The BEPS "Revolution" and the Future of Corporate Income Taxation

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INTRODUCTION

Certain tax-motivated behaviors of multinational corporations ("MNCs") have left governments perplexed. MNCs conduct a significant amount of business among their own related entities, and they can manipulate the prices of transactions between these entities to achieve lower effective tax rates. These behaviors—often termed "profit shifting"—have garnered a growing amount of attention in the last couple of decades as MNCs have taken advantage of the lack of cooperation among governments and their tax laws. Globally, while wealthy countries like the United States have struggled to rein in corporate profit shifting, poorer, developing countries tend to struggle more because, historically, they lack an adequate seat at the table in international tax discussions. Profit shifting takes place not only across international borders but within the United States as well. The difficulties that U.S. states face in trying to control profit shifting resemble the same roadblocks that have plagued international tax reform efforts.

For decades, the international tax community has failed to meaningfully address how MNCs exploit the tax laws of sovereign nations. This is partially due to the inherent difficulties in coordinating cross-border tax rules, but it is also a result of wealthy countries maintaining aggressive positions to protect their tax sovereignty. The tax strategies discussed in this Note, while executed lawfully, foment distrust in government and corporate institutions. As major corporations saw a 41% increase in profit over the first years of the COVID-19 pandemic, and workers saw only a 5% increase in their wages, it should not come as a surprise that "low-wage workers [are] quitting at near-record rates."[1] The strategies also disproportionately harm the least developed countries that are often major exporters of valuable resources but, somehow, have failed to develop economically.[2]

This Note contributes to the wide range of economic and legal literature discussing the United States and the Organization for Economic Cooperation and Development's ("OECD") responses to profit shifting in the modern world. This Note seeks to fill a gap in the literature by arguing that, while the most recent shifts in the treatment of MNC tax behavior have been radical in some ways, the United States' role as the chief influencer in international corporate tax reform has frustrated true progress.

The Note proceeds in seven parts. Following this introduction, Part I provides an overview of tax-motivated profit shifting via transfer pricing. It addresses how, over time, MNCs have created a geographical chasm between their profit-making activities and their actual profits and how developing countries have experienced a disparate amount of harm as a result. It also provides a brief historical discussion of the OECD's responses to MNC tax planning prior to the launch of its monumental Base Erosion and Profit Shifting ("BEPS") project. Part II first discusses the United States' position in the international tax system as a key influencer of global policy and then explores Delaware's role as a tax haven and how U.S. states are impacted by this system.

Part III provides a closer look at the factors that have contributed to developing countries' unequal role in international tax reforms. Part IV outlines the OECD BEPS project, with a specific focus on its two-pillar solution, and then examines the likely impact the BEPS project will have on developing countries. Part V assesses the United States' uncertain role in a two-pillar world, and its states' success in reforming their tax laws to prevent artificial profit shifting and tax base erosion. Finally, this Note provides concluding comments on the power shifts exemplified by

1 Juliana Kaplan & Madison Hoff, *5 Major Companies Together Saw Their Profits Increase 41% During the Pandemic, 8 Times Faster Than Their Workers' Wages, According to a New Brookings Report*, BUS. INSIDER (Apr. 26, 2022, 9:42 AM), https://www.businessinsider.com/major-companies-together-saw-profits-grow-faster-than-real-wages-2022-4 [https://perma.cc/P7D6-83NP]. The companies studied included Amazon, Walmart, CVS, Target, and Kroger, and the data reflects profits and wages from January 2020 to October 2021. *Id.*

2 *See* discussion *infra* Part I.B.3.

the two-pillar solution and speculates on what the solution's likely fate indicates about the state of the global tax order.

I. BACKGROUND

A. Tax Competition and Profit Shifting

Technological development and the resulting globalization of economic activity have led to the massive growth of MNCs.[3] National governments have struggled to regulate certain cross-border business activities of MNCs due to their "aggressive tax planning," which results in revenue gaps for tax authorities.[4] In 2013, the OECD, the leading organization on international tax policy, launched its BEPS project to address the competitive advantage held by MNCs because of their tax planning strategies.[5] The vast success of these strategies has raised questions of fairness in terms of treatment under the law and has been subject to massive public scrutiny.[6]

In conflict with the goal of international tax fairness is the desire of individual countries to lower their corporate tax rates to attract investment.[7] On average, the statutory corporate tax rate of OECD countries declined from 41% to 23% between 1981 and

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3 *See* Connor L. Smith, *Reflections from the Brink of Tax Warfare: Developing Countries, Digital Services Taxes, and an Opportunity for More Just Global Governance with the OECD's Two-Pillar Solution*, 63 B.C. L. REV. 1797, 1803–04 (2022).

4 OECD, BEPS PROJECT EXPLANATORY STATEMENT: 2015 FINAL REPORTS 4 (2015), https://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf [https://perma.cc/ZKQ4-GJDE] [hereinafter BEPS Explanatory Statement].

5 *See What Is BEPS?*, OECD, https://www.oecd.org/tax/beps/about/ [https://perma.cc/6N8R-CLRU] (last visited Nov. 11, 2023). The OECD's stated purpose is to, "develop policy standards to promote sustainable economic growth." *The Organization for Economic Cooperation and Development (OECD)*, U.S. DEP'T OF STATE, https://www.state.gov/the-organization-for-economic-co-operation-and-development-oecd/ [https://perma.cc/62BZ-5FRH] (last visited Nov. 11, 2023).

6 *See, e.g.*, Megan Cerullo, *60 of America's Biggest Companies Paid No Federal Income Tax in 2018*, CBS NEWS (Apr. 12, 2019, 11:15 AM), https://www.cbsnews.com/news/2018-taxes-some-of-americas-biggest-companies-paid-little-to-no-federal-income-tax-last-year/ [https://perma.cc/J64M-AEA8]; Luke Harding, *What Are the Panama Papers? A Guide to History's Biggest Data Leak*, THE GUARDIAN (Apr. 5, 2016, 5:42 AM), https://www.theguardian.com/news/2016/apr/03/what-you-need-to-know-about-the-panama-papers [https://perma.cc/7ARK-NSBV] (explaining the whistleblower documents known as "The Panama Papers" which revealed widespread use of offshore tax havens).

