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In this article, the authors examine the status of the OECD's two-pillar approach to modernizing the international tax system and consider the international implications of the different paths countries are taking to implement pillars 1 and 2.

In October 2021 the OECD inclusive framework on base erosion and profit shifting claimed victory in its effort to address the tax challenges arising from the digitalization of the economy by reaching agreement on a two-pillar solution.[1] Pillar 1 would change the way taxing rights over the largest, most profitable multinationals are allocated among countries,

[1] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy" (Oct. 8, 2021). The statement recognized that four members of the inclusive framework — Kenya, Nigeria, Pakistan, and Sri Lanka — did not sign on to the two-pillar solution, a position those countries had retained as of the publication of this article.

while pillar 2 would introduce globally coordinated minimum effective tax rules.

Political considerations meant the two pillars have always been presented as a package deal. Some countries wanted to change where big businesses (primarily U.S. tech companies) paid taxes; others wanted to introduce minimum effective tax rules. So the OECD put together a package with both. In October countries agreed that the two pillars should be implemented together, and come into effect in 2023.

However, in recent months, it has become increasingly apparent that the pillars' paths are diverging. The OECD has published model rules and commentary that give countries the main tools they need to introduce pillar 2 but has yet to reach a similar agreement on pillar 1.

This article explores the pillars' status and considers what might come next.

Pillar 2

Although one usually comes before two, for the OECD's two-pillar solution, it is increasingly likely that pillar 2 will be implemented well in advance of pillar 1.

The OECD has moved at lightning speed (at least in the context of international tax reform), releasing pillar 2 model rules on December 20, 2021,[2] and commentary to the model rules on March 14.[3] Although the OECD is still working on administrative guidance, an implementation framework, and the subject-to-tax rule (STTR),[4] the implementation of pillar 2 is now largely in the hands of national governments.

To understand why pillar 2 is likely to precede pillar 1, we need to look at the legal process for implementing it — or, more precisely, the income inclusion rule and undertaxed profits rule, which together make up the global anti-base-erosion (GLOBE) rules.[5]

First, the GLOBE rules agreed by the inclusive framework have the status of a common approach. That means there is no obligation for countries to implement the rules but that if they choose to, they must do so in a way that is consistent with the model rules and commentary agreed by the inclusive framework.[6] So in simple terms, the OECD has provided the model for the GLOBE rules, but it is only through action by national legislatures that the rules can be brought to life.

Second, the inclusive framework has agreed that there are no existing legal impediments to countries applying the GLOBE rules and, importantly, that the rules are not incompatible with existing bilateral tax treaties.[7] That means that, from the inclusive framework's perspective, countries are free to implement the GLOBE rules without needing to renegotiate their existing tax treaties, clearing a relatively smooth path to implementation. That said, the commentary to the model rules implicitly acknowledges that there are questions about the compatibility of applying the UTPR through an "equivalent adjustment" with existing treaties and emphasizes that such a mechanism would need to be coordinated with existing international obligations.[8] That hints at the potential for both disputes and legal challenges down the line, depending on how the UTPR is ultimately implemented.

So are countries on the road to implementation by 2023?

As has been widely reported, the Biden administration's efforts to reform the global intangible low-taxed income regime to align with the GLOBE rules through the Build Back Better Act (H.R. 5376) have slowed since the turn of the year, and it is far from clear that U.S. lawmakers are willing to support such a change.

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[2] OECD, "Tax Challenges Arising From the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)" (Dec. 20, 2021).

[3] OECD, "Tax Challenges Arising From the Digitalisation of the Economy — Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)" (Mar. 14, 2022).

[4] Pillar 2 has two components: interlocking domestic rules, consisting of the income inclusion rule and undertaxed profits rule; and the treaty-based STTR. Although the inclusive framework has reached agreement on the IIR and UTPR, it has yet to reach agreement on the STTR.

[5] The final part of the GLOBE architecture is the qualifying domestic minimum top-up tax (QDMTT). Although QDMTTs are referenced throughout the GLOBE model rules and commentary, neither prescribes how countries should implement them.

[6] OECD, *supra* note 1, at 3.

[7] OECD, "Tax Challenges Arising From Digitalisation — Report on Pillar Two Blueprint: Inclusive Framework on BEPS," at 173-177 (Oct. 14, 2020).

