Strategic Incentives for Adopting the Global Minimum Tax

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Abstract

The United States, along with Canada and a majority of nations in the world, currently faces an important policy choice: should it adopt the global minimum tax, proposed by the Organization for Economic Cooperation and Development (OECD) and designed to subject large multinationals to no lower than a minimum of corporate income taxation wherever they operate? For all nations pondering the choice, *what other nations will do* is an essential consideration. On the one hand, the global minimum tax—also known as "Pillar Two"—has generated extensive controversy and opposition. On the other hand, over 20 countries have implemented the tax according to the OECD's model rules. According to a popular narrative, this may already amount to a "critical mass" of countries that makes global Pillar Two adoption inevitable.

This Article sets out a novel conceptual framework for predicting and interpreting the course of Pillar Two's global adoption. It analyzes self-interested incentives for adopting Pillar Two on the part of governments aiming to maximize national income. The analysis demonstrates that there is nothing inevitable about Pillar Two adoption. Countries from which multinationals originate will likely suffer deep losses, and most will be better off pulling out of Pillar Two. Pillar Two's enforcement mechanisms lack effectiveness; accounts of their purported clever design are plagued by logical inconsistencies. Whatever sense of novelty in institutional design Pillar Two introduces, it is sustained only by a refusal to consider fundamental normative questions about consistency with international law.

Contents

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Introduction

In the past three years, through a surprisingly rapid and impressively high-profile sequence of events, the world witnessed the apparent emergence of a new international regime on the taxation of multinational enterprises (MNEs). In 2021, the Organization for Economic Cooperation and Development (OECD) announced an in-principle agreement among over one hundred countries to implement international tax reform.[1] In December 2022, the European Union (EU) adopted a Directive mandating all 27 member states to enact legislation to put into effect certain "Global Anti-Base Erosion Model Rules" developed by the OECD.[2] These rules—colloquially referred to as "Pillar Two" in an OECD policy package,[3] or, more descriptively, as the "global minimum tax"—aim to ensure that MNEs pay no

[1] *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy,* THE ORG. FOR ECON. COOP. & DEV. ["OECD"] (July 1, 2021), 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 [hereinafter *OECD July 2021 Statement*]; *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy,* OECD (Oct. 8, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf [hereinafter *OECD October 2021 Statement*]. These statements purportedly represent agreements among over 130 jurisdictions (including the U.S. and Canada) participating in a multilateral exchange called the "Inclusive Framework." *See* Michael Lennard*, Boats Against the Current? Tax Multilateralism in Turbulent Times,* 106 TAX NOTES INT'L 1157 (May 30, 2022).

[2] *See* Council Directive 2022/2523 of 14 December 2022 on ensuring a global minimum level for taxation for multinational enterprise groups and large-scale domestic groups in the Union, 2022 O.J. (L 328/1) (EC).

[3] "Pillar One" of the OECD's "two pillar solution" proposal for international tax reform would reallocate taxing rights over the residual profits of a small group of MNEs. For scholarly analyses, *see e.g.*, James R. Hines Jr., *Digital Tax Arithmetic*, 76 NAT'L. TAX J. 119 (2023); Wei Cui, *New Puzzles in International Tax Agreements*, 75 TAX L. REV. 201 (2021). Pillar One is not germane to the main themes of this Article and thus beyond its scope.

less than a 15% rate of income tax wherever they operate.[4] As of the beginning of 2024, 21 countries in Europe and 4 countries elsewhere are listed by the accounting firm PwC as having "final law in force" to implement all or parts of Pillar Two.[5] Numerous other countries have also either advanced draft legislation for or announced the intention to adopt the "global minimum tax," all based on rules designed by the OECD.[6] These developments have received salient and persistent global media coverage.[7] Even for casual readers of global news headlines, the impression that many nations are acting in unison in taxing MNEs may have formed.

In the United States, however, the global minimum tax remains deeply controversial. Along with Canada and other G-7 countries, the U.S. was a leading sponsor of the tax in 2021.[8] The Biden Administration proposed to implement rules consistent with Pillar Two both in the 2022 Build Back Better legislative package and the 2023 Treasury Greenbook,[9] but the proposal has faced strong Republican opposition.[10] House Republicans even advanced H.R. 3665, the Defending American Jobs and Investment Act, in May 2023, threatening retaliation against foreign governments that adopt "extraterritorial" and "discriminatory" taxes under Pillar Two that "attack U.S. businesses."[11] Nonetheless, both sides of U.S. debate have taken widespread adoption of the global minimum tax by

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[4] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)* (2021) [hereinafter *Pillar Two Model Rules*]. These rules are elaborated in subsequent commentaries and guidance. *See, e.g.,* OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)* (2022) [hereinafter *Commentary on Model Rules*].

[5] *OECD's Pillar Two country tracker*, PwC, https://www.pwc.com/gx/en/services/tax/pillar-two-readiness/country-tracker.html.

[6] *Id.*

[7] For recent coverage, *see* Emma Agyemang, *Global minimum tax on multinationals goes live to raise up to $220bn*, FINANCIAL TIMES (Dec. 31, 2023), https://www.ft.com/content/191d8388-c5c0-419c-95d6-918df6f09fc5; Mark Johnson, *A global minimum tax on firms is finally taking shape*, THE ECONOMIST (Nov. 13, 2023), https://www.economist.com/the-world-ahead/2023/11/13/a-global-minimum-tax-on-firms-is-finally-taking-shape; Julie Zauzmer Weil, *Biden won a global tax rate. Now Americans wonder if it was a good deal.,* WASH. POST (July 5, 2023, 6:00 AM EDT), https://www.washingtonpost.com/business/2023/07/03/global-minimum-tax-american-businesses/; Alan Rappeport, *New Corporate Minimum Tax Ushers In Confusion and a Lobbying Blitz*, N.Y.TIMES (Sept. 7, 2023), https://www.nytimes.com/2023/09/07/business/corporate-minimum-tax-impact.html.

[8] Press Release, U.S. Department of the Treasury, G7 Finance Ministers & Central Bank Governors Communiqué (June 5, 2021), https://home.treasury.gov/news/press-releases/jy0215.

[9] Press Release, The White House, President Biden Announces the Build Back Better Framework (Oct. 28, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/28/president-biden-announces-the-build-back-better-framework/; Press Release, U.S. Department of the Treasury, U.S. Department of the Treasury Releases Greenbook, Outlining Tax Proposals to Reduce the Deficit, Expand Support for Working Families, and Ensure the Wealthy and Large Corporations Pay their Fair Share (Mar. 9, 2023), https://home.treasury.gov/news/featured-stories/us-department-of-the-treasury-releases-greenbook-outlining-tax-proposals-to-reduce-the-deficit-expand-support-for-working-families-and-ensure-the-wealthy-and-large-corporations-pay-their-fair-share.

[10] Press Release, U.S. Senate Foreign Relations Committee, Congressional Republicans: Administration Neglected U.S. Interests in OECD Deal, Invited Extraterritorial Tax on U.S. Companies (Dec. 15, 2022), https://www.foreign.senate.gov/press/rep/release/congressional-republicans-administration-neglected-us-interests-in-oecd-deal-invited-extraterritorial-tax-on-us-companies; Letter to Secretary Janet Yellen, HOMELAND SECURITY COMMITTEE (July 31, 2023), https://estes.house.gov/uploadedfiles/2023-07-31-letter_to_treasury_-_oecd.pdf.

[11] *Ways and Means Republicans Introduce Bill to Combat Biden's Global Tax Surrender*, COMMITTEE OF WAYS AND MEANS (May 25, 2023), https://waysandmeans.house.gov/ways-and-means-republicans-introduce-bill-to-combat-bidens-global-tax-surrender/.

other countries as given. In a recent revenue projection, the Joint Committee on Taxation assumes that a large group of countries (including EU member states and Canada) are already adopting Pillar Two.[12]

In reality, though, while in few other countries has Pillar Two sparked as much political drama, the U.S. is by no means alone in holding back from the global minimum tax. Many of the G20 countries that initially lent support to the OECD proposal and that host significant MNE activities, including China, India, Brazil, Indonesia, Australia, and others, have also not pursued relevant legislation.[13] Two years ago, the magazine *The Economist* argued that there were so many uncertainties associated with Pillar Two's implementation that only two things could be predicted: "A bonanza awaits tax lawyers and accountants. And the new equilibrium will be less favorable to companies."[14] As we enter 2024, tax advisors around the world are still unsure about the size of their bounties, and no one knows yet how long it will take for a "new equilibrium" in international taxation to settle in.

Against this background, this Article sets out a novel conceptual framework for predicting and interpreting the course of Pillar Two's global adoption. The framework is simple but delivers a rich array of results. A striking overall conclusion is that even if a significant number of countries initially adopt Pillar Two, the latter may still unravel, insofar as countries act out of national self-interest in the long term. This conclusion directly refutes a very popular narrative, widely offered by politicians, tax advisors, and even academic commentators, to the effect that once a "critical mass" of countries adopts Pillar Two, other countries must follow *precisely because* it is in their national self-interest to do so.[15] This Article's analyses show that countries' self-interested incentives for Pillar Two adoption are quite weak. By implication, governments rushing into Pillar Two adoption on purportedly self-interested grounds are either misguided in their judgments or, in truth, acting on other motives.

This conclusion is of vital policy and scholarly significance. In terms of policy, all national governments, in considering the adoption of the global minimum tax and projecting its revenue and other economic consequences, must make assumptions about what other countries will do.[16] Many recent government projections simply assume that other countries will adopt Pillar Two, despite the fact that the press releases put out by the OECD in 2021 have no binding legal effect.[17] Such assumptions are thus likely to be based on an implicit acceptance of claims about the inevitability of global Pillar Two adoption once an initial group of countries adopt it. Unfortunately, such claims have remained unexamined. Worse, they are often advanced by parties (e.g., tax advisors and politicians) who cannot

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[12] U.S. JOINT COMM. ON TAXATION (JCT), POSSIBLE EFFECTS OF ADOPTING THE OECD'S PILLAR 2, BOTH WORLDWIDE AND IN THE UNITED STATES (June 2023), https://www.finance.senate.gov/imo/media/doc/118-0228b_june_2023.pdf.

[13] PwC Pillar Two tracker, *supra* note 5. Canada's Federal government announced that it would implement a global minimum tax in 2024, and released draft legislation in early August of 2023. *See Legislative Proposals Relating to the Global Minimum Tax Act*, GOVERNMENT OF CANADA (Aug. 8, 2023), https://fin.canada.ca/drleg-apl/2023/ita-lir-0823-l-4-eng.html. However, as of January 2024, such draft legislation has yet to be adopted by Parliament.

[14] *The long trend of falling corporate taxes is being reversed,* THE ECONOMIST (Jan. 10, 2022), https://www.economist.com/special-report/2022/01/10/the-long-trend-of-falling-corporate-taxes-is-being-reversed.

[15] *See infra* notes 157-162 and accompanying text.

[16] *See e.g.*, JCT, *supra* note 12; JANE G. GRAVELLE & MARK P. KEIGHTLEY, CONG. RSCH. SERV., R47174, THE PILLAR 2 GLOBAL MINIMUM TAX: IMPLICATIONS FOR U.S. TAX POLICY (2023).

[17] For careful analyses of the nature of the purported agreements of the OECD's Inclusive Framework, *see,* Lennard*, supra* note 1; Scott Wilkie, *Next Steps for the OECD Pillars: Moving From a Political Deal to an Enforceable Law*, 104 TAX NOTES INT'L 889 (Nov. 22, 2021).

be said to be disinterested in the conclusions of such predictions. A transparent conceptual framework for evaluating such claims is therefore critical—and what this Article offers.

The significance of this Article's conclusions for scholarship on international taxation also requires emphasis from the start. Most importantly, one must understand that the normative assessment of Pillar Two—whether, overall, it is a good arrangement for the world or for any particular country—is a complex exercise and will remain controversial for many years to come. This is not just because, as a purported compromise among a large number of countries, Pillar Two necessarily differs from scholars' policy recommendations.[18] It is also because even the idealized goals of Pillar Two—curtailing MNE profit shifting and curbing tax competition—are intensely disputed among scholars. There are sharp scholarly disagreements about how severe the problems of MNE profit shifting[19] and international tax competition[20] are, and what the sources of cooperative surplus are for the coordination of national tax policies.[21] Thus, notwithstanding political sound bites and superficial (though ubiquitous) journalistic accounts, it is unlikely for scholars to reach a consensus on the normative assessment of the global minimum tax any time soon.

However, precisely because of the inadequacy of existing scholarship to produce consensus, it is quite tempting for researchers to take widespread adoption of Pillar Two simply as a fact about the world, an exogenously *given* starting point for routine doctrinal, empirical, and normative analyses: whatever we think about it, the global minimum tax is *there*. Such scholarship is already beginning to emerge.[22] Yet it is impossible not to notice that in scholarly narratives, the landscape of international taxation has just undergone an extraordinary, unexplained, *deux ex machina* transformation. The analyses of this Article show that this abrupt turn in the study of international taxation is both erroneous and unnecessary. It is erroneous, because attempts to posit Pillar Two adoption as a given fact require substantial factual distortions. It is also unnecessary, because the course of Pillar Two (non-)adoption can and should be analyzed using premises and concepts consistent across time and contexts.

What arguments does the Article offer to support these important, but seemingly contrarian, conclusions? In the Article's core analysis, I examine countries' self-interested incentives for Pillar Two adoption. A basic premise is that countries are likely to act, in the long term, in their own national

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[18] Reuven Avi-Yonah & Young R. Kim, *Tax Harmony: The Promise and Pitfalls of the Global Minimum Tax*, 43 MICH. J. INT'L L. 505 (2022).

[19] For recent reviews, *see* Dhammika Dharmapala, *Do Multinational Firms Use Tax Havens to the Detriment of Non-Haven Countries?*, *in* GLOBAL GOLIATHS: MULTINATIONAL CORPORATIONS IN THE 21ST CENTURY ECONOMY 437 (C. Fritz Foley, James R. Hines, & David Wessel, eds., Brookings Institution Press, 2021); Scott Dyreng & Michelle Hanlon, *Tax Avoidance and Multinational Firm Behavior*, *in* GLOBAL GOLIATHS: MULTINATIONAL CORPORATIONS IN THE 21ST CENTURY ECONOMY 361 (C. Fritz Foley, James R. Hines, & David Wessel, eds., Brookings Institution Press, 2021).

[20] Michael P. Devereux & Simon Loretz, *What Do We Know About Corporate Tax Competition*?, 66 NAT'L. TAX J. 745 (2013); Wei Cui, *The Mirage of Mobile Capital* (Peter A. Allard School of Law Working Paper, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4440596; Michael Keen, Li Liu & Hayley Pallan, *International Tax Spillovers and Tangible Investment, with Implications for the Global Minimum Tax* (International Monetary Fund, Working Paper 2023/159, 2023), https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-10427 (most up-to-date study showing that there is little evidence that foreign direct investment responds to effective marginal corporate tax rates). See also text accompanying footnotes 53-56 infra (on the lack of evidence for tax competition for MNE headquarters).

[21] Scott Wilkie, *Pillar 2 — 'What's It All About?'*, 110 TAX NOTES INT'L 499 (Apr. 24, 2023).

[22] *See* Avi-Yonah & Kim, *supra* note 18; Roberto Gómez-Cram & Marcel Olbert, *Measuring the Expected Effects of the Global Tax Reform,* 36 REV. FIN. STUD. 4965 (2023); and scholarship on Pillar Two cited in *infra* note 30.

interest, particularly in the sense of maximizing their respective national wealth/income. It is important to note that proponents of Pillar Two have often appealed to the very same premise,[23] whatever one thinks about its plausibility. The core analysis offered here is distinctive not for the premise adopted, but for applying the premise more thoroughly and not in an *ad hoc* way.[24]

I present countries as deciding whether to adopt—or to retain after initial adoption— Pillar Two's various components simultaneously with other countries facing similar choices. Countries act *strategically* or non-cooperatively*,* in the sense that each tries to maximize its own objectives, given the expectation that other countries will act the same way. In this analysis, whether Pillar Two stands will depend on countries' incentives for adopting each of Pillar Two's three distinct components. In contrast to existing commentaries, I do not take the adoption of any of these components for granted.

The first component of Pillar Two is generally considered most relevant for countries in which MNEs are headquartered (including both rich countries like the U.S. and Canada and large emerging economies like China and India). Referred to as the "Income Inclusion Rule" (IIR), it implements the "inclusion" of unrepatriated foreign profits of MNEs in the calculation of the taxable income of the ultimate parent companies in MNE groups, and taxes such profit at 15%.

Pillar Two's second component is relevant for all countries that host MNE subsidiaries and that may have attempted to attract MNE through low corporate income tax rates or other tax incentives. Referred to as the Qualified Domestic Minimum Top-Up Tax (QDMT), it denotes the idea of such host countries increasing the tax specifically for MNEs that fall within the scope of Pillar Two to 15%.

Finally, the third component, the under-taxed profit rule or UTPR, is relevant for all countries that host MNE subsidiaries and that, according to Pillar Two design, wish to enforce IIR and QDMT adoption by other countries. Specifically, it is triggered when the profit of MNE operations elsewhere is "under-taxed" because of the failure of other countries to adopt the IIR or QDMT.

In respect of these three parts of Pillar Two, this Article's core analysis establishes the following results:

1. Pillar Two threatens massive wealth transfers from MNE headquarter countries to countries of foreign subsidiaries, by encouraging the latter countries to enact QDMTs in response to the IIR. Adopting the Income Inclusion Rule is thus highly unlikely to be in the self-interest of MNE headquarter countries (such as the U.S. and Canada).[25]

2. QDMT adoption is rational if and only if in response to IIR adoption. But since IIR adoption is irrational conditional on QDMT adoption by other countries in response, the combination of IIR and QDMT adoption is unstable. Therefore, transient QDMT adoption, such as what the world has witnessed since 2023, is a poor predictor of the long-term viability of Pillar Two.[26]

[23] *See* literature cited in *infra* notes 32-37.
[24] *See infra* Part V.1 discussing the plausibility of this basic premise and how it is more consistently applied in this Article.
[25] *See infra* Part II.1.
[26] *See infra* Parts II.2 and V.2.

3. Contrary to widespread beliefs, IIR adoption is generally not an effective response to UTPR adoption, and in most policy-relevant circumstances, QDMT adoption is not a rational or effective response to UTPR adoption. Therefore, the purported enforcement power of the UTPR—what many commentators believe holds Pillar Two together—is illusory.[27]

In addition to this core analysis, this Article argues for a careful distinction between two legal interpretations of the UTPR, which differ in their answers to the question of whether the UTPR introduces a new, extraterritorial taxing right. While the incentive effects of the UTPR are identical between the two interpretations—they are both weaker than commonly supposed, per result 3 above—the extraterritorial interpretation of the UTPR implies the permissibility of a new type of taxing power that may be used in destabilizing ways.[28] The Article thus both confirms and more clearly articulates serious concerns that have been expressed about the UTPR's legality under international law and its normative justifiability.[29] Its second main conclusion is that Pillar Two has sown seeds of vital legal controversies which are likely to have an important impact on whether and how it will be implemented.