7 *See* Kimberly A. Clausing, *Taxing Multinational Companies in the 21st Century*, *in* TACKLING THE TAX CODE 240 (Jay Shambaugh & Ryan Nunn eds., Brookings 2020) [hereinafter Clausing, *Taxing Multinational Companies*].

2014.[8] Commenting on the phenomenon of corporate tax competition, economist Kimberly Clausing stated:

> In many countries policymakers have responded to tax competition pressures by slowly and steadily lowering corporate tax rates and shifting more of the tax burden onto labor and consumption. These trends are troubling for a number of reasons. In a larger economic context of increasing economic inequality and a declining labor share of income, such tax policy trends risk both exacerbating income concentration and reducing possible public revenue sources. There are also risks to the larger integrity of income tax systems.[9]

While corporate profits in the United States spiked between 2000 and 2015, U.S. corporate tax revenue remained relatively static over the same period.[10] This discrepancy between profits and tax revenue reflects that, through policy preference or accepted practice, the United States has taxed less corporate profit than what its statutory rate portends to apply. One explanation for the divergence is profit shifting.[11]

When MNCs shift profits, the taxes they pay to one tax authority may not reflect the extent of their "real economic activities" in that jurisdiction.[12] Instead, profits generated from real economic activities are moved, usually between affiliates of the same MNC, to low-tax jurisdictions where the income-generating activity does not take place.[13] One method of profit shifting that takes place between intra-firm affiliates is through transfer pricing.[14] Transfer pricing is the process of MNC affiliates transacting with one another, and the transfer price is the price charged for the transaction.[15] Profit shifting is achieved when transfer prices are manipulated in these transactions to reflect an artificially

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8 Kimberly A. Clausing, *The Nature and Practice of Capital Tax Competition*, *in* GLOB. TAX GOVERNANCE 6 (Peter Dietsch & Thomas Rixen eds., ECPR Press 2015) [hereinafter Clausing, *The Nature and Practice of Capital Tax Competition*].

9 Clausing, *Taxing Multinational Companies*, *supra* note 7, at 238.

10 *See Hearing on Increasing U.S. Competitiveness and Preventing American Jobs from Moving Overseas: Hearing Before the H. Comm. on Ways & Means*, 115th Cong. 1–3 (2017) (statement of Kimberly A. Clausing, Thormund A. Miller and Walter Mintz Professor of Economics, Reed College) [hereinafter Clausing, 2017 Testimony].

11 *Id.* at 3.

12 Clausing, *The Nature and Practice of Capital Tax Competition*, *supra* note 8, at 9.

13 *Id.* at 9–10; Markus Henn, *Tax Havens and the Taxation of Transnational Corporations*, FRIEDRICH-EBERT-STIFTUNG 4 (June 2013), https://library.fes.de/pdf-files/iez/global/10082.pdf [https://perma.cc/E3FU-RFSV].

14 *See Action Plan on Base Erosion and Profit Shifting*, OECD 19, https://www.oecd.org/tax/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm [https://perma.cc/GM94-898G] (last visited Nov. 13, 2023) [hereinafter OECD 2013 Action Plan]; Henn, *supra* note 13, at 12.

15 Henn, *supra* note 13, at 4.

low or high price.[16] This process allows MNCs to move costs to high-tax jurisdictions while moving profits to low-tax jurisdictions.[17]

Consider the following example. In 2010, tax authorities in Zambia conducted an independent audit to assess the tax information of copper and cobalt mines owned by Glencore, one of the world's largest mining multinationals.[18] The audit revealed several inconsistencies in Glencore's transactions between its Zambian mining affiliate and other related affiliates. The tax authority found it suspicious that the Zambian affiliate reported $90 million in labor *costs*, double what it reported in the previous year, "without any increase in the number of employees."[19] The audit also uncovered that the mines' cobalt production and copper and cobalt sale prices reported in transactions with Glencore affiliates were unreasonably low when compared to the production rates of similar mines and the international exchange rate of similar minerals.[20] At first glance, it appears that the Zambian affiliate got a bad deal for these exports, but because it sold to a Swiss-based Glencore affiliate subject to a lower tax rate than the Zambian entity, Glencore achieved a tax benefit from this transfer pricing strategy.[21] This example demonstrates that distortions in transfer prices can occur not only in transactions of tangible commodities, like copper and cobalt, but also with transactions of intangible goods, like labor costs.

This transfer price manipulation was apparently executed for the purpose of reducing taxable income in the source country where the profits were technically generated. The OECD and its members have made strides toward international cooperation to undermine and disincentivize this kind of profit shifting. Still, the pressures from tax competition play a major role in determining the extent and scope of this cooperation. The OECD defines base erosion and profit shifting as MNCs "exploit[ing] gaps and mismatches or loopholes in the international tax rules to

16 JANE G. GRAVELLE, CONG. RSCH. SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION 1 (2022).

17 Henn, *supra* note 13, at 4.

18 *Id.* at 5; M. Garside, *2023 Global List of Leading Mining Companies Based on Revenue*, STATISTA (Oct. 30, 2023), https://www.statista.com/statistics/272707/ranking-of-top-10-mining-companies-based-on-revenue/#:~:text=Mining%20company%20Glencore%20was%20ranked,In%20second%20place%20was%20BHP [https://perma.cc/Q9MM-QX5Q].

19 Henn, *supra* note 13, at 5.

20 *See id.* at 6.

21 *See id.*

artificially shift profits to lower the amount of tax they pay."[22] These loopholes have persisted because of the pressures of tax competition. Tax competition-driven policy choices result in a vacillating approach toward international reforms, even though the United States and other similarly situated countries acknowledge that profit shifting is a problem warranting international cooperation.

