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Money Grab: How The G20/OECD Inclusive Framework for Taxation Could Unnecessarily Disrupt Corporate Incentives and Misallocate Taxing Rights

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William T. Anderson, 'Money Grab: How the G20/OECD Inclusive Framework for Taxation Could Unnecessarily Disrupt Corporate Incentives and Misallocate Taxing Rights' (2022) 55 Vand J Transnat'l L 1051 Please note: citations are provided as a general guideline. Users should consult their preferred citation format's style manual for proper citation formatting.

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Money Grab: How The G20/OECD Inclusive Framework for Taxation Could Unnecessarily Disrupt Corporate Incentives and Misallocate Taxing Rights

ABSTRACT

The Organisation of Economic Co-operation and Development (OECD) is proposing a dramatic shift to international corporate taxation that both sets a floor for corporate tax rates across the globe and transforms how countries obtain taxing rights over large multinational corporations. This Note focuses on the proposed framework for re-allocating taxing rights over corporations away from the traditional requirement of a physical presence in a country to mere revenues in a country. This Note identifies problems with the proposal as it relates to artificially altering corporate incentives and structures, as well as the proposal's incompatibility with theories of taxation—including Adam Smith's views on the necessity and evaluation of taxes. To resolve these problems, this Note suggests modifying the OECD proposal by removing the segmentation rule for companies that would not otherwise qualify for Pillar One taxation and allocating taxing rights to countries based on jurisdiction-specific profits, not revenues. While the OECD proposal will face obstacles, these suggestions should reduce the obstacles by limiting the proposal's disruptive impact on US corporations and addressing legislators' concerns about disproportionate impact on the United States.

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I. INTRODUCTION

In the wake of the 2008 financial crisis (the Great Recession), wealthy countries faced a dangerous combination of declining tax revenues coupled with increased spending.[1] In 2009, the International Monetary Fund (IMF) estimated that the world's ten largest economies would see their debts increase to 114 percent of gross domestic product

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1. *See* Brett Ryder, *The Biggest Bill in History*, ECONOMIST (June 12, 2009), https://www.economist.com/leaders/2009/06/11/the-biggest-bill-in-history [https://perma.cc/4HSE-ZLT3] (archived July 18, 2022).

(GDP) by 2014.[2] In addition to increased spending related to the Great Recession, these deficits were also caused by the broader trend of declining corporate tax revenues.[3] Across the then–thirty or so richest countries in the world, tax revenues decreased by 11 percent from 2008 to 2009.[4] Specifically, governments suffered from a 28 percent decline in corporate income tax revenue, followed by a 16 percent decline in individual income tax revenue.[5]

While the Great Recession contributed to shrinking corporate tax revenue as corporate earnings fell, declining tax rates also played a role. Since 2000, the global average statutory tax rate for corporations has fallen from 28.3 percent in 2000 to 20.0 percent in 2021.[6] Out of 111 countries over this period, the tax rate fell in ninety-four, remained constant in thirteen, and increased in only four.[7] This trend represents a race to the bottom where countries lower their corporate tax rates to attract inbound investment that, theoretically, contributes positively to domestic economic growth.[8]

The math for corporations, and for countries, only works when there are meaningful differences in effective corporate tax rates across jurisdictions. When these differences exist, companies may even seek to relocate entirely rather than shift the location of their assets. In 2015, Pfizer, a US pharmaceutical company, planned to merge with Allergan, an Irish pharmaceutical company.[9] As part of the $160 billion USD merger, Pfizer would have re-domiciled to Ireland, subjected itself to Ireland's lower taxing regime, and ceased to be a US-headquartered corporation—thereby completing a tax inversion.[10] The re-domiciled

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2. *Id.*

3. *See* Daniel Bunn, *Tax Policy and Economic Downturns*, TAX FOUND. (Mar. 18, 2020), https://taxfoundation.org/government-revenue-most-hit-recession/ [https://perma.cc/W75V-HHR2] (archived July 18, 2022).

4. *Id.*

5. *Id.*

6. *See* ORG. FOR ECON. COOP. & DEV., CORPORATE TAX STATISTICS: THIRD EDITION, 9 (July 29, 2021), https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-third-edition.pdf [https://perma.cc/P4ND-R2AU] (archived July 18, 2022).

7. *Id.* at 10.

8. *See* Gabriel Zucman & Gus Wezerek, Opinion, *This is Tax Evasion, Plain and Simple*, N.Y. TIMES (July 7, 2021), https://www.nytimes.com/interactive/2021/07/07/opinion/minimum-corporate-tax.html[https://perma.cc/9MFR-ABYX] (archived July 18, 2022); *see also* Chris Edwards, *Corporate Tax Laffer Curve*, 49 CATO INST. TAX & BUDGET BULL. (2007), cato.org/sites/cato.org/files/pubs/pdf/tbb_1107_49.pdf [https://perma.cc/M29D-KMUS] (archived July 18, 2022) ("The Laffer curve illustrates the idea that above a certain tax rate, cuts to the rate cause the tax base to expand sufficiently for revenues to increase.").

9. Inho Andrew Mun, *Reinterpreting Corporate Inversions: Non-Tax Competitions and Frictions*, 126 YALE L.J. 2152, 2156 (2017).

10. *See id.* Pfizer still would be subject to US taxes on sales within the United States, but re-domiciling would reduce Pfizer's overall effective tax rate by subjecting a greater portion of profits to Irish taxes and thus removing United States' claim to tax the non-domestic profits.

company would have saved up to $35 billion USD in US corporate taxes as a result.[11]

In response, US legislators and administrators from the Internal Revenue Service (IRS) and Department of the Treasury (Treasury) sought to make the deal less favorable from a tax perspective by reducing Pfizer's ability to capture potential tax savings.[12] The merger was eventually called off in 2016 due to reduced tax advantages.[13] This was part of a broader trend, not an isolated event.[14] As countries raced to the bottom of corporate taxation, companies followed suit by leaving countries with comparatively higher taxing regimes.[15] A year later in 2017, the United States sought to catch up in the race by reducing its top effective corporate tax rate from 35 percent to 21 percent.[16]

Amid the Great Recession at the Group of Twenty (G20) Summit in Pittsburgh, Pennsylvania, the Leaders' Declaration endorsed the OECD Global Forum on Transparency and Exchange of Information (Global Forum).[17] More specifically, the G20 endorsed the Global Forum's goal to "improve tax transparency and exchange of information so that countries can fully enforce their tax laws to protect their tax base."[18] The emphasis on protecting the countries' tax bases likely reflected the tax revenue shortfalls these countries faced due to the Great Recession.[19] Also at the summit, the G20 Leaders officially designated the OECD as "the premier forum for international economic co-operation."[20] An endorsement from the leaders of the twenty most powerful countries in the world is not to be taken lightly.

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11. *Id.*

12. *See id.* at 2157.

13. *See id.*

14. *Id.* at 2158 ("In 2014, several U.S. firms with a combined worth of more than $500 billion announced their intention to invert.") (internal citations omitted).

15. *See* Edwards, *supra* note 8, at 1 ("Evidence indicates that taxation significantly influences the location of foreign direct investment, corporate borrowing, transfer pricing, dividend and royalty payments, and research and development performance.") (quoting James Hines, *Introduction*, *in* INTERNATIONAL TAXATION AND MULTINATIONAL ACTIVITY 1 (Univ. Chicago Press, 2001)).

16. *See* William G. Gale, *Did the 2017 tax cut—the Tax Cuts and Jobs Act—pay for itself?*, BROOKINGS INST. (Feb. 14, 2020), https://www.brookings.edu/policy2020/votervital/did-the-2017-tax-cut-the-tax-cuts-and-jobs-act-pay-for-itself/ [https://perma.cc/ZVM7-VA7F] (archived July 18, 2022).

17. ORG. FOR ECON. COOP. & DEV., G20 LEADERS' STATEMENT: THE PITTSBURGH SUMMIT ¶ 15 (Sept. 24–25, 2009), https://www.oecd.org/g20/summits/pittsburgh/G20-Pittsburgh-Leaders-Declaration.pdf [https://perma.cc/S8NL-XSE9] (archived July 18, 2022) [hereinafter G20 LEADERS DECLARATION].

18. *Id.*

19. *See* Allison Christians, *Taxation in a Time of Crisis: Policy Leadership from the OECD to the G20*, 5 NW. J.L. & SOC. POL'Y 19, 21 (2010).

20. G20 LEADERS DECLARATION, *supra* note 17, ¶ 19.

The OECD is an international organization that for sixty years has worked to "build better policies for better lives."[21] As a multi-member body with thirty-six member countries and five partners representing 80 percent of world trade and investment, the OECD has developed 450 international standards covering areas such as finance and investment, governance, and the environment.[22] Of the 450 international standards, 250 are currently in force as legal instruments.[23] International tax reform, through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (Inclusive Framework), is one of the organization's current initiatives and the topic of this Note.

The OECD's role in international tax policy is not a new development. Following the G20's support, the Global Forum has worked with its member countries to end banking secrecy and tax evasion through two primary international standards, which began receiving comments in 2009.[24] The first standard is an Exchange of Information on Request framework that "provides for exchange on request of foreseeably relevant information for carrying out the provisions of a tax convention or for the administration or enforcement of the domestic tax laws of a requesting party."[25] The second standard is an Automatic Exchange of Information process where "a pre-defined set of information on financial accounts held by non-residents is automatically exchanged each year."[26] In tandem, these standards operate to promote the flow of critical information to support domestic tax investigations and enforcement.

While the Global Forum is focused on preventing illegal tax evasion from reducing countries' tax bases, countries' tax bases are also

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21. *About Us*, ORG. FOR ECON. COOP. & DEV., https://www.oecd.org/about/ (last visited Aug. 5, 2022) [https://perma.cc/AS9Y-QGPB] (archived July 18, 2022). When referenced in ECONOMIST articles, the magazine refers to the OECD with a description as "a club of mostly rich countries," which the magazine notes the OECD is not pleased by. *What is the OECD?*, ECONOMIST (July 6, 2017), https://www.economist.com/the-economist-explains/2017/07/05/what-is-the-oecd [https://perma.cc/M3PH-FMQV] (archived Sept. 8, 2022).

22. ORG. FOR ECON. COOP. & DEV., RAISING THE BAR 4, 16 (Sept. 2019), https://www.oecd.org/about/document/raising-the-bar.pdf [https://perma.cc/9KY6-7PZT] (archived July 18, 2022).

23. *Id.* at 4.

24. *See Putting an End to Offshore Tax Evasion*, ORG. FOR ECON. COOP. & DEV. (Sept. 29, 2001), https://www.oecd.org/tax/transparency/ [https://perma.cc/T9XA-SX7A] (archived July 18, 2022).

25. *Exchange of Information on Request: A Robust and Transparent Review Process*, ORG. FOR ECON. COOP. & DEV. (Sept. 29, 2001), https://www.oecd.org/tax/transparency/what-we-do/exchange-of-information-on-request/exchange-of-information-on-request-peer-review-process.htm [https://perma.cc/EBV9-5754] (archived July 18, 2022).

