OECD global agreement on minimum taxation of multinationals called into question

The US withdrawal from Pillar Two and its impact on European taxation and competitiveness

On his inauguration date (20 January 2025), US president Trump issued numerous executive orders ("EOs") on a variety of different topics, including the US commitment to the "Global Tax Deal". This undefined term used in the public communication of the White House mainly refers to the global minimum tax rules agreed upon at OECD/G20 level, i.e., the so-called Global Anti-Base Erosion ("GloBE") rules or "Pillar Two"[1].

While the US were amongst the driving initiators of the Pillar Two initiative, the GloBE rules have not been implemented in the US. On its first day, the new US administration definitely pulled the plug for any potential implementation of Pillar Two in the current legislation period. Accordingly, the EO states that "*any commitments made by the prior administration on behalf of the United States with respect to the Global Tax Deal have no force or effect within the United States*". The EO also directs the US Treasury Department to assess foreign tax regimes for compliance with US treaties and potential discriminatory effects on American businesses as well as appropriate "protective" (in other words retaliatory) measures.

So far, the EU and other countries remain committed to their international obligations and the OECD announced its openness to a meaningful dialogue with the US administration. Whether a productive exchange is possible at this stage remains to be seen, especially since a dialogue is defined as a conversation between two or more parties (as opposed to the imposition of a view by the stronger party).

To the best of our knowledge, no country has officially announced their withdrawal from Pillar Two (yet) as a result of the EO. However, the US position and willingness to take punitive measures create doubts and uncertainties. Indeed, these events raise the legitimate question regarding the impact of the EO on the effective implementation and the execution of Pillar Two in Europe and worldwide. As a result, previously raised concerns about the validity of certain Pillar Two rules in the context of international tax treaties will need to be assessed in more detail.

Background

Back in December 2021, the GloBE rules were released through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("**Inclusive Framework**").

The GloBE rules provide for a co-ordinated system of taxation intended to ensure that large multinational enterprise ("**MNE**") groups pay a minimum level of tax on the income arising in each of the jurisdictions where they operate. Numerous clarifications, interpretations and additional technical provisions to these rules were provided afterwards within various sets of administrative guidance.

The GloBE rules were published after 134 members (later increased to 139) out of 147 members of the Inclusive Framework, representing more than 95% of global GDP, consented to the Inclusive Framework, including the US, Russia and China. The participating jurisdictions committed to reform the international tax rules and tackle the challenge of a fair level of taxation for MNE groups in a digitalized and globalized economy. The OECD Base Erosion and Profit Shifting project also includes the "Pillar One" initiative (together with Pillar Two the "**Two-Pillar Solution**"). Pillar One aims to transform the allocation of taxing rights on corporate profits between countries by allocating taxing rights to markets jurisdictions. Pillar One is still subject to discussions at OECD level and has currently not been implemented yet.

The GloBE rules were supposed to be treated as a common approach. Accordingly, jurisdictions are not obliged to adopt the GloBE rules, but if they choose to do so, they must implement and administer the rules in a manner consistent with the agreed outcomes. This common approach also means that Inclusive Framework members, including the US, accepted the application of the GloBE rules by other members. In the context of Pillar Two, the Inclusive Framework specifically agreed to consider the conditions under which the US Global Intangible Low-Taxed Income ("**GILTI**") regime will coexist with the GloBE rules to ensure a level playing field.

Various jurisdictions have already implemented Pillar Two[2], including the EU member states on the basis of a Council Directive (the "**Pillar Two Directive**"), Australia, Brazil, Canada, Guernsey, Switzerland, United Arab Emirates, Türkiye, the United Kingdom, Vietnam, Barbados, Curacao, Japan, Korea, Indonesia, Isle of Man, Malaysia, Kuwait, Kenya, Jersey, Singapore, Oman, Norway, New Zealand and Thailand. Other jurisdictions such as Hong-Kong, Qatar, Puerto Rico, South Africa or Antigua & Barbuda have published draft legislations. Finally, jurisdictions such as Israel indicated that their governments were working on a domestic top-up tax.

