

Implementing a (global?) minimum corporate income tax: an assessment of the so-called “Pillar Two” from the perspective of developing countries

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Almost eight years have passed since the BEPS Action Plan was launched by the OECD and Action 1 identified corporate income tax challenges derived from the digitalization of the economy as a relevant area to be addressed. As from January 2019, the stream of work at the OECD has changed. Apparently, a novel era - “BEPS 2.0” - has begun under the slogan of working on a “without prejudice” basis and a two-pillar approach with the aim of reaching an agreement on a global solution. Though the author recognizes the need to find a coordinated answer, she believes that in the construction of said solution, attention should be given to specific features and policy preferences evidenced by developing countries. Under this scenario, this contribution focuses on the so-called “Pillar Two” and assesses its “Global Anti-Base Erosion (GloBE) proposal” from said perspective. After her analysis, the author concludes that this rushed political-driven proposal not only has been designed in the benefit of major and more advanced economies, but it goes far more beyond “BEPS”. In this vein, the author advocates for concentrating the efforts and resources on a transparent discussion that directly addresses efficient and fairer nexus and profit allocation rules - main concern for developing countries and, in the author’s view, the base problem to be solved.

Keywords: corporate income tax, global minimum tax, Pillar Two, BEPS, tax competition, developing countries.

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The opinions expressed hereinafter are the sole responsibility of the author and do not necessarily reflect the position of any of the organizations with which she is affiliated



Abbreviations

BEAT	Base Erosion and Anti-Abuse Tax
BEPS	base erosion and profit shifting
CFA	Committee on Fiscal Affairs (OECD)
CbCR	Country by Country Reporting
CBT	Centre for Business Taxation (Oxford University)
CFC	controlled foreign companies
CIAT	Inter-American Center of Tax Administrations (<i>Centro Interamericano de Administraciones Tributarias</i>)
CIT	corporate income tax
DWG	G20 Developing World Group
EC	European Commission
EU	European Union
ETR	effective tax rate (GloBE)
GILTI	Global Intangible Low-Taxed Income
GloBE	Global Anti-Base Erosion
GNI	gross national income
ICTD	International Centre for Tax and Development
IF	OECD/G20 Inclusive Framework on BEPS
IMF	International Monetary Fund
IIR	income inclusion rule
MNE(s)	multinational enterprise(s)
OECD	Organisation for Economic Co-operation and Development
PE	permanent establishment
PoW	programme of work (IF)
STR	subject to tax rule
UN	United Nations
UNDP	United Nations Developing Programme
UTPR	undertaxed payments rule
TCJA	Tax Cuts and Jobs Act (US)
WBG	World Bank Group

Introduction

The OECD/G20 Inclusive Framework on BEPS (hereinafter, IF) is currently working on addressing corporate income tax challenges that are deriving from the digitalization of the economy under a two-pillar approach. As originally declared (OECD 2019c, 6), Pillar One is supposed to deal with the international allocation of taxing rights while Pillar Two is supposed to address “remaining” base erosion and profit shifting (hereinafter, BEPS) issues. In this respect, the members of the IF² have committed to reaching an agreement on a global solution.³

Though the author recognizes the need to find a global coordinated answer - as tax issues in a highly economic integrated world are certainly global - she believes that, in the construction of such solution, attention should be given to specific features and policy preferences evidenced by developing countries. Particularly, in relation to the fight against BEPS, there seems to be awareness of this “developing countries’ personalisation” being possible to identify several international initiatives dealing with this matter.⁴ However, despite this awareness, it is relevant to evaluate if the perspective of developing countries is in fact being considered in the construction of said global solution.

Under this scenario, the objective of this contribution is to focus on one of the two pillars of the work undertaken by the IF - Pillar Two - and to assess the so-called “Global Anti-Base Erosion (GloBE) proposal” from the viewpoint of developing countries. This choice responds to diverse reasons.⁵ While both pillars seem to be politically linked in terms of the abovementioned agreement⁶, if such an agreement is not finally reached at

² The IF has a membership of 138 jurisdictions (January 2021).

³ The deadline for reaching said agreement has been postponed; according to the last statement of commitment adopted by the IF, a consensus-based solution is expected by mid-2021 (OECD 2020c, 3).

⁴ As for these international initiatives, it can be mentioned - though not exhaustively: (i) at the OECD level, the elaboration at the request of the G20 Developing Working Group (DWG) of a two-part report on the impact of BEPS in “low income countries” (OECD 2014) and the creation of the IF itself in 2016; (ii) also at the request of the DWG, the elaboration of a report on the use of tax incentives by low income countries (IMF, OECD, UN and WBG 2015) by a group of organizations that later, in 2016, launched the so-called “Platform for Collaboration on Tax”, a joint effort of the International Monetary Fund (IMF), OECD, United Nations (UN), and World Bank Group (WBG) that continued producing toolkits and guidance; (iii) at the UN level, the handbooks (UN 2015, 2017a) and practical portfolios (UN 2017b, 2017c, 2017d) in relation to the protection of the tax base of developing countries; the last focused on BEPS issues derived from payments for interest, rent, royalties and services fees.

⁵ One of these reasons is that the author has addressed nexus and profit allocation rules - topic that is declared to be dealt with under Pillar One - somewhere else (Riccardi 2020).

⁶ In fact, the commitment of the IF was “to bridge the remaining differences and reach agreement on a consensus-based solution by the end of 2020, noting that this agreement will depend on the further *concurrent work* which

the IF, the rules under the GloBE proposal - either individually or as a package - may still have the chance to be implemented by its supporters. Instead, the mechanics under Pillar One cannot be implemented without consensus. Therefore, and beyond assessing the two-pillar approach as a package from a developing countries' standpoint, one interesting question in this debate is: should the implementation of any of the rules under the GloBE proposal be on the agenda for the developing world if no consensus is finally reached?⁷ Answering to this question will by itself (i) help developing countries understand Pillar Two implications for both their national economies and the functioning of the international tax standards, and (ii) provide developing countries with arguments for defending their preferences and claiming a more balanced solution in the current political two-pillar discussion. *A priori*, the author believes that “GloBE” is a rushed political-driven proposal than not only has been designed in the benefit of major and more advanced economies but also goes *far more beyond* “BEPS”. By implementing a “super” CFC-type rule, it may affect tax sovereignty and the allocation of taxing rights which are said to be dealt with under Pillar One. In this vein, she advocates for concentrating the efforts and resources on a transparent discussion directly addressing efficient and fairer nexus and profit allocation rules - main concern for developing countries and in the author's view, the base problem to be solved.

The author's analysis is approached from a conceptual and policy perspective. While a “natural order” at the IF would have been to first define a conceptual framework agreeing on tax policy issues and, then, work on the technical design of a concrete proposal⁸ - currently included in the so-called ‘Blueprints’⁹ -, it is worth stressing that, at the time of finishing this contribution, agreement has not been reached and,

will be carried out on the two pillars”, authors' emphasis (OECD 2020a, 5). Also, the 2019 programme of work recognized that “[w]hile the two issues of the ongoing work on remaining BEPS challenges and a concurrent review of the profit allocation and nexus rules *are distinct, they intersect and a solution that seeks to address them both could have a mutually reinforcing effect*. Therefore, the Inclusive Framework agreed that both issues should be discussed and explored in parallel”, the author's emphasis (OECD 2019c, 6). This position was confirmed in the cover statement issued by the IF in October 2020: “[a] consensus-based solution comprised of two pillars” (OECD 2020c).

⁷ If an agreement is reached, the agenda will be set by the political compromise assumed.

⁸ Brauner (2020, 272) refers to the work being performed and mentions “the focus on the technical, so-called pragmatic solution that masked the potentially undesirable impact of the project's outcome on such countries [less powerful economies]”.