This Article aims to substantially advance the emerging legal and economic literatures on the new international tax landscape in several ways. First, it offers the first systematic scholarly examination of non-cooperative incentives for Pillar Two adoption. Several early influential papers by economists assume that low-tax source countries will strategically raise tax rates in reaction to income inclusion rules adopted by other countries, and examine the welfare properties of such rate increases.[30] These analyses do not examine IIR adoption incentives, and thus (unjustifiably) assume IIR adoption as given. Likewise, some legal scholars have suggested that QDMT adoption may be a rational response to IIR and UTPR,[31] but do not analyze the incentives for IIR or UTPR adoption, and thereby implicitly take the latter as given. This Article refutes some of these arguments and more generally fills the important gap in the analysis of incentives for IIR and UTPR adoption.

Second, several U.S. scholars advocating for Pillar Two adoption portray it as securing global coordination through novel enforcement mechanisms that may be extended to other areas, such as climate policy.[32] In other words, institutional developments in international taxation may hold valuable lessons for international law and international cooperation in general. Such claims, though never elaborated in detail, often suggest mechanisms acting on countries' self-interested incentives to enforce

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[27] *See infra* Parts II.3 and III.

[28] *See infra* Parts III.1 and IV.

[29] Regarding the likely consistency of the UTPR with international law, *see* Peter Hongler et al., *UTPR — Potential Conflicts with International Law?*, 111 TAX NOTES INT'L 141 (2023); Sjoerd Douma et al., *The UTPR and International Law: Analysis from Three Angles*, 110 TAX NOTES INT'L 857 (2023).

[30] *See* Eckhard Janeba & Guttorm Schjelderup, *The Global Minimum Tax Raises More Revenues than You Think, or Much Less*, 145 J. INT'L ECON. 103837 (2023); Niels Johannesen, *The Global Minimum Tax*, 212 J. PUB. ECON. 104709 (2022); Shafik Hebous & Michael Keen, *Pareto-Improving Minimum Corporate Taxation*, 225 J. PUB. ECON. 104952 (2023); James R. Hines Jr, *Evaluating Tax Harmonization* (Nat'l Bureau of Econ. Rsch., Working Paper No. 31900, 2023).

[31] *See* Noam Noked, *The Case for Domestic Minimum Taxes on Multinationals,* 174 TAX NOTES FEDERAL 819 (Feb. 7, 2022); Michael P. Devereux, John Vella & Heydon Wardell-Burrus, *Pillar 2: Rule Order, Incentives, and Tax Competition,* OXFORD UNIVERSITY CENTRE FOR BUSINESS TAXATION POLICY BRIEF 2022 (Jan. 14, 2022), https://ssrn.com/abstract=4009002.

[32] *See* David Kamin & Rebecca Kysar, *The Perils of the New Industrial Policy: How to Stop a Global Race to the Bottom*, FOREIGN AFFAIRS (Apr. 18, 2023) foreignaffairs.com/united-states/industrial-policy-china-perils.

global cooperation.[33] The introduction of such mechanisms is supposed to be essential to Pillar Two's design.[34] These claims by Pillar Two proponents have also been reinforced by other scholarly writing that characterizes Pillar Two as representing a piece of "diabolical machinery",[35] as possessing a "devilish logic,"[36] or as "incentive compatible".[37] This Article argues that claims about the enforcement properties of the UTPR are over-hasty and do not withstand scrutiny. For example, it would not make sense to interpret countries' IIR adoption as a rational response to other countries' UTPR adoption, if such a response is demonstrably *not* rational.[38] Other explanations must be sought. And if the process by which countries come to agree to Pillar Two is very idiosyncratic, any success achieved will not be easily generalizable to other international agreements.

Third, there is an intense, ongoing debate among legal scholars about the legality and ethical justifications of the UTPR.[39] These normative discussions generally assume that the UTPR will have the intended effect of compelling other countries to adopt Pillar Two, and debate about whether such use of the UTPR is a good thing. This Article demonstrates, by contrast, that UTPR lacks the enforcement power ascribed to it, and that a coherent normative assessment of the UTPR cannot proceed without a better understanding of the nature of the threats posed by, as well as the limits of, the UTPR.

The rest of the Article proceeds as follows. Part I illustrates Pillar Two's three components with a schematic example and explains Pillar Two's logic in a way accessible to non-specialist readers. Part II first shows that the adoption of the Income Inclusion Rule is irrational for many national-income-

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[33] In fact, the UTPR had been anticipated in the Biden Administration's "SHIELD" (Stopping Harmful Inversions and Ending Low-tax Developments) proposal in 2021. Jordan Weissman, *Joe Biden Wants to Put the World's Corporate Tax Havens Out of Business*, SLATE (Apr. 9, 2021), https://slate.com/business/2021/04/joe-biden-tax-havens-corporate-global-minimum.html. The proposal may have emanated, or at least received early endorsement, from high-profile academics. *See* Kimberly A. Clausing, Emmanuel Saez & Gabriel Zucman, *Ending Corporate Tax Avoidance and Tax Competition: A Plan to Collect the Tax Deficit of Multinationals* (UCLA Sch. L., Law & Econ. Research Paper Series No. 20-12, 2021)

[34] *See, e.g.,* Press Release, U.S. Department of the Treasury, Remarks by Assistant Secretary for Tax Policy Lily Batchelder at the 2022 Tax Conference hosted by the Federal Bar Association (Mar. 3, 2022), https://home.treasury.gov/news/press-releases/jy0629 (Professor Lily Batchelder, then speaking as Assistant Treasury Secretary for Tax Policy, argued that "in a novel step for international tax law, the [Pillar Two] agreement includes a strong enforcement mechanism…that ensures countries honor their commitments, while heavily incentivizing non-signatory countries to join the common framework…These enforcement rules are what makes the regime so strong and protects against countries cheating the system."); Kimberly A. Clausing, *The Global Minimum Tax Lives On: America Has Abandoned It for Now but Will Likely Come Around*, FOREIGN AFFAIRS (Aug. 17, 2022), foreignaffairs.com/united-states/global-minimum-tax-lives ("countries that enact the agreement's provisions will be able to tax multinational companies based in countries that do not adopt the provisions…This provides a strong incentive for countries…to eventually follow through on their pledge to abide by the agreement.").

[35] Ruth Mason, *A Wrench in GLOBE's Diabolical Machinery*, 107 TAX NOTES INT'L 1391 (2022).

[36] *Id.*

[37] Michael P. Devereux, *International Tax Competition and Coordination with A Global Minimum Tax*, 76 NAT'L. TAX J. 145 (2023).

[38] *See infra* Part III.2.

[39] *See* Douma et al., *supra* note 29; Hongler et al., *supra* note 29; Jinyan Li, *The Pillar 2 Undertaxed Payments Rule Departs From International Consensus and Tax Treaties,* 174 TAX NOTES FED. 1695 (2022); Angelo Nikolakakis & Jinyan Li, *UTPR: Unprecedented (and Unprincipled?) Tax Policy Response*, 109 TAX NOTES INT'L 743 (2023); Tarcísio Diniz Magalhães & Allison Christians, *UTPR, Normative Principles, and the Law: A Rejoinder to Nikolakakis and Li*, 109 TAX NOTES INT'L 1137 (2023).

maximizing governments. It then shows that, without considering any enforcement effect of the UTPR, QDMT adoption is unstable: it makes sense only in response to IIR adoption, but it simultaneously deters IIR adoption. Part III introduces the UTPR, as well as a distinction between two legal interpretations of the instrument: extraterritorial v. non-extraterritorial. It will first be shown that in the presence of the QDMT, the UTPR cannot incentivize IIR adoption. Then, by reference to the non-extraterritorial interpretation of the UTPR, Part III explains why QDMT adoption is not a rational response to the UTPR in many policy-relevant circumstances. Finally, it is argued that the same conclusions hold for the extraterritorial interpretation of the UTPR. Overall, the purported "enforcement" powers of the UTPR are largely illusory. Together, Parts II and III lay out the Article's core analysis.

Part IV begins by describing an impasse in the debate between UTPR critics and advocates about its legality. To advance beyond the impasse, the UTPR is analyzed a novel form of a two-part tax, analogizable to ant-deferral rules imposed on MNE parent entities. Part IV argues that once decoupled from an implicit foreign tax credit feature, the type of extraterritorial taxing right (that some believe to be) introduced by the UTPR has the potential of increasing national income, but precisely because of this, the self-interested incentives for exercising such taxing right are too strong, and the challenge of resolving conflicting jurisdiction too great. It is thus unlikely that the new taxing right implied by the extraterritorial interpretation of the UTPR can be unconstrained. At the same time, even the non-extraterritorial interpretation of the UTPR raises grave concerns under international law, which Part IV argues UTPR defenders are wrong to dismiss and UTPR critics are wrong to neglect.

Part V considers three types of objections to the Article's main arguments and conclusions. The first is objections to the premise that countries act to maximize national income. I show that this premise is in fact critical to the arguments made by many Pillar Two proponents, and that it is in any case much more plausible than another premise often relied on by commentators—namely that governments act to maximize tax revenue. The second set of objections is based on the observation that many countries have already enacted Pillar Two. I explain how the conclusion that Pillar Two may still unravel can be reconciled with recent adoptions, and why, in general, facts are distorted when Pillar Two adoption is posited as a given fact about the world. Third, I explain why it is mistaken to dismiss potential challenges to Pillar Two under international law, and why legal controversies may turn out to be crucial to the next stage of Pillar Two developments. A brief Conclusion restates the significance of the Article's conclusions.

I. Pillar Two's Three Components: A Schematic Example

The OECD's Pillar Two proposal has garnered attention around the world, from the vast population of tax professionals. Summaries of its main provisions and explanations of technical details are easy to find.[40] Instead of repeating such abundant summaries, the following schematic example illustrates Pillar Two's main components and intended effects. Through the example, some jargon—in particular and unfortunately, some acronyms—will be introduced.[41] However, the example should be

[40] For concise and informative summaries, *see* Gravelle & Keightley, *supra* note 16; JCT, *supra* note 12; Michael P. Devereux, Johanna Paraknewitz & Martin Simmer, *Empirical Evidence on the Global Minimum Tax: What Is a Critical Mass and How Large Is the Substance-Based Income Exclusion?*, 44 FISCAL STUD. 9 (2023).

[41] The international tax discourse is notorious for its unconstrained use of acronyms. The three unavoidable acronyms in discussions of Pillar Two are the IIR, the QDMT, and the UTPR. I will also occasionally resort to the acronym "UPE" for "ultimate parent entity," given the analytic centrality of jurisdictions home to such entities. I

accessible without prior knowledge of international taxation, and all irrelevant details of the Pillar Two proposal are omitted.

One can start by considering four country types. First, some countries are large economies from which a significant number of multinational enterprises originate, and which typically host the headquarters of such multinationals. In Pillar Two terminology, these are jurisdictions hosting the "ultimate parent entities" (UPEs) in multinational groups. Examples include the U.S., China, Germany, Japan, Canada, Brazil, India, etc. These countries also offer tax incentives to both domestic and foreign MNEs, such that many MNE subsidiaries operating in them have effective corporate income tax rates below 15%, the minimum required by Pillar Two.[42] In our illustrative example, Country U represents countries of this first type.

A second type of countries—represented in the example by Countries X and Y—host operating subsidiaries of multinationals and have relatively high corporate income tax rates. MNE subsidiaries in such countries display effective tax rates (ETRs) above the minimum rate of 15%. One can think, for example, of France and Germany as members of this country type.[43] In contrast, while also hosting MNE subsidiaries, countries of a third type—in our example, Country Z—impose low corporate income tax rates. This, perhaps along with other tax preferences, results in effective tax rates lower than 15% among many MNE subsidiaries. Many countries offering preferential tax treatments to foreign direct investment may fall into this type, but well-known examples include Ireland, Switzerland or Singapore.

Fourth and finally, some countries host holding companies in MNE groups (referred to in Pillar Two as "intermediate parent entities" or IPEs), which are subject to ETRs of close to 0%. Examples may include Luxembourg, Hong Kong, or Bermuda

Pillar Two only applies to MNE groups that exceed a EUR 750 million annual revenue threshold. Controlled subsidiaries within covered MNE groups are referred to as "constituent entities". Constituent entities with ETRs below 15%—which can be found in countries Z, U, and H—are labeled "low-taxed constituent entities." Figure 1 depicts an MNE group, *M*, which has its ultimate parent entity, *P*, in Country U. *M* has high-ETR subsidiaries in Countries X and Y, low-taxed subsidiaries in Countries Z and U, and an intermediate parent entity in Country H.

We can now describe the three main components of Pillar Two. These rules intend to ensure that a covered MNE group bears a minimum of 15% of ETR in each jurisdiction in which it operates. The first way to achieve this outcome is through the application of the "Income Inclusion Rule" or IIR, by jurisdictions hosting parent entities. U, as the country where the ultimate parent entity of group *M* is located, may impose a "top-up" tax on *P*, *in respect of* the low-taxed profit of *M*'s Country Z subsidiary. The amount of the tax is a function of the difference between the 15% minimum ETR required by Pillar Two and the actual ETR displayed by the Z subsidiary.[44] The idea is that such top-up tax imposed on *P* in

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will minimize the use of other acronyms (e.g., "IPE" for intermediate parent company—the term "holding company" is used instead). Other acronyms, such as MNEs for multinationals and ETR for effective tax rates, are more familiar in standard discourse and will be used from time to time. The abbreviation "ET" for "extraterritorial" will hopefully be tolerated by readers old enough to know Steven Spielberg's movie.

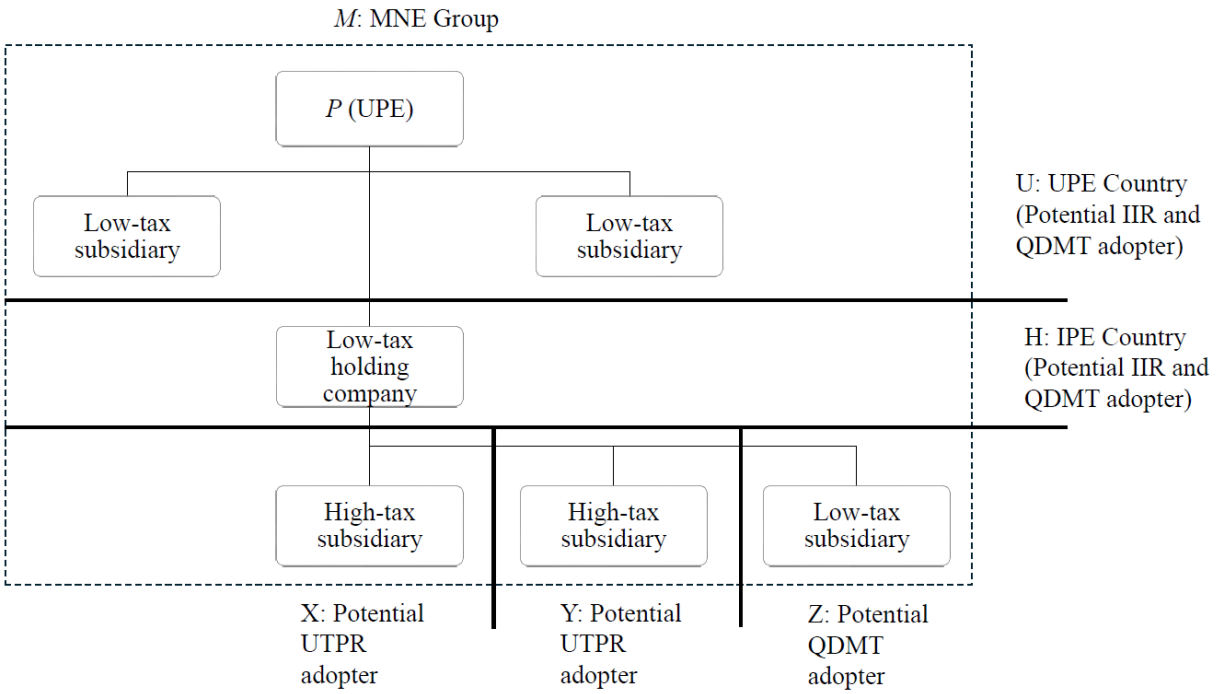
[42] Felix Hugger, Ana Cinta González Cabral & Pierce O' Rielly, *Effective Tax Rates of MNEs* (OECD Tax. Working Papers No. 67, 2023)

[43] Some countries can thus belong to multiple country types, e.g., both of the first two.

[44] There is a "substance-based carveout" based on tangible assets and payroll in Country Z that reduces the amount of the top-up tax.

Country U, along with any Country Z tax already imposed on the Country Z subsidiary, together ensure that the Country Z subsidiary's profit is subject to an aggregate minimum 15% rate.

Figure 1: Illustrative Example of Country Types



The design of the IIR is familiar to international tax specialists. For almost a century now, governments have recognized the desirability of levying some tax on the income of foreign entities owned by their residents: otherwise, their residents could easily avoid taxation by keeping income in foreign entities they control without making distributions. When the use of foreign subsidiaries is viewed as posing such risk of abuse, a standard technique is to *deem* the income of the foreign subsidiaries to have been distributed and to tax such deemed distributions. The technique is employed in familiar "anti-deferral" or "controlled foreign corporation" ("CFC") rules. At the same time, if the foreign subsidiary income that is thus taxed to shareholders has already been subject to tax abroad by foreign governments, the country imposing the shareholder-level tax usually allows a "foreign tax credit" (FTC) for the foreign tax paid against the shareholder-level tax.

The IIR works exactly this way: the "top-up tax" it imposes can be thought of as simply a 15% minimum tax on the undistributed income of a subsidiary, but with foreign tax credit granted for foreign taxes already paid on such income.

Suppose Country U does not adopt the income inclusion rule. This would mean that the Country Z subsidiary's profit still enjoys a low tax rate. Pillar Two envisions two remedies. First, since *P* holds the Country Z subsidiary through a holding company in Country H, Country H could impose a top-up tax, on that holding company, in respect of the Country Z subsidiary's undertaxed profit. That is, Country H can substitute for Country U in imposing the IIR. Second, if Country H also fails to adopt the IIR, Country X or Country Y, or the two collectively, can step in and impose the under-taxed profit rule (UTPR) in respect of the under-taxed profit of the Country Z subsidiary. According to the Pillar Two Model Rules, they

would collect a top-up tax from the Country X or Country Y subsidiaries of *M*, corresponding to the tax that was not collected in Country Z.

While the IIR can raise the aggregate ETR of M's subsidiaries outside Country U to 15%, it is not designed to do so to subsidiaries in U. This means that *M* will continue to have low-taxed subsidiaries in U. According to the Pillar Two Model Rules, Country X or Country Y, or both jointly, is also allowed to collect additional top-up taxes in respect of the low-taxed profit of Country U subsidiary by applying the under-taxed profit rule.[45] Again, such "UTPR" top-up taxes are to be collected from *M*'s subsidiaries in Country X and Country Y, respectively.