On the other hand, major jurisdictions have not yet implemented Pillar Two and will likely not do so in the short term. Despite previous statements supporting the importance of Pillar Two, China has been rather quiet about Pillar Two in the recent past. India, that has always expressed concerns about Pillar One, is assessing whether the Two Pillar Solution can still work following the US withdrawal.

Certain tax experts also speculate whether Germany's new coalition may put the application of Pillar Two into question and try to withdraw from the Two-Pillar Solution. However, this does not seem realistic at this stage as the repeal of the Pillar Two Directive would require the unanimous agreement of all EU member States - it will therefore be difficult for Germany to implement such a decision unilaterally.

Nevertheless, the EU needs to decide how to position itself in light of the EO including related measures and whether it would accept the risk of an extension of the trade war already fuelled by additional mutual tariffs recently imposed by both the US and the EU on a number of products. Uncertainty in regard to a potentially significant amount of additional tax burden for MNE groups will hamper investment and impede desperately required economic growth/recovery within the EU. In the long run, a standoff involving a vicious circle of punitive taxes and increased tariffs is counterproductive for both sides and may, next to an increasingly complex tax system, severely impact the EU's attractiveness and competitiveness. In the meantime, the OECD seems to do business as usual. On 15 January 2025, the Inclusive Framework issued several additional Pillar Two transition rules and statements.

US position

Since the very beginning, the US have had mixed feelings about the Two-Pillar Solution. In a certain way, the US pioneered the implementation of global minimum tax rules to prevent profit shifting to low tax jurisdictions. In 2017, US Congress introduced the GILTI regime as a measure to combat base erosion, targeting income that is highly mobile and subject to low effective tax rates[3]. Like the income inclusion rule ("**IIR**") under Pillar Two, the GILTI regime aims to ensure a global minimum effective tax rate on US GILTI by imposing a residual US tax on the US parent entity of an MNE group.

While the Biden administration generally rallied behind the Two-Pillar Solution, severe concerns were raised from the outset against the Undertaxed Profit Rule ("**UTPR**") that is part of Pillar Two. The UTPR works as a backstop notably when a parent jurisdiction does not apply a qualified IIR. In simple terms, this may oblige an EU subsidiary company of a US MNE group in the scope of Pillar Two to levy top-up taxes on US income. Taking the example of a Luxembourg holding company of a US multinational potentially having to collect (Luxembourg) top-up taxes on income generated in the US further up the chain does indeed raise a number of questions on the enforceability of the UTPR in such a context.

The American Free Enterprise Chamber of Commerce, for example, supported by the American Chamber of Commerce (the "**ACC**"), filed an action for annulment in front of the Belgian Constitutional Court against the UTPR implemented by the Pillar Two law in Belgium that transposes the Pillar Two Directive[4]. The Court has to assess whether the Belgian law breaches the rights protected by the Belgian Constitution, such as equality.

US opposition to the UTPR, such as the ACC and the Republican Party[5], is based on the following statements:

- The UTPR will adversely impact US MNEs with European subsidiaries. Indeed, according to the ACC, although the statutory corporate income tax rate in the United States is 21%, the overall U.S. effective tax rate ("**ETR**") of many US MNE groups could fall below 15% due to inconsistencies in the calculation of ETR for US income tax and Pillar Two purposes.
- The UTPR will undermine legitimate bipartisan US public policy goals because Pillar Two favours so-called- "qualified refundable tax credits" over non-refundable tax credits, which is problematic for US businesses since their tax credits are typically non-refundable. This contradicts US public policy aimed at encouraging investments in areas like domestic research and affordable housing and undermine US public policy goals related to the deduction for foreign-derived intangible income ("**FDII**"). This treatment of US tax credits and incentives is seen as unfair and disadvantageous to US MNEs compared to their EU-based competitors since US MNEs investing considering US tax credits are engaging in legitimate business activities, not tax avoidance. This point is a bipartisan argument.
- The UTPR, notably under the Pillar Two Directive, will inappropriately tax US MNEs by failing to recognize the US GILTI as a qualified IIR despite initial suggestions by OECD officials that this regime —the prototypical global minimum tax—would be taken into consideration and respected as such under Pillar Two. As a result, many US MNEs that are subject to the GILTI regime will also be subject to foreign top-up tax under the UTPR.
- The UTPR's application would breach the principle of territorial jurisdiction under customary international law because it allows a jurisdiction to levy a local top-up tax on US profits that have no nexus to that jurisdiction. On the contrary, GITLI, as well as commonly applied controlled foreign company ("**CFC**") taxes or top-up tax based on the IIR are levied at parent company level in relation to directly or indirectly economically owned profits of a foreign subsidiary. Here, a nexus between the jurisdiction in which the parent company is resident and the profits of its foreign subsidiary are usually recognised.
- The UTPR could threaten the economic viability of foreign subsidiaries that may not have sufficient means to settle a large tax bill levied by reference to the US profits of its U.S. parent company.
- The UTPR will be ineffective against Chinese companies because China which, like the US, has not adopted Pillar Two will take advantage of the deal's 'loophole' for direct government subsidies.

In September 2024, the Republicans in the US House of Representatives already suggested retaliatory "countermeasures" against jurisdictions that seek to apply the UTPR against US-based companies. Subsequently in January 2025, a bill that was already presented in 2023 was reintroduced in the House of Representatives ("Defending American Jobs Act"). The retaliatory countermeasures would primarily take the form of increased taxation on US income of foreign investors and companies based in jurisdictions identified as having "extraterritorial taxes or discriminatory taxes" such as the UTPR or similar taxes on US MNEs. The bill suggests increased tax rates of up to 20% until these foreign discriminatory taxes are abolished.

In line with these measures, President Trump also signed another EO in January 2025 authorizing the unprecedented use of Section 891 of the Internal Revenue Code ("IRC"), which could even double US tax rates on income earned by foreign companies and individuals in the US. The total tax levied would generally be capped at 80% of the taxpayer's income[6]. Under Section 896 of the IRC, the president may also act against "more burdensome taxes" if a foreign jurisdiction imposes higher effective tax rates on US taxpayers than on its own taxpayers "under similar circumstances." The application of retaliatory measures towards foreign investors while at the same time trying to attract them seems however counterproductive as investors are generally looking for legal certainty and stability. It should also be noted that, so far, the US have not withdrawn from the OECD.

The OECD Two-Pillar Solution (in)compatibility with double tax treaties

As agreed at OECD level, the GloBE rules have to be treated as a common approach under which jurisdictions are not obligated to adopt these rules, which is the route currently taken by the US. The US have also withdrawn from its commitment to accept the application of the GloBE rules by other jurisdictions. With that in mind, the effectiveness of the OECD Two-Pillar Solution in general, and more specifically Pillar Two therefore has to rely on existing international law, including bilateral double tax treaties which generally take precedence over national laws. Double tax treaties based on the OECD Model Convention (or the US Model Convention) establish a framework for allocating taxing rights notably with respect to business profits of persons and entities among residence and source states. Double tax treaties also generally include non-discrimination provisions[7].

For Pillar One and the Subject to Tax Rules[8] ("**STTR**") that complement the GloBE rules under Pillar Two, the Inclusive Framework concluded that modifications of bilateral double tax treaties through the adoption of multilateral agreements ("**MLI**") were needed for their effective application. Those rules affect and may override the usual allocation of rights to tax profits under double tax treaties based on the OECD Model Convention. As a result, an MLI was deemed necessary because profits of a taxpayer would be reallocated to jurisdictions where that taxpayer does not have a permanent establishment ("**PE**") or other taxable nexus as required under international tax standards.

However, the Inclusive Framework judged, despite many doctrinal articles concluding otherwise, that such amendments were not required for the effective application of the IIR and the UTPR under Pillar Two. The OECD strongly asserted that the IIR and the UTPR do not breach double tax treaty provisions[9].