⁹ See OECD (2020d, 2020e).

particularly, in respect to Pillar Two it has been declared that diverging views around key policy elements (carve outs, rule order and minimum tax rate) still exist among IF members¹⁰. It is precisely because of this “apparent”¹¹ indetermination that the voice of developing countries may still have the chance to be heard.

For this purpose, the author structured her contribution in four main chapters. Chapter 2, “The current international discussion on corporate income taxation and the birth of a two-pillar approach”, summarises how the international tax discussion has evolved during the last decade and introduces the context in which the GloBE proposal emerged. This is relevant for understanding the new approach based on two pillars followed by the IF which clearly tries to balance - though, in the author’s view, unsuccessfully - the diverging policy preferences of its members. Chapter 3, “Pillar Two: The Global Anti-Base Erosion (GloBE) proposal”, is dedicated to exploring the policy rationale and general mechanics behind the rules constituting the GloBE package, focusing on some aspects identified by the author in order to forward some comments which she understands as better serving the general interests of developing countries. Finally, in chapter 4, “Concluding remarks”, a concluding remark and reflection is shared.

To end this introductory chapter, the author considers it is relevant to comment on the scope of the term “developing countries” for the purpose of this contribution. In effect, contrary to what may be expected, there is no unique criteria followed by international organizations¹² to define “developing countries”. For her analysis, the author adopts the criterion followed by Burges and Mosquera (2017, 29) in defining developing

¹⁰ While technical input on Pillar Two has been assigned to subsidiary bodies of the OECD Committee on Fiscal Affairs (CFA) and an economic analysis and impact assessment to the OECD Secretariat (OECD 2019c, 37-40), the policy discussion has been mainly carried out at the Steering Group of BEPS. The composition of this group as of January 2021 can be consulted at the OECD website. It seems relevant to mention that developing countries, in particular smaller ones, may not be that represented in said group; as an example, South America representatives are three large economies: Colombia that became an OECD member very recently, and Argentina and Brazil, G20 members, that have publicly expressed their intention in the recent past to become members of that organisation.

¹¹ The adjective intends to provocatively point out that it is possible these political decisions have already been taken by the most powerful economies.

¹² For example, the WBG (2019) classifies countries based on gross national income (GNI) per capita into four groups: low income, lower-middle income, upper-middle income, and high-income countries with the first two being categorised as developing economies. Additionally, the United Nation Development Programme (UNDP) resorts to the Human Development Index built on various indicators including income, education and health.

countries as those that are neither OECD¹³ nor G20¹⁴ members. However, even under such criterion, the author must note that a wide spectrum of different degrees of economic development can be distinguished¹⁵, meaning that she is aware that there is *no one-size-fits-all* and that every measure being considered should be assessed under the specific circumstances of each “developing” country. Notwithstanding, in the author’s opinion these countries in general evidence two common characteristics: (i) being net capital importing countries - inbound investment flows supersede outbound (sometimes even non-existent) investment flows, and (ii) not hosting headquarters of big multinational groups. As a result, they normally function and play the role of what the international tax world refers to as “source” countries.

The current international discussion on corporate income taxation and the birth of a two-pillar approach

The (anti-)BEPS Project, promoted by the G20, was launched by the OECD in 2013 with the objective of countering certain structures and arrangements being exploited by multinational enterprises (hereinafter, MNEs) to eliminate or significantly reduce their global tax burden in a manner inconsistent with the policy objectives of existing international tax standards.¹⁶ Indeed, eroding tax bases by shifting profits to jurisdictions

¹³ OECD members: Australia, Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States. G-20 members: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italia, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the European Union.

¹⁴ G20 members: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the European Union.

¹⁵ In this regard, Baéz Moreno (2017, 20) has identified the indetermination around the expression “developing countries” or “low income countries” as the origin of a number of technical deficiencies when recommending a specific measure; the spectrum of countries being covered show differences not only in relation to the level of productivity or income per capita but also in respect to intrinsic characteristics such as the possession of natural resources or raw materials which may delineate particular interests and stands.

¹⁶ “The main purpose of that plan [BEPS action plan] would be to provide countries with instruments, domestic and international, aiming at better aligning rights to tax with real economic activity” (OECD 2013a, 51).

where no economic activity was developed and no value was created¹⁷ - was stated to undermine the international tax framework in force.¹⁸

To counter the BEPS phenomenon, the OECD designed an action plan comprised of 15 actions, each addressing a sensitive BEPS area (OECD 2013b). After two years of work, in 2015, and except for Action 1 (with a broader scope aimed at addressing the tax challenges derived from the digitalization of the economy)¹⁹, recommendations for each action were delivered.²⁰

The fight against BEPS was said to be important as BEPS opportunities threatened the integrity of the corporate income tax (hereinafter, CIT) by creating unintended competitive advantages and distorting investment decisions (raising, therefore, fairness and efficiency issues, respectively). Additionally, and most importantly, BEPS opportunities also damaged voluntary tax compliance systems, for all taxpayers, including individuals (OECD 2013a, 8). In effect, the political support that the abovementioned project received (a fact that definitely made the difference for its success in respect of previous OECD initiatives²¹) may have emerged as a direct

¹⁷ For the discussion around the meaning of “value creation”, see, for example, Becker and Englisch (2018), Christians (2018), Deveraux and Vella (2018), Hey (2018). In the author’s opinion, the notion of value creation, that has to be analyzed under the particular political and economic context that gave birth to the BEPS Project, can perfectly be considered a “remake” (though hidden) of “source” (Riccardi 2020).

¹⁸ “[T]he interaction of domestic tax rules in some cases leads to gaps and frictions (...) The spread of the digital economy also poses challenges for international taxation (...) These weaknesses put the existing consensus-based framework at risk, and a bold move by policy makers is necessary to prevent worsening problems. Inaction in this area would likely result in some governments losing corporate tax revenue, the emergence of competing sets of international standards, and the replacement of the current consensus-based framework by unilateral measures, which could lead to global tax chaos marked by the massive re-emergence of double taxation” (OECD 2013b, 9-11).

¹⁹ In relation to the 2015 report on Action 1 and specifically regarding direct taxes (the report also covered indirect tax challenges), though some alternative solutions were presented, no recommendation was delivered (OECD 2015a).

²⁰ The other actions constituting the plan were grouped under four objectives, specifically: (i) establishing international coherence of CIT (Action 2: Neutralise the effects of hybrid mismatch arrangements; Action 3: Strengthen controlled foreign companies or CFC rules; Action 4: Limit base erosion via interest deductions and other financial payments; Action 5: Counter harmful tax practices more effectively taking into account transparency and substance); (ii) restoring the full effects and benefits of international standards (Action 6: Prevent treaty abuse; Action 7: Prevent the artificial avoidance of permanent establishment or PE status; Actions 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation); (iii) ensuring transparency while promoting increased certainty and predictability (Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it; Action 12: Require taxpayers to disclose their aggressive tax planning arrangements; Action 13: Re-examine transfer pricing documentation; Action 14: Make dispute resolution mechanisms more effective); (iv) from agreed policies to tax rules: the need for a swift implementation of the measures (Action 15: Develop a multilateral instrument); (OECD 2013b).

²¹ Certainly, many of the topics comprised in the BEPS action plan were not completely new and had been already analysed by the OECD, though with much fewer consequences. Some of these previous works are the reports on “Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues” (2012), “Tackling Aggressive

reaction to increasing social outrage; while governments - due to the 2008 financial and economic crisis - were increasing tax pressure on consumption and income derived from more immobile factors of production (i.e. labor), it was stated that well-known MNEs were not paying their “fair share of tax”²². However, the author believes it is also fair to recognize that, in most cases, these MNEs were benefiting from disparities between national tax systems and of both outdated domestic legislation and international standards but not breaching, strictly speaking, any statutory rule. This means that, by not enacting adequate coordinated legislation, governments were also responsible for BEPS. What is more, the so-called “harmful” tax competition among States contributed to BEPS. CIT was at the center of the public eye and, as Morse (2018, 197) argued, the mission of the BEPS Project was “to save the corporate income tax”.