B. The Role of Transfer Pricing and Historical Responses to Profit Shifting

To be sure, transfer pricing is a widely used mechanism by MNCs in a global economy where a significant portion of "trade" occurs between related entities.[23] The exchange of intangible and tangible goods between members of the same MNC is not "trade" as it is traditionally understood.[24] Instead of goods and services being traded between independent entities, intra-firm trade, as it suggests, involves moving goods and services between related affiliates of the same MNC.[25] Because the MNC exercises significant control over these intra-firm transactions and because of the many different tax rules governing cross-border trade, ensuring that profits are appropriately taxed presents challenges to tax authorities.[26] Hypothetically, one MNC affiliate could sell to a related party "worthless goods for millions" and thereby allocate those inflated profits to a low-tax jurisdiction, reaping major tax benefits.[27] More commonly, though, transfer pricing manipulation happens on a smaller scale, making it difficult both to detect and to regulate.[28]

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22 *See Combatting International #Tax Avoidance: Ending Offshore Profit Shifting*, OECD, https://www.oecd.org/about/impact/ending-offshore-profit-shifting.htm [https://perma.cc/VK4M-VPG9] (last visited June 17, 2023).

23 *See* Tim Hirschel-Burns, *Countering Complexity's Corporate Bias: Tax Simplification as a Strategy to Reduce Profit Shifting in the African Extractive Sector*, 47 YALE J. INT'L L. 165, 170 (2022); Henn, *supra* note 13, at 4; Nick Shaxson, *Over a Third of World Trade Happens Inside Multinational* Corporations, TAX JUST. NETWORK (Apr. 9, 2019), https://taxjustice.net/2019/04/09/over-a-third-or-more-of-world-trade-happens-inside-multinational-corporations/ [https://perma.cc/WQM9-7E3A]; *SOI Tax Stats – Country by Country* Report, IRS, https://www.irs.gov/statistics/soi-tax-stats-country-by-country-report [https://perma.cc/EL68-9KT6] (last visited June 17, 2023).

24 *See* Henn, *supra* note 13, at 4–5.

25 *See id.* at 4.

26 *See id.* at 5; OECD 2013 Action Plan, *supra* note 14, at 9.

27 *See* Henn, *supra* note 13, at 5.

28 *See, e.g.*, *id.*; Richard Thompson Ainsworth, *IT-APAs: Harmonizing Inconsistent Transfer Pricing Rules in Income Tax – Customs – VAT*, 34 RUTGERS COMPUT. & TECH. L.J. 1, 6–7 n.12 (2007); Hirschel-Burns, *supra* note 23, at 171.

1. The Arm's Length Principle

The line between legal tax avoidance and illegal tax evasion is quite fine in the context of transfer pricing.[29] An MNC establishing a business in a low-tax country "to take advantage of low foreign corporate tax rates is engaged in avoidance," but an individual U.S. citizen failing to report income in an offshore account is considered tax evasion.[30] Because intra-firm transactions are purposefully structured, in most cases, to be legally compliant, transfer pricing that benefits an MNC's tax position is often classified as technically legal *tax avoidance*.[31] However, when price setting between MNC affiliates is manipulated to an artificial level to benefit the MNC's tax standing, it may be more accurately viewed as evasion.[32]

Generally, transfer prices are evaluated by tax authorities under the arm's length principle, where MNC subsidiaries are treated as separate entities for accounting purposes despite their fundamental commonality.[33] If the price paid in an intra-firm transaction is reasonably comparable to the price of a similar transaction between unrelated parties, the transfer price is at arm's length.[34] In practice, though, even if MNCs are brought to court over suspect instances of transfer pricing, MNCs can distinguish comparable transactions to justify their chosen transfer price.[35] Therefore, profits being shifted through abusive transfer pricing are elusive. It is difficult to classify transfer pricing as abusive in the first place because of the limitations inherent in using the arm's length standard, which further complicates any attempts to measure the extent of profits shifted by means of manipulated transfer prices.[36]

Tax-motivated transfer pricing in transactions exchanging tangible goods, like oil or cobalt, presents difficulties for developing economies in terms of regulation and enforcement.[37] However, when intra-firm transactions involve intangible goods,

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29 *See* Hirschel-Burns, *supra* note 23, at 172; GRAVELLE, *supra* note 16, at 1.

30 GRAVELLE, *supra* note 16, at 1.

31 *See id.*

32 *See id.*

33 *See* Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 96 (2008).

34 *See id.*

35 *See* Hirschel-Burns, *supra* note 23, at 171.

36 *See id.* at 171–72; *see also* GRAVELLE, *supra* note 16, at 1.

37 *See* Hirschel-Burns, *supra* note 23, at 176–77.

the difficulties faced by both developed and developing countries in addressing profit shifting are much greater.[38] The arm's length price for a tangible good can be more objectively determined "because there are standardized and easily observable international prices" for such commodities.[39] Transactions of intangibles, on the other hand, often involve industry or entity-specific goods and services that lack market comparables.[40] Some examples of intangibles that intra-firm affiliates might exchange include patents for mineral extraction processes,[41] licenses for the use of certain technologies,[42] and general management services.[43] Technology MNCs, for example, have sold the intellectual property underlying their most crucial technologies to subsidiaries established in Ireland and Bermuda for tax purposes.[44] Once the subsidiary owns the technology in the low-tax country, other affiliates of the same MNC in high-tax countries "pay billions of dollars in royalties" to the subsidiary.[45] This reduces the taxable

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38 *See id.* at 171; *see also* Henn, *supra* note 13, at 5.

39 Hirschel-Burns, *supra* note 23, at 194.

40 *See* U.N. Dep't Econ. & Soc. Affs., *Practical Manual on Transfer Pricing for Developing Countries*, 29, U.N. Doc. ST/ESA/ (2017) https://www.un.org/esa/ffd/wp-content/uploads/2017/04/Manual-TP-2017.pdf [https://perma.cc/29KL-JQSX].

41 *See* Hirschel-Burns, *supra* note 23, at 171–72.

42 *See* EMMANUEL SAEZ & GABRIEL ZUCMAN, THE TRIUMPH OF INJUSTICE: HOW THE RICH DODGE TAXES AND HOW TO MAKE THEM PAY 74–75 (2019).

43 *See* Monica Iyer, *Transferring Away Human Rights: Using Human Rights to Address Corporate Transfer Mispricing*, 15 NW. J. HUM. RTS. 1, 4 (2017).

