STATEMENT OF WILLIAM H. MORRIS
TO THE SENATE FINANCE COMMITTEE
"CROSS-BORDER RX: PHARMACEUTICAL MANUFACTURERS AND U.S. INTERNATIONAL TAX POLICY"

MAY 11, 2023

Chairman Wyden, Ranking Member Crapo, and distinguished members of the Committee. I appreciate the opportunity to appear this morning as the Committee considers important questions of International Tax. My testimony will focus on what is currently one of the most significant areas of interest in this area: the Organization for Economic Co-operation and Development (OECD) "Two Pillar" project. I had the privilege of working as Associate International Tax Counsel in the Office of Tax Policy at the US Treasury from 1997-2000. For the past six years, I have worked at PwC, in both London and Washington, on international tax policy. Additionally, from 2012-2022 I was Chair of the Tax Committee of Business at OECD (also known as BIAC) in Paris, which allowed me to see first-hand the development of the Base Erosion and Profit Shifting (BEPS) project from 2012-15 and the Two Pillar Project since 2017.

I am appearing today on my own behalf and not on behalf of PwC, Business at OECD, or any client. The views I express are my own.

Introduction

The significance of the OECD Two Pillar Project cannot be overstated. It represents a true sea change in international taxation. Pillar One would allocate more taxing rights (i.e., tax base) to countries where sales take place. Pillar Two would institute a global minimum tax of 15%, implemented on a harmonized basis. (*See* Appendix 1 for more detailed explanations of both Pillars.)

The Project arose out of concern that the international consensus on allocation of taxing rights was dissolving as several governments began enacting unilateral measures, which caused concern for the United States, including for members of this Committee. In order to restore stability to the international tax system, the OECD, as the global standard setter for international tax matters for decades, was a logical convener of the discussion. By broadening the participants to include countries that were not members of the OECD, first the G20, and then smaller developing countries, the OECD sought to create an inclusive framework (the "Inclusive Framework") where the interests of developing countries could be explored together with the interests of the developed countries that represent the membership of the OECD.

At its inception in 2017, the OECD's "*Project on the Tax Challenges Arising from the Digitalization of the Economy"*, which became Pillar One, set out to answer the question: "how can the international tax system be amended/augmented to allow market countries to tax the increased ability of companies through digitization to access markets without a physical presence?" This question remains outstanding, however, because Pillar One has not been completed, and the viability of Pillar One is an open question.

As regards Pillar Two, after the United States enacted a minimum tax in 2017, other governments wanted to follow suit. While that could have represented a welcome leveling of the playing field for US-headquartered companies, to date that is not the way things have turned out because of choices made in the drafting process. As OECD administrative guidance stands today, the Pillar Two Minimum Tax could work to the disadvantage of the US fisc and US-headquartered companies. First, the US fisc could lose global intangible low-taxed income (GILTI) tax revenue because the rules give Qualified Domestic Minimum Top-up Taxes (QDMTTs) of other countries primacy over GILTI. Secondly, in its effort to ensure a level playing field, the Undertaxed Profits Rule (UTPR) was drafted so that it effectively would give countries that have adopted Pillar Two rules the right to tax the nonrefundable credits and incentives

granted by other countries, including the United States. What that means is that US-headquartered businesses would lose the benefit of those US credits and incentives. The UTPR taxes imposed by other countries would not be creditable in the United States.

Let me emphasize two things before continuing. First, an answer to the original question that led to Pillar One is important to restore greater stability and certainty to international tax relations among countries. The world and business models are changing rapidly. An agreement that satisfies a wide range of countries would allow those business models to flourish, which will in turn create jobs and foster global economic growth. Second, Pillar Two is in the process of happening. While there may be adjustments to the workings of Pillar Two, there's no turning back the clock as other countries begin to legislate. The question for this Committee, therefore, is how the United States should respond to these global developments. Can the OECD, the United States, and other countries continue to work together to ensure Pillar Two achieves its objective without disadvantaging the United States or impeding key legislative objectives? Doing so has the greatest likelihood of stabilizing the international tax regime for the long term, which would benefit the United States as well as other countries.