26. *About, Tax & Transparency*, ORG. FOR ECON. COOP. & DEV., https://www.oecd.org/tax/transparency/who-we-are/about/ (last visited Aug. 5, 2022) [https://perma.cc/TW57-AUWM] (archived Aug. 5, 2022).

being reduced by base erosion and profit shifting from multinational enterprises (MNEs).[27] MNEs shift profits artificially, rather than organically, by engaging in aggressive tax planning.[28] Aggressive tax planning involves shifting profits to low-tax jurisdictions through a combination of tax entity structures and transfer pricing of intercompany transactions between separate legal entities within the same parent MNE.[29] The evidence of these profit-shifting efforts can be seen by a misalignment in the company's expenses, revenues, and earnings across countries.[30] For example, in 2011, 30 percent of Apple's pre-tax income was attributable to the United States despite 39 percent of Apple's sales coming from the United States.[31] This 2011 misalignment of sales revenue and income is evidence of tax planning, which is legal, given Apple's status as a US-domiciled corporation and the United States' then–corporate tax rate of 35 percent.[32] In a 2012 Senate hearing with Tim Cook, the Apple CEO, Senator Carl Levin's panel asserted "[Apple] transfer[ed] valuable intellectual property assets offshore and shift[ed] the resulting profits to a tax haven jurisdiction."[33]

In 2012, the G20 Leaders' Declaration continued the tone of the 2009 Pittsburgh Leaders' Declaration but more directly emphasized the need for a more coherent international tax framework.[34] Specifically, the G20 leaders reiterated "the need to prevent base erosion and profit shifting" and their plans to "follow with attention the ongoing work of the OECD in this area."[35] Following the G20's

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27. *See Statistics Explained*, EUROSTAT, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Multinational_enterprise_(MNE) (last visited Nov. 11, 2021) [https://perma.cc/39GE-Q6TM] (archived July 18, 2022) ("A multinational enterprise, abbreviated as MNE and sometimes also called multinational corporation (MNC), just multinational or international corporation, is an enterprise producing goods or delivering services in more than one country.").

28. *See* J. Richard Harvey Jr., *Corporate Tax Aggressiveness – Recent History and Policy Options*, 67(4) NAT'L TAX J. 831, 848 (2014).

29. *See id.*

30. *See id.* at 839.

31. *See id.* at 839–40. Additionally, Apple "had 67 percent of its employees, 79 percent of its compensation expense" in the United States. That same year, Apple's effective tax rate abroad was only 2.5 percent. *Id.* at 839. (internal citations omitted).

32. *See* Patrick Temple-West & Kevin Drawbaugh, *Apple CEO Makes No Apology for Company's Tax Strategy*, REUTERS (May 21, 2013), https://www.reuters.com/article/us-usa-tax-apple/apple-ceo-makes-no-apology-for-companys-tax-strategy-idUSBRE94J0U320130521 [https://perma.cc/VFW6-8TYX] (archived July 18, 2022) ("The Senate Permanent Subcommittee on Investigations has found that Apple in 2012 alone avoided paying $9 billion in U.S. taxes, using a strategy involving three offshore units with no discernible tax home, or 'residence.'").

33. *Id.*

34. *See G20 Leaders Declaration: The Los Cabos Summit*, ¶ 48 (June 18–19, 2012), http://www.g20.utoronto.ca/2012/2012-0619-loscabos.html [https://perma.cc/6UWG-GZYR] (archived July 18, 2022).

35. *Id.*

request, the OECD released their Action Plan on Base Erosion and Profit Shifting (BEPS), which addressed the three main problems associated with taxing MNEs in the digital age: (1) declining MNE effective tax rates leading to tax revenue shortfalls in government budgets; (2) higher tax burdens for other taxpayers across the world to make up for the shortfalls; and (3) increased aggressive tax planning harming the competitive abilities of less aggressive companies (both purely domestic enterprises that cannot take advantage of disparate taxing regimes across jurisdictions and less aggressive MNEs that choose not to take advantage of such disparate regimes).[36] The G20 leaders endorsed the action plan in 2013 and at the 2015 G20 Leaders' Summit in Antalya "[called] on the OECD to develop an inclusive framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions which commit to implement the BEPS project, including developing economies, on an equal footing."[37]

After years of deliberation and planning, the OECD released the Inclusive Framework in July 2021 with 130 countries endorsing the proposal.[38] The goal of the proposal is "to ensure that large MNEs pay tax where they operate and earn profits, while adding much-needed certainty and stability to the international tax system."[39] The proposal has two pillars: the first is designed to focus taxation on the location of business activities and profits (Pillar One), and the second is designed to establish a global minimum tax (Pillar Two).[40] Pillar One, and Amount A in particular, "provide[s] a new taxing right to market jurisdictions, by re-allocating a portion of an in-scope MNE group's residual profit based on a formulary approach."[41] Amount A refers to the eligibility, amount, and eventual allocation of taxing rights over 25

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36. *See* ORG. FOR ECON. COOP. & DEV., ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING 8 (2013), https://www.oecd.org/ctp/BEPSActionPlan.pdf [https://perma.cc/EMX9-M93F] (archived July 18, 2022) [hereinafter OECD ACTION PLAN].

37. ORG. FOR ECON. COOP. & DEV., PROGRESS REPORT JULY 2016-JUNE 2017: INCLUSIVE FRAMEWORK ON BEPS 4 (June 2017), https://www.oecd.org/tax/beps/inclusive-framework-on-BEPS-progress-report-july-2016-june-2017.pdf [https://perma.cc/XTW3-KNWV] (archived Sept. 8, 2022).

38. *130 Countries and Jurisdictions Join Bold New Framework for International Tax Reform*, ORG. FOR ECON. COOP. & DEV. (July 1, 2021), https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm [https://perma.cc/N78Z-QYWX] (archived July 18, 2022) [hereinafter OECD July 2021 Update].

39. *Id.*

40. *Id.*

41. KPMG, OECD/G20 INCLUSIVE FRAMEWORK AGREEMENT ON BEPS 2.0 1 (Oct. 9, 2021), https://assets.kpmg/content/dam/kpmg/us/pdf/2021/10/tnf-inclusive-framework-oct9-2021.pdf [https://perma.cc/X2MA-BNLL] (archived July 18, 2022) [hereinafter KPMG BEPS 2.0 UPDATE].

percent of MNE's residual profits to market jurisdictions.[42] Generally, in-scope MNEs are those that meet profitability and revenue thresholds with residual profits amounting to those profits over 10 percent of revenue.[43] The 25 percent of residual profits is then allocated, based on revenue allocation rules, to eligible market jurisdictions where the MNE sells sufficient products or services.[44] Many details are still being finalized and the group is currently planning to implement Pillar One in 2023.[45] Pillar Two and the Amount B application of arm's length principles to certain in-country activities are beyond the scope of this Note.

While the Biden administration currently supports Pillar One of the proposal, that was not always the case.[46] Previous administrations viewed Pillar One as "potentially disproportionately affecting US corporations."[47] However, modifications to Pillar One to limit its initial application to only the largest and most profitable global companies have, to the current administration, assuaged some of those concerns.[48] Furthermore, Treasury Secretary Janet Yellen has asserted that Pillar One would be "largely revenue neutral" to the United States by losing taxing rights to some companies and gaining rights over others.[49] Nevertheless, some Senators have expressed that Pillar One, even in its more restrictive state, disproportionately impacts US-leading MNEs.[50]

Although the OECD intends that the proposal will reduce tax base erosion and profit shifting, Pillar One has three potential problems due to its design. First, the Pillar One taxing scheme could lead to the breakup of conglomerate companies with multiple business segments.

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42. *OECD Releases Pillar One Public Consultation Document on Draft Nexus and Revenue Sourcing Rules*, ERNST & YOUNG, https://www.ey.com/en_gl/tax-alerts/oecd-releases-pillar-one-public-consultation-document-on-draft-nexus-and-revenue-sourcing-rules (last visited Feb. 24, 2022) [https://perma.cc/2KTD-MRCL] (archived July 18, 2022) [hereinafter *EY on Draft Revenue Sourcing Rules*].

43. KPMG BEPS 2.0 UPDATE, *supra* note 41, at 2.

44. *Id.* at 2–3.

45. OECD July 2021 Update, *supra* note 38.

46. *See* Martin T. Hamilton, Stephen Pevsner & David M. Ward, *A Step Closer to Agreement on Taxation of the Digital World*, PROSKAUER TAX BLOG (Oct. 22, 2021), https://www.proskauertaxtalks.com/2021/10/a-step-closer-to-agreement-on-taxation-of-the-digital-world/ [https://perma.cc/QR3U-TJCP] (archived July 18, 2022) ("The Biden administration had previously stated that it could not accept any result which is discriminatory against US firms.")

47. *Id.*

48. *See id.*

49. Christopher Hanna, *United States: Congressional Reaction to OECD Pillars*, BAKER MCKENZIE (Nov. 1, 2021), https://insightplus.bakermckenzie.com/bm/tax/united-states-congressional-reaction-to-oecd-pillars [https://perma.cc/BB4R-2FCR] (archived July 18, 2022) (internal quotation marks omitted).

50. *See* Aime Williams, *G7 Tax Deal Faces Opposition in US Congress*, FIN. TIMES (June 9, 2021), https://www.ft.com/content/6c98b271-bd13-4517-81bb-6ef7f1798085 [https://perma.cc/F23K-F8SW] (archived July 10, 2022).

Once a company meets the revenue and profitability thresholds, up to 25 percent of the residual profits over 10 percent will be subject to Pillar One taxation. If a company stays below the thresholds, it is not subject to the taxing regime. Initially, this presents a problem where similarly situated companies could be subject to different taxing regimes simply due to a difference of $100,000 USD of annual revenue. Alternatively, if a company does not meet the thresholds in aggregate but has a segment that does, the segment could be subject to the taxing regime. Taken together, these issues may disincentivize marginal growth and profitability, or, more perversely, incentivize breaking up companies where a segment meets the threshold while the parent does not.

Second, the allocation of taxing rights based on complex revenue sourcing rules may misallocate tax revenue to locations where rights to the tax revenue are not justified according to traditional theories of taxation—including Adam Smith's views as well as the benefit and ability-to-pay theories of taxation. Depending on the revenue-sourcing methods, there is a potential for countries with larger populations to receive a disproportionate portion of the allocated tax revenue even if the MNE is not earning a comparable percentage of profit in the jurisdiction now eligible for tax revenue under Pillar One. While not a principal concern for the MNE (the taxes on the residual profits will be reallocated elsewhere), it begs the question of whether mere revenue, absent profit, is sufficient to grant a country taxing rights in the first place. Additionally, the revenue sourcing rules, and their application, may prove overly burdensome for qualifying MNEs.