44 *See* SAEZ & ZUCMAN, *supra* note 42, at 74–75. Not long before Google was listed as a public company in August of 2004, it sold the technology underlying its search and advertising features to its Irish-incorporated subsidiary, "Google Holdings," which "for Irish tax purposes [was] a resident of Bermuda." *Id.* at 74. While the amount Google Holdings paid for this technology is not publicly known,

> [I]t's easy to conjecture that the price paid . . . was modest. Why? Because if it had been high, Google would have paid a substantial tax in the United States in 2003. But that year, according to the prospectus it filed in 2004 with the Securities and Exchange Commission, it paid $241 million globally. Even if the company's entire tax bill resulted from the sale of Google's intangibles to its Bermuda subsidiary (which is unlikely, as Google probably paid taxes for other reasons), it would imply a sale price for the intangibles of less than $700 million. That's not much for an asset that has generated dozens of billions in revenue since then.

Id. at 74–75. Similarly, Skype sold its important voice-over technology to a Skype affiliate incorporated in Ireland in 2004. *See id.* at 75. Financial documents that were leaked in 2014 revealed that Skype's Ireland affiliate paid 25,000 euros for this technology, a dubious amount considering eBay purchased Skype for $2.6 billion only a few months later. *See id.* at 75. For context, Bermuda has a corporate tax rate of 0%, and Ireland has a legal tax rate of 12.5%, though "in practice [it is] often much less." *Id.* at 73, 75.

45 *Id.* at 75.

income of the affiliate in the higher-tax jurisdiction while shifting profits to the subsidiary in the low-tax jurisdiction.[46]

2. Tax Havens

The primary mechanism that makes profit shifting effective for avoiding or evading taxes is the use of shell entities in tax havens.[47] Tax havens are usually countries with low populations and effective governments that impose minimal tax rates on foreign investors.[48] Coupled with having low or zero foreign corporate tax rates, tax havens have historically offered a level of secrecy "with varying degrees of refusal to co-operate with other jurisdictions in exchanging information."[49] A notable characteristic of tax havens highlighted by the OECD is the lack of a requirement that incorporated entities have substantial economic activity in the haven jurisdiction.[50] It is this segregation between true economic activities and profit allocation by MNCs that requires international cooperation to address unfair MNC tax practices.[51]

Data on MNC activity in the lowest tax jurisdictions tend to validate that MNC affiliate establishment in these jurisdictions is almost wholly tax-motivated. In tax havens, non-domestic corporations record substantially greater profits than entities domestic to that haven jurisdiction.[52] In high-tax jurisdictions, however, foreign corporations "are slightly *less* profitable than local firms."[53] Foreign firms surpassing the profits of domestic firms is a trait unique to haven jurisdictions.[54] Moreover, in 2011, seven out of the ten countries with the highest foreign profits for

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46 *See id.*

47 *See* Kimberly Clausing, *Five Lessons on Profit Shifting from the US Country by Country Data*, 169 TAX NOTES FED. no. 6 925, 926 (2020) [hereinafter Clausing, *Five Lessons*].

48 Dhammika Dharmapala & James R. Hines Jr., *Which Countries Become Tax Havens?*, 93 J. OF PUB. ECON. 1058, 1058 (2009) ("Indeed, there are almost no poorly-governed tax havens.").

49 Nicholas Shaxson, *Explainer: What Is a Tax Haven?*, THE GUARDIAN (Jan. 9, 2011), https://www.theguardian.com/business/2011/jan/09/explainer-what-is-tax-haven [https://perma.cc/YL8P-PXAX].

50 *See* Org. for Econ. Coop. and Dev. [OECD], *Harmful Tax Competition: An Emerging Global Issue*, 22, ¶ 52 (1998), https://www.oecd.org/ctp/harmful/1904176.pdf [https://perma.cc/P8YT-ZU2K].

51 *See* OECD 2013 Action Plan, *supra* note 14, at 10.

52 *See* Thomas Tørsløv, Ludvig Weir, & Gabriel Zucman, *The Missing Profits of Nations,* REV. OF ECON. STUD. 3 (2022).

53 *Id.* (emphasis added).

54 *See id.* at 3.

U.S. MNCs had an effective tax rate of less than 6.5%.[55] Out of all U.S. MNC foreign profits for that year, 46.5% were earned in those seven countries, but only 5% of U.S. MNCs' foreign employment was attributed to them.[56]

In contrast, in the top ten countries where U.S. MNCs employ the most people, none have a tax rate lower than 6.5%.[57] These higher-tax countries wherein U.S. MNCs employ the most people "are the obvious large market countries where one would expect U.S. multinational corporations to have operations abroad for economic purposes."[58] However, the disproportionate profits recorded in countries with minimal employment suggests that there are other nonoperational reasons for an MNC to establish and allocate profits there. The contrast between higher tax rates where U.S. MNC real economic activity is located and the lower tax rates where profits are found indicates that tax-motivated behaviors are at play.

Several jurisdictions located in the Caribbean, West Indies, and Europe have been identified by various authorities and experts as tax havens.[59] Understanding the role that tax havens play in global tax competition, the OECD launched its "harmful tax practices" project in 1996[60] and published its first tax haven list in 2000.[61] Over time, some jurisdictions originally identified by the OECD as havens were removed from its list due in part to the OECD's renewed focus on cooperation and transparency.[62] Despite the assumed progress associated with greater cooperation with haven jurisdictions, some point out that the reduction in the number of havens on the OECD's list did not correlate with a reduction in tax haven activity.[63]

55 *See* Clausing, *The Nature and Practice of Capital Tax Competition*, *supra* note 8, at 10. The seven low-tax countries in 2011 wherein U.S. MNCs recorded some of their highest foreign profits were the Netherlands, Ireland, Luxembourg, Bermuda, Switzerland, the Cayman Islands, and Singapore. *Id.* at fig. 3.

56 *Id.* at 10.

57 *Id.* The ten higher-tax countries where U.S. MNCs employ the most people are the U.K., China, Canada, Mexico, India, Germany, Brazil, France, Japan, and Australia. *See id.* at fig.4.

58 *Id.* at 10.

59 GRAVELLE, *supra* note 16, at 4.

60 JAMES K. JACKSON, CONG. RSCH. SERV., R40114, THE OECD INITIATIVE ON TAX HAVENS 9 (2010).

61 GRAVELLE, *supra* note 16, at 4.

62 *Id.* at 5.

