

## GLoBE: The Potential Costs of Cooperation

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*This article argues that the fact that the 2021 global tax deal (focusing on Pillar 2) is cooperative is not in itself proof of the deal being beneficial (and certainly not equally beneficial) for all parties. Developing countries particularly may benefit less and possibly even lose from the agreement. The article focuses on two features of cooperation that may tilt the playing field in favour of developed countries: agenda influence and structural incentives to cooperate. Since the OECD had control over both the agenda and the ways in which the game was structured, it is not surprising that the deal served the interests of its members.*

*Moreover, the mechanism of Pillar 2 encourages participation and discourages future defection. In the current stage of the international tax regime, this is considered a virtue. However, it might also harbour future risks such as lock-in and cartelistic effects that might benefit the leaders of this initiative (the OECD in this case) at the expense of others. Moreover, the current regime grants significant power to those with their hands on the steering wheel. Such power could be used to disadvantage others. In the absence of mechanisms that would curtail the monopolistic power of the former, other countries risk paying excessive prices to belong in this regime.*

**Keywords:** GLoBE, Pillar II, international tax, cooperation, OECD, developing countries, agenda influence, incentives to cooperate, lock-in, cartels.

### I INTRODUCTION

2021 has been an important year for international taxation. After a long time of waiting for the United States to take a stand on the tax deal proposed by the OECD's inclusive framework, the finance ministers of the G7 nations agreed to support a 'two pillar' initiative comprised of a reallocation of taxing rights to market countries (Pillar 1) and a new global minimum tax rate that companies would have to pay regardless of where they are based (Pillar 2). The deal was confirmed in October 2021 by 136 out of the 140 members of the 'inclusive framework'<sup>1</sup> in a statement outlining the basic mechanisms of the two pillars.

The 2021 deal is presented as a sharp twist in the 100-year-old plot of the international tax regime. It 'marks the beginning of a new era of international cooperation which acknowledges the need for simpler approaches to the rules and standards ... The agreement is the first serious multilateral step in a paradigm shift relating to the global income allocation system'.<sup>2</sup>

This article is an attempt to assess the 2021 global tax deal. It argues that the fact that the solution is cooperative is not in itself proof of its being beneficial (and certainly not equally beneficial) for all parties. Developing countries particularly may benefit less and possibly even lose from the agreement. One key potential cost for developing countries is their reduced (though not fully eliminated) ability to pursue competitive tax strategies. Another issue is the fact that the 2021 agreement locks-in a regime that – mildly stated – does not prioritize the interests of developing countries that are in the greatest need for global support. While the proposals that were brought to the table were not necessarily harmful for them, these proposals were neither effectuated by nor designed to serve their interests.

For almost 100 years, nations of the world operated under a decentralized regime in which countries inexorably pursued their self-interests. Naturally, states' independence yielded competition among them that was blamed not only for racing states' tax rates to the bottom, but also for initiating a destructive process of

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<sup>1</sup> Established as an invitation by the OECD for nations of the world to join their cooperative efforts. Many scholars, however, have challenged the concept of cooperation within the IF. See e.g., Yariv Brauner, *Serenity Now! The (Not So) Inclusive Framework and the Multilateral Instrument*, 26 Fla. Tax Rev. U. Fla. Levin C.L. Legal Stud. Res. Paper Series No. 22–6 (2021).

<sup>2</sup> OECD, *Developing Countries and the OECD/G20 Inclusive Framework on BEPS: OECD Report for the G20 Finance Ministers and Central Bank Governors*, Oct. 2021, Italy, OECD, Paris (2021), <https://www.oecd.org/tax/beps/developing-countries-and-the-oecd-g20-inclusive-framework-on-beps.htm> (accessed 23 Jul. 2023).

fragmentation that facilitated tax avoidance. Multilateral cooperation on minimum taxation that was commonly supported as the correct if unachievable solution came as a surprising (but certainly blissful in the eyes of many) sudden change.<sup>3</sup>

The new global tax deal was described in heroic terms as a 'historic',<sup>4</sup> 'unprecedented',<sup>5</sup> and a 'once-in-a-generation accomplishment for economic diplomacy'.<sup>6</sup> It was praised as a triumph of cooperation and compromise over fierce competition, a joint effort to resolve a destructive collective action problem, and a victory of fairness over greed.

Rishi Sunak, Britain's Chancellor of the Exchequer, announced the agreement and hailed it as a deal that would make the global tax system 'fit for the global digital age'<sup>7</sup> and ensure 'the right companies pay the right tax in the right places'.<sup>8</sup> Commissioner Paolo Gentiloni stated that 'Getting to this point has required difficult choices for many countries, both in the EU and elsewhere. A spirit of compromise and common interest, in Europe and worldwide, enabled us to get here'.<sup>9</sup> Janet Yellen, the US Treasury Secretary, stated that 'global minimum tax would end the race to the bottom in corporate taxation, and ensure fairness for the middle class and working people in the U.S. and around the world'.<sup>10</sup> Yellen was further quoted saying, 'I believe what you are seeing is a revival of multilateralism'.<sup>11</sup>

The aim of this grand multilateral effort was to fix the international tax system. The problem was – as stated by the OECD – 'unhealthy tax competition',<sup>12</sup> and the two pillars were suggested as the remedy. This article focuses on one part of the deal, i.e., Pillar 2, a cartel-like agreement whereby cooperating countries agree to a coordinated 15% tax rate<sup>13</sup> to be levied on the world's largest Multinational

Enterprises (MNEs). The agreement is supported by a defensive device that is designed to counteract potential defection. Under it, if one country waives taxation, another participating country will impose a tax. The cooperative multilateral solution was featured as being normatively justified. MNEs will pay their 'fair share', middle class taxpayers in the United States and across the world will be treated fairly, and developing countries are not only included in the framework but are also bound to gain from the new deal. The tax imposed by the agreement is not only a cure for unhealthy tax competition but is factually 'the right tax'.<sup>14</sup>

The new tax deal is certainly an impressive accord of cooperation and a major accomplishment for the OECD. This is by no means a trivial achievement. In fact, many, including this author, have long doubted the prospects of the international community attaining such cooperation. Moreover, recent developments suggest that countries are increasingly adopting the deal in their legislation. However, even the current step of agreement in itself is consequential and – as many have previously argued – may signal a new phase in international taxation. Yet, I believe, some caution praising it as a success is warranted.

It seems intuitive to equate cooperation with desirable outcomes. After all, if all parties consensually join a pact, surely it encapsulates what is good for all and thus, presumably, is the proper thing to do. Cooperation, under this intuition, is a proxy for the desirability of the agreement. This contribution nonetheless contends that cooperation does not necessarily ensure that the agreement is indeed desirable even if it is sustained. This is true not only in the obvious cases when there is coercion or deception when reaching agreement.<sup>15</sup> Even in the absence of

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<sup>3</sup> While some cooperative efforts were attempted earlier, it has only been since 2015 – when the BEPS accord, the MLI, and the inclusive framework were embarked upon, that cooperation and multilateralism entered this major stage. See OECD, *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing (2013), [https://www.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profit-shifting\\_9789264202719-en](https://www.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profit-shifting_9789264202719-en); OECD *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, OECD Publishing (2016), <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm>.

<sup>4</sup> *A Communiqué of the Fourth G20 Finance Ministers and Central Bank Governors meeting*, [https://www.mef.gov.it/inevidenza/2021/article\\_00064/G20-FMBCBG-Comunique-Fourth-G20-FMBCBG-meeting-13-October-2021.pdf](https://www.mef.gov.it/inevidenza/2021/article_00064/G20-FMBCBG-Comunique-Fourth-G20-FMBCBG-meeting-13-October-2021.pdf) (accessed 13 Oct. 2021).

<sup>5</sup> Alan Rappeport, *Finance Leaders Reach Global Tax Deal Aimed at Ending Profit Shifting*, The New York Times, <https://www.nytimes.com/2021/06/05/us/politics/g7-global-minimum-tax.html%20> (accessed 21 Oct. 2021).

<sup>6</sup> See e.g., US Dept. of Treasury, *Statement from Secretary of the Treasury Janet L. Yellen on the OECD Inclusive Framework Announcement*, <https://home.treasury.gov/news/pressreleases/jy0394> (accessed 8 Oct. 2021), ('Today's agreement represents a once-in-a-generation accomplishment for economic diplomacy. We've turned tireless negotiations into decades of increased prosperity – for both America and the world').

