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Is the Tug of War Between the Senate and the U.S. Administration over BEPS Pillar One Jurisdiction at Least Partially Illusionary?

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TABLE OF CONTENTS

I. OVERVIEW

The home country of a multinational (MNE) with at least €20 billion global revenue, if among the 136 countries that have subscribed to the October 8, 2021, agreement to adopt a "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy,"[1] may be required to grant the MNE credit under Pillar One for foreign taxes that do not arise under relevant pre-Pillar One foreign domestic tax law and treaty law.

Where the home country is the United States, there have been reports about a budding tug of war between the Senate and the Biden Administration over jurisdiction to enter into the multi-country convention (agreement) under which the United States might have to grant such foreign tax credits (FTCs).[2] But nothing appears to have been written about the circumstances where such tug of war may be irrelevant and illusionary.

Those circumstances are where all of part of worldwide business of the U.S. MNE is carried on through foreign subsidiaries (i.e., CFCs).

The purpose of this article is to examine the validity of the proposition that the United States will have no direct jurisdiction over the manner in which a foreign subsidiary of a U.S.-based MNE will be taxed abroad under Pillar One and therefore subject to a GILTI factor[3] there will be no jurisdictional tug of war between the Senate and the Biden Administration to be resolved in such circumstances.

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[1] *OECD/G-20 Base Erosion and Profit Shifting Project — Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (October 8, 2021).

[2] See note 6, below, and related text respecting such reports.

[3] GILTI — the Global Intangible Low-Taxed Income Rule — enacted in 2017 by the Tax Cuts & Jobs Act (TCJA), imposes immediate tax on U.S. shareholders of CFC's in respect of their active business income.

II. THE BASIC NATURE AND OPERATION OF PILLAR ONE (INCLUDING THE PROPOSED MULTILATERAL CONVENTION)

Pillar One — intended to see multinationals with at least €20 billion of revenue and a net profit margin on sales of at least 10%[4] (herein an ''In-scope multinational'') pay tax in more countries (where they have at least €1 MM of sales — €250,000 in some cases) than at present — stems from the project organized by the OECD and the G-20 in 2013 under the slogan ''Base Erosion Profit Shifting'' (BEPS) to counter multinationals international tax planning. A 15 ''Action'' plan to be developed was announced in mid-2013. The very first Action was to develop tax rules for the ''Digitalization of the Economy,'' with an emphasis on very substantially expanding the taxation of digital giants. But firm proposals for Action 1 did not materialize by October 2015 when the 15-step Action plan was otherwise completed and released, with Action 1 being deferred for further study. That culminated in the October 8, 2021, agreement to extend, under Pillar One, tax nexus not arising under current domestic and treaty law, and to impose, under Pillar Two, a 15% minimum tax (no doubt inspired by the U.S. GILTI rules).

The Essence of Pillar One is to allow a country (herein a ''market country'') in which an In-Scope Multinational has at least €1 million of revenue (whether from sale of goods or provision of services or provision of use) to impose tax even though under pre-existing law the multinational either is not engaged in a trade or business in the market country under its domestic tax laws or is but not through a permanent establishment under a relevant treaty involving the market country.

On what may the market country impose tax? The precise answer will be known or determinable only when the details of the multilateral agreement (convention) called for in the October 8 agreement are developed. But the parameters set out in the agreement are clear.

The main rule (so-called Amount A) will have two legs. First, it will see a pot of taxable income in respect of the multinational calculated as being 25% of the excess of its profits over 10% of its revenues (such excess being referred to as its residual profit). Second, that pot ''will be allocated to market jurisdictions with nexus using a revenue based allocation key'' (per page 2 of the October 8 Statement). In February, the OECD issued a consultation paper on that key.

The market country presumably will then impose on the multinational, in respect of its share of the pot, its usual corporate tax, and, presumably, the multilateral convention will call for the home country of the relevant multinational to provide an FTC for that market country tax.