63 *Id.*

The United States had rejected the OECD's characterization of "harmful tax practices" in 2001 when the Treasury Secretary under the George W. Bush Administration described those practices as "provid[ing] a more attractive investment climate without facilitating noncompliance with the tax laws of any other country."[64] In response, the OECD tempered its approach from targeting "harmful tax practices" to "improving exchanges of tax information between member countries."[65] Therefore, tax havens continued to contribute to unfettered tax competition because attempts at increasing transparency did not deter MNCs' use of them, and the incentives to use them for tax-motivated profit shifting remained.[66] Tax competition, in this sense, describes tax havens' ability to set rock-bottom corporate tax rates and the inclination of MNCs to shift their taxable income to the lowest tax jurisdiction available.[67] The former Treasury Secretary communicated the United States' view at the time that this type of tax competition should not be discouraged—it should be applauded because it spurs economic investment. The OECD's retreat from a more potent response exhibits the OECD's willingness to capitulate because of these concerns about tax competition. It demonstrates the United States' sway over the organization and, in turn, the magnitude of any collective condemnation of unfair tax practices.

3. MNC Investment and Profit Shifting from Developing Countries

Developing countries—countries classified as low or middle-income with underdeveloped economies—tend to suffer from the effects of profit shifting at a higher degree than their further developed counterparts.[68] This unique harm results, in part, from developing economies having generally weaker "fiscal capacity" and a greater reliance on corporate tax revenue than developed countries.[69] When developing countries with weak tax authorities lose out on corporate tax revenue, they are unable to improve

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64 JACKSON, *supra* note 60, at 11.

65 *Id.*

66 *See* GRAVELLE, *supra* note 16, at 5.

67 *See* Dharmapala & Hines, *supra* note 48, at 1059.

68 Niels Johannesen et al., *Are Less Developed Countries More Exposed to Multinational Tax Avoidance? Method and Evidence from Micro-Data*, 34 THE WORLD BANK ECON. REV. 790, 792 (2020).

69 *Id.*; *see also* BEPS Explanatory Statement, supra note 4, at 4.

their government infrastructure.[70] Revenue loss has also been found to correlate with a greater accumulation of debt, as tax base erosion compels governments to find external sources of capital for public investments.[71]

Interestingly, many countries classified as developing countries—countries with lower GDPs, income, and political accountability, and higher rates of poverty and government corruption—are often "resource-rich."[72] For example, African countries produce a significant portion of the world's cobalt, platinum, diamond, chromium, and gold supply, which attracts substantial MNC investment.[73] Additionally, 66% of African exports are natural resources, including minerals, oils, and gas.[74] But at the same time, the "rates of poverty [in Africa] are unmatched by any other continent."[75] Though levels of poverty and revenue loss cannot be entirely attributed to MNC profit shifting, the concentration of high-value resources, a heavy reliance on taxing investing MNCs, and the power imbalance between developing country tax authorities and MNCs make resource-rich developing countries highly susceptible to profit shifting and its harms.[76]

The extensive use of subsidiaries in secrecy jurisdictions by oil and mining multinationals makes it difficult for the tax authorities of developing countries to track and assess the related party transactions of these MNCs. Indeed, in 2010, ten of the

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70 *See* Samuel D. Brunson, *The U.S. as Tax Haven? Aiding Developing Countries by Revoking the Revenue Rule*, 5 COLUM. J. TAX. L. 172, 174 (2014) ("A country that cannot effectively collect taxes faces significant limitations on 'the extent to which [it] can provide security, meet basic needs or foster economic development.'").

71 *See id.* at 174 n.14.

72 Patrick J. Keenan, *International Institutions and the Resource Curse*, 3 PENN ST. J. L. & INT'L AFF. 216, 223, 252 (2014); TOM BURGIS, THE LOOTING MACHINE: WARLORDS, OLIGARCHS, CORPORATIONS, SMUGGLERS, AND THE THEFT OF AFRICA'S WEALTH 4, 6 (2015).

73 *See* Hirschel-Burns, *supra* note 23, at 177; Pietro Guj et al., *Transfer Pricing in Mining With a Focus on Africa: A Briefing Note* 1 (WORLD BANK Grp., Working Paper No. 112344, 2017), https://documents1.worldbank.org/curated/en/213881485941701316/pdf/112344-REVISED-Transfer-pricing-in-mining-with-a-focus-on-Africa-a-briefing-note-Web.pdf [https://perma.cc/FYS5-47DH].

74 BURGIS, *supra* note 72, at 7; Charles J. Lundgren et al., *Boom, Bust, or Prosperity? Managing Sub-Saharan Africa's Natural Resource Wealth*, IMF, 2013, at 4, https://www.imf.org/external/pubs/ft/dp/2013/dp1302.pdf [https://perma.cc/XFJ6-D2QR].

75 Hirschel-Burns, *supra* note 23, at 177. Developing countries in Africa are not the only developing countries that are considered resource-rich; however, the African continent is home to most of the least developed countries identified by the U.N. *The Least Developed Country Category: 2021 Country Snapshots*, U.N. DEP'T OF ECON. AND SOC. AFFS. & COMM. FOR DEV. POL'Y (2021), https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/Snapshots2021.pdf [https://perma.cc/Q7JT-6YPW].

76 *See* Hirschel-Burns, *supra* note 23, at 177–78.

world's largest oil and mining MNCs had a total of over 6,000 subsidiary companies, "a third of which were registered . . . in tax havens, where all but the most basic company information can be concealed."[77] Chevron, which operates extensively across the African continent, had 62% of its subsidiary companies registered in secrecy jurisdictions.[78] Nearly 30% of Chevron's subsidiaries in 2010 were incorporated in Delaware, which imposes no state corporate tax on profits derived from intangible assets.[79] The significance of subsidiary establishment in secrecy jurisdictions is that many of these jurisdictions overlap with those classified as tax havens. When a jurisdiction requires minimal transparency and provides bank secrecy, financial information about MNC subsidiaries is difficult or impossible to obtain. These difficulties in assessing the financial information of an MNC undermine developing countries' attempts to tax the economic activity of MNC affiliates operating within their borders. This certainly implies that the opportunity for tax haven-related benefits exists for MNCs operating in resource-rich countries.

