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On an animal farm and 'equality, however' according to the Pillar 2 Commentary

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Summary

Yesterday, on 14 March 2022, the OECD published the Commentary on the Pillar 2 Model Rules, the global minimum rate for large multinationals. When reading the first pages, the author was overwhelmed by the urge to write this opinion and, 'equally, however', to make a connection with an animal farm.

1 Introduction

Yesterday, on 14 March 2022, the OECD published the Commentary on the Pillar 2 Model Rules, the global minimum rate for large multinationals and the additional levy up to that minimum rate where countries do not comply with the minimum. Already after reading the first pages,[2] I was overwhelmed by the urge to write this opinion piece. You are undoubtedly familiar with George Orwell's novel Animal Farm, and otherwise the famous proclamation from the book: 'All animals are equal, but some animals are more equal than others'.[3] On dictionary.com I read that this is about: "A proclamation by the pigs who control the government in the novel Animal Farm, by George Orwell. The sentence is a comment on the hypocrisy of governments that proclaim the absolute equality of their citizens but give power and privileges to a small elite." I was suddenly reminded of this when I put together some of the passages in the commentary from the Introduction and Chapter 1, including the commentary on Article 1.1 on the scope of the measures. This, in addition to some thoughts that came to mind about the ever-changing nature of the measures and which I would like to save for another time.[4]

2 Coordination and consistency

On page 11 of the Commentary there are some passages about the importance of a coordinated and consistent approach, under the heading 'Co-ordination and consistency requirements under common approach'. For the sake of convenience, a quote:

"14. The GloBE Rules are intended to be implemented as part of a common approach. A jurisdiction that joins the common approach is not required to adopt the GloBE Rules but, if it chooses to do so, it agrees to implement and administer them in a way that is consistent with the

outcomes provided under the GloBE Rules and this Commentary. Consistency in the implementation and administration of the GloBE Rules is intended to result in a transparent and comprehensive system of taxation that provides predictable outcomes for MNEs and avoids the risk of double or over-taxation."

Consistency, that sounds good, although it is still a question of how we are going to guarantee that (legally) but that aside. The document then emphasises the importance of coordination, for example also when it comes to determining the scope of the measures. Here's a quote:

"15. The limitations on scope in Article 1.1 play an important role in the co-ordination mechanics for the GloBE Rules by ensuring that the application of the rules in one jurisdiction does not come into conflict with the intended outcomes under the GloBE Rules in another jurisdiction. For example, if a jurisdiction were to set a lower revenue threshold for the application of the UTPR under its domestic law this would cause the UTPR to operate as the primary rule for those MNE Groups that were above this domestic threshold but below the agreed GloBE threshold, resulting in outcomes that were contrary to the basic design of the GloBE Rules and undermining the expected outcomes for MNEs headquartered in jurisdictions that have adopted a Qualified IIR."

That also sounds good. It is not the intention that countries could start to levy additional taxes beyond the scope of the measures on foreign income of companies under the application of the UTPR, the so-called undertaxed profits (was: 'payments') rule. This, for example by applying the rules to domestic operational group entities of companies with a foreign low-taxed headquarter entity that do not meet the turnover threshold test of 750 million euros. A turnover threshold as a lower limit for measure-scoping purposes is simply a turnover threshold as a lower limit for measure-scoping purposes, you would say. Well, not quite, another quote:

"16. Equally, however, a co-ordinated approach to the GloBE Rules does not prevent those jurisdictions that adhere to the common approach from introducing additional measures to tax their own domestic taxpayers in respect of the foreign income of their subsidiaries and branches, provided those rules do not come into conflict with the intended outcomes under the GloBE Rules. For example, the introduction of a tax in respect of income of foreign subsidiaries that was similar to the IIR, but applied only to the foreign income of smaller locally headquartered MNE Groups (i.e. MNE Groups with annual consolidated revenues below the threshold in Article 1.1), would not be contrary to the design of the GloBE Rules or undermine the rule order that had been agreed as part of the common approach."

That sounds a bit less good, at least in my way of thinking. Apparently, it is the intention that countries can levy additional taxes beyond the scope of the measures on foreign income of companies under the application of the IIR, the so-called income inclusion rule. This, for example by applying the rules to domestic headquarter entity of companies with low-taxed foreign operational group entities that do not meet the turnover threshold test of 750 million euros. Apparently, a turnover threshold as a lower limit for measure-scoping purposes is not a turnover threshold as a lower limit for measure-scoping purposes. This, at least when it comes to the application of the IIR in the headquarter's jurisdiction.

Further on, on page 14 in the Commentary, under the heading Article 1.1 – Scope of GloBE Rules on the scope of the measures, the following passage is written:

"3. Article 1.1 limits the application of the GloBE Rules to MNE Groups whose annual

consolidated revenues in at least two of the four preceding Fiscal Years equal or exceed EUR 750 million. These scope rules ensure that smaller Groups and purely domestic Groups remain unaffected by the GloBE Rules. The Article also clarifies that Entities that are Excluded Entities are not subject to the GloBE Rules. (…) This threshold limits the application of the rules to those MNE Groups with consolidated revenue of at least EUR 750 million in at least two of the four preceding Fiscal Years. (…)"

The scope provisions ensure that the rules are not applied to smaller groups, and that these smaller companies remain unaffected by the GloBE Rules. Is the scope provision respected or not? Yes and no, because 'all animals are equal, but some animals are more equal than others,' or so it seems.

