GILTI. This tax is set at half the domestic rate (10.5 %) on profits earned abroad that exceed a certain threshold, which is defined as 10 % of a foreign subsidiary's tangible assets (called qualified business asset investment (QBAI)) such as buildings and equipment. This means that while the provision nominally targets income on intangible assets overseas, it really targets any income that can be defined as 'excessive' measured relative to a foreign subsidiary's tangible assets (Gray, 2021)[30]. GILTI ensures that US multinationals remain subject to a minimum taxation on income produced abroad by their controlled companies. In short, it is a sort of strengthened and pervasive CFC rule that operates as an alternative minimum tax at a reduced rate on a world-wide rather than country-by-country basis.

Eliminating the tax consequences of repatriation reduces the incentive to keep earnings offshore (i.e. the lock-out effect). This change could increase domestic investment, as companies that are now facing a lower tax barrier to repatriating earnings are liquidity-constrained (Faulkender and Petersen, 2012). However, literature seems to be inconclusive. Evidence from a previous episode, during which the tax incentive to repatriate earnings was temporarily enhanced, found that the induced repatriations led to little additional domestic investment (Dharmapala *et al.*, 2011). Similarly, when examining the switch from a worldwide to a territorial tax system for the taxation of repatriated foreign earnings in the UK and Japan, results indicate that payouts increase, but that there is no change in domestic investment (Arena and Kutner, 2015).

With regard to foreign investments, the results are also mixed, with some suggesting an increase (Clausing, 2020; Beyer *et al.*, 2023) and others a decline (Amberger and Robinson, 2023). Evaluating the impact of the TCJA on foreign subsidiaries of US MNEs shows that since the introduction of the TCJA, these companies exhibit lower capital and labor investment compared to non-US-owned subsidiaries (Samuel, 2023). However, this reduction is efficient, leading to higher productivity of US-owned subsidiaries. In other words, the TCJA allows US MNEs to operate more efficiently abroad. Moreover, the decrease in capital and labour investment, and the increase in productivity, are concentrated in subsidiary countries with low corporate income tax rates. US multinationals' investment behaviour may also depend on many other factors, such as domestic liquidity, investment opportunities and the cost of debt (Beyer *et al.*, 2021).

[30] Companies are also eligible to use 80 % of their foreign tax credits, calculated on a worldwide basis, to offset the minimum GILTI tax.

Concerns have been raised with regard to two main features of GILTI. First, and in contrast to the OECD Model Rules, GILTI operates on a global rather than per-country basis[31]. This means that firms are able to cross-credit or blend low-income and high-income taxes together, thereby reducing their GILTI liability (Kamin *et al.*, 2019). Thus, companies are incentivised to locate investment in low-tax countries and blend that income with income from high-tax countries. By creating a stream of zero-tax income that brings the average foreign taxes down to the minimum rate, a firm can shield profits in tax havens by choosing to invest in high-tax countries[32].

Second, the TCJA exempts from the GILTI minimum tax a deemed 10 % return on tangible assets abroad measured by tax basis. However, this encourages US firms to locate tangible assets (and accompanying jobs) overseas (Dharmapala, 2018; Clausing, 2020). This is because the more a firm increases its US tax basis in foreign assets abroad, the smaller the tax base subject to GILTI. In other words, the more factories, machinery and buildings constructed overseas, the more tax-free income a corporations can earn (Beyer *et al.*, 2021).

5.2 Base Erosion and Anti-Abuse Tax

The second provision that the TCJA introduced is the Base Erosion and Anti-Abuse Tax (BEAT), which is a minimum tax of 10 % on the income of MNEs operating in the US (i.e. with US affiliates), whether they are owned by a US or by a foreign parent corporation. BEAT was conceived in order to limit the extent to which companies can shift reported profits out of the US. It targets base erosion of the US tax base by imposing additional tax liability on US corporations that excessively reduce their US tax liability by making deductible payments[33] to their foreign affiliates.

However, there are several problems with BEAT. First, BEAT excludes payments for cost of goods sold. This means that if a foreign affiliate can incorporate the foreign intellectual property (IP) into a product and then sell the product back to a US affiliate, the cost of the goods sold does not fall within BEAT (Kamin *et al.*, 2019). Thus, it allows supply chain restructuring in a way that base erosion payments can be repackaged in order to avoid falling within BEAT's scope (Wells, 2018).

Second, BEAT only applies to corporations that have average annual gross receipts in excess of USD 500 million over a three-year period. Its restricted applicability to only very large corporations allows MNEs with significant base-shifting activity (and revenues below USD 500 million) to avoid tax (Kysar, 2018)[34].

Third, unless an MNE makes base erosion payments that exceed 3 % of the overall deductible payments of the corporation (or 2% for financial groups), BEAT is not triggered. As a result, cliff effects may incentivise companies to engage in activities to get just inside the line (Shaviro, 2018).

[31] This is also one of the differences between GILTI and the OECD's Pillar Two. In the latter, the minimum tax is calculated on a per-country basis, while in the former it is calculated on an aggregate basis. That is to say, Pillar Two allocates income to affiliates operating in a particular jurisdiction. But under GILTI, the threshold is measured on an aggregate basis, meaning that tax revenue is not allocated among foreign jurisdictions (Morse, 2021). It has been found that that a country-by-country regime, relative to a global average regime, generates more tax revenue from MNEs and is more effective in preventing race-to-the-bottom incentives in the setting of tax rates – and thus tax competition between taxing jurisdictions (Sanchirico, 2022).

[32] Or to invest in countries with higher tax rates than the US, given that income and taxes from these countries can be used to blend down the US minimum tax to zero.

[33] Deductible (or 'base erosion payments') payments are amounts paid to a foreign affiliate, such as interest or amounts in connection with depreciable or amortisable property, and certain reinsurance premiums.

[34] As a comparison, under Section 385 of the US tax code, large multinationals are defined as those having either USD 50 million in annual revenues or total assets exceeding USD 100 million.

5.3 Foreign-Derived Intangible Income

The third provision, called Foreign-Derived intangible income (FDII), aims to motivate both US and foreign MNEs to locate within the US their mobile income generated from the supply of goods, services or intangible property that is ultimately used or consumed outside the US. In particular, a US corporation is allowed as a deduction 37.5 % of the portion of its taxable income classified as FDII[35].

Although FDII differs from GILTI and BEAT, as it is a rule that benefits MNEs rather than imposing new tax burdens on them, it complements them as part of a coherent overall scheme. FDII has common characteristics with GILTI (e.g. both use the same QBAI 10 % deemed return concept[36]) and share the same intention. This is to disincentivise foreign – and reward domestic – high reported profits, whether this is a matter of substantive locational choices or merely of profit shifting. Or to put it differently, GILTI is a stick that discourages low-tax foreign-source income, while FDII is a carrot that encourages reporting domestic-source income (Shaviro, 2018; Sanchirico, 2018).

FDII resembles the 'patent box' tax rules adopted in many other countries (Sheppard, 2018; Sullivan, 2018)[37], which aim to encourage companies to keep and commercialise IP in their country, and apply a lower rate of corporate tax to profits earned from patented inventions. However, and in contrast to a patent box that is directly related to income earned from IP, FDII does not refer specifically to income generated by IP[38]. Instead, it applies to export income[39].

FDII may be seen as a 'carrot' in respect of the normal statutory rate, but acting together with GILTI and BEAT it ensures a minimum level of taxation higher than the effective taxation incurred by many US multinationals. These three new regimes are novelties in international taxation: they pursue the objective of reducing base erosion and profit shifting, the same objective as BEPS, but in a different way, dystonic in respect of the Action Plans. While they are not in tune with the achievements in international cooperation reached by BEPS, they have inspired the subsequent revival of international cooperation that has led to the agreement on the two Pillars, in particular on the minimum tax of Pillar Two, which is strongly supported by the Biden Administration.

5.4 Build Back Better and Made in America

The Build Back Better programme was the US government's response to the economic consequences of the COVID-19 pandemic, focusing on a long list of social policies and programmes ranging from education to healthcare to housing to climate. In order to fund these activities, the Build Back Better Act (BBBA) included a package of tax policies and provisions, based on the proposals put forward in the Made in America Tax Plan. In particular, the proposals included reforms to address profit shifting and offshoring incentives, as well as to level the playing field between domestic and foreign corporations. The aim of the plan was to generate revenue through changes to tax provisions, which will be used to

[35] This would result in an ETR of 13.125 % on FDII. The remaining portion of FDII, meaning 62.5 %, is subject to the 21 % US tax rate.

[36] With FDII applying it to domestic assets.

[37] There are currently 14 European countries that have a patent box regime in place: BE, CY, ES, FR, HU, IE, IT, LT, LU, NL, PL, PO, SK and UK.

[38] See, for example, the letter sent by five EU finance ministers (of France, Germany, Italy, Spain and the United Kingdom) to Treasury Secretary Steven Mnuchin in December 2017.

[39] FDII encourages companies to locate their export-related activities in the US, particularly those involving intangible assets, which typically will not show up in the asset base calculation and so will not raise the threshold above which earnings are tax favoured (Auerbach, 2018).

offset the costs of large-scale public investments in infrastructure, the production of clean energy and the care economy, among others[40].

Taking into account concerns raised regarding the TCJA (and explained above), the plan found that the corporate tax rate reduction from 35 % to 21 % has mainly benefited shareholders (often also foreign), as windfall gains in the form of dividends and buybacks. In fact, it has not encouraged large businesses to make significant additional investments in the US, while GILTI and FDII were even found to encourage the diversion of fixed asset investments from the US abroad. Despite the TCJA, the US tax system still allows large-scale profit shifting (Bratta *et al*., 2021).

In an effort to regain control over the corporate tax base, the following proposals were put forward:

- Increase the corporate tax rate from 21 % to 28 %.
- Adapt GILTI by: i) increasing the GILTI rate from 10.5 % to 21 %; ii) switching to a 'per-country blending model' (instead of a global model) for calculating the GILTI minimum tax; and iii) eliminating the QBAI deduction from the GILTI calculation.
- Replace BEAT with Stopping Harmful Inversions and Ending Low-tax Developments (SHIELD)[41], a rule similar to the UTPR.
- Repeal FDII and replace it with direct funding of research and development (R&D) activities.
- Introduce a minimum corporate tax of 15 % on book income (i.e. accounting profits)[42].

The proposed changes to GILTI and FDII were meant to encourage domestic R&D in the US and increase manufacturing operations (onshoring), and to disincentivise corporations from shifting manufacturing operations abroad (offshoring), thereby benefiting from both regimes and paying only a bare minimum tax in the US. With regard to SHIELD, which targeted financial reporting groups with over USD 500 million in global annual revenues, the intention was to deny multinational corporations a US tax deduction by referencing payments made to foreign related parties subject to a low ETR.

However, in September 2021, when the House Ways and Means Committee released its version of the revenue provisions of the BBBA, many of the previous tax proposals were scaled back or even abandoned. For example, among the changes were a corporate tax rate of 26.5 % (instead of 28 %), a GILTI rate of 16.6 % (instead of 21 %) and an FDII rate of 20.7 % (instead of being eliminated). On 3 November 2021, the House passed a further revised version of the BBBA that was even more watered down than the Ways and Means version. This version was stalled in the Senate: by the end of 2021, prospects for meaningful tax reform were dim. The Republicans' win at the 2022 midterm elections and the deadlock in Congress resulted in the BBBA being called 'dead'.

[40] Although the initial amount of public expenditure was set at around USD 3.5 trillion on the upcoming eight years, it has been whittled down to approximately USD 1.7 trillion. The Made in America Tax Plan, together with the American Jobs Plan and the American Families Plan, were part of the Biden Administration's Fiscal Year 2022 Revenue Proposal (commonly referred to as the Green Book).

[41] The new provision, SHIELD, is a deduction-limitation measure for intra-group payments to group entities in low-taxing jurisdictions abroad.

[42] The aim was to prevent situations in which companies simultaneously present large commercial profits and low or no corporate taxable income, and consequently pay little or no corporation tax.

5.5 The Inflation Reduction Act and Corporate Alternative Minimum Tax

Surprisingly, however, on 16 August 2022 Biden's Administration signed the Inflation Reduction Act (IRA). Although significantly different from the BBBA and significantly scaled back, it contains important measures on the agenda of the Biden Administration aimed at containing inflation and in favour of green energy and environmental policies. The IRA also introduces a minimum tax on corporate income: Corporate Alternative Minimum Tax (CAMT).

CAMT applies to US resident companies with profits exceeding USD 1 billion, and provides for a 15 % tax rate on profit, as per the balance sheet results, with some adjustments. Companies will be required to pay the greater of the corporate tax (as calculated on the normal tax base) and CAMT. Moreover, CAMT is a purely domestic tax regime, which enters the determination of the US corporate tax. Although it pursues the same general objective as Pillar Two because it intends to implement a worldwide minimum tax, it differs in many respects (as will be shown in the next section).

5.6 Interaction with Pillar One and Pillar Two

Although the Biden Administration has declared its strong commitment to implementing the OECD agreement on Pillar One and Pillar Two, significant changes are still needed in US tax law for it to be consistent with the two pillars. In particular, Pillar One would require the US to cede taxing rights to countries with the relevant markets, at least for the largest US-based multinationals. Secretary Janet Yellen has indicated a willingness to do this, but the BBBA did not include any provisions relevant to Pillar One.

As for Pillar Two, there are much more significant challenges for the US tax system to overcome in order to coordinate with it. With regard to GILTI, despite the fact that the US already employs a minimum tax (10.5 %), it is not compliant with Pillar Two and the 15 % minimum corporate tax rate. The BBBA, which would have increased the rate and brought the GILTI regime into conformity with Pillar Two, passed the House of Representatives in November 2021, but stalled in the Senate. In addition, some other aspects of the GILTI rules are inconsistent with Pillar Two, such as the exclusion of QBAI from GILTI, and the calculation of the tax rate on a worldwide instead of country-by-country basis (Morse, 2021).

Moving to BEAT, the US currently subjects large corporate groups to a minimum rate of tax (10.5 %) if cross-border payments to related parties exceed 3 % of the company's total deductible payments. This is inconsistent with Pillar Two's UTPR, which follows completely different rules. Although originally the BBBA would have replaced BEAT with SHIELD – which conformed more closely to the UTPR – the actual legislative text of the BBBA would have left BEAT unchanged.

Another point of concern are so-called 'soak-up' taxes. If a country does not enact the country-by-country minimum tax on its resident multinationals, other countries will apply the minimum tax to those multinationals via their subsidiaries and soak up all the revenue that the non-implementing country could have collected. Currently, the GILTI rules include a limitation on foreign tax credits, which discourages low-tax jurisdictions from raising their tax rates to 'soak up' tax revenue that the US would otherwise collect. If the GILTI rules were changed to conform to Pillar Two, they would have to contend with the extent to which taxes paid to low-tax jurisdictions would be creditable.

Both pillars require considerable international agreement over their application and dispute prevention and resolution mechanisms. Pillar One, for example, will require dispute resolution processes in order to prevent double taxation of Amount A[43]. Without international co-ordination, successful implementation and operation of the rules are at risk, while controversies may arise. However, historically, the US has been hesitant to submit to the kind of international arbitration that would be necessary to resolve those disputes.

As mentioned above, in August 2022 the unexpected approval of the IRA introduced a new minimum tax on corporate income (i.e. CAMT) that pursues the same objective of implementing a worldwide minimum tax but differs in many respects from Pillar Two model rules (see Table 1). Perhaps the most important difference is that CAMT follows a worldwide approach, rather than the jurisdictional taken by Pillar Two[44]. Furthermore, the IRA does not provide for changes to GILTI and BEAT. Basically, for now, the adoption of Pillar Two by the US is not on the agenda in parliamentary proceedings, nor are changes to GILTI and BEAT.

Table 1. Differences between the Inflation Reduction Act and Global Minimum Tax rules

	Inflation Reduction Act: Corporate Alternative Minimum Tax	Global Minimum Tax: Qualified Domestic Minimum Top-up Tax
Rate	15 %	15 %
Exclusion for tangible assets	Depreciation deductions are excluded	8 % (incrementally reduced to 5 % over the first five years)
Exclusion for payroll costs	None	10 % (incrementally reduced to 5% over the first five years)
Loss carryovers	Capped at 80 % of adjusted financial income and limited to losses after 2019	Included in Deferred Tax Asset
Foreign tax treatment	Provides a credit for foreign taxes	Deferred tax asset recast at 15 % rate
Jurisdictional calculation	Applies to the worldwide income of US companies	Applies to domestic income
Threshold for application	USD 1 billion in financial profits	EUR 750 million (USD 769 million) in global revenues
Income definition	Financial profits as defined by accounting standards and adjusted to align more closely to taxable profits	
Treatment of tax credits	Provides a carveout for US tax credits	If a credit is not refundable, it will get clawed back
Treatment of capital investments	Capital investment deductions get clawed back	Included in the deferred tax asset measured at a 15 % rate

Source: Bunn (2022).

[43] Scope disputes could arise between a parent company and the tax administration in its home jurisdiction, or between multiple tax administrations. Although scope disputes with a single tax administration might be resolved through a simplified or jurisdiction-specific process, disputes among multiple tax administrations would require a standardised process in the MLC.

[44] CAMT applies to the global income of US companies, while Pillar Two requires MNEs to disaggregate income to every taxing jurisdiction. The lack of CbCR fails to reduce the incentives for MNEs to shift profits to low-tax jurisdictions; one of the key motivators behind Pillar Two.