C. Evolution of the OECD's Attempts to Curb Profit Shifting

In the last couple of decades, the OECD has attempted to combat profit shifting and its harmful effects. The post-World War II OECD focused on "facilitating economic relationships between its member states and boosting those states economically."[80] While the organization's incentives are largely the same today, advising members on fiscal investment has evolved into addressing concerns about gaps in international tax laws.[81] In the 1990s, the OECD promulgated modern transfer pricing guidance and issued an important report on "harmful tax practices."[82] Transfer pricing guidance was necessary in a world of increasing intra-group transactions. And on a broader scale, tax laws, and the gaps between them, were facilitating and incentivizing the use of tax

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77 BURGIS, *supra* note 72, at 168–69.

78 NICK MATHIASON, PIPING PROFITS 8 (2011), https://ciperchile.cl/wp-content/uploads/Piping-profits.pdf [https://perma.cc/9PKL-W7FF].

79 *See id.*; Xuan-Thao Nguyen, *Promoting Corporate Irresponsibility? Delaware as the Intellectual Property Holding State*, 46 IOWA J. CORP. L. 717, 719 (2021). For a more detailed discussion of Delaware's role as a tax haven, see *infra* Part II.

80 Nana Ama Sarfo, *How the OECD Became the World's Tax Leader*, FORBES (Aug. 11, 2020, 9:01 PM), https://www.forbes.com/sites/taxnotes/2020/08/11/how-the-oecd-became-the-worlds-tax-leader/?sh=1770d53f6628 [https://perma.cc/G89X-X6WR].

81 *Id. See also* OECD 2013 Action Plan, *supra* note 14, at 9.

82 Sarfo, *supra* note 80.

havens and "promot[ing] unfair tax competition."[83] So, the OECD embarked on several projects to increase transparency among tax jurisdictions, including the Model Tax Convention and the 2002 Model Agreement on Exchange of Information on Tax Matters.[84] Despite these efforts to enhance transparency and reporting, the amount of profits shifted to tax havens continued to increase.

Concerned about MNCs' seemingly unstoppable tax planning capabilities in a more digital and globalized economy, the OECD launched the BEPS project in 2013.[85] In the initial action plans and reports, G20 and OECD countries reaffirmed their acknowledgment that international cooperation to address profit shifting is necessary.[86] Otherwise, applying the tax rules of independent nations without proper coordination could result in double taxation or gaps in the taxation of certain corporate income.[87] According to the OECD, "[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."[88] These sentiments demonstrate that while fairness is implied as a basis for its calls for tax cooperation, the OECD has tempered its calls for fairness to assuage its most influential members who have concerns about the competitiveness of their nations' MNCs.

II. THE UNITED STATES' ROLE IN THE INTERNATIONAL TAX SYSTEM AND PROFIT SHIFTING BEHAVIOR WITHIN ITS BORDERS

A. Profit Shifting by U.S. MNCs

The ability of MNCs to outmaneuver tax authorities has expanded over time. Toward the end of the twentieth century, a growing focus on shareholder satisfaction in an exponentially globalizing economy made profit shifting more appealing and feasible as a tax planning strategy.[89] At least with respect to U.S. MNCs, a change in corporate culture in some ways contributed to the rise of profit shifting. Corporate leaders today "consider it their

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83 *Id.*

84 *See id.*; JACKSON, *supra* note 60, at 4.

85 *See* ORG. FOR ECON. COOP. AND DEV., BACKGROUND BRIEF: INCLUSIVE FRAMEWORK ON BEPS 6 (2017), https://web-archive.oecd.org/2017-01-17/425229-background-brief-inclusive-framework-on-beps.pdf [https://perma.cc/6BMY-CXFZ].

86 *See id.*; OECD 2013 Action Plan, *supra* note 14, at 13.

87 *See* OECD 2013 Action Plan, *supra* note 14, at 9.

88 *Id.* at 10.

89 *See* SAEZ & ZUCMAN, *supra* note 42, at 72.

duty to maximize shareholder value," whereas before the 1970s, U.S. corporations generally held a more holistic view in terms of their stakeholders.[90] The older view considered "a broad[er] class of stakeholders beyond [corporate] owners: employees, customers, communities, and governments."[91] The goal that corporations be "responsible business enterprises" has evolved to where the "principal objective" is "generat[ing] economic returns to its owners."[92] This evolution of the focus of corporate duty may partially explain the rise of tax-motivated profit shifting as "[l]ess tax paid means more after-tax profits that can be distributed in dividends to shareholders or used to buy back shares."[93]

The growth of MNCs and the corresponding increase in cross-border economic activity also made profit shifting more accessible. For example, U.S. entities in the 1980s "made less than 15% of their earnings abroad."[94] When much of a corporation's revenue was made domestically, relocating profits to foreign shell entities might have provoked unwanted scrutiny by U.S. tax authorities.[95] However, in the late 1990s and the early twenty-first century, U.S. corporate revenues made abroad increased dramatically, paving the way for U.S. MNCs to seize the gaps in the international tax system.[96] MNCs also began exchanging more intangible goods and services where a fair market price was difficult or impossible to determine.[97] Assets like Apple's logo, Nike's "iconic 'swoosh,'" and Google's technology, for example, are unique to those MNCs in that they "are never traded externally" and have no clear price that can be used to calculate the arm's length tax.[98]

Despite the challenges associated with calculating profit shifting and its effect on tax revenue, several economists have concluded that

90 *Id.* at 69.

91 *Id.*

92 Jia Lynn Yang, *Maximizing Shareholder Value: The Goal that Changed Corporate America*, WASH. POST (Aug. 26, 2013), https://www.washingtonpost.com/business/economy/maximizing-shareholder-value-the-goal-that-changed-corporate-america/2013/08/26/26e9ca8e-ed74-11e2-9008-61e94a7ea20d_story.html [https://perma.cc/PEV2-ND6D].

93 *See* SAEZ & ZUCMAN, *supra* note 42, at 69.

94 *Id.* at 72.

95 *See id.*

96 *See id.*; *see also* Gabriel Zucman, *Taxing Across Borders: Tracking Personal Wealth and Corporate Profits*, 28 J. ECON. PERSPS. 121, 124–25 (2014).

97 *See* SAEZ & ZUCMAN, *supra* note 42, at 73–74 ("Assets and services such as logos, trademarks, and management services have no observable market value, thus making the arm's-length principle impossible to enforce.").