<sup>7</sup> Rappeport, *supra* n. 5.

<sup>8</sup> *Ibid.*

<sup>9</sup> European Commission, *Statement by Commissioner Gentiloni on the G20's Endorsement of the Agreement on International Taxation Reform*, [https://ec.europa.eu/commission/presscorner/detail/en/statement\\_21\\_5247](https://ec.europa.eu/commission/presscorner/detail/en/statement_21_5247) (accessed 15 Oct. 2021).

<sup>10</sup> *Ibid.* Yellen further claimed that 'the global minimum tax would also help the global economy thrive, by leveling the playing field for businesses and encouraging countries to compete on positive bases, such as educating and training our work forces and investing in research and development and infrastructure'.

<sup>11</sup> *Ibid.*

<sup>12</sup> See OECD/G20 Base Erosion and Profit Shifting Project, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, <https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> (accessed Oct. 2021).

<sup>13</sup> The actual effective tax rate is lower than that. See s. 3(a) below for a more detailed (and more accurate) explanation.

<sup>14</sup> Rappeport, *supra* n. 5.

<sup>15</sup> Notably, some have debated the lack of coercion. See e.g., Shu-Yi Oei, *World Tax Policy in the World Tax Polity? An Event History Analysis of OECD/G20 BEPS Inclusive Framework Membership*, 47 Yale J. Int'l L. B.C. L. Sch. Legal Stud. Res. Paper No. 568 (2021); ATAF, *The Place of Africa in The Shift Towards Global Tax Governance: Can the*

these, cooperation in itself is no assurance for serving the interests of the cooperating parties.

Cooperative mechanisms may yield biases providing some actors with excessive power especially in the multi-lateral context. This article focuses on two features of cooperation that may tilt the playing field. One is the ability of the OECD to control the agenda, and the other is the structure of the game that induces cooperation. Both features have the power to bias the outcomes of the process in favour of one side – that of developed countries. In the negotiations towards the 2021 tax deal, G7 countries, and later the OECD took the lead on both setting the agenda and structuring the game. This, I believe, warrants caution in celebrating the agreement as inherently desirable simply because it is cooperative.

While leveraging on the collective power of the cooperating parties may have certain advantages (e.g., in enforcing tax rules on MNEs, mobile resources, and mobile taxpayers), it may also provide incentives for some actors to join the cooperative accord although they would have been in a more advantageous position under a different accord (or no cooperation at all). In fact, as will be explained below, cases when cooperation harms some of the cooperating parties are well known to international taxation.<sup>16</sup> Hence, the deal should be independently evaluated rather than assuming that the 2021 global tax deal benefits all signatories simply because they have signed up for it. The results of a deal could indeed be mutually beneficial and allocate increased benefits fairly (as it was advertised). It could also benefit some actors more than others (which may raise issues of global justice), or – even though consensual – it might even be harmful for some of the actors in the short or long run.

Moreover, the cooperative accord and the newly created multilateral regime may be harbouring increased risk in the future for non-core-actors. The mechanism of Pillar 2 encourages participation and discourages future defection. In the current stage of the international tax regime, this is considered a virtue. However, alongside its cooperative-enhancing qualities, the new structure risks a future lock-in and cartelistic effects that might benefit the leaders of this initiative at the expense of others. Thus, even if the regime does not currently harm any countries, by creating this new cooperative standard, it may facilitate a path that might block future – potentially superior – standards. Moreover, the current regime grants significant power to those with their hands on the steering wheel (the OECD in this case). Such power could be used to disadvantage others.

In the absence of mechanisms that would curtail the monopolistic power of the former, other countries risk paying increasingly excessive prices to belong in this regime.

There is another layer for reconsideration when evaluating the 2021 tax deal, which is probably beyond the scope of the current contribution, i.e., whether the deal was a missed opportunity for a much more ambitious pact.<sup>17</sup> Could the combination of the current time of crisis and the existing level of political goodwill have been used to set an entirely new agenda for international taxation? This could perhaps be one that would not only serve the best interests of states (and the institutions that lead them) but also humanity in general. Such a utopic multinational tax regime would conceivably promote the basic goals of taxation on a global scale. It would seek to efficiently provide public goods – global health, food and water security, and the environment – and embrace global justice. This enormous task, however, must wait for another day.

This article proceeds as follows. Section 2 briefly describes the pre-2021 international decentralized tax regime yielding competition between states and the fragmentation of the international tax landscape. It further explains why cooperation was considered an unlikely development. Section 3 describes the 2021 tax deal, the loud voices cheering for it as a miracle solution, and the somewhat more sheepish voices arguing that the deal serves the interests of developed countries but not so much those of the Developing Countries (LDCs). Section 4 puts the current deal in a broader perspective and contends that the new deal should not be an abrupt turn away from a self-interested uncoordinated international tax regime towards a cooperative all-benefiting formula. Rather, it should be considered as another step in a strategic interaction among global actors (notably OECD countries) that has been used in the past as a vehicle to promote their own interests while disregarding those of others. Similar mechanisms, specifically the promotion of an explicit standard and controlling the agenda, explain both the biased results of the past and the concerns regarding the current accord and its future. Section 5 concludes.

## 2 INTERNATIONAL TAX – A COLLECTIVE ACTION PROBLEM?

The international tax regime began in the early 1920s as a fully decentralized regime, the product of the interaction of states independently making their own choices regarding tax rules and rates in order to maximize their national

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*Taxation of the Digitalised Economy be an Opportunity for More Inclusiveness?*, [https://events.ataftax.org/index.php?page=documents&func=view&document\\_id=35](https://events.ataftax.org/index.php?page=documents&func=view&document_id=35) (2019) noting that some African countries were greylisted for not committing to join the IF or implementing the BEPS minimum standards by the end of 2019.

<sup>16</sup> As I have argued in the past. See Tsilly Dagan, *The Tax Treaties Myth*, 23(4) N.Y.U. J. Int'l L. & Pol. 939–996 (2003), doi: 10.2139/ssrn.379181.

<sup>17</sup> Alternatively, as others have suggested, as an opportunity to consider broader (and allegedly superior reforms such as the DBCFT; see Michael P. Devereux et al., *Taxing Profit in a Global Economy or a Formula Apportionment* (OUP 2021); Reuven S. Avi-Yonah & Clausing Kimberly, *A Proposal to Adopt Formulary Apportionment for Corporate Income Taxation: The Hamilton Project*, U. Mich. L. & Econ., Olin Working Paper No. 07–009, U. Mich. Pub. L. Working Paper No. 85 (2007), doi: 10.2139/ssrn.995202 (proposing unitary taxation of MNEs' income allocated among jurisdictions based on their domestic sales).

interests.<sup>18</sup> In the absence of any central global authority, market powers reigned, and countries engaged in competition for resources and residents with tax largely becoming the currency of such competition.

Demand for resources and competition for (some) residents encouraged states to offer attractive tax and public goods 'deals' to potential residents and investors. Tax policies almost inevitably became marketized as countries attempted to tailor their taxation and benefit packages to the needs and requirements of their most sought after investors and residents. In this competitive international tax regime, mobile capital enjoyed lower tax rates; foreign investors benefited from attractive exemptions; and sought-after MNEs take advantage of favourable tax regimes.

Tax competition is by no means perfect market competition. In fact, competition between states was blamed for tax rates racing to a suboptimal level.<sup>19</sup> The uncoordinated decentralized nature of the international tax regime also led to several inconsistencies between systems which created gaps and frictions between taxing jurisdictions thus generating barriers for economic activity and opportunities for free riding by avoiding taxes. These conditions have eroded the ability of states to collect taxes to finance their public fisc, pursue their normative goals, and particularly to fight inequality. The substantial challenges of income taxation in this globalized competitive setting have sent policymakers and scholars in search of a viable solution for sustaining the states' power to tax. Since so many of the problems of international taxation derive from its decentralized structure, cooperation seems like the textbook answer. If only countries could do so to coordinate their policies (and thus attempt to efficiently address the gaps and frictions), exchange information (to limit tax evasion), and agree on a minimum rate of taxation (to stop the infamous race to the bottom), they would be able to regain their capacity to effectively impose their taxes even in a globalized world.