[8] OECD, *supra* note 3, at article 2.4.1.

The EU has also found it difficult to agree to a directive that would require its 27 members to implement the GLOBE rules from December 31, 2023 (effectively a 12-month delay in implementation to 2024). For the past few months, Poland had been the final holdout, withstanding significant pressure from other members and a visit from U.S. Treasury Secretary Janet Yellen. Poland's stated objection to implementing pillar 2 was that the two pillars were meant to be a package deal, and as discussed below, the future of pillar 1 is far from certain.

In the last round of EU negotiations, the dispute with Poland looked to have finally been resolved via a compromise under which the European Commission would monitor pillar 1 progress from June 30, 2023, and if appropriate, in the absence of a pillar 1 solution, submit a legislative proposal to address taxation of the digital economy.[9] That compromise almost led to the groundbreaking result that the EU managed to adopt its pillar 2 directive — before Hungary backtracked from its earlier support for the proposal, vetoing it at the 11th hour and saying the rules would significantly reduce EU and Hungarian tax competitiveness. Given Hungary's previous support, its volte-face could be considered a strategic maneuver to secure concessions in other outstanding files with the EU, primarily over rule-of-law breaches and disputes over EU funding.[10] The French EU presidency worked incredibly hard to reach an agreement before its presidency ended July 1, and the incoming Czech presidency is expected to continue to prioritize this file in the months ahead.

With the continuing absence of an EU agreement, most observers have been watching Canada and the United Kingdom as countries that are most likely to implement pillar 2 first. Both have released public consultations that indicate they intend to introduce the IIR from 2023 and the UTPR from 2024, in line with the implementation dates agreed by the inclusive framework. On June 14 the United Kingdom published a letter reemphasizing its intention to implement the GLOBE rules but only for accounting periods beginning on or after December 31, 2023.[11] At this stage, the Canadian government has not given any indication whether it will also delay implementation of the GLOBE rules, although there is every chance it seeks safety in numbers and adopts the same implementation date as the United Kingdom (and probably the EU).

Jurisdictions that would traditionally have been thought of as investment hubs, such as Hong Kong, Mauritius, Singapore, Switzerland, and the United Arab Emirates, have all indicated that they will likely implement at least part of the pillar 2 rules. In particular, it seems likely that those jurisdictions will introduce qualifying domestic minimum top-up taxes (QDMTTs) to ensure that other countries are not able to tax their low-taxed profits. The U.K. commitment to implement the GLOBE rules from December 31, 2023, and likely implementation by the EU, sets those jurisdictions a clear timetable for implementing QDMTTs.

Some observers are still asking whether pillar 2 will ever happen. While you should never say never, it seems unlikely that the OECD — or anyone else for that matter — will be able to put the pillar 2 genie back in the bottle. For the OECD, pillar 2 is a major success story, which means it has little to gain and much to lose if there are further delays to implementation. For countries (other than the United States, which already benefits from GILTI), the GLOBE rules provide them with a ready-made framework to increase their tax revenue from large multinationals at a point when their finances have been stretched to breaking point by the COVID-19 pandemic. Moreover, the UTPR has a built-in first-mover advantage: If one country introduces the rule before other countries have adopted either the IIR or UTPR, it can pick up and tax the entire low-taxed profits of in-scope groups, potentially a major windfall.

All that means that at this stage, groups need to prepare for the possibility that the IIR could be

[9] EU Council, Draft Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union — Presidency compromise text and draft Council statement, 10497/22 (June 21, 2022).

[10] Sam Fleming and James Politi, "Hungary Withdraws Support for Minimum Corporate Tax in EU," *Financial Times*, June 17, 2022.

[11] HM Treasury, "Letter From the Financial Secretary to Respondents of the OECD Pillar 2 Implementation Consultation" (June 14, 2022).

implemented in at least some jurisdictions — for example, Canada — in 2023; plan for U.K. implementation of the IIR from January 1, 2024; and continue monitoring what is happening elsewhere, particularly in the EU and United States. And, unfortunately, being prepared is not just about assessing the potential tax impact but also thinking about the compliance and reporting process.

Pillar 1

Pillar 1 is in a completely different place than pillar 2.