Under the current legislation, the GILTI rate is expected to increase at the end of 2025. Perhaps on that occasion an adaptation of the US legislation to Pillar Two may come back to the discussion, if a consistent number of other countries have adopted it, and if some of the adopting countries dare to apply a UTPR to CEs belonging to a US UPE. For the time being, observers hold as the most likely scenario that the US will not adopt Pillar Two. The approval of the IRA has cast even more doubts on not only the capacity, but also the willingness of the US to adopt Pillar Two. CAMT and GILTI may be the eventual solution for the US, while the rest of the world adopts Pillar Two.

Under this scenario, the question is how would CAMT and GILTI be treated by countries that adopt GloBE rules? CAMT will be a component of US corporation tax, hence should be a covered tax for Pillar Two and treated as such in calculating the ETR on companies resident in the US: no particular problem seems to arise for the application of Pillar Two. The case for GILTI is more problematic: the question is whether GILTI must be treated as a qualified CFC regime, or not (see Section 7.6 below).

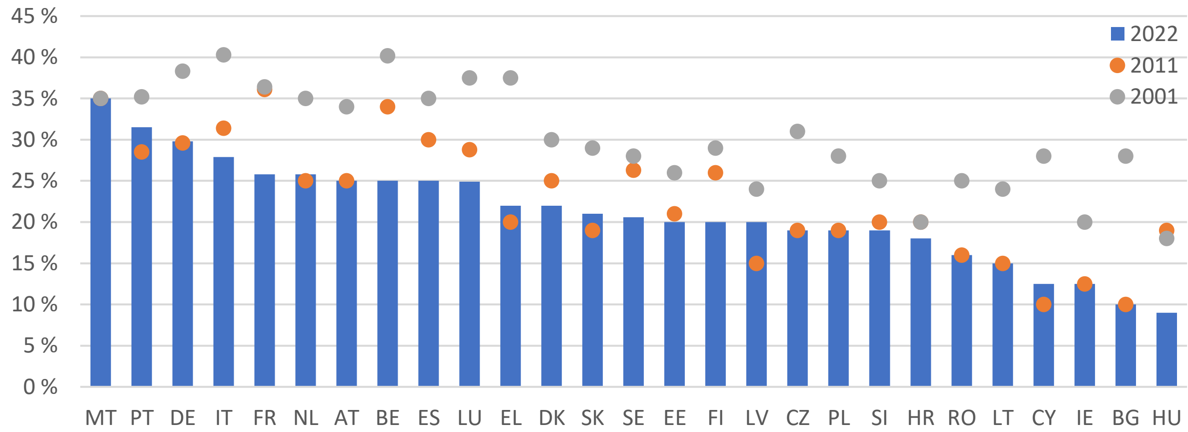
Uncertainties begin to arise on the implementation of Pillar One. This depends on the finalisation of the work in progress on the technical definitions of the content of the MLC, as well as on the achievement of a 'critical mass' of countries that will adhere to the MLC. Furthermore, the climate of international cooperation within the G20 has recently deteriorated. It may be the case that the US eventually do not adhere to Pillar Two, or to Pillar One. The US staying out of both pillars, after strongly promoting the whole initiative, would be a paradox and certainly would weaken the momentum of the initiative.

Moreover, if a consensus is not reached on Pillar One, or if the US does not adopt it, the issue of DST will again arise. The Commission is still committed to putting forward a new proposal for a directive on DST if Pillar One fails to be implemented. The Czech Minister of Finance alluded to this outcome when holding the rotating EU presidency (Fleming and McDougall, 2022). Other non-EU countries might take analogous initiatives, at the risk of serious confrontation with the US. It may be that concerns about this risk will foster further efforts and lead to a successful conclusion of the project (McDougall, 2022).

6. What we can learn from the data?

Statutory CIT rates have been in a downward trend over the last years in almost all EU Member States (see Figure 5). There are countries in which CIT rates have remained stable (e.g. Malta) or decreased marginally (e.g. Hungary), while in others they have decreased significantly (e.g. by 18 percentage points in Bulgaria and by 15.5 percentage points in Cyprus). As of 2022, Malta has the highest rate at 35 %, followed by Portugal and Germany with 31.5 % and 29.8 % respectively[45]. On the other hand, Hungary (9 %) and Bulgaria (10 %) have the lowest rates. This means that the difference between the maximum and minimum CIT rates across Member States is as high as 26 percentage points. The widening of the gap over the years (22.3 percentage points in 2001) is a sign, among other things, of intense tax competition and profit shifting between jurisdictions. It has been found that a one percentage point decrease in the statutory corporate tax rate will expand the before-tax income of global firms by 1 % (Beet *et al*., 2020).

Figure 5. Statutory corporate income tax across EU Member States (%)



Note: The figure shows the basic combined central and sub-central (statutory) corporate income tax rate given by the central government rate (minus deductions for sub-national taxes) plus the sub-central rate.
Source: Author's calculations based on data from the OECD Tax Database.

6.1 Multinationals

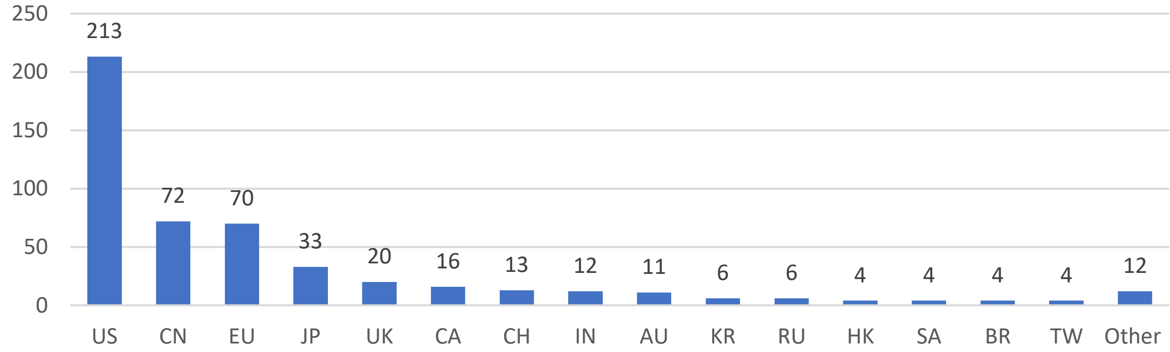
The first step in assessing the impact of Pillar Two is to identify the companies falling under its scope. Pillar Two rules apply to MNE groups with global revenues exceeding a EUR 750 million threshold, in line with current Country-by-Country Reporting (CbCR) obligations. An MNE group is defined as a collection of enterprises that are consolidated for financial accounting purposes. Moreover, Pillar Two applies to the CEs of MNEs: subsidiaries included in the consolidation and PEs, including branch operations and entities that are disregarded for income tax purposes.

The starting point for the analysis of MNEs is the OECD's Analytical Database on Individual Multinationals and their Affiliates (ADIMA), which provides information on 500 of the world's largest MNEs (by sales) covering 33 headquarter jurisdictions. Data show that 43 % (or 213 MNEs) of the multinationals are headquartered in the US (see Figure 6). About 14 % of the multinationals'

[45] For some countries, there are add-ons/surcharges that apply on top of the CIT rate. In Portugal, for example, although the statutory rate is by default 21 %, surtaxes increase this number to 31.5 %. This is due to: a local surtax of up to 1.5 % varying across municipalities, a state surtax that ranges from 3 % to 9 % depending on the amount of taxable profits, as well as a regional surtax that ranges from 2.1 % to 6.3 % depending on the amount of taxable profits.

headquarters are located in China (72 MNEs) and the EU (70 MNEs), followed by Japan (7 %, or 33 MNEs) and the UK (4 % or 20 MNEs). Thus, developed countries would benefit the most from Pillar Two, as the majority of MNEs (75 %) are located in them. This leaves developing countries with 23 % of MNEs, and the only economy in transition (Russia) with 1 % (or six MNEs).

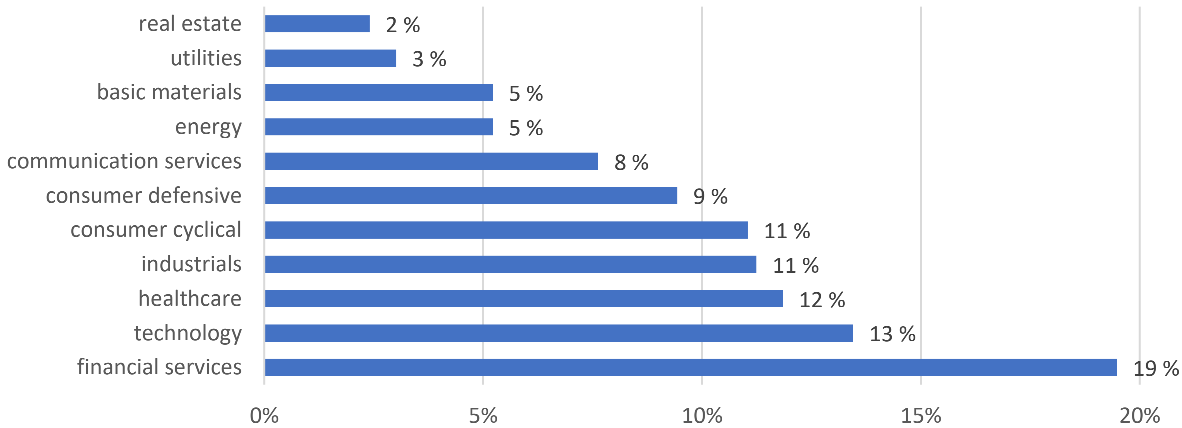
Figure 6. Location of the world's largest 500 MNEs (2020)



Notes: EU includes: BE, DE, DK, ES, FI, FR, IE, IT, NL and SE. The category 'Other' includes: AE, AR, ID, MX, NO, QA, SG and TH.
Source: Author's calculations based on data from OECD ADIMA.

With regard to the sectors in which MNEs operate, 19 % (or 97) are concentrated in the financial services sector, with technology and healthcare-intensive activities accounting for a smaller share (see Figure 7). A large proportion of MNEs are also active in consumer-related activities (either in the cyclical or defensive sector), while those involved in the discovery, extraction and processing of raw materials, as well as energy, are in the minority.

Figure 7. Sector of the world's largest 500 MNEs (2020)



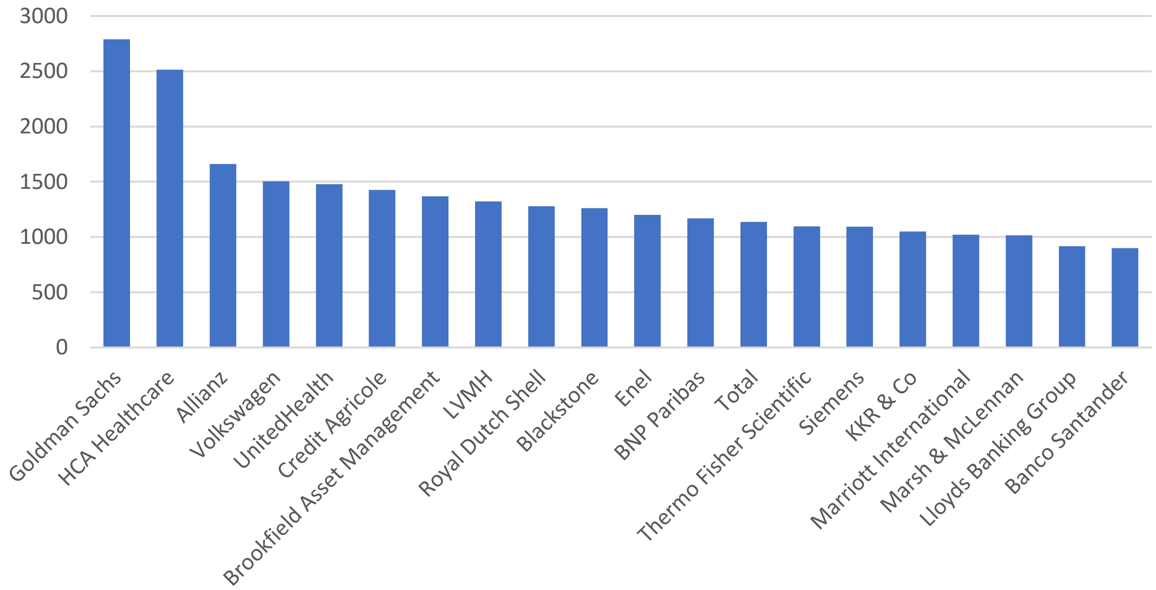
Source: Author's calculations based on data from OECD ADIMA.

Looking at MNEs' affiliates, the world's 500 largest MNEs are structured around 112 305 affiliates. US MNEs account for 43 % of these affiliates, followed by France (10 %), Germany (9 %) and the UK (8.5 %). Zooming in on the top 20 MNEs, some of them – such as Goldman Sachs and HCA Healthcare – have more than 2 500 affiliates, while others – such as Lloyds and Banco Santander – have fewer than a thousand (see Figure 8)[46]. Moreover, half of them are financial services providers (of which four are

[46] These numbers should be treated cautiously, as they may be far larger than those reported in annual reports submitted to the national supervisors. For example, US MNEs are required to disclose to the Securities and Exchange Commission (SEC) 'only' significant subsidiaries, although many multinationals may disclose most or all of their affiliates in their annual reports submitted to the SEC (OECD 2018).

headquartered in the EU), three MNEs are engaged in healthcare and three in the consumer sector. Overall, such a complex design structure, illustrates that some MNEs may create elaborate chains of affiliates (including holding companies and special purpose entities) in an effort to minimise taxes.

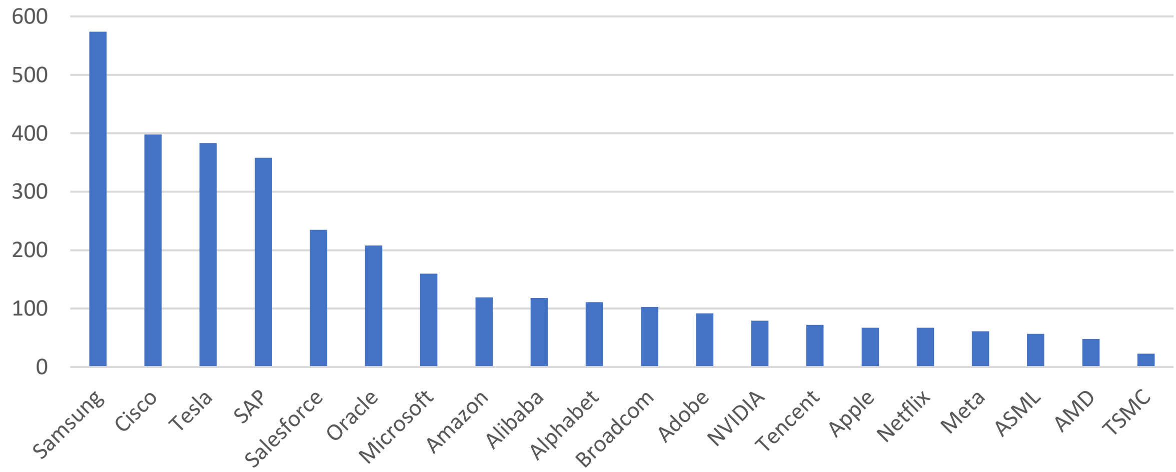
Figure 8. Top 20 MNEs by number of affiliates (2020)



Note: The figure shows the number of affiliates in the Physical Register for each MNE.
Source: Author's calculations based on data from OECD ADIMA.

As for the big-tech companies, their number of affiliates is significantly lower (see Figure 9). With the exception of Samsung which has more than 550 affiliates, most of the tech companies have fewer than 100 affiliates (among them Apple, Meta and Netflix). The majority (14) of the big-tech companies are headquartered in the US, two in China (Alibaba and Tencent) and one in Korea (Samsung) and Taiwan (TSMC) respectively. Only two of the top 20 tech giants are located in the EU: ASML in the Netherlands and SAP in Germany.