In particular, for developing countries that, as mentioned, are generally net capital importing jurisdictions, saving the CIT seems relevant. Indeed, it can be considered as “an instrument whereby source countries exercise their established right to tax all corporate income originating within their borders, including the income accruing to foreign-owned corporations operating in the country” (OECD 1991, 23). Regarding BEPS and in accordance with the previous statement, Ault and Arnold (2017, 5) have highlighted that developing countries evidence some specificity that requires an independent analysis. The mentioned specificity is mainly for three reasons: (i) primary concern with the reduction in source-based taxation, (ii) corporate tax on inward investment typically accounting for a greater share of total revenue, and (iii) limited administrative capacity. Therefore, the fight against BEPS also became a priority for developing countries.

However, it is broadly shared the understanding that developing economies were not given an active role in the design of the BEPS action plan, plan that in the end comprised measures that mainly responded to the

Tax Planning through Improved Transparency and Disclosure” (2011), “Restricting the Entitlement to Treaty Benefits” (2003), “The Application of the OECD Model Tax Convention to Partnerships” (1999), “Harmful Tax Competition: An Emerging Global Issue” (1998), “Double Taxation Conventions and the Use of Conduit Companies (1986)”. See Escribano (2017, 513-16).

²² The famous phrase expressed by Margaret Hodge as President of the Public Accounts Committee at the British Parliament in November 2012 when meeting Matt Brittin (Chief Executive Officer, Google UK), Troy Alstead (Global Chief Financial Officer, Starbucks), Andrew Cecil (Director Public Policy, Amazon): “We aren’t accusing you of being illegal, we are accusing you of being immoral” (UK Parliament Site, 2012).

concerns of more advanced economies. Scholarship has extensively written on this point. For example, Mosquera (2018) has identified “output legitimacy deficits”, mentioning that relevant concerns of developing countries (particularly, the allocation of taxing rights between source and residence countries or the need to attract investment via tax incentives) were not dealt by the initiative. Hearson (2020, 3) highlights that the original BEPS Project “was led by the OECD and G20 and focused on their priorities” adding that “[w]ith a few small exceptions, it neither reallocated taxing rights nor simplified existing rules” which, in his opinion, are the two primary concerns developing countries face with existing international tax rules.

Indeed, instead of undertaking a true revision - which does not necessarily mean the abandon but an update - of existing international standards, the BEPS Project introduced a wide diversity of complex anti-avoidance measures, sometimes even replicating national approaches of develop countries, and hoping²³ that these would also contribute to solving the more structural tax challenges around nexus and profit allocation rules posed by the digitalization of the economy.²⁴

While it may have been clear from the beginning that, in order to be truly effective, the BEPS action plan, and particularly the so-called “minimum standard”²⁵, needed to be implemented by as many countries as possible, it was not until mid-2016, i.e. after issuing the above-mentioned recommendations, that the IF was established and opened to interested countries in order to work together “on an equal footing” “on implementing [as mentioned, already designed] BEPS package consistently on a global basis, and to develop further standards *to address remaining BEPS issues*”, the author’s emphasis (OECD 2017a, 5).²⁶

²³ “[I]t is expected that the measures developed in the BEPS Project will have a substantial impact on BEPS issues previously identified in the digital economy, that certain BEPS measures will mitigate some aspects of the broader tax challenges” (OECD 2015a, 148).

²⁴ Herzfeld (2017) refers to pre-IF experiences with the BEPS project and states: “[t]he project also failed to address another set of broader, more philosophical questions, rooted in economics but also in concerns over fairness in the context of global economic development... In a coordination setting, larger countries can and likely will act to negotiate and implement rules that may work to their best advantage, potentially to the disadvantage of smaller and less powerful countries, and the BEPS project largely failed to assuage such concerns”.

²⁵ The minimum standard is nourished by Actions 5, 6, 13 and 14, and members of the IF are obligated to adopt it.

²⁶ It has been said that the establishment of the IF “conferred a degree of ex post legitimacy on the BEPS Project” (Christians, Schön and Shay 2018, 192).

After an interim report issued - now yes - by the IF in 2018, the still by then unfinished work on Action 1 had no choice but to evolve and, in 2019, the IF adopted a two-pillar approach establishing a programme of work (hereinafter, PoW) on a “without prejudice” basis, compromising in order to achieve a global consensus-based solution - originally - by the end of 2020. In effect, by 2018 the world has started witnessing increasing tax unilateralism that attempts against the international distribution of taxing rights advocated by the OECD, leaving the international tax order on the edge of collapse. As Dourado (2018) pointed out, the silence of the BEPS Project opened Pandora’s Box.

A first pillar - Pillar One - that is said to address the broader direct tax challenges derived from the digitalization of the economy, i.e., “beyond BEPS”²⁷, focuses on revisiting profit allocation and nexus rules and, therefore, may result in an international reallocation of taxing rights. Meanwhile, a second pillar - Pillar Two - and the focus of the present contribution, is supposed to deal with “remaining” BEPS issues. In effect, it is considered that the initial measures recommended under the BEPS action plan, either already implemented or in the way of being so, have left some BEPS issues unresolved. However, as the political discussion evolved, the author believes and explains *infra*, that this second pillar also goes (far more) beyond BEPS, not only affecting tax sovereignty and the allocation of taxing rights but entailing negative consequences from a developing country perspective.

The work reorganized around two pillars was said to open a novel “without prejudice” era, the so-called “BEPS 2.0”. Now that the work is (at least formally²⁸) under the sphere of the IF, developing countries may have the opportunity to put their stamp on it.

²⁷ The broader/beyond BEPS tax challenges, related to nexus, data, and income characterisation, had been identified by the 2015 report on BEPS Action 1 (OECD 2015a).

²⁸ At least this is what the OECD website on BEPS states: “The OECD/G20 Inclusive Framework on BEPS has a global membership, including about 70% of non-OECD and non-G20 countries from all geographic regions. With greater inclusiveness and participation, developing countries’ perspectives and inputs are increasingly influencing the development of international standards on corporate taxation. As such, capacity building support for developing countries is core to the Inclusive Framework, prioritising active, equal participation in the BEPS process”. On the discussion of whether there is true participation on an equal footing of all members of the IF, see, e.g. Christians and Van Apeldoorn (2018), Christians (2019), Dickinson (2019) and Mosquera (2019b), Christensen, Hearson and Randriamanalina (2020).

Pillar Two: The Global Anti-Base Erosion (GloBE) proposal

As mentioned, Pillar Two is one of the two pillars on which the current work undertaken by the IF relies in relation to the direct tax challenges arising from the digitalization of the economy. Below, the policy rationale and general mechanics behind the package of rules being proposed are explored, evaluating them in order to suggest the path that the author understands may more effectively accord with general interests of developing countries. Notwithstanding, as already noted in the Introduction, each of her statements should then be assessed under each developing country’s specific circumstances.

What is the policy rationale behind Pillar Two?

Pillar Two introduces what has been referred to as “the GloBE proposal” that, as mentioned, apparently intends to address “remaining BEPS challenges”. For this purpose, said proposal presents “a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax” (OECD 2019c, 26).