Third, if compliance costs are too high relative to profits in a particular jurisdiction, companies may choose not to operate in certain markets. In countries where MNEs have low profit margins or limited growth prospects, companies may decide not to offer their products or services in the jurisdiction at all. While a remote possibility, it still warrants consideration as a developing country may be better off with its residents having access to certain technologies even if the government is potentially losing nominal tax revenue.

This Note examines the Inclusive Framework proposal contained in Pillar One and the Amount A taxation of residual profits. This choice is driven by the delayed timeline for Pillar One Amount B and Pillar Two finalization, as well as the unique potential for Pillar One to alter the incentives of corporations. Part II provides an overview of the legacy rules governing international taxation and the challenge of taxing digital companies under those rules. It also explores the benefits that digital companies provide to both countries and their citizens. Additionally, Part II outlines Pillar One of the OECD proposal before detailing the path to implementation, including domestic opposition and the potential paths to implementing the proposal in the United States. Understanding the current criticisms leveled by elected

representatives is critical as, if not addressed, the unresolved criticisms could lead to later United States defection from the proposal in part, or entirely.

Part III evaluates three potential problems with Pillar One including: (1) how Pillar One could lead to corporate breakups and/or modify incentives for corporate growth, (2) whether Pillar One is incompatible with traditional theories of taxation and therefore improperly allocates taxing rights, and (3) if Pillar One compliance may lead companies to exit jurisdictions where they are not materially profitable due to compliance and reporting costs. Part IV proposes two modifications to the OECD proposal which should minimize the potential problems with Pillar One: (1) removing the segmentation exception for companies that would not otherwise meet the criteria of Pillar One; and (2) shifting to a profit-, not revenue-, based allocation methodology to apportion taxing rights.

II. BACKGROUND

This Part provides an overview of the incompatibility of historical taxing regimes with the digital economy, and the role of international tax competition in the race to the bottom. To later explore the consistency of the Pillar One tax with general principles of taxation, it continues by considering the benefits these digital corporations provide to countries seeking to capture a portion of the companies' residual profits. Next, it details the OECD Pillar One proposal, which arose in response to the emergence of digital companies and corporate tax avoidance through aggressive tax planning. Finally, it outlines the debate surrounding the path to enacting the OECD proposal in the United States.

A. *Difficulties of Taxing in the Digital Age and Problems with the Trajectory of International Taxation*

Generally, taxation of non-resident corporations is based on a corporation having a physical presence or sufficient business activity, known as a permanent establishment (PE), in the country seeking to levy taxes.[51] Absent a PE, taxing authorities have difficulty identifying and levying taxes.[52] Today, digitization has enabled new business models where non-resident companies can sell goods or services in another country without a physical presence or level of activity

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51. *See* MICHAEL P. DEVEREUX, ALAN J. AUERBACH, MICHAEL KEEN, PAUL OOSTERHUIS, WOLFGANG SCHÖN & JOHN VELLA, TAXING PROFIT IN A GLOBAL ECONOMY 94 (2021).

52. *See id.*

sufficient to establish a PE.[53] Even if a PE is established, the principle of source-based taxation limits the taxable income attributable to the PE based on the value created at the PE relative to the non-resident corporation.[54] With the rise of intellectual property in the digital economy and clever accounting, it is easier for companies to shift a greater percentage of their income away from the sales destination to the foreign entity where the greatest value was added—the home of the intellectual property. For companies engaged in aggressive tax planning, they will invariably locate their intellectual property in a low-tax jurisdiction.

The PE-based system of taxation historically made sense, but as the world economy has evolved, its compatibility with the digital age has been tested.[55] In 1960, the largest American corporations by revenue were: General Motors, Exxon Mobil, Ford, General Electric, U.S. Steel, Mobil, Gulf Oil, Texaco, Chrysler, and Esmark.[56] These companies made and sold physical goods where some presence of the company or a distributor, often a PE, was necessary for their operations. In 2020, the ten largest global companies by market capitalization were: Apple, Saudi Aramco, Microsoft, Amazon, Alphabet, Facebook, Tencent, Tesla, Alibaba, and Berkshire Hathaway.[57] Unlike the companies of the 1960s, many of these companies do not need a PE in a jurisdiction to generate revenue from their digital products and services. Today, the digital economy

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53. *See OECD and Taxation of the Digital Economy*, BLOOMBERG TAX (Apr. 4, 2022), https://pro.bloombergtax.com/brief/digital-services-tax-challenges/ [https://perma.cc/35H7-V2K3] (archived July 10, 2022).

54. *See* DEVEREUX, AUERBACH, KEEN, OOSTERHUIS, SCHÖN & VELLA, *supra* note 51, at 95 ("Rather, the principle is that the market country is entitled to tax the profit that can be attributed to the functions performed by the [PE].").

55. *See* ORG. FOR ECON. COOP. & DEV., ADDRESSING THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY 9 (July 2021), https://www.oecd.org/tax/beps/brochure-addressing-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf [https://perma.cc/XGY8-CGPW] (archived July 13, 2022) ("One hundred years ago, when business revolved around factories, warehouses and physical goods, this made perfect sense. But in today's digitalised world, MNEs often conduct large-scale business in a jurisdiction with little or no physical presence there.") [hereinafter OECD ON ADDRESSING TAX CHALLENGES OF DIGITALISATION].

56. *Archive of Fortune 500 Lists*, FORTUNE, https://archive.fortune.com/magazines/fortune/fortune500_archive/full/1960/ (last visited July 13, 2022) [https://perma.cc/Z49R-SMEH] (archived July 13, 2022).

57. PRICEWATERHOUSECOOPERS, GLOBAL TOP 100 COMPANIES BY MARKET CAPITALISATION 22 (May 2021), https://www.pwc.com/gx/en/audit-services/publications/assets/pwc-global-top-100-companies-2021.pdf [https://perma.cc/N7B5-N4GD] (archived July 13, 2022).

represents almost 16 percent of worldwide GDP and has grown 250 percent faster than worldwide GDP since 2005.[58]

In response to the difficulty of taxing these digital services in the legacy tax system, many countries are enacting Digital Service Taxes (DST) ranging from 1 percent to 7 percent.[59] Typically, the country-specific DSTs are imposed once companies satisfy large minimum-revenue thresholds above which the tax is levied on companies' "*receipts* from the sale of advertising space, provision of digital intermediary services such as the operation of online marketplaces, and the sale of data collected from users."[60] Critically, these taxes apply to companies' gross receipts as opposed to the portion of value generated by a PE of a non-resident corporation. To return to a more coherent framework, countries are supposed to repeal these DSTs along with Pillar One adoption.[61]

While there have been changes, the current rules governing international taxation are largely based on agreements and treaties from the 1920s.[62] The rules generally align with "the OECD Model Tax Convention on Income and on Capital, the U.N. Model Double Taxation Convention between Developed and Developing Countries, and the U.S. Model Income Tax Convention."[63] These treaties, and taxation in general, largely rely on the PE as the nexus for a country seeking taxing rights if there is not an alternate right to taxation such as residency.[64] When a service is delivered digitally, servers and intellectual property may be all that is needed to deliver the service, and if they are not located in a jurisdiction, establishing taxing rights is challenging.[65] This very problem, along with revenue shortfalls, is what led countries to enact DSTs. Countries such as Ireland exacerbate this problem when they incentivize companies to relocate valuable

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58. Amie Ahanchian, Donald Hok, Philippe Stephanny & Elizabeth Shingler, *Digital Services Tax: Why the World is Watching*, BLOOMBERG TAX (Jan. 6, 2021), https://news.bloombergtax.com/daily-tax-report/digital-services-tax-why-the-world-is-watching [https://perma.cc/CPM8-CYWU] (archived July 13, 2022).

59. *See id.*

60. *Id.* (emphasis added).

61. ORG. FOR ECON. COOP. & DEV., STATEMENT ON A TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY 3 (Oct. 8, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf [https://perma.cc/9H5B-YA2G] (archived July 13, 2022) [hereinafter OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION].

62. OECD ON ADDRESSING TAX CHALLENGES OF DIGITALISATION, *supra* note 55, at 9.

63. Assaf Harpaz, *Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First-Century Economy*, 46 YALE J. INT'L L. 57, 61 (2021).

64. *See id.*

65. *See id.* at 62.

intellectual property to low-tax jurisdictions by offering the companies favorable tax incentives.

In 2015, Ireland's GDP increased by over 26 percent from the prior year.[66] Outside of 2015, the highest percentage increase of annual Irish GDP was approximately 11 percent in 1997.[67] From 1971 to 2020, the average Irish GDP growth rate was 4.96 percent and when 2015 is excluded, the average falls to 4.55 percent.[68] One major contributor to the decades of GDP growth was Ireland's status as a tax haven offering favorable tax rates to multinational corporations relative to tax rates in other countries.[69] In 2015, Ireland's corporate tax rate was 12.5 percent.[70] This was nearly 50 percent lower than the global average corporate tax rate in 2015, and substantially lower than the then US corporate tax rate of 35 percent.[71] The prior year, Ireland introduced a "knowledge development box" category taxing revenue derived from intellectual property at 6.25 percent.[72] Scholars and politicians have argued that raising corporate tax rates negatively impacts GDP, whereas reducing corporate tax rates positively impacts GDP.[73] As the world becomes increasingly connected, MNEs can simply relocate, either entirely or merely a subset of assets, to a different jurisdiction where the tax rate is lower.[74] The Irish tax authorities can certainly attest to companies' ability, and desire, to do so.

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66. Paul Krugman, Opinion, *Biden, Yellen and the War on Leprechauns*, N.Y. TIMES (Apr. 8, 2021), https://www.nytimes.com/2021/04/08/opinion/biden-corporate-taxes.html [https://perma.cc/7AP6-BKYE] (archived July 14, 2022).

67. *See GDP growth (annual %) – Ireland*, WORLD BANK, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2020&locations=IE&start=1971&view=chart (last visited July 14, 2022) [https://perma.cc/7JWE-XYGR] (archived July 14, 2022).

68. *See id.*

69. *See* Krugman, *supra* note 66.

70. Douglas Dalby & Mark Scott, *Ireland, Accused of Giving Tax Breaks to Multinationals, Plans an Even Lower Rate*, N.Y. TIMES (Oct. 13, 2015), https://www.nytimes.com/2015/10/14/business/international/ireland-tax-rate-breaks.html [https://perma.cc/S69V-RG4C] (archived July 14, 2022).

71. *See Corporate Tax Rates Table*, KPMG, https://home.kpmg/it/it/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (last visited July 14, 2021) [https://perma.cc/N6VW-ABGH] (archived July 14, 2022).

72. Dalby & Scott, *supra* note 70.

73. *See* Alex Muresianu & Erica York, *Raising the Corporate Rate to 28 Percent Reduces GDP by $720 Billion Over Ten Years*, TAX FOUND. (Apr. 21, 2021), https://taxfoundation.org/increase-corporate-tax-rate-28-percent/ [https://perma.cc/5FJ4-AGT6] (archived July 14, 2022) ("Using the Tax Foundation General Equilibrium Model, we estimate the long-run impact of a 28 percent corporate income tax rate would be a 0.7 percent reduction in GDP, amounting to about $160 billion (in today's dollars) of lost output each year. Similarly, the level of American incomes (measured by Gross National Product, GNP), the capital stock, wages, and full-time equivalent employment would also be lower.").