Indeed, since the early days of the international regime, cooperative solutions for international tax problems gained much support. Cooperative bilateral mechanisms paved the way for further cooperation. Treaties for the prevention of double taxation were signed between pairs of countries in the hope that, by cooperating, host and residence countries would be able to reduce barriers for

cross-border trade. These treaties have become immensely popular with currently over 3,000 bilateral treaties signed. A highly influential model introduced and updated by the OECD makes their language, structure, and much of their terms adhere to a very similar pattern.

In recent years, further cooperative efforts evolved under the leadership of the OECD. Initially, this occurred with multilateral tools to increase transparency and share tax information among participating jurisdictions.<sup>20</sup> Then came the ambitious Base Erosion and Profit Shifting (BEPS) Project attempting to coordinate the treatment of major tax planning challenges across national borders. Finally, the inclusive framework was introduced that was originally designed to facilitate the negotiations of the Multilateral Instrument (MLI)<sup>21</sup> and then extended to make a collective effort to address the challenges of the digital economy. Many – including this author – tended to doubt the ability of these efforts to attain and sustain cooperation. Hence, despite the OECD's enthusiasm, many were sceptical about the likelihood of such an agreement emerging.

It should be noted that, despite the great expectations of many of its supporters, there is still quite a long way before the agreement is actually adopted by the domestic systems of many of its signatories. Moreover, there is still concern that some of the states that have joined the agreement might withdraw from it once its actual costs and benefits become clear. Yet, recent developments, and specifically the adoption of an EU Directive,<sup>22</sup> is certainly a significant step forward. In any event, there is no doubt that the emergence of the two-pillar deal in itself is an extraordinary achievement for the OECD and its leaders.

### 3 THE GLOBAL MINIMUM TAX – A COOPERATIVE SOLUTION?

If successful (and, honestly, even if stalled), the emerging international agreement is a game changer.<sup>23</sup> This is not only due to the ability of the OECD to bring so many jurisdictions to agree to the basic terms of the two pillars. It is also because of this agreement's content. Instead of the OECD's pre 2021 agenda that seemed to focus on issues of enforcement (such as transparency and curtailing

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<sup>18</sup> Certain shared standards have emerged in the process, e.g., the concepts of source and residence and the arm's length principle. Reuven Avi-Yonah, e.g., insists that these standards have developed into nothing less than customary international law. See Reuven S. Avi-Yonah, *International Tax as International Law* (New York: Cambridge University Press 2007).

<sup>19</sup> For a discussion of the costs and benefits of tax competition, see Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation* (Cambridge tax law series). Cambridge: Cambridge University Press (2018) Ch. 4.

<sup>20</sup> In the year 2000, the OECD founded the Global Forum on Transparency and Exchange of Information for Tax Purposes and invited non-member countries to join. See OECD, *Harmful Tax Competition: An Emerging Global Issue* (1998), doi: 10.1787/9789264162945-en.

<sup>21</sup> See Brauner, *supra* n. 1.

<sup>22</sup> Council Directive No. 8778, <https://data.consilium.europa.eu/doc/document/ST-8778-2022-INIT/en/pdf> (accessed 25 Nov. 2022).

<sup>23</sup> As John Vella, has argued in 2021 'If the two pillars are implemented properly by participating countries, they could have a significant impact on the international business tax system. They would certainly constitute a departure from the paradigm currently underpinning the system, and, once this breakthrough is achieved, they may even be harbingers of more extensive reform in the future'. John Vella, *The OECD/G20 Inclusive Framework's Two-Pillar Solution*, (5) Brit. Tax Rev. 515–521 (2021).



profit shifting), the new agenda aims at the core of tax sovereignty in constructing a globally coordinated and cooperatively enforced minimum tax.

In that, it leverages on the coercive powers of cooperating states that are *combined* to gain control over MNEs and subject them to an agreed-upon level of taxation.<sup>24</sup> The 2021 agreement thus launches a (cooperative) taxing scheme that states acting individually could not impose. This is why the 2021 compromise<sup>25</sup> was hailed not only as a ‘historic’<sup>26</sup> tax revolution<sup>27</sup> but, more importantly, for the purposes of this article, as a triumph of cooperation over competition.

On first reflection, it seems like a ‘happy end’ cooperative solution to a collective action saga. Instead of racing each other’s tax rates to a suboptimal level, states – under the leadership of the OECD – managed to agree on a cooperative solution. It is one that would benefit all participants and force MNEs to pay at least a minimum level of taxation. Yet, as described below, significant criticism is being expressed concerning the distributive results of the agreement. Critics argue that the agreement disproportionately benefits developed nations compared to developing ones, and some even argue that it negatively effects the interests of developing countries.<sup>28</sup> It may be wondered why developing countries would sign the agreement if it is not good for them. Alternatively, stated differently, if they have signed it, is that not proof of the fact that the agreement serves their interests? The rest of this section describes in more detail the agreement, its claimed virtues, and the critiques that were raised against it. The next chapter will examine the significance of developing countries’ consent.

### 3.1 About Pillar II

Under Pillar 2 – the Global anti-Base Erosion Rules Global Anti-Base Erosion (GLoBE) – states agreed to impose a global minimum tax of 15% on MNEs’ ‘excess

profits’ with a turnover of more than EUR 750 million per year.<sup>29</sup> The cartel-like agreement was secured with two measures. First, it was agreed that, if some jurisdictions where an MNE operates fail to impose the minimum tax (or a Qualified Domestic Minimum Top-up Tax (QDMTT) substitute<sup>30</sup>), the jurisdiction where the ultimate parent entity (UPE) of the MNE resides will impose a ‘top-up tax’ equal to the tax not collected.<sup>31</sup> Second, to avoid home jurisdictions’ competition, if the residence country of the MNE fails to impose the top-up tax, other jurisdictions can step in and collect the tax not levied under what was termed the Undertaxed Profits Rule (UTPR).<sup>32</sup> The additional tax thus collected would be distributed among the cooperating countries in which the MNEs tangible assets and employees are located’.

The OECD claims that the agreement is a win-win deal as all countries will benefit from signing it by collecting more revenues from MNEs than they currently do. The benefits in cooperation among developed countries follows this logic. As Ruth Mason describes, ‘High-tax-states – having competed with each other on taxes for years – resolved to cooperate to ensure that their effective tax rates on financial accounting income did not fall below 15%’.<sup>33</sup> In order to do so without losing business, investments, and headquarters to lower-tax states that did not join the deal and to avoid the constant threat of defection among cooperating states:

an ingenious solution was devised under the auspices of the OECD. It capitalizes on two phenomena: (1) the concentration of the ultimate parent companies (UPCs) of the world’s most successful multinationals in only a handful of high-tax states; and (2) a current desire among these high-tax states to reduce global tax competition, even if doing so requires severely reducing their own ability to use their tax laws to effectively deliver tax incentives.<sup>34</sup>

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<sup>24</sup> At times even infringing on their tax sovereignty. See Ana Paula Dourado arguing that Pillar 2 introduces taxes in certain jurisdictions that fall on income of companies that are residents of other jurisdictions. See Ana Paula Dourado, *Editorial: The Pillar Two Top-Up Taxes: Interplay, Characterization, and Tax Treaties*, Intertax, 50(5) 395. (2022), doi: 10.54648/TAXI2022045.

<sup>25</sup> Ruth Mason, *The 2021 Compromise*, 172 Tax Notes Fed. 569 (2021).

<sup>26</sup> HM Treasury, *G7 Ministers Agree Historic Tax Deal*, <https://www.gov.uk/government/news/g7-finance-ministers-agree-historic-global-tax-agreement> (accessed 5 May 2021).

<sup>27</sup> See *supra* n. 12, at 4.

<sup>28</sup> See Michael Devereux & John Vella, *A Historic Global Minimum Tax Has Been Agreed! But Has It?* Oxford University Centre for Business Taxation (2021); DIASSO, Sebastien Babou, *Global Minimum Tax Rate: Detached from Developing Country Realities*, Tax Cooperation Policy Brief, No. 23 (2011) <https://www.southcentre.int/tax-cooperation-policy-brief-23-11-february-2022/>.