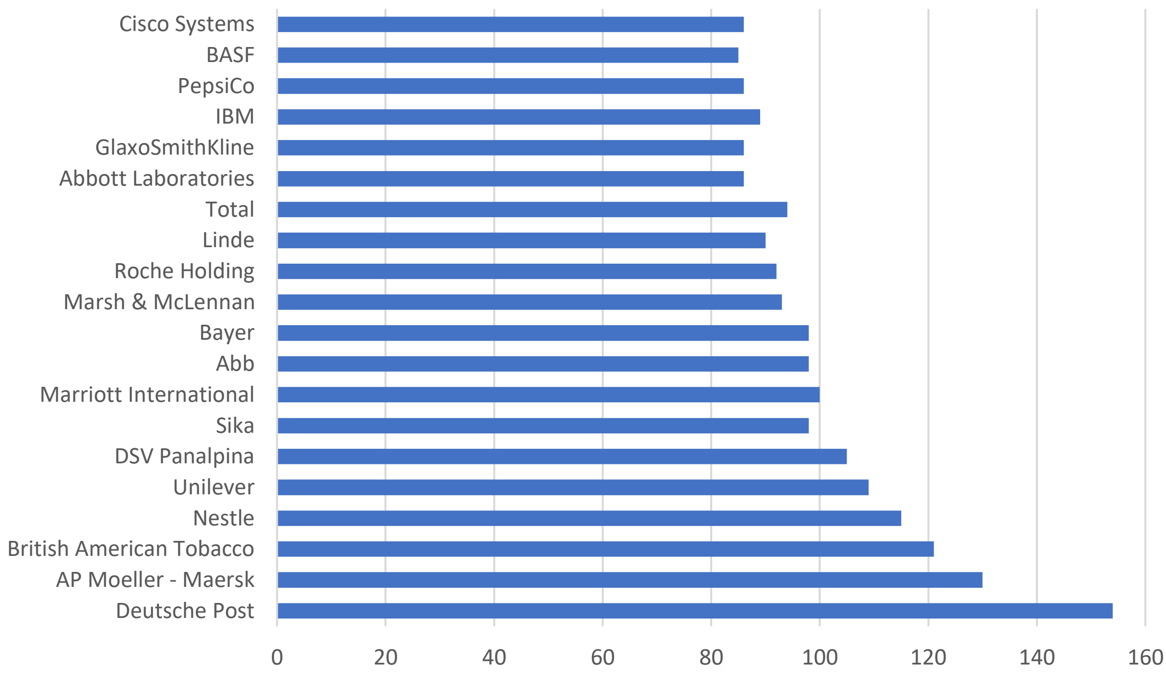
Figure 9. Number of affiliates of the top 20 tech MNEs (2020)



Notes: The figure shows the number of affiliates in the Physical Register for each MNE. The Top 20 tech MNEs are determined by market capitalisation of only publicly listed tech companies, on 9 August 2023.
Source: Author's calculations based on data from OECD ADIMA.

By their very nature, MNEs are large, with a multitude of activities across a number of jurisdictions. Although spreading their businesses across borders helps maximise the efficiency and profitability of their operations, it also puts them under the simultaneous scrutiny of multiple jurisdictions. This is evident when considering the number of different jurisdictions declared by each MNE in its annual report (see Figure 10). Multinationals, like the German Deutsche Post and the Danish AP Moeller – Maersk, are active in as many as 152 and 129 jurisdictions respectively, while others (e.g. the German BASF) in 83. The majority of the top 20 MNEs are involved in the manufacturing sector, either in food and tobacco or in chemicals, petroleum, rubber and plastic. Furthermore, 14 of them are located in Europe: six in the EU, and four each in Switzerland and the UK.

Figure 10. Top 20 MNEs by number of jurisdictions (2020)

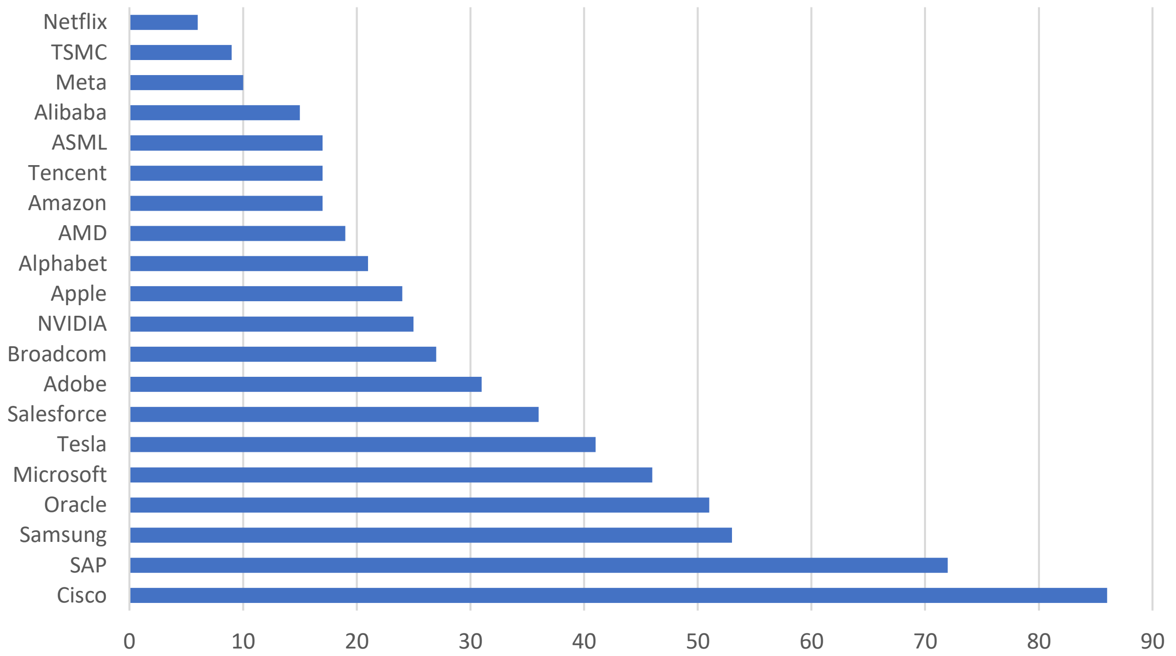


Source: Author's calculations based on data from OECD ADIMA.

Big-tech companies that sell non-physical product, can establish an international presence without the need to physically set foot in another country. This also allows them to shift profits to tax havens or low-tax jurisdictions with relative ease. Revenues are not necessarily reported in the countries where they were earned, which makes it more difficult for market jurisdictions to tax them. This leads to a disparity between the location of digital consumers and the location of booked revenues.

Companies like Meta, Netflix and TSMC are physically present in fewer than 10 jurisdictions each (see Figure 11). Others, however, – like Cisco, Samsung and SAP – have chosen to establish a physical presence in several jurisdictions. Under Pillar One, market jurisdictions – the locations/countries where goods and services are consumed – are given rights over the revenues of companies despite an absence of physical presence in their jurisdiction. Netflix, for example, which has subscribers worldwide and earns revenues therefrom, does not have to pay tax in market jurisdictions under current tax rules. But this is now changing with Pillar One.

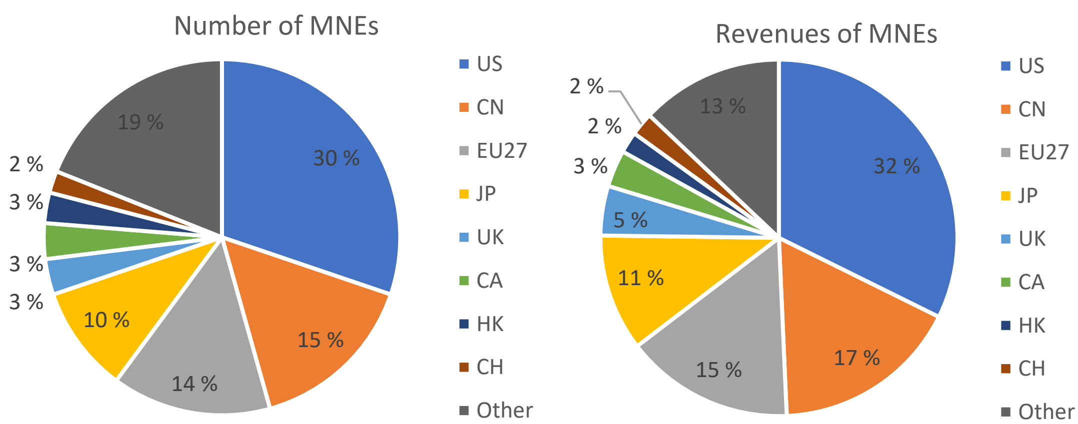
Figure 11. Number of jurisdictions of the top 20 tech MNEs (2020)



Note: The figure shows the number of affiliates in the Physical Register for each MNE. The Top 20 tech MNEs are determined by market capitalisation of only publicly listed tech companies, on 9 August 2023.
Source: Author's calculations based on data from OECD ADIMA.

Given the limited coverage of the OECD's ADIMA database, we expand the sample of MNEs using the latest available data from the Global 2000 list – the Forbes list of the 2 000 largest publicly traded multinationals in 2022 (in terms of sales profits, assets and market value). In doing so, we are able to include in our sample a larger number of MNEs expected to have an impact on the revenues that can be collected by countries, given that the minimum corporate tax rates will be collected by the headquarter country. Less than a third (30 %) of MNEs are located in the US, 15 % in China, 14 % in the EU and 10 % in Japan (see Figure 12, left-hand panel). US MNEs are also responsible for 32 % of global revenues, with Chinese and EU-27 multinationals accounting for 17 % and 15 % of global revenues respectively (right-hand panel).

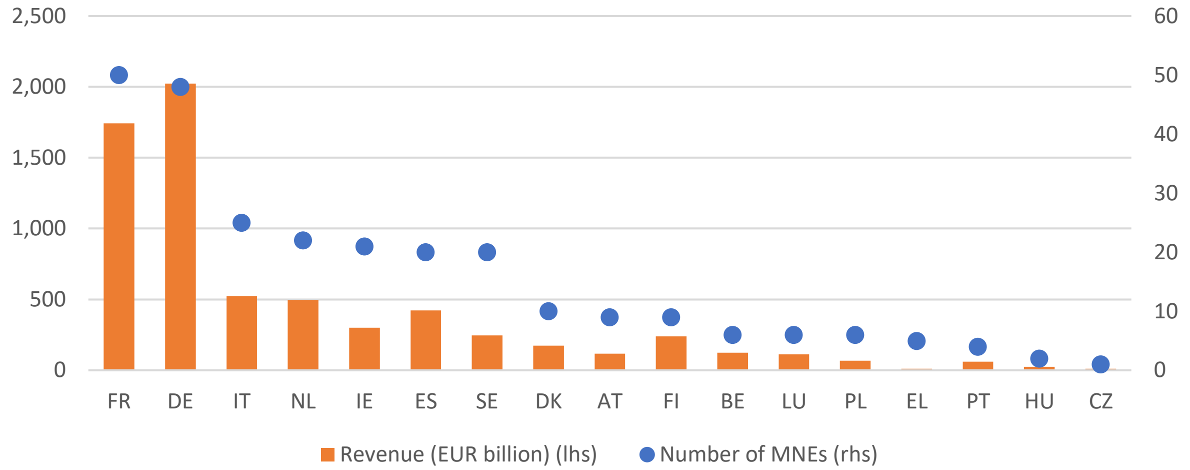
Figure 12. Share of the 2 000 largest MNEs in terms of number and revenues, by location (2022)



Note: The category 'Other' in both figures includes: AE, AR, AU, BH, BM, BR, CL, CO, EG, ID, IL, IN, KR, KW, KY, KZ, MA, MX, MY, NG, NO, PE, PH, QA, SG, TH, TR, TW, UY, VN and ZA.
Source: Author's calculations based on data from the Forbes Global 2 000 list.

Within the EU, MNEs are distributed across 17 Member States, with France and Germany accounting together for 37 % of the total MNEs in the region (see Figure 13). As a result, these two countries collect 56 % of the EU-27 revenues.

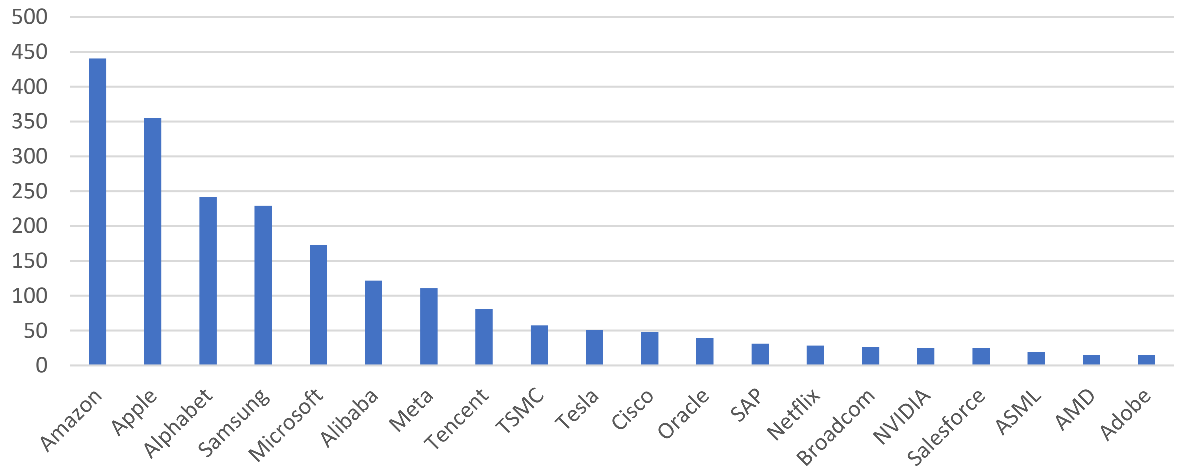
Figure 13. Number of MNEs and revenues of EU MNEs (2022)



Source: Author's calculations based on data from the Forbes Global 2 000 list and Eurostat.

Focusing on the top 20 tech companies, their total revenue in 2022 was EUR 2.1 trillion, representing about 6 % of the revenue of the 2 000 largest publicly traded MNEs (see Figure 14). Since 2019, big-tech companies' combined revenue has grown by 89 % (EUR 1.1 trillion in 2019). Last year, five of them – Alphabet, Amazon, Apple, Microsoft and Samsung – generated a revenue of EUR 1.4 trillion. To put this into context, this is a bit less than the GDP of the Central Eastern European region (EUR 1.8 trillion in 2022).

Figure 14. Revenue of the top 20 tech companies (EUR billion, 2022)



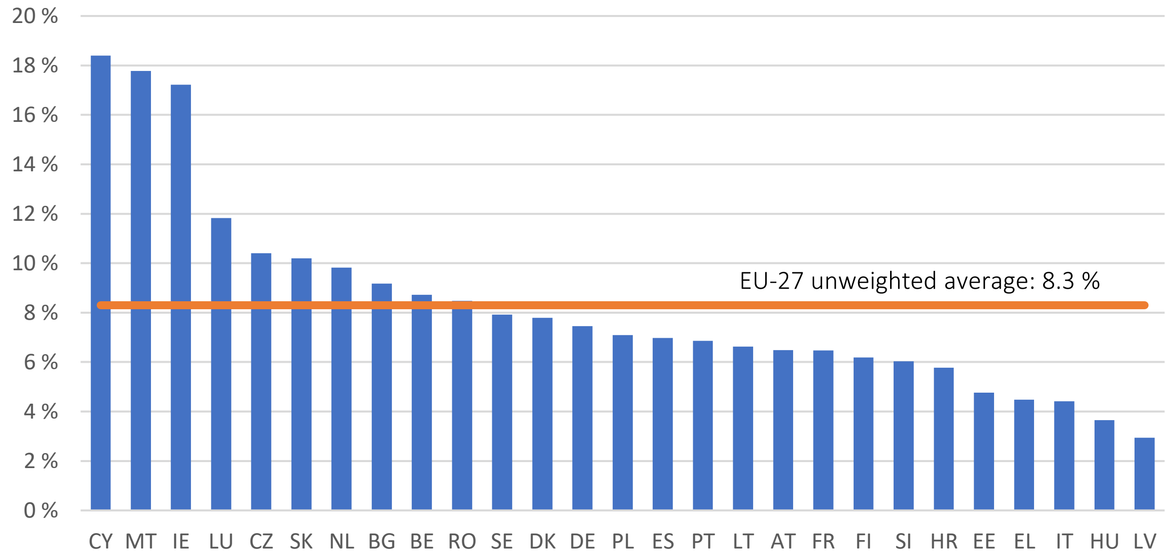
Note: The Top 20 tech MNEs are determined by market capitalisation of only publicly listed tech companies, on 9 August 2023.
Source: Author's calculations based on data from the Forbes Global 2 000 list and Eurostat.

6.2 Corporate tax revenue and productivity

With regard to the revenue collected from corporate tax, it becomes evident that CIT is an important source of revenue for some Member States (see Figure 15). In 2021, CIT revenue accounted for 8.3 %

of the total EU tax revenue collection[47]. However, in countries like Cyprus, Malta and Ireland, corporate tax revenue is more than twice as high as the EU average. On the other hand, CIT revenue is the lowest in Italy, Hungary and Latvia.

Figure 15. CIT revenue across EU Member States (% of tax revenue, 2021)

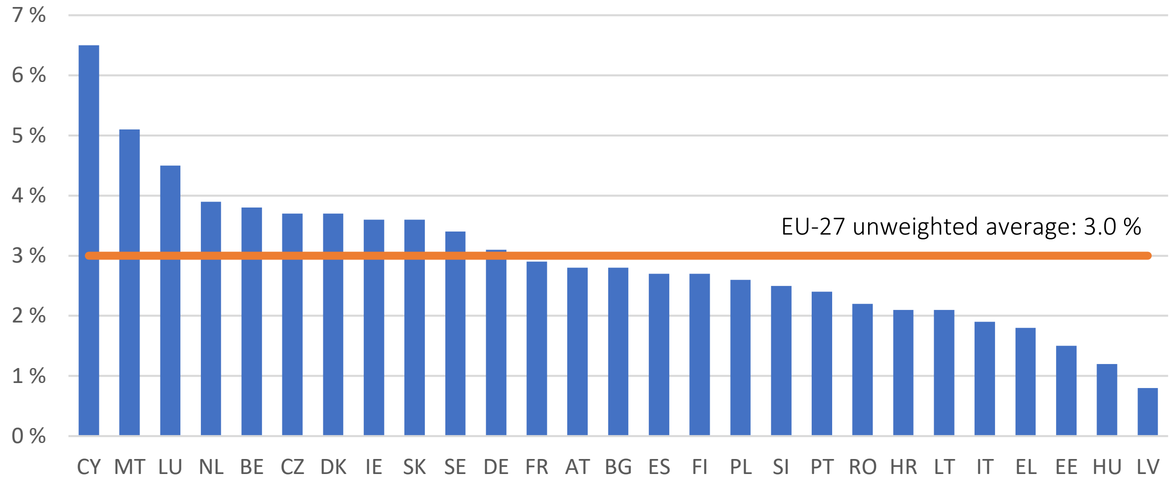


Note: 2021 is the last year for which tax revenue data is available.
Source: Author's calculations based on data from the European Commission.