74. *See* Alex Brill & Kevin Hassett, *Revenue-Maximizing Corporate Income Taxes: The Laffer Curve in OECD Countries* 4 (Am. Enter. Inst. for Pub. Pol'y Rsch.,

The prospect of lower taxes led to corporate entity reorganizations and transfers of productive assets to Irish subsidiaries, which subsequently shifted corporate profits associated with those assets to those Irish subsidiaries.[75] As evidence of this trend, the value of productive assets in Ireland increased by €300 billion EUR in 2015.[76] Apple moved some of its intellectual property to Ireland and AerCap, an aircraft leasing company, shifted the domicile of its €35 billion EUR fleet to Ireland.[77] In 2016, the European Commission ruled that Ireland had historically undertaxed Apple by €11.5 billion EUR and Ireland's taxing regime was therefore uncompetitive.[78] Apple challenged the ruling, but so too did Ireland—effectively challenging their right to recover Apple's unpaid taxes to Ireland.[79] Ireland's response in defending the suit suggests they believed that the favorable tax treatment of MNEs was worth at least €11.5 billion EUR.[80] Ireland, however, is not alone as a tax haven for multinational companies.[81]

In 2017, there was approximately $40 trillion USD of foreign direct investment (FDI)[82] around the world.[83] Much of this investment

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Working Paper No. 137, 2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2235697 [https://perma.cc/S827-KB6G] (archived July 14, 2022).

75. *See, e.g.*, Krugman, *supra* note 66; Cliff Taylor, *Ireland's GDP Figures: Why 26% Economic Growth is a Problem*, IRISH TIMES (July 15, 2016), https://www.irishtimes.com/business/economy/ireland-s-gdp-figures-why-26-economic-growth-is-a-problem-1.2722170 [https://perma.cc/67GA-8BND] (archived July 14, 2022).

76. Taylor, *supra* note 75.

77. *Id.*

78. *See* Cases T-778/16 & T-892/16, Ir. & Others v. Comm'n, ECLI:EU:T:2020:338 (July 15, 2020); *see also* John Campbell, *Apple Irish Tax Case Appeal Heard by EU Court*, BBC (Sept. 17, 2019), https://www.bbc.com/news/world-europe-49724786 [https://perma.cc/6SH9-ZQQF] (archived July 14, 2022) (providing a summary of the European Commission's decision).

79. In 2020, the European Union's General Court ruled for Apple and Ireland due to insufficient evidence to prove Ireland's taxing scheme was illegal under European Union law. *See Apple has €13bn Irish Tax Bill Overturned*, BBC (July 15, 2020), https://www.bbc.com/news/business-53416206 [https://perma.cc/93UK-3C7F] (archived July 14, 2022).

80. *See* Dalby & Scott, *supra* note 70 ("Ireland's corporate tax rates may be low by international standards, but the revenue they generate is a major contributor to the country's Treasury. In 2014, Ireland's total tax take was 41 billion euros, or $46.6 billion, and corporate tax accounted for 11 percent of the total.").

81. *See, e.g.*, Krugman, *supra* note 66.

82. *Foreign direct investment (FDI)*, OECDILIBRARY, https://www.oecd-ilibrary.org/finance-and-investment/foreign-direct-investment-fdi/indicator-group/english_9a523b18-en (last visited July 14, 2022) [https://perma.cc/72GJ-LUA6] (archived July 14, 2022) ("Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.").

83. *See* Jannick Damgaard, Thomas Elkjaer & Niels Johannesen, *The Rise of Phantom Investments*, 56 IMF FIN. & DEV. 11, 12 (2019), https://www.imf.org/external/pubs/ft/fandd/2019/09/the-rise-of-phantom-FDI-in-tax-havens-damgaard.htm [https://perma.cc/7THB-99P9] (archived July 15, 2022).

simply passes through special purpose entities, such as shell companies, that exist as pass-through or holding entities.[84] This type of FDI is referred to as phantom FDI and reached almost 40 percent of global GDP in 2017.[85] While this type of investment does not bring the same benefits as legitimate capital investments in an income-producing resident entity producing goods or services, certain countries still seek this type of investment as it may bring nominal tax revenue, administrative revenue, and professional services fees.[86] Ten countries, including Ireland, account for approximately 85 percent of this phantom FDI.[87] In 2017, the same amount of FDI, $4 trillion USD, was sent to the United States as was sent to Luxembourg, a country with six hundred thousand people.[88] While Luxembourg has a corporate income tax rate ranging from 17 percent to 25 percent, this tax only applies to income "generated in Luxembourg."[89] Given Luxembourg's taxation of income "generated in Luxembourg," income associated with special purpose entities and shell companies is not subject to the tax.

It is worth noting that companies seeking to minimize their tax burdens is imminently reasonable, and certainly legal if executed properly. Taxes are one way to provide benefits to a country and its citizens, but there are other ways these same companies provide real benefits to countries outside of funding government coffers.

B. *Benefits Technology Companies Provide in Developing Countries and the Income They Make*

This subpart begins by exploring the benefits that certain companies provide to countries and their citizens in order to contextualize what could be lost if Pillar One taxation proves problematic with deconsolidation, altering corporate incentives, or

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84. *See id.*

85. *See id.* See the source's chart on the bottom of page 12, which shows phantom FDI as reaching approximately 40 percent of global GDP for the year 2017. *Id.*

86. *See id.* ("Even if the empty corporate shells have no or few employees in the host economy and do not pay corporate taxes, they still contribute to the local economy by buying tax advisory, accounting, and other financial services, as well as by paying registration and incorporation fees.").

87. *Id.* ("Luxembourg and the Netherlands host nearly half. And when you add Hong Kong SAR, the British Virgin Islands, Bermuda, Singapore, the Cayman Islands, Switzerland, Ireland, and Mauritius to the list, these 10 economies host more than 85 percent of all phantom investments.").

88. *Id.*

89. DLA PIPER, GUIDE TO GOING GLOBAL: LUXEMBOURG 4 (May 25, 2022), https://www.dlapiperintelligence.com/goingglobal/tax/index.html?t=02-taxable-income&c=LU (May 25, 2022) [https://perma.cc/772Z-6YKE] (archived July 15, 2022) ("Income from Luxembourg sources include commercial income realized by, for example, a permanent establishment/representative in Luxembourg, income from the lease of property and securities income.").

proves too burdensome from a compliance perspective. Next, it explores the geographic revenue distribution of select corporations to reveal that profits do not necessarily align with revenue or population. Doing so exposes a potential for the misallocation of tax revenue based on the revenue sourcing rules of Pillar One.

In the 1970s, Milton Friedman penned a *New York Times* op-ed titled *The Social Responsibility of Business Is to Increase Its Profits*.[90] He argued that charitable contributions of widely held corporations should be made by the shareholders, not the companies, while also acknowledging "[i]n the present climate of opinion, with its widespread aversion to capitalism, profits, the soulless corporation . . . [social responsibility] is one way for a corporation to generate goodwill as a by-product of expenditures that are entirely justified in its own self-interest."[91] An alternate view of corporations engaging in socially responsible endeavors, as opposed to purely seeking profits, is that there are legitimate business reasons for creating social improvement as "the more a social improvement relates to a company's business, the more it leads to economic benefits as well."[92] Assuming companies do not provide benefits in countries for free, it is worth exploring whether Pillar One taxation could disincentivize companies from providing certain benefits at all. Whether from increased taxation of a segment resulting in less available cash, or increased compliance costs associated with operating in a jurisdiction, companies could question their presence in unprofitable jurisdictions.

In 2013, Facebook (now Meta) partnered with telecommunications companies as part of Internet.org to help deliver internet connectivity to the 5 billion people around the world without network connectivity.[93] Shortly thereafter, Internet.org launched an app in Zambia to allow "users to browse [thirteen] services without data charge[s], including Google, Facebook, Wikipedia, a Johnson & Johnson-sponsored maternal health site, the Zambian government's app, a local job portal, and a women's rights organization."[94] The service continued to grow across the continent and morphed into Facebook Free Basics, which provided free access to Facebook in forty-two countries as of 2016.[95] The program was challenged before being banned in India where

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90. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at 17.

91. *Id.* (internal quotation marks omitted).

92. Michael E. Porter & Mark. R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARV. BUS. REV. 57, 59 (2002).

93. *See* Toussaint Nothias, *Access Granted: Facebook's Free Basics in Africa*, 42(3) MEDIA, CULTURE & SOC'Y 329, 331 (2020).

94. *Id.* at 332.

95. *See* Maeve Shearlaw, *Facebook Lures Africa with Free Internet – But What is the Hidden Cost?*, GUARDIAN (Aug. 1, 2016), https://www.theguardian.com/world/2016/aug/01/facebook-free-basics-internet-africa-mark-zuckerberg [https://perma.cc/9THF-NYTW] (archived July 19, 2022).

Facebook's CEO, Mark Zuckerberg, denied the program was purely profit-seeking when he wrote, "[I]f people lose access to free basic services, they will simply lose access to the opportunities offered by the internet today."[96]

Continuing the effort to promote connectivity, Facebook partnered with other technology and telecommunications companies in 2020 to construct a twenty-three thousand mile cable connecting Africa, Europe, and the Middle East called 2Africa.[97] The cable, to be completed in 2024, will provide "much-needed internet capacity, redundancy, and reliability across Africa; supplement a rapidly increasing demand for capacity in the Middle East; and support further growth of 4G, 5G, and broadband access for hundreds of millions of people."[98] In a similar endeavor, Alphabet, through their company Loon, released thirty-five balloons over Kenya in 2020 to provide 4G LTE network connectivity to thirty-one thousand miles across Kenya.[99] Loon shuttered the project in 2021 as "[t]he road to commercial viability has proven much longer and riskier than hoped."[100] Alphabet, through Project Taara, is also working on technology in Kenya to provide connectivity through beams of light closer to the ground.[101]

In addition to companies questioning the benefits they provide and/or their presence in certain jurisdictions, Pillar One presents further problems based on the revenue sourcing methods and the need to allocate revenue when direct revenue attribution is not possible. As revealed in the OECD's February 2022 consultation document, if companies cannot properly attribute revenue to a particular jurisdiction, companies are to use an allocation key, such as GDP, as a workaround.[102] However, the 2020 financials of Facebook and Alphabet suggest that such a workaround is not likely to properly

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96. *Id.*

97. *See* Loni Prinsloo, *Facebook to Expand Planned Undersea Cable Network in Africa*, BLOOMBERG (Aug. 16, 2021), https://www.bloomberg.com/news/articles/2021-08-16/facebook-to-expand-planned-undersea-cable-network-in-africa [https://perma.cc/A75D-WWJ3] (archived July 19, 2022).