<sup>29</sup> Some exceptions apply; see the discussion of carve-outs below.

<sup>30</sup> The QDMTT is different from a domestic CIT because it is levied on excess profits as defined by GloBE rules and not on taxable profits as defined by domestic law (Art. 10.1.1 of the Model Rules). Additionally, it is considered as a direct reduction of the top-up tax liability (Art. 5.2.3 of the Model Rules) not as a covered tax for the purpose of calculating the ETR. See OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (2021), <https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm>.

<sup>31</sup> The UPE jurisdiction can levy the top-up tax on what is known as low-tax constituent entities by applying an income inclusion rule (IIR). If the UPE jurisdiction opts-out of Pillar 2, priority will be given to the country where the next intermediate parent entity (IPE) in the ownership chain resides as per Arts 2.1.2. and 2.1.3. of the Model Rules. See *ibid*.

<sup>32</sup> Under-taxed payment rule.

<sup>33</sup> Ruth Mason, *A Wrench in the GLOBE’s Diabolical Machinery*, 107 Tax Notes Int’l 1390, at 1392 (2022).

<sup>34</sup> *Ibid*.

The claim of the OECD is that developing countries will also benefit.<sup>35</sup> 'What do developing countries get out of this deal?' asks the OECD in the brochure advertising it,<sup>36</sup> and replies:

The Two-Pillar Solution ... provides for a global minimum tax, which will help put an end to tax havens, lessen the incentive for MNEs to shift profits out of developing countries, and reduce pressure on developing country governments to offer wasteful tax incentives and tax holidays, while providing a carve-out for low-taxed activities that have real substance. This means that developing countries could still offer effective incentives that attract genuine, substantive foreign direct investment ... Developing countries will gain revenue ... With a rate of 15%, the global minimum tax is expected to generate around USD 150 billion in additional global tax revenues per year. In addition to this, developing countries are expected to gain further revenues under a treaty-based subject to tax rule (STTR) which will allow countries to retain their right to tax certain payments made to related parties abroad which often pose BEPS risks, such as interest and royalties. The subject to tax rule will be made available to all developing countries.

### 3.2 The LDC's Claims Against Pillar 2

Despite this highly convincing case by the OECD, LDCs raised three main complaints regarding the outcomes expected from the new deal.

The first focused on the allocation of the expected tax revenues between states.<sup>37</sup> When the new deal was first

published, it was expected to grant the right to tax excessive profits (that were not taxed by non-cooperative states) to MNEs' countries of residence that are predominantly OECD countries. If this was the case, revenue allocation was biased against the LDCs. However, this complaint was partially addressed later in the process as more details of the deal emerged by allowing a new type of tax. This is the QDMTT that grants source states the possibility to impose soak up taxes on those extra profits.<sup>38</sup> Thus, it addresses the suspected bias in the allocation of tax revenues.

The second complaint focused on LDC's concerns regarding their tax bases.<sup>39</sup> Such countries were long bothered by their dwindling tax bases due to MNEs stripping their local profits using transfer pricing and allocating considerable parts of the MNEs' costs to the LDCs' jurisdictions. This issue was supposed to be dealt with under the subject to tax rule by allowing developing countries to collect increased withholding taxes from the income being stripped.<sup>40</sup> As things proceeded forward, however, the blueprint resorted to a version of the subject-to-tax rule (STTR) that was much less satisfactory to LDCs. Thus, it currently advises that the STTRs will be structured as a stand-alone bilateral treaty rule that will be limited to specific base-eroding transactions carried out between closely related parties<sup>41</sup> and depended on the existence, renegotiation, or signing of a treaty.<sup>42</sup> Its limited scope and complexity as well as the fact that it requires separate treaty negotiations makes the STTRs disappointing as far as LDCs are concerned.

LDCs could, of course, resort to imposing unilateral withholding taxes as the BEPS Monitoring Group has suggested.<sup>43</sup> However, such taxes might not benefit

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<sup>35</sup> See *supra* n. 12.

<sup>36</sup> *Ibid.*

<sup>37</sup> Mr Mathew Gbonjubola, the Group Lead Special Tax Operations Group, and Nigeria's representative at the OECD Inclusive Framework argued that the Two-Pillar Solution may, in fact, have a negative revenue outcome for developing countries; see Don Silas, *Why Nigeria Didn't Sign OECD Minimum Corporate Tax Agreement – FIRS*, <https://dailypost.ng/2021/11/30/why-nigeria-didnt-sign-oecd-minimum-corporate-tax-agreement-firs/> (accessed 30 Nov. 2021).

<sup>38</sup> International organizations representing developing countries claimed that the initial rule order that gave priority to the UPE jurisdictions through the IIR jeopardized developing countries. The QDMTT was thus included in order to address these concerns. See ICRIT, *ICRICT Response to the OECD Consultation on the Pillar One and Pillar Two Blueprints*, <https://www.icrit.com/icrit-documentsoecd-submission> (accessed Dec. 2020); South Centre, *Statement by the South Centre on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, <https://www.southcentre.int/statement-october-2021-3/> (accessed 13 Oct. 2021); ATAF, *130 Inclusive Framework Countries and Jurisdictions Join a New Two-Pillar Plan to Reform International Taxation Rules – What Does This Mean for Africa?*, <https://www.ataftax.org/130-inclusive-framework-countries-and-jurisdictions-join-a-new-two-pillar-plan-to-reform-international-taxation-rules-what-does-this-mean-for-africa> (accessed 1 Jul. 2021); BMG, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, <https://www.bepsmonitoringgroup.org/news/2021/7/31/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy> (accessed 31 Jul. 2021).

<sup>39</sup> See *ibid.*

<sup>40</sup> The Oct. 2021 Statement stressed that the STTR was 'an integral part of achieving a consensus on Pillar Two for developing countries' and, yet the Model Rules released in Nov. did not include a proposal for it. The commentaries suggest that the STTR will take priority in the rule order and be considered as a covered tax under Art. 4.2.1.(d), but they do not clarify the difference between the STTR and other withholding taxes covered by the same provision. Additionally, the OECD postponed the public consultation process on the Model Treaty Provision for the STTR initially scheduled for Mar. 2022 See EY, *OECD Releases Model Rules on Pillar Two Global Minimum Tax: Detailed Review* (2021), [https://www.ey.com/en\\_gl/tax-alerts/oecd-releases-model-rules-on-pillar-two-global-minimum-tax-deta](https://www.ey.com/en_gl/tax-alerts/oecd-releases-model-rules-on-pillar-two-global-minimum-tax-deta).

<sup>41</sup> It will not seek to address a broader treaty policy but will target certain categories of payments that present a greater risk of base erosion (covered payments). As per the Blueprint, the STTR Model Rule – when published – will include a definitive list of the categories of payment to which the STTR will apply, and it is now known that it will only be effectuated when the receiving entity resides in a country that taxes corporate income below a statutory rate of 9%. See OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint-abb4c3d1-en.htm> (accessed 14 Oct. 2020).

<sup>42</sup> See Dourado, *supra* n. 24.

<sup>43</sup> BMG, *supra* n. 39.

from the mitigating mechanisms of the pillars; because they are not part of the cooperative standard, they will presumably not reduce any top-up taxes. If top up taxes are to be collected in addition to such taxes imposed unilaterally by LDCs, they might increase the effective tax rate for investments in the countries that choose to impose them.<sup>44</sup>

The third – and possibly the most important – complaint that LDCs have against Pillar 2 focuses on their ability to make independent decisions regarding the incentives they provide for Foreign Direct Investment (FDI).<sup>45</sup> Unlike developed countries that seem to prefer the limited competition offered by the pillars, many developing countries prioritize their ability to compete for FDI over their tax revenues. Such competition stands at the core of the efforts of Pillar 2. It essentially ensures (through the Income Inclusion Rule (IIR) mechanism) that excess profits (basically profits beyond a certain markup on labour and assets) will be taxed at 15% somewhere. This thus undermines the ability of states to attract FDI by providing tax incentives. Therefore, tax incentives that aim at attracting FDI (and not approved by Pillar 2 guidelines) will only mean that another jurisdiction will collect taxes rather than an incentive being provided. However, Pillar 2 also includes some pre-approved options to allow states to attract FDI.