As a percentage of GDP, CIT revenue accounted for 3.0 % of the EU's GDP in 2021, and above 4-5 % in countries like Cyprus, Malta and Luxembourg (see Figure 16). Moreover, and although tax rates have been on a downward trend, CIT revenue collection as a percentage of GDP has steadily increased over the last years (from 2.5 % in 2010). This (contradictory at first glance) development, which is sometimes referred to as the 'rate-revenue puzzle' in corporate taxation (Nicodeme *et al*., 2018), can be attributed to several reasons, such as: i) tax rate reductions are usually accompanied by a broadening of the tax base (Devereux *et al*., 2002), ii) the size of the corporate sector in the economy has increased (De Mooij and Nicodeme, 2008), iii) there are shifts from the personal to the corporate income tax as the latter regime has become increasingly attractive for small businesses and the self-employed (Fuest *et al*., 2022); and iv) the profitability of the financial sector has increased over the years (Devereux *et al*., 2004; Becker and Fuest, 2007).

[47] For comparison, revenue collected from taxes on personal income, accounted for 24.1 % of the EU's total tax revenue.

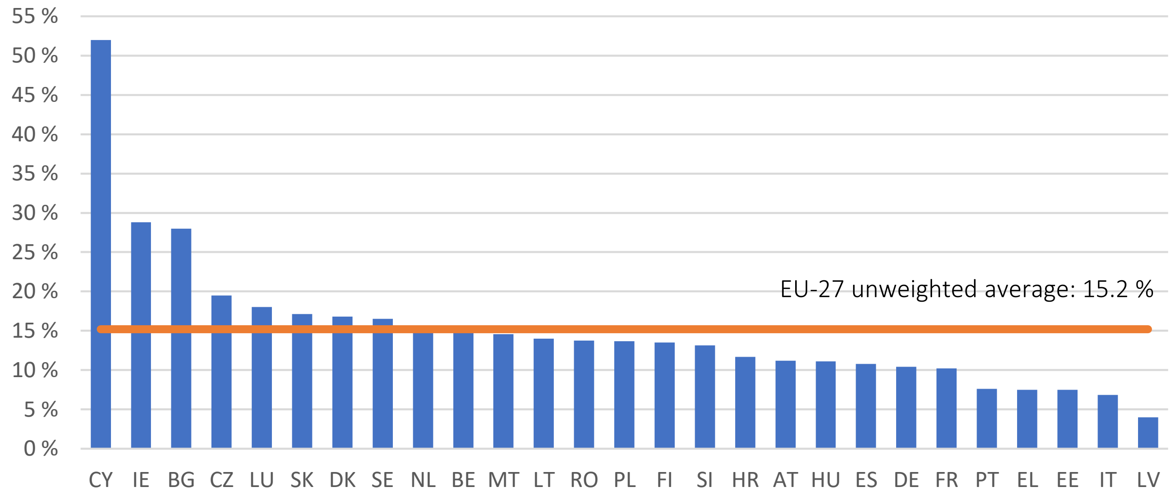
Figure 16. CIT revenue across EU Member States (% of GDP, 2021)



Note: 2021 is the last year for which tax revenue data is available.
Source: Author's calculations based on data from the European Commission and Eurostat.

Digging deeper and trying to estimate how much revenue is raised by each percentage point of the CIT rate, we calculate CIT productivity defined as the ratio of CIT revenue divided by the product of CIT rate and GDP (Crivelli *et al*., 2021). Although CIT revenue productivity averaged 15.2 % in Europe in 2021 (up from 12 % in 2010), there is significant variation across countries (see Figure 17).

Figure 17. CIT productivity across EU Member States (2021)



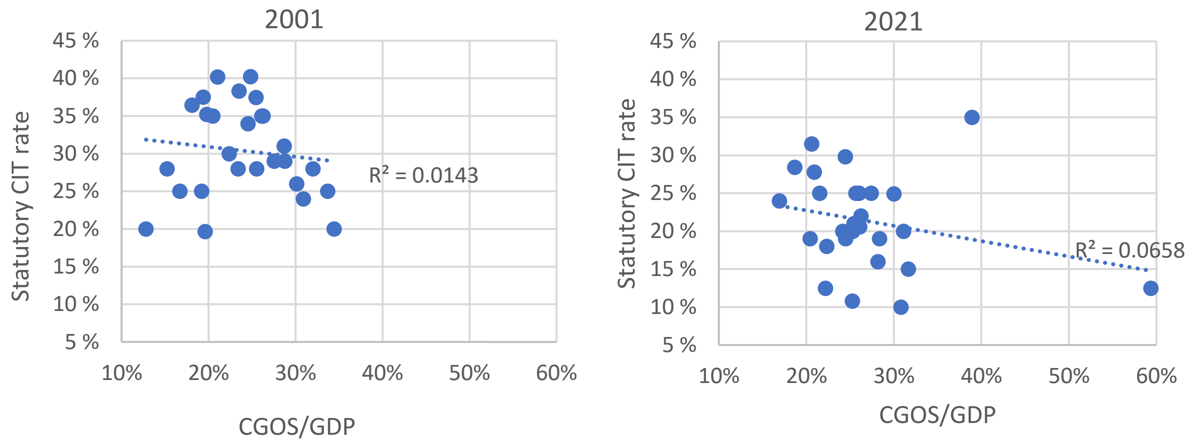
Note: 2021 is the last year for which tax revenue data is available.
Source: Author's calculations based on data from the European Commission.

Taking into account the corporate gross operating surplus (CGOS)[48], we find that there is a negative relationship between CIT rates and the share of profits in GDP (see Figure 18). Moreover, this

[48] The CGOS is the aggregate earnings before interest, tax, depreciation and amortization of a domestic corporation. It shows the magnitude of value added that is produced by a resident corporation and not allocated to employees through compensation, or to governments through taxes on production and imports (Mendoza *et al*., 1994; IMF, 2014; Ueda, 2018). CGOS provides some proxy to what the base would be if profits were allocated on something broadly similar to a 'source' basis. However, it does not capture interest income received from foreign operations, or the tax base that a residence country operating a worldwide tax system would derive from foreign source income.

relationship has worsened over the years. This is evidence of tax competition and profit shifting, as countries try to make their tax systems more attractive than those of others by offering lower tax rates. Low CIT rates combined with high shares of corporate profits can explain in most cases the higher CIT productivity observed in countries like Bulgaria and Ireland, for example.

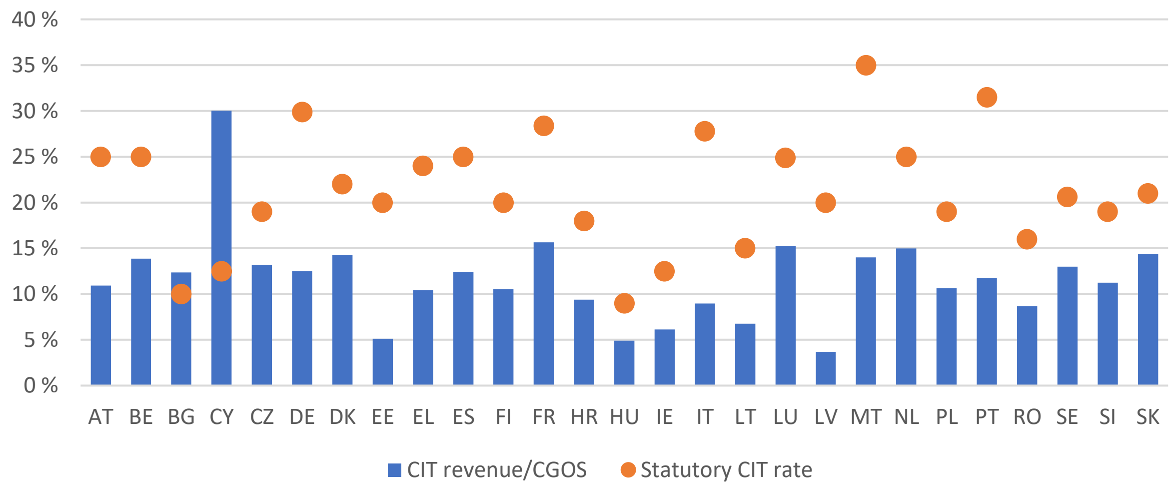
Figure 18. Statutory CIT rate and CGOS across EU Member States



Notes: For the CGOS, both financial and non-financial corporations have been used. The latest available observation for Bulgaria is 2017, while for Romania 2020.
Source: Author's calculations based on data from the European Commission and Eurostat.

Looking from a different angle, we calculate the ratio of CIT revenue to CGOS (see Figure 19). This ratio shows the average tax paid by corporates on reported profits (Ueda, 2018; Crivelli *et al.*, 2021). The fact that in all countries except Cyprus the ratio is well below the statutory CIT rate indicates that CIT productivity is reduced. This may partly reflect relatively generous incentives that narrow the CIT base, profit shifting to low-tax jurisdictions (induced by the relatively high CIT rate) and revenue losses for the government (De Mooij *et al.*, 2018).

Figure 19. Ratio of CIT revenue to CGOS across EU Member States (2021)

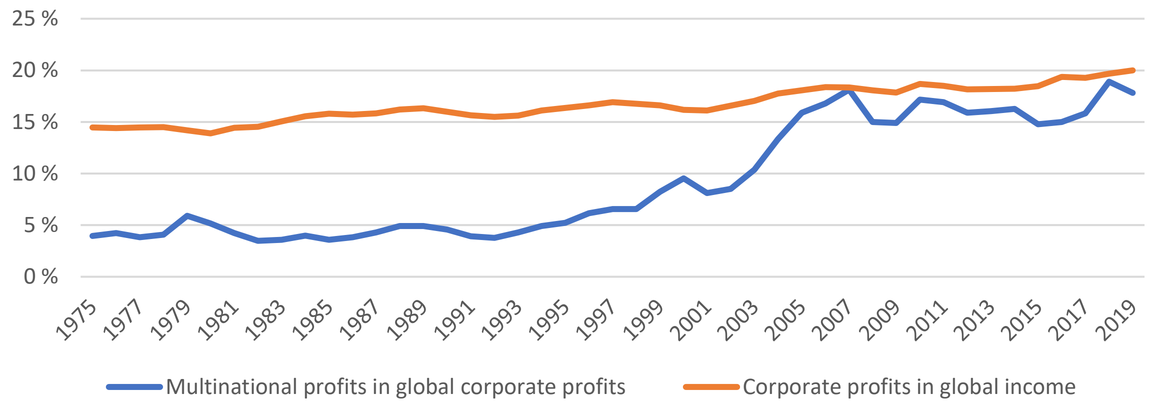


Notes: 2021 is the last year for which tax revenue data is available. For the CGOS, both financial and non-financial corporations have been used. The latest available observation for Bulgaria is 2017, while for Romania 2020.
Source: Author's calculations based on data from the European Commission.

6.3 Profit shifting

It is well documented that in an effort to avoid taxes, MNEs exploit the inadequacies of international tax rules and shift profits to low- or non-tax jurisdictions (Hines and Rice, 1994; Gumpert *et al*., 2016; Dowd *et al*., 2017; Gravelle, 2022; Laffitte, 2022). Despite the fact that corporate profits have increased over the last years, multinational profits have grown at a much faster pace (see Figure 20). Between 1975 and 2019, the share of corporate profits in global income increased from about 14 % to 20 %. However, at the same time, the share of multinational profits – profits booked by a corporation in a country other than its headquarters – in global profits quadrupled, from 4 % to 18 %.

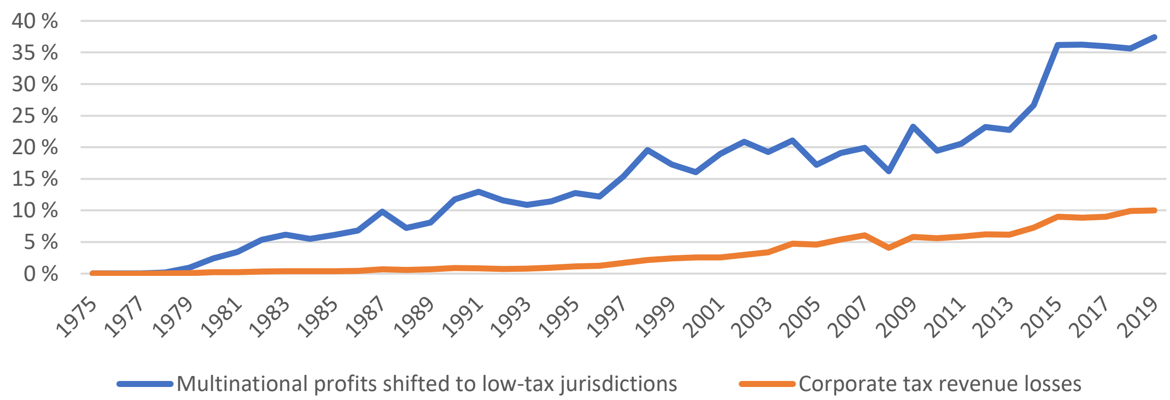
Figure 20. Share of global corporate profits and multinational profits (1975-2019)



Notes: Multinational profits refer to profits booked by corporations outside their headquarter country. Not to be confused with multinationals' profits, which are profits booked by corporations in their headquarter country and outside of it. The blue line depicts the share of multinational profits in corporate profits. The orange line depicts the share of corporate profits in global income (i.e. global GDP minus capital depreciation).
Sources: Tørsløv *et al*. (2022), Wier and Zucman (2022).

As multinational profits increased, so did the share of profits shifted to low-tax jurisdictions. While back in the 1970s profit shifting was very limited, it gradually increased over the years, reaching 37 % by the end of 2019 (see Figure 21). Although up until the late 1990s this rise resulted in marginal corporate tax revenue losses of about 2.5 %, from the beginning of the 2000s and the fast growth of MNEs (Erel *et al*., 2021), the corporate tax lost from profit shifting reached 10 % in 2019.

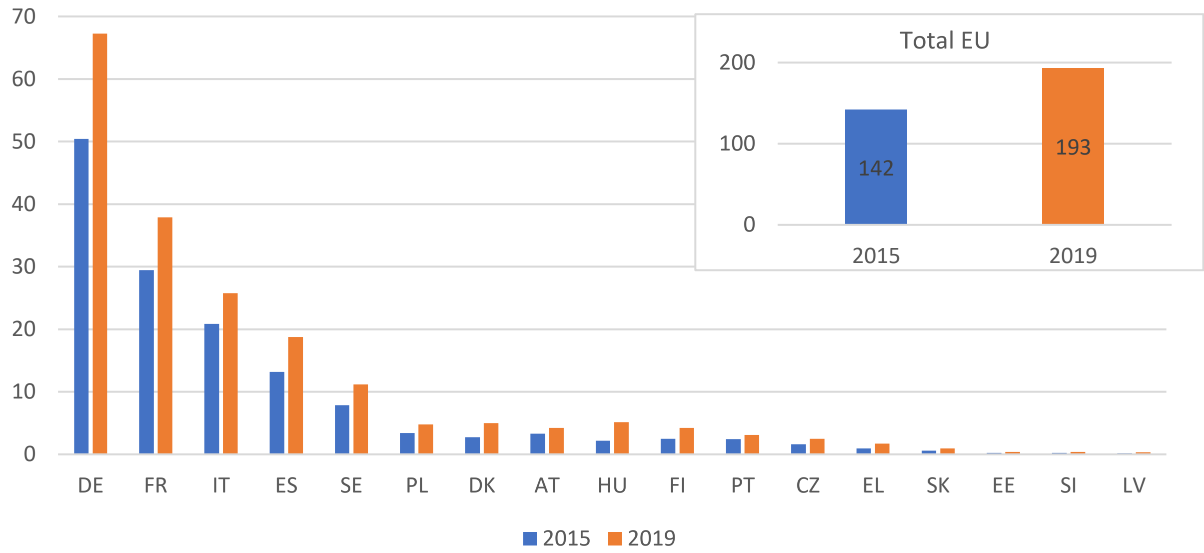
Figure 21. Share of multinational profits shifted to low-tax jurisdictions and corporate tax loss (1975-2019)



Notes: The blue line depicts the share of profits shifted to low-tax jurisdictions to multinational profits. The orange line depicts the share of corporate income tax revenue loss to global corporate tax receipts.
Sources: Tørsløv *et al*. (2022), Wier and Zucman (2022).

Concentrating on the EU, the amount of profit that was shifted to low-tax jurisdictions increased by 36 %, from about EUR 142 billion in 2015 to EUR 193 billion in 2019 (see Figure 22). The biggest exporters are MNEs headquartered in Germany, France and Italy. These three countries collectively account for 69 % of the total profits shifted out of the EU in 2019[49]. In some countries, the amount of profits more than doubled between 2015 and 2019 (+134 % in Hungary), while in others a significant rise was recorded (e.g. +85 % in Latvia, +83 % in Denmark, and +78 % in both Greece and Slovenia.