98. Najam Ahmad & Kevin Salvadori, *Building a Transformative Subsea Cable to Better Connect Africa*, ENG'G AT META (May 13, 2020), https://engineering.fb.com/2020/05/13/connectivity/2africa/ [https://perma.cc/GE3Y-2WD7] (archived July 19, 2022).

99. *See* Abdi Dahir, *A Bird? A Plane? No, It's a Google Balloon Beaming the Internet*, N.Y. TIMES (July 7, 2020), https://www.nytimes.com/2020/07/07/world/africa/google-loon-balloon-kenya.html [https://perma.cc/DZ8Z-TLS6] (archived July 19, 2022).

100. Socrates Mbamalu, *Google's Ambitious Loon Internet Balloon Project Has Crash-Landed*, QUARTZ AFRICA (Jan. 22, 2021), https://qz.com/africa/1961328/why-googles-loon-internet-balloon-project-crash-landed/ [https://perma.cc/ZG9S-WQ8M] (archived July 19, 2022).

101. *See* Mahesh Krishnaswamy, *Bringing Light-Speed Internet to Sub-Saharan Africa*, X (Nov. 10, 2020), https://x.company/blog/posts/bringing-light-speed-internet-to-sub-saharan-africa/ [https://perma.cc/5E3R-JCNM] (archived July 19, 2022).

102. *See EY on Draft Revenue Sourcing Rules*, *supra* note 42.

attribute revenues, and certainly will not properly attribute profits at the jurisdiction level.

In 2020, Facebook, which does not publicly report users or revenue by country, had 598 million daily active users across Africa, Latin America, and the Middle East (Rest of World) compared to 1,845 million globally.[103] Despite the collective Rest of World representing about 32 percent of Facebook's users, the region only accounted for 8.5 percent of Facebook's 2020 global revenue of $85.965 billion USD.[104] Alphabet, Google's parent company, does not release user/customer data by country and instead reports their revenue across four geographic segments: United States; Europe, Middle East, and Africa (EMEA); Asia Pacific (APAC); and Other Americas.[105] In 2020, 30 percent of Alphabet's revenue came from EMEA, down from 31 percent in 2019.[106] This figure is roughly aligned with EMEA's 26.8 percent share of the global population in 2020. The same year, APAC represented 18 percent of revenue and the United States represented 47 percent.[107] In 2020, APAC accounted for 59.5 percent of the global population and the United States represented 4.25 percent.[108]

C. *OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting*

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting currently consists of the general framework for the two pillars to address base erosion and profit shifting.[109] Pillar One provides participating countries with a new right to tax companies based on the location of the companies' customers, irrespective of the location of the companies themselves, and Pillar Two establishes a global minimum

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103. Facebook Inc., Annual Report (Form 10-K) 54 (Jan. 27, 2021).

104. *Id.* at 96.

105. Alphabet Inc., Annual Report (Form 10-K) 30 (Feb. 2, 2021).

106. *Id.*

107. *Id.*

108. *Archive of World Population Data*, WORLDOMETERS, https://www.worldometers.info/world-population/ (last visited Sept. 29, 2021) [https://perma.cc/Z6KS-YQ9P] (archived July 19, 2022). In 2021, the United States had a GDP per capita of approximately $69,300 USD whereas China and India (the two most populous APAC countries) came in at approximately $12,560 USA and $2,300 USD respectively. *GDP per capita (current US$)*, WORLD BANK, https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?name_desc=false_(last visited Aug. 11, 2022) [https://perma.cc/9Z7T-FP35] (archived Sept. 8, 2022). In addition to varied competition and internet access, this GDP misalignment across countries helps explain the revenue misalignment for Alphabet, and others, given the varied degree of citizen wealth across the countries.

109. *See* Alex Granwell & Joshua Odintz, *Agreement on Global Tax Reform: What Happened and What's Next*, HOLLAND & KNIGHT (Aug. 18, 2021), https://www.hklaw.com/en/insights/publications/2021/07/agreement-on-global-tax-reform-what-happened-and-whats-next [https://perma.cc/XPA2-V8H8] (archived July 19, 2022).

level of taxation.[110] Both Pillar One and Pillar Two only apply to MNEs that satisfy the revenue requirements associated with each pillar.[111] Similarly, certain industries are exempt from the taxing requirements associated with each pillar.[112]

Historically, taxing rights over MNEs were predicated on the companies' PE in a jurisdiction.[113] The Inclusive Framework proposal, through Pillar One, builds on the DST approach but in a harmonized manner by "[aligning] taxing rights more closely with local market engagement."[114] The proposal assumes the existing DSTs will be repealed by the participating countries.[115] Once the country-specific DSTs are repealed and the Inclusive Framework is implemented, various types of transactions (i.e., sales of user data, advertising revenue, and sales of goods) will have unique sourcing rules to attribute MNE revenue to the end-user jurisdiction and establish countries' taxing rights over their share of the MNE's tax revenue.[116]

Despite the lengthy negotiations and global involvement that has gone into it, Pillar One, as it is currently proposed, will likely only apply to one hundred companies.[117] At implementation, MNEs will be in-scope for Pillar One taxation if they meet each of three criteria: (1) global revenue over €20 billion EUR (approximately $24 billion USD); (2) global pre-tax profit over 10 percent; and (3) that the company does business in an included industry (regulated financial services and extractives are currently excluded).[118] As of the October 2021 statement, companies' satisfaction of the revenue and profit criteria

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110. *BEPS 2.0: Pillar One and Pillar Two*, KPMG, https://home.kpmg/xx/en/home/insights/2020/10/beps-2-0-pillar-one-and-pillar-two.html (last visited Sept. 29, 2021) [https://perma.cc/2M5M-NWJ7] (archived July 19, 2022).

111. ORG. FOR ECON. COOP. & DEV., STATEMENT ON A TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY 4 (July 1, 2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf [https://perma.cc/Y6CW-PUU3] (archived July 19, 2022) [hereinafter OECD JULY 2021 STATEMENT].

112. *Id.*

113. *See* Daniel Bunn, *Recent Analysis Explores Pillar 1 Risks and the Potential for Disputes*, TAX FOUND. (May 10, 2021), https://taxfoundation.org/oecd-pillar-1-amount-a/ [https://perma.cc/JD6A-8UP6] (archived July 19, 2022).

114. *See* KPMG, PILLAR ONE: PROFIT ALLOCATION AND NEXUS (Sept. 2021), https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/10/beps-2-0-pillar-one-profit-allocation-and-nexus.pdf [https://perma.cc/6DCS-NEB2] (archived July 19, 2022).

115. *See id.*

116. *See* OECD JULY 2021 STATEMENT, *supra* note 111, at 2.

117. *See* Richard Rubin & Sam Schechner, *The Global Tax Plan: Questions and Answers*, WALL ST. J. (July 1, 2021), https://www.wsj.com/articles/the-global-tax-plan-questions-and-answers-11625168109 [https://perma.cc/QC73-66K4] (archived July 19, 2022).

118. OECD JULY 2021 STATEMENT, *supra* note 111, at 1.

will be determined using averages of a yet unspecified period of time.[119] Following its successful implementation, the global revenue threshold will be reduced, likely to €10 billion EUR in seven years.[120] In certain cases, companies will be subject to segmentation where a segment of a company meets the inclusion criteria even though the company as a whole does not.[121]

The available tax base to be allocated, the Quantum, is 25 percent of an MNE's worldwide profits that exceed 10 percent of worldwide revenue (the residual profits).[122] If subject to segmentation, the residual profits would be calculated at a segment level within a company.[123] Whether an MNE owes taxes to a particular participating country is then determined by the special purpose nexus rule whereby countries obtain taxing rights to the residual profits in two possible manners: (1) for countries with a GDP under €40 billion EUR, a country's taxing rights are predicated on the MNE deriving at least €250,000 EUR of revenue from the country; or (2) for countries with a GDP over €40 billion EUR, a country's taxing rights are predicated on the MNE deriving at least €1 million EUR of revenue from the country.[124]

Once a jurisdiction is entitled to a portion of the Quantum under the nexus rules, the specific amount of taxes owed is determined by category-specific revenue sourcing rules based on the proportional consumption of the MNE's goods and services across the qualifying jurisdictions.[125] This amount is subject to limitation, however, in two ways. If MNEs are already subject to taxation in a jurisdiction entitled to a portion of the Quantum, the amount of tax owed to the jurisdiction will be capped in a manner to be further elaborated.[126] Critically, "[d]ouble taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method."[127]

The OECD's February 2022 Pillar One public consultation document provided further clarity on the revenue sourcing rules companies need to apply when determining the portion of the Quantum

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119. OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 2.

120. OECD JULY 2021 STATEMENT, *supra* note 111, at 1.

121. *See* Rubin & Schechner, *supra* note 117 ("Such a provision would make Pillar One apply to Amazon.com Inc.'s cloud division, Amazon Web Services, even though Amazon as a whole isn't profitable enough to qualify.").

122. OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 2.

123. *See* OECD JULY 2021 STATEMENT, *supra* note 111, at 2.

124. *Id.* at 1.

125. *See* OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 2.

126. *See id.*

127. *Id.*

eligible jurisdictions are entitled to.[128] Overall, there are eight primary revenue categories, with further subcategories, each listing an indicator to be used by the company to properly attribute the source of the revenue.[129] Generally, the goal of the indicator and sourcing rules is to attribute the revenue to the location of the end-user or consumer.[130] If there is no reliable indicator, companies may use an allocation key such as GDP or other economic indicators to attribute otherwise untraceable revenue.[131]

From an administrative perspective, the MNE entity that earns the residual profit bears the tax liability and the process may be managed through a single entity.[132] In case of MNE disputes over eligibility, revenue sourcing, or amounts, there will be a binding dispute resolution mechanism.[133] Getting to the point where the binding dispute resolution mechanism and proposal at large is implemented, however, is still subject to domestic obstacles including the very path to enactment as is discussed below.

D. *Path to Implementation of the OECD Proposal, Including Likely Political Challenges*

By 2023, the Multilateral Convention (MLC) for Amount A will be developed and available for signature.[134] Model rules for domestic enactment will accompany the MLC along with an explanatory statement.[135] As part of the MLC, member countries are to remove current DSTs and not enact new DSTs, or similarly designed taxes, between October 8, 2021 and until either the MLC is enacted, or December 31, 2023.[136] Assuming this is all satisfied, the goal is for the Pillar One Amount A taxation scheme to come into effect in 2023.[137]

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128. *See generally* ORG. FOR ECON. COOP. & DEV., PILLAR ONE – AMOUNT A: DRAFT MODEL RULES FOR NEXUS AND REVENUE SOURCING (Feb. 4, 2022) https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-nexus-revenue-sourcing.pdf [https://perma.cc/F57V-Q4KW] (archived July 19, 2022).

129. *See EY on Draft Revenue Sourcing Rules*, *supra* note 42.