As Parts IV and V will discuss, unlike the IIR, how the UTPR operates has generated much confusion. It is generally agreed that, in some important sense, the UTPR is unprecedented.[46] Although, as just stated, the UTPR tax is collected by X or Y from corporate entities resident in them, the amount of the UTPR tax is determined by *M*'s profit in Countries Z and U: the existence of such profit may in fact have nothing to do with Countries X and Y. On a popular but casual reading of Pillar Two—which Section III.1 defines as the *extraterritorial* interpretation of the UTPR—the UTPR allows X and Y to tax *M*'s profit in Z and U (or anywhere else in the world), simply because *M* has subsidiaries in X and Y. To many (though not all) commentators, it is hard to see why Country X or Y can claim such taxing power. But as we will see in Section III, the UTPR is highly unusual even on a non-extraterritorial interpretation.

Finally, a "qualified domestic minimum top-up tax" (QDMT) may be adopted by Country Z or Country U. Country Z may adopt a QDMT to raise the ETR of *M*'s subsidiary located there to 15%. If it does so, Pillar Two no longer allows Country U to apply the IIR in respect of the Country Z subsidiary (as the latter would no longer be low-taxed). For the same reason, Country X or Y would no longer impose a UTPR top-up tax on the subsidiaries located in them in respect of the (now higher-taxed) profit of the Country Z subsidiary. Country Z could also have precluded other countries' application of top-up taxes in respect to *M*'s subsidiary operating in it by raising the general corporate income tax rate or cut back tax preferences. However, the QDMT allows Country Z to avoid such general policy changes and offer a more targeted response to other countries' threat of top-up taxes. Similarly, Country U could apply a QDMT to raise the ETRs of subsidiaries operating in it to the 15% minimum, thereby precluding the application of UTPR in Country X or Y in respect of Country U subsidiaries.

The QDMT is a tax imposed on corporate income by the country in which a corporation is resident. In this sense, it is—like the IIR and *unlike* the UTPR—a traditional tax instrument. Countries could always have imposed it (unless prohibited by international agreements), but they are supposed to have new incentives to do so under Pillar Two.

It should be noted that the concept of the QDMT was introduced by the Pillar Two Model Rules only after the October 2021 Inclusive Framework statement,[47] and Pillar Two considers the QDMT an optional component.[48] Nonetheless, the QDMT plays a critical role in Pillar Two's logic.

We now proceed to consider adoption incentives for these three components of Pillar Two.

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[45] Indeed, such Country U LTCE may include *P*, the ultimate parent entity itself.
[46] *See e.g.*, Li, *supra* note 39.
[47] *See* Hongler, *supra* note 29.
[48] Commentary on Model Rules, *supra* note 4, at 118.

II. The Instability of IIR and QDMT Adoption

We start with incentives for adopting the IIR. As mentioned earlier, the Income Inclusion Rule belongs to a familiar family of policy tools—"anti-deferral" or "controlled foreign corporation" legislation—that governments deploy to prevent their residents from avoiding home country taxation of foreign income. These tools are regarded as key to maintaining the integrity of residence-based taxation and the fairness of the income tax.[49] They are also expected to raise revenue. Their efficiency properties are more disputed,[50] but the issues are sufficiently unclear that the adoption of such rules is not generally regarded as irrational by a national-income-maximizing government. Over decades, many countries have adopted them, with little coordination among themselves.[51]

In recent years, policy debates have alluded to two purported disincentives in the adoption of anti-deferral rules. The first arises if the location of MNE headquarters is mobile and there is competition among countries for MNE headquarters. Any country that adopts strong worldwide corporate taxation regimes may risk losing out in such competition. The second disincentive arises if, even without assuming that headquarters location decisions are tax-sensitive, strong worldwide corporate taxation negatively affects the competitiveness of a country's MNEs. For example, one can view a country's decision to subject the foreign income of its MNEs to lower effective taxation as a form of subsidy: reducing such subsidy by strengthening residence-based taxation may, it is feared, put one's own multinationals at a disadvantage. Both these possible disincentives imply that countries should be more willing to adopt anti-deferral rules when others also adopt them: there is *complementarity* in such adoption.

These alleged disincentives against unilateral adoptions of anti-deferral rules face many unanswered questions. For one, one might expect the number of countries engaged in headquarters competition to be relatively small. If mitigating headquarters competition is the goal, such countries should negotiate among themselves to form a small tax cartel, as opposed to enlisting the majority of countries in the world to adopt Pillar Two.[52] Why should countries choose Pillar Two to implement collective IIR adoption?

Even more importantly, there is little systematic—or even anecdotal—evidence that MNE HQs easily move in response to tax policies, especially when it comes to global headquarters that correspond to the "ultimate parent entities" in Pillar Two design. The evidence usually cited for headquarter mobility comprises two types:[53] (i) corporate "inversions" by American MNEs, where the publicly listed entities of MNE groups move from high-tax to low-tax jurisdictions; and (ii) international mergers and

[49] The limited scope of Pillar Two implies that in many countries, anti-deferral rules that have broader application than the IIR would continue and co-exist with it.
[50] Some scholars have questioned whether corporation taxation of worldwide income, when adopted by some countries but not others, enhances global economic efficiency, and whether it maximizes national welfare. *See* Mihir A. Desai & James R. Hines, *Evaluating International Tax Reform*, 56 NAT'L. TAX J. 487 (2003); Dhammika Dharmapala, *The Consequences of the TCJA's International Provisions: A Conceptual Framework and Survey of the Evidence* (University of Chicago Coase-Sandor Institute for Law & Economics Working Paper No. 966, 2023).
[51] *See* Johannes Voget, *Relocation of Headquarters and International Taxation*, 95 J. PUB. ECON. 1067 (2011).
[52] Countries hosting foreign MNE investments may even be hurt by the reduction of subsidies from HQ countries.
[53] *See* Voget, *supra* note 51.

acquisitions.[54] But neither type truly matches the notion that headquarters move. "Inversions" usually involve the change of a holding company rather than operational headquarters.[55] They also seem to be largely an American phenomenon and discussed little elsewhere. International M&As, on the other hand, implicate much more than change of headquarters and are not readily evaluated as such. Governments around the world may promote their national champions, but it would be highly inaccurate to describe this as a matter of competing for headquarters.[56]

Nonetheless, let us simply assume that there is complementarity in the adoption of IIR-like rules. Does Pillar Two, therefore, increase the likelihood of such adoption?

1. Pillar Two's massive wealth transfers

The answer is, surprisingly, no. Since 2021, it has become increasingly problematic to interpret the IIR in terms of traditional policy justifications, for two reasons. First, anti-deferral rules are generally a response to—they presuppose—the fact that the foreign income of the taxpayers to whom the rules are applied is taxed at a low rate. Taxpayers do not avoid taxation in their home countries by going places where they are also heavily taxed. Second, anti-deferral rules also typically incorporate standard foreign tax credits, allowing foreign taxes paid to offset domestic tax liability. This offers double taxation relief, but it is based on the assumption that the source or host country would not increase taxes, knowing that such taxes would simply reduce the taxpayers' liabilities elsewhere.

By contrast, it is now commonly assumed that Pillar Two adoption will lead countries that previously taxed MNE operations at low rates to introduce higher taxes, and that they would do so *because* such host country taxes would reduce, dollar-for-dollar, top-up tax liabilities in home countries. Indeed, the QDMT aims specifically to facilitate such response by previously low-tax countries without changing their general corporate income tax rules.[57] In its Economic Impact Assessment in 2020, the OECD assumed that 50% of all countries that have corporate income taxes will raise their tax rate to the global minimum if Pillar Two were implemented.[58] In more recent revenue projections made by individual governments (such as the report of the U.S. Congress' Joint Committee on Taxation),[59] *all* countries that adopt Pillar Two are assumed to enact a QDMT.[60]

In fact, under Pillar Two, it is clear that the adoption of the Income Inclusion Rule would merely result in large wealth transfers away from the IIR adopting country. The transfers work this way. Many countries that are homes to MNEs, e.g., Germany, Canada, and arguably even the U.S., currently tax their MNEs' foreign profits lightly. This encourages the MNEs to shift profit to low tax jurisdictions. Pillar Two invites these MNE home countries to increase the tax on such foreign profits to 15% through the

[54] In international M&As, the acquisition of an MNE of one country (e.g., Volvo or Jaguar) by an MNE of another country (e.g., Geely or Tata) necessarily implicates a "movement" of headquarters, e.g., from Sweden to China in the case of Volvo's acquisition by Geely, and from Britain to India in the case of Jaguar's acquisition by Tata.
[55] Mihir A. Desai, *The Decentering of the Global Firm*, 32 THE WORLD ECONOMY 1271 (2009).
[56] There is also little indication that Pillar Two intends to bring an end to governments' promotion of their own MNEs.
[57] Devereux et al., *supra* note 31, at 10.
[58] OECD, TAX CHALLENGES ARISING FROM DIGITALISATION – ECONOMIC IMPACT ASSESSMENT, OECD/G20 BASE EROSION AND PROFIT SHARING PROJECT 111-112 (2020), https://www.oecd-ilibrary.org/content/publication/0e3cc2d4-en.
[59] JCT, *supra* note 12.
[60] JCT, *supra* note 12. An increase in tax haven country rates to 15% is also taken as an exogenous given in all economics models offered in the papers cited in *supra* note 30.

IIR. If the U.S., Germany, Canada and other home countries to MNEs did so, they would have raised revenue both directly, by increasing the tax rate on profit located overseas, and indirectly, by reducing profit shifted to low tax jurisdictions in the first place. But Pillar Two also invites the low-tax countries where MNE profits are currently booked (e.g., Switzerland, Singapore and Hong Kong) to also tax the profits at 15%, *while* requiring the MNEs' home countries to *then* reduce the IIR top-up tax they impose. Thus, home countries would enact the IIR, only to allow low-tax host countries to collect revenue.

Now, for any MNE's home country (U.S., Canada, etc.), its MNEs' foreign profits contribute to its national income. When it taxes such profit, the revenue raised also represents its national income. The tax levied by such a country thus leaves the country's total national wealth unchanged: it merely accomplishes an *intra*-nation wealth transfer. When the country's MNE's profits are taxed by a foreign government, however, its national wealth leaks to the that foreign country: an *inter*-nation wealth transfer happens. Of course, other countries have the right to tax MNEs' operations in their borders. However, Switzerland,[61] Singapore,[62] Hong Kong[63] and other low-tax jurisdictions have all made clear that they would introduce a minimum tax (QDMT) *only because* this would reduce MNEs' top-up tax liabilities elsewhere. Therefore, it is countries' participation in Pillar Two that results in such inter-nation wealth transfers.[64]

Scholarly analyses recognized the large implied inter-nation wealth transfer early on.[65] But the issue achieved political salience only in 2023, due to a report by the U.S. Congress' Joint Committee on Taxation. The U.S. currently taxes its MNEs' foreign profit more than countries like Canada do, hence more of its national wealth shows up as tax revenue. The report estimates that the U.S. would lose tens of billions of dollars of *revenue* under Pillar Two, because it must give credit for significantly higher foreign taxes on U.S. MNEs. This has fueled fierce partisan debate in the U.S.[66] But the issue is equally relevant in Canada and other MNE headquarter countries. If Canada shows no revenue loss from Pillar Two, that would only be because it has previously left a part of its national wealth untaxed. Pillar Two would nonetheless transfer such wealth to other countries.

How large are the inter-nation wealth transfers implied by Pillar Two? The best answer to this question comes from a recent analysis based on extensive data gathered by the German government

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[61] Umsetzung des OECD/G20-Projekts zur Besteuerung der digitalin Wirtschaft, BBL 1700 (2022), https://www.fedlex.admin.ch/eli/fga/2022/1700/de (Switz.).

[62] Lawrence Wong, Deputy Prime Minister and Minister for Fin., Singapore Government's Budget Statement for Financial Year 2023 in Parliament (Feb. 14, 2023) (Sing.)

[63] The Hon Paul MP Chan, Fin. Sec'y, Second Reading of the Appropriation Bill 2023 (Feb. 22, 2023) (H.K.)

[64] It is thus misleading to claim that increased foreign taxation of (for example) U.S. MNEs' profits under Pillar Two should not trouble the U.S., because such profits were free for other countries to tax to begin with. (*See* Kimberly A. Clausing, *The Revenue Consequences of Pillar 2: Five Key Considerations*, TAX NOTES INT'L for such a claim.) Pillar Two was supposed to mitigate the problem of tax competition. (*See*, Cui, *supra* note 3; Clausing et al., *supra* note 33.) If countries adopt low tax rates in tax competition, they are precisely not (adequately) taxing MNEs—leaving U.S. MNE profits to remain a part of U.S. national income. The implementation of Pillar Two thus leads to a loss of U.S. national income that would not have otherwise occurred.

[65] Johannesen, *supra* note 30 (concluding that the overall effect on IIR adopting countries' welfare is likely negative, given existing estimates of how much MNE profit shifting responds to tax rate changes)

[66] *JCT: U.S. Stands to Lose Revenue Under OECD Tax Deal*, UNITED STATES SENATE COMMITTEE ON FINANCE (June 20, 2023), https://www.finance.senate.gov/ranking-members-news/jct-us-stands-to-lose-revenue-under-oecd-tax-deal.

through country-by-country reporting by MNEs that operate in Germany.[67] Clemens Fuest and Felix Neumeier calculated the revenue gains governments can expect from implementing the IIR. Given significant foreign profits currently taxed at low rates, if UPE countries introduced the IIR, *but nothing else changed*, they would mechanically raise revenue. Fuest and Neumeier estimate that for Germany, this potential revenue source amounts to between €5.1 and €6.7 billion a year, while for all MNEs covered in their database (leaving out U.S. multinationals),[68] it amounts to €40-49 billion a year. Fuest and Neumeier also recognize that Pillar Two can generate revenue for UPE countries *indirectly*: it should cause MNEs to reduce their profit shifting, knowing that profit shifted abroad will always be subject to the IIR. Such reduced profit shifting leads to higher revenue in the UPE country. Based on prior scholarly analyses of the sensitivity of profit shifting to tax rate changes, one can estimate such further potential revenue gains, which range from €1.4 billion for Germany and €17 billion for other countries (not including the U.S.).

But what happens when, in reaction to the adoption of IIRs, countries that hosted low-tax subsidiaries of foreign MNEs raise the tax on such subsidiaries to the global minimum? When the minimum tax is collected by host countries, the IIR raises no revenue. The only revenue gain for IIR-imposing countries would then come from reduced profit shifting. Meanwhile, the minimum tax imposed by host countries would result in *inter*-nation, not *intra*-nation, wealth transfers, from MNEs' to their host countries. By Fuest and Neumeier's calculation, when all host countries impose a minimum tax, Germany would raise only €1.7-1.9 billion of additional annual revenue after introducing the IIR: all of this is from reduced profit shifting by German MNEs. However, the €5.1-6.7 billion of revenue that Germany could have collected from its MNEs under the IIR just by taxing existing low-taxed foreign profit would be gone—surrendered to host countries imposing the minimum tax. To put it differently, the execution of an intra-nation transfer of €1.7-1.9 billion costs Germany a loss of €5.1-6.7 billion of German wealth to other countries.

There is nothing unique about Germany in this logic. Using their database, Fuest and Neumeier calculate that for all countries other than the U.S., the IIR would raise annually an aggregate €21-23 billion of revenue from reduced shifting, but the revenue they could have collected from existing low-taxed foreign profit of their own MNEs would be collected by other countries—the magnitude of which, as mentioned, is €40 to 49 billion a year. From the perspective of national self-interest, this is a very expensive way to raise revenue—surrendering to other countries a greater quantity of national wealth than the revenue raised from one's own residents.

While any particular revenue projection depends on myriad assumptions, Fuest and Neumeier's revenue estimates confirm theoretical predictions.[69] Indeed, their results highlight an important feature of Pillar Two revenue estimates, whether done globally or for any particular country: the massive wealth transfer contemplated by Pillar Two—from UPE countries to countries hosting MNE subsidiaries—are revealed only by separately estimating Pillar Two revenue effects with *and* without the adoption of

[67] Clemens Fuest & Florian Neumeier, *The Revenue Effect of a Global Effective Minimum Tax*, 23 ECONPOL FORUM 33, 35-36 (2022).
[68] Fuest and Neumeier, *supra* note 67, assume that the U.S. will not adopt Pillar Two but retain its GILTI regime.
[69] *See* Johannesen, *supra* note 30.

QDMTs. Any revenue estimate from Pillar Two adoption is thus misleading if, first, it does not consider QDMT adoption,[70] and second, it does not provide revenue estimates *with and without* QDMT adoption.

Consider, for example, the Joint Committee on Taxation's estimates for Pillar Two's revenue implications for the U.S.[71] The JCT shows that if a sizeable group of countries that announced the intention to adopt Pillar Two indeed begin to impose Pillar Two taxes in 2024, but the U.S. does nothing, the U.S. may either lose or gain substantial revenue, depending on assumptions about MNE behavior adopted. If U.S. MNEs shift profits to other countries (since the 15% rate of minimum tax is still lower than rates in the U.S.), the U.S. would lose tens of billions dollars of revenue. If U.S. MNEs shift profits back to the U.S. (in light of the generally higher tax rates abroad), the U.S. would raise revenue. Because of the uncertainty about MNE profit shifting behavior, the JCT treated this scenario—where many countries adopt Pillar Two but the U.S. does not—as one with neither increased nor decreased revenue for the U.S. The JCT then uses this "benchmark" scenario to show the consequences of U.S. action or inaction if the rest of the world beyond the initial adopting countries implements (or fails to implement) Pillar Two. Congressional Republicans immediately attacked the Biden Administration on the basis of the large revenue losses to the U.S. projected in some of the scenarios. But in reality, the largest loss of national income for the U.S. may have already transpired in the "benchmark" scenario. Even though the JCT treats that scenario as having zero revenue impact (due to uncertainty about MNE profit shifting), many countries have already significantly increased taxes on U.S. MNEs. This in itself damages U.S. national welfare, even if U.S. revenue may increase or decrease as a result of other factors.[72]

It follows that for governments aiming to maximize national income, the IIR is irrational to adopt.[73] This conclusion should be taken seriously even by those who do not believe the direct revenue effect of IIR adoption to be the most important. For example, some have argued that the IIR's most important benefit is to get source countries to raise their tax rates and to create a floor to tax rate competition. Reduced tax competition would enable high-tax countries to further raise their tax rates and generate greater revenue, even if the IIR itself does not raise revenue. [74] Yet such an interpretation implies the welfare losses that countries like the U.S. suffer from international tax competition is very large—in the tens or even hundreds of billions of dollars a year—and no scholarly evidence for such assumption has ever been provided. The interpretation is also difficult to reconcile with the actual design of Pillar Two: the 15% minimum tax rate is still substantially lower than the corporate tax rates of many UPE jurisdictions. Profit shifting incentives to low tax jurisdictions will therefore remain significant after Pillar Two is implemented. This means that UPE countries' ability to further raise tax rates (and revenue) will be uncertain, whereas the loss of national income from the increased foreign taxation of

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[70] Some widely-discussed projections of revenue gains by IIR-adopting countries explicitly do not account for QDMT-adoption. *See, e.g.,* Mona Baraké et al., *Revenue Effects of the Global Minimum Tax Under Pillar Two*, 50 INTERTAX 689 (2022); *Revenue impact of international tax reform better than expected*, *OECD* (Jan. 18, 2023), oecd.org/newsroom/revenue-impact-of-international-tax-reform-better-than-expected.htm.