By introducing a global minimum level of tax, the proposal claims to seek to affect the behaviors of both taxpayers and jurisdictions. On the one hand, Pillar Two foresees deterring MNEs from engaging in “profit shifting to entities subject to no or very low taxation” (OECD 2019 c, 25). On the other hand, Pillar Two seeks to establish a floor for the so-called “race to the bottom”. But what does this mean?

Starting with the first-mentioned intention, it must be noted that “BEPS” was not defined by the BEPS Action Plan. However, it is reasonable to say that while it covered reductions in the CIT base resulting from practices that implied booking profits in low tax jurisdictions where no economic activity had taken place, legitimate behaviors such as a business deciding to move its activity to a low tax jurisdiction, did not seem to represent an issue because profits and economic activities were kept aligned: “[n]o or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that *artificially segregate taxable income from the activities that generate it*”, the author’s emphasis (OECD 2013b, 10).

Notwithstanding, this rationale seems not to be valid anymore under Pillar Two. Indeed, the rationale may have changed, and though it is not written in black and white in any of the IF documents published by the

OECD, the Director of the Centre for Tax Policy and Administration at this organisation, Pascal Saint-Amans, has recently stated:

Pillar Two, which is what we tried to get adopted through Action 3 of the BEPS action plan, which was the idea that you should have strengthen CFC, and going beyond strengthened CFC, and address the weaknesses of the work on harmful tax practices, where every time you close down a harmful tax regime you may end up with a more generous, I mean more generous tax regime offered to all the companies, with no ring fencing. And so, at the end of the day, you wonder why you are doing all this work if it actually is providing more substance to jurisdictions, where there was no substance. It`s a bit contrary to the philosophy of BEPS, which was to say let`s align the profits with the location of the activities. Well sometimes we can see the reallocation of the activities where profits were booked, which was not necessarily the policy guiding all the efforts. So we have these“ (CBT, 2020).

Then, in the author`s opinion, it seems that, at least in relation to Pillar Two, instead of “BEPS 2.0”, the name of the new (“without prejudice”?) era should be “base erosion and activity shifting” and, the activity shifting to low tax jurisdictions, the phenomenon to be fought. Additionally, Pillar Two claims to address the so-called “race to the bottom”²⁹. This race refers to the global reduction of statutory CIT rates since the 1980s due to tax competition among jurisdictions. As stated by Chand (2020), “tax competition” consists, in very broad terms, of “actions taken by countries within their fiscal policies which lead to preserving or increasing the attractiveness of the given area as a location to carry out business operations”. This second intention of Pillar Two also needs clarification. Indeed, the fight against tax competition, has been traditionally limited to that of a “harmful” character³⁰, this is, fighting those regimes that by favouring BEPS practices may harm the tax base of other jurisdictions.

²⁹ On this phenomenon, see, for example, OXFAM (2016), Elke (2020).

³⁰ For the characterization of tax competition as “harmful”, see OECD (1998) and OECD (2015c). It must be noted that the 1998 OECD Report on Harmful Tax Competition and the 2015 Final Report on BEPS Action 5 address tax incentives in the form of preferential tax regimes. For a detailed description on them, see Mosquera (2020).

In this vein, the 2019 PoW claimed that the GloBE proposal “posits that global action is needed to stop a *harmful* race to the bottom” the author’s emphasis (OECD 2019c, 25), and the 2019 public consultation document added that this harmful race to the bottom “risks shifting the burden of taxes onto less mobile bases” (OECD 2019d, 6).

Therefore, one would reasonably think that Pillar Two and the design of the GloBE proposal would have been closely linked to the previous work accomplished under BEPS Action 5 on countering harmful tax practices that, by the way, was precisely centered on preferential regimes granted to mobile activities. However, and as per the abovementioned (anti-) “base erosion and activity shifting” approach, this may not be exactly the case. Indeed, as it arises from Pascal Saint-Amans words and is analysed by the author in the following chapters, the abovementioned original policy stream against harmful tax competition may have also changed. For example, Dourado (2020b, 154) does state “both cooperative and non-cooperative jurisdictions are targeted”. To a certain extent, this has been recognized in the 2019 public consultation document:

[l]ike Pillar One, the GloBE proposal under Pillar Two represents a substantial change to the international tax architecture... the GloBE proposal is intended to address the remaining BEPS challenges linked to the digitalization of the economy, but it goes even further and addresses these challenges more broadly (OECD 2019d, 6).

In this regard, the author anticipates that in her view, Pillar Two does not address “remaining” BEPS challenges “more broadly”, but the proposal presented in the Blueprint goes *far more* beyond such challenges. The 2019 PoW also argued that Pillar Two operates “as a *backstop* to Pillar One for situations where the *relevant profit is booked* in a tax rate environment below the minimum rate” (OECD 2019c, 26), the author’s emphasis. While, again, the language used, “booked”, adds confusion, in any case, the statement leads the author to make another point on this unclear discussion. If Pillar Two is a backstop to Pillar One, it seems reasonable to say that Pillar 1 is addressed before Pillar Two, or at least, implementation follows this order.

Under Pillar One, the creation of a new non-physical nexus in “market” jurisdictions and the allocation of a portion of the deemed non-routine/residual profit of the MEN to this nexus is being discussed.³¹ Apparently, Pillar Two is also related to this notion of “residual profit” as it is claimed “any rules developed under this Pillar should not result in taxation where there is no economic profit” (OECD 2019c, 25). This means that the target of the GloBE proposal intends to be also residual profits of MNEs, profits that may be linked - though in the author’s opinion, not exclusively - to the use of intangibles. Indeed:

[w]hile the measures set out in the BEPS package have further aligned taxation with value creation and closed gaps in the international tax architecture that allowed for double non-taxation, certain members of the Inclusive Framework consider that these measures do not yet provide a comprehensive solution to the risk that continues to arise from structures that shift profit to entities subject to no or very low taxation.... Profits shifting is particularly acute in connection with profits relating to intangibles, prevalent in the digital economy, but also in a broader context; for instance[,] group entities that are financed with equity capital and generate profits, from intra-group financing or similar activities, that are subject to no or low taxes in the jurisdictions where those entities are established (OECD 2019c, 25).

The author resumes the abovementioned aspects *infra*. However, at this point she considers relevant to introduce what, at least in her view, has been the true trigger, and explanation, for Pillar Two.

In the author’s view the evolution and division of the international tax debate into a two-pillar approach and, therefore, the birth of Pillar Two, clearly responds to the tax policy preferences of a reduced but powerful group of nations. In this regard, it is relevant to mention that the GloBE package was initially proposed by two major European powers, Germany

³¹ See OECD (2019a, 2019b, 2019d, 2020a, 2020d). ³² In the past - year 2004 - France and Germany had proposed that the European Council analysed the adoption of a minimum CIT rate within the EU. This proposal responded to the threat of businesses relocations to new member States offering reduced tax rates or no CIT at all. See Vallejo (2005, 159).

and France³², and was inspired in two measures introduced domestically in the United States in December 2017 via the Tax Cuts and Jobs Act (TCJA)³³, the biggest US tax reform within the last 30 years: the “Global Intangible Low-Taxed Income (GILTI) regime” and the “Base Erosion and Anti-Abuse Tax (BEAT)”. However, and ironically, while implementing these measures, the US tax reform also reduced the statutory CIT rate to 21% contributing to the “undesired” race to the bottom.