Nevertheless, significant doubts of compatibility with international tax treaties remain with regard to the UTPR. The arguments raised by the OECD seemingly overlook an essential fact: the UTPR modifies, in a certain way, the allocation of taxing rights on MNE profits. This is precisely why there is a global consensus that double tax treaty modifications were required to avoid any double tax treaty violation for Pillar One and the STTR. Surprisingly, the OECD itself acknowledges that "*although it is not a prerequisite, a multilateral convention would be the only means to enshrine rule coordination in a legally binding form.*" If double tax treaty provisions are applicable and prevail over Pillar Two rules, the OECD Two-Pillar Solution would have no effect at all. Taking back the above example of a Luxembourg holding company that is a subsidiary of a US MNE group: According to the double tax treaty between the US and Luxembourg, Luxembourg would not have any taxing rights on US source income realised further up the chain by the US group entities (and which is not allocable to any taxable presence of the Luxembourg company in the US). Thus, this raises questions about the practical enforceability of the UTPR under Pillar Two in cases involving double tax treaty partners. (in particular where the parent jurisdiction has not introduced Pillar Two into its domestic laws). Similar considerations apply, vice versa, from a US perspective on the application of Section 891.

Conclusion

The new US administration's stance on Pillar Two, its return to the law of the jungle in bilateral negotiations and its willingness to use tariffs and punitive taxes to impose their will unilaterally have put the EU and national governments under massive pressure. While the Trump administration is not excelling at the art of diplomacy, it has pointed out a significant weakness of the legal basis of the GloBE rules in an international context that may even jeopardise the effectiveness of some of its fundamental principles. It is indeed debatable whether the UTPR is in line with existing international tax treaties.

As a result, taking into consideration the US position, it may be expected that US MNE groups subject to foreign top-up taxes, especially where they are levied under the UTPR, will try to challenge such taxation. Disputes may quickly escalate to the highest political level and entail severe economic consequences as currently being demonstrated by the ongoing trade war.

All of this leaves businesses with legal uncertainty and instability in an already challenging economic and political environment. The OECD and, consequently, the EU have been particularly quiet on this topic since the signature of the EO and related measures. They are probably waiting for the results of the US Treasury Department's assessment of foreign tax regimes for compliance with US treaties and potential discriminatory effects on US businesses, before taking any action or issuing any official position.

In the meantime, businesses have to take decisions on how to position themselves and handle potential risks. EU companies are facing yet another competitive disadvantage in global competition, given that neither their US, Chinese nor Indian competitors have to manage the heavy (and often disproportionate) administrative burden imposed by Pillar Two in an already overregulated European environment. In the interest of the EU economy and given the unprecedented global dimension of the issue, the EU is hopefully prepared to act quickly. In any case, a solution has to be found as soon as possible to avoid discouraging investments, the EU's attractiveness and its competitiveness in global markets.

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1) OECD (2021), Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris as well as related administrative guidance issued by the OECD.
2) For a large part applicable to fiscal years starting on or after 31 Dec 2023.
3) See S. Comm. on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Prt. No. 115-20, at 370 (Comm. Print 2017).
4) Constitutional Court, Case n° 8267, https://lc.cx/Y7BTar
5) https://lc.cx/JhEWwV
6) G. Mazzoni, A. Martinez, "US rejects OECD global tax deal, raising policy questions", 13 February 2025, *RSM Insights*, https://lc.cx/VAL1NJ
7) According to such provisions, nationals or residents of one contracting state cannot be subjected to more burdensome taxation or related requirements in the other contracting state than the nationals or residents of the latter, in similar circumstances.
8) This rule allows source jurisdictions to "tax back" defined categories of intra-group income where they are subject to nominal corporate income tax rates below the STTR minimum rate of 9%, and domestic taxing rights over that income have been allocated to the resident state under a double tax treaty. It aims to enhance the GloBE rules by withholding treaty benefits for certain deductible payments made within a group to jurisdictions where these payments face minimal or no taxation.
9) See OECD/G20, *Base Erosion and Profit Shifting Project - Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint*, 2020 : https://lc.cx/2vn2Rn