98 *Id.* at 74.

the impacts are significant. One study examining U.S. MNCs produced estimates of over $100 billion in lost U.S. tax revenue in 2017.[99] Another estimated that in 2015, U.S. corporate tax revenues were reduced by 14% due to profit shifting by U.S. MNCs.[100] More recent data shows that in 2018, U.S. revenues were reduced by as much as 23%, and on average, twenty-one high-tax countries lost 10% of their tax revenue to profit shifting.[101] While not all this lost tax revenue can be attributed to tax-motivated transfer pricing, several studies have found that it is a major contributor.[102]

B. The Arm's Length Principle and the U.S. Shift Toward a Minimum Tax

The United States' influence on key aspects of international tax policy indicates that the effects of the BEPS project will depend on the coherence of the United States' position regarding profit shifting. The United States has, for decades, imparted significant influence on OECD tax policy.[103] The OECD adopted the separate entity approach and the arm's length principle in 1963 in the OECD Draft Model, influenced by the 1933 League of Nations' Carroll Report.[104] The separate entity approach and the arm's length principle work in tandem: MNC subsidiaries are to be treated as separate entities, and any transactions made between them should be compared to unrelated party transactions to assess their reasonableness.[105] While the United States was not a member of the League of Nations, a leading U.S. tax expert, Mitchell B. Carroll, was appointed by the intergovernmental organization to address the problems of transfer pricing and income allocation in a growing global economy.[106] The resulting

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99 *See* Kimberly A. Clausing, *How Big Is Profit Shifting?* (May 17, 2020) (manuscript at 12, 16), https://ssrn.com/abstract=3503091 [https://perma.cc/E9W5-DRGL].

100 Tørsløv et al., *supra* note 52, tbl.3.

101 Thomas Tørsløv, Ludvig Weir, & Gabriel Zucman, *The Missing Profits of Nations: 2018 Figures*, at 1–2 (2021), https://missingprofits.world/wp-content/uploads/2021/08/TWZUpdate.pdf [https://perma.cc/86GL-49KT]. The twenty-one high-tax countries observed in this study were: Germany, the United Kingdom, France, the United States, Italy, Spain, Greece, Brazil, Denmark, Portugal, Mexico, South Africa, Australia, Canada, Israel, Turkey, India, Russia, China, Japan, and Korea. *Id.* at fig.3.

102 *See* GRAVELLE, *supra* note 16, at 25.

103 *See* Eduardo Baistrocchi, *The International Tax Regime and Global Power Shifts*, 40 VA. TAX REV. 219, 244–47 (2021).

104 *See id.*

105 Zucman, *supra* note 96, at 123.

106 *Id.* at 242; *see also* Madeline Woker, *Global Taxation Is a Mess. Here's How to Start Fixing It.*, NATION (Dec. 20, 2019), https://www.thenation.com/article/archive/france-tax-wine-tariff/ [https://perma.cc/K3LF-9KYP] (providing a deeper historical context of Carroll's work for the OECD).

Carroll Report advocated for the separate entity approach and the arm's length principle as the solution to profit shifting achieved through transfer pricing.[107] Meanwhile, the United States had itself endorsed the arm's length principle when it incorporated the standard into its federal tax statutes in 1935.[108]

The highly impactful Carroll Report failed to consider the lack of available comparable transactions for intangibles like technology patents or brand logos. Decades later, realizing difficulties in applying the arm's length standard to intangibles, U.S. Congress amended its transfer pricing statute, section 482 of the Internal Revenue Code, to require that the transfer price of intangibles be "commensurate with income."[109] However, the commensurate with income ("CWI") requirement was difficult to reconcile with the arm's length principle, and instead of abandoning the latter, the United States interpreted the former in such a way that allowed the previously ineffective arm's length standard to prevail.[110]

Still, the OECD implemented the CWI requirement in 1995, and it has remained in the OECD's transfer pricing guidelines through its 2017 version.[111] This apparent synergism is not coincidental—"it is the consequence of long-standing U.S. tax policy to export section 482 regulations to OECD countries and beyond, via the OECD model, with a view to creating international consensus on the application of the [arm's length principle]."[112] Despite the CWI requirement's attempt to modernize the arm's length standard, in the United States, the result was that transfer prices merely had to be within a wide range of "reasonable (rather than exact) comparables,"[113] giving MNCs broad leeway to comply with the rule. The OECD also "openly acknowledged substantial difficulties" in applying the modified standard.[114]

The nature of intangible transactions between MNC affiliates makes the arm's length standard an ineffective method for evaluating transfer prices. Firms often keep the value of their intangible property highly confidential to maintain their

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107 *See* Baistrocchi, *supra* note 103, at 242–43.
108 *See* Brauner, *supra* note 33, at 96.
109 *Id.* at 96–97.
110 *See id.* at 101.
111 *See* Baistrocchi, *supra* note 103, at 245.
112 *Id.* at 246–47.
113 Brauner, *supra* note 33, at 97.
114 Baistrocchi, *supra* note 103, at 247.

competitive edge, which further frustrates tax authorities' ability to find market comparables.[115] The strategic organization of MNC transactions, as compared to transactions between unrelated firms, also calls into question why market comparables were ever chosen as a mechanism for MNC transfer pricing enforcement. Describing this enigma, tax professor Yariv Brauner stated:

> The issue is that MN[C]s specifically choose to internalize the costs of and take advantage of their hierarchical structure rather than engage in market transactions, so comparing the transactions of MN[C]s to transactions by players who choose the market as an efficient transactional medium may be attempting to compare the incomparable.[116]

Because the arm's length approach is extremely difficult to apply to intangibles, the current approach by the United States and the OECD fails by attempting to tweak that difficult standard to produce fair outcomes.[117]

More recently, instead of focusing on making the arm's length principle more compatible with modern MNC transactions, the United States has changed its tax code to reduce profit shifting incentives. An important factor in how individual countries influence the tax behaviors of their resident multinationals is the treatment of foreign-derived income. Before the enactment of the Tax Cuts and Jobs Act ("TCJA") in 2017, taxation of foreign corporate income in the United States operated under a worldwide system in which, upon repatriation of income, U.S. corporate profits were taxed at the U.S. rate of 35%, no matter where the income was earned.[118] Although, in reality, repatriation and, thus, U.S. taxation of income in low-tax jurisdictions, could be deferred indefinitely.[119] Clausing explains, "[w]hile such income could not be used for U.S. investments or be returned to shareholders, it could (and frequently was) held in U.S. assets, thus making the funds available to U.S. capital markets."[120] This treatment of

115 *See* Brauner, *supra* note 33, at 106.