This tax reform in the United States - no more and no less than the world’s largest economy, leader in respect of tax policy making,³⁴ and home of most of the MNEs under scrutiny³⁵ - certainly changed the game rules, delineating the path taken by the OECD afterwards. It should be born in mind that the two-pillar approach and, with it, the commencement of the era of BEPS 2.0, in certain way, may have emerged as a solution to satisfy both *relevant* sides in the “tax and commercial war” that was occurring at that time between Europe and the United States.³⁶ Indeed, several jurisdictions, including many European countries³⁷, had been introducing unilaterally - or were planning to do so³⁸ - some type of “digital service tax”, reaching mainly US MNE tech companies. Additionally, a reminiscence from BEPS 1.0 should not be forgotten. As stated by Brauner and Davis (2020, 857), while the United States “had made it a priority to promote universalization of CFC legislation in the context of the BEPS Project”, its effort failed during BEPS 1.0 when BEPS Action 3 entitled “Strengthening controlled foreign company (CFC) legislation” was catalogued as “best practices”.

Before examining the relationship between Pillar Two, CFC legislation and the US GILTI, a brief description of the US GILTI and BEAT seems worth it.

³² In the past - year 2004 - France and Germany had proposed that the European Council analysed the adoption of a minimum CIT rate within the EU. This proposal responded to the threat of businesses relocations to new member States offering reduced tax rates or no CIT at all. See Vallejo (2005, 159).

³³ P.L. 115-97, 22 December 2017.

³⁴ CFC rules, LOB clauses, and the Foreign Account Tax Compliance Act or FATCA (March 2010) are effective examples of previous international tax implications derived from US tax policy.

³⁵ The US rejection to Pillar One is broadly known in the international tax arena. The Secretary of the Treasury Steven Mnuchin expressed “we have serious concerns regarding potential mandatory departures from the arm’s-length transfer pricing and taxable nexus standards-longstanding pillars of the international tax system upon which U.S. taxpayers rely” (letter to the OECD Secretary-General, José Ángel Gurría, dated December 3, 2019).

³⁶ To obtain an overview of this scenario, see Lamer (2018a, 2018b, 2018c)

³⁷ Such as the United Kingdom, Spain, Hungary, Italy, and France.

³⁸ Even at the level of the European Union (EU), its introduction has been proposed by the European Commission. See EC (2018).

Concisely, the US GILTI regime introduced a minimum level of US tax on outbound investment returns. The principal reason behind the introduction of this new category of income subject to tax in the United States was to address the recurrent practice of shifting intangible assets developed in the US and, with them the associated income, to low-tax jurisdictions. The regime, which is applicable to US shareholders that own 10% or more of a CFC - where more than 50% of the CFC is owned by US shareholders - imposes a US minimum tax of 10.5% (half of US CIT) on the "global intangible low taxed income". This is determined as the aggregate of the income of foreign CFCs³⁹ that exceeds a deemed *routine* return on *tangible assets* located abroad⁴⁰. It is relevant to observe that, as per this design, the portion of the CFC income determined as the GILTI by the new rules may not necessarily derive from intangible assets. This may be the case when the CFC assets are largely depreciated or the activity of the CFC does not require a significant investment on tangible assets, e.g. personal services in general.⁴¹ As a credit equivalent to 80% of the foreign tax paid on such income is allowable to offset the US tax on the GILTI, it can be posited that the regime imposes a minimum rate on the GILTI of 10.5 if no tax is paid abroad, with the US tax liability being eliminated completely when the foreign tax is at least 13.125% (IMF 2019, 22).

Meanwhile the BEAT that represents, in practice, a minimum tax on inbound investment (IMF, 2019, 23), intends to restrict excessive base erosion payments, i.e. US deductible payments to foreign affiliates. However, it must be stated that the BEAT is a tax on the US taxpayer and not a tax being withheld at source. It applies to MNEs with gross receipts over USD 500 million that make payments from the United States to affiliates of more than 3% of total deductible expenses. In general, the measure targets "typical" base eroding payments, i.e. royalties, interest, and management fee payments to foreign affiliates. Under the BEAT, the US taxpayer will pay whichever is the greater amount: the tax liability under regular CIT rules or the tax calculated at a lower rate - currently 10% - but on a tax base that does not allow base eroding payments, therefore, establishing this latter amount as a minimum charge. It must be noted that

³⁹ It excludes certain categories of income, e.g. income subject to US tax as subpart F.

⁴⁰ In general terms, this return is equivalent to the 10% of the US tax basis - considering the US shareholder's share in the CFC - of CFC tangible assets subject to depreciation.

⁴¹ See Tognazzolo (2019, 458).

the BEAT calculation is independent from any qualitative indicia of abuse (for example any substance consideration), therefore, possibly covering genuine (not “artificial”) intragroup transactions as well.

The next chapter, dedicated to presenting the set of rules being proposed under Pillar Two, will explain on its own the influence of the US TCJA.

Assessing the proposed set of rules

To introduce global minimum level of taxation, the GloBE proposal intends to establish a system based on two rules - the so-called “GloBE rules”: a primary rule, the “income inclusion rule” (hereinafter, IIR), and a secondary/backstop rule, the “undertaxed payments rule” (hereinafter, UTPR). These two rules would be implemented by way of changes in domestic legislation and, eventually, a multilateral instrument for coordination purposes. Under a tax treaty scenario, the IIR would be complemented by a switch-over rule to ensure the application of the former when the exemption method has been adopted by the Contracting parties to eliminate double taxation on business profits obtained through a permanent establishment (hereinafter, PE).

Before exploring each of the GloBE rules, it must be mentioned that this system may end applying to the largest multinational groups. Indeed, according to the Blueprint, they target MNEs that meet or exceed a EUR 750 million annual gross revenue threshold, scope that deliberately follows that of the so-called “Country by Country Reporting” or CbCR established in accordance to BEPS Action 13. Likewise, it relies with minor difference on CbCR definitions and on the consolidation standard under financial accounting. As declared in the Blueprint, this approach seeks not only to create synergies and reduce compliance costs but also to avoid adverse impacts on small and medium businesses. Furthermore, it is argued that while 85%-90% of MNEs would be outside the referred scope, those in scope earn over 90% of global corporate revenues (OECD 2020e, 23-44).

A fourth rule, the subject to tax rule, though it is part of Pillar Two, would operate outside the abovementioned GloBE rules system, following a completely different logic. The rule is analysed by the author in the chapter “The subject to tax rule: the solution for developing countries?”.

The GloBE rules: an (excessive?) extension of tax sovereignty granted to residence countries

As anticipated, the IIR is the primary GloBE rule to operate and would do so in “residence jurisdictions”, this is, in broad and simplified terms⁴², in those jurisdictions where a “parent entity” of an MNE is resident according to domestic legislation⁴³. In this regard, a “parent entity” is an entity part of an MNE that owns directly or indirectly an interest in another entity of that group and is resident in a jurisdiction that has implemented an IIR.

Basically, the IIR would imply imposing a top-up tax in the parent jurisdiction on the income of a foreign controlled entity - or foreign branch⁴⁴ - if that income has not been effectively subject to tax at an agreed minimum rate, still to be defined⁴⁵. In such a way, the rule would operate in the parent jurisdiction as a *top-up tax* to this minimum rate. For this purpose, the Blueprint proposes to start by calculating the so-called “GloBE effective tax rate” (hereinafter, Globe ETR)⁴⁶ on a jurisdictional basis. If the GloBE ETR determined at the jurisdictional level is below the agreed minimum rate - the jurisdiction results to be a “low tax jurisdiction” - a top-up tax percentage would be determined. This top-up percentage is then applied to the income of each subsidiary/PE in the low tax jurisdiction, determining the additional tax to be paid by the group in the parent jurisdiction applying the IIR.

To avoid over taxation due to the simultaneous application of an IIR by various parent entities throughout the ownership chain of the group, a top-down approach is proposed. As a result, the IIR would mostly apply in jurisdictions where ultimate parent entities are tax resident.⁴⁷ Meanwhile the UTPR, and as part of the GloBE rule system, is said to have the same general purpose as the IIR, particularly, “to protect jurisdictions against base erosion through intra-group payments to low-taxed entities” (OECD

⁴² The Blueprint defines exhaustively the terms “group”, “MNE group”, “constituent entity”, “ultimate parent entity”, “parent” (OECD 2020e, 24-30, 112).