[71] JCT, *supra* note 12.

[72] The Canadian federal government's revenue projection for Pillar Two adoption also suffers from not accounting for national income losses. See CANADA, DEPARTMENT OF FINANCE, BUDGET 2023 – A MADE-IN-CANADA PLAN: STRONG MIDDLE CLASS, AFFORDABLE ECONOMY, HEALTHY FUTURE 192, 208 (2023).

[73] IIR adoption may be irrational for many governments even if they are assumed to be revenue- maximizing, rather than national-income- maximizing. For one, whether IIR adoption increases revenue depends on what other tax instruments a government already deploys (as shown by the JCT estimates). In any case, the purported concerns with HQ competition and promoting national champions already suggest that governments have aims other than revenue maximization.

[74] *See* Clausing, supra note 64.

their MNEs is much more certain.[75] Similarly, the speculative benefit of curtailing HQ competition also needs to be weighed against such certain losses.[76]

In summary, by intentionally encouraging previously low-tax countries to adopt the QDMT, Pillar Two stands the traditional logic of anti-deferral rules on its head. Foreign taxes can no longer be assumed either as low or as not responsive to home country policy: they specifically rise to reduce the top-up tax liability under IIR. This means IIR adoption in general will not directly raise revenue. Moreover, the idea that countries would adopt the IIR *only to subject their own MNEs to greater taxation in other countries* directly conflicts with the idea of national income maximization. IIR adoption looks like a kind of action that *puts money on the table* for other countries to take.

2. QDMT: response or deterrent to IIR?

It seems easy to understand QDMT adoption by a previously low tax country (e.g., Country Z in Part I's schematic example) in response to IIR adoption by UPE countries (e.g., Country U). By imposing an IIR top-up tax on *M* in respect of its foreign subsidiaries, Country U reduces the tax attractions of Country Z's low tax rates. If M nonetheless invest in Country Z,[77] Z would be better off, relative to the choice of leaving Country U to collect the top-up tax, to collect such top-up tax itself from M's subsidiary in Country Z—and this leaves *M* no worse off. Remarkably, the QDMT precisely prescribes such a response, allowing Country Z immediately to exact a cost from Country U for the latter's adoption of the IIR.

Indeed, the more targeted the QDMT is, the better it is for the country adopting it. The most targeted QDMT is a top-up tax imposed only on subsidiaries of MNEs from countries that impose the IIR. In this strategy, no QDMT would be imposed on the subsidiary of any foreign MNE from a UPE country that imposes no IIR. Nor would any QDMT be imposed on any purely domestic company that enjoys a low ETR. A targeted QDMT preserves the status quo for all MNEs other than those from IIR-adopting countries. If such status quo (of low taxation) was the country's previously preferred policy, then the targeted QDMT allows the adopting country to deviate from that status quo only where necessary.

Even in July 2021, when the Inclusive Framework first announced an in-principle agreement on the Two Pillar proposal, few anticipated a targeted QDMT becoming a key part of Pillar Two design. It was thought that low tax countries may raise their general CIT rates in reaction to coordinated IIR adoption,[78] thereby allowing nations to realize the goal of "putting a floor" to tax competition. The idea that tax rates would only be strategically raised for subsidiaries of foreign MNEs within the scope of Pillar Two, and only for MNEs from IIR-adopting countries, would have seemed not just overtly undiplomatic but also in violation of tax treaties and other international agreements that prohibit discrimination based on nationality.[79] However, when the QDMT concept appeared for the first time in the December 2021 Pillar Two Model Rules, nothing in it prohibited a discriminatory instrument.[80] While the EU has taken the position that a minimum tax imposed only on foreign MNEs would be

[75] Janeba & Schjelderup, *supra* note 30, further argue that subsidy competition among high taxed countries may also eliminate any revenue gain from the new ability to raise tax rates brought about by a global tax rate floor.
[76] *See* text accompanying notes 53-56 *supra* for the lack of evidence for international headquarter tax competition.
[77] If *M* decides not to invest in Z after it is subject to the IIR, Z would of course not collect any revenue.
[78] OECD, *supra* note 58.
[79] *See* Douma et al., *supra* note 29.
[80] Pillar Two Model Rules, *supra* note 4, art. 10.1.1 (definition of "Qualified Domestic Minimum Top-up Tax").

discriminatory in ways that violate EU law, and therefore adopted a directive requiring EU member states to impose such a tax on purely domestic firms,[81] such considerations have not featured in government announcements elsewhere. Indeed, defenders of Pillar Two have suggested that facially discriminatory rules in Pillar Two are treaty-compatible or represent harmless treaty overrides, and in any case are not defeated by any existing international agreements.[82] The same arguments would presumably apply to a discriminatory (targeted) QDMT.

The permissibility of targeted QDMTs is important even if, initially, no country designs the QDMT to be targeted only at MNEs from IIR-adopting countries. The point remains that any country adopting a targeted QDMT will be better off than countries adopting a less targeted one, because the targeted QDMT allows a low-tax country stay closer to its original preference, and win whatever tax competition there remains for investment from non-IIR adopting countries.

However, if we assume that QDMT adoption is strategic—the likes of Country Z would not have adopted it but for Pillar Two—then even targeted QDMTs may be irrational to adopt. As we have seen, IIR adoption is irrational for national-income-maximizing governments if it triggers QDMT adoption. If a country considering QDMT adoption expects UPE countries to be national-income-maximizing, then it would recognize that the threat of QDMT adoption should deter IIR adoption, making QDMT adoption unnecessary. In fact, as discussed in Part V, this logic may shed light on the striking fact that some of the apparent early movers in Pillar Two implementation were low-tax countries (e.g., Ireland and Switzerland): by emphasizing their willingness to adopt QDMT, they may be testing out UPE countries' commitments to a strategy that is not national-income maximizing.

Likewise, consider a situation where (in Part I's example) Country Z has adopted the QDMT and Country U, the IIR: Pillar Two is in place. In this scenario, Country U raises no revenue from the IIR. Its own MNE, *M*, has less after-tax profit after paying the QDMT in Country Z, compared to a situation where Pillar Two is not implemented. If Country U now abolishes the IIR, it would lose no revenue. *M* may begin to look for investment locations without a QDMT. Anticipating *M* to act this way, Country Z may remove its QDMT. Pillar Two would then unravel. Country U is motivated to withdraw from Pillar Two because it is better off without Pillar Two when the wealth of its own MNE is taken into account. Country Z is better off under Pillar Two if *M* continues to invest in it,[83] but it is not in a position to sustain the QDMT without Country U's non-income-maximizing choice.

The combination of IIR and QDMT is thus unstable. It is overhasty to predict that countries will adopt the QDMT, "in the safe knowledge" that other countries would collect a top-up tax through IIRs anyway.[84] If one *assumes* IIR adoption by UPE countries, QDMT adoption by host countries looks eminently rational. But why should one assume IIR adoption by UPE countries? At best, one might imagine that some low-tax countries adopt the QDMT while others do not.[85] This provides revenue-based incentives for enough UPE countries to adopt the IIR, which in turn leads some low-tax countries

[81] *See Council Directive, supra* note 2.

[82] These arguments are made mainly in connection with the UTPR. *See e.g.*, Allison Christians & Stephen E Shay, *The Consistency of Pillar 2 UTPR With U.S. Bilateral Tax Treaties* 109 TAX NOTES INT'L 445 (2023). *See also infra* Part V.2 for further discussion.

[83] It is worse off if M ceases to invest in Z after the IIR's imposition.

[84] Devereux et al., *supra* note 31.

[85] This may be because, for example, countries somehow cannot adopt perfectly targeted QDMTs, and they are concerned that QDMTs imposed on MNEs from non-IIR-adopting countries would deter investment.

to adopt QDMT in response. Meanwhile, MNEs from UPE countries that do not adopt IIR still find the non-QDMT-adopting countries to be attractive locations. Consequently, both IIR and QDMT adoption remains partial.

The foregoing analysis is reinforced by the following reflection: countries have long adopted anti-deferral or CFC rules before Pillar Two; they have also long offered foreign tax credits when taxing foreign income. However, allowing an FTC under a regime of worldwide taxation does not maximize national income, because the FTC treats taxes paid to foreign governments similarly as taxes paid to a country's own government.[86] FTC regimes are viable only if other countries are discouraged from strategically enacting "soak-up" taxes to shift revenue to themselves. There is no reason to think that this logic has changed under Pillar Two. Therefore, Pillar Two's explicit endorsement of "soak-up" taxes in the form of the QDMT severely undercuts the benefit of anti-deferral rules.

Any new strategic incentive *for* Pillar Two adoption, therefore, must come from some other rule. The next Part will examine whether the UTPR introduces new incentives for IIR or QDMT. Before moving onto that analysis, however, a brief consideration of the incentives for IIR adoption among holding company jurisdictions is in order.

3. Incentives from competition for IIR adoption?

Beyond complementarity in IIR adoption by UPE countries, it has been suggested that Pillar Two creates competition for IIR adoption between the UPE jurisdiction and holding company jurisdictions.[87] Under Pillar Two, the UPE country has "priority" in applying the IIR, but if a UPE country fails to adopt the IIR, the holding company or IPE jurisdiction may apply the IIR and collect revenue that the UPE jurisdiction "foregoes". In such a scenario, an MNE would still be subject to IIR and benefit little from the failure of IIR adoption by the UPE country. Does this not generate an additional incentive for the UPE country to adopt IIR? Because jurisdictions like Luxembourg,[88] Switzerland,[89] and Hong Kong[90] have announced intentions to impose the IIR, the question seems especially relevant.

Such reasoning, however, is easily seen to be flawed. To begin, if the QDMT is widely adopted, there is no revenue to be raised by the IIR, whether for the UPE or the holding company jurisdiction. There is then no question of either type of jurisdiction competing for revenue. Further, IIR adoption by holding company jurisdictions should be seen as puzzling from the perspective of national self-interest. The location of holding companies in current MNE structures is highly tax-sensitive. Such locations (e.g., Singapore, the Netherlands, Luxembourg) are generally chosen because they (i) impose low effective tax on foreign-earned profits, while (ii) enjoying a large network of tax treaties that can be used to reduce

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[86] *See* Cui, *supra* note 3.

[87] Elodie Lamer, *Opposition to Pillar 2 Proposal Shrinks at ECOFIN Meeting*, TAX NOTES (Mar. 16, 2022), taxnotes.com/tax-notes-today-international/corporate-taxation/opposition-pillar-2-proposal-shrinks-ecofin-meeting/2022/03/16/7d8vy (EU Tax Commissioner Paolo Gentiloni cited as claiming that if countries failing to implement Pillar Two would lose tax revenue to other countries);

[88] Stephanie Soong, *Luxembourg Government Approves Global Minimum Tax Bill*, TAX NOTES INT'L (Aug. 1, 2023).

[89] Stephanie Soong, *Swiss Cantons Could Raise $600 Million Under Global Minimum Tax*, 111 TAX NOTES INT'L 882 (Aug. 14, 2023).

[90] *Implementation of Global Minimum Tax and Hong Kong Minimum Top-up tax Consultation Paper,* FINANCIAL SERVICES AND TREASURY BUREAU, INLAND REVENUE DEPARTMENT (Dec. 2023), https://www.fstb.gov.hk/tb/en/others/consultation.htm (H.K.).

source-country taxes on payments from operating subsidiaries. Holding company location competition, in other words, is much more plausible than headquarter competition. By adopting the IIR and imposing top-up taxes on foreign income, holding company jurisdictions would eliminate some of the main reasons why MNEs choose them as locations for IPEs. If there are sufficiently many other jurisdictions that do not adopt the IIR, MNEs that are not subject to IIR in their UPE countries would move their holding companies to these IIR-free jurisdictions and away from those that adopt IIR. Such disincentives imply that UPE countries should not fear that, by not adopting IIR, they are leaving "money on the table" to holding company jurisdictions.

It is worth noting that if a previously low-tax holding company jurisdiction imposes the IIR top-up tax on a holding company, this is generally not regarded as legally objectionable.[91] However, such a tax would often not be justifiable on the basis of any real contribution the holding company makes to these foreign profits, but only on the basis of the purely nominal ownership and control the holding company has over its subsidiaries. *In this sense*, the holding company's jurisdiction to tax holding companies' foreign income is arbitrary, though condoned by international tax norms. As we will see in Part IV, some commentators object to the UTPR (under an extraterritorial interpretation) because it allows a country to tax profits arising elsewhere in the world that have nothing to do with it.[92] To this objection, it may be countered that international taxation has tolerated other things arguably just as arbitrary, such as a tax haven's extraterritorial power to impose traditional worldwide taxation in respect of the holding company's subsidiaries.[93] What the argument in the preceding paragraph shows, however, is that even if it is otherwise legally permissible for a tax haven to impose such an extraterritorial tax, the haven country, acting on self-interest, is unlikely to do so. Part IV will explain that what is problematic about the UTPR is not that it can be just as arbitrary as some applications of the IIR. Instead, it is that it holds out for much greater potential for abuse.

III. The UTPR's Illusory Enforcement Power

Even before any country has put it into practice, the UTPR has generated extensive controversy.[94] Beneath such controversy, there is also substantial confusion about how the UTPR really is supposed to function. Conflicting interpretations of the UTPR have so far largely gone unarticulated, let alone resolved. This confusion matters for multiple reasons. To begin, different interpretations of how the UTPR operates affect the assessment of countries' incentives both in responding to the UTPR and for adopting the UTPR—the aim of this Part and the next Part. Moreover, different interpretations of the UTPR raise distinct normative controversies and issues of international law, and Part V will argue that issues will likely bear on Pillar Two's future evolution.

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[91] To put it differently, if a UPE country's imposition of the IIR is regarded as permitted under international law (which it evidently is, given its similarity to widely adopted CFC rules), such imposition by an IPE country is also likely to be regarded as unproblematic.

[92] Nikolakakis & Li, *supra* note 39.

[93] Indeed, the European Commission has tried to force Ireland and Luxembourg to tax U.S. MNEs on profits that none of the parties regarded as belonging to Ireland and Luxembourg. *See* Foo Yun Chee & Bart H. Meijer, *Apple suffers setback in fight against EU's $14 billion tax order*, REUTERS (Nov. 9, 2023), https://www.reuters.com/technology/eu-court-adviser-backs-eus-14-bln-tax-order-apple-2023-11-09/; Foo Yun Chee, *Blow for EU crackldown on tax deals as Fiat wins* appeal, REUTERS (Nov. 8, 2023), https://www.reuters.com/business/autos-transportation/top-eu-court-backs-fiat-appeal-against-30-mln-euro-eu-tax-payment-order-2022-11-08/.

[94] *See* sources cited in *supra* notes 29 and 39.

This Part will begin by distinguishing between two interpretations of the UTPR: a non-extraterritorial and an extraterritorial interpretation. The former is the interpretation consistent with the text of the Pillar Two Model Rules, while the latter is widely invoked by commentators on Pillar Two, despite its seeming inconsistency with the text of the Model Rules. The analysis in this Part will then show that, under either interpretation, the UTPR (i) lacks the power to incentivize the adoption of the IIR, and (ii) fails to incentivize QDMT adoption in many policy-relevant circumstances. That is, contrary to popular claims,[95] the UTPR is unable to police the adoption of Pillar Two's other components. Part IV will further probe the extraterritorial interpretation of the UTPR and explain why it is controversial and arguably dangerous, even if it fails to serve as Pillar Two's enforcement mechanism.

1. The non-ET v. ET interpretations of the UTPR: preliminary discussion

The UTPR can first be interpreted as non-extraterritorial (non-ET) in nature and not introducing any new taxing right to the international tax landscape. Consider UTPR adoption by Country X in Part I's schematic example. As explained there, the UTPR requires Country X to collect a top-up tax from the subsidiary of a MNE group in X, when that MNE group, *M*, has subsidiaries in other countries (i.e., Countries Z and U) that are low-taxed and when the UPE country, Country U, imposes no IIR top-up tax. Critically, *Country X's UTPR can only be levied on M's subsidiary in X.* Country X could *always* have imposed such a tax. What the UTPR requires X to do is to tax the MNE subsidiary in its own jurisdiction more heavily, when subsidiaries of the same MNE are taxed lightly elsewhere.

On the second interpretation, the UTPR is extraterritorial (ET) and introduces a new taxing right: by reference to Part I's schematic example, it is as though Country X can tax *M*'s profit in Countries Z and U directly, and independently of how it taxes *M*'s subsidiary in X itself. A most explicit expression of such a tax instrument would be one that entitles a UTPR-adopting country to make *M*'s group companies in other countries legally liable for the top-up tax the country imposes. However, as will be explained in Part IV, less explicit versions of such an ET tax are possible. The ultimate *substantive* difference between the non-ET and ET interpretations of the UTRP is that under the former, the adopting country can only modify that tax burden borne by the MNE's operation in that country, but under the latter, the adopting country can vary the tax burden borne by MNE operations in that country *and in other countries* independently.[96]

The non-ET interpretation of the UTPR is consistent with the Pillar Two Model Rules. In no part of these rules does the UTPR entitle an adopting country to make MNEs' subsidiaries in other countries legally liable for the top-up tax it imposes.[97] Moreover, the Pillar Two Model Rules contemplate that the UTPR top-up tax would be imposed through the denial of deductions in the calculation of a domestic taxpayer's income tax liability,[98] or the making of an adjustment "equivalent to a denial of a deduction."[99] Overall, liability under the UTPR top-up tax, as depicted in the Pillar Two Model Rules,

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[95] See sources cited in *supra* notes 32-37, 87 and *infra* note 157-159.

[96] In the terminology introduced in Part IV, a non-ET UTPR is a one-part tax, while an ET UTPR is a two-part tax.

[97] Christians and Shay, *supra* note 82, at 445.

[98] Commentary on Model Rules, *supra* note 4, art. 2.4.1, ¶¶ 43-49. The Commentary explicitly discusses how a given UTPR amount allocated to a particular jurisdiction is to be converted into an amount of deductions that must be denied—based on the income tax rate that the MNE subsidiary is subject to under domestic law.

[99] *Id*., art. 2.4.1, ¶ 46 (such an adjustment is referred to as an "equivalent adjustment"). There is also no indication that the UTPR can be implemented through adjustments to rules under the value added tax, social insurance

results from a modified calculation of a domestic taxpayer's income tax liability. There is no way to collect the tax without increasing the income tax burden on the MNE's subsidiary in the adopting jurisdiction.

If one accepts this interpretation of the UTPR, it should be surprising that many discussions perpetuate the idea that the UTPR gives the adopter country a right to dip into a pot of undertaxed profit when other countries fail to adequately tax such profit. The idea that UTPR adoption provides costless access to profit tax bases elsewhere—costless, in the sense that it does not necessarily increase the burden on the taxpayer's domestic income—can be found in arguments made by both proponents[100] and critics[101] of Pillar Two, as well as in many academic and professional exegeses of UTPR mechanics.[102] A common formulation that expresses this idea would say, for example, that if Country U or Country Z does not impose a top-up tax (the IIR or QDMT) on or in respect of the low-tax profit in M's Country Z subsidiary, then other countries (e.g., X or Y) will tax *it*—"it" being the low-tax profit in Z. Under the non-ET interpretation of the UTPR, however, Country X or Y taxes not what is in Z, but what is in X or Y.