The OECD has not yet finished writing the rules for pillar 1, which has two components: amount A, which would give market jurisdictions a new taxing right over large, highly profitable multinationals, and amount B, which would standardize returns for "in-country baseline marketing and distribution activities" in a way that aligns with the arm's-length standard. The OECD is undertaking a rolling public consultation on amount A but has yet to publish anything on amount B following the October statement.

One of the issues the OECD has been facing is that the group- and destination-based approach adopted by amount A represents a major shift from the existing tax system, which makes drafting rules technically difficult. But it is ultimately the politics that have made the process so challenging. Amount A will result in profits — and hence, taxes — being reallocated from some countries to others, which is unsurprisingly something that countries are sensitive about.

That leads to another important difference in the way the two pillars would be implemented. Pillar 1, and specifically amount A, is not compatible with existing bilateral tax treaties, so countries might want to amend their treaties to be consistent with the negotiated amount A taxing right. If a country with a large treaty network did not sign up to amount A, its treaties could prevent its treaty partners from taxing profits that are reallocated to them under amount A — in effect, giving any country with an extensive treaty network a de facto veto over pillar 1.

Moreover, the October statement committed the inclusive framework to provide tax certainty on both amount A and all related issues, such as transfer pricing disputes.[12] To provide certainty in the way envisioned by the inclusive framework, countries need a single legal framework to determine how they will work together to ensure tax certainty and, when necessary, provide relief from double or multiple taxation.

For those reasons, the October statement stated that amount A would be implemented through a multilateral convention that all countries implementing amount A would be expected to sign and ratify.

That the implementation of amount A requires a multilateral legal agreement is particularly relevant, given that there seems to be limited support for pillar 1 in the U.S. Congress. Without support from Congress, particularly the Senate, it is difficult to see how the United States could ratify a multilateral convention to amend its tax treaties to implement pillar 1. And given that U.S. businesses make up approximately half the groups in scope of amount A, it seems reasonable to assume that without U.S. involvement, there would be no pillar 1.

All that means the future of pillar 1 is uncertain. At the World Economic Forum in Davos, Switzerland, OECD Secretary-General Mathias Cormann acknowledged that it is likely that implementation of pillar 1 will be pushed back until 2024 without addressing the more fundamental question of whether there is a viable path to implementation.

But — and it is an important but — if the inclusive framework is unable to reach a deal on pillar 1, it will leave unaddressed a primary driver of the whole two-pillar project: the dispute between the United States and Europe (among other countries) over digital services taxes. There is a clear path to resolving that dispute if countries are able to agree on pillar 1, and no clear path to resolving it without agreement. That alone will make all parties to the negotiation hesitant to walk away from the table and means that discussions on pillar 1 could continue despite the lack of a clear path to implementation.

The deal the EU thought had been reached — that is, the European Commission will submit

[12] There is, however, an allowance for some developing economies to apply an elective mechanism for issues related to amount A. *See* OECD *supra* note 1, at 2.

legislative proposals to address digital economy taxation issues in the absence of international agreement — puts further pressure on the inclusive framework to reach a deal on pillar 1. Without a timely deal being reached by the inclusive framework, the EU could be left to explore the introduction of an alternative approach to taxing the digital economy, creating the risk of an EU-U.S. trade dispute.

What Might Come Next?

Over the next few months, it seems likely that the decoupling of pillars 1 and 2 will become much clearer, and we will start to get clarity on exactly when the GLOBE rules will come into effect in different countries.

If Hungary joins the EU consensus, we will likely see European-wide implementation of the GLOBE rules at the end of 2023, with the United Kingdom mirroring the EU's implementation timetable. The Canadians might or might not implement the IIR earlier in 2023. Other countries, such as Australia and Japan, will start to announce their plans over the next few months. Although everyone will be watching what happens in the United States, it seems entirely plausible that we could see the widespread adoption of the GLOBE rules without any amendment to U.S. legislation, making additional guidance on the interaction between the GLOBE rules and GILTI critical. At some point, we are also expecting the OECD to release further details on the STTR.

The future of pillar 1 is less certain, but without it, there remains the risk of a trade dispute between the United States and Europe. The inclusive framework will move its deadline for reaching a deal, perhaps to December 2023. If it does, that would be a good point to reassess the future of pillar 1, including taking into account the potential impact of the U.S. midterm elections.[13] ■

[13]The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author(s) only and does not necessarily represent the views or professional advice of KPMG LLP.