⁴³ The Blueprint includes some comments on stateless and dual resident entities, but states that further work should be undertaken (OECD 2020e, 27).

⁴⁴ Under the IIR, PEs are given the treatment of foreign subsidiaries.

⁴⁵ Regarding this minimum level of tax and based on tax policy objectives behind the proposal (setting a level playing field, minimizing administration and compliance costs), it was declared that an approach using a fixed percentage (rather than a percentage of the parent jurisdiction’s CIT rate or a range of CIT rates) would be selected (OECD 2019c, 27-8). This approach was confirmed in the Blueprint (OECD 2020e).

⁴⁶ It is determined by dividing the amount of “covered taxes” by the “GloBE tax base”. See OECD (2020e, 45-81).

⁴⁷ However, the so-called “split-ownership rule” is an exception to this top-down approach; it pushes the taxing obligation down by requiring the partially owned intermediate parent entity to apply the IIR in priority to the IIR rule of its parent (OECD 2020e, 115-19).

2020e, 122). By using the same mechanics as the IIR for determining the GloBE ETR and the top-up tax (including, possible carve-outs), the jurisdiction applying the UTPR would limit or deny a deduction for, or impose an additional tax (including a withholding tax) on for a payment to a related party.⁴⁸ As anticipated, the UTPR is the secondary/backstop GloBE rule: it would only operate when no IIR has been applied by an entity further up the ownership chain. This rule order is said to largely respond to compliance and simplicity considerations. In practice, it means that “the scope for the application of the UTPR is expected to be relatively narrow” (OECD2020e, 122).

Having said this, the author analyses the legitimization of the IIR and its implications for developing countries in the following chapter.

A CFC-type rule

Requiring a shareholder in a foreign corporation to bring into account the proportionate share of the income of that corporation if that income was no subject to an effective rate of tax at or above a minimum rate, is not a novelty. Indeed, it may be stated that the IIR is a controlled foreign company or CFC-type rule that, in fact, may supplement CFC rules existing in a country. For example, Pistone et al. (2020, 72) have stated “GloBE should apply in a subsidiary fashion and only to the extent that CFC rules are not already effective”. In this respect, while the Blueprint recognizes that “the operation of the IIR is, in some aspects, based on traditional controlled foreign company (CFC) rule principles”, states (in a footnote!) that “[a]lthough similar in operation, the IIR and CFC rules can co-exist because they have different policy objectives” (OECD 2020e, 15). In the author’s understanding it then seems relevant to identify clearly said different policy objectives.

CFC rules are known to be a specific anti-abuse/avoidance⁴⁹ measure that protects the tax base of “residence jurisdictions”. Indeed, CFC legislation prevent residents from avoiding or, at least, deferring taxation on their worldwide income by using a CFC in a no or low-tax jurisdiction to earn foreign source income (Arnold 2016, 118). These rules generally apply on foreign passive income - mobile income by nature. However, the design of

⁴⁸ Apparently, the mechanism to make the adjustment would be left to national legislation (OECD 2020e, 134).

⁴⁹ As Arnold (2016, 111) states, “[t]ax avoidance is difficult to define precisely, but generally means transactions or arrangements entered into by a taxpayer in order to minimize the amount of tax payable in a lawful manner”.

CFC legislation varies from one country to another⁵⁰ depending on what each country considers as “inappropriate deferral”⁵¹ and, certainly, on other policy considerations⁵².

CFC rules were first adopted in 1963 by the United States - the so-called “Subpart F”⁵³ - primarily targeting foreign passive income. The historical exclusion of active income is said to respond to different factors: a compromise between capital export and capital import neutrality in Congress, the view that source countries should have primary taxing rights over active income, and global competitiveness concerns (Kofler et al. 2020, 4; Brauner and Davis, 833-34; Arnold 2016, 121). However, it is relevant to mention that the US is one of the few countries that applies CFC rules regardless of the level of taxation verified in the CFC residence jurisdiction. From a tax policy perspective, the implementation of CFC rules may make sense in those countries that, as noted before, not only have taxpayers with outbound investments - and can actually play de role of residence jurisdictions - but also face a real risk of tax avoidance.⁵⁴ Otherwise the costs derived from the adoption and implementation of this type of not simple rules will exceed not only the revenue being collected but, most significantly, their anti-abuse purpose. In this regard, as it was previously mentioned, while BEPS Action 3 (OECD 2015b) specifically addressed CFC rules, its recommendations have not even been comprised as part of the BEPS minimum standard. What is more, in relation to developing countries, Action 3 has been categorized in the OECD document “Two-part Report to G20 Developing Working Group on the Impact of BEPS in Low Income Countries” (OECD 2014, 32) as being of *low relevance*.

Having said this, it may then be inferred that the introduction of a CFC-type rule may not *per se* represent a priority for every country and, in fact, for some countries, its implementation may pose more costs than benefits. In effect, developing countries as defined in this analysis - i.e. neither OECD

⁵⁰ On the design of CFC legislation in 41 countries see Kofler et al. (2020).

⁵¹ Expression extracted from Brauner and Davis (2020, 852-53).

⁵² On these policy considerations see OECD (2015b, 13-5).

⁵³ “Subpart F” rules were based on similar rules applicable to individuals (the foreign personal holding company rules) adopted in 1937 (Arnold 2016, 119).

⁵⁴ Dueñas (2019, 34) quotes the case of China where CFC rules, though implemented, may have not been necessary because many Chinese companies investing abroad are owned by the government and, therefore, there is actually no risk for tax avoidance.

nor G20 members - are not headquartering very many MNEs.⁵⁵ In fact, a quite recent study (Clausing 2018) that examines headquarters location of top companies, has shown that the United States, China, Japan and the United Kingdom were not only the four countries with the largest share of big companies in 2017⁵⁶ but also are “important examples of countries that have focused on attracting headquarters activities in recent years” (Clausing 2018, 45). What is more, the analysis shows “a clear, if imperfect, relationship between the world’s largest economies and the headquarters of the world’s largest public companies” (Clausing 2018, 49). Therefore, it is reasonable to posit that the IIR being proposed - particularly, considering the abovementioned global revenue threshold suggested in the Blueprint - would only be minimally applied among developing countries.

An excessive extension of residence taxation?

Another aspect closely related to tax jurisdiction and, therefore, to the stream of work - nexus and profit allocation rules - which is supposed to be dealt with under Pillar One, that the author believes to be worth mentioning, refers to the legitimization of CFC rules, including a “super” CFC-type rule, under the current international tax framework.

Under typical CFC rules, a CFC is a foreign subsidiary that is controlled by persons - theoretically - within the parent`s residence country and that is subject to no or a low level of income taxation in comparison to the level of taxation in the parent`s residence jurisdiction. Resorting to CFC rules enables the parent`s residence jurisdiction to “pierce the corporate veil” of the CFC (Kofler et al. 2016, 3) and tax it directly. By doing this, CFC rules deviate from the separate entity standard⁵⁷. In practice, it may imply the exercise of taxing rights on foreign income obtained by, strictly speaking, a “non-resident” person, and this, just because the latter is controlled by a

⁵⁵ Some of these net capital importing countries may even adhere exclusively to source corporate taxation. In Latin America, this is the case of Bolivia, Costa Rica, El Salvador, Guatemala, Nicaragua, Panama and Uruguay.

⁵⁶ Avi-Yonah and Xu (2016, 234-5) who support taxing active income primarily at residence, argues that 90% of large MNEs are headquartered in G20 countries and “[i]f the G20 countries taxed their MNEs based on where the headquarters are located on a current basis and restricted the ability to move the headquarters, the problem of taxing active income would be largely resolved”.