3 Coordination and consistency?

Additional taxation by countries applying the UTPR beyond the scope of the measures undermines the system design, according to the Commentary. Additional taxation by countries applying the IIR beyond the scope of the measures does not undermine the system design 'equally, however', according to the same Commentary (p. 11). At the same time, the scope rules ensure that the measures do not affect cases beyond the scope of the measures. Thus again the Commentary (p. 14). Of course, that is not possible, at least, except under the new and improved Pillar 2 principle of equality.

Which countries again are those countries that are going to raise additional tax under the application of the primary rule, the IIR that is? These are the headquarters jurisdictions, the G7 countries, and to a lesser extent the G20 countries, the large(er) countries with the large(er) economies that is. Which countries again are those countries that are going to raise additional tax under the application of the safety net rule, the UTPR that is? These are the other countries, the operational jurisdictions, the small(er) countries with the smaller(er) economies that is. The picture unfolds: big countries are allowed to top-up tax companies beyond the scope of the measures and small countries are not allowed to top-up tax companies beyond the scope of the measures.

The Pillar 2 ordering rule is more important than the Pillar 2 scoping rule. The ordering rule apparently is some kind of a Pillar 2 core rule that should not be undermined and the scope rule apparently is some kind of a Pillar 2 periphery rule that can be undermined, at least by countries where the headquarters are located. Which country are those again that are the members of the Pillar Two project managing OECD, the 'rich country think tank'? Well, for all mismatches and disputes and ambiguities that we will soon inevitably be coming across upon the implementation and operation of the 'two-pillar solution' – for example when it comes to the demarcations between the newly introduced distinction between 'core rules' and 'peripheral rules' – we now know how to address and solve all these issues in an orderly fashion, as consistency will now be secured on the basis of the new Pillar 2 principle of equality: i.e., large countries first.

4 Closing remarks

The OECD press release of 8 October 2021 on the two-pillar solution states that: "Today's agreement will make our international tax arrangements fairer and work better," and: "This is a major victory for effective and balanced multilateralism." This fairer, better major victory for balanced multilateralism does not mean – as it seems for the time being – to be bringing reciprocity between sovereign nation states. After all, raising additional tax beyond the scope of the measures

is allowed for head office jurisdictions and, “equally, however”, not for operational jurisdictions. And I’m only on page 14. Anyway, maybe I’m too worried and perhaps we should consider all this as a ‘slip of the pen’ that was not picked up with the final review.

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[2] OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Antibase Erosion Model Rules (Pillar Two), OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-thedigitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf (Commentary).

[3] George Orwell *Animal Farm*, Secker and Warburg, London, England, 17 August 1945.

[4] Commentary, p. 8: “The Globe Rules apply a system of Top-up Taxes – that is, an IIR and a UTPR – that brings the total amount of taxes paid on an MNE’s Excess Profit in a jurisdiction up to the Minimum Rate. This Top up Tax does not operate as a typical direct tax on income of an Entity. Rather it applies to the Excess Profits calculated on a jurisdictional basis and only applies to the extent those profits are subject to tax in a given year below the Minimum Rate. Rather than a typical direct tax on income, the tax imposed under the Globe Rules is closer in design to an international alternative minimum tax, that uses standardised base and tax calculation mechanics to identify pools of low-taxed income within an MNE Group and imposes a co-ordinated tax charge that brings the Group’s ETR on that income in each jurisdiction up to the Minimum Rate. The design of the Globe Rules as a Top-up Tax facilitates the co-ordinated application of the Globe Rules by ensuring that the aggregate amount of incremental tax payable under the rules in each jurisdiction does not cause the ETR to exceed the Minimum Rate. The design of the IIR and UTPR as Top-up Taxes, however, does not restrict a jurisdiction from legislating those rules under a corporate income tax system in its domestic law.”

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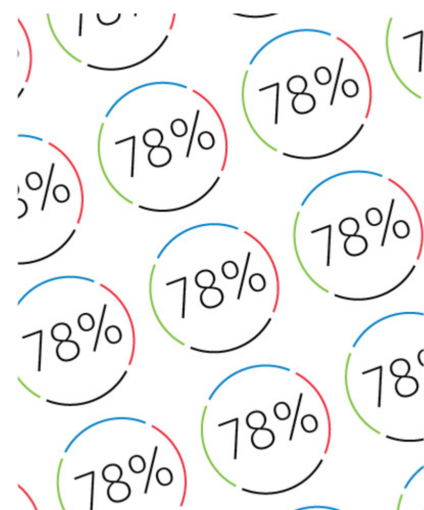

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