Another example of the ET interpretation of the UTPR is offered by the following exegesis of the allocation of top-up tax amounts among UTPR-adopting jurisdictions. Under the Pillar Two Model Rules, if a certain amount of top-up tax is identified for a low-taxed subsidiary in Country Z, if Country U fails to impose an IIR, and if Countries X and Y both adopt the UTPR, then the top-up tax amount is allocated among X and Y in proportion to the tangible assets and payroll of M's subsidiaries in X and Y. It has been explained that if Country X does not collect the UTPR top-up tax, it "loses" the UTPR percentage to Country Y: Y "gets" to collect the entire top-up tax. Some commentaries suggest that this incentivizes countries to adopt UTPR,[103] because non-adoption would leave money on the table.

This seems to be an illusion, when the UTPR is given a non-ET interpretation. Neither Country X nor Country Y has access to the profit earned by the subsidiary in Country Z (or to the profit earned in each other). All they can do is tax (more heavily) the profit of the MNE subsidiary that they each host. *They could always have done that*. Doing so does not become more beneficial or less costly for either country, by pretending that the additional tax on local operations is actually a tax on under-taxed profits elsewhere, or that it is "precluding" some other country from taxing their local operations more heavily.

To summarize, the reading of the UTPR as a non-ET tax is supported by the text of the Pillar Two Model Rules. But it conflicts with discussions of the UTPR that implies that the UTPR offers new ET taxing rights over MNE profits in other countries. Such ET taxing rights would be obvious if Countries X and Y are allowed by the GLoBE rules to collect the UTPR top-up tax from M's subsidiaries in Country Z and Country U—to impose legal obligations on these foreign entities.[104] In the next Part, a more

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contributions, property taxes, or other non-income taxes, nor that it would be collected simply as a separate excise tax (there is an adjustment to *something*).

[100] *See e.g.*, the sources cited in *infra* notes 116, 119-120, and 149.

[101] Li, *supra* note 39 (suggesting that the UTPR is a tax sharing rule that "effectively shift" tax bases from some countries to others).

[102] *See, e.g.,* Devereux, *supra* note 37, at 157 ("if the country of the parent does not introduce the IIR… then other countries in which the MNE has a presence may collect the same revenue" through the UTPR).

[103] *Inclusive Framework BEPS Agreement – Policy Perspectives*, KPMG, home.kpmg/xx/en/home/insights/2021/12/inclusive-framework-beps-agreement-20-december-2021.html.

[104] Again, some UTPR critics write as though the UTPR essentially does so, and that this is why it is objectionable. *See* Li, *supra* note 39.

reflective analysis of the substantive differences between the two interpretations of the UTPR will be offered. In this Part, we will see that on *either* interpretation, the UTPR fails to incentivize other countries to adopt the IIR, or, in most policy relevant circumstances, the QDMT.

2. IIR adoption in response to the UTPR

We can begin by considering the UTPR's impact on incentives for IIR adoption. Both proponents of and commentators on Pillar Two present the UTPR as a key instrument to motivate UPE countries to adopt the IIR.[105] Referring to Part I's example, the question is: If Countries X and Y adopt the UTPR to collect top-up tax amounts calculated by reference to the ETR of M's subsidiary in Country Z, should Country U have greater incentives to impose the IIR in respect of the Country Z subsidiary?

If one adopts the non-ET interpretation of the UTPR, the reasoning supporting an affirmative answer might go as follows. While the UTPR top-up taxes in Countries X and Y merely increase the tax burdens of *M*'s operations in X and Y (rather than the tax burdens of *M*'s operations in Z), this may be viewed by Country U as reducing its own national welfare: M's profit before Country U taxes is part of U's national income. If U imposes a top-up tax with respect to the Country Z subsidiary under the IIR, it would eliminate the Country X and Y UTPR, while collecting more revenue for itself. An inter-national wealth transfer is preempted by an intra-national wealth transfer.

Clearly, an identical line of reasoning is available under the ET interpretation of the UTPR. If the UTPR top-up taxes in Countries X and Y increase the tax burdens of *M*'s operations in Z, this also reduces Country U's national income. If U imposes a top-up tax with respect to the Country Z subsidiary under the IIR, it would eliminate Country X and Y's ET tax on the profit in Country Z. An intra-national wealth transfer again preempts an inter-nation wealth transfer.

The problem, however, is that if Country Z acts rationally, it would—as Part II argued—respond to Country U's IIR adoption through QDMT adoption. This would defeat the purpose of U's adoption of IIR in response to the UTPR. In fact, there is an inescapable dilemma here. Countries X and Y's UTPRs, whether under the non-ET or the ET interpretation, either induce Country Z's adoption of the QDMT or not.[106] If Country Z adopts the QDMT, Country U will no longer raise any revenue from adopting the IIR—it is deferred from IIR adoption. If Country Z does *not* adopt the QDMT, Country U will still not be able to protect its national income, because U's adoption of the IIR will induce Country Z to adopt the QDMT. U will lose national income anyway.[107] Therefore, in the presence of the QDMT, the UTPR cannot police IIR adoption.

Another way of putting this remarkable result is that the QDMT not only defeats the point of IIR adoption, it also defeats a major purpose of UTPR adoption. Claims that the UTPR would police IIR adoption have simply neglected the effect of the QDMT on IIR adoption incentives.

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[105] For example, in a July 2023 Congressional testimony, responding to Republican politicians' anger that the UTPR might threaten U.S. tax policy sovereignty, a U.S. Treasury official stated that the U.S. has supported the UTPR mainly because it would punish China for failing to adopt the IIR. *See* Martin A Sullivan, *Some Simple and Overlooked Economics of the OECD's Pillar 2*, 111 TAX NOTES INT'L 375 (2023). *See also* Devereux, *supra* note 37.

[106] It will be argued later in this Part that they will not.

[107] In other words, even if Z does not enact the QDMT directly in response to Countries X and Y's UTPR adoption, it should enact the QDMT in response to any IIR adoption by Country U, thus indirectly to UTPR adoption by X and Y. Country U thus has nothing to gain from its response to Countries X and Y's UTPR.

This argument for the conclusion that the UTPR cannot police IIR adoption is quite straightforward. We can turn to the UTPR's effect on QDMT adoption incentives. The analysis will take a few more steps—and we will need to consider both the non-ET and the ET version of the UTPR—but the intuitions remain simple.

3. The QDMT as a response to the (non-ET) UTPR

Suppose Country X is interested in making Country Z raise tax rates, reduce tax incentives, or otherwise ensure that MNEs' subsidiaries in Z are subject to a minimum 15% ETR. X applies the UTPR, interpreted as a non-ET tax, to *M*'s Country X subsidiary. For *M*, the top-up tax X imposes makes investment in X less attractive, but it also indirectly reduces the worth of tax incentives in Z. In this case, should Country Z adopt the QDMT?

Country Z's decision turns out to first depend on the nature of M's investment in each of Country X and Country Z: in particular, whether such investments are *marginal* or *inframarginal*.[108] Some numerical examples will help illustrate.

Suppose *M*, the MNE investing in different parts of the world, requires a minimum 10% rate of return on any investment. A project is "marginal" if it yields exactly a 10% return. A project is "infra-marginal" if it yields a higher-than-10% return. Any project yielding less than a 10% return, however, will not attract *M*'s investment—unless a government offers a subsidy that allows the project to yield at least 10% (making it a marginal investment). Suppose X and Z each offers a potential project costing $100. *M* has enough capital to consider both investments (as well as other projects elsewhere). Consider three scenarios.

In the first scenario, the Country Z project yields only a 9% return. Country Z offers a subsidy of $1 (in the form of tax incentives) to *M* for investing in the project. Even though this costs $1 of revenue to the Country Z government, assume the subsidy is worthwhile to Z—M's investment brings benefits worth more than $1. Meanwhile, Country X offers an inframarginal project yielding a return of 12%. Suppose that X also imposes a UTPR: for every $1 of subsidy *M* receives in Country Z, it will impose a $1 UTPR on the Country X project.[109] In this scenario, how should Country Z respond?

There are two possibilities. Possibility A is that Country Z withdraws the $1 subsidy by imposing a QDMT. *M* will, therefore, not invest in the project in Z. *M* still makes the investment in X, earns $12 of return, and no UTPR applies. In this case, Country Z fails to attract M's investment. Even though it keeps the $1 that would have gone to M as a subsidy, Z is worse off, because by assumption it would have had greater national income if *M* had invested in Z when given a subsidy.

Possibility B is that Country Z continues to offer the $1 subsidy. Should *M* invest in Z? Even though the project in Z is now a marginal investment, M's investment in the project in X would have become burdened with $1 of UTPR. This reduces the return on the project in X to $11. M would be

[108] Consistently with Part II, it will be assumed here that Countries X and Z do not consider the profit of M's subsidiaries in them as a part of their national income (because such profit is completely foreign-owned by *M*), but regard any revenue they raise from such profit as parts of their national income.

[109] We can imagine Country X does so on the belief that countries shouldn't be subsidizing projects that are not independently viable, and that such subsidies create an uneven playing field.

better off not investing the project in Z: it could invest in X and retain the $12 return, and could earn $10 of return on investments elsewhere.

In other words, X's UTPR has neutralized the attraction of Z's subsidy, making *M* indifferent to the subsidy even if it were offered. X's UTPR makes Z worse off no matter what Z does—there is no difference between possibilities A and B from Z's perspective. But this also means that there is no reason for Z to withdraw the subsidy, i.e., to adopt the QDMT, because doing so brings no improvement.

In the second scenario, the Country Z project still yields only a 9% return, and Z still offers a $1 subsidy for investing in the project. Suppose, however, Country X presents only a marginal project with a return of 10%. X still imposes a UTPR: for every $1 of subsidy *M* receives in Country Z, it will impose an $1 UTPR on the X project. In this scenario, how should Country Z respond?

Again, consider two possibilities. One is that Country Z imposes a QDMT and effectively withdraws the $1 subsidy. *M* does not invest in the project in Z. *M* still invests in X, earns $10 of return, and no UTPR applies. As in the first scenario, Country Z fails to attract M's investment and is worse off.

However, there is a new possibility. *M* may decide to invest in Z and not invest in X. It could receive a 10% return on the Z project (after the $1 subsidy), and it can earn at least a 10% return elsewhere, as long as it can find another investment opportunity in a country that imposes no UTPR. In other words, because Country X offers only a marginal investment to *M*, it is in no position to impose a UTPR. Even more clearly than in the first scenario (where the project in X is inframarginal), Country Z has no reason to impose a QDMT—it might even be better off keeping it. Indeed, it should be clear that if Country X offers only a marginal project, it is in no position to impose the UTPR regardless of whether the project in Z is marginal or inframarginal.

In the third and final scenario, Country Z offers a marginal investment yielding 10%, but Z still maintains a subsidy of $1, making the investment an inframarginal one that yields a $11 return.[110] Meanwhile, as in the first scenario, Country X offers an inframarginal project yielding 12%, and imposes a UTPR. Because the investments in Country Z and Country X are both inframarginal, M will invest in both countries in any case. Any subsidy M receives in Z will be cancelled dollar-for-dollar by the UTPR in X. If, as a result, M is indifferent to receiving the subsidy in Z, Z is better off removing the subsidy (by imposing the QDMT)—it would keep $1 of revenue. It might thus seem that QDMT is a rational response to UTPR adoption.

Note, however, that when an investment is made by a foreign MNE, Z would have been better off removing the subsidy *even without the UTPR*, since the subsidy is unnecessary to induce M *to* invest. Z thus did not gain any new opportunity to maximize national income. It has such an opportunity only because, merely by assumption, it has failed to maximize national income before. Note that X's imposition of the UTPR is also possible only because it has not already taxed away M's profit in Country X. Country X would have been better off taxing such profit—converting M's profit into Z's national income—regardless of how Z taxes or subsidizes M in Country Z.

In other words, the narrative of QDMT as a national-income maximizing response on the part of Country Z to the UTPR (under the non-ET interpretation) seems very contorted. Country Z is said to be

[110] In other words, Country Z offers an unnecessary subsidy, in the sense that M would have invested in Z without the subsidy. Many subsidies may possess such character because it is difficult to target only marginal decisions.

motivated to tax *M*'s profit in its own (i.e., Country Z's) borders only if Country X is willing to tax *M*'s profit in *its* own (i.e., Country X) borders. Conversely, Country X is portrayed as being motivated to tax *M*'s profit in its own (Country X) borders only to make Country Z willing to tax *M*'s profit in *its* own (Country Z) borders. It's difficult to understand such preferences: given that the investments are inframarginal, national income maximization would have suggested that each country should consider taxing *M*'s profit regardless of what the other does. It is hard to cast Z's QDMT adoption incentives coherently, in national income maximization terms.

The analysis is different in this third scenario when the subsidized project is in the UPE country. Suppose X imposes a UTPR in respect of a subsidized project of *P* in Country U. When U removes the subsidy for this domestic project by imposing a QDMT, there is no change in its national income.[111] The UTPR imposed by X, however, reduces U's national income.[112] By adopting the QDMT, therefore, Country U can increase its national income. QDMT adoption is thus rational. The difference between Country Z and Country U is that, in the latter's case, there is an answer to the question of why M's inframarginal project in U has not been taxed before: doing so would not have increased U's national income.

Table 1 summarizes the examples so far. The rows in Table 1 depict features of the investment in X, while the columns depict features of the investment in Z or U. The cells summarize the rational response of Z or U to X's UTPR. What the table makes clear is that when *either* the investment in Z (or U) *or* the investment in X is marginal, the UTPR is ineffective in forcing Z to adopt a QDMT. Only when the investments in X and Z (or U) are *both* inframarginal—when it is certain that M will invest in both countries—does the possibility of UTPR effectiveness even arise. And even here, a coherent national income maximization narrative for QDMT adoption is unavailable for Z, and is available only for U.

Table 1 QDMT Adoption in Response to the UTPR (non-ET interpretation)

	Z (or U): marginal with subsidy	Z (or U): inframarginal with subsidy
X: marginal with UTPR	No reason to impose QDMT	No reason to impose QDMT
X: inframarginal with UTPR	No reason to impose QDMT	No coherent national income maximization narrative for Z Reason to impose QDMT for U

Note that the possibility that the QDMT and UTPR may apply to marginal investments (in respect of projects in Countries Z and X, respectively) is not just theoretical. Country Z presumably would have justified offering tax incentives (giving rise to potential Pillar Two top-up tax liability) mainly because it believed them to be necessary to attract investment. And even aside from the UTPR, Country X presumably could have raised its tax on *M*'s investment in X higher—thereby increasing its national welfare—if it believed that such investment is safely inframarginal. Thus, the scenario where *both* investments in X and Z are inframarginal should be viewed by both countries as unusual cases. An important oddity of the UTPR, therefore, is that these unusual cases are critical to its effectiveness.

[111] M's profit and U's revenue all represent U's national income.

[112] Contrast this with Country Z's QDMT: X's UTPR does not reduce Z's national income, but Z's subsidy to a foreign MNE (*M*) does.

In summary, with one exception, the UTPR, interpreted as a non-ET tax, remarkably creates no effective or new incentives for other national-income-maximizing governments to adopt the QDMT. This is the case even if the UTPR has the power of neutralizing other countries' tax incentives, thereby making MNEs and other countries worse off. The one exception is that the UTPR generates a positive QDMT adoption incentive for the UPE country (Country U, not Country Z) for the MNE subsidiaries located there. This result—that the UTPR fails to motivate Country U's IIR adoption but succeeds to motivate U's QDMT adoption—seems not to have been recognized by other commentators before.

Does the ET interpretation of the UTPR change this analysis? We now turn to this question.

4. The QDMT as a response to the (ET) UTPR

Let us now assume, per the ET interpretation of the UTPR, that Country X imposes a UTPR by taxing profits in Country Z, not profits in X. How does this affect Country Z's decision in the scenarios examined above?

In the first scenario, Country Z offers a marginal investment opportunity while Country X offers an inframarginal one. In particular, Z presents a project costing $100 that offers a 9% return: because *M*'s required rate of return is 10%, the project is viable only with a $1 subsidy. X has a project with 12% return, but X promises to tax away the $1 subsidy offered by Z to *M*, with a UTPR on *M*'s Z operation. In this scenario, *M*'s best choice is not to invest in Z: it would earn only a 9% return there after the subsidy is negated by the UTPR, whereas it can earn a 10% return elsewhere while keeping the 12% return in X. Since *M* does not invest in Z, *Country Z is indifferent between offering or withdrawing the subsidy*, and thus may not impose a QDMT. Nor does X raise any revenue from Z with the UTPR.

In the second scenario, Countries Z and X each offer a marginal investment opportunity: Z's project returns 9% along with a 1% subsidy; X's project returns 10% but X threatens to tax the Z subsidy away with an UTPR. As before, *M* may choose to invest in X or not. If it invests in X, X's UTPR renders the investment in Z non-viable. If it does not invest in X, however, it will be able to receive a 10% return in Z, just as it would by investing in X. Thus, Z again gains nothing from imposing the QDMT (and X again raises no revenue from Z with the UTPR). The difference from the first scenario is that Country X risks losing *M*'s investment. The same reasoning applies if the subsidized Country Z project is inframarginal but the Country X project is marginal: X is in no position to impose the UTPR in this case.

In both of these first two scenarios, therefore, QDMT adoption incentives in response to the UTPR interpreted as an ET tax are identical to those in response to the UTPR as a non-ET tax.

Now consider the third scenario featuring inframarginal investments in both Country X and Z. The Country Z project returns 10% but still receives a 1% subsidy; the Country X project returns 12% but is accompanied by a UTPR on the Country Z profit. Since M will continue to operate in Z, the subsidy Z offers to M would result in a UTPR: M earns only $22 of return in total, because instead of staying in M's pocket, the subsidy leads to a transfer from the Country Z project to X. Country Z is thus better off not offering the subsidy. In that case, M still invests in both countries and realizes a total return of $22.

Although in this last scenario, Country Z's response to the ET version of UTPR is the same as its response to the non-ET version of the UTPR, the narrative is somewhat different. Under the non-ET version of the UTPR, if the Z subsidy continues, $1 would go from Z to one "pocket" of *M*'s (the Country

Z subsidiary), while $1 would go from another "pocket" of *M*'s (the Country X subsidiary) to X. By contrast, under the ET version of the UTPR, the $1 of Z subsidy would go to X as tax revenue via the same "pocket," i.e., the Country Z subsidiary. *M*'s "pocket" of profit in Country X would remain untouched. This idea that X and Z contribute or take from the same "pocket" seems to give substance to the idea that by adopting the QDMT, Z preempts X from encroaching on Z's tax base. And it might seem more intuitive than the contorted narrative available for the non-ET version of the UTPR, where Z dips into a pocket it always had access to, just to preclude X from dipping into a different pocket that X always had access to.