130. Pie Geelen, Sorina van Kommer & Michael F. Patton, *OECD Makes Progress on Pillar 1 – Release of Draft Sourcing and Nexus Rules of Amount A*, DLA PIPER (Feb. 7, 2022), https://www.dlapiper.com/en/pr/insights/publications/2022/02/oecd-makes-progress-on-pillar-1-release-of-draft-sourcing-and-nexus-rules-of-amount-a/ [https://perma.cc/6UX9-87YG] (archived July 19, 2022).

131. *See EY on Draft Revenue Sourcing Rules*, *supra* note 42.

132. OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 2–3.

133. *Id.* at 2.

134. *See id.* at 3.

135. KPMG BEPS 2.0 UPDATE, *supra* note 41, at 12.

136. *See* OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61.

137. *Id.* at 3.

Some US legislators, namely Senate Republicans, have expressed concerns that: (1) the proposal is not revenue neutral to the United States, (2) it disproportionately targets US MNEs, and (3) the need for countries to pass the MLC independently into law could leave the United States exposed if other countries don't follow suit.[138] Additionally, House Democrats have further commented on the need for "ensuring the competitiveness of US companies with their foreign counterparts" on both substance of the OECD proposal and timing of enactment.[139] Ensuring the OECD proposal addresses the concerns of legislators may be necessary to prevent repeal, or at least to ensure enactment and adherence.

Aside from fundamental opposition, there is some debate as to what is required to enact the MLC into law.[140] Treaties require a two-thirds majority in the Senate as outlined in the Constitution.[141] On the other hand, bills dealing with revenue are to originate in the House of Representatives and need only be approved by a majority in the Senate.[142] Several commentators, including Counselor to the Assistant Secretary of the Treasury Rebecca Kysar, have suggested that tax treaties are better viewed as revenue bills.[143] In a 2013 law review article, Kysar argued that "tax treaties must not be self-executing but instead must be implemented through legislation passed by both houses or else be approved as congressional-executive agreements."[144] Regardless of the ultimate path, enacting the MLC into law is not a guarantee, and given the ever-changing political landscape, temperatures are better checked once the proposal is closer to enactment and the political power of that time is clear.

III. ANALYSIS

Aside from issues with implementation, either domestically or internationally, Pillar One still presents three potential problems related to altering corporate structures and marginal incentives, misallocating taxing rights based on traditional theories of taxation, and causing corporations to leave unprofitable jurisdictions. Part III evaluates the degree to which each problem may manifest itself and if

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138. *See* Williams, *supra* note 50.

139. Hanna, *supra* note 49.

140. *See id.*

141. U.S. CONST. art. II, § 2, cl. 2 ("[The President] shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur . . .").

142. U.S. CONST. art. I, § 7, cl. 1 ("All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills.").

143. *See* Hanna, *supra* note 49.

144. Rebecca M. Kysar, *On the Constitutionality of Tax Treaties*, 38 YALE J. INT'L L. 1, 4 (2013).

so, whether the outcomes are still consistent with the broader goals of the Pillar One proposal.

A. *Could Pillar One Taxation Cause Corporate Breakups or Otherwise Disincentivize Revenue or Profit Maximization on the Margin?*

When considering the impact of Pillar One on corporate structuring and incentives, it is critical to consider the potential impacts both in a vacuum as well as in the context of the broader economic and legislative trends. In both instances, Pillar One may alter incentives in favor of breaking up conglomerate companies and dissuading companies from seeking maximum tax agnostic revenue/profit on the margin. This subpart explores the role of Pillar One in altering those incentives in a vacuum. It next considers the role of Pillar One in the context of domestic legislation (specifically, corporate tax/antitrust legislation) and recent corporate de-consolidations.

Given that Pillar One will initially only impact the largest one hundred companies, the in-scope companies often operate multiple segments with tangentially related businesses.[145] Where companies as a whole do not qualify for Pillar One inclusion but a segment does, this could put pressure on companies to reconsider their business segments to avoid Pillar One inclusion entirely.[146] This is especially true where the segments are not directly related to the core business and there are no material synergies associated with ownership of nominally related segments. General Electric (GE) provides a fitting example of such a company where, on the margin, additional taxation might cause the company, or an active investor, to reconsider the corporate structure if subjected to Pillar One taxation.

In 2020, GE had total revenues of $76 billion USD across its five business segments (Power, Renewable Energy, Aviation, Healthcare, and Capital).[147] While GE would be in-scope for Pillar One taxation from a revenue perspective, GE's 2020 profit margin of 10 percent would leave no residual profit to be allocated to countries from the Quantum.[148] Furthermore, if subject to segmentation, only GE's Healthcare segment would come close to being in-scope for Pillar One taxation with a profit margin of 17 percent, but revenues falling short

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145. *See* Rubin & Schechner, *supra* note 117.

146. *See id.* ("Such a provision would make Pillar One apply to Amazon.com Inc.'s cloud division, Amazon Web Services, even though Amazon as a whole isn't profitable enough to qualify.").

147. Gen. Elec. Co., Annual Report (Form 10-K) 6 (Feb. 12, 2021).

148. *See id.*; *see also* OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 2.

of the $24 billion USD turnover threshold.[149] Should that segment be considered in-scope, could it call into question the conglomerate structure to begin with?

For GE, we will never know, as the scenario cannot materialize in its 2020 structure. In 2021, GE announced it would separate into three distinct companies: Healthcare, Power and Energy, and Aviation.[150] The underlying rationale is that "GE is worth more as the sum of its parts rather than as a stand-alone enterprise."[151] While this deal is not tied to the OECD tax proposal, it illustrates a broader trend seen in 2021. In 2021, Johnson & Johnson, Toshiba, IBM, and AT&T also announced breakups.[152] These companies decided that getting rid of tangentially related businesses would be positive for shareholders. It is possible that an additional external influence, Pillar One taxation, could cause other companies to make the same decisions.

If Pillar One taxation and the recent trend towards breaking up conglomerates are not enough, a growing sentiment in favor of antitrust enforcement may, in totality, be enough to cause companies to rethink their corporate structures. In July 2021, President Biden issued an executive order focused on the technology sector emphasizing the government's ability to "challenge transactions whose previous consummation was in violation of [antitrust laws]."[153] Striking a similar tone, Senators Klobuchar and Cotton introduced a bill in November 2021 to target technology platform dominance and promote competition by making future acquisitions more difficult for dominant players.[154] Even if Pillar One, along with the recent trends of de-consolidation and antitrust enforcement, does not incentivize corporate breakups, Pillar One does not wholly align with the traditional theories of taxation.

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149. *See* Gen. Elec. Co. Annual Report, *supra* note 147, at 6; *see also* OECD JULY 2021 STATEMENT, *supra* note 111, at 1.

150. Al Root, *The Math Behind GE's Breakup Makes Sense. Here's How.*, BARRON'S (Nov. 14, 2021), https://www.barrons.com/articles/general-electric-breakup-stock-larry-culp-51636741225 [https://perma.cc/U434-RV35] (archived July 20, 2022).

151. *Id.*

152. *See* Allan Sloan, *Giants like GE and IBM are Splitting up. The Picture for Shareholders is Complicated*, WASH. POST (Nov. 23, 2021), https://www.washingtonpost.com/business/2021/11/23/ibm-general-electric-johnson-johnson-toshiba-breakup/ [https://perma.cc/KHV8-UWZW] (archived July 20, 2022).

153. Exec. Order No. 14036, 86 Fed. Reg. 36987, 36988 (July 9, 2021).

154. *Klobuchar, Cotton Introduce Bipartisan Legislation to Protect Competition and Consumer Choice Online*, U.S. SENATOR AMY KLOBUCHAR (Nov. 5, 2021), https://www.klobuchar.senate.gov/public/index.cfm/2021/11/klobuchar-cotton-introduce-bipartisan-legislation-to-protect-competition-and-consumer-choice-online [https://perma.cc/A3SH-P9PP] (archived July 20, 2022).

B. *Is Pillar One and its Revenue-Based Allocation of Taxing Rights Consistent with Theories of Taxation?*

Thus far, this Note has explored the development of international taxation of MNEs leading to the OECD's proposal to modify the current framework. It is also worth assessing the proposal relative to theories of taxation. This Note does so by looking to Adam Smith's views on the necessity and evaluation of taxes, as well as two related theories of taxation: the benefit theory of taxation and the ability-to-pay theory of taxation. While there are multiple theories of taxation, these theories provide a sufficient framework by which to analyze Pillar One from a theoretical perspective. On balance, the current OECD Pillar One proposal is in tension with the traditional theories of taxation. This tension is best understood when considering the *needs* of the states and the benefits companies receive, or do not receive, by operating in a jurisdiction.

In his book, *The Wealth of Nations*, Adam Smith penned four key principles of taxation. While Smith's principles are detailed below, the principles require taxes to be: (1) proportional to a taxpayer's ability-to-pay and benefits received from the state, (2) certain in amount and process to the taxpayer, (3) convenient for the taxpayer to pay, and (4) not overly burdensome relative to the needs of the state.[155]

> 1. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is in proportion to the revenue which they respectively enjoy under the protection of the state . . . In the observation or neglect of this maxim . . . [influences] what is called the equality or inequality of taxation . . .
>
> 2. The tax which each individual is bound to pay, ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person . . .
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> 3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it . . .
>
> 4. Every tax ought to be so contrived, as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury [of the state].[156]

Today, Adam Smith's first principle has evolved into two competing theories of taxation: the benefit theory of taxation and the ability-to-pay theory of taxation.[157] On one hand, the benefit theory of taxation stands for the proposition that "taxes should be considered

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155. *See* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 258–59 (4th ed., vol. II, Lincoln & Gleason, Printers 1804) (1776).

156. *Id.*

157. *See* Mun, *supra* note 9, at 2178.

payments for services rendered by the state to the taxpayers and so proportioned."[158] On the other hand, the ability-to-pay theory suggests that "one's tax burden should reflect one's ability to pay, where income is often used as a measure of an individual's ability to pay tax."[159]

C. *Benefit Theory of Taxation*

In an extension of Adam Smith's first principle, the benefit theory of taxation, the benefits foreign MNEs receive from the state where they operate can be viewed as the income from engaging with a countries' citizens, as government spending makes the engagement possible.[160] Absent a taxing mechanism, the benefits received would go untaxed.[161] In a simple example, if a country has invested in an internet infrastructure for its citizens, Google is relying on that infrastructure when it provides access to its services. Said differently, "in the absence of those facilities and the markets generated by them, the foreign corporations would be unable to earn local revenues."[162] Theoretically, a government's investment in its citizens and infrastructure is what enables MNEs to make money by interacting with the government's citizens. As is discussed below, this view overlooks the benefit that the MNEs in turn provide to the government and citizens, including whether the benefits may be lost due to excessive taxation.