⁵⁷ Though, from an economic perspective, the author recognizes that the separate entity approach is itself a fiction, the approach has been - and it seems it will continue to be - so far the international tax standard. According to the separate entity principle, different juridical persons (even different parts, i.e. PEs) of the same business group are considered as if they were economically independent persons. To discuss on the suitability of the separate entity approach as the international tax standard and the place of incorporation as the proxy to determine the tax residence of legal entities, exceeds this contribution.

resident taxpayer. Are then these rules an excess of tax power at residence jurisdictions? The answer to this question may be debatable. In any case, it is important to bear in mind that the measure may represent in principle a deviation from the separate entity standard.

Some authors have analysed this aspect of CFC rules. For example, Avi-Yonah (2007), who argues that an international tax regime does exist, rises to the level of customary international law⁵⁸ and, therefore, is part of international law, makes some comments that provide interesting input in relation to CFC rules legitimation⁵⁹. While first asking and answering... “[c]an a country simply decide to tax non-residents that have no connection to it on foreign source income? The answer is clearly no, both from a practical perspective and, I would argue, from a customary international law perspective.”, he justifies CFC rules based on a change in customary international law. Indeed, because the United States considered “a breach of international law” to tax a foreign corporation on foreign source income just because it was controlled by residents, in 1963 adopted the so-called “deemed dividend rule”, to at least avoid taxing “directly” the non-resident.⁶⁰ However, once “other countries began to copy the CFC regime”, many even abandoning that deemed dividend approach, customary international law changed and the US did not feel bound any more (Avi-Yonah 2004). According to Avi-Yonah (2008, 472) “what CFC rules do is redefine the residence of a CFC (i.e. make it a resident of its parent’s residence country)”, and this expansion of tax jurisdiction in the tax arena is justified based on the “first bite at the apple rule”: while source jurisdictions have the primary right to tax income, residence taxation applies residually when source abstains from taxing and therefore, he says, this does not harm the right of source jurisdictions to tax first.

For its part, when analysing justice in the international tax regime, Hongler (2021, 85-6) opposes Avi-Yonah’s understanding arguing that there is no sufficient state practice to justify the existence of customary international law, and argues that only in abusive circumstances (when there is no substance in the state of the CFC) there are persuasive reasons

⁵⁸ This implies that those standards and practices are followed from a sense of legal obligation (*opinion juris*).

⁵⁹ See also Avi-Yonah (2004).

⁶⁰ “This deemed dividend rule was adopted precisely because the US felt bound by a customary international law rule not to tax non-residents directly on foreign source income, even though they are controlled by residents” (Avi-Yonah 2007).

to understand that the actual nexus - jurisdictional connection - is within the parent jurisdiction.

Furthermore Hongler (2021, 475-86) observes: “CFC rules per se (depending on the design) might infringe the principles of sovereignty and fiscal self-determination to another state”, by forcing a State to raise the tax rate or even implementing a CIT to avoid the application of the CFC rule. He therefore explains that CFC rules only based on the tax rate and not on the existence of abusive circumstances, infringe the principle of fiscal self-determination.

Hongler’s appreciation results crucial for this contribution’s analysis. In this regard, the author agrees with his argument and adds that, “super” CFC-type rules may even infringe the generally accepted claim according to which taxation should be aligned with economic activities. Indeed, the adoption of the GILTI category - source of inspiration for Pillar Two - certainly expanded the scope of the US CFC regime⁶¹, and in a certain way, with the introduction of the IIR, the GloBE proposal may be following now the same path.⁶² Precisely, said proposal provides (residence) jurisdictions with a right to tax back where other - source - low tax jurisdictions have not exercised their primary taxing rights (OECD 2020c, 2). Not to mention that the GloBE proposal does not requires any substantive activity test in the parent’s jurisdiction as a precondition for the application of the IIR. As a result, and based on the abovementioned argumentation, source jurisdictions’ tax sovereignty may be affected, in particular, these jurisdictions may be taken away the right to not to tax or grant tax incentives *on income generated domestically*.

Similar comments in relation to the absence of a sufficient connection, would be argued in relation to the application of the UTPR. The author has analysed this issue somewhere else⁶³ and has been very critical in relation to extending taxing rights beyond the source of production. Her position may contradict that of some developing countries (including for example the criterion embraced in Article 12A of the UN tax treaty model convention)

⁶¹ See Dueñas and Blunn (2019). It is relevant to mention that GILTI rules, which were introduced outside Subpart F, apply only beyond the Supart F (Brauner and Davis 2020, 856).

⁶² As Englisch and Becker (2019) state, “the minimum tax regime is potentially much broader in scope than traditional CFC rules and switch-over clauses, because it is not limited to certain categories of passive income or circular arrangements (...) [t]he objective to also neutralize ‘excessive’ tax competition for real activity rather implies a broad scope of application, covering all kinds of profits generated by lower-tier group companies”.

⁶³ Riccardi (2020).

which have adopted a broader “anti-base erosion” approach and the so-called “source of payment” criteria without any consideration of the place where activities are carried out, where factors of production are applied (source of production). Though the author believes that source taxation is unfairly limited by international tax standards, she disagrees with recovering taxing rights on the basis of the so-called “source” of payment (Riccardi 2020). The author explores the tax sovereignty argument below.

What about tax incentives?

Both, the January 2019 IF policy note announcing the two-pillar approach and the PoW established later, clearly stated that jurisdictions would remain free “to set their own tax rates or not to have a CIT system at all” (OECD 2019a, 2), “to determine their own tax system, including whether they have a corporate income tax and where they set their tax rates” (OECD 2019c, 25); this is, tax sovereignty would be respected.

However, once a jurisdiction is afforded the right to “tax back” - regardless of abusive circumstances - foreign income, when the source jurisdictions has not exercised its taxing right or have exercised it at a level lower than a minimum level, countries may certainly lose some freedom not only in setting their national CIT rates but also in choosing their tax incentives policy. Additionally, this may be particularly unfortunate in terms of tax sovereignty when the jurisdictional connection with the country taxing back, is, as explained *supra*, controversial.

Not only national CIT rates may be affected but the use of taxes with a regulatory purpose may lose effectiveness as well. CIT rates are said to represent an instrument to boost the competitiveness of a country (Andersson 2017, 591) and tax incentives in general are used to attract investment and its positive spillovers. They are, therefore, an instrument broadly used by developing countries.

Pillar Two negative view on utilizing tax incentives by the developing world, has been present since the birth of the Pillar Two:

[o]ver recent decades, tax incentives have become more widespread in developing countries as they seek to compete to attract and retain foreign direct investment. Some studies have found that, in developing countries, tax incentives may be redundant in attracting investment. Revenue forgone from tax

incentives can also reduce opportunities for much-needed public spending on infrastructure, public services or social support, and may hamper developing country efforts to mobilise domestic resources. There is evidence that tax incentives are frequently provided in developing countries in circumstances where governments are confronted with pressures from businesses to grant them (OECD 2019c, 26).

The author does share the position that inefficient tax incentives, the so-called ‘wasteful tax incentives’ (Mosquera 2020, 454), should not be granted or, at least, redesigned.⁶⁴ However, she also believes that generalizing the inefficiency to every tax incentive being granted by a developing economy, is very unfortunate - “the innocents end paying for the sinners” -- but also ignores the specific circumstances that are evidenced by the developing world. By granting tax incentives, the developing world *try to compete* with the developed world.

