

# Kluwer International Tax Blog

## On Pillar 2 Controversy and Trust

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*Issues involving controversy surrounding the operation of the newly devised Pillar Two rules in company taxation seem to have moved strikingly up business agendas and political agendas recently. On an informal meeting of tax practitioners from business and consultancy in Amsterdam, the Netherlands, on 30 May 2023, the author of the current blog was invited to elaborate on the topic of Pillar Two and controversy – from an academic, or perhaps, personal perspective. Playing the hand that had been dealt, the result of the honorable task assigned was a staging of Pillar Two as a new theatre of potential escalation in international relations, and a newly devised source of societal distrust in the way we are governed and taxed. Please read further below for a report on the results of the endeavor.*

### 1. Introduction

Thinking of Pillar Two and controversy, many, perhaps, feel that something is dormant, that something is going on. Something eerie. The EU has implemented the global minimum tax via the EU Pillar Two Directive.<sup>[1]</sup> The Netherlands, my home country, has transposed the Pillar Two rules into domestic law via the Minimum Tax Act 2024.<sup>[2]</sup> The OECD is still in the process of adding informal rule sets, just the other day with CBCR guidance and its transplants into the Pillar Two rulebooks via the Safe Harbour,<sup>[3]</sup> and the OECD secretariat report, at the request of the G7, on dispute resolution, on a vision on the governance surrounding Pillar Two that still has some snags to make it a reality.<sup>[4]</sup> To be honest, my feel is that when policy officials start talking about visions, that might just as well be the cue that nothing actually may ever happen.

In practice, we are having conversations with each other and with the people of the Finance ministries on the application of the new rules. Oftentimes, we are not sure how the new rules will operate, there's lots of legal uncertainty. In the meanwhile, we read in the newspapers that planning is already underway – out-from-under<sup>[5]</sup> – and batches of anti-abuse guidance/rules are also starting to follow-up on each other in an increasingly rapid pace.<sup>[6]</sup> New batches of administrative guidance are anticipated shortly. In addition, some more flexible rules are being introduced to remain benevolent to some large countries, via the UTPR Safe Harbour for instance.<sup>[7]</sup> A 20% statutory rate that is, that suffices, to shield UTPR exposure, for now, and perhaps indefinitely, we'll see. In the meantime, the EU rules are not being changed and we tell each other that it is still perfectly fit from an EU law point of view.<sup>[8]</sup> It all feels a bit awkward.

The topic addressed today is that awkwardness. Why is it there? While preparing this introduction, several words and terms came to mind when thinking about this, and one of them kept echoing a bit: trust. We don't trust it, or at least I don't, and that's why Pillar Two is controversial, at least as far as I'm concerned – and as far as I'm concerned, it's justified to distrust Pillar Two, there's some chilling in it. Please let me elaborate a bit.

## 2. Trust

Trust is about the expectation of behavior, back and forth, trust needs some reciprocity. Does he or she do what he or she says? Is he or she transparent about his or her motives? My feeling is that we sometimes say we care when that is socially desirable, or correct, to say so, while we may only act with care when such aligns with our interest, and if we can afford such, that is, if we are powerful enough to do so. Without trust, between individuals and organizations, between companies, countries, politicians, or the legal system, much becomes more difficult. Without trust any ball could just stop rolling, just think of it. On a much larger scale, the same is true for countries. Where there is trust in international relations, we can work together, address the challenges we face. Without trust, well, things can suddenly become a bit more hostile. Yet we live in a time of declining trust, between individuals and the state, between states and between regions, between the global North and South, for example.[9]

What we are telling the world is that Pillar Two is about jointly addressing the tax challenges of the digitalizing economy.[10] We tell each other a happy story, alluding to the bright and shiny side of us, of mankind. We say that we want to tackle tax avoidance and that we want to tackle tax competition. To achieve this, together, we have agreed on an informal basis that we will effectively tax large companies up to 15% on their profits and that otherwise other countries may intervene to tax up to that level: *“I’ll tax if you don’t”*. [11] If the race to the bottom hypothesis is correct, we will soon be racing together, globally, to a 15% tax level instead of a zero level. That means a global coordination of company taxation, a global company tax along the lines of the Model GloBE Rules,[12] where local company taxes are the real top-up taxes and which will decline in time to zero, in the new equilibrium. No firm hard law agreements, however, have been made in the form of, for example, a treaty – an instrument of public international law. There is only a soft agreement,[13] and several countries and regions have now started to implement the rules hard,[14] the EU leading the way with the directive.[15] On a global level, however, so far, there’s no governance instrumentation, neither hard nor soft.[16]

## 3. Incentives

We tell each other a fairy tale. If you look at what countries are really doing, in the real world, countries do exactly what they always did: they pursue their self-centered interests, explicitly, or implicitly, dependent on how powerful they are. Reality, as is often the case, seems a bit darker than we tell ourselves and each other.