First, it offers some leeway in creating a ‘substance based income exclusion rule’ Substance-Based Income Exclusion (SBIE) designed to exclude parts of the tax base from the top-up tax thus allowing countries wishing to compete by imposing taxes below the new minimum standard to do so. This exclusion is limited to a predefined part of MNEs’ profits calculated as a 10% presumed return on the value of tangible assets or payroll costs.<sup>46</sup> The results of this limited

competitive arena are yet to be seen as MNEs are expected to react to whatever incentives are offered by states through relocating real activities.<sup>47</sup> Second, Pillar 2 offers ‘preferential’ treatment for certain types of tax incentives,<sup>48</sup> i.e., refundable credits.<sup>49</sup> Singling out refundable credits favours countries that can afford them which is not developing countries.<sup>50</sup> The LDCs, on the other hand, struggle to offer refundable credits due to the restricted cash flow nature of their budget and their concerns regarding their potential for corruption.<sup>51</sup>

The bottom-line is that Pillar 2 seems to relieve the competitive pressure for residence countries by applying a minimum tax of 15%. Yet, since it is still based on the separate entity rationale and further develops MNEs’ internal profit allocation, it fails to resolve the structural problems of profit allocation between developing and developed countries. The QDMTT – although certainly an improvement regarding the allocation of tax revenues – only partially addresses the LDCs’ concerns. Thus, although the priority rule it sets effectively prevents the transfer of some tax revenues from host countries to countries of residence, it does not allow the former to curtail intercompany payments that erode their tax base.<sup>52</sup> Finally, Pillar 2 prevents developing countries from competing for FDI both among themselves and vis-à-vis developed countries. The results of this anti-competitive rule are not yet evidenced.

## 4 AN OLD NEW STORY: COOPERATION AND ITS DISCONTENTS

Many of the efforts of the international tax community in the past 100 years were devoted to promoting international tax cooperation. Cooperation was featured as a

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<sup>44</sup> As Victoria Perry explains in the STTR context: ‘A mandatory increase in previously negotiated low or zero withholding rates under the STTR will – unlike the QDMTT case – result in a higher tax burden on investment subject to the provisions. If the payor (source) country does not choose to impose higher withholding tax through the STTR, neither would higher taxes be paid elsewhere. This is a tax competition issue ... In essence, this gives source countries that are parties to covered treaties the opportunity for reconsideration and mandatory revision of those treaties – again, should they so choose. Under the current structure, LDCs may be better served by incorporating the QDMTT into their domestic regulations. The QDMTT will still, however, not allow LDCs to regain the tax base eroded by intercompany payments’. See Victoria Perry, Article: Pillar 2, *Tax Competition, and Low Income Sub-Saharan African Countries*, 51(2) Intertax 105–117 (2023), doi: 10.54648/TAXI2023004.

<sup>45</sup> *Ibid.*

<sup>46</sup> Making Pillar 2 more of a mechanism fighting paper profit shifting than a minimum global tax. As Victoria Perry has argued *ibid.*: ‘Adoption of the SBIE goes to the very heart of the intention behind Pillar 2 and an international minimum effective tax rate. Was the purpose to impose a basic, unavoidable, level of income taxation on international taxable profits wherever and however derived? Or rather, was it to adopt another post-BEPS, perhaps more effective, defense against artificial shifting of easily moved income? If the former, a substance based carve out does not make sense. If the latter, it may, as a simplified approach to determining something akin to the idea of economic rents (though not identical therewith), implicitly assumed to be derived largely from mobile factors of production – generally, intangible assets’. See *ibid.*

<sup>47</sup> Heydon Wardell-Burrows, *MNE Strategic Responses to the GloBE Rules*, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4231683](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4231683) (accessed 27 Sep. 2022).

<sup>48</sup> Other types of incentives will not be protected by the regime. Thus, non-qualified refundable tax credits and other tax credits or incentives (non-qualifying tax incentives) will be subtracted from the numerator, reducing the total amount of covered taxes for the purpose of computing the ETR (Art. 4.1.3.(b)).

<sup>49</sup> In short, if the tax credits become refundable in four years, they will be deemed qualified refundable tax credits (QRTCs) and may be treated as additional income of the constituent entity, thus adding to the denominator for purpose of calculating the ETR (Art. 4.1.2.).

<sup>50</sup> Developed countries are in a more advantageous position to adapt their current tax incentives to meet the pillar’s requirement. The UK’s R&D expenditure credit, e.g., already meets the requirements to be considered a QRTCs. Similar economies are likely to follow the same strategy. As Victoria Perry notes: ‘Refundable CIT credits are perhaps the one approach not frequently used now as an incentive in low-income countries. ... systems that require in effect writing checks by government are (sometimes rightly) viewed as ripe for evasion and corruption’. See Perry, *supra* n. 44.

<sup>51</sup> See Nupur Jalan, *Can Subsidies Replace Tax Incentives?*, J. Int’l Tax. (2021); UNCTAD, *Tax Incentives and Foreign Direct Investment, A Global Survey. ASIT Advisory Studies. United Nations Publications, Geneva* (2000), [https://unctad.org/system/files/official-document/iteipcmisc3\\_en.pdf](https://unctad.org/system/files/official-document/iteipcmisc3_en.pdf). Indeed, the key difference between the QRTCs and other tax incentives is that the former can entail direct costs to the granting jurisdictions because they undertake the obligation of ‘refunding’ certain amounts even if the constituent entity has no tax liability.

<sup>52</sup> The QDMTT may benefit investment hubs more than developing countries since they are the recipients of the passive income that erodes the tax base of the latter and thus have the right to tax this income under their domestic CITs and the QDMTT. See BMG, *supra* n. 39.

miracle wand that would resolve the maladies of international taxation from cases of double taxation to harmful tax competition, racing tax rates to a suboptimal bottom, and tax avoidance. These efforts were always described as promoting efficiency and justice in an effort to overcome collective action problems that undermine mutually desirable goals. In fact, however, the story of international taxation has been (perhaps not surprisingly) one under which some actors (notably OECD countries) used cooperation as a vehicle to promote their own interests that was sometimes at the expense of others.

The best example for this is, in fact, the most successful cooperative mechanism in international taxation – the impressive spread of the bilateral tax treaties regime under which pairs of countries sign treaties to alleviate what is portrayed as a classic collective action problem, i.e., double taxation. Over 3,000 treaties have been signed to date with the vast majority of them adhering to not only similar patterns but to an almost identical language that is compatible with a model designed and interpreted by the OECD.<sup>53</sup> Thus, the tax treaties apparatus became to be seen by many as an international tax regime in crystallization.<sup>54</sup> Under the official story, if not for a treaty, had the host and residence countries followed their interests and each were to tax both incoming and outbound investments, double taxation would prevail. This would consequently harm the interests of residence and source countries alike by curtailing cross-border investments. Under a treaty, on the other hand, each country forfeits some of its taxing powers in order to

facilitate cross border investments, thus benefiting both residence and host countries. In fact, however, while the official story claims that the reduction of tax revenues for host countries is compensated by the increase in FDI under a treaty, theoretical research,<sup>55</sup> and empirical evidence are mostly inconclusive.<sup>56</sup> If treaties do not increase FDI, then the claim that treaties benefit both signatories in reducing double taxation is false. Instead, the reduction in tax revenues that host countries incur is simply the price they pay in order to belong in the ‘tax treaties club’.<sup>57</sup>

The past years have seen a host of multilateral efforts<sup>58</sup> led by the OECD in an attempt to effectively address the failures of the international tax market of states walking a fine line between regulating the market and protecting sovereignty that states are keen to preserve. These moves were criticized for not being responsive enough to developing countries. This criticism seems to have encouraged the OECD to advance wider participation in its most recent cooperative accord known as ‘the inclusive framework’.<sup>59</sup> The inclusive framework was celebrated by many and culminated in over 140 jurisdictions joining it.

It is easy to be taken by the hopeful potential of cooperation. It seems like a text-book answer for the inherent problems (e.g., a race to the bottom, transaction costs, and lack of transparency) that plague the competitive international tax market. Moreover, it is allegedly based on the attractive concept of consent rather than power. It should thus not be surprising that cooperation was enthusiastically advocated as universally beneficial.<sup>60</sup>

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<sup>53</sup> Elliott Ash & Omri Marian, *The Making of International Tax Law: Empirical Evidence from Natural Language Processing*, 24 Fla. Tax Rev. (2020).