Indeed, low levels of taxation may serve to balance the provision of poor public goods and services in developing countries. A country’s competitiveness is not determined - at least, not exclusively - by the tax factor but workforce skills and education, research and development spending, infrastructure, property rights, institutional stability and macroeconomic indicators (Clausing 2018, 44), are even more important. That is may explain why, as noted, headquarters of top companies are located in large developed economies.

Though taxation is supposed to return a portion of the economic value to the State that it, for its own part, has assisted in producing (Vogel 1988, 57), foreign direct investment often provides substantial benefits to the host country (Green 1993, 30). These benefits sometimes even exceed the costs that the corporate taxpayer imposes on the host government, and this explains “why developing countries are often willing to offer tax holidays to attract foreign direct investments”. In the same line, the UN and the Inter-

⁶⁴ The current scenario may be an excellent opportunity for States to review their tax incentive policies, redesigning or eliminating those which result to be inefficient. In this regard, tax incentives should be designed transparently in order to attract genuine investments and generate positive spillovers, enhancing the economy and, ultimately, domestic resource mobilization for financing sustainable development. Besides, it is imperative that tax incentives are monitored and their effects measured. This would contribute to making informed decisions.

American Center of Tax Administrations (CIAT, as per the Spanish abbreviation) report, "Design and Assessment of Tax Incentives in Developing Countries", notes that, while much of the attention on tax incentives has been put on the taxes imposed by the government, it may also be relevant to examine "the government spending side of the equation" (UN and CIAT 2018, 5).⁶⁵ Cipollini (2020, 250-1) also suggests

focusing the attention not only on the effective tax rate applied in a single jurisdiction, but also on the value of the public services and infrastructures available in that jurisdiction (...) opening the door to the use of the tax variable to compensate the entities established in developing countries from the economic delays and the lack of an adequate level of infrastructures and public services.

Furthermore, Mosquera (2019a, 2020, 446) explains:

[t]ax incentives in developing countries aim to attract foreign direct investment (FDI) in order to increase economic growth by creating more employment, to transfer technology and to improve economic conditions in a specific sector/region.

Additionally, the limitation to tax sovereignty may be particularly sensitive for developing small countries, as Andersson (2018, 688) states,

small countries could not set the corporate tax rate to compensate companies for the disadvantages of doing business in a small country relative to a large country. Large countries have an advantage over smaller countries, even if they have a higher corporate tax rate due to the size of their consumer market.

⁶⁵ However, the author also agrees that correcting certain deficiencies such as inadequate protection of property rights, rigid employment legislation, or poorly functioning of legal systems, with tax incentives may not be the solution (UN and CIAT, 7). That is why taxes incentives should be carefully designed.

Notwithstanding the negative view on tax incentives, the PoW did mandate to explore *possible* carve-outs, including those “regimes compliant with the standards of BEPS Action 5 on harmful tax practices, and *other substance based* carve-outs” but “noting however such carve-outs would undermine the policy intent and effectiveness of the proposal” (OECD 2019c, 29). The alternative of “a return on tangible assets” was also suggested.

Furthermore, as it was noted in the 2019 public consultation document prepared by the OECD Secretariat (OECD 2019e, 23) the existence and design of any carve-outs will impact on the neutrality of the tax system and on compliance and administration costs for taxpayers and tax administrations.

In this regard, the author believes that prioritizing economic development and global welfare over the abovementioned policy considerations is completely justified. Although the author can understand that major economies may consider developing countries genuine tax incentives as diverting real investment from their countries, at the same time, it may be necessary for them to realize that those incentives may be legitimate (based on the arguments noted *supra*) and an effective option for reaching *global* welfare - not just the welfare of already more advanced economies.

Finally, the Blueprint is currently proposing a “formulaic substance-based carve out” aimed at excluding “a fixed return for substantive activities within a jurisdiction” from the scope of the GloBE rules. This makes sense if, as abovementioned, Pillar Two intends to target residual/non-routine profit.⁶⁶ Of course, whether this is technically correct, would depend on the underlying policy rationale. In practice it means the profit above the carved-out normal return that is taxed below an agreed minimum CIT level, would be taxed by the jurisdiction of, probably, the ultimate parent of the group. The fixed return - which has been characterized as “modest” in the Blueprint itself - has two components: the payroll component and the tangible asset component, calculated as fixed percentages on expenditures for payroll and on tangible assets respectively.

⁶⁶ In this regard, Englisch (2020) states, “[t]he rationale of a substance-based carve-out... is that the deemed routine return is not susceptible to have been created through BEPS (or by tax competition for IP holdings and, possibly, for corresponding R&D investments)”.

In the author's opinion, the introduction of the abovementioned formulaic carve-out does not provide a satisfactory answer; limiting the carve-out to a deemed amount of routine profit, supports the idea according to which residual profit should be allocated to residence jurisdictions. Not to mention the fact that what constitutes residual profit is defined - as it seems it would be under the two-pillar approach - in an arbitrary way.

The subject to tax rule: the solution for developing countries?

As mentioned, the STR is a rule that would operate outside the mechanics of the GloBE rules, following a completely different logic. Consisting of a standalone tax-treaty rule the STR foresees a jurisdiction would only grant treaty benefits (no taxation or reduced taxation)⁶⁷ provided that the item of income is subject to tax at or above a minimum rate at the State of residence. The rule applies individually on a payment-basis and requires a nominal tax rate test. Of course, any top-up tax recovered under the STR would be taken into account in determining the GloBE ETR.

The scope of the rule is limited to a defined set of intragroup payments. Indeed, contrary to the lack of clarity around the scope and the effects of possible carve-outs under the IIR (and the UTPR, if applicable at all) - possibly because of its payment-based approach - the STR anti-avoidance intention seems clearer. The set of payments under scope is limited to those considered presenting "greater BEPS risk" (OECD 2020e, 153). This character is verified if "the value of the payment is primarily compensation for mobile factors such as capital, assets, or risks that are owned or assumed by the person entitled to the payment"; if "the value of the payment is primarily linked to functions performed by the person entitled to the payment", payments are said to present a lower risk.

Though the STR may restore taxing rights, this restoration is conditioned to the level of taxation imposed by the State of residence. In the author's view, STR should not be assessed as a "gain" for developing countries but as a measure that indirectly preserves an inefficient and unfair tax treaty system that supports and privileges residence taxation. The Blueprint itself (OECD 2020e, 148) recognises that the STTR is not premised on concerns that the current allocation of taxing rights between jurisdictions needs to be

⁶⁷ This may refer to the following treaty benefits established in the OECD model convention: the limitation on the taxation of business profits of non-residents unless those profits are attributable to a permanent establishment (Article 7); the limitations on taxation of interest or royalties (Articles 11 and 12). See OECD (2020e, 148-49).

revisited. In fact, the author wonders whether developing countries should not start thinking of reviewing their tax treaty network and practices.

Concluding remarks

From her analysis, the author concludes that Pillar Two is a rushed political-driven proposal that fails to delineate its underlying policy rationale.⁶⁸ As per the technical design in the Blueprint, it seems quite clear that the proposal does not address “remaining” BEPS issues, but it goes *far more beyond* “BEPS”, not only affecting tax sovereignty and the allocation of taxing rights, but entailing negative consequences from a developing country perspective.

Most importantly, it seems that again efforts and resources are being deviated from the base problem in the international tax arena: the need to *update and define common nexus and profit allocation rules*. This issue, which has proved to be one of, if not, the most important concern for developing countries, has already been intentionally ignored during BEPS 1.0. The outcome of that era is well known: the opening of a Pandora’s box. Former mistakes must not be repeated.

Acknowledgements

The author would like to thank Assistant Prof., Jur.dr. Yvette Lind as well as NJOLAS reviewers for their invaluable comments and suggestions.

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⁶⁸ This has been previously claimed by the author (2019b).

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