However, this narrative improvement still does not add up to a coherent explanation of the incentives for QDMT adoption. For one, as observed above, if *M*'s projects in Z and X are inframarginal (in Z's case, because of the subsidy), national-income-maximizing governments in Z and X should have been taxing both more (in Z's case, by removing the subsidy). Why, for example, should Country X tax only *M*'s project in Country Z and not *M*'s project in X? That is, scenarios where both projects in Z and X are inframarginal should be viewed as unusual, rather than the baseline case. Even more importantly, the ET interpretation of the UTPR introduces another layer of mystery. If Country X has the power to tax the profit in the Z project, wouldn't it always be in its interest to do so, and not just when Country Z provides a subsidy? For example, if *M*'s project in Z was inframarginal (e.g., it returned 11%) without a subsidy, why shouldn't Country X tax the project to maximize X's national income? Conversely, why shouldn't the government in Country Z not tax *M*'s inframarginal project in X, which would increase Z's national income?

The ET interpretation of the UTPR, in other words, raises more questions than it answers. These questions are also not easily dismissed—the next Part shows that they go to the heart of normative controversies regarding the UTPR's legitimacy. For now, with respect to QDMT adoption incentives, it should finally be noted that the incentives generated by a Country X UTPR when it comes to QDMT adoption in the UPE country remain the same under the ET version of the UTPR. It would be rational for Country U to discontinue a subsidy in respect of M's inframarginal project in U, insofar as it precludes X from taxing such project, which would reduce *M*'s profit and thereby U's national income. From U's perspective, X's tax on profits in X (i.e., non-ET UTPR) and X's tax on profits in U (i.e., through the ET version of the UTPR) are equally bad, while the removal of the subsidy does not change national income.

The virtual equivalence between the ET and non-ET versions of the UTPR just demonstrated helps to explain why it is easy for commentators to conflate the two interpretations. A more reflective examination, however, shows that they are characterized by vital differences.

IV. Challenges Arising from a New Extraterritorial Taxing Power

A country can access the tax base elsewhere by imposing a tax on a foreign entity—even if the entity neither operates nor derives income from the country—and holding it legally liable for such a tax.[113] The UTPR does not provide for such taxing power.[114] However, governments can access tax bases in other countries in another way—and, in that sense, exercise extraterritorial taxing power. Consider the Income Inclusion Rule. The IIR top-up tax applies to an ultimate parent entity in the IIR-imposing jurisdiction, but *in respect of* the low-taxed profit of a subsidiary abroad. Only the parent entity, not the

[113] This statement does not claim that such power is permissible under international law. It simply describes a form of governmental power that may or may not be permissible.
[114] *See* text accompanying *supra* notes 97-99.

foreign subsidiary, is liable for the top-up tax. Nonetheless, taxing ultimate owners on undistributed foreign profits may be viewed as succeeding to tax the profits. In this regard, the IIR operates very similarly to traditional anti-deferral rules.[115]

In this Part, I will analyze the ET version of the UTPR in analogy with the IIR and other anti-deferral rules applied to parent entities in MNE groups. What this means can be illustrated by reference to Part I's schematic example. When Country X imposes a UTPR top-up tax on *M*'s Country X subsidiary because *M*'s profit in Country Z is subject to low tax, we will imagine that *M* views this not as a tax on its Country X subsidiary's profits, as it would if the UTPR were understood as a non-ET tax. Instead, we will imagine that *M* views the UTPR top-up tax simply as a tax on its Country Z profit. This is analogous to *M*'s view of the IIR if Country U imposes the latter on *P*: *M* does not view the IIR top up tax as imposed on its profits in Country U, but directly as a tax on its profit in Country Z.

1. The UTPR at a two-part tax

For many critics of the UTPR, this very attempt to analogize the UTPR to the IIR and other anti-deferral rules shows what is wrong with the tax. In their view, ownership of foreign profit is an essential premise of anti-deferral rules.[116] Anti-deferral taxes imposed on parent entities in MNE groups by countries where such entities reside are properly levied, because the taxpayers, as ultimate owners, have access to the profits of subsidiaries in other countries. The profits subject to tax are connected with the taxing jurisdiction by way of ownership. By contrast, an MNE subsidiary on whom the UTPR may be imposed generally lacks any ownership interest on the profits of MNE group members elsewhere.[117] In fact, *M*'s Country Z low-taxed profit, as a potential target of a Country X UTPR top-up tax, seems to *have nothing to do* with Country X.

To many, this disanalogy between the UTPR imposed on MNE subsidiaries and anti-deferral taxes imposed on parent entities makes it self-evident that the UTPR transgresses international legal norms.[118] Others, however, dismiss the import of the disanalogy. It has been asserted, for example, that "a distinction between mere ownership 'up the chain' for [anti-deferral] taxes and 'within the book group' for the UTPR seems like a rather subtle distinction to justify opposite outcomes."[119] Others suggest that anti-deferral rules themselves were once controversial, though no longer perceived to be so.[120] It may further be pointed out that there are plenty of instances of arbitrary assignments of taxing right under international law.[121] Consider the fact that the international tax community is unlikely to object, as a matter of law, if a tax haven country that hosts a mere holding company imposes traditional

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[115] Under U.S. anti-deferral rules, the profit of a foreign subsidiary is *deemed* to have been distributed to a resident, who can then be taxed upon it. The deemed distribution prevents taxpayers from deferring taxation until the time of actual distribution. The basic logic of anti-deferral rules was prominently discussed in the recent U.S. Supreme Court case Moore v. United States, No. 2:19-cv-01539 (W.D. Wash. 2020), *aff'd*, 36 F.4th 930 (9th Cir. 2022), *reh'g denied*, 53 F.4th 507 (9th Cir. 2022), *cert. granted*, No. 22-800 (U.S. 2023).

[116] *See* Jefferson Vanderwolk, *The UTPR: Taxing Rights Gone Wild*, 108 TAX NOTES INT'L 1369 (Dec. 12, 2022); Nikolakakis and Li, *supra* note 39.

[117] Consequently, legal fictions about deemed distributions are unavailable.

[118] *Id.*; Nikolakakis & Li, *supra* note 39.

[119] Michael L. Schler, *UTPR: The CFC Precedent*, 109 TAX NOTES INT'L 27 (Jan. 2, 2023); *see also* Michael L. Schler, *Pillar 2 and Minority Interests*, 109 TAX NOTES INT'L 715 (Feb. 6, 2023) (arguing that the differences between the UTPR and IIR are too esoteric to render the former, but not the latter, inconsistent with international law).

[120] Reuven Avi-Yonah, *The UTPR and the Treaties*, 109 TAX NOTES INT'L 45 (Jan. 2, 2023).

[121] *See supra* notes 97-99.

worldwide taxation in respect of the holding company's subsidiaries. Such a tax would often be justifiable only on the basis of merely nominal ownership and control.[122] Is it really much *more arbitrary* to allow countries in which an MNE conducts real operations to tax profits elsewhere?

Overall, UTPR critics see the UTPR, interpreted as an ET tax, as introducing an unprecedented taxing power that is illegitimate under international law. UTPR defendants, on the other hand, claim that plenty of analogies can be made between the UTPR and prior international tax norms. The indignation and alarm of UTPR critics and the studied nonchalance of UTPR defenders have produced a stalemate.

It is possible to advance beyond this stalemate, by comparing the UTPR and anti-deferral rules more abstractly. The UTPR, under the ET interpretation, can be said to instantiate a *two-part tax*. Such a tax comprises first a domestic prong, imposed on the profits of an MNE arising from the taxing country. A second, ET prong is imposed on profits of the MNE arising from other countries. Critical to the idea of the two-part tax is that not only are the tax bases of the two prongs different, the rates in the two prongs may also differ. A standard example of a two-part tax is a corporate income tax with anti-deferral rules: a tax is imposed on domestic source income; another tax is imposed in respect of the income of foreign branches and subsidiaries. While anti-deferral rules traditionally applied the same rate to both domestic and foreign income, more recent designs—such as the GILTI tax in the U.S. and the IIR—allow the application of different rates to domestic and foreign income.

Suppose we view the UTPR as a new form of worldwide taxation based on corporate residence, except countries can impose it with respect not to the foreign subsidiaries or branches of a domestic taxpayer, but to other fellow members of a domestic taxpayer in an MNE group.[123] Together with the adopting country's domestic tax imposed on domestic taxpayers, the UTPR, in this reading, is simply a new subtype of the two-part tax. What is objectionable about this tax, other than that it is new?

To answer this question, two important features of the UTPR (as an ET tax)—which, to my knowledge, no previous commentator has shown awareness of—must be considered. First, a two-part tax imposed on parent companies and a two-part tax imposed on MNE subsidiaries have different revenue raising potentials. There is an *upper bound* to the revenue that a UTPR-imposing country can raise from profits located elsewhere: that upper bound equals the amount of MNE profit located in the country itself. Anti-deferral rules, by contrast, are not constrained by the same amount.

This can be illustrated by reference to Part I's schematic example. Suppose *M* earns $3 of profit through its Country Z subsidiary; $2 of profit through its Country X subsidiary; and $2 of profit through its Country U operations. Country X is considering imposing the UTPR and Country U, the IIR. What is the maximum amount of tax that each can impose in respect of the Country Z profit? The answer, for Country X, is $2—the profit earned in Country X—and not $3, the profit earned in Country Z. The reason is that if X tries to tax more than $2 of *M*'s profit in Z, *M* would be better off leaving Country X altogether: it would forego $2 of profit in X, but avoid more than $2 of tax liability in X.[124]

[122] As discussed in *supra* Part II.3, Pillar Two precisely affirms the right of IPE jurisdictions to impose such a tax (i.e., the IIR).

[123] Magalhães & Christians, *supra* note 39.

[124] This is of course precisely the reason why, as discussed in Part III.3-4, Country X is in no position to impose any (non-ET) UTPR on a marginal investment in X.

By contrast, Country U does not face this constraint in taxing the Country Z profit. The maximum revenue Country U can collect under the IIR is $3. The reason is that the UPE, *P*, owns both the $3 profit in Country Z and the $2 of profit in Country U. There is thus no question of *P* giving up the $2 of profit in Country U in order to avoid the tax on the $3 profit in Country Z.

Critically, this boundedness of the UTPR implies that a UTPR interpreted as an ET instrument can never raise more revenue than a UTRP interpreted as a non-ET instrument: both are capped by the amount of MNE profit in the UTPR-imposing jurisdiction.[125]

Second, interpreting the UTPR as an ET tax incorporates an implicit but important assumption: since the ET-tax-imposing country allows the UTPR to be preempted or substituted by QDMTs, it effectively grants a foreign tax credit for QDMTs.[126] This feature is absent from the non-ET interpretation of the UTPR, because there, the QDMT and the UTPR target different tax bases, i.e., profits of the Country Z and Country X subsidiaries, respectively. When Country X and Country Z are collecting tax from different bases, the UTPR (under the non-ET interpretation) is most naturally thought of as a *sanctioning* instrument: it is withdrawn when the behavior it targets (i.e., low tax in Z) changes. When Country X is collecting tax from the same tax base as Country Z (per the ET interpretation), however, deferring to Country Z to collect the tax amounts to concession, not coercion.

Importantly, the idea of a two-part tax—with separate prongs for domestic and foreign income—is conceptually distinct from foreign tax credit mechanisms. It is well understood that the traditional worldwide taxation imposed on parent companies is conceptually distinct from the choice of using the FTC as a method of providing double taxation relief.[127] Likewise, the fact that the UTPR in the Pillar Two Model Rules serves as a "top-up tax"—implicitly providing a credit for other top-up taxes—should be seen as distinct from its membership in the two-part tax family. To fully analogize the UTPR to anti-deferral rules applicable to parent entities, one must accept that the ET taxing power implied by it can be separated from any particular policy design regarding whether or how to relieve double taxation.

Once the UTPR's implied ET taxing power is separated from the priority given to the QDMT in Pillar Two, however, it becomes clear that it can be used in ways other than as a sanctioning instrument: the ET tax can amount to a way of forcing real revenue transfers from one country to another.

2. The real consequences of the UTPR's implied ET taxing power

To see this, suppose that X simply levies an ET tax of $1 on each $100 of *M*'s Country Z investments: that is, suppose this ET tax, unlike the UTPR, is not conditional on there being a subsidy in Z. At the same time, suppose X imposes no tax on *M*'s investment in X—a possibility allowed only under a two-part tax. X offers an inframarginal investment with a 12% return on $100: in other words, the ET tax X imposes on *M*'s Country Z project is within the bounds of *M*'s profit in X. Consider then two scenarios. First, assume that in the absence of taxes, the Z investment offers a marginal return of 10%.

[125] This sheds light on a question raised towards the end of Part III: if Country X has the power to tax the profit in the Z project, wouldn't it always be in its interest to do so? For example, if *M*'s project in Z was inframarginal (e.g., it returned 11%), why shouldn't Country X tax the project to maximize X's national income? The answer is that X could, but it would never raise more revenue by doing so than by simply taxing M's profit in Country X.

[126] This aspect of the UTPR is recognized by, e.g., Devereux, *supra* note 37, at 159.

[127] Other methods include allowing only a deduction but not credit for foreign taxed paid, or allowing only a partial credit. *See, generally*, Daniel Shaviro, *The Case Against Foreign Tax Credits*, 3 J. LEGAL ANALYSIS 65 (2011).

Given that X taxes any return *M* realizes from Z, the investment in Z is not viable unless Z offers a subsidy. If Z would like to attract investments from *M*, then, it would have no choice but to offer a $1 subsidy to the latter (which it may find worthwhile). Suppose Z offers such a subsidy, and *M* invests in Z, generating $1 of tax revenue for X. In a real sense, Z has transferred revenue to X.

In a second scenario, the project in Z offers an 11% return. When X imposes a $1 ET tax on the project, *M* is left with a project with only a marginal return. Any tax that Z imposes on the project would render it non-viable. Therefore, X's ET tax suppresses the level of tax that Z can impose on projects within its own borders. X thus makes Z worse off, in a way it could not merely with a non-ET UTPR.

What the two scenarios highlight is the following. While an ET taxing power granted to the jurisdiction in which an MNE subsidiary resides can never generate more revenue for the jurisdiction than the non-ET tax, it provides the jurisdiction with a novel way of raising revenue. In the example, Country X can raise revenue from *M* via *either* the Country X project *or* the Country Z project. Either would increase Country X's national income. However, the ET tax injures the interest of another country, namely Z. This injury is different from the neutralization of tax incentives offered by Country Z that results from the non-ET version of the UTPR (or its ET equivalent). It is a harm that country Z and other countries similarly situated may want to protect themselves against.

a. Incentives for UTPR adoption

To elaborate on these points, consider first countries' incentives for adopting the non-ET version of the UTPR. Part III showed that the UTPR, as a non-ET tax, can neutralize the effect of subsidies in other countries.[128] If this is the objective of the country, then the UTPR is a reasonable policy to adopt. However, the UTPR may jeopardize marginal investment in the UTPR-adopting country: its adoption is, in this sense, not costless[129] Therefore, it is rational to levy the UTPR only when a country knows that the burden imposed by the UTPR is within the bounds of the MNE's profits in its own borders, or when the risk of such bounds being exceeded is outweighed by the desirability of the UTPR's objective (e.g., neutralizing subsidies elsewhere).

Even more critically, because UTPR imposition assumes that there is untaxed MNE profit in the adopting country, and because such profit is not part of the country's national income, the country considering UTPR adoption, by assumption, already is not national income maximizing.[130] In addition, at least in the examples considered in this Article, subsidies offered in other countries do not affect the national income of the UTPR-adopting country. The preference for neutralizing subsidies in other countries must be taken as exogenously given, not derived from national income maximization.[131]

The incentives for adopting the non-ET version of the UTPR thus may seem rather unusual. A country must have a preference for the effective tax rates of MNEs in other countries to increase. Such preference would need to be present even if MNEs' tax profiles in other countries have no impact on the country's own revenue or national income. This desire must, moreover, be sufficiently strong that

[128] Part III.4 showed that, in addition, the ET version of the UTPR that gives priority to the QDMT has similar effect.
[129] The maximum amount of UTPR that can be collected is the amount of profit an MNE earns in the UTPR-adopting country. Where all of the MNE's investments in the country are marginal, this amount is zero. This holds whether the UTPR is interpreted as non-ET or an ET tax that is preempted by the QDMT.
[130] To maximize national income, it should already have taxed the MNE's profit in itself.
[131] The same can be said for the UTRP as an ET tax that allows itself to be preempted by the QDMT.

the country is willing to act on it, by imposing a heavier tax burden on the MNE operations it hosts than it would otherwise have. Preferences of this kind certainly have not featured in standard analyses of international taxation before. Even if they seem to capture political sentiments in some countries now, one may wonder how enduring they will turn out to be. Moreover, how widely shared such ideological preference is among nations that participate in Pillar Two is also open to question.[132]

This assessment completely changes when we consider the ET version of the UTPR—particularly, its implied ET taxing power with the foreign tax credit feature appended. For any country armed with such power, taxing an MNE group's foreign profits elsewhere bearing no connection with it (other than the mere fact that the MNE operates in both countries) becomes *just as good* a way of increasing national income as taxing the MNE earns in the country itself. This power clearly may appeal to more countries than the power to neutralize other countries' tax incentives. Claiming such power seems plausibly to be in each nation's self-interest—unless other countries also claim the same power.

b. Harms from the UTPR's implied ET power

The potential harms from the UTPR's implied extraterritorial power are also remarkable. Any country that hosts an MNE's operations would have to recognize that the profit of the operation is open to *any other* country in which the MNE operates to tax. Essentially, all countries in which an MNE operates possess concurrent taxing right over the tax base in any given host country. Moreover, all these other countries may have ordinary (revenue or national income) incentives to extract from the tax base, and not just because they happen to dislike a particular type of tax or subsidy policy of the host country. Finally, as illustrated by the two scenarios above, such overlapping taxing rights can constrain the tax policy of a given host country in all kinds of ways—whether to offer a subsidy, whether to impose a tax, how much of either to offer or impose, and so on.

Contrast this situation with the extraterritorial taxing power implicit in anti-deferral rules applied to MNEs' parent companies. It is easy to verify that any extraterritorial tax imposed by a UPE country, when not coupled with a foreign tax credit, has the same negative effects on host countries as depicted above for the ET tax wielded by another host country.[133] In fact, the concurrent jurisdiction of source (i.e., host) and residence (i.e., ultimate parent) countries over income from cross border investments lies at the core of the subject of international taxation: how such jurisdiction is to be demarcated between source and residence countries is a fundamental question, answers to which continue to evolve.[134] Yet this traditional problem is largely confined to the concurrent jurisdiction between two countries. Moreover, source and residence countries, while asymmetrically situated,[135] also benefit from each other: one needs the import (export) of the other. By contrast, when all countries in which an MNE operates possess concurrent taxing right over the tax base in any given host country,

[132] For example: consider the UK, Canada, and Japan, three G7 countries that are among the leading sponsors of the 2021 OECD tax deal. In these countries' international tax policies prior to 2021, there was little evidence that they promoted high corporate tax rates in *other* countries.