Just look at the incentives. The company tax architectural make up is devised in such a way that it stimulates both companies and countries to position themselves strategically. The Separate Accounting (SA) / Arm’s Length Standard (ALS) model gives companies grip on the tax consequences because of the grip they have on the legal structuring of their business affairs. In transfer pricing, one controls both sides of the internal contract, and with that, the price. The allocation of the tax base to origin jurisdictions provides a grip on the tax consequences because of the grip companies have on their investment location decisions. Companies strategize on their investment location decisions and countries respond accordingly, or perhaps the other way around – as countries at the end of the day are more powerful than companies. Tax competition.

Pillar Two does exactly the same thing in terms of design as a typical company tax and thus leads to the same strategic positioning possibilities. When it comes to strategization, already, the focus in practice is on the Effective Tax Rate-calculation, the allocation of tax base, on the allocation of

taxes, on the allocation of the top-up tax, if any – just steer the top-up tax to a jurisdiction that gives the money back as a subsidy, or a jurisdiction that isn't top-up taxing while allowed to do so by others – and of course on the utilization of differences between Pillar Two and company taxation and Pillar Two and GAAPs and Pillar Two and Pillar Two Safe Harbours, and of course the mutual differences between the various Pillar Two rules in countries. Every difference, every mismatch, will be used strategically, by companies and by countries. It is just the consequence of the systemic incentives provided and the competitive responses that steer decision making processes. The Pillar Two system, unfortunately, is fundamentally flawed and riddled with loopholes.[17] The Whac-A-Mole game is embarking full speed.

And then the top-up tax to the minimum level. This should dampen all anticipated effects. This, based on a tax of which any geographical connection with underlying economic activities – nexus – has been abandoned.[18] This is also the problem when it comes to the interaction of Pillar Two with the tax treaties. Tax treaties distribute taxing rights, mine and yours, along national borders, after which countries leave each other alone; Pillar Two does the opposite, we intervene in each other's economies. And the question is whether that will actually happen in the future. In the newspapers we read about planning and the fight against abuse,[19] and about countries that want to return Pillar Two revenues in the form of subsidies.[20] In the meantime, we see countries moving very cautiously. No one is taking a position, perhaps afraid to diverge from one another. And moreover, will France actually move, come forward, and top-up tax US profit? Are we going to top-up tax Chinese profit? We'll have to see on that one.[21] If you do something other than you say, it affects trust, I imagine.

#### 4. Stability

The Pillar Two system, because of all this, is intrinsically unstable. It addresses tax competition while opening-up opportunities for such, through credits for instance and subsidies, and weak systemic design. At the same time, such subsidies et cetera – or stretchy interpretations of the Pillar Two rules – provide openings to disqualify each other's Pillar Two systems.[22] We do as if we are going to implement the globally developed rules in a globally coordinated manner, when in reality we are doing the opposite: we operationalize the rules at a decentralized level, and at the same time, there is nothing to base upon any assumption that countries will actually interpret the rules in the same way worldwide. On the contrary, if you look around and see countries positioning themselves, explicitly – enforcing UTPR Safe Harbours – or more implicitly – with subsidy initiatives, or via informal bilateral relationships with corporate taxpayers, it seems rather the case that countries continue to pursue their self-interests and utilize the space they have available for that purpose to its fullest extent. The question, then is, how countries and companies will respond to each other some later time, when the rubber hits the road, when the (foreign) taxman arrives, and it is time to pay the tax bill. Who's going to pick up that one?