<sup>54</sup> Yariv Brauner, *An International Tax Regime in Crystallization*, 56(2) Tax L. Rev. 259 (2002).

<sup>55</sup> Dagan, *supra* n. 16.

<sup>56</sup> For a useful review of the literature, see Fabian Barthel et al., *The Relationship Between Double Taxation Treaties and Foreign Direct Investment*, in *Tax Treaties: Views From The Bridge – Building Bridges Between Law and Economics* 16 (Michael Lang et al. eds 2010); Rebecca M. Kysar, *Unraveling the Tax Treaty*, Minn. L. Rev. (104 Min. L. Rev. 1755 (2020)) (2019); Dagan, *supra* n. 19, at 108–10; IMF, *Spillovers in International Corporate Taxation* 26 (2014), <https://www.imf.org/external/np/pp/eng/2014/050914.pdf>: ‘The empirical evidence on the investment effects of treaties is mixed ... Identifying causality is inherently problematic, since treaties may precede investment not because they spur the latter but because they may be concluded only when there is an expectation of such investment. (This can be a deliberate feature of treaty policy, as it traditionally has been in the US). Studies using macro-level data indeed find a wide range of effects, though perhaps with some signs that a positive effect on FDI is most likely for middle-income countries. Work using firm-level data finds a significant impact on firms’ entry into a particular country, though not on the level of their investment once they are present’.

<sup>57</sup> See also Eric M. Zolt, *Tax Treaties and Developing Countries*, 72 Tax L. Rev. (2020).

<sup>58</sup> Famous among these are BEPS, CRS, and the more recent MLI and the OECD ‘pillars’ on the digital economy. See e.g., European Commission, *COUNCIL DIRECTIVE 2011/16/EU on Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC* 9 (2019), <https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32011L0016>; OECD, *Action Plan on Base Erosion and Profit Shifting*, *supra* n. 3; OECD, *CRS by Jurisdiction*, <https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction/>; OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, <https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf> (accessed 31 May 2019). For a description of some of the recent cooperative accords, see also Dagan, *supra* n. 19, Ch. 5.

<sup>59</sup> Yariv Brauner, *The Multilateral Instrument as a Platform for Co-ordination of International Tax Policies*, 4 Brit. Tax Rev. 437 (2019); The OECD followed up in Feb. 2016, presenting a more concrete idea for the inclusive framework to G20 finance ministers at their Feb. 26–27 meeting in Shanghai. It proposed that all non-OECD and non-G20 jurisdictions that are interested in and committed to the BEPS Project receive ‘BEPS associate’ status in the OECD’s Committee on Fiscal Affairs (CFA), the organization’s decision-making body on tax issues. By doing so, it was claimed that these jurisdictions would have just as much influence in BEPS standard setting, implementation, and monitoring as the OECD and G20 countries.

<sup>60</sup> See e.g., OECD, *Addressing Base Erosion and Profit Shifting* (2013): ‘Though governments may have to provide unilateral solutions, there is value and necessity in providing an internationally co-ordinated approach. Collaboration and co-ordination will not only facilitate and reinforce domestic actions to protect tax bases, but will also be key to provide comprehensive international solutions that may satisfactorily respond to the issue. Co-ordination in that respect will also limit the need for individual jurisdictions’ unilateral tax measures’. *Ibid.*; Base Erosion and Profit Shifting Project, *Explanatory Statement*, <https://www.oecd-ilibrary.org/docserver/9789264263437-en.pdf?expires=1683433035&id=id&accname=guest&checksum=484B1C73D12AAE7DD01D5C9BA3661D44In> a globalized economy, governments need to cooperate and refrain from harmful tax practices, to address tax avoidance effectively, and provide a more certain international environment in order to attract and sustain investment. Failure to achieve such cooperation would reduce the effectiveness of CITs as a tool for resource mobilization which would have a disproportionately harmful impact on developing countries. In fact, the claim is that it is actually developed countries that reject developing countries’ requests to enter into such treaties and not vice versa. *Ibid.*



However, even when all (or most) parties get a seat at the table, the results may not work to the benefit of all – as could be seen in the dissatisfaction with the cooperative accord expressed by so many, including jurisdictions that have signed up to join it.

#### 4.1 *Is LDCs' Consent Proof That the Deal Is Good for Them?*

Why, then, might countries that consent to such an international accord join it if it does not serve them properly, and – even more interesting – if they consent, is it not proof that the deal is beneficial to them? Countries' consent against their best interest might be explained by the lack of experience or lacking expertise of one of the negotiating parties.<sup>61</sup> It may be a result of the application of political power by strong countries<sup>62</sup> or by differences in bargaining power enjoyed by various actors. However, the interesting point from a strategic perspective is that, even when the parties are not explicitly coerced into signing and even if they received the best advice available, the results may benefit some more than others.

In what follows, I explain that the structure of the international tax system places some states in a position where they might willingly cooperate even though, ex ante, they would have preferred cooperation not to have evolved or that a different standard would have emerged.

Two features of the current negotiations can demonstrate this claim. One is the ability of the OECD to control the agenda, and the other is the structure of the game that promote cooperation.<sup>63</sup>

*Controlling the Agenda:* In the past decades, the OECD controlled the international tax agenda. Developed countries benefited from their ability to cooperate among themselves and from their 'first mover' advantage.<sup>64</sup> In operating the international agenda, they attempted to address specific issues separately and naturally focused on those that best served their own interests.<sup>65</sup> The first issue

on the international tax agenda was double taxation – an issue that concerned OECD countries from the outset. This was dealt with first (and separately from issues that came to the forefront later in the process) by allocating taxing rights between source and residence countries. Only later did countries (led by the OECD) turn to other issues such as information sharing or tax competition. Profit shifting and base erosion were confronted only after the 2008 crises whereas the two-pillar solution was proposed only quite recently.<sup>66</sup> The international tax agenda was thus 'sliced' into steps. Since each topic was separately considered, parties were unable to consider trade-offs.<sup>67</sup> Each such step yielded some benefit for developed countries and presumably also to other cooperating countries. Together, however, these steps created a regime that is not favourable to developing countries. The international tax system has established a few leading principles beginning with the 1923 league of nations' report. It allocated taxing rights among countries between source and residence countries and further recognized the separate entity of corporations and, importantly, the arms' length principle. These standards, while appropriate in the initial stages of international taxation, became increasingly lacking with changing times. In fact, they became the background conditions allowing much of the fragmentation of international taxation and, together with the mobility of capital and residents, yielded tax planning opportunities and states' tax competition.

The recent Pillar 2 proposal did not challenge many of these basic principles but rather adhered to the same path. It thus opted for 'fixing' the current system rather than testing novel ideas that would overhaul it.<sup>68</sup> This explains, for example, why LDCs' complaints of their dwindling tax bases (due to allocation of costs between corporate entities) were not seriously addressed (the STTR notwithstanding). In any event, while the proposals that were brought to the table were not necessarily harmful for developing countries, the lack of a forum to discuss their (other) complaints undermined their interests.<sup>69</sup>

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<sup>61</sup> This is as much true now as it was in the past. LDCs are seldom informed of the risks involved in negotiating tax treaties. See e.g., Charles R. Irish, *International Double Taxation Agreements and Income Taxation at Source*, 23(2) Int'l & Comp. L.Q. 292–316 (1974), doi: 10.1093/iclqaj/23.2.292; Martin Hearson, *When Do Developing Countries Negotiate Away Their Corporate Tax Base?*, 30(2) J. Int'l Dev. 233 (2018), doi: 10.1002/jid.3351 and references there.

<sup>62</sup> Vella notes: 'Although countries participate on "an equal footing" in the Inclusive Framework, some countries, unsurprisingly, are more equal than others. This affects powerful countries, which had to wait for the US's green light before moving forward at different points. But it particularly affects less powerful countries which, it is suggested, were leaned on to join the agreement, or, in practice, were given little choice'. See Vella, *supra* n. 23, at 515.

<sup>63</sup> Other reasons may be strategic positions of developing states vis a vis one another and differing cooperative abilities among groups of countries (specifically OECD and other groups of countries). For an analysis, see Dagan, *supra* n. 19.