[133] If Country U taxes the profit in Country Z without giving any credit for the tax in Z, it suppresses the level of tax that Z may impose. Similarly, any subsidy offered by Country Z may simply be taxed away by Country U.

[134] The foreign tax credit is by no means an inevitable or even compelling answer to this question. As Part II demonstrated, without other constraints on nations' behavior, the foreign tax credit can result in significant losses to residence (i.e., ultimate parent) countries.

[135] Recall that (per Part II) the IIR top-up tax merely accomplishes an intra-nation transfer from one country's residents to its government.

conflicts over the tax base arise among multiple parties, many of whom are more likely to be symmetrically situated, as well as less likely to offer mutual benefits.

Table 2 Comparing Extraterritorial Taxing Powers Granted to UPEs and Subsidiaries

	Anti-deferral rules applicable to UPEs	**Extraterritorial taxing power for non-parent entities**
Supports two-part tax	Yes	Yes (contrast with non-ET version of UTPR)
Examples	Traditional CFC rules, GILTI, corporate alternative minimum tax, IIR	ET version of UTPR; IIR applied by pure holding company jurisdictions
Boundedness by local profit	No	Yes
Separability from foreign tax credit feature	Yes	Yes
Adoption incentives	Raises revenue and is perceived as fair	Potentially national income maximizing (contrast with sanctioning motive of non-ET version of UTPR)
Concurrent jurisdiction	Between two parties	Between multiple parties
Context	Mutually beneficial exchange	Zero-sum game
Coordination among concurrent jurisdiction	Negotiated, multiple paradigms	Negotiation unlikely among multiple parties in zero sum game.

These observations suggest that nonchalance towards the UTPR's implied extraterritorial power[136] is untenable. Table 2 compares the extraterritorial taxing power under anti-deferral rules applied to ultimate parent entities, on the one hand, with such powers granted to MNEs subsidiaries by the UTPR (and by the IIR to mere holding companies), on the other. The table shows that whether an ET taxing power arises from ultimate ownership of the underlying profit does matter: such ownership ensures that any conflict arising from concurrent jurisdiction also arises in the context of a mutually beneficial exchange among two parties, as opposed to multiple parties coming together merely for a zero-sum game. And it is no answer to point out that international taxation has often tolerated arbitrary assignments of taxing right, e.g., by allowing (potentially multiple) holding company jurisdictions to claim extraterritorial taxing power. When these holding company jurisdictions host no real activity, their ability to benefit from such taxing power is nil—their capacity to increase national income by ET taxation is capped by the zero local profit they offer.[137]

The UTPR's implied extraterritorial power, in conclusion, is truly radical. Whether it is permissible under international law, and whether its exercise may be unjustified or illegitimate, are questions of enormous significance. It is important, though, to distinguish several distinct objections to the UTPR (and to the defense it has received).

3. The UTPR's normative and legal controversies

[136] *See supra* notes 119-120.
[137] *See supra* Part II.3.

It should be acknowledged at the outset that there is remarkable ambiguity regarding how to interpret the UTPR. None of the OECD Inclusive Framework's 2021 statements,[138] the Pillar Two Model Rules, the OECD Commentaries on the model rules, etc., are proper legal instruments.[139] Nor do they represent binding agreements among countries. Moreover, the UTPR (understood as different from an original proposal for an "undertaxed payment rule") was introduced (along with the QDMT) by the OECD after the Inclusive Framework's October 2021 statement.[140] These non-legal and ambiguous texts offer fluid narratives open to divergent interpretations, leaving it highly indeterminate what countries have agreed on and are willing to do to (and be done by) one another. Even though the Pillar Two Model Rules are more consistent with a non-ET interpretation of the UTPR, this has not prevented the ET interpretation from dominating debates surrounding the UTPR.

If the UTPR is interpreted as a non-ET instrument, it would not have introduced any new taxing right. However, countries would be putting existing taxing rights to a novel use: most importantly, as shown in Part III, the UTPR can be used to neutralize some countries' use of corporate tax incentives—making them worse off as a result—and to force others to change their tax policies.[141] Should such policy instruments be permissible, especially when the targets of their sanctioning power do not cause direct harm to other countries? If they are permitted, should countries also be permitted to enact policies to constrain other countries' choices regarding, for example, how heavily to tax their richest individuals, whether to impose a wealth tax, or whether to subsidize fossil fuel?[142] Is it intelligible that countries are permitted to sanction other countries' handing out income tax benefits to corporations, but are not permitted to sanction policies that deliver other (even equivalent) benefits to the same corporations?[143]

To many readers, those questions clearly make sense and should be answered in a non-arbitrary fashion. Issues of right and wrong are at stake. They also connect to foundational doctrines in international law on limits on nations' *jurisdiction to prescribe*.[144] Should countries have the power to enact laws to constrain or sanction other countries' choices about how to tax corporations, when those choices are only speculatively connected to the welfare of the former, sanction-imposing countries?[145] It is fundamental to the coherence of international law that there are limits to nations' jurisdiction to prescribe, even if doctrines regarding those limits may be radically incomplete.[146]

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[138] OECD July 2021 Statement and OECD October 2021 Statement*, supra* note 1.
[139] *See* Wilkie, *supra* note 17; Lennard, *supra* note 1; Hongler et al., *supra* note 29.
[140] *Id.*
[141] *See supra* Part III.3 (host countries' investment subsidies are neutralized, while UPE countries are forced to raise taxes on domestic profits.)
[142] In Hongler et al., *supra* note 29, the authors suggest that the goal of combating climate change may permit greater jurisdiction to prescribe than the goal of raising more (corporate) tax revenue or limiting (corporate) tax competition.
[143] *See infra* Part V.2 for Pillar Two's deliberate encouragement of subsidy competition.
[144] Am. Soc'y Int'l L., *Jurisdictional, Preliminary, and Procedural Concerns*, *in* BENCHBOOK ON INTERNATIONAL LAW (Diane Marie Amann ed., 2014); Hongler et al., *supra* note 29, at 142-3.
[145] *See* F. Hoffman-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 164 (2004)(the U.S. Supreme Court "ordinarily construes ambiguous statutes to avoid unreasonable interference with the sovereign authority of other nations"); Microsoft Corp. v. AT&T Corp., 550 U.S. 437, 455 (2007) ("As a principle of general application . . . courts should assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws.")
[146] Bernard H. Oxman, *Jurisdiction of States*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW ¶ 10 (Nov. 2007), https://opil.ouplaw.com/display/10.1093/law:epil/9780199231690/law-9780199231690-e1436.

Note, however, that these concerns are poorly captured by critiques of the UTPR for the latter's alleged introduction of new ET taxing powers. Such critiques may lend UTPR proponents plausible deniability: as a textual matter, the UTPR is a non-ET instrument. They also mis-diagnose what is problematic about the UTPR: just because a new extraterritorial taxing power would present grave challenges to the international legal order, one need not accept that all exercises of non-ET taxing powers are innocuous.

If the UTPR is interpreted as an ET instrument, on the other hand, it seems that the use of the instrument must be explicitly regulated by international law. It simply cannot be the case that anything goes in the use of such instruments—that what is not prohibited is permitted. The incentives for countries to adopt them would simply be too strong. If Country X tries to tax *M*'s profit in Country Z, what prevents Country Z from taxing *M*'s profit in Country X? And if the threat of reciprocal deployment of such ET taxing power is all that constrains its use, should we not expect some countries using them with far less inhibition than others? For example, countries where MNEs are highly profitable would be much more capable of using such ET taxing power, since they should have the least fear that MNEs would cease investing in them altogether. Contrary to the assertions of some UTPR defenders,[147] it would be quite surprising if international law in general, and international tax rules in particular, would be completely indifferent to such scenarios.

This aspect of the controversiality of the ET interpretation of the UTPR has remained obscure, possibly because what limits will be put on the ET interpretation is an open question. Compare the UTPR in this regard with the IIR: although the IIR is designed as a similar top-up tax as the UTPR, the principles underlying the IIR have more general application. Countries can impose an ET tax on the income of foreign subsidiaries of a resident taxpayer without limitations on the tax rate or committing to any form or extent of relief from double taxation. They also have the discretion to apply such tax to some types of companies and not others. In other words, the principle of worldwide taxation by a parent entity jurisdiction is not limited to its instantiation in any particular rule. Can one say the same about the principle of ET taxation by any MNE member entity jurisdiction? Or is this principle acceptable only when implemented through a particular and arbitrary rule that is the UTPR? If countries have permission (by nothing more than a set of OECD model rules) to impose the UTPR, what is to prevent them from claiming that other variations of ET taxes have also become acceptable under international law?

In claiming that the UTPR is little different from the IIR and traditional anti-deferral rules imposed on parent entities, advocates for the UTPR strongly imply that the UTPR's implied ET power has general application. Indeed, an extreme form of advocacy for the UTPR claims that all taxing powers are permissible unless explicitly prohibited,[148] and that if many countries implement the UTPR, the UTPR's implied ET power becomes a part of customary international law.[149] Such arguments do not appeal to any special place the UTPR's implied ET power has in Pillar Two. But they are reckless, if they intend to do more than defend Pillar Two itself. As Part III argued, if the type of ET instrument UTPR has been interpreted to embody is deployed only for Pillar Two's designated purpose, it is *equivalent* to a non-ET instrument. There is no need to deploy rhetoric suggesting nihilism about international law, just to produce the illusion of effectiveness for a controversial policy.

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[147] Magalhães and Christians, *supra* note 39123, at 1142.

[148] *Id.*; Avi-Yonah, *supra* note 120.

[149] Heydon Wardell-Burrus, *Four Questions for UTPR Skeptics*, 108 TAX NOTES INT'L 699 (Nov. 7, 2022); Reuven S. Avi-Yonah, *UTPR's Dynamic Connection to Customary International Tax Law*, 108 TAX NOTES INT'L 951 (Nov. 21, 2022).

V. Three Objections and Replies

Three objections may be raised to the previous Parts' arguments. First, Parts II-III argued that Pillar Two should unravel, if countries act rationally to maximize national income, and if they expect other countries to do the same. But why should we accept this premise about how countries behave? Second, many countries have already enacted Pillar Two; does that not prove that something must be wrong with the analyses offered here? Third, Part IV argued that both the non-ET and the ET versions of the UTPR may be illegitimate under international law. Is this not refuted by the fact that countries agreed to implement Pillar Two in 2021? Alternatively, will it not be rendered moot, if countries proceed to adopt Pillar Two in the coming years?

1. Do countries aim to maximize national income?

Parts II-III showed that it is against the self-interest of a national-income maximizing government in a UPE country to adopt the Income Inclusion Rule,[150] and because of this, the under-taxed profit rule has no power to enforce IIR adoption in that country.[151] Similarly, national-income maximizing governments that host MNE subsidiaries should generally be indifferent to other countries' adoption of the UTPR, instead of adopting the qualified domestic minimum top-up tax in response.[152] They would also abandon the QDMT once UPE countries fail to implement the IIR.[153] Pillar Two thus would crumble, even if some countries initially adopt it. If some countries continue to insist on implementing the UTPR, then, at the most, we should expect QDMT adoption in some UPE countries in response—unless, that is, these countries choose to retaliate against the UTPR-adopting countries (as Congressional Republicans threatened to do in the U.S.),[154] or take such countries to court.[155]

This prediction about Pillar Two's future evolution will probably surprise casual readers about international taxation and specialists alike. A first objection may be directed at a basic premise of this Article's analyses: Do countries act out of self-interest to maximize national income?[156]

Perhaps the most important way to reply to this objection is to ask: What do Pillar Two advocates say? At least until recently, it was the most ardent proponents of Pillar Two who proclaimed that self-interested motives are what guarantee Pillar Two's wide adoption, especially when an initial "critical mass" of countries adopt it.[157] For example, OECD Secretary-General Mathias Cormann declared that once there are enough countries on board, "it becomes very hard not to become part of it because essentially, you leave money on the table for other countries to collect if you don't adopt Pillar Two."[158] Former Director of OECD Centre for Tax Policy and Administration Pascal Saint-Amans also explained Pillar Two adoption incentives in such terms: "If somebody just grabs the tax — your tax — well, you will

[150] *See supra* Part II.1.
[151] *See supra* Part III.2.
[152] *See supra* Part III.3.
[153] *See supra* Part II.3.
[154] *See supra* note 10.
[155] *See supra* Part IV.3.
[156] I thank Reuven Avi-Yonah for pressing this point.
[157] For the use of the notion of "critical mass", *see* Mason, *supra* note 35; Devereux, *supra* note 37, Section V; Devereux et al., *supra* note 40; Wardell-Burrus, *supra* note 149.
[158] Stephanie Soong Johnston, *OECD Pillar 1 Implementation Now Expected for 2024*, *Cormann Says*, 106 TAX NOTES INT'L 1191 (2022).

not let it go. You will act yourself."[159] Similar pronouncements from other advocates of Pillar Two frequently appeared in media reports—especially in 2022, before the EU and countries elsewhere announced specific plans to implement Pillar Two.[160] When one or a few countries are contemplating Pillar Two adoption, how do they know that the rest of the world will follow? The basic answer on offer to this most important question has been: Pillar Two's design will *force* the hands of other countries otherwise hesitant to join Pillar Two, by acting on their calculations of self-interest. Its alleged leverage on national self-interest is essential to Pillar Two's sales pitch.

This sales pitch has also garnered a remarkable amount of scholarly support. Academics have lauded the "ingenious" design of Pillar Two that deploys "fiscal fail-safes" to give the regime a "no exit" quality, an "ineluctability" to taxation.[161] They have affirmed Pillar Two's "incentive compatibility"—"the agreement is in the individual interests of each country."[162] They have argued that Pillar Two solves a general problem of cooperation: enforcement mechanisms must be in place to punish defectors. To these scholars, whether self-interested nations will sustain Pillar Two implementation is not just a sales pitch, but also an unavoidable question of institutional design.

The core analysis of this Article, therefore, makes no departure from a common premise in the Pillar Two discourse. It engages with that discourse *on its own terms*. The analysis here has simply challenged what others erroneously believe follows from the premise. Essentially, two challenges have been presented. First, does it make sense for a country purportedly making a rational choice to simply *assume* that other countries will act irrationally? For example, for any host government that considers the QDMT as a rational response to UPE countries' IIR adoption, does it make sense to entirely ignore the fact that the IIR is irrational for UPE countries to adopt?[163] Or, for any UPE country government that considers the IIR as a rational response to the UTPR, does it make sense to neglect the possibility that the IIR will trigger QDMT adoption?[164] Instead, it seems much more plausible that countries would pursue rational courses of action *while expecting others to do the same*. Many of the erroneous claims about Pillar Two's incentive compatibility seem to be based on neglecting this point.

A second type of challenge this Article presents to prior claims about Pillar Two's incentive compatibility relates to more specific institutional details. For example, most commentators on the UTPR's enforcement power have conflated the non-ET and ET versions of the UTPR: most tend to read the UTPR through an ET interpretation.[165] The idea that a UTPR-imposing country and a QDMT-imposing country share concurrent taxing power over the tax base located in the latter country lends a rhetorical, though ultimately illusory, force to the UTPR narrative.[166] The cost of such casual conflation, however, is that commentators have failed to articulate their assumptions about what national-income-maximizing countries would do when they host inframarginal foreign MNE investments. There may be no coherent assumption on this issue that would help make the case that MNE host countries would adopt the QDMT to preempt the UTPR.

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[159] Elodie Lamer, *Pillar 2 Needs a First Mover, Saint Amans Says,* TAX NOTES (Jun. 14, 2022).
[160] *See, e.g*., Lamer, *supra* note 87. Core members of the Biden Administration's Treasury team made such claims: *see* U.S. Department of the Treasury, *supra* note 34; Clausing, *supra* note 34; Kamin and Kysar, *supra* note 32.
[161] Mason, *supra* note 35.
[162] Devereux, *supra* note 37, at 146.
[163] *See supra* Part II.2.
[164] *See supra* Part III.2.
[165] The main exception is Christians and Shay, *supra* note 82.
[166] *See supra* Part III.4.

Of course, there is a more general reply to the question of whether national income maximization drives government behavior on the international stage. Such an assumption clearly involves dramatic simplifications: whether it is proper to adopt depends on expectations about explanatory power. For example, most commentaries on the OECD's "Pillar One" proposal for allocating taxing rights over very large MNEs explain the impasse in Pillar One negotiations in terms of conflicting national interests: the U.S. and other countries from which such large MNEs originate are loath to give permission to other countries to tax such MNEs more—under either Pillar One or the taxing instrument it's meant to replace, the digital service tax—because it would reduce their respective national income.[167] Few would question such an explanation, especially when self-interest in the form of national income maximization is used to explain so much else we observe on the international stage. We do not begrudge the assumption's simplifications when it has so much explanatory power. There is no reason why we should not apply the same assumption to the analysis of Pillar Two adoption incentives.

Finally, it may be pointed out that Pillar Two commentators often appeal to *worse* premises about what drives national behavior. One such premise is that governments maximize tax revenue. The OECD, for example, repeatedly released projections about how much more revenue, globally, Pillar Two would allow governments to raise,[168] implying that the more revenue is raised, the more governments should be interested in implementing Pillar Two. But as Part II.1 discussed, it seems incredible that the German government would be motivated to raise €1.7-1.9 billion of annual revenue from its own MNEs if the cost of that is Germany losing €5.1-6.7 billion of national income annually to other countries. Similarly, the controversy surrounding the JCT's estimate of the revenue consequences of Pillar Two for the U.S. centered on how much tax revenue the U.S. would raise or lose, as though that is what a U.S. decision should hinge on. But it seems implausible that the U.S. government cares only about how much revenue it can extract from its own MNEs, while having no concern about how heavily its MNEs are taxed by others.[169]

2. Does the theory fit the evidence?

A second objection to the analyses in this Article is the following. Many countries—including most EU member states—have already enacted legislation to implementing Pillar Two.[170] In light of these developments, are the arguments offered here—to the effect that countries should in many circumstances decline to implement Pillar Two—not demonstrably unpersuasive? Does the evidence not instead weigh in favor of those who claim that Pillar Two introduced the right incentives?

The reply is that this Article's analyses in fact offer novel insights into the course of Pillar Two adoption so far.[171] Part II explained that QDMT adoption is a rational response to IIR adoption, but IIR adoption is irrational conditional on the response of QDMT adoption by others. This potentially sheds light on the important momentum contributed by QDMT adoption to the appearance of widespread

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[167] *See* Hines, *supra* note 3; Cui, *supra* note 3. For conflicts over the digital services tax, *see also* Wei Cui, Insight: Who is afraid of the digital services tax?, BLOOMBERG TAX (Dec. 9, 2019, 12:00 AM PST), https://news.bloombergtax.com/daily-tax-report-international/insight-who-is-afraid-of-the-digital-services-tax.

[168] *See, e.g.,* Hugger et al., *supra* note 42.

[169] *See* text accompanying *supra* notes 71-72.

[170] *See* PwC Pillar Two tracker, *supra* note 5.

[171] Another reply is that whatever their predictions about what countries will do by way of Pillar Two implementation, the analyses here identify false explanations of policy choices, or false bases for predictions. This is important given the centrality of national self-interest to Pillar Two's sales pitch.