D. *Ability-to-Pay Theory of Taxation*

The second extension of Adam Smith's first principle, the ability-to-pay theory of taxation, presents a potential challenge to the OECD proposal. The challenge is not in totality. The companies have an ability to pay, but the tension is where the companies are to pay taxes relative to the benefit received in a particular jurisdiction. Here, the tension lies with a revenue-based allocation of the Quantum. Consider a company operating in three countries, A, B, and C, with the respective profits and revenues by country detailed in Table 1 below. Using a revenue-based allocation of residual profits, Country A would be entitled to half of the residual profits even though the company only made a third of its residual profits by operating there. Yes, the company has the ability to pay, but one could argue it should instead

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158. *Id.*
159. *Id.*
160. *See* Vijay Govindarajan, Anup Srivastava, Hussein Warsame & Luminita Enache, *The Problem with France's Plan to Tax Digital Companies*, HARV. BUS. REV. (July 17, 2019), https://hbr.org/2019/07/the-problem-with-frances-plan-to-tax-digital-companies [https://perma.cc/8B5W-N5D3] (archived July 20, 2022).
161. *See id.*
162. *Id.*

be paying taxes based on the actual profits associated with operations in each country.

Table 1: Relative Corporate Revenue and Profitability Alignment Across Countries

	Country A	Country B	Country C
Attributable Percent of Total Revenue	50%	25%	25%
Attributable Percent of Total Profits	33%	33%	33%

When extending this simplified example to a scenario where a company is not profitable (or even loses money) in a particular jurisdiction, the rationale for that country asserting taxing rights over a company is further challenged. In this Table 2 scenario using a revenue-based allocation methodology for taxing rights, Country A would remain entitled to half of the residual profits even though the company made no profit by operating in the country. While an unlikely scenario, it is evidence of an edge case where the taxing rationale of the revenue-based allocation is called into question.

Table 2: Extreme Corporate Revenue and Profitability Misalignment Across Countries

Table 2	Country A	Country B	Country C
Attributable Percent of Total Revenue	50%	25%	25%
Attributable Percent of Total Profits	0%	50%	50%

E. *Certain in Amount and Process to the Taxpayer*

Concerning Adam Smith's second principle, certainty, the requirement that countries remove existing DSTs and refrain from introducing new ones should provide greater certainty to in-scope companies.[163] When commenting on the proposal, Facebook, Amazon,

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163. *See* ORG. FOR ECON. COOP. & DEV., TWO-PILLAR SOLUTION TO ADDRESS THE TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY 7 (Oct. 8, 2021), https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-

and Google representatives voiced their support and emphasized the stability the proposal would give to the international tax framework.[164] Given the patchwork emergence of DSTs impacting these companies, the response is sensible. Furthermore, the "dispute prevention and resolution in a mandatory and binding manner between all jurisdictions" should further the goal of certainty.[165] While the revenue sourcing rules should initially provide for certainty, the ongoing process of adjusting for new categories of transactions and potential segmentation of businesses could present opportunities for uncertainty.[166] On balance, the proposal appears likely to improve certainty, yet this understanding may change as development continues.

F. *Convenient for the Taxpayer to Pay*

Concerning the third principle, convenience, the OECD would assert that the increased certainty and stability of global taxation would be convenient for MNEs.[167] If MNEs are able to manage the process through a single entity, this may indeed prove to be true.[168] At this time, not enough is known about how companies will pay their tax liability, including to what countries and through what method. As a result, it is premature to assess consistency with the principle of convenience.

G. *Not Overly Burdensome Relative to the Needs of the State*

Evaluating Adam Smith's fourth principle—that taxes are not overly burdensome relative to the needs of the state—requires focusing on the needs of the state in a more philosophical sense. In 2020, an OECD survey of forty-five countries reveals that most appear to be proponents of Modern Monetary Theory (whether by choice or simple necessity) by operating ongoing budget deficits where government

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challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf (last visited July 20, 2022) [https://perma.cc/95S4-H7NN] (archived July 20, 2022) [hereinafter OECD TWO-PILLAR SOLUTION BROCHURE].

164. *See* Ryan Browne, *Amazon, Google and Facebook will be hit hard by the G-7 tax deal. Here's how they responded*, CNBC (June 7, 2021), https://www.cnbc.com/2021/06/07/g-7-tax-deal-amazon-google-and-facebook-respond-.html [https://perma.cc/9TYH-BXYX] (archived July 20, 2022).

165. OECD TWO-PILLAR SOLUTION BROCHURE, *supra* note 163, at 10.

166. *See id.* at 6.

167. *See generally* OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61; *see also* Browne, *supra* note 164 and accompanying text.

168. *See* OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 7.

outflows exceed inflows.[169] In today's world, it is difficult to argue that governments do not *need* the additional inflows that may result from the OECD proposal. This contention, however, is tested in two situations: (1) if governments operate at surplus, or (2) where government spending does not warrant external funding. In 2007, before the Great Recession, eighteen countries (all currently supporting the OECD tax proposal) ran government surpluses ranging from .07 percent to 17 percent of GDP.[170] Should we return to such a world, is it truly legitimate to argue that a country operating with a 17 percent annual surplus truly *needs* additional external tax revenue? Likely not.

One way to challenge the argument that governments truly *need* external tax revenue is by considering what governments choose to spend money on, deficits aside. Transparency International, a corruption watchdog, publishes an annual public sector corruption index of 180 countries.[171] Ranging from 0 to 100, over a third of countries are rated below 50, and "nearly half of all countries have been stagnant on the CPI for almost a decade. These countries have failed to move the needle in any significant way to improve their score and combat public sector corruption."[172]

Corruption aside, countries often spend money in ways that others may find distasteful. Without guardrails in place on spending, which there are not, Pillar One's reallocation could serve to bankroll some of these distasteful endeavors. In fact, current events provide a timely example of government spending that is objectionable. Russia, a current member of the Inclusive Framework,[173] invaded Ukraine in 2022, embarking on "the biggest war in Europe since World War Two."[174] Extremes aside, if tax revenues may be misused once reallocated, it is worth considering whether certain countries *need* the external tax revenue in the first place. Regardless of countries' use of funds, Pillar One may disincentivize companies from operating in certain countries if it proves too costly.

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169. *See General Government Deficit*, ORG. FOR ECON. COOP. & DEV., https://data.oecd.org/gga/general-government-deficit.htm#indicator-chart (last visited July. 20, 2022) [https://perma.cc/AFR5-FHX5] (archived July 20, 2022) [hereinafter *OECD General Government Deficit*]; *see also* Warren Coats, *Modern Monetary Theory: A Critique*, 39 CATO J. 563 (2019).

170. *OECD General Government Deficit*, *supra* note 169.

171. *Corruption Perceptions Index*, TRANSPARENCY INT'L (2020), https://www.transparency.org/en/cpi/2020 (last visited Jan. 20, 2022) [https://perma.cc/H9XY-EXQA] (archived July 14, 2022).

172. *Id.*

173. ORG. FOR ECON. COOP. & DEV., MEMBERS OF THE OECD/G20 INCLUSIVE FRAMEWORK ON BEPS 1 (Nov. 1, 2021), https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf [https://perma.cc/WU7K-D6FN] (archived July 14, 2022).

174. Paul Kirby, *Why Has Russia Invaded Ukraine and What Does Putin Want?*, BBC (May 8, 2022), https://www.bbc.com/news/world-europe-56720589 [https://perma.cc/6G5B-Q3CX] (archived July 14, 2022).

H. *Could Pillar One and the Amount A Allocation Disincentivize Companies from Offering Services in Jurisdictions Where They Are Nominally Profitable and Would Incur Unnecessary Compliance Costs?*

While aggressive tax planning has its advantages, it also comes with compliance costs associated with operating an MNE with tax liabilities in various jurisdictions.[175] Absent implementation of the OECD proposal and repeal of proliferating DSTs, the OECD estimates the reduced certainty and increased compliance costs could lead to a 1 percent reduction in global GDP.[176] While not enough is currently known, the OECD asserts that MNEs should benefit from a more streamlined tax administration process and harmonization across participating jurisdictions.[177] When the European Union proposed a Consolidated Corporate Tax Proposal to harmonize rules and filings across member states for large MNEs, one 2020 study suggested the harmonization would indeed reduce MNEs' compliance costs and promote economic growth.[178]

Following the February 2022 release of the Pillar One revenue sourcing rules, some initial analysis has suggested that the revenue sourcing rules may fall short of the OECD's promise of streamlined administration.[179] As accounting firm Alvarez & Marsal put it, "[the revenue sourcing rules] would require in-scope companies to trace the chain of commerce for all their products and services, for which they could not be reasonably expected to have any knowledge."[180] Another accounting firm, EY, noted that "the draft model rules would have significant implications for companies that are in scope of Pillar One Amount A, including with respect to the development or adaptation of information systems, and could create substantial uncertainty."[181] Should a company be unable to reliably identify the eventual source of revenue (say if it sells a product to a distributor, who then sells it to another distributor, who then sells it to a manufacturer, etc.), the company is to rely on the allocation key of GDP, personal consumption, or simply population to attribute the revenue.[182] If that is the case, the

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175. *See* Salvador Barrios, Diego d'Andria & Maria Gesualdo, *Reducing Tax Compliance Costs Through Corporate Tax Base Harmonization in the European Union* 41 J. INT'L ACCT., AUDITING & TAX'N 1, 2 (2020).

176. OECD TWO-PILLAR SOLUTION BROCHURE, *supra* note 163, at 16.

177. *See id.* at 7.

178. *See generally* Barrios, d'Andria & Gesualdo, *supra* note 175.

179. *See e.g.*, Kevin M. Jacobs, Kenneth Brewer, Charles Cope & Emily Foster, *Dividing Pillar 1 Spoils Not as Easy as OECD Claims*, ALVAREZ & MARSAL (Feb. 11, 2022), https://www.alvarezandmarsal.com/insights/dividing-pillar-1-spoils-not-easy-oecd-claims [https://perma.cc/Z8J7-GUND] (archived July 14, 2022).

180. *Id.*

181. *EY on Draft Revenue Sourcing Rules*, *supra* note 42.

182. *See* Jacobs, Brewer, Cope & Foster, *supra* note 179.

very goal of properly allocating taxing revenues to the jurisdictions where companies sell their products or services is wholly defeated. However, as the companies would be on the hook for the same amount of tax regardless and it is simply the eventual recipient jurisdiction that is in limbo, one wonders to what degree MNEs will simply rely on the allocation key for expediency.

While the final revenue sourcing rules are still in development, initial commentary from EY and Alvarez & Marsal suggests compliance might not be as easy as promised. The potential compliance costs coupled with the seemingly "arbitrary" nature of the revenue sourcing process, the determination of the Quantum, and the allocation key suggests that modifications to Pillar One may better achieve the OECD's goals of equitable and efficient taxation of large MNEs.[183]

IV. SOLUTION

The Inclusive Framework is designed to better align countries' taxing rights with MNE operations. This Note's proposals to remove the segmentation rule and switch to a profit-based allocation are consistent with the OECD's current goals and address problems with the current design.[184] In particular, the proposals should assuage the concerns of some current legislators and thus help ensure enactment and compliance.[185] Namely, the misalignment between profits and revenues could potentially diminish US taxing rights, as in-scope companies often attribute a greater percentage of their profits to the United States relative to revenue.[186] To avoid Pillar One inclusion altering MNE incentives for market entry and growth on the margin, the OECD should remove the segmentation rule. To better align the OECD proposal with the theories of taxation, namely the benefit theory and a localized ability-to-pay approach, a profit-based allocation methodology is more sensible.