Figure 22. Profits shifted out of the EU by Member States (EUR billion, 2015 and 2019)

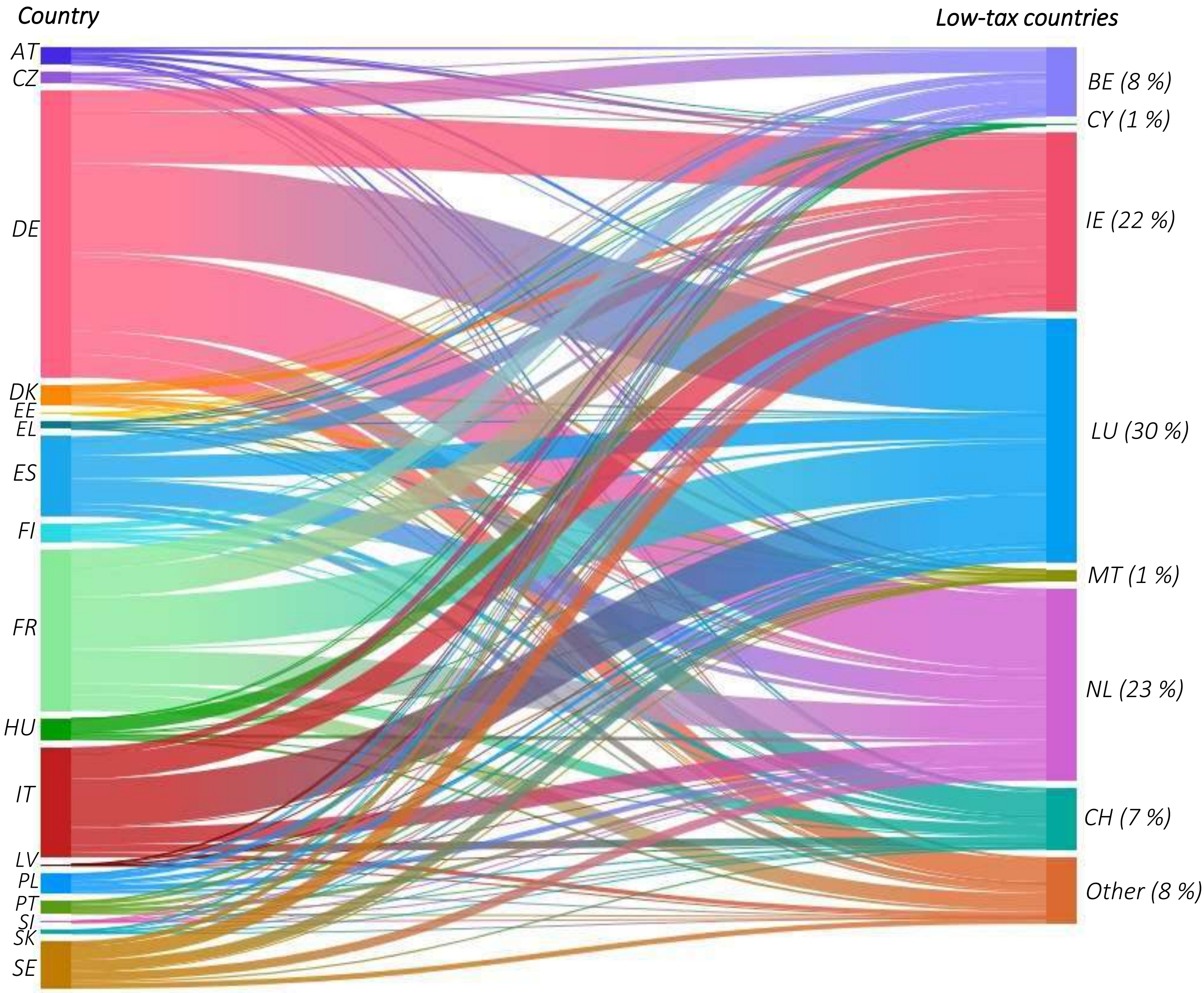


Notes: The figure depicts the amount of profit shifted out of the EU by Member States. Sixteen EU Member States were considered: AT, DE, DK, EE, EL, ES, FI, FR, HU, IT, LV, PL, PT, SE, SI and SK. Low-tax EU jurisdictions were excluded.
Sources: Author's calculations based on data from Tørsløv *et al*. (2022), Wier and Zucman (2022) and Eurostat.

With regard to the destination of the EUR 193 billion in profits shifted to low-tax jurisdictions, 84 % went to low-tax Member States (see Figure 23). This represents an increase of 7 percentage points compared to 2015. The remaining 16 % were shifted to Switzerland and other offshore low-tax jurisdictions. Three low-tax EU Member States – Luxembourg, the Netherlands and Ireland – are the preferred destinations for shifted profits by MNEs. However, the largest increase in shifted profits received between 2015 and 2019 is observed in Malta. From about EUR 487 billion in 2015, Malta received EUR 2.8 trillion in 2019. The flow of profits sent to Cyprus and the Netherlands also recorded an increase of 76 % and 71 % respectively, while profit flows to Switzerland declined by 12 %.

[49] In particular, Germany accounts for approximately 35 % of the profits shifted out of the EU on an annual basis, France 20 % and Italy 14 %.

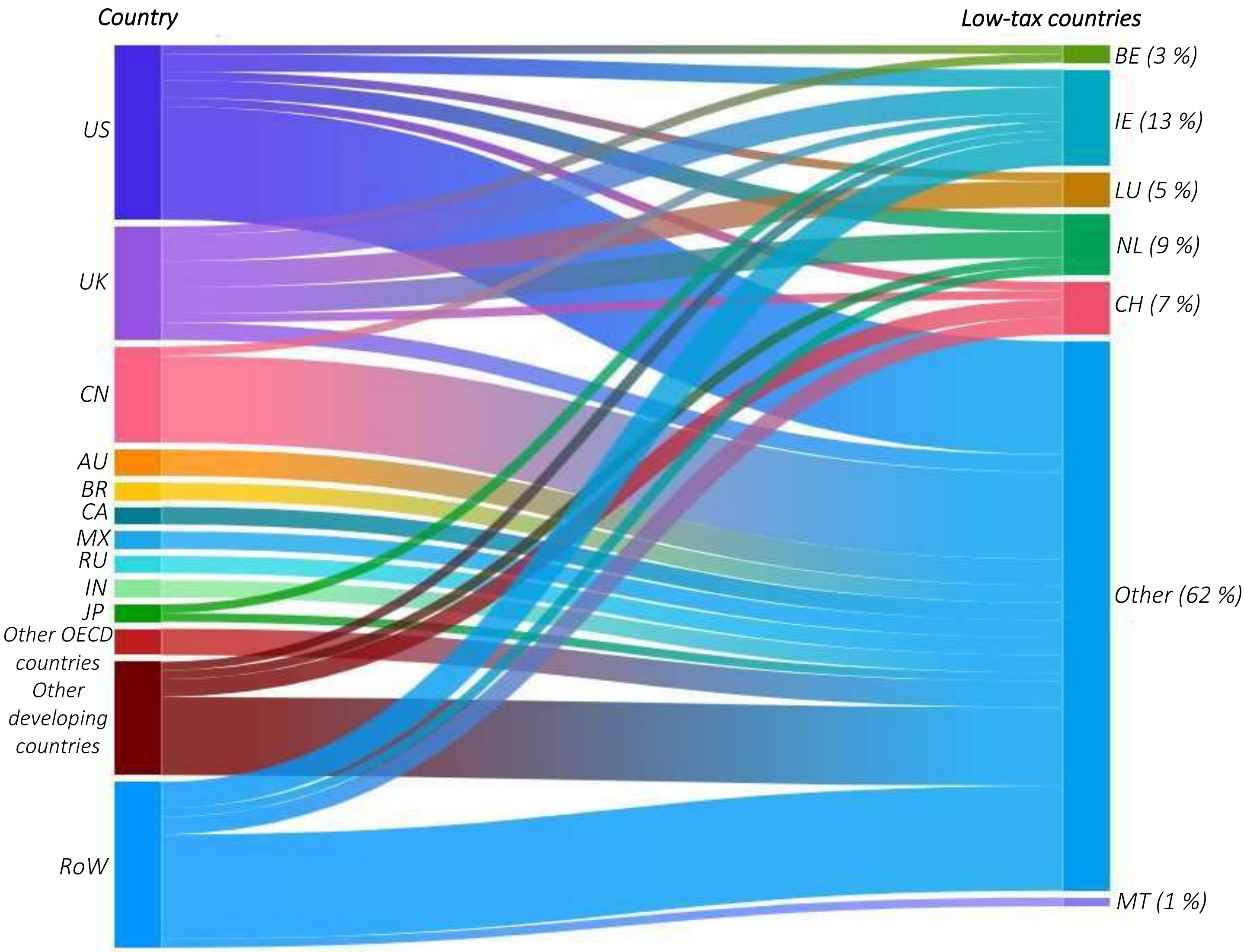
Figure 23. Mapping of profit shifting from EU to low-tax countries (% of total EU profits shifted, 2019



Notes: The figure shows the flow of cross-border transactions (primarily royalties and intra-group interest payments) from an origin country to the intermediate counterpart low-tax jurisdiction. The category 'Other' includes the following low-tax jurisdictions: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Grenada, Guernsey, Hong Kong, Isle of Man, Jersey, Lebanon, Liechtenstein, Macao, Marshall Islands, Mauritius, Monaco, Netherlands Antilles, Panama, Puerto Rico, Samoa, Seychelles, Singapore, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos, and Vanuatu. For a detailed overview of the methodology, see Section 3.4 of Tørsløv *et al*. (2022).
Sources: Author's calculations based on data from Tørsløv *et al*. (2022), Wier and Zucman (2022) and Eurostat.

Looking at profit shifting from non-EU countries towards low-tax countries, there is a clear predominance of residence countries such as the US, the UK and China, and to a lesser extent Australia, Brazil and Canada (see Figure 24). In particular, the first three countries account collectively for about 43 % (or EUR 327 billion) of the total profits shifted from non-EU countries in 2019. The largest increase was observed in the UK, where shifted profits rose by as much as 73 % from 2015 to 2019 (from EUR 56 billion to EUR 97 billion). Non-EU offshore low-tax jurisdictions are the desired destination of shifted profits (62 %), followed by Ireland (13 %) and the Netherlands (9 %).

Figure 24. Mapping of profit shifting from non-EU to low-tax countries (% of total non-EU profits shifted, 2019)



Notes: The figure shows the flow of cross-border transactions (primarily royalties and intra-group interest payments) from an origin country to the intermediate counterpart low-tax jurisdiction. The category 'Other' includes the following low-tax jurisdictions: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Grenada, Guernsey, Hong Kong, Isle of Man, Jersey, Lebanon, Liechtenstein, Macao, Marshall Islands, Mauritius, Monaco, Netherlands Antilles, Panama, Puerto Rico, Samoa, Seychelles, Singapore, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos, and Vanuatu. The category 'Other OECD countries' includes: Chile, Iceland, Israel, Korea, New Zealand, Norway and Turkey. The category 'Other developing countries' includes: Colombia, Costa Rica and South Africa. For a detailed overview of the methodology, see Section 3.4 of Tørsløv *et al*. (2022).
Sources: Author's calculations based on data from Tørsløv *et al*. (2022), Wier and Zucman (2022) and Eurostat.

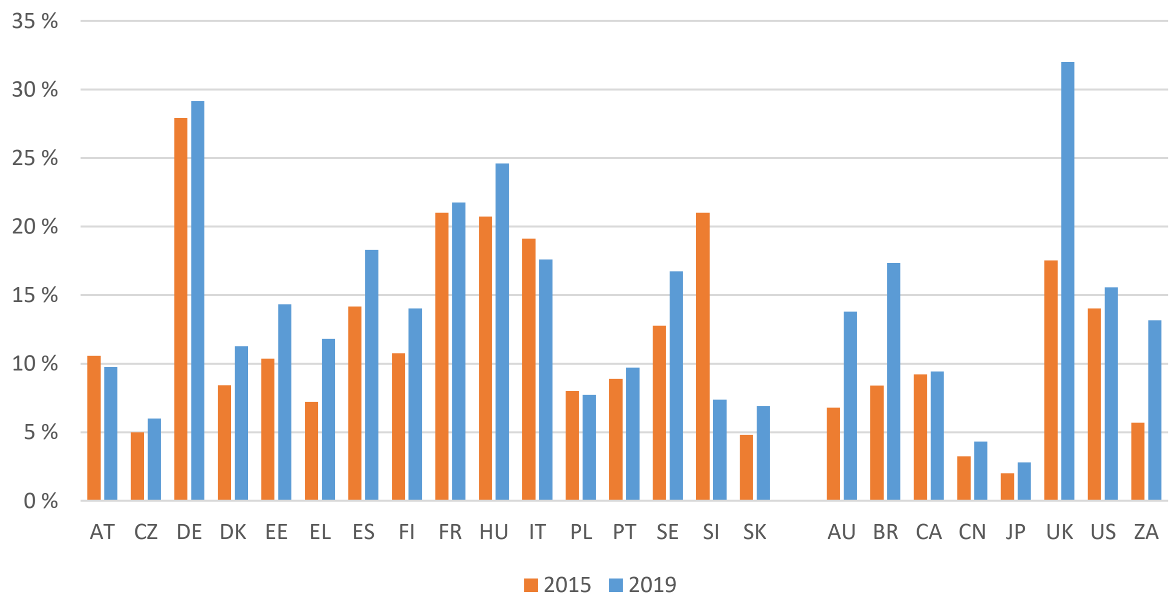
It is important here, however, to highlight that these figures represent profit shifting on an immediate counterpart/low-tax country basis. This means that profits that were initially shifted to a certain low-tax country, do not necessarily stay there. Instead, they may be transferred to another low-tax country. In other words, the ultimate destination of shifted profits can be completely different from the destination country presented in Figures 23 and 24. For example, while in total Luxembourg receives about EUR 91 billion on an immediate basis, it pays back half of this to non-EU low-tax jurisdictions.

Another caveat of these estimates is the quality and effectiveness of data to appropriately capture profit shifting (Blouin and Robinson, 2020). Knowing the distribution of corporate income across different countries and how accounting methods can affect the estimation of MNE profits, is crucially important. Depending on the methods and data sources used, significant differences can occur. For example, the way in which income of indirectly owned affiliates (i.e. equity income) is captured in financial accounting data varies across countries[50]. It is often the case that foreign profits are reported in at least two countries – once in the country of the affiliate owner and once in the country of the affiliate that generated the income – or reported at an aggregate level, thus making geographic disclosure less transparent (Akamah *et al*., 2018). Moreover, equity income has been found to be disproportionately reported in tax havens (Dharmapala, 2019 and 2020).

6.4 Impact of a 15 % minimum corporate tax on revenues

Due to the rising share of multinational profits in global profits (Figure 20 above), the tax loss resulting from profit shifting has increased over the last years (see Figure 25). However, and despite national differences in the estimated tax loss, in general countries have seen a moderate increase in this loss. In countries like Estonia, Greece, Hungary, Spain and Sweden, revenue losses due to profit shifting increased by 4-5 percentage points from 2015 to 2019, while in others countries (e.g. Denmark, France and Portugal) by 1-2 percentage points over the same period. Overall, it is observed that higher-tax countries such as France, Germany and Hungary have higher losses relative to revenue collected than lower-tax countries such as Eastern European countries. Finally, three Member States (Austria, Italy and Slovenia) experienced a decrease in revenue losses.

Figure 25. Corporate tax revenue loss (% of corporate tax revenue collected, 2015-2019)



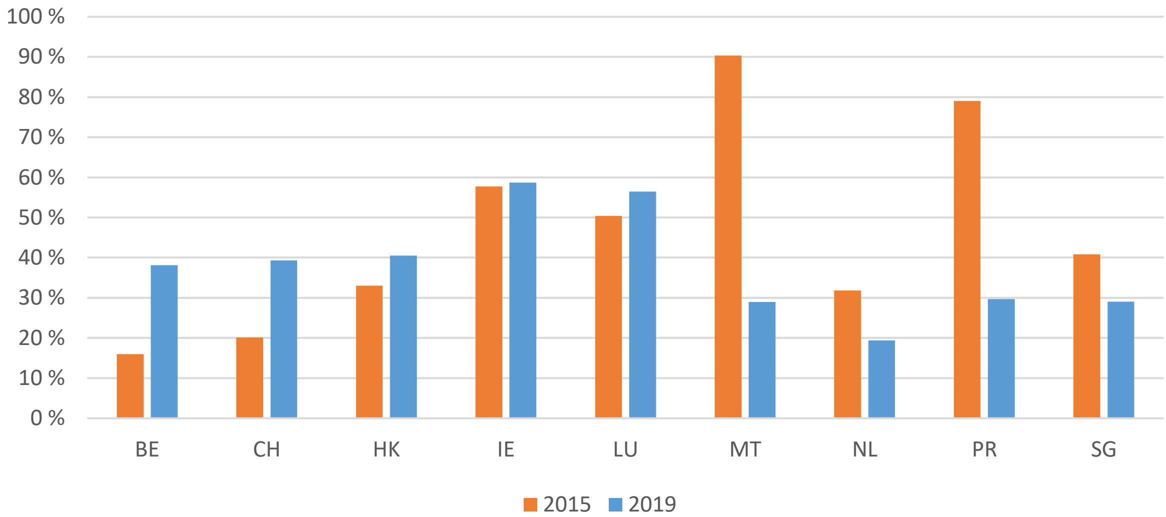
Note: The bars represent the amount of corporate taxes lost due to profit shifting, as a share of corporate tax revenue collected. *Source*: Wier and Zucman (2022).