The challenge ahead

Congress has several options to consider on both Pillars. It should be said at the outset that the acceptance and durability of an international negotiation that would redraw taxing rights among countries will be greater if the decisions of one country can coexist with the decisions of other countries regarding their own tax systems, which may differ. Put slightly differently, if the negotiations aim for "interoperability" – a level of coexistence – between tax systems, that allows different tax systems to operate alongside each other with a mutual understanding of and respect for the choices that legislatures in different countries may make based on each country's unique circumstances, the result is more likely to be stable over the long term. The Pillar Two Model Rules' effort to level the playing field heads more in the direction of tax "harmonization." Multilateral cooperation to achieve interoperability is important, but so is the ability of countries to address the needs of their citizenry and achieve their sovereign goals.

The work on the OECD Two Pillar Project should be continued in order to allow the United States – and all other governments as well – to enact the laws Congress determines to be appropriate, including to incentivize certain types of activity through the tax system, and to protect the US tax base. Congress's goal should be to ensure that the United States remains an attractive and vibrant location for creating jobs, starting a business, and making investments, and to have the ability to address the country's economic, national security, and public health needs. The on-going international tax negotiations must allow other countries to carry out their own tax policy choices as well while preventing, to the greatest extent possible, value-destroying friction at the international/multilateral level (i.e., finding the appropriate interoperability). While there has been progress towards interoperability through the OECD's administrative guidance, it is important for that effort to continue to produce a result that is sustainable.

Particularly in relation to Pillar Two, the Model Rules limit governments' ability to use incentives delivered through the tax system. The Model Rules include criteria on what constitutes "qualified" tax base elements, including for credits and incentives. Two examples of what this means practically for the United States are:

- GILTI, the minimum tax that gave rise to Pillar Two, does not satisfy the OECD requirements for a qualifying minimum tax, and the corporate alternative minimum tax (CAMT), enacted by Congress last year, does not satisfy the OECD requirements for a qualifying domestic minimum top-up tax.
- The OECD Model Rules permit favorable treatment for government grants and for tax incentives such as R&D credits, but only if they are structured as "qualified" refundable tax credits. The US

R&D and many other credits are not refundable, and thus not qualified under Pillar Two. Furthermore, other longstanding provisions of the Internal Revenue Code, such as the exemption for municipal bond interest, would not be recognized. The practical effect of this is that these US-granted incentives would be brought into the tax base of other countries, thus undoing the policy Congress intended.

Background: Dissatisfaction with the international tax rules

In the aftermath of the Global Financial Crisis starting in 2007-8 (although with many roots predating that) there was widespread dissatisfaction in many countries, including the United States, with the international tax rules.

- The United States had concerns that US law created a disincentive for US companies to reinvest foreign profits in the United States, allowed profit shifting to low tax jurisdictions, funded other countries' taxes through the US foreign tax credits ('FTCs'), encouraged acquisitions of US companies by foreign companies, and created incentives to redomicile.

- Some countries, including other G7 "residence" countries, believed they were not getting their "fair share" of taxes from large US technology companies, in particular.

- Many developing countries, large and small, believed that the 100-year-old tax framework that allocated much of the tax base (and thus tax revenue) to the providers of capital rather than to countries where goods or services are used or consumed, resources extracted, etc., needed overhauling to allocate more tax rights (tax base) to countries where sales took place ("market-based taxation").

The international response to these concerns initially resulted in the Base Erosion and Profit Shifting (BEPS) project of 2013-15, which resulted in agreement on significant coordinated measures on restrictions on interest deductibility, anti-hybrid measures, strengthening transfer pricing, preventing the abuse of treaties and "Country by Country" reporting among tax jurisdictions. In many areas BEPS has achieved the objectives set for it. But many countries (and regions) decided that they also needed to take individual action to address the issues outlined above. I describe those briefly below, and then move to the follow-on OECD project launched in 2017.

US: Tax Cuts and Jobs Act

The United States' answer to its concerns was included in the Tax Cuts and Jobs Act (TCJA) – with a minimum tax on overseas income (GILTI) and a minimum tax aimed at preventing erosion of the US's domestic tax base (the Base Erosion and Anti-Avoidance Tax or 'BEAT').[1] The TCJA significantly changed the taxation in respect of earnings of non-US corporations owned directly or indirectly by US persons. The GILTI tax is an annual tax on low-taxed income earned by a controlled foreign corporation ('CFC'). The BEAT requires certain US corporations to pay a minimum tax associated, broadly speaking, with deductible payments to non-US related parties.