<sup>64</sup> For a detailed discussion of the first mover advantage, see Martin Hearson, *Imposing Standards* (Cornell University Press 2021).

<sup>65</sup> Dagan, *supra* n. 19, Ch. 5 – cooperation and its discontents.

<sup>66</sup> Mason, *supra* n. 25.

<sup>67</sup> Thus, e.g., developing countries were unable to renegotiate the allocation of taxing rights when information sharing was discussed, although, had the issues been jointly considered, developing countries might have been able to successfully achieve a more advantageous agreement in exchange for their willingness to share information.

<sup>68</sup> But see in comparison the newly allocated taxing rights to market countries see Richard S. Collier & Michael P. Devereux, *On Why It Really Is Such A Big Deal*, <https://oxfordtax.sbs.ox.ac.uk/article/on-why-it-really-is-such-a-big-deal> (accessed 2 Jul. 2021).

<sup>69</sup> Once a proposal is introduced, a decision needs to be made on whether to adopt it based on the current state of affairs. Many of the proposals were based on the same basic principles, and thus the principles themselves were not renegotiated.

*The structure of the game:* The second reason for why the structure of the international tax game may yield results that are biased in favour of developed countries is strategic. Pillar 2 is a cooperation-enhancing mechanism for two types of countries, i.e., those where MNEs reside (home countries) and countries where they invest (host countries). Broadly speaking, developing countries tend to be host countries while developed countries are more likely than others to serve as home countries.

As mentioned earlier, Pillar 2 offers a coordination mechanism for cartelistic behaviour. The mechanism is designed to allow countries to coordinate not only the cartelistic ‘price’ (15% tax) but also the punishing mechanism for non-compliers (a top-up tax imposed by any cooperating country). For home countries – the initiators of this cartel – the goal was to have MNEs pay at least 15% taxes *somewhere* (although, obviously, each state would presumably rather maximize its own tax revenues if possible). Whether they were focusing on curtailing tax competition or preventing profit shifting, the goal was arguably to establish a floor on corporate taxation.

The value of such a mechanism is derived from the fact that multiple users adopt it. Thus, while a single country imposing a tax would be subject to competition by other jurisdictions, where multiple actors collude on a set price such competitive pressure would be curbed. Although a cartel is always vulnerable to defection, the punishing mechanism introduced by Pillar 2 reduces the incentive of individual actors to defect and increases the incentive of other countries to cooperate. Simply stated, if a country refuses to collect the cartelistic ‘price’, other countries will intervene and impose it in its stead (in the form of a top-up tax).<sup>70</sup> Thus, in effect, the complying countries extend their power to have MNEs pay 15% tax *beyond* their own jurisdictions. Assuming that a critical mass of complying jurisdictions evolves, the power of MNEs to escape taxation diminishes along with the power of non-complying countries to offer an alternative.<sup>71</sup>

According to the deal, participating countries need to share some of the tax revenues they collect with other complying countries. Thus, presumably, increasing the number of participants is not in the best interest of each participant as it might reduce their tax revenues. and yet, I argue that countries have an interest in increasing the number of participants. This is due to the fact that their main interest, and the one they prefer even over collecting more revenues is preventing competition. Thus, at least up to a certain level (the creation of a critical mass), the value of Pillar 2 for participants increases with the addition of new participants by reducing the threat of competition.<sup>72</sup> Similarly, the greater the number of complying jurisdictions, the lower the benefit for non-compliant (or defecting) countries from being able to attract MNEs to reside in their jurisdiction by way of lowering their tax ‘prices.’ The reason for that is that reducing their taxes does not necessarily mean that MNEs will be subject to lower overall taxes. Instead, to the extent they have subsidiaries in some complying jurisdictions – these MNEs are going to be subject to taxes in such complying jurisdictions anyway.<sup>73</sup> Since home countries are unable to attract MNEs to reside in their jurisdictions by offering them reduced tax ‘prices’, their second-best option is to at least benefit by collecting whatever taxes they. Hence, the incentive is for home countries to join the agreement even if, in its absence, they would rather compete for resident MNEs.

The mechanism also encourages host countries to join.<sup>74</sup> Although some of them might have preferred competing for investments, they are left with their second-best option, i.e., to collect whatever taxes the agreement prescribes them.<sup>75</sup> Importantly, they are prompted to adopt a specific model of rules and a detailed set of guidelines.<sup>76</sup> When their systems match the model, the taxes they collect are considered ‘recognized’ taxes and thus bar any top-up taxes from being imposed by other complying countries. Similarly, when their timing rules are synched with those

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<sup>70</sup> But see Michael Devereux, John Vella, & Heydon Wardell-Burrows, *The Impact of the Global Minimum Tax on Tax Competition*, World Tax J. (2022). Technically, it would not create an incentive for countries to increase their corporate tax rates to 15%, although some countries may well choose to respond in this manner for political or other reasons.

<sup>71</sup> If they decided not to impose 15% taxes and assuming ‘their’ MNEs have some presence in other complying states, such other states may impose the 15% as a top-up tax. This, of course, assumes that MNEs will be reluctant to cease their activity in such other complying states.

<sup>72</sup> It is true that, once critical mass has been reached, additional participants may decrease the tax revenues without reducing the risk of competition. Yet, this is the case in many networks.

<sup>73</sup> Intermediary entities in the ownership chain may be subjects to the IIR if the UPE jurisdictions opt-out.

<sup>74</sup> Implementation of the GloBE rules by a critical mass of countries would create incentives for others to also implement them or to respond by adopting a qualified domestic minimum top-up tax. See the discussion in Michael Devereux, *International Tax Competition and Coordination With a Global Minimum Tax*, National Tax J. (2022), doi: 10.2139/ssrn.4335055. John Vella, *The Two Pillar Solution One Year on*, (5) Brit. Tax Rev. 508 (2022), Thomson Reuters and Contributors notes: ‘What constitutes a “critical mass” for these purposes is an open question, but work by colleagues at the Oxford University Centre for Business Taxation suggests that even the G7 countries could suffice’.

<sup>75</sup> As Argentine Economy Minister Martin Guzman argued ahead of a last push to clinch a deal: ‘Global talks to rewrite the rules of cross-border corporate taxation have so far failed to reflect the concerns of developing nations ... We policymakers from developing countries are forced to choose between something bad and something worse, worse is to get nothing and bad is what we are getting ...’. See Leigh Thomas, *Developing Countries Get Short Shrift in Global Tax Deal-Argentina*, <https://www.reuters.com/article/global-tax-argentina-idTRNLI1N2R31UH> (accessed 7 Oct. 2021).

<sup>76</sup> Under the Oct. 8th statement, countries ‘are not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, including in light of model rules and guidance agreed to by the IF’.

of other complying states and when the incentives they provide (e.g., payable credits) are recognized, no top-up taxes should be imposed. If, on the other hand, the incentives they provide or the taxes they impose are incompatible with the model, MNEs operating within their jurisdictions may face increased taxes and thus undermine their competitiveness.

The inclusive framework was promoted as an effort to provide non-OECD G20 countries a platform to participate on an equal footing with OECD countries. However, as has been seen in the bilateral context, (even) having a seat at the table is not enough to guarantee desirable results. As Hugh Ault recently stated, ‘Under the mantra of tax cooperation, [developing] countries are often coerced into adopting measures which are not in their own interests when the overall situation is taken into account’.<sup>77</sup> Cooperation – despite its benefits – has its drawbacks, and its results are not necessarily desirable for all or even those who participate in the negotiations.

With the control of a critical mass of cooperating states<sup>78</sup> and with a hold on the agenda, the OECD is bound to have excessive power over participating states. This, I believe, raises some serious concerns going forward.

## 5 POTENTIAL FUTURE RISKS FOR LDCs

The structure of Pillar 2 along with the power of the OECD to control the agenda is cause for special concern entailing two major risks. One is lock-in, and the other is providing extreme power to those in control of the standard and the agenda, in this case, the OECD.