[50] Equity income only arises from foreign affiliates that are indirectly owned by the MNE parent. It represents neither dividend income nor asset flow between two foreign affiliates. Equity income is only an accounting construct that arises when MNEs must report affiliate-level financial data by jurisdiction.

With regard to non-EU countries, a similar pattern emerges. In the UK, for example, revenue loss has increased by as many as 14 percentage points, from 18 % in 2015 to 32 % in 2019. Brexit is one of the factors that contributed to this development, as it has cost the UK billions of euros in lost tax revenues (CER, 2022). In the US, and despite the introduction of specific provisions aimed at reducing profit shifting out of the country (e.g. BEAT and the TCJA), tax losses rose slightly, from 14 % of corporate tax collections in 2015 to 16 % in 2019[51].

As for low-tax countries, we see that they tend to collect significantly more corporate tax revenue relative to their national income than high-tax countries (see Figure 26). This is the case for countries like Ireland and Luxembourg, which derive more than half of their CIT revenue from taxes collected on shifted profits.

Figure 26. Corporate tax revenue loss in low-tax countries (% of corporate tax revenue collected, 2015-2019)

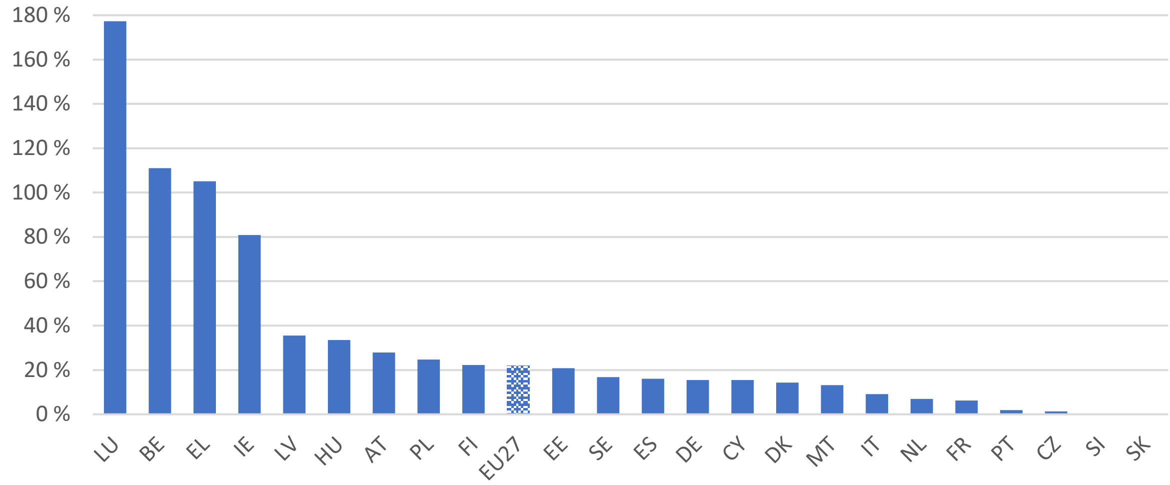


Note: The bars represent the amount of corporate taxes lost due to profit shifting, as a share of corporate tax revenue collected.
Source: Wier and Zucman (2022).

Taking into account the Commission's Directive for a 15 % minimum effective tax for MNEs, the natural question is how much revenue could the EU potentially collect? Barake et al. (2021a and 2021b) estimate that on aggregate, with a minimum tax rate of 15 %, the EU would increase its current corporate tax revenue by EUR 83 billion, or by approximately a quarter of its current corporate tax revenue (see Figure 27). In relative terms, this would represent an increase in tax revenue of about 1.2 % of GDP (from 2.4 % of GDP to 3.6 % of GDP). However, this projected increase may be overestimated given the effects of the QDMTT and the substance-based income exclusion (SBIE).

[51] In particular, it has been shown that post reform, US multinationals book a larger share of their profits in the US. Although this change is very small, Garcia-Bernardo *et al*. (2022) find that the share of profits booked abroad has decreased by 3-5 percentage points to about 27 % for all US companies. At the same time, the geographical allocation of foreign profits has remained unaffected by reforms such as the TCJA. Data show that the share of foreign profits booked in low-tax countries remained stable at around 50 % between 2015 and 2020. The authors conclude that while some firms have responded to incentives introduced by the TCJA, in general the global allocation of profits by US MNEs have changed relatively little.

Figure 27. Tax deficit as % of corporate income tax revenue for a minimum tax rate of 15 % (EU-27)



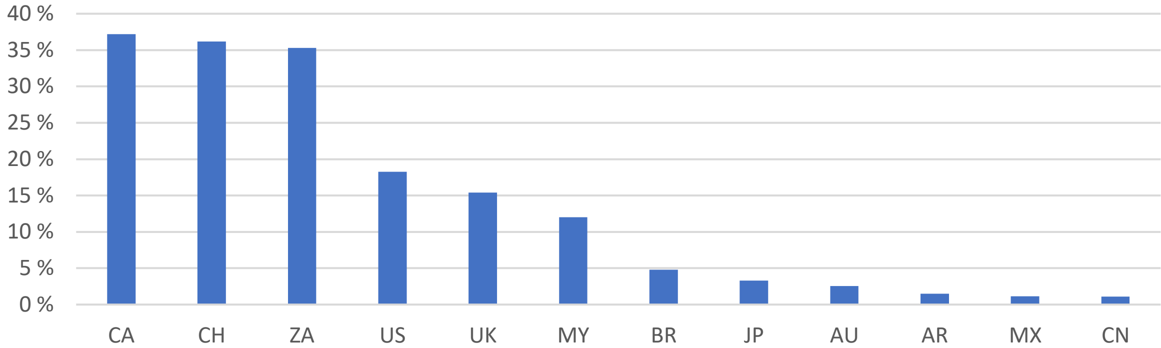
Notes: This figure shows the projected increase in corporate income tax revenue for a 15 % minimum tax without carve-outs. Estimates are based on the OECD's 2017 CbCR data. Revenue is expressed as a percentage of corporate tax revenue in 2021 (the latest year for which data are available). 23 EU Member States have been considered, due to data limitations for BG, HR, LT and RO. The very high observation of Belgium is related to 'unusual' observations in connection with the parent-partner relationship of Belgium with the Netherlands and the UK. For more information, see Barake *et al*. (2021b).
Sources: Author's calculations based on data from Barake *et al*. (2021a and 2021b), OECD Tax Database and Eurostat.

Between Member States, there is a high level of heterogeneity. European low-tax countries like Belgium, Ireland and Luxembourg would benefit significantly from a 15 % minimum tax[52]. Similarly, Eastern European countries like Estonia, Hungary, Latvia and Poland, which have low ETRs, would see their corporate tax revenues rise[53]. On the other hand, corporate tax revenues would increase to a lesser extent in large EU Member States such as France, Germany, Italy and Spain.

With regard to non-EU countries, the largest increase would take place in those jurisdictions where MNEs tend to be incorporated, such as Canada and the US (see Figure 28). In particular, corporate tax revenues are expected to increase in Canada by EUR 24 billion (or by 37 %) and in the US by EUR 57 billion (or by 17 %). Other countries that would benefit from a global minimum corporate tax rate include Switzerland and the UK, as well as developing countries such as Brazil, Malaysia and South Africa. Although developing countries host relatively fewer MNEs, the benefits can be even higher considering the indirect impact that a minimum tax could have. This is because such a policy would make it easier for them to increase taxation on corporate profits without risking capital flight.

[52] However, this benefit would materialise assuming that these countries will maintain the MNEs' headquarters that they have attracted.
[53] For example, in Latvia (ETR of 16.7 %), Hungary (ETR of 11.1 % in 2021) and Poland (ETR of 16.8 %), corporate tax revenues would increase by 35.6 %, 33.4 % and 24.6 % respectively. In Estonia, where the ETR is 10.2 %, a 15 % minimum tax would result to 20.8 % more in corporate tax revenues.

Figure 28. Tax deficit as % of corporate income tax revenue for a minimum tax rate of 15 %



Notes: This figure shows the projected increase in corporate income tax revenue for a 15 % minimum tax without carve-outs. Estimates are based on the OECD's 2017 CbCR data. Revenue is expressed as a percentage of corporate tax revenue in 2021 (the latest year for which data are available).
Sources: Author's calculations based on data from Barake *et al*. (2021a and 2021b), OECD Tax Database and Eurostat.

On a global scale, the authors find that a minimum corporate tax rate of 15 % is expected to result in annual revenue gains of around EUR 200 billion, or 12 % of global CIT revenue. This is in line with a recent OECD (2023) analysis, which find an additional corporate tax revenue of close to EUR 193 billion, representing an increase of 9 % of global corporate tax income. The International Monetary Fund (IMF), on the other hand, estimates a 5.7 % increase in global CIT revenue, a third lower than the OECD analysis (IMF, 2023). The IMF estimates that 18.5 % of the global profit of MNEs (about EUR 1.3 trillion in 2019) is taxed below 15 %, with the average tax rate on these profits being 5 %[54].

However, these figures should be treated cautiously, as Pillar Two's implementation is underway and more 'accurate' analyses on its impact on tax revenues are becoming available. Preliminary estimates of some governments indicate that the expected revenues might be well below the forecasted amounts. According to the French government, for example, Pillar Two would raise at least EUR 1 billion in corporate tax revenue annually, representing an increase of at least 1.4 % in annual revenue (see Table 2). This is significantly lower than the EUR 3.9 billion (or 6.1 %) of additional revenue presented in Figure 27.

Table 2. Estimated revenue for a minimum tax rate of 15 % in selected countries

	Additional revenue (EUR billion)		Corporate income revenue in 2021 (EUR billion)	Additional revenue as % of corporate income revenue	
	National authorities	Barake *et al.* (2021b)		National authorities	Barake *et al.* (2021b)
BE	0.3	21.2	19.1	1.7 %	111.0 %
DE	5.1 – 6.7	13.1	110.2	4.6 % – 6.1 %	15.5 %
DK	0.3 – 0.4	1.8	12.6	2.4 % – 3.2 %	14.3 %
FR	at least 1	3.9	73.0	at least 1.4 %	6.1 %
NL	0.4 – 0.5	2.3	33.4	1.2 % – 1.5 %	6.9 %
AU	0.2	1.8	67.3	0.4 %	2.5 %
CA	1.7 – 1.9	24.4	65.6	2.6 % – 2.9 %	37.2 %
CH	0.9 – 2.5	7.5	20.7	4.3 % – 12.1 %	36.2 %
UK	2.6	11	71.4	3.6 %	15.4 %

[54] Firms' behavioural responses, which can significantly modify the distribution of revenue across countries, were not part of the analysis.

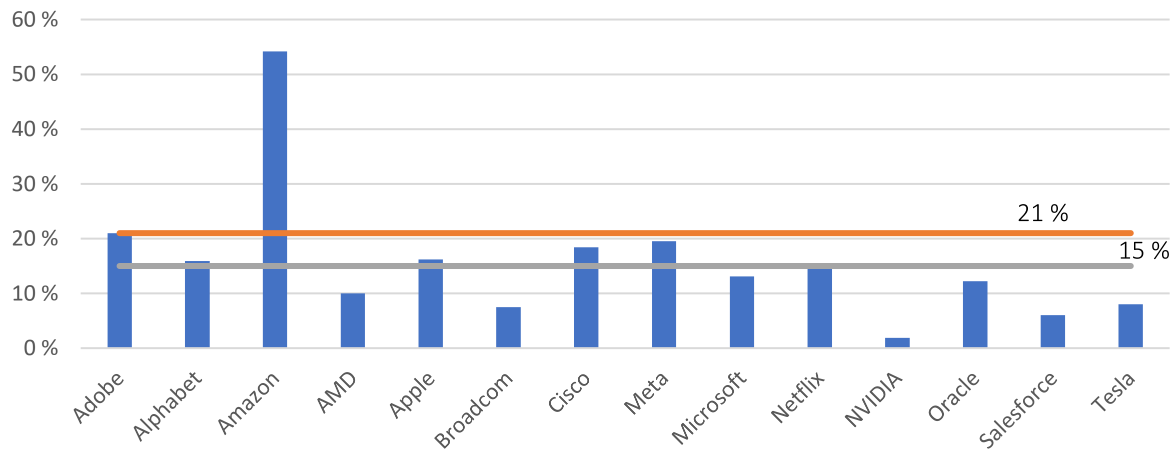
Notes: The table depicts the estimates of additional corporate tax revenue from the implementation of Pillar Two, as produced by national authorities in nine countries, and compares them to those presented by Barake *et al*. (2021a and 2021b).
Sources: Author's calculations based on data from national authorities, Bunn and Weigel (2023), European Commission (Directorate-General for Taxation and Customs Union), OECD Revenue Statistics and Eurostat.

Using CbCR data on 51 European banking groups[55] for the period 2014 to 2020, Barake (2022) finds that banks lower their tax burden through their affiliates. In particular, profit shifting of EU-27 banks accounts for about 2.1 % of the total profits booked abroad, suggesting tax losses of around EUR 720 million annually. Revenues from the introduction of a 15 % minimum corporate tax rate have been estimated at approximately EUR 930 million when the headquarter country collects the top-up tax, and approximately EUR 500 million if the host country applies the top-up tax. The revenues collected would compensate for the profit shifting tax losses.

In a similar exercise, Barake *et al*. (2021a) focus on a smaller group of 32 European banks headquartered in 11 EU Member States for the year 2019. They find that banks' tax deficit (i.e. the difference between what they currently pay in taxes and what they would pay if they were subject to a 15 % minimum tax rate) reached about EUR 1.1 billion in 2019, the equivalent of about 4.4 % of the taxes they paid that year. This means that European banks would have to pay 4.4 % more in taxes if they were subject to a 15 % country-by-country minimum tax. Last, for a group of nine European non-bank MNEs, the authors conclude that they would have to pay about 11.2 % in taxes if they were subject to a 15 % minimum tax.

Among the big-tech companies, the majority are already paying lower taxes than the current statutory corporate tax rate established in their countries. In some cases, this is even lower than the 15 % minimum global tax that Pillar Two introduces. In the US, for example, companies like Alphabet, Apple, Microsoft, Netflix and Tesla have effective rates below the US statutory rate of 21 % (see Figure 29). The company with the lowest ETR is NVDIA. This is primarily due to income earned in low-tax jurisdictions such as the British Virgin Islands, Israel and Hong Kong, as well as recognition of US federal research tax credits and various tax benefits related to stock-based compensation.

Figure 29. ETR of selected US tech companies (2022)



Sources: Author's calculations based on data from individual companies annual reports on Form 10-K filings.

[55] The sample includes 37 multinational systemic banks headquartered in 11 European countries (AT, BE, DE, DK, ES, FI, FR, IT, NL, SE and UK) operating in 90 jurisdictions worldwide, as well as 14 European non-systemic banks headquartered in 10 European countries (AT, BE, BG, CY, DE, EL, FI, HU, IE and LU).

7. Concerns with regard to Pillar Two and the EU Directive

The business community has reacted to the agreement on Pillar Two and to the EU Directive with surprise and some discomfort, due to the breadth and complexity of the new obligations, especially in the light of the very short timeframe for their entry into force. The calculation of the ETR involves many complex adjustments on both the accounting data from financial reporting and the fiscal data from tax records, which concern a plurality of jurisdictions. Compliance with the new rules requires the timely preparation of a coordinated information system, and implementation of the IT procedures necessary to manage it. The deadlines that have been set are considered very (too) stringent.

The complexity of the Pillar Two rules risks making their implementation very problematic, not only for the MNEs that fall within its scope, but also for tax administrations. The business community is concerned that many tax administrations, especially those that are less technically gifted, might encounter serious difficulties in implementing Pillar Two, which could lead to differing interpretations and application of the agreed rules. The consequences of this would be double taxation and, above all, legal uncertainty, possible disputes and increased tax risks. In this regard, there is a deep concern about the absence of a dispute resolution mechanism, not only in the OECD rules, but also in the EU Directive.

7.1 Dispute resolution mechanisms

The Business at OECD Tax Committee (BIAC, 2022)[56] noted that it would be useful to codify and coordinate jurisdictions' political commitment regarding the agreed approach to Pillar Two, and would support[57] the preparation of a legally binding MLC which, in particular, could also contain a mechanism for multilateral dispute resolution. If this is not possible, the Implementation Framework should specify a robust dispute resolution framework that would ensure coherent application of the Model Rules, facilitate audits and resolve disputes between companies and authorities, or between authorities.

At EU level, a proposal has been made to link the rules of the Dispute Resolution Directive to the Pillar Two Directive. On one hand, there is already a Directive on tax dispute resolution mechanisms in the EU that Member States can rely on, as well as specific provisions in bilateral tax treaties (BTTs) to resolve double taxation disputes. However, this directive only applies to disputes arising from the application of agreements and conventions that provide for the elimination of double taxation. Moreover, double taxation dispute resolution will only be available under some bilateral treaties that Member States have entered into, and will only be relevant to issues related to top-up tax allocated and charged under the proposed EU directive where the respective tax treaty allows for the resolution of disputes on taxes not covered by the Directive.