EU: Digital Services Taxes

The European Union's answer was the 2018 proposal for an EU-wide digital services tax ('DST') that was temporarily rejected, followed by the adoption of DSTs by some EU member states (including France, Spain, Austria, Poland, and Italy, as well as then-EU member, the United Kingdom). The EU has put its

[1] The TCJA also includes other base protection measures (anti-hybrid rules, tightened transfer pricing rules, and interest deduction limitations) and a one-time tax on prior unrepatriated foreign earnings of US corporations.

DST proposal on hold pending the outcome of the OECD's Two Pillar Project. Other non-EU countries have enacted or proposed DSTs as well.

OECD: The Two Pillar Project

In 2019, the OECD's project on the taxation of the digitalizing economy identified two policy options (organized into two separate "pillars"). Pillar One addressed taxing rights and nexus rules, while Pillar Two outlined a global minimum tax and a tax on base-eroding payments.

Pillar One was originally aimed at technology companies but was broadened in response to US objections to a narrow scope that appeared focused on US companies. At the US Treasury's urging, the qualitative scope of Pillar One – which was originally focused on automated digital services (e.g., online search engines, intermediation platforms, gaming, and advertising) and consumer-facing businesses – was narrowed in July 2021 and replaced with a quantitative scope targeted at companies with more than €20 billion in revenue and more than 10% in profit. This shifted the focus of Pillar One away from digital businesses. It also significantly reduced the number of companies likely to be in scope (approximately 100 companies, about half of which are expected to be US companies – *see,* page 6, below). The Inclusive Framework aims to finalize a multilateral convention implementing Pillar One by this summer.

Pillar Two proposes that countries enact a global minimum tax that resembles GILTI and an undertaxed profits rule that originally resembled BEAT. The goal of Pillar Two is to require companies to pay a minimum rate of tax in each jurisdiction where they have a taxable presence. US implementation of GILTI and BEAT regimes encouraged several EU countries to advance this initiative within the OECD's Inclusive Framework as a forerunner to EU action on a Directive (see below). When the Pillar Two rules were being designed, it was acknowledged by the OECD that GILTI was more stringent overall in its application than the Pillar Two design.

The OECD released Pillar Two Model Rules in December 2021 and Commentary in March 2022. The Model Rules provide details on two interlocking measures, the Income Inclusion Rule (IIR) and the UTPR,[2] whereby income taxed at less than 15% under the Pillar Two financial accounting base would be subject to additional taxation. The rules also enabled countries to adopt their own domestic minimum top-up tax that applies to low-tax profits within a country's own borders (referred to as a QDMTT).

In December 2022, the EU adopted a Directive to implement Pillar Two, requiring EU members to transpose the global minimum tax rules into their national legislation by December 31, 2023, and a number of those EU members have already started that legislative process. Outside of the EU, an increasing number of countries are also moving forward with Pillar Two implementation in the form of proposed legislation, public consultations, and announced target dates (including Australia, Canada, Colombia, Guernsey, Hong Kong, Japan, Jersey, Malaysia, Mauritius, New Zealand, Norway, Panama, Singapore, South Korea, Switzerland, the United Arab Emirates, and the United Kingdom).

[2] Prior to December 2021, as explained in more detail on page 6, this was known as the Undertaxed Payment Rule, and required an actual deductible payment to trigger the provision.

Issues with current Pillar One and Two that affect the United States

My testimony covers three issues concerning Pillar Two and one with Pillar One.

Pillar Two

1. Treatment of tax credits and incentives

The first issue is the treatment of credits for the purposes of calculating the tax base. Whether credits are refundable or non-refundable determines how they are treated under Pillar Two. Given the United States' traditional reliance on non-refundable credits to achieve Congressional policy objectives, this distinction has an adverse impact on the United States.

Briefly, non-refundable credits are treated as a reduction in income tax paid, which has the effect of making it more likely that the company will be subject to another country's UTPR. Refundable credits, in contrast, are treated as income to the company, rather than a reduction in tax paid. While the increased income will also affect whether a company is subject to another country's UTPR, the effect is much smaller. This is explained through an example in accompanying footnote 3.[3]

The financial accounting for tax credits generally depends upon how the tax credit will be monetized. Non-refundable credits are generally accounted for as part of income tax expense. Other credits may be accounted for as part of pre-tax income. This will generally be the case when the credit can be monetized without regard to the existence of an income tax liability. For example, a refundable credit is typically accounted for as part of pre-tax income. In other cases, the financial statement accounting may be based on accounting policy choices an entity has made.