Pillar Two adoption. Even though the concept of the QDMT was circulated only after the October 2021 Inclusive Framework statement, and even though the Pillar Two Model Rules considers the QDMT optional,[172] QDMT adoption is reported just as frequently as IIR adoption, and more frequently than UTPR adoptions. According to PwC, at the beginning of 2024, at least 5 jurisdictions announced plans to implement the QDMT without implementing Pillar Two's other components (i.e., IIR or UTPR).[173] Seven jurisdictions—including the important economies of Malaysia, Singapore, Vietnam, and the U.K., along with three haven jurisdictions (Guernsey, Isle of Man, and Jersey)—announced plans to adopt the IIR and QDMT, but refrained from announcing UTPR adoption. Only 5 jurisdictions are reported as implementing Pillar Two without a QDMT: Japan and Thailand (no UTPR either), along with New Zealand, South Korea and Spain.[174] In addition, among these countries that plan to adopt both the IIR and QDMT, some indicate that they expect the QDMT to raise more revenue than the IIR.[175]

Early QDMT adoption can in fact serve several purposes other than responding to expected IIRs. First, it may *deter* IIR adoption by others. This potential effect is captured by revenue projections in several countries for whom the IIR is most relevant. As mentioned earlier, the U.S. has projected that it would lose tax revenue if it implements Pillar Two along with the rest of the world, because QDMTs would erode the tax base that had until recently generated revenue under the U.S.' panoply of anti-deferral rules (i.e., CFC rules, GILTI, and the corporate alternative minimum tax).[176] Germany forecasts relatively little revenue raised under Pillar Two, [177] again because of QDMT adoption by other countries. Australia's revenue estimate for Pillar Two implementation is similarly modest.[178] QDMT adoption is clearly affecting political debates about the wisdom of Pillar Two adoption in UPE countries.

Second, announcing QDMT adoption allows countries intent on attracting foreign investment to begin exploring what investment incentives will continue to be permissible—after a purported global attempt to curtail tax competition. Some prominent forms of tax incentives, such as accelerated depreciation,[179] refundable tax credits,[180] and transferrable tax credits,[181] have already been made permissible under Pillar Two. Most governments that have announced QDMT adoption have also made general statements indicating the intent to explore other policies favorable to foreign investors.[182] Such governments can be seen as exploring a potential bargain that minimizes the power of international agreements to limit government attempts to tilt the playing field.

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[172] Commentary on Model Rules, *supra* note 4, at 118.
[173] Barbados, Columbia, Gibraltar, Slovakia, and Switzerland.
[174] In most instances, countries are announcing plans to adopt all three components of Pillar Two. This is required, for example, by the EU Directive, *supra* note 2.
[175] Switzerland, Singapore, Hong Kong are some examples. *See* sources cited in *supra* notes 61-63.
[176] JCT, *supra* note 12.
[177] Florian Neumeier & Harald Schultz, *OECD Reform of Corporate Taxes Brings Germany Additional Revenue of EUR 2.4–3.4 Billion per Year*, IFO INSTITUTE (July 31, 2023), https://www.ifo.de/en/press-release/2023-07-31/oecd-reform-corporate-taxes-brings-germany-additional-revenue.
[178] BUDGET MEASURES 2023-2024, DEPARTMENT OF FINANCE, AUSTRALIA 20 –21 (May 9, 2023), https://budget.gov.au/content/bp2/download/bp2_2023-24.pdf.
[179] Pillar Two Model Rules, art. 4.4.5.
[180] Pillar Two Model Rules, arts. 3.2.4 and 4.1.2.
[181] *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD (July 2023), https://www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf.
[182] *Id.* at 30-35.

However, it is an open question whether adequate policy substitutes for low effective corporate income tax rates will generally be available. Pillar Two's limitations on income tax incentives may spur an initial global policy experiment to find such substitutes, but the prospect of success is unclear. Richer countries, for example, may be better able to deliver business subsidies (because of ready availability of tax revenue from other sources) than poorer ones.[183] If sufficiently many countries find that there are no adequate substitutes for income tax incentives, then the cost of QDMT adoption—the diminished ability to attract foreign investments—will be more keenly felt.

Overall, therefore, transitory QDMT adoption need not be in conflict with national income maximization. By the same token, it is misleading to resort to transitory QDMT adoption as evidence for the rationality of Pillar Two's architecture.

What about IIR adoption on the part of countries that host many MNEs' headquarters?[184] Here, the evidence in favor of this Article's analysis is substantial. Neither the U.S. nor China is expected to join Pillar Two any time soon. All large emerging economies (e.g., India, Brazil, Indonesia, and South Africa) are likewise on the sidelines. The main significant examples of IIR adoption are European countries hosting major MNEs (e.g., Germany and France), the U.K., Japan, and Canada. What might explain these countries' decisions?

It is unlikely that these governments do not view the foreign profits of MNEs from their own countries as representing national income: the foreign income of one's own citizens is a standard part of national income accounting, after all. Some may argue that foreign governments can always be expected to tax income arising in their countries, so governments may be less sensitive to the loss of national income from foreign taxation.[185] Alternatively, foreign profits of one's own MNEs may be given no weight in computing national welfare:[186] a government may be national *welfare* maximizing without maximizing national income. All such suggestions, however, contradict longstanding assumptions that countries are highly sensitive to the allocation of MNE profits among themselves—assumptions entirely consistent with the current struggle over the OECD's Pillar One proposal.

A more common argument in favor of IIR adoption is that collective IIR adoption introduces indirect benefits that exceed its direct, short-term revenue gains. Such benefits allegedly come from governments' ability to increase corporate income tax rates, once a floor is in place for tax competition: the greater ability for raising taxes—both on foreigners and even more importantly on one's own residents—is envisioned to be welfare improving, e.g., because it allows greater taxation of capital.[187]

The problem with this argument is that the direct loss of national income as a consequence of IIR adoption is truly large. It is implausible that any country that hosts a large number of MNEs is *so desperate* for tax revenue that it would be willing to deliberately transfer tens of billions of dollars of national wealth a year to an arbitrary set of foreign countries. In reality, most of the world's richest countries have ample other, indeed more efficient, means for raising tax revenue than the corporate

[183] *See* Réka Juhász et al., *The Who, What, When, and How of Industrial Policy: A Text-Based Approach*, (STEG Working Paper 050, Jan. 2023).
[184] For countries that host few ultimate parent entities of UPEs, IIR adoption is merely nominal and has no real significance.
[185] Clausing, *supra* note 64. As explained in that note, this claim is wrong.
[186] Johannesen, *supra* note 30.
[187] Clausing, *supra* note 64.

income tax. These include, most importantly, the personal income tax, the skilled implementation of which can basically replace the business income tax altogether. In the United States, for example, more than half of total business income is earned through non-corporate entities, and such income is taxed directly in the hands of individual taxpayers.[188] Mark-to-market taxation of unrealized capital gains is another tax instrument that removes the need for corporate income tax.[189]

In the end, IIR adoption by some UPE countries may imply that their governments, in the context of Pillar Two adoption at least, have not been national-income maximizing. This, however, does not refute the analyses in this paper. At most, one would say that the evidence is mixed. The actions (i.e., non-adoption) of U.S., China and in fact the vast majority of countries are perfectly sensible. It is the actions of Germany, France, the U.K., Japan, Canada, and perhaps another handful of countries that require special explanation. Their IIR adoption must be explained by other hypotheses of varying degrees of generality: perhaps they believe themselves to be acting cooperatively instead of strategically to achieve some common goal; perhaps they are committing cognitive errors; or perhaps one should jettison the attempt to explain the behavior of *countries* altogether, and instead explain Pillar Two adoption in terms of the behavior of particular types of individuals (e.g., particular politicians and finance bureaucrats). None of such explanations, however, give the air of ineluctability to Pillar Two.

3. The UTPR and international law

Part IV.3 argued that both the non-ET and ET versions of the UTPR raise obvious concerns from the perspective of international law, though these concerns are distinct from one another and from other international law concerns that have been raised about Pillar Two.[190] Pillar Two proponents have tended to dismiss critiques of Pillar Two offered in terms of international law with four types of arguments. They may offer the same dismissals for the concerns advanced in this Article. The four types of arguments are: (1) Pillar Two represents an agreement reached by 137 countries in 2021 and *is* international law, it, therefore, cannot be held to violate international law; (2) by implementing Pillar Two (and not merely through the 2021 OECD press releases), countries are creating new customary international law, therefore Pillar Two cannot violate international law; (3) there is no existing international law that the UTPR violates; and (4) it is unlikely that any lawsuit will slow down the momentum of Pillar Two adoption.

The first argument, that the Inclusive Framework's agreement in 2021 itself creates new international law,[191] is incorrect and rejected by commentators[192] and governments alike.[193] All that

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[188] Matthew Smith et al., *Capitalists in the Twenty-First Century*, 134 Q. J. ECON. 1675 (2019).
[189] *See* Eric Toder & Alan Viard, *Replacing Corporate Tax Revenues with A Mark-To-Market Tax on Shareholder Income*, 69 NAT'L. TAX J. 701 (2016).
[190] *See especially* Hongler et al., *supra* note 29; Douma et al., *supra* note 29. *See also* Błażej Kuźniacki, *Pillar 2 and International Investment Agreements: 'QDMTT Payable' Seals an Internationally Wrongful Act*, 112 TAX NOTES INT'L 159 (Oct. 9, 2023).
[191] *See* Avi-Yonah, *supra* note 149 ("last fall, 137 countries agreed to the UTPR…This represents a change in [customary international tax law], and it is too late to argue that [international law] precludes any of these countries from applying the UTPR").
[192] *See*, Wilkie, *supra* note 17; Lennard, *supra* note 1; Hongler et al., *supra* note 29, at 143; Douma et al., *supra* note 29.
[193] The Swiss government, for example, confirmed that "jurisdictions are under no political or legal obligation to adopt [the OECD] rules." *See* FEDERAL DEPARTMENT OF FINANCE OF SWITZERLAND, Q&A ON THE IMPLEMENTATION OF THE OECD MINIMUM TAX RATE IN SWITZERLAND (Jan. 13, 2022) (on file with author).

transpired in 2021 were a few OECD press releases about purported agreements among Inclusive Framework members.[194] There was no signed document or record of voting procedures confirming undertakings made any country. Notoriously, the undertaxed profit rule and QDMT were both introduced later in the Pillar Two Model rules, catching most observers by surprise.[195] This would not have been possible if the Inclusive Framework statements had created any binding agreement. Even the OECD itself never claims that any legal obligation emerged from the Inclusive Framework statements.

The second argument, that as countries begin to implement Pillar Two, the rules in Pillar Two become part of customary international law,[196] represented a rather strange defense of the legality of the UTPR (and other Pillar Two rules) before Pillar Two implementation began in some countries in 2024: it effectively asserted the tautology that if a rule becomes legal under international law, it will no longer be illegal.[197] But more importantly, as other scholars have pointed out, Pillar Two does not become customary international law even after some countries enact it and thereby initiate a practice: there must also be *opinio juris*—a belief among states that the practice is "rendered obligatory by the existence of a rule or law requiring it."[198] If countries protest against the UTPR, for example, the UTPR will not rise to customary international law for them. Countries may protest against the UTPR because they believe it is illegal, or because it is otherwise unacceptable. The legality of the UTPR, therefore, cannot be defended by assuming that countries will not protest against it.

The third argument, that nothing in existing international law explicitly prohibits the UTPR, therefore, it must be permitted,[199] rests on a tendentious understanding of international law (and of law in general) that many would reject. Legal norms are often not spelled out in existing rules. That is why courts and administrators are called upon to clarify them. When judges, for example, try to fill in gaps in existing rules, they generally believe themselves to be guided by underlying principles that are expressed through but not exhausted by the letters of existing rules.[200] If, as Part IV.3 argued, we believe that there must be restrictions on countries' jurisdiction to prescribe, and if, moreover, we believe that such restrictions are unlikely to be completely arbitrary—e.g., countries can sanction each other for the corporate income tax rate they adopt, but not for the personal income tax or other tax policy choice—then the absence of explicit restrictions on the jurisdiction to prescribe tax rules suggests that international legal principles ought to be clarified, not that they do not exist. Conversely, if we are told that there are no non-arbitrary restrictions on the jurisdiction to prescribe, we should be alarmed, because the question then is how there can be an international legal order at all.

The fourth argument, that litigation—if any emerges—challenging the legality of Pillar Two's various components will take a long time to resolve and be unlikely to slow down the momentum of Pillar Two adoption,[201] seems quite premature. For one, this Article has shown that there is no ineluctable momentum to Pillar Two adoption—Pillar Two goes against the self-interest of many countries, after all! Moreover, there are many reasons why Pillar Two has not faced litigation so far. The OECD (or the Inclusive Framework it convenes) creates no law. The OECD also enjoys immunity from

[194] *See* OECD July 2021 Statement and OECD October 2021 Statement*, supra* note 1.
[195] Li, supra note 39.
[196] Avi-Yonah, *supra* note 120; Wardell-Burrus, *supra* note 149.
[197] Or, worse, it is akin to arguing to a court that if the court rules an act to be legal, the act will be legal, therefore the court should treat the act as legal in adjudication.
[198] Hongler et al., *supra* note 29, at 143.
[199] Magalhães & Christians, *supra* note 39.
[200] Ronald M. Dworkin*, The Model of* Rules, 35 U. CHI. L. REV. 14 (1967)
[201] Wardell-Burrus, *supra* note 149.

every form of legal process.[202] It can thus afford to remain silent on —even indifferent to—the international legality of Pillar Two and sidestep related controversies. National governments that implement Pillar Two, however, both create binding law and can be called to court or arbitral tribunals. The OECD's indifference to international law is not available to them. The time for legal disputes involving Pillar Two to be even possible, therefore, has just begun.

Not only are both the non-ET and ET versions of the UTPR potentially objectionable under international law, as remarked on in Part II.2, there are at present no clear boundaries on the design of the QDMT either. Suppose, for example, that only 30 countries or so adopt the IIR. What precludes QDMT adopting countries from limiting the application of their QDMTs to only MNEs from these 30 countries? The QDMT's legality under tax treaties, investment agreements, and other aspects of international law may be subject to growing scrutiny.

These legal considerations all reinforce the conclusion from this Article's analyses from the perspective of national self-interest: it would be highly unjustified to take the implementation of Pillar Two as an *already given* fact about the world.

Conclusion

As 2024 begins, the United States confronts a vital policy choice, which also faces the vast majority of nations in the world: should it adopt the global minimum tax, proposed by the OECD and designed to subject large MNEs to a minimum of 15% corporate income taxation wherever they operate? For all nations pondering the choice, *what other nations will do* is an essential consideration. On the one hand, the global minimum tax proposal has given rise to extensive domestic and international controversy.[203] Any facile claim that all countries share common interests in taxing MNEs, and that the OECD secured most countries' agreement to a proposed solution in 2021, should be vigorously questioned in light of these controversies. On the other hand, close to 30 countries have enacted or proposed legislation to implement the global minimum tax according to the OECD's Pillar Two Model Rules. This may already amount to a "critical mass" of countries that, according to an extremely popular narrative, would make Pillar Two adoption "ineluctable:" even for purely self-interested nations that are indifferent to Pillar Two's grand goals, might it already be too late to opt out?

This Article has sought to demonstrate that there is nothing inevitable about Pillar Two adoption. Countries from which MNEs originate will likely suffer deep losses, and most will be better off,

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[202] *See* OECD, *Supplementary Protocol No. 1 to the Convention for European Economic Co-operation on the Legal Capacity, Privileges and Immunities of the Organisation* art. 2 (Apr. 16, 1948); OECD, *Supplementary Protocol No. 2 to the Convention on the OECD* (Dec. 14, 1960). *See* Kuźniacki, *supra* note 190 for recent commentary on the OECD's immunity.

[203] By far the most important international controversy—though the topic is well beyond this Article's scope—relates to the fact that in November 2023, the United Nations General Assembly voted by a landslide majority to adopt a resolution in favor of a new framework convention on international taxation that serves as an explicit alternative to the OECD. G.A. Res. 78/230, Promotion of inclusive and effective international tax cooperation at the United States (Nov. 22, 2023). The resolution, proposed by a group comprising most African countries voicing strong discontent with the OECD process, defeated a concerted effort to block the vote by the U.S., U.K., and E.U., who were publicly accused of negotiating in bad faith. The resolution was adopted with 125 votes in favor, 48 against, and 9 abstentions. *OECD's tax deal may discriminate on the basis of gender and race – UN experts warn*, CENTER FOR ECON. AND SOCIAL RIGHTS (Feb. 6, 2024), https://www.cesr.org/oecds-tax-deal-may-discriminate-on-the-basis-of-gender-and-race-un-experts-warn/.

from the perspective of national self-interest, pulling out of Pillar Two. Pillar Two's purported enforcement mechanisms lack effectiveness; accounts of its "devilish logic" are filled with logical inconsistencies. Whatever sense of novelty in institutional design there is in the Pillar Two proposal, it is sustained only by a neglect of, or a willful refusal to consider, obvious and fundamental normative questions about principles of international law.

For policymakers around the world, the analyses offered here hold two implications. First, those who believe that a global minimum tax is ultimately good for the world need to step up the effort to persuade others who are skeptical. Their arguments should be based on moral and pragmatic principles, instead of merely repeating the dubious assertion that countries have already agreed to Pillar Two, or, even worse, threatening other countries with sanctions and claiming that all countries have consented to such sanctions. Such coercive rhetoric would perhaps be even more alarming if they were backed by real power, but it is no less objectionable when, as this Article argues, the alleged sanctions befuddle more than anything else. Second, for countries more interested in responding to rather than leading Pillar Two implementation, this Article's analyses offer a reminder that estimates of tax revenue alone rarely capture what is at stake in Pillar Two implementation. Moreover, the semblance of inevitability surrounding Pillar Two may have more to do with the global tax profession's deep hunger for a fee bonanza than any coherent, coolheaded reasoning.

Arguably, Pillar Two confronts scholars of international taxation similarly with fundamental choices. Should they pursue research—whether empirical, theoretical, doctrinal, or normative—under the assumption that the policy and legal landscape of international taxation has already irreversibly changed? If Pillar Two is largely unanticipated and deviates from most scholars' policy recommendations, does this point to inadequacies in their prior conceptual frameworks, or should they simply accept without question a new set of descriptions about the institutions of international taxation?

This Article has argued that recent scholarship supporting claims about Pillar Two's purported novel enforcement mechanisms is mistaken. Indeed, it is possible that such faulty scholarly analyses have themselves contributed to the popular, erroneous acceptance of Pillar Two's inevitability. But more generally, if scholars complacently accept purported policy choices, without trying to interpret or rationalize such choices, they seem first to abandon any aspiration to contribute to rational policymaking. They also threaten to set international taxation adrift as a field of inquiry, with no better anchor than what press releases happen to come out of whichever international organizations the news media happens to be reporting on. This Article has illustrated how, instead, one can use generally applicable social scientific premises to question popular interpretations of Pillar Two. There is much more that scholars with a skeptical cast of mind can do to shed light on the ongoing drama in international taxation.