One way to ensure that taxpayers have access to effective dispute resolution procedures would be to make the Directive on tax dispute resolution mechanisms applicable to disputes that may arise in the context of the proposed EU directive on a minimum effective corporate tax rate. In addition, a provision should be introduced for the resolution of disputes between EU and non-EU countries. For example, there can be cases where non-EU jurisdictions fail to approve the rules, or impose taxes that do not qualify as GloBE-covered taxes[58].

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[56] See also the position expressed by William Morris, Chairman Emeritus of the Taxation and Fiscal Committee of Business at OECD (Morris, 2022), and the reply on behalf of the OECD Secretariat (Pascal Saint-Amans *et al.*, 2022).
[57] Despite the opposition expressed by several countries participating in the Inclusive Framework.
[58] Or as qualified IIR/domestic top-up taxes, and therefore the GloBE offset mechanisms will not be available.

In December 2022, the OECD opened a public consultation on 'Tax Certainty for the GloBE Rules' and addressed the issue on two fronts: dispute prevention and dispute resolution. With regard to prevention, the intention is to ensure common interpretation and application of the GloBE rules by tax administrations and taxpayers. The Model Rules, the Commentary and the Administrative Guidance will be continuously updated and streamlined; and the Inclusive Framework will provide clarification on specific issues that need interpretative guidance. As for dispute resolution, possible solutions include a new specific MLC, special agreements between competent authorities, reliance on existing tax treaties, and the introduction of common dispute resolution rules in domestic laws.

7.2 Simplification and streamlining of Pillar Two rules

As already mentioned, according to the BIAC, the Implementation Framework should, first and foremost, eliminate administrative burden wherever possible. This could be achieved, in part, by implementing a centralised filing mechanism, consistent formatting of submissions (i.e. standardised templates) and consistent means of reporting and notification requirements, and by imposing uniform deadlines. A central repository of information on covered income taxes, QDMTT and refundable tax credits that have been recognised as qualified would also be very useful. This repository could be administered by a sort of supernational entity (a standing body, with the presence of the Secretariat of the Implementation Framework), which could also determine the jurisdictions that can be considered as safe harbours.

The BIAC holds that the development of broad, simple and administrable safe harbours is vital to the administrability of the GloBE rules, and to the ability of MNEs to manage the complexity and additional compliance imposed by the rules. To this end, has proposed some possible safe harbours. For example, jurisdictions where under-taxed profits are unlikely to be made due to high statutory tax rate and large tax base could be excluded. Jurisdictions applying a QDMTT that is recognised as qualifying, or those in which balance sheet profit (without adjustments) is nullified by the exclusion for actual economic presence could also be excluded.

Many other simplification and improvement proposals have been put forward by the business world and individual commentators in response to the consultations promoted by the OECD in April 2022. Work on safe harbours has progressed, with the delicate problem of balancing the need for simplification with the objective of keeping the substance of Pillar Two rules alive, without watering them down in a new and over-simplified set of rules.

In an effort to address the concerns expressed by stakeholders, in December 2022 the OECD Inclusive Forum approved a guidance document on safe harbours and penalty relief. The document confirmed the introduction of transitional safe harbours, due to last until 2026, using simplified calculations based on CbCR information. A jurisdiction will qualify as a safe harbour for the constituent entities resident in that jurisdiction if it passes one of the following three tests: a de minimis test, a simplified test and a routine profits test[59].

Furthermore, a framework for the development of permanent safe harbours has been established. It will apply the same three tests as the transitional safe harbours, but instead of using CbCR and qualified

[59] The de minimis test requires total CbCR revenue of less than EUR 10 million and CbCR profit (loss) before income tax of less than EUR 1 million. The simplified ETR test (calculated by dividing the simplified covered taxes reported in the MNE's financial statements by the profit or loss before tax reported in the MNE group's CbCR) must be at least 15 %. The routine profits test requires that profit or loss before income tax is less than (or equal to) the SBIE.

financial statement data, the calculations will be carried out using the GloBE rules, with simplified calculations of income, revenue and tax.

A transitional penalty relief has been recommended, reflecting a common understanding among the implementing jurisdictions. If an MNE has taken 'reasonable measures' to ensure the correct application of the GloBE rules (and the MNE can demonstrate that it acted in good faith to understand and comply with the GloBE rules), a relief from sanctions and penalties should apply. The relief will obviously not cover cases of avoidance, fraud or abuse, and the MNE will remain liable for unpaid or underpaid top-up tax due to its errors. This relief will be at the discretion of individual governments, and not subject to any type of multilateral procedure or review.

Finally, the document contains a commitment for the continuation of future simplifications and safe harbours. In addition, it addresses many of the concerns raised by the business sector, and has eased the adoption of Pillar Two. However, some of the concerns put forward during the consultations were not addressed, in particular those regarding the design of the UTPR and its consistency with existing treaties and national principles (see Section 7.4 below).

7.3 Coordination of Pillar Two with BEFIT

In May 2021, the Commission published its Communication on Business Taxation for the 21st Century, and announced that BEFIT would be a single corporate tax rulebook for the EU[60]. This was followed by a public consultation launched in October 2022, with the aim of proposing a directive by the third quarter of 2023.

BEFIT would replace national corporate tax systems. It will be mandatory for groups of companies (MNEs and large-scale domestic groups) that fall within the scope of Pillar Two. Groups with revenues lower than EUR 750 million would be allowed to opt into the system. BEFIT would establish a common tax base, computed from financial accounts, with limited adjustments. The tax bases of all members of a BEFIT group would be consolidated into a single pool, which would be apportioned to the different Member States in which the group operates using a formula that includes sales by destination, tangible assets, labour (payroll and heads) and a proxy for intangible assets. The apportioned profits would be taxed in each Member State according to the national rate. The formulary apportionment would replace existing transfer pricing rules based on the ALP within the EU. BEFIT would provide significant simplification for large-scale corporate groups, which currently have to calculate their tax base according to up to 27 different sets of national CIT rules and use complex transfer pricing rules to determine their taxable profits in each Member State.

Consequently, BEFIT could provide ample benefits to firms active in the EU in terms of simplification of compliance requirements, a reduction in related costs, and promotion of tax certainty. It could be an important opportunity for European businesses, and could also remove a number of tax obstacles to the functioning of the internal market. However, to reach these results, BEFIT should be properly coordinated with the EU Minimum Tax Directive and any future potential EU action in response to the Pillar One initiative.

[60] BEFIT has four key objectives: i) increase the resilience of businesses by reducing the complexity of tax rules and the compliance costs; ii) remove obstacles to cross-border investment and make the single market a more attractive location for international investment; iii) create an environment conducive to fair and sustainable growth by paving the way for administrative simplification; and iv) provide sustainable tax revenue.

The formulary apportionment of BEFIT would replace the ALP as the tool for the division of profits within the EU, but would not apply vis-à-vis third countries. This means that standard transfer pricing rules would regulate corporate tax coordination between Member States and non-EU jurisdictions. Hence, it is necessary to ensure the compatibility of the BEFIT framework with the current international tax standards (e.g. OECD transfer pricing guidelines), as well as existing double tax treaties. BEFIT requires a holistic review of the current treaties with non-EU jurisdictions, and a strategy on how it can be incorporated into the existing treaties. In order to be effective and achieve its policy goals, BEFIT requires careful design and assessment of the interactions and overlaps with implemented or ongoing EU and global initiatives.

BEFIT will be 'successful' if a large number of businesses outside the scope of Pillar Two voluntarily opt into it. To this end, three factors will be determinant: i) simplification; ii) a reduction in compliance costs; and iii) uniformity within the EU.

Using a single set of common rules instead of 27 sets of national rules, and replacing TP with formulary apportionment, already imply a significant reduction in compliance costs. But the rules of BEFIT could – and should – be as simple as possible, and should be as close as possible to the rules of Pillar Two in order to alleviate compliance costs. The duplication of accomplishments should be avoided and their overlapping pursued. The tax base should be as close as possible to profits as determined from financial reporting: the number of tax adjustments should be extremely limited.

Uniformity within the EU is instrumental to achieving simplification and to reducing compliance costs. In this respect, it would be very important to adopt a single set of accounting standards. In the EU, companies that want access to regulated financial markets must already adopt International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). Thus, and in order to achieve uniformity across the EU, BEFIT should be based only on IAS and disallow the use of national accounting standards (which Pillar Two admits).

The common tax base will probably be more stable than the national rules, which are subject to frequent changes in national fiscal policies. This relative stability would also reduce compliance costs and tax uncertainties connected with changes to the rules.

The provision of a one-stop shop would also be crucial for the same goals, allowing businesses to deal with just one tax authority, instead of 27. The simplification and standardisation of rules would also benefit tax administrations, which would be able to reduce their administrative costs and concentrate their actions on the application of a single and more stable set of rules.

Finally, in terms of timeline and milestones, the timing of BEFIT should take into account the various initiatives that are already ongoing at OECD, EU and domestic level, and the very demanding changes required of both taxpayers and tax authorities to fulfil the new rules and compliance obligations.

In conclusion, BEFIT is an important concrete attempt to coordinate business taxation through a comprehensive approach. It builds on Pillar Two, but goes further: it is an important opportunity to compensate for the complexities of Pillar Two with some substantial simplification, and to achieve positive results on other fronts. In fact, by setting common rules, BEFIT would also significantly reduce the scope for tax arbitrage and tax planning that exploit inconsistencies between national legislations. Thus, it might bring increased revenues. It might also provide a solid base for the EU budget's own resources. Additionally, by setting common rules, it would curtail the scope for tax competition among Member States.

7.4 Undertaxed Payment Rule (UTPR) or Undertaxed Profit Rule (UTPR)?

The two main rules under Pillar Two are the IIR and the UTPR – collectively known as the GloBE regime. The former, which imposes top-up tax on a UPE in respect of the low-taxed income of a CE, will tax foreign earnings of companies under certain conditions. The latter, which is intended to backstop the IIR, allows a country to increase its taxes on a business, if that business is part of an MNE that is not subject to the IIR where the parent company is resident, and that pays less than the proposed 15 % global minimum tax in other jurisdictions. In other words, the UTPR applies additional tax on a subsidiary of a multinational that has low-taxed profits outside the jurisdiction applying the UTPR.

However, it is not very clear what the real meaning of the letter 'P' is in UTPR. To start with, there is no definition in the OECD GloBE rules (OECD, 2021). Chapter 10 defines the UTPR as 'the rules set out in Article 2.4 to Article 2.6', while in these three articles there is no reference to either payments or profits. In fact, the rules do not spell out UTPR, but rather use the initialism from the very beginning. Although the original intention appears to be referring to 'payments', the UTPR can apply without regard to whether payments have been made. Thus, it is more accurately referred to as an undertaxed 'profits' rule (Lebovitz *et al*., 2022). This is what it is called in the EU Directive[61].

A change in the meaning of the letter 'P' from 'payments' to 'profits' can have significant implications. It has been argued that the difference between payments and profits is like transforming the UTPR from an anti-base-erosion rule to a tax-base-sharing or anti-tax-competition rule (Li, 2022). This is because there is no need for the taxpayer's profit (or the UTPR jurisdiction's tax base) to be reduced by any outgoing payments to a low-tax CE within the group in order for the tax to be triggered. Thus, the UTPR jurisdiction can gain a tax base by charging the tax that is not charged by the country where the low-tax entity is located and profit is generated[62].

Moving from a payment- to profit-based UTPR can reduce the incentive to shift profits to low- or no-tax jurisdictions by creating a floor on tax competition among jurisdictions. However, by not requiring the low-taxed profits to have any nexus with the taxing jurisdiction (VanderWolk, 2022), the rule effectively creates a new basis for tax jurisdiction. Thus, it departs not only from the consensus in the October 2021 agreement, but also from international tax norms, EU law and bilateral income tax treaties (Debelva and De Broe, 2022; Noren, 2022).

Pillar Two departs from one of the fundamental principles of the BEPS project, namely that profits should be taxed in the jurisdiction where they are derived. BEPS Actions 8-10 intended to align transfer pricing outcomes with the value creation of the MNE group. Value creation can be evidenced by production and other economic activities, ownership of financial capital and intangible property, and the development, enhancement, maintenance, protection and exploitation of intangibles. However, by using a formula for the allocation of top-up tax that is not connected to the generation of undertaxed profits, the UTPR ignores the value creation principle. As a result, it is indifferent to the alignment of the location of taxation with the location of value creation (Nikolakakis, 2021).

[61] This is also what the UK does when referring to the UTPR in its consultation on the implementation of Pillar Two launched in January 2022 by HM Revenue and Customs (HMRC, 2022).

[62] Although the UTPR is a supplement for the minimum tax, there are no rules prohibiting a country from imposing a UTPR tax as long as there is a top-up tax that is not picked up by an IIR (or a QDMTT) in another jurisdiction.

In fact, the UTPR is a necessary backstop to the IIR, a 'devilish' solution to make Pillar Two work. Its consistency with current international norms has been questioned, as has its consistency with domestic tax principles, such as the ability to pay.

During the consultations, the BIAC proposed revising the rules of the UTPR to avoid a CE that does not record profits in a fiscal year being forced to pay the top-up tax on under-taxed profits recorded by other CEs belonging to the same group but located in other jurisdictions. The case raised by the BIAC poses some issues of coordination with the basic principles of national tax laws, in particular the constitutional principles of the ability to pay and equal treatment.

Can a taxpayer that has not made any profits be obliged by the jurisdiction in which it is resident to pay a profit tax because another entity that is resident in another jurisdiction has made under-taxed profits, on the basis that the two taxpayers, while carrying out different activities and having no direct connection, belong to the same multinational group? The Swiss government appears to share this concern: a revision of the Swiss Constitution allows departures from the principles of 'economic substance' (ability to pay) and generality and uniformity of treatment in order to introduce domestic rules on large companies, consistent with international standards set by the OECD/G20 on minimum tax and taxation in the jurisdiction of commercialization.

The UTPR was also a point of criticism as a fundamental flaw of Pillar Two in a letter signed by all Republican members of the Senate Finance Committee and House Ways and Means Committee, dated 14 December 2022. The letter urged the Biden Administration to stop encouraging foreign countries to assert new taxing rights against American interests, in violation of existing treaties. The application of Pillar Two legislation in the EU, or in other countries, could lead to the application of the UTPR rule on profits of CEs belonging to US headquartered multinationals[63]. Consequently, it could raise questions with regard to the compatibility of top-up taxation under Pillar Two with existing BTTs or bilateral investment treaties. Similar issues arise in relation to any potential top-up taxation by EU Member States under the Directive on investment returns in other regions and (emerging) economies in the world.

The emergence of potential controversies on the issue of the application of UTPR rules was postponed with the issuance of the second set of Administrative Guidelines in July 2023, which established a temporary safe harbour rule for UTPR. The UTPR amount will be zero if the UPE jurisdiction has a nominal corporate tax rate of at least 20 %. Since the CIT rate in the US is 21 %, the UTPR will not apply to CEs whose UPE is resident in the US during the transition period[64]. However, for almost all EU based MNE Groups, this advantage will not be available, as the Member State in which they are headquartered will be required to apply the IIR starting in 2024. This is because the safe harbour rule for UTPR will not apply to EU Member States. Based on the adopted EU Directive, as of January 2024 EU Member States will have to apply the IIR before applying the UTPR. Although an exception applies to a few very small EU Member States, almost all EU-headquartered MNEs will be confronted with the IIR for all jurisdictions where they are active. This will create an uneven playing field for EU Member States and offer an advantage to MNEs headquartered in jurisdictions where the GloBE rules may not apply (e.g. the US or China).

[63] However, this can happen only to the extent that the US does not levy a sufficient level of company taxation and/or does not collect a sufficient top-up tax to meet the Pillar Two minimum standard (e.g. under a tax incentive regime).

[64] Transition period means the fiscal years running no longer than 12 months that begin on or before 31 December 2025 and end before 31 December 2026.

Consider, for example, the case where the nominal tax rate is 21 % for both the US and an EU Member State, and that in both countries a (tax) incentive is provided for EUR 500 million (e.g. supporting the fight against climate change, reducing CO2 emissions). In both countries, this incentive would bring the ETR to 5 %. In the EU, however, the Pillar Two rules would require an IIR to apply, significantly reducing the benefit of the incentive. Given that the US is not subject to the UTPR, the same consequence would not apply[65].

7.5 Tax competition will not disappear, but will take other forms

Although there is a distinction between the sovereign right of countries to engage in tax competition and the harmful tax practices that allow income via transfer pricing, debt/equity arbitrage or other means of escaping taxation (OECD, 1998; OECD, 2015b), Pillar Two aims to prevent all tax competition, at least below a certain amount. A key feature of Pillar Two is the application of a substance-based carve-out tied to indicators of real activity. The carve-out reduces the tax base to which the Pillar Two top-up tax rate applies. This is intended to preserve the possibility for countries to compete for real and productive investment, while at the same time leaving room for them to engage in tax competition through their domestic tax systems.