The impact of the treatment of non-refundable credits was raised in March 2022 by the business group BIAC in a letter (which is linked here) to the members of the Inclusive Framework (i.e., the 140+ participating governments) addressing the disparate treatment of qualified versus non-qualified tax credits under the Pillar Two rules. The letter highlights three cases where the treatment of non-qualified credits can have undesirable societal effects: in the case of R&D incentives that are not qualified refundable tax credits ('QRTC'); "social" incentives (e.g., Low Income Tax Housing Credit); and credits for renewable energy in relation to "green transition." The letter requested governments to consider the impact of this issue on their home country incentive regimes. In relation to the United States, had there been a process for Treasury and Congress to exchange views before other countries began to legislate, the problem might have been more easily addressed – as it was when the same issue was identified and solved in the design of CAMT. [4]

Examples of other congressionally enacted incentives the benefits of which would be affected by the UTPR are included in Appendix 2.

[3] For purposes of calculating the Pillar Two effective tax rate (referred to as the "GloBE ETR") in a jurisdiction, the total amount of the adjusted covered taxes of all group entities domiciled in that jurisdiction is divided by the net GloBE income of these entities. The Pillar Two Model Rules distinguish between Qualified Refundable Tax Credits ("QRTCs") and other credits. This distinction has a significant impact on the ETR because QRTCs increase the denominator of the ETR (that is, GloBE income) and other income tax credits decrease the numerator (that is, adjusted covered taxes). In effect, QRTCs are treated as items of income rather than reductions of taxes. The following simplified example illustrates the different treatment of QRTCs and other tax credits: A constituent entity has GloBE income of 1,000 (without consideration of any impacts of refundable credits) and pre-credit tax expense of 200, and qualifies for a tax credit of 100. If the credit is a QRTC, the ETR (under the Pillar Two Model Rules) is 18.2% (200/(1,000 + 100)); however, if the credit is not a QRTC, the ETR is 10% ((200 - 100)/1,000). As a result, treatment of an income tax credit as a QRTC may result in less top-up tax for a company in scope of Pillar Two, even if the effect on the non-GloBE tax liability of the company is the same as a non QRTC.

[4] *See,* proposal on page 8.

In sum, features of the US tax system through which Congress has historically delivered job-creating incentives and fiscal support for the economy, etc., will be limited by Pillar Two absent continuing negotiations, for example, to create a safe harbor. It is critical that the on-going work on Pillar Two give further consideration to ensure an appropriately balanced coordination that preserves the flexibility of the United States and other countries with respect to the treatment of credits and incentives.

2. UTPR changed from an undertaxed "payment" to "profits" rule

The scope of the UTPR was significantly broadened in December 2021 in the Model Rules to allow a country to impose the UTPR both through denials of deductions as well as through a collection of top-up tax on a group company in its jurisdiction. This ability to collect tax, not just deny deductions, effectively changed the UTPR from an 'undertaxed payments' rule to an 'undertaxed profits' rule. Following the December 2021 change, all jurisdictions in which a group operated were subject to the UTPR rules on low-taxed income, not just those jurisdictions between which deductible payments had occurred. This now meant that any country in which a member of the group operated could collect UTPR tax from that member, including in respect of "low taxed" income in the home country of its parent calculated under Pillar Two tax base rules.

This change came as a surprise to those who had understood, based on earlier OECD explanations including the 2020 "Blueprint,"[5] that this was an extension of BEPS principles where there had to be a deductible payment into a low tax jurisdiction to trigger application of the rule. The Commentary on the Model Rules, released in March 2022, reinforced the position that there need not be a connection and/or transaction between the group member that a country collects UTPR top-up tax from, and other members of the group in a low-tax country, including the home country (the formula for allocating UTPR top-up tax among implementing jurisdictions is not tied to a group's economic activity in a country but based on a formula).[6] This means that all tax credits in the 'home country'[7] are now covered by Pillar Two.

In addition to being a significant change in relation to the ability of the home country to determine and order its own tax affairs, there are tax treaty implications. Contrary to longstanding international tax treaty practice, it also gives countries the right to tax income not earned in their jurisdiction based on calculations not necessarily agreed to by the home country. The compatibility of the UTPR with tax treaties seems likely to be litigated.

It is worth noting that, originally, the UTPR had been envisaged as a back-up to the IIR, where a home country did not itself enact an IIR. Governments and businesses (including in the United States) were concerned that some large economies might not enact an IIR, and thus that the businesses in such countries might be advantaged against businesses in those countries that had enacted IIRs. However, the change in the UTPR in 2021, which opened up the possibility of much greater taxation by other countries of home country income, is an example of where this project has expanded beyond the stated original intent.