It is the latter factor that is the key object of this commentary— and in particular where the multinational is U.S. based—when will U.S. agreement to Pillar One be required and when will it possibly not, with any tug of war between the Senate and the Administration over jurisdiction to implement the convention being relevant only in the former case.

III. THE SITUATION WHERE THE U.S. PARENT OR U.S. SUB OPERATES DIRECTLY IN A FOREIGN COUNTRY

A. Effects of Pillar One

Suppose the parent of an in-scope U.S. based multinational or other U.S. member of the group has revenue of at least €1 MM from doing business with customers in Canada but, before Pillar One, was not ''carrying on business'' in Canada under the Income Tax Act, or if it was, it did not do so through a permanent establishment as defined by Article V of the Canada-U.S. Tax treaty and it did not engage withholding tax (on the gross) type rules (Part XIII of the Act)[5].

In these circumstances, Canada will now invoke the multilateral convention to override the pre-existing constraints to provide it the basis for imposing tax on a calculated portion of the profits of the relevant member of the U.S. group. But, will it only be able to look to the convention if the United States has signed up? And if the United States has not signed up, will Canada unilaterally legislate new taxing rules including the Digital Sales Tax introduced in Parliament this past December?

The U.S. consolidated group will seek FTCs in determining its U.S. tax liability. It will first look to the Internal Revenue Code. If that is not effective, it will look to the new convention, but only if the United States has signed on. Therefore, both the Canadian government and the U.S. multinational group seem to have an interest in the United States implementing the convention.

This leads to the question of whether such implementation may be obstructed by a jurisdictional tug of war.

B. The Jurisdictional Tug of War to Commit to the Multilateral Convention

Why is there any concern that implementation may be obstructed by a jurisdictional tug of war? The con-

[4] These thresholds will be reducing.

[5] The relationship between Pillar One and such regimes is beyond the scope of this article.

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cern seems to be rooted in a political tug of war over the separate and inter-related fates of the Administration's international tax program and the two pillar agreement, with ratification both caught in the middle and the weapon of choice.

Constitutionally and customarily it is the Senate, by way of a two-thirds majority vote, that ratifies international treaties. But with a split Democrat — Republican Senate, the Administration does not control the treaty agenda and is concerned that the Republicans will reject the Pillar One deal.

That has led the Administration to suggest that it may be able to by-pass the treaty ratification process. These suggestions have drawn sharp rebuke from Senate Republican leaders rejecting any such notion in letters written by them on October 8 and December 22 of last year to Treasury Secretary, Janet Yellen, and from several members of the House in a January 19, 2022, letter to Yellen.[6].

IV. THE SITUATION WHERE THE U.S. GROUP OPERATES IN A FOREIGN COUNTRY THROUGH A FOREIGN SUBSIDIARY (CFC)

A. Effects of Pillar One

Suppose the hypothetical business in Canada of the U.S. group discussed above were carried on by a subsidiary formed and based in Ireland, not by the U.S. parent or U.S. subsidiary.

Given that the Articles 5 and 7 of the Canada-Ireland tax treaty are comparable to Articles V and VII of the Canada-U.S. treaty, the results for the Irish subsidiary in Canada before Pillar One should be the same as those described in the preceding section. And in Ireland assume the Irish subsidiary is paying 12.5% tax.

If Pillar One is implemented by both Canada and Ireland subscribing to the multilateral convention, Canada will start taxing the Irish subsidiary and Ireland will provide FTCs. What is the role of the United States in this situation (and the tug of war between the Senate and the Administration)?

B. Where Does the United States (and the Jurisdictional Tug of War Between the Senate and the Administration) Fit In?

Although in the absence of a draft of the multilateral convention, it is difficult to be categorical, there appears to be no role for the United States in respect of the entry by Canada and Ireland into the Pillar One multilateral convention. If that is correct, subject to the GILTI factor discussed below, the jurisdictional tug of war described above would be irrelevant to the interests of the parties.