A. *Removing the Segmentation Rule for Pillar One Inclusion*

Today, US and international accounting standards require companies to separately report business segments responsible for greater than 10 percent of a company's revenue, profits, or assets.[187]

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183. *See id.*

184. *See* OECD July 2021 Update, *supra* note 38.

185. *See supra* Part II.D.

186. *See supra* Part II.B.

187. *See* Michael Lebovitz, Jenny Austin, Warren Payne, Kenneth Klein, Lucas Giardelli & Tyler Johnson, *G20 Agrees on Framework for Pillars One and Two and Targets 2023 Effective Date*, MAYER BROWN (July 12, 2021), https://www.mayerbrown.com/en/perspectives-events/publications/2021/07/g20-agrees-on-framework-for-pillars-

While the OECD proposal suggests segmentation is only available in exceptional circumstances, the OECD has yet to define what qualifies as an exceptional circumstance. Once one chooses to arbitrarily segment businesses for taxing purposes absent accounting or operational requirements, there are many ways a business could be segmented.[188] In such cases, countries may not agree on how to segment the business as varied formulations may yield different results for countries' allocation of the Quantum.[189] This hardly contributes to the OECD's promise of tax certainty and efficiency for MNEs subject to taxation under Pillar One. Certainty aside, segmentation disrupts corporate organization and incentives. As a result, MNEs subject to segmentation could alter spending patterns or reorganize segments, or the company, to avoid a segment being subject to Pillar One taxation.

Companies have every right to fund their operations how they choose if they are compliant with applicable laws and regulations. Today, a company may rely on a profitable segment to fund operations elsewhere, grow a new business, or invest the segment's proceeds in research and development. Alternatively, companies may use proceeds to fund humanitarian efforts. A 2014 study of 260 firms found they contributed 1.01 percent of pre-tax profits on average.[190] As profits go down, contributions follow. Whether it is Facebook working with Zambia to provide internet access[191] and in Africa more broadly with 2Africa,[192] or Alphabet's Loon[193] and Project Tara in Kenya,[194] these efforts cost money—money generated by profitable business segments. In 2020, Zambia and Kenya ranked 124th and 117th respectively out of 180 countries in the Transparency International Corruption

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one-and-two-and-targets-2023-effective-date (last visited Feb. 24, 2022) [https://perma.cc/UG2W-FQX7] (archived July 15, 2022).

188. *See* Michael J. Graetz, *A Major Simplification of the OECD's Pillar 1 Proposal*, 101(2) TAX NOTES INT'L 199, 204 (2021) ("It is uncertain under the OECD's segmentation requirements to allocate residual profits whether Apple has two lines of business—products and services—or at least 11, including iPhones, Mac computers, iPads, AirPods, Apple Watches, home accessories, Apple Music, Apple TV, the App Store, AppleCare warranties, and iCloud services.").

189. *See id.* at 219 ("When countries see their results, based on an MNE's financial statement segmentations, they might want to demand changes, but there is no reason to expect all countries to want the same changes. And when MNEs see the results under their existing financial accounting practices, they might try to aggregate or disaggregate products or services into different segmentations. After all, the prices of their securities turn on their overall profitability, not necessarily how they segment their lines of business in their financial statements.").

190. Hao Liang & Loc Renneboog, *Corporate Donations and Shareholder Value* 2 (European Corp. Governance Inst., Working Paper No. 491/2016, 2016) (internal citation omitted).

191. *See* Nothias, *supra* note 93, at 332.

192. *See* Prinsloo, *supra* note 97.

193. *See* Dahir, *supra* note 99.

194. *See* Krishnaswamy, *supra* note 101.

Perceptions Index.[195] Those countries' citizens may benefit more from MNE investments than a nominal increase in their countries' coffers.

By subjecting a segment to Pillar One taxation where the company would otherwise not qualify, the company's ability to use those funds as they previously intended is now diminished by the amount of the tax. Recall the lengths Pfizer went to in Part I above to reduce its tax liability by re-domiciling.[196] Similarly, in Part II, recall the actions taken by Apple and AerCap to transfer assets to a favorable jurisdiction to capture tax advantages.[197] It is highly possible that companies would similarly re-think their organizational structure if a segment, but not the MNE as a whole, was subject to segmentation for Pillar One taxation purposes.

Perhaps segmentation for Pillar One taxation purposes alone would be enough to alter corporate incentives to operate in certain areas or otherwise rethink their structures. Today's environment of regulation and the trend towards de-consolidation coupled with the risk of segment taxation under Pillar One are certainly enough to alter corporate incentives and structures. The largest corporations with segments potentially subject to Pillar One taxation are also facing a growing appetite for antitrust enforcement,[198] a focus on competition in the technology sector,[199] and a trend towards de-consolidation as evidenced by the likes of GE,[200] IBM, and AT&T.[201]

The OECD should remove segmentation from Pillar One because it promotes uncertainty and could lead companies to restructure partially, or entirely, to avoid a segment being subjected to Pillar One taxation, in which case the real beneficiaries would be the accountants, lawyers, and bankers—not the countries seeking to obtain taxing rights over a portion of a MNE's proceeds.

B. *Applying a Profit-Based, Not Revenue-Based, Allocation to Pillar One Amount A*

The OECD proposal contemplates that firms need profits as a precursor to Pillar One taxation, among other requirements.[202] After all, the Quantum is 25 percent of a qualifying MNE's residual profits above the 10 percent threshold.[203] This intuitively makes sense as,

195. *Corruption Perceptions Index*, *supra* note 171.
196. *See* Mun, *supra* note 9, at 2156.
197. *See* Taylor, *supra* note 75.
198. *See* Exec. Order No. 14036, 86 Fed. Reg. 36,987, 36,988 (July 9, 2021).
199. *See* Klobuchar, *supra* note 154.
200. *See* Gen. Electric Co., Annual Report, *supra* note 147.
201. *See* Sloan, *supra* note 152.
202. *See* OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 2.
203. *Id.*

absent profits, firms would not have sufficient funds to pay their tax liabilities. However, the OECD proposal runs afoul of the traditional theories of taxation by allocating taxing rights based on MNE revenue, not profits, derived from qualifying jurisdictions. The tension lies with the localized ability-to-pay theory and the benefit theory of taxation, the extensions of Adam Smith's first principle.[204] Switching to a profit-based, as opposed to revenue-based, allocation of taxing rights to jurisdictions would resolve the tension.

Profit-based allocation is consistent with the localized ability-to-pay theory. Once an MNE is determined in-scope for Pillar One taxation, its qualifying profitability in a jurisdiction demonstrates the MNE's ability to pay jurisdiction taxes based on profits from that jurisdiction. The tension with the revenue-based allocation of taxing rights and the benefit theory of taxation is diminished when switching to a profit-based allocation at a jurisdiction level. While simplistic, the hypothetical firm in Table 2 above proves the point. In that scenario, Country A could receive up to 50 percent of the Quantum even though the firm made no money in Country A. While that hypothetical firm generated revenues in Country A, they have no cash to show for it at the end of the day. It begs the question as to what actual benefit they received. In dollar terms, the answer is zero.[205] Since for many firms this would result in greater allocation of taxing rights to the United States than under a revenue-based allocation, it should assuage some of the legislators' concerns about revenue neutrality.[206]

Two potential objections to switching to a profit-based allocation of taxing rights are (1) the concern that companies may overstate costs to avoid taxes, and (2) potential costs of compliance and complexity.[207] The concern that companies may overstate their costs may be dismissed for three reasons. First, the large MNEs qualifying for Pillar One taxation are all audited and publicly traded companies. While some studies have advocated for revenue-based taxation to combat firms overstating costs and thus diminishing profits, that rationale makes less sense in a large firm setting where managers are evaluated by firm profitability every quarter.[208] Second, the OECD proposal itself already relies on profitability when determining the Quantum.[209] As a result, any incentives to overstate costs would be present whether or

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204. *See supra* Part III.B.

205. *See supra* Part III.B.

206. *See supra* Part II.B.

207. Tiago Scott, *Profits vs. Revenue Tax: How to Make Corporations Pay their Fair Share?*, WORLD BANK BLOGS (Dec. 10, 2020), https://blogs.worldbank.org/impactevaluations/profit-vs-revenue-tax-how-make-corporations-pay-their-fair-share-guest-post [https://perma.cc/KHG3-D5FA] (archived July 15, 2022).

208. *See id.*

209. OECD OCTOBER 2021 STATEMENT ON TWO-PILLAR SOLUTION, *supra* note 61, at 2.

not the Quantum is allocated to countries based on an MNE's revenue or profits in a particular jurisdiction. Third, once a firm qualifies for Pillar One taxation, altering the allocation of the Quantum between jurisdictions should not bother an MNE as the liability remains—it is merely the recipient that changes.

The potential objection to a profit-based allocation—additional compliance and complexity—is, however, more problematic because it is a legitimate concern. Instead, switching to a profit-based allocation will ensure consistency with the benefit theory of taxation. Given the revenue sourcing rules, accounting firms such as EY and Alvarez & Marsal have already acknowledged potential compliance costs for in-scope MNEs.[210] These costs are liable to increase if companies are required to use indicators or allocation keys for costs based on the current requirements for revenue. Costs aside, the switch will ensure jurisdictions are entitled to their allocation of the Quantum based on benefits MNEs receive from operating in those jurisdictions.

Overall, the removal of the segmentation rule and switch to a profit-based allocation of the Quantum promises to limit the impact the OECD proposal will have on corporate incentives, as well as better align countries' taxing rights with the benefits the qualifying MNEs receive by operating in jurisdictions entitled to a portion of the Quantum.

V. CONCLUSION

The OECD's Pillar One proposal for taxation of large MNEs sought to solve the problem of diminished corporate tax revenues flowing to government coffers.[211] In doing so, the arbitrary determination of the Quantum and the revenue sourcing rules put the proposal in tension with the theories of taxation.[212] Removing the segmentation rule and shifting to a profit-based allocation of taxing rights to market jurisdictions helps alleviate these tensions by minimizing the disruption to corporate incentives, and ensuring the jurisdictions' taxing rights are better aligned with MNE profitability in qualifying jurisdictions. Furthermore, these proposals have the benefit of likely increasing the United States' allocation of taxing rights given the often disproportionate relationship between US-attributable profits and revenue for in-scope MNEs.[213] As the OECD proposal continues to develop, it will face implementation challenges both domestically and abroad.

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210. *See supra* Part III.C.
211. *See* OECD ACTION PLAN, *supra* note 36, at 8–11.
212. *See* Jacobs, Brewer, Cope & Foster, *supra* note 179.
213. *See supra* Part II.B.

These modifications could serve to reduce domestic opposition to the proposal in its current form.

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