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[5] See Chapter 7 of OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en.

[6] The UK's initial January 2022 public consultation on implementing the Pillar Two Model Rules re-defines "UTPR" as the "Undertaxed *Profits* Rule" (replacing "payments" for "profits").

[7] The 'home country' is the country where the 'Ultimate Parent Entity' (UPE) is located. The OECD Pillar Two Model Rules generally defines UPE as the main entity of a group (which is not owned, with a controlling interest, directly or indirectly by another entity).

3. Introduction of the QDMTT

The introduction of a new top-up tax – the QDMTT – in the final Pillar Two Model Rules, although connected to the other two issues, above, is a separate issue. The QDMTT arose out of the desire of some countries to raise their own tax rates to capture tax revenue in respect of earnings arising in those countries rather than have any amount below 15% taxed in the home country of the parent entity. An additional factor for the United States is the subsequent February 2023 clarification on the ordering rules, which means that GILTI revenues will be reduced perhaps substantially, because other countries that enact a QDMTT will have primary taxing jurisdiction over that income.

The Pillar Two ordering rules mean that in practice, QDMTTs will apply before any GILTI allocations and the IIR and UTPR. For countries that adopt a QDMTT, any allocation of taxes paid under GILTI will not be taken into account when determining the local QDMTT liability. The QDMTT, thus, has the effect of locking in a primary taxing right for these countries, as opposed to residence countries, and/or countries in which value creating activity occurred.

Pillar One issue

Pillar One was originally aimed at preventing the "ring-fencing of the digital economy" under income tax rules, and subsequently aimed at preventing the gross basis taxes known as DSTs. As the Pillar One rules have become increasingly complex, however, countries (especially developing countries both large and small) have become concerned about administrability as well as results.

This has led to difficulties in getting countries to agree on several critical provisions of Pillar One. Treasury officials have recently confirmed that significant political and technical issues remain for which consensus must be reached before there is a final Pillar One agreement, including the treatment of withholding taxes, dispute resolution provisions (including a form of binding arbitration), and the scope of "unilateral" measures (including DSTs) that are subject to standstill and withdrawal. Because of the complex structure of Pillar One, and the potential falling short in the resolution of the outstanding issues, it may not be possible for the United States to sign the agreement – expected to be produced in July – despite the leading role Treasury has played in its design. Alternatively, even if the Administration does sign, prospects for Senate ratification would seem uncertain given the well-known procedural challenges of treaty consideration in the Senate even when there is broad, bipartisan support for an agreement.

What that means – either way – is that in January 2024, when Treasury's October 2021 standstill agreement on DSTs expires, then if Pillar One has not entered into force, Congress should anticipate the introduction and implementation of new DSTs falling primarily on US businesses.[8] This will likely be of bipartisan concern to Senators on this Committee.

In short, Pillar One still faces challenges and has not yet delivered stability to the system. This is not an outcome that will promote growth and jobs, and it will be necessary to continue to work on it.

What can be done, including possible Congressional action?

The UTPR/home country issue

The home country issue needs to be solved by the beginning of 2025 when UTPRs will generally come into effect. However, there are significant challenges in the legislative options that have been proposed for the US Congress to resolve these issues:

[8] As the November 2022 UK National Audit Office (NAO) report (link here) (which examines the UK implementation of their DST) has shown, these DSTs will be paid almost exclusively by very large companies (many of which are likely to be US companies).

- Moving to country-by-country effective tax rate (ETR) calculations under GILTI. While this would likely make GILTI a "qualified IIR," it would not address the UTPR/home country issue. If under the Pillar Two tax base rules the US income of a business is calculated to have been taxed below 15% (e.g., because of the R&D credit or some of the new Inflation Reduction Act credits), then the qualified status of GILTI will not help.

- Making all US credits refundable within four years. Refundability would solve the UTPR/home country problem, but it would also upend long-standing US tax policy and could carry a significant revenue cost.[9]

- Enact a QDMTT. While this would protect the US fisc, it would not allow Congress to grant effective credits and incentives to the extent those reduce the tax below a rate of 15% for Pillar Two purposes, because they would simply be taxed under the QDMTT.