The GILTI factor is as follows: The U.S. parent of an Irish subsidiary operating in Canada will presumably be subject to the Code GILTI rules in respect of the profits of the Irish subsidiary. One of the elements of course is the 80% FTC.

The question is whether the U.S. parent (or the U.S. consolidated group of which it is a part) will be able to claim — based solely on the Code—credits for that portion of the foreign taxes that Canada has levied against the Irish subsidiary? Or will the claim require reliance on a tax treaty such as the proposed multilateral convention?

If the claim will require the assistance of the multilateral (or other new) convention, then the tug of war will be relevant in all circumstances involving Pillar One.

If the opposite, the tug of war will have no relevancy to foreign operations of in scope U.S. multinationals that are carried out through foreign subsidiaries.

Subject to what transpires with a backlash against certain new FTC regs (see note 8)[7] or to the outcome of any claim that they are invalid, the answer to the questions just posed is that the FTC claim will require the assistance of a multilateral convention and the tug of war will be relevant in all circumstances.

This is because recent regulations[8] would not give market country source treatment, for GILTI FTC purposes, to profit allocated to a market country under Pillar One. More specifically (in the context of the U.S.-owned Irish subsidiary operating in Canada) if there is a reallocation under Pillar One from the Irish subsidiary of what would have been Irish-source income to Canada the regs won't, without a treaty, recognize the resourcing of the inclusion.[9]

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[6] See the following: Christopher Condon, *The Global Tax Deal Faces Threat in Senate Treaty Threat Challenge (1)*, Daily Tax Rep. Int'l (Oct. 12, 2021); Michael Rapoport, *GOP Senators Say Administration 'Stonewalling' on OECD Tax Pact*, Daily Tax Rep. (Dec. 22, 2021); Genevieve Douglas and Patrick Ambrosio, *HILL TAX BRIEFING: Senate a Possible Hurdle for Global Tax Deal*, Daily Tax Rep. (Oct. 12, 2021); Isabel Gottlieb, *Lawmakers See Alternative to Senate Treaty Approval of OECD Deal*, Daily Tax Rep. (Oct. 12, 2021); Christopher Condon, *Yellen Confident Congress Will Follow Through on Global Tax Deal*, Daily Tax Rep. (Oct. 10, 2021); Frederic Lee, *GOP Senators Warn Against Skipping Treaty Process on Pillar 1*, Tax Notes Int'l (Oct. 12, 2021).

[7] *Hamza Ali, "U.S. Companies Demand Withdrawal of Foreign Tax Credit Regs*, Daily Tax Rep. (Feb. 25, 2022). See the underlying letter from the Alliance for Competitive Taxation to the Treasury dated Feb. 24, 2022.

[8] T.D. 9959, 87 Fed. Reg. 276 (Dec. 28, 2021).

[9] *See* Jeff VanderWolk, *U.S.-Based Multinationals Face a*

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V. CONCLUDING COMMENTS

It is evident that the relationship between the United States and the other members of the Inclusive Framework over the evolution of the BEPS project, both before and after the October 2015 agreement on the 15 Action program has been intense and at times rocky, yet Treasury Secretary Janet Yellen was a leading proponent of the October 8, 2021, Two Pillar agreement and the United States, in principle, a leading supporter.

Ironically, however that international comity hasn't always been matched by broad accord within the United States and as discussed above, the conflict points are well known and widely reported.

Double Tax Whammy, Daily Tax Rep. (Feb. 7, 2022).

But as highlighted in this report, there has been virtually no discussion of whether one of the key points of friction — a tug of war over jurisdiction to enter into the critical Pillar One multilateral convention — is in one fundamental area possibly illusionary.

That area, as discussed above, involves jurisdiction over the tax claims against CFCs of in-scope U.S. multinationals and in particular whether the United States will have no role to play even though GILTI is central to the overall effects. If that were to transpire, it would render irrelevant the question of whether the Senate alone through a two-thirds vote controls committing the United States to Pillar One.

How this plays out should come into focus sooner than later.

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