Jurisdictions that adopt the Pillar Two rules can still compete on corporation tax rates for entities outside Pillar Two's reach. For example, it has been found that QDMTT may actually increase the incentives for certain jurisdictions to offer low (possibly zero) CIT rates to all corporate entities, including large MNEs (Devereux *et al*., 2022). This is because such jurisdictions could comply with OECD rules, adopt QDMTT and collect top-up taxes from entities within the scope of Pillar Two, while keeping a lower (even zero) general level of domestic corporate taxation and attracting companies that do not qualify for the application of Pillar Two. In other words, by introducing a QDMTT, a country can collect the revenue that would otherwise have been collected by another country under Pillar Two through the IIR or the UTPR, and keep competitive taxation on the generality of the companies located in their jurisdiction through low tax rates or extensive tax reliefs.

In fact, governments may also take advantage of the limitations of the international tax framework and MNEs' desire for lower taxes by offering tax incentives aimed at reducing the taxpayer's tax liabilities. This can result in tax competition between countries. Such incentives can take the form of CIT holidays, reduced tax rates, or increased tax deductions for certain taxpayers or sectors, and special economic zones with a range of direct and indirect tax concessions. Often, businesses operating in the digital economy are the target of these tax incentives, as countries are eager to attract investment in the sector (Mullins, 2022).

Regarding MNEs falling within the scope of Pillar Two, tax competition may take new forms outside of corporation taxes, targeting mandatory levies other than corporation tax such as energy taxes, property taxes, indirect taxes, payroll contributions and other non-tax factors. For energy tax, for example, Sweden's favourable tax regime awards significantly reduced taxation of electricity taxes to data centres. In particular, the 2017 tax reform made a 97 % tax cut on any electricity used by data centres, resulting in a reduction of an individual data centre's total electricity bill of up to 40 %. This has incentivised multinational tech giants (e.g. Amazon, Facebook, Microsoft and Netflix) to build their data

[65] Another example is where both an EU group and a US group perform the same activities in the US, make the same investment and benefit from the same incentive. Because of the incentive, the ETR is 5 % for both groups. Nevertheless, for the EU group the IIR will raise the tax level in the US to 15 %, while for the US group the ETR will remain at 5 %.

centres in the country and to benefit significantly compared with many domestic companies (i.e. colocation centres) that are excluded. The tax reduction results in revenue gains for the MNE tech giants in the range of EUR 50 million annually (Lind, 2021).

But tax competition may also exploit some features of the Pillar Two rules. A specific issue regards corporate tax incentives. Some incentives do not reduce the tax base of the company, but are paid out as tax credits (i.e. as compensation of the tax due, or of other mandatory levies). Under the Pillar Two rules, such tax credits may qualify as 'refundable tax credits' if the amount of the credit that eventually remains uncompensated after four years may be claimed by the company as a direct reimbursement. Moreover, under the Pillar Two rules the tax credits that qualify as refundable are considered as public expenditures, not as tax rebates. Consequently, they will not reduce the covered tax (the numerator of the ETR); instead, they will be considered as contributions to the GloBE income and will enter the denominator of the ETR (OECD, 2022c).

The Administrative Guidelines issued in July 2023 introduced a new set of tax credits: marketable transferable tax credits. These credits – which are legally transferable or marketable with third parties – will be considered as part of GloBE income rather than a reduction of covered taxes, and will have the same effect of refundable tax credits on the ETR.

Jurisdictions willing to maintain their fiscal competitiveness could adopt measures aimed to reach this result while respecting the rules of Pillar Two. Some tax rebates (such as R&D, patent box and fast depreciation) that today enter the determination of the corporation tax base and therefore lower the ETR might be transformed into qualified tax credits, refundable against the payment of other taxes and obligatory levies, or into transferable or marketable tax credits[66]. Doing this transformation, the ETR will be higher, while the benefits for the company will remain unchanged. Most jurisdictions are considering this strategy.

What could the outcome of Pillar Two be in term of tax competition? There will probably be a group of large, developed countries that result as 'winners', insofar as they are able to maintain their ETR just above 15 % and attract FDI through the strategic use of refundable tax credits (the UK is a good candidate). Other large, developed high-taxing countries with an ETR well above 15 % (e.g. France and Germany) will achieve smaller gains than the first group, but still will benefit from reduced competition from tax havens and low-taxing countries. Low-taxing countries (e.g. Ireland, Singapore and Switzerland) will probably lose some competitiveness, but may limit the negative effects on FDI using other non-tax incentives (besides the refundable tax credits).

In a fourth group of countries, tax havens but also some developing countries might come out as 'losers', suffering a reduction in their tax attractiveness that will be difficult to substitute. The effects on the two largest countries is currently unclear. China has not taken an official position. The US will not apply Pillar Two in the foreseeable future, and opposition is mounting in Congress against the application of the UTPR to US MNEs by other countries. The provisions of the IRA denote a strong willingness to foster the competitiveness of the US and attract domestic repatriated and foreign investment.

Examining the impact of tax competition on national tax policies and welfare, Johannesen (2022) finds that a global minimum tax at a low rate could radically change the incentives for tax havens and may

[66] In other words, jurisdictions might transform existing tax incentives that reduce the corporate tax (i.e. the covered tax that enters the numerator of the ETR) into refundable or transferable/marketable tax credits. These do not reduce the eligible tax and are instead treated as contributions from the public sector, entering the denominator of the ETR as contributions to the GloBE income.

pose significant risks to other countries. This is because, a coordinated tax rate increase in tax havens would be costly for multinational firms in other countries (i.e. non-havens)[67] and negatively impact the overall welfare effect on these countries. In contrast, if the global minimum tax rate is high enough to end profit shifting, the welfare effect is unambiguously positive. Thus, if a global minimum tax is introduced at a rate that is too low, profit shifting continues and tax havens capture part of the global revenue gain created by the policy.

In ending tax competition and profit shifting, governments can play a very important role. Clausing *et al*. (2021) illustrate that an effective action plan should be based on three pillars. The first pillar is exemplarity, under which countries should collect the tax deficit of their multinationals. The second one is international coordination, whereby all countries agree to jointly adopt a country-by-country minimum tax (i.e. Pillar Two). The third pillar is about defensive measures against non-cooperative tax havens. Although the ideal solution would be for these defensive measures to be based on international coordination, unilateral actions may also be effective. One such example is the Foreign Account Tax Compliance Act (FATCA) introduced in 2010 under President Obama's Administration, which imposes taxes on financial transaction with uncooperative havens[68]. Or, alternatively, a country could collect a fraction of the tax deficit of multinationals headquartered in uncooperative states[69].

7.6 Coordination between CFC, GILTI and QDMTT rules

The GloBE Model Rules and related Commentary prescribe that CFC rules are adopted in the first place, together with national corporate tax. After that, the top-up tax is determined and paid. The GloBE top-up tax rules and rationale are very different from the CFC rules.

CFC rules were first adopted by the US in 1962 in an effort to protect its tax base and prevent long-term deferral. From 1998 and after the report on harmful tax competition (OECD, 1998), by which time 19 countries had adopted CFC rules, their number grew to 50 in 2019. A large contributing factor to this development was the BEPS Action 3 in 2015, which set out recommended approaches to the development of CFC rules[70]. The intention was to counter certain offshore structures that resulted in no – or indefinite deferral of – taxation, and thus to ensure the taxation of certain categories of MNE income in the jurisdiction of the parent company. Having comprehensive and effective CFC rules in place, can reduce the incentive to shift profits to a low-tax jurisdiction. The rules operate by attributing the undistributed income of a CFC to the controlling company, or to a connected company in the jurisdiction of the controlling company[71].

CFC rules typically distinguish between active and passive income, and they focus mainly on the latter. This is because active income is considered less abusive than highly geographically mobile passive income. For example, Article 7(2) ATAD highlights that non-distributed income of the entity or the income of the PE is the one derived from the following categories: interest, royalties, dividends, income

[67] As it would create an additional tax cost for profit-shifting firms.
[68] Under the FATCA, there is an automatic exchange of data between foreign financial institutions and the IRS about financial accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest. There are currently 113 FATCA Agreements and Understandings signed between the US and other jurisdictions, among them low-tax jurisdictions such as Bermuda, British Virgin Islands, Cayman Islands, Luxembourg, Netherlands and Switzerland.
[69] For example, if a company incorporated in a low-tax jurisdiction makes half of its sales in a certain country, then that country would collect half of its global tax deficit.
[70] ATAD 1 of 2016 helps to extend the coverage of enacted CFC rules within the EU.
[71] Undistributed income might arise from non-genuine arrangements aiming to obtain a tax advantage.

from finance leasing and financial activities (e.g. insurance, banking), and income arising from related parties (e.g. intra-group income from sales and services).

On the other hand, the GloBE rules include all income. This is because the starting point is the net income or loss used for preparing the consolidated financial statements of the UPE before eliminating intra-group transactions. As a result, GloBE is wider in scope than the CFC rules and intends to pick up any income of an MNE's group in case such income was not subject to a 15 % ETR calculated on a jurisdictional basis (Theophilou, 2022)[72]. A further difference between the two is the fact that CFC rules typically focus on preventing parent stripping (foreign-to-domestic stripping) (Dourado, 2015; OECD, 2015a), whereas the IIR focuses on preventing both foreign-to-foreign stripping (income generated in third countries) and parent stripping.

Moreover, there are differences in terms of the liability for the top-up tax (Sharma, 2022), which usually falls on the UPE of the MNE group. Under certain circumstances, however, the GloBE rules (namely the UTPR) are designed so that the liability for the top-up tax shifts to one or more of the other CEs of the MNE group. This entails a level of coordination of IIR among jurisdictions. On the other hand, CFC rules, though they may have tax credit rules designed to avoid double taxation, typically do not have this level of coordination.

Finally, GloBE rules cover only large MNEs, while national CFCs typically have a much larger application. Thus, the rules do not interfere with national CFCs, but rather intend to coordinate CFCs with Pillar Two. They do so by mandating that in calculating the ETR the CFC revenues are pushed back from the controlling corporation to the CE. In other words, the CFC is subtracted from the covered taxes paid by the UPE and added to the covered taxes of the CE. This solution implies that the ETR of a low-taxed CE is increased, reducing the size of the top-up tax of the CE. Therefore, the potential revenue increase stemming from GloBE application in the jurisdictions where the CE is resident is curtailed, to the benefit of the jurisdiction where the parent company is located and where the CFC has been paid.

The issue of the ordering of the GloBE system rules is therefore important in determining the distribution of the additional revenues of Pillar Two among the participating jurisdictions. A specific case is the US GILTI. As already mentioned (see Section 5.1 above), GILTI is levied on a worldwide basis, blending the incomes of controlled companies located in low-taxing and high-taxing jurisdictions. This feature differentiates GILTI from traditional CFC rules, which tax undistributed profits of controlled companies separately for each jurisdiction. This feature also makes GILTI unsuitable to be recognised as a CFC under Pillar Two rules[73]. Therefore, countries adopting Pillar Two could not consider GILTI in the calculation of the ETR of the CEs located in their jurisdiction. In particular, countries applying a QDMTT (or UTPR) to a CE of a US multinational group would not consider GILTI as a qualified CFC, with the consequence of a lower ETR and a larger share of top-up tax revenues. This might well result in higher (double) taxation for a CE belonging to a US multinational group.

The nature of GILTI, and the inability of the Biden Administration to pass modifications in US legislation to make it consistent with GloBE rules, raised a serious problem of coordination in the design of the GloBE system, and sowed the seeds of potential conflict between European (and other) countries and

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[72] The IIR does not have an economic substance-based carve-out, but rather uses tangible assets and employees as proxies. In doing so, the IIR relies heavily on both accounting principles such as IAS, which are the starting point for determining the GloBE tax base and international tax rules.

[73] Because of a lack of relevant information, it would be impossible to push down the CFC tax from the UPE to the single CE and assess its ETR.

the US. In February 2023, this issue was resolved with the publication of the Administrative Guidance. The agreement reached by the Inclusive Framework provides specific rules for apportioning GILTI (and other 'blended' CFCs) among the CEs using special formulas. Hence, GILTI can now be treated as a qualified CFC.

This solution, though technically not perfect and somehow complex, eliminates the risk of double taxation on US MNEs and makes the GloBE system workable. In comparison with the opposite scenario, however, in which GILTI was not recognised as a qualified CFC, this solution implies a shift of revenues from the jurisdictions where the CEs of US MNEs are located to the US. In order to reach a compromise, the Administrative Guidance has introduced a change in the ordering of the GloBE rules. According to the Model Rules and related Commentary, the sequencing was: i) national corporate taxes; ii) CFC and other anti-abuse measures; iii) QDMTT; iv) IIR; and v) UTPR. The Administrative Guidance has established that a CFC on a resident CE paid by a non-resident UPE is ignored (i.e. not credited) in computing the QDMTT of that CE[74]. This innovation in the sequencing of the GloBE rules implies lower revenues for the US and higher revenues for the jurisdictions where the CEs of US MNEs are located and are subject to a QDMTT.

However, it also creates problems for the application of the EU Directive, which follows the ordering of the GloBE Model Rules and Commentary. The EU Directive is legally binding, while the Administrative Guidance is not. This may require a change in the Directive if an interpretative solution is not feasible. As a more general issue, the relationship between the agreements reached in the OECD Inclusive Framework and EU (and national) legislation needs further investigation, especially when the Inclusive Framework approves documents that are intended to provide interpretation and application guidelines, but in fact contain changes to the basic rules.

[74] However, the Administrative Guidelines issued in July 2023 established that if the application of a QDMTT is challenged by an MNE on constitutional grounds, or under an international investment agreement, or on a specific agreement with the government, the amount challenged shall not be treated as QDMTT payable. Thus, the top-up tax payable under the QDMTT does not reduce the top-up tax that may be collected by other jurisdictions under the GloBE rules.

8. Policy recommendations

The Task Force proposes the following recommendations:

1. **Consistency** between the sequencing of GloBE rules in the EU Directive and the OECD's Administrative Guidance should be achieved in order to **avoid double taxation**. Improved **coordination** between changes in the GloBE rules and EU legislation is highly necessary.

2. Within the EU, the **principles of the single market** must be fulfilled, while the constant **streamlining of national rules** should be promoted.

3. The definition of definitive **safe harbours** should bring stable and substantial simplification to the GloBE rules. If the definition process is prolonged, however, an **extension of the transitory country-by-country safe harbour rules** should be considered.

4. The agreement and implementation of rules for **settling litigation** should be highly prioritised within the Inclusive Framework, while **special rules at EU level** should also be considered.

5. **BEFIT** should aim for **simplification, a reduction in compliance costs and uniformity within the EU** (e.g. through the provision of a one-stop shop), in order to **increase the EU's competitiveness**. Thus, it should **build on Pillar Two rules** as much as possible. The Commission proposes that **the rules should be mandatory** for MNEs that fall within the scope of Pillar Two and optional for all other groups. However, businesses ask for **optionality** for all, as they advocated for the CCCTB. This solution could be considered, at least on a **temporary basis**, to test the appropriateness and attractiveness of BEFIT. After all, the 'success' of BEFIT would be measured by the number of businesses that opt for it on a voluntary basis.

6. **BEFIT** should be based on a **strict derivation from financial reporting**, with very few corrections. Hence, for the sake of simplification and uniform application within the EU, IAS and IFRS rules should apply and, contrary to the GloBE rules, the **use of national accounting rules** (i.e. local GAAP) **should not be allowed**. However, as a subordinate solution, the use of national accounting standards might be left **optional for businesses**.

7. As for the **timing of implementation** of BEFIT, an adequate timespan in relation to the implementation of the GloBE rules should be granted, to **avoid overburdening tax administrations and taxpayers**.

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Annex 2. List of Abbreviations

ADIMA	Analytical Database on Individual Multinational and their Affiliates
ALP	Arm's Length Principle
ATAD	Anti-Tax Avoidance Directive
BBBA	Build Back Better Act
BEAT	Base Erosion and Anti-Abuse Tax
BEFIT	Business in Europe: Framework for Income Taxation
BEPS	Base Erosion and Profit Shifting
BTT	Bilateral Tax Treaty
CAMT	Corporate Alternative Minimum Tax
CbCR	Country-by-Country Reporting
CCCTB	Common Consolidated Corporate Tax Base
CCTB	Common Corporate Tax Base
CE	Constituent Entity
CFC	Controlled Foreign Company
CGOS	Corporate Gross Operating Surplus
CIT	Corporate Income Tax
Commission	European Commission
DST	Digital Services Tax
ECJ	EU Court of Justice
ETR	Effective Tax Rate
FATCA	Foreign Account Tax Compliance Act
FDI	Foreign Direct Investment
FDII	Foreign Derived Intangible Income
FFC	Fiscal Financial Committee
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
GILTI	Global Intangible Low-Taxed Income
GloBE	Global Anti-Base Erosion
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IIR	Income Inclusion Rule
IMF	International Monetary Fund
IP	Intellectual Property
IRA	Inflation Reduction Act
IRS	Internal Revenue Service
MLC	Multilateral Convention
MNE	Multinational Enterprise
OECD	Organisation for Economic Co-operation and Development
PBT	Profit Before Tax

PE	Permanent Establishment
QBAI	Qualified Business Asset Investment
QDMTT	Qualified Domestic Minimum Top-up Tax
R&D	Research and Development
SBIE	Substance-Based Income Exclusion
SDP	Significant Digital Presence
SEC	Securities and Exchange Commission
SHIELD	Stopping Harmful Inversions and Ending Low-tax Developments
STTR	Subject to Tax Rule
TCJA	Tax Cuts and Jobs Act
TFEU	Treaty on the Functioning of the European Union
UPE	Ultimate Parent Entity
UTPR	Undertaxed Profit Rule
VAT	Value-Added Tax

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