- By otherwise conforming all aspects of the US tax base to Pillar Two rules. While conformity would solve the UTPR/home country problem, it would also be a significant, time-consuming undertaking, and would be disruptive to both the US government and taxpayers' long-standing tax expectations. In addition to the credits and incentives issue above, many aspects of the US tax code that give rise to timing differences would need to be identified and amended. Furthermore, beyond tax, Pillar Two is closely based on IFRS, so where US GAAP diverges, with that result leading to a different characterization under Pillar Two, also would need to be addressed. It also would require revisiting the recently enacted CAMT's treatment of nonrefundable credits.

Another route for resolving the issues, noted above, would be through the ongoing OECD work – perhaps through Safe Harbors – which could address the issue and provide further flexibility for governments to provide qualified tax credits and incentives. This could be achieved most likely in one of two ways:

- By focusing on problem areas – expanding the rules for tax credits and timing items, for example, to treat certain societally and/or economically beneficial credits in the same way as refundable credits. While this raises definitional issues, based on long-standing parameters established in US and other countries' laws for different types of credits, that issue is soluble from a technical point of view.

- By focusing more generally on taxation elements in the home country (e.g., a safe harbor based on a mix of local country statutory rate, an absence of "harmful" regimes, etc.). An exemption or safe harbor test could be applied that looks at a combination of a country's statutory tax rate, an absence of "harmful" regimes, any home country domestic minimum tax, the proportion of domestically generated income, a business's overall global rate (including the home country), and other similar tests. Viewing these facts in their totality should give interested parties confidence that certain home country jurisdictions (including the US) are not in fact "low tax jurisdictions."

Moving forward in this manner will require full engagement by Treasury to convince other countries in the Inclusive Framework to come around to changing what will be fully enacted statutes in some jurisdictions. That will not be easy, but it would be beneficial to other countries as well as the United States to have greater flexibility to use the tax system when they deem it appropriate to address the needs of their citizenry. It certainly seems preferable to the tensions that might otherwise result.

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[9] Peter R. Merrill, Karl Russo, Aaron Junge, Damien Boudreau and Florian Holle, *Where Credit Is Due,* TAX NOTES INT'L, MAR. 20, 2023, P. 1627

Dissatisfaction of countries with the current international tax regime

In the medium/longer term some of the outstanding issues (e.g., the demands of market jurisdictions for a greater allocation of taxing rights) along with revealed shortcomings in the process of international tax rule making (e.g., how smaller developing countries are included) will need to be thoughtfully studied and addressed.

What did not happen in the early stages of Pillar One (but can still happen now) was the establishment of the tax policy process needed to achieve a coherent and broadly accepted understanding of the issue which underlies this dissatisfaction – namely, what gives rise to the right to tax? Is it the market (i.e., sales)? Is it the provision of capital? Is it where innovative activity occurs and/or where IP is owned? Is it where certain key functions[10] are performed? Or is it some combination of all of those and more? And, if so, in what proportions? And how do we balance all of that with creating the conditions that lead to economic growth, jobs, and investment? Only with broadly agreed answers to these questions can a stable agreement be reached.

Pillar One has let the genie of market-based taxation out of the bottle (with a little help from BEAT), and there will be no getting it back in. It should be noted that the United States, with one of the biggest and most developed markets in the world, should not automatically be at a disadvantage. The process has not yet restored the promised stability and certainty to international tax affairs, but there is no going back. A renewed process for reaching agreement on these and other issues is needed both among countries and within them to achieve stability and certainty. Within the United States, the process should include the close involvement of the Congress. A continuation of the process could lead to a broad and sustainable agreement.

Preventing this problem from arising in the future

Finally, from a US systemic/institutional standpoint, no one wants to have this happen again. There must be a way for the Congress to provide direction for Treasury's position in international tax negotiations, at least when the negotiations would significantly affect the United States' jurisdiction to tax or would require statutory changes. One model that might be considered is Trade Promotion Authority, which requires active consultation and oversight by the appropriate committees of Congress when an agreement is being negotiated.[11] That could strengthen Treasury's hand in negotiations by telegraphing to negotiating partners what is politically realistic for the United States.