#### 5. Basis

The basis for the Pillar Two system, ultimately, is an informal one.[23] Soft law, a wolf in sheep's clothing here, as far as I'm concerned. It provides a basis for not moving, and it provides a basis for moving. We are going to pick the benefits from our neighbors, the fruits of their garden, just because they don't do that sufficiently themselves – in our interpretation. Or not. And vice versa. Which countries are we going to disqualify? Which ones not so much? In an environment without the rule of law, the law of the strongest applies. It is not without reason that we curbed power at a certain point in time by dividing it into an executive, a judicial and a legislative branch, with the

primacy of the latter embedded in parliament where the people's mandate rests. This is not the case with Pillar Two. There is no central legislator, there is no central judge, there is no central executive. Without any institutional safeguarding, instrumentalization and arbitrariness arises. We are not going to levy additional taxes on American and Chinese profits. Because we are not powerful enough. We are going to levy additional taxes on profits in less powerful states. Because we are powerful enough. Others are going to tax our profits if they are powerful enough, or not, because they don't have enough power. Or we'll tax ourselves and become a lesser attractive investment location, *ceteris paribus*. The weakest are going to pay. The stronger will use all available instruments and means in getting away. The application of the rules becomes an instrument to serve an interest. The final result is arbitrary taxation, arbitrary government action or arbitrary government inaction. That is not how the law should operate, and that undermines trust. Or isn't it?

## 6. Integrity

We read about yet another batch of guidance released the other day, to protect the integrity of the GloBE CbCR Safeharbour. But isn't it the other way around? Isn't what we are seeing that the integrity of the system is being tampered with, to begin with and by introducing all kinds of ex-post interpretations that are actually ex-post rules, with retroactive effect even[24] – just because we come to know, or perhaps we already did, that the rules do not work? The system is already failing, and has been, right after the publication of the first blueprint.[25] And at the end of the day, the powerless will lose out to the powerful. Powerless countries will lose out. Powerless companies will lose out, customers and employees will bear the cost. It is what it is.

Inclusive Framework countries, or United Nations countries perhaps, underlying drivers, please, be brave and behave trustworthy. Be honest in your motives. Do we want to compete, or do we want to coordinate? Act accordingly. Now we say one thing and do another, while the tax bill will soon be on the table. At the end of the day, positions will have to be taken. Taxation is the compulsory contribution to the financing of society. The charge to tax must have a basis in the law. Otherwise, taxation transforms into unlawful expropriation of income. And a corporate tax world that is ruled by the exercise of power instead of the rule of law. That has little to do with integrity. That has little to do with trust. That has little to do with courage either. And that is the reason for the discomfort felt when we're talking about Pillar Two and the controversy it brings.

## 7. Closing comments

I am arriving at my closing comments. Pillar Two is intrinsically unstable. What we say and what we do, do not coincide. Country interests do not align. What's next? Conflict? Escalation? Nothing? Red tape only? Matters in future will depend on country behaviors and country power structures. Informal rulebooks bring arbitrary taxation, a tool to be gamed and strategized upon by the stronger. The Pillar Two instrumentation is not rule of law based, it is power based, and so will any future potential top-up tax-enforcement, or any lack thereof. The integrity of the company tax was at stake previously, pre-BEPS. And now it is again, government induced. And that is a serious problem lying in wait. Trust me.

[1] See Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

[2] See Wet minimumbelasting 2024 (Dutch Minimum Tax Act 2024), Staatsblad (Official

Gazette) 2023, 510.

[3] See OECD (2024), *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13*, OECD, Paris.

[4] See OECD (2024), *2024 Progress Report on Tax Co-operation for the 21st Century: OECD Report for the G7 Finance Ministers and Central Bank Governors*, OECD Publishing, Paris.

[5] See <https://news.bloombergtax.com/daily-tax-report/us-companies-move-behind-american-shield-to-delay-global-tax>. A Dutch journalist reported on the same development: <https://nos.nl/artikel/2504462-amerikaanse-multinationals-ontwijken-nederlandse-bijheffing-mini-mumbelasting>.

[6] See Article 3.2.7. Pillar Two Model Rules, OECD (2021), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, see OECD (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, December 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, and see OECD (2024), *Tax Challenges Arising from the Digitalisation of the Economy – Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2023): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, and OECD (2024), *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13*, OECD, Paris.

[7] See OECD (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, July 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

[8] The Finance Ministers of the European Union (EU) adopted a Council Statement during the ECOFIN meeting on 9 November 2023 welcoming the progress on BEPS 2.0. The Council Statement was accompanied by a statement of the European Commission, see the statements on <https://www.consilium.europa.eu/media/67850/st14732-re01-en23.pdf>. A statement politically welcoming something, obviously, is something different from taking position from a legal perspective and creating legitimate expectations.

[9] The lines in this paragraph have been taken from Sam Wrighton, *Trust in international relations public diplomacy and soft power*, A review of the literature and data, British Council, 2022, available on [https://www.britishcouncil.org/sites/default/files/trust\\_in\\_international\\_relations\\_public\\_diplomacy\\_and\\_soft\\_power.pdf](https://www.britishcouncil.org/sites/default/files/trust_in_international_relations_public_diplomacy_and_soft_power.pdf).