The lock-in effect makes a spontaneous shift to an alternative agreement unlikely and one with a different critical mass emerging very difficult to build. Other ideas for rebuilding the international tax regime, even if superior, have fewer chances of infiltrating the international tax market and certainly not dominating it.<sup>79</sup> Even more than other cases of path-dependence, Pillar 2 may be particularly hard to challenge due to the fact that its application requires domestic legislation within the countries

adopting it. This requirement makes the agreement of a critical mass more difficult to attain as the sheer signing of the agreement by the state is not enough. Rather, each state should enlist its domestic political institutions to adopt Pillar 2-compatible legislation. However, the harder it is to reach a critical mass, presumably the greater efforts needed to change course in the future *after* the event. Thus, if successful, Pillar 2 might be stickier going forward.

An effort by the UN is currently being seen to take a more active part in the international tax scene.<sup>80</sup> Despite the desirability of offering an alternative to the emerging new international tax regime, it might be wondered whether this move by the UN may be too late once wide agreement to and domestic adoption of Pillar 2 are achieved.

The power to control the agenda further amplifies the power of the OECD going forward. In controlling the agenda, it has the power to push forward new guidelines, safe harbours, and standards that serve the interests of its members.<sup>81</sup>

The implementation framework will be fundamental to the success of the GloBE, but it is also likely to be a critical moment for countries with different views. This could unfortunately also be an opportunity for agenda-setters to stall on ideas that may be important for developing countries.<sup>82</sup>

In short, by controlling the standard, the OECD will have considerable control over its implementation and is thus capable of increasing the price for non-owners.

## 6 CONCLUSION: POSSIBLE SOLUTIONS

The architects of Pillar 2 claim that the deal is a pareto-optimal solution. They state that it would increase the collective tax revenues pie to such a level that even the thin slice that some countries will be entitled to would compensate for the costs associated with the deal and would thus yield a net benefit compared to the current situation. Time (and empirical studies) will tell whether this is, in fact, the case.

### Notes

<sup>77</sup> Hugh Ault, *Tax Competition and Tax Cooperation: A Survey and Reassessment*, in *International Taxation in a Changing Landscape: Liber Amicorum in Honour of Bertil Wiman* (Jérôme Monsenego & Jan Bjurberg eds, Wolters Kluwer 2019).

<sup>78</sup> OECD, *Global Anti-Base Erosion Model Rules (Pillar Two) – Frequently Asked Questions* (2021), <https://www.oecd.org/tax/beps/pillar-two-model-GloBE-rules-faqs.pdf>, specifically highlights the fact that ‘a critical mass of jurisdictions’ needs to adopt Pillar 2.

<sup>79</sup> See Dagan, *supra* n. 19, at 174–176.

<sup>80</sup> See General Assembly Resolution on ‘Promotion of Inclusive and Effective Tax Cooperation at the United Nations’ (A/RES/77/244). See also *The 2023 Tax Report of the Committee on Economic and Social Affairs*, <https://www.un.org/development/desa/financing/tax-report-2023#:~:text=On%2030%20December%202022%2C%20the,aggressive%20tax%20avoidance%20and%20evasion> (accessed 30 Dec. 2022), the General Assembly adopted a resolution on ‘Promotion of inclusive and effective tax cooperation at the United Nations’ that reaffirms earlier international commitments to scale up international tax cooperation, fight illicit financial flows and combat aggressive tax avoidance and evasion. The resolution decides to begin intergovernmental discussion at the United Nations Headquarters in New York on ways to strengthen the inclusiveness and effectiveness of international tax cooperation. It does so without calling for or ruling out an international tax cooperation framework or instrument that is developed and agreed upon through a United Nations intergovernmental process’.

<sup>81</sup> For the most recent guidelines, see OECD, *International Tax Reform: OECD Releases Technical Guidance for Implementation of the Global Minimum Tax*, <https://www.oecd.org/tax/beps/international-tax-reform-oecd-releases-technical-guidance-for-implementation-of-the-global-minimum-tax.htm> (accessed 2 Feb. 2023).

<sup>82</sup> This may be a possible explanation for why the STTR has been delayed. As to how helpful it is for developing countries even if it is promoted, see Dourado, *supra* n. 24; Heydon Wardell-Burrows, *Pillar Two and Developing Countries: The STTR and GloBE Implementation*, Oxford University Centre for Business Taxation Working Paper, WP 22/13 (2022).

The fact that LDC countries sign up to this deal may – at best – indicate that, given the choice of taking this deal at this time or staying behind when the rest of the world moves on with it, the latter was better for them. If its architects are correct, it may even mean that the deal is better for them than the current no-deal reality.

Yet, even if this claim is true in terms of tax revenues, the complaints raised by LDCs focus on two additional aspects of the deal that deserve consideration. The first is the classic ‘compared to what’ question. Even if the deal is indeed an improvement relative to the current situation, there could still be another alternative that the parties could pursue that might be even more beneficial for all or some of them.

Moreover, should LDCs not be able to dispute and renegotiate the very baseline on which the deal is premised? Does global justice not demand that they receive greater rather than lesser benefits than other countries involved in the negotiations?<sup>83</sup> Finally, if LDCs do consent to the current regime, are they making a decision that endorses

the Inclusive Framework (IF) to an extent that it might take them in a direction that would undermine their interests in the future?

It is hard to tell what the future entails for this cooperative accord. The impressive agreement of dozens of states may be too significant to roll back, and the positive signal from the EU directive is surely a significant indication of a momentum supporting the cooperative accord.<sup>84</sup> Yet, in the current situation, the future of the deal and certainly its success is still not entirely clear.<sup>85</sup> Pascal Saint-Amans, the OECD’s departing tax chief who ‘masterminded the most radical reforms to corporate taxation for almost a century’, has warned that the United States and Europe risk reviving trade wars and face hundreds of billions of dollars in lost revenue if they fail to implement last year’s global deal.<sup>86</sup> This article in turn warns of a reform that is perhaps too successful thus securing a deal that is less than ideal – at least for some of the countries – for the long run.

## Notes

<sup>83</sup> For an argument that the current regime, in leveraging on the collective power of states, imposes a duty of justice beyond national borders, see Tsilly Dagan, *International Tax and Global Justice*, 8 Theoretical Inquiries L. 1 (2017), doi: 10.1515/til-2017-0002; See also Dagan, Tsilly, *Re-Imagining Tax Justice in a Globalized World* (2020), doi: 10.2139/ssrn.3602678; Mathias Risse & Marco Meyer, *Tax Competition and Global Interdependence*, 27(4) J. Pol. Phil. 480–98 (2019), doi: 10.1111/jopp.12185; Ivan Ozai, *Two Accounts of International Tax Justice*, 33(2) Can. J. L. & Juris. 317–339 (2020), doi: 10.1017/cjlj.2020.8; Laurens van Apeldoorn, BEPS, *Tax Sovereignty and Global Justice*, 21(4) Critical Rev. Int’l Soc. & Pol. Phil. 478–499 (2018), doi: 10.1080/13698230.2016.1220149.

<sup>84</sup> However, see the recent EU directive noting that ‘Moreover, in a separate process, the OECD Inclusive Framework will establish conditions under which the US GILTI regime will co-exist with the GloBE rules, to ensure a level playing field’. EU, *Proposal for a Council Directive on Ensuring A Global Minimum Level of Taxation for Multinational Groups in the Union* 11, [https://eur-lex.europa.eu/resource.html?uri=cellar:fa5dbfaf-633f-11ec-9136-01aa75ed71a1.0001.02/DOC\\_1&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:fa5dbfaf-633f-11ec-9136-01aa75ed71a1.0001.02/DOC_1&format=PDF) (accessed 22 Dec. 2021).

<sup>85</sup> Despite these developments, John Vellasp words (argued back in 2021) still seem relevant: formatogress stutters and cracks in this broad coalition of countries become more prominent, countries that joined the agreement despite reservations may then start agitating more vigorously for change. But this is only one possible scenario. The road ahead may be significantly more, but also significantly less, bumpy. It is hard to tell’. see Vella, *supra* n. 62.

<sup>86</sup> Mary McDougall, *OECD Tax Chief Warns of Trade Wars if Global Deal Is Not Implemented*, Financial times in London, <https://www.ft.com/content/fd64cff6-3fa8-4c44-8eb1-069b4a7e0d96?segmentId=114a04fe-353d-37db-f705-204c9a0a157b> (accessed 31 Oct. 2022).