Above and beyond helping to keep other countries informed of Congress' views, this process would also strengthen the validity and legitimacy of the entire international tax rulemaking process from the beginning to the end in the United States. It should be noted that this is an issue which at its inception touches upon the powers granted by the Constitution under Art. 1, Secs. 7 and 8 relating to revenue bills (origination and amendment), and the power to lay and collect taxes.[12] For that reason, it is important to have a process whereby both the House and Senate have the ability to exchange views with the Treasury on international negotiations affecting tax in which the Administration is, or intends to become, involved. In this way, the Treasury will understand the parameters within which it can operate with some level of assurance of Congressional support – and so will foreign countries. At the same time, Congress will be

[10] The so-called DEMPE approach (development, enhancement, maintenance, protection and exploitation). This was developed at OECD level within Actions 8-10 of the BEPS Project, which had the aim to align transfer pricing outcomes with value creation between associated enterprises in order to ensure that transfer prices reflect the economic circumstances of a transaction. 'DEMPE' stands for Development, Enhancement, Maintenance, Protection and Exploitation.

[11] Mindy Herzfeld, Can Congress Fix Treasury's GLOBE Mistakes? 110 TAX NOTES INT'L 7 (APR. 3, 2023)

[12] ***See,*** Kysar, Rebecca M., "On the Constitutionality of Tax Treaties" (May 3, 2013). *Yale Journal of International Law*, Vol. 38, 2013, Brooklyn Law School, *Legal Studies Paper No. 274*, Available at SSRN: https://ssrn.com/abstract=2034904

made aware of challenges that the positions of other countries may present to the United States, and Congressional input can strengthen the hand of the Treasury in such circumstances.

Conclusion

As noted, the OECD Two Pillar Project is the most significant overhaul of international tax rules in many decades and will bring about a sea change in tax relations between countries. As it now stands, its outcomes may be sub-optimal both for the stability of the international tax system more generally, and, specifically, for the interests of the country whose members this distinguished Committee represent – the United States.

It is not too late to address the elements causing concern. Moreover, doing so is likely to provide greater long-term stability. Furthermore, there are ways to ensure that Congress provides direction to Treasury before international tax negotiations begin in the future.

Given the importance of tax to funding the activities of the state and achieving a range of economic and social goals, a necessary level of international coordination to allow for interoperability, coupled with the flexibility that allows each country to achieve their legislative objectives, is key to a stable global tax regime. Conflict and discord in the international tax system will discourage cross-border trade and investment (which the economic evidence shows creates more and better jobs). Continuing the work of the OECD, with the support of the Congress, is the best means of achieving a positive outcome for the United States and other countries as well.

Thank you again for inviting me to testify. I would be pleased to answer any questions you may have or otherwise to assist the Committee in its important work.

Appendix 1: Common acronyms / explanations

OECD: Organization for Economic Co-operation and Development
Inclusive Framework: OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting
BIAC: Business at OECD
BEPS: Base Erosion and Profit Shifting
MNE: Multinational enterprise
GAAP: General accepted accounting principles
IFRS: International Financial Reporting Standards

Pillar One

Amount A: Under "Amount A" of Pillar One, a formulaic share of a portion of the consolidated profit of MNEs will be allocated to markets (i.e., where sales arise). Amount A applies to MNEs with revenues exceeding EUR 20 billion and a profitability greater than 10%. It reallocates 25% of the MNE's profit in excess of 10% of its revenues to 'market jurisdictions' (jurisdictions where goods or services are used or consumed) in which the MNE satisfies the 'quantitative nexus' test, subject to adjustments under the marketing and distribution profits safe harbor (MDSH). The Amount A tax base will be quantified using an adjusted profit before tax measure, derived from the consolidated financial accounts of in scope groups, rather than on a separate entity basis. Two sectors remain carved out from Amount A: extractive industries and regulated financial services. Amount A is expected to affect approximately 100 of the world's largest companies; it is estimated that approximately 50% of those are US MNEs. The intention is for the rules under Amount A to be included in a multilateral convention, which the OECD has indicated should be available for signature in the summer of 2023. For Amount A to enter into force, a "critical mass" of countries, including particularly the United States, but also Japan, Germany, the UK and France -- which possess a substantial majority of parent companies for in-scope groups -- must ratify the convention.

Amount B: "Amount B" forms part of the Inclusive Framework's Pillar One proposal and is focused on simplifying and streamlining the remuneration of baseline marketing and distribution activities in-market. The aim is that this would enhance tax certainty around marketing and distribution returns, while reducing disputes between taxpayers and tax authorities in this area. Amount B potentially has relevance to MNEs far beyond Amount A, both due to the lack of a specific size threshold for Amount B to apply, and since the possibility of including the Amount B rules in the OECD Transfer Pricing Guidelines is being contemplated.