[10] See OECD/G20 Base Erosion and Profit Shifting Project, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy*, 1 July 2021, available on <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf>.

[11] See Maarten de Wilde and Ciska Wisman, ‘OECD Consultations on the Digital Economy: ‘Tax Base Reallocation’ and ‘I’ll Tax If You Don’t’?’, in: Pasquale Pistone and Dennis Weber



(Ed.), ‘Taxing the Digital Economy; The EU Proposals and Other Insights’, IBFD, Amsterdam, 2019, Ch. 1, at 3-23.

[12] See OECD (2021), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris

[13] See OECD/G20 Base Erosion and Profit Shifting Project, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy, 1 July 2021, available on <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf>.

[14] See OECD (2024), *2024 Progress Report on Tax Co-operation for the 21st Century: OECD Report for the G7 Finance Ministers and Central Bank Governors*, OECD Publishing, Paris, at 3: at 3: “The Global Minimum Tax is now in effect in over 30 jurisdictions, and an increasing number of other jurisdictions have announced their intention to implement the GloBE rules within the next year”.

[15] See Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

[16] Note that as soon as countries were to move to, for instance, adopting white lists, these countries immediately abolish – effectively and substantively that is (outside any red tape issues) the operation of the Pillar Two rules.

[17] See EU Tax Observatory, Global Tax Evasion Report 2024, EU Tax Observatory, 2024, available on [https://www.taxobservatory.eu/www-site/uploads/2023/10/global\\_tax\\_evasion\\_report\\_24.pdf](https://www.taxobservatory.eu/www-site/uploads/2023/10/global_tax_evasion_report_24.pdf), at 6: “the global minimum tax of 15% on multinationals, which raised high hopes in 2021, has been dramatically weakened. Initially expected to increase global corporate tax revenues by close to 10%, a growing list of loopholes has reduced its expected revenues by a factor of 2 (and by a factor of 3 relative to a comprehensive minimum tax of 20%)”. See also Maarten de Wilde, ‘Is There a Leak in the OECD’s Global Minimum Tax Proposals (GLOBE, Pillar Two)?’, Kluwer International Tax Blog, March 1, 2021.

[18] See Filip Debelva, Luc De Broe, ‘Article: Pillar Two: An Analysis of the IIR and UTPR from an International Customary Law, Tax Treaty Law and European Union Law Perspective’, (2022), 50, Intertax, Issue 12, pp. 898-906, and see Maarten de Wilde, ‘Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification’, Kluwer International Tax Blog, January 12, 2022.

[19] See <https://news.bloombergtax.com/daily-tax-report/us-companies-move-behind-american-shield-to-delay-global-tax>.

[20] See, e.g., <https://www.vietnam-briefing.com/news/draft-global-minimum-tax-support-fund-unveiled.html/>, and see e.g., Martin A. Sullivan, ‘Will Singapore’s Refundable Investment Credit Trigger Pillar Two Tax?’, Tax Notes International, 13 May 2024.

[21] See, for a comparison, the clip on Youtube entitled ‘Trump puts on heavy French accent to mock Emmanuel Macron’: “You better un-pass...”.

[22] See Laura den Ridder, Pieter Ruige, and Maarten de Wilde, ‘Fiscal Subsidies Aspirers Beware of the No Benefit Requirement in Pillar Two’, Kluwer International Tax Blog, September 18, and the comments below.

[23] OECD/G20 Base Erosion and Profit Shifting Project, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy, 1 July 2021.

[24] See OECD (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, December 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

[25] See OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

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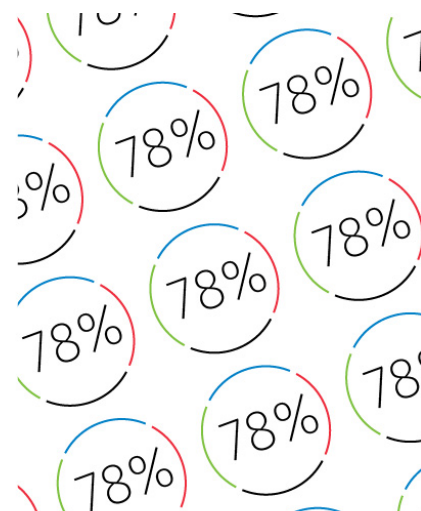
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