Digital Service Taxes (DSTs): Tax on gross revenue modeled on the original "digital services tax" proposed by the EU Commission in March 2018. The particular services and revenue in scope vary by country. In general, these taxes apply to gross revenue from the provision of goods and services via digital platforms and must be paid by the company earning such revenue, regardless of whether the company has a permanent establishment in the country. The key impetus of the global negotiations on the OECD's digital tax project was to preclude unilateral measures (e.g., DSTs) from being imposed by different jurisdictions. The October 8, 2021, Inclusive Framework agreement formalized this resolution. The agreement noted that the Pillar One multilateral convention would remove existing DSTs and "relevant similar measures" for all companies, presumably including those that are not in scope of Pillar One. It also commits parties not to introduce any new DSTs or other relevant similar measures. Specifically, the agreement requires the parties not to impose any newly enacted DSTs (or other such measures) from October 8, 2021, until the earlier of December 31, 2023, or the coming into force of the multilateral convention.

Marketing and Distribution Profits Safe Harbor (MDSH): Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbor will cap the residual profits allocated to the market jurisdiction through Amount A. The MDSH is primarily designed to address issues related to 'double counting' that may occur, for example, if a market jurisdiction already has the ability to tax residual profits of an MNE in two ways: (i) once under existing profit allocation rules (typically transfer pricing); and (ii) again through Amount A allocations. Further work on the design of the safe harbor is ongoing.

Pillar Two

Global anti-Base Erosion (GloBE) Rules: The global minimum tax rules under Pillar Two, referred to as the GloBE Rules, will apply to MNEs with annual global consolidated revenues above EUR 750 million and consist of (1) the income inclusion rule (IIR), which will impose a top-up tax for the difference between the jurisdictional Pillar Two effective tax rate (ETR) and the 15% minimum rate; and (2) the UTPR (formerly known as the "Undertaxed Payments Rule"), which is intended to apply as a backstop if low-taxed income is not fully collected under the IIR. In addition to the IIR and the UTPR, the respective country with the top-up tax may collect the amount via a qualified domestic minimum top-up tax (QDMTT). The IIR and QDMTT could be implemented by countries as early as December 31, 2023. Countries implementing a UTPR are expected to do so as early as December 31, 2024.

Income Inclusion Rule (IIR): The IIR is applied before the UTPR. The IIR imposes a top-up tax on a parent entity with respect to the low-taxed income of a member of the group (i.e., income that has not been subject to an effective minimum tax of at least 15%). Generally, the IIR is applied at the top, at the level of the ultimate parent entity, and works its way down the ownership chain.

Undertaxed Profits Rule (UTPR): Where there is remaining top-up tax after the IIR has been applied, such that the UTPR backstop kicks in, the adjustment or additional cash tax expense can be achieved in the manner each jurisdiction decides, e.g., denial of a deduction, an additional tax, a reduction in any allowance for equity, or deemed income (reversing a related party expense). The total UTPR amount is allocated among implementing jurisdictions under a formula that is based on the relative proportion of employees and tangible assets in each jurisdiction. Importantly, under this formula, there is no requirement that an entity in a UTPR jurisdiction actually makes deductible payments to a low-taxed affiliate.

Qualified Domestic Minimum Top-up Tax (QDMTT): A QDMTT allows countries to impose top-up tax on the exclusively domestic income of companies in scope of Pillar Two. The application of a QDMTT can prevent the levying of a top-up tax on these domestic profits in other countries through either their IIR or UTPR. Many countries are considering implementing a QDMTT. For a domestic minimum top-up tax to be considered "qualified", it must (1) be consistent with the design of the GloBE Rules; and (2) provide for outcomes that are consistent with the GloBE Rules.

Appendix 2: Examples of Congressionally Enacted Incentives Potentially Negated by the UTPR*

Incentives to Promote Economic Growth, Investment, and Jobs	Incentives to Help Economic Recovery	Incentives to Promote Social and Environmental Goals
• Research credit • Investment tax credits • Incentives for the development and retention in the US of intellectual property • Targeted employment incentives such as the work opportunity credit	• Carryback of net operating losses • Modification of limitation on business interest deduction • Liberty Zone investment and employment credits • Hurricane and other disaster relief incentives	• State and local tax-exempt bonds • Energy investment credit • Energy production credit • Empowerment Zone incentives • Opportunity Zone incentives • Rehabilitation credit

* Narrow exceptions are provided under the Pillar Two rules for tax credits that are i) refundable or ii) received through investments in certain tax equity structures. These narrow exceptions will not – on their face – protect transferable tax credits.