116 *Id.* at 107–08.

117 *See id.* at 108. In the United States, courts deciding transfer pricing disputes have required MNCs to use transfer prices within an acceptable range to account for a lack of adequate comparable transactions. *Id.* But, "[t]here are sufficient degrees of uncertainties within the 'reasonable' price ranges, so the clear incentive created by the system is to push the envelope and reach the price that is most aggressive, yet still within the very wide margin of reasonability." *Id.*

118 Clausing, *Taxing Multinational Companies*, *supra* note 7, at 247.

119 *Id.* at 243.

120 *Id.* Some of this unrepatriated income was technically taxable under the Revenue Act of 1962, which prevented deferral of income earned from passive investments, or

foreign income, while on its face appearing to reduce foreign profit shifting incentives, left open many avenues for profit shifting in its execution.

The worldwide aspect of the U.S. tax system was basically abandoned upon the passage of the TCJA, which changed the tax treatment of U.S. MNCs' foreign income to reflect a more territorial system.[121] This move toward a territorial system is manifested in a 100% deduction of foreign-derived income for many U.S. MNCs.[122] Generally, U.S. MNCs are now taxed at the statutory rate of 21% "only [on] income derived within [the United States'] borders."[123] On one hand, a territorial system might make U.S. MNCs more competitive in foreign markets. If a U.S. MNC does not have to pay taxes on income earned abroad, it has an advantage over foreign-based competitors that are subject to taxes on foreign-derived income in their home jurisdiction.[124] But, even with a reduced home tax rate of 21%, U.S. MNCs that can use low or no-tax havens to accumulate foreign income are still incentivized to do so. While pre-TCJA U.S. MNCs were incentivized to accumulate foreign income abroad *and* avoid repatriation through deferral, the territorial system encourages the same foreign income accumulation without concerns about repatriation when making distributions to U.S. shareholders.[125]

This territorial shift—grounded in a desire for greater U.S. MNC competitiveness—was at odds with the TCJA's simultaneous

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"subpart F" income. Joshua Ashman & Nathan Mintz, *GILTI and Subpart F Treatment of Distributions of Appreciated Property*, TAX ADVISER (Feb. 1, 2021), https://www.thetaxadviser.com/issues/2021/feb/gilti-subpart-f-distributions-appreciated-property.html [https://perma.cc/8U44-JXG6]. But taxation pursuant to subpart F lost much of its steam when the Treasury Department enacted the check-the-box rules in 1997. Thomas L. Hungerford, *The Simple Fix to the Problem of How to Tax Multinational Corporations – Ending Deferral*, ECON. POL'Y INST. 4 (Mar. 31, 2014), https://www.epi.org/publication/how-to-tax-multinational-corporations/ [https://perma.cc/SAB6-NX6N]. The goal of subpart F was to reduce the extent of deferred income that went untaxed, but the check-the-box rules allow a controlled foreign corporation to designate a tax-paying affiliate as a "disregarded entity (DRE) by literally checking a series of boxes on IRS form 8832." *Id.* The effect is that the tax-paying affiliate in a high-tax jurisdiction is considered a branch of a non-tax-paying affiliate in a low-tax jurisdiction, a branch that can be relieved of its tax liability. *See id.*

121 *See* Clausing, *Taxing Multinational Companies*, *supra* note 7, at 247.

122 *Tax Cuts and Jobs Act: A Comparison for Large Businesses and International Taxpayers*, IRS (May 1, 2023), https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-a-comparison-for-large-businesses-and-international-taxpayers [https://perma.cc/QMF9-4UVH].

123 Alex Trostorff & B. Trevor Wilson, *Worldwide Tax System vs. Territorial Tax System*, NAT'L L. REV. (Feb. 1, 2017), https://www.natlawreview.com/article/worldwide-tax-system-vs-territorial-tax-system [https://perma.cc/BY79-43AV].

124 *See* Clausing, *Taxing Multinational Companies*, *supra* note 7, at 241.

125 *See id.* at 243.

implementation of some fundamentally worldwide provisions. Although the TCJA exempted foreign income from taxation at the new 21% corporate rate, it included some measures designed to collect tax on foreign corporate profits.[126] In a clear attempt to combat U.S. tax base erosion, the TCJA effectively "applies limited worldwide taxation as a backup to territorial taxation."[127] The global intangible low-taxed income ("GILTI") tax is a minimum tax of 10.5% (13.125% after 2025) imposed on untaxed or undertaxed foreign profits after a 10% deduction in overall foreign profits is applied.[128] The Base Erosion and Anti-Abuse Tax ("BEAT") taxes income derived from payments for certain intangibles between related foreign parties.[129]

The GILTI and BEAT taxes are a meaningful step for the United States as it attempts to control out-of-control profit shifting, but some of the rules' complexities provide paths for MNCs to reduce their liability. Foreign tax credits granted under GILTI allow U.S. MNCs to offset their GILTI tax owed.[130] So, a U.S. MNC with profits allocated in haven jurisdictions can reduce the GILTI tax owed by receiving credits for taxes paid on income in a higher-tax foreign country. U.S. MNCs, then, are encouraged to allocate profits strategically in both low or no-tax countries and higher-tax *foreign countries* to achieve a balance between the right amount of foreign credits and GILTI-taxed haven income. Like before the TCJA, the incentive is to allocate profits anywhere but here. As for the BEAT tax, MNCs can deduct payments for "cost of goods sold" ("COGS"), which may encourage MNCs to "reclassify

126 *See id.* at 247.

127 *Briefing Book*, TAX POL'Y CTR., https://www.taxpolicycenter.org/sites/default/files/briefing-book/tpc_briefing_book-may2022.pdf [https://perma.cc/MXZ6-HQJ8] (May 2020).

128 *Id.*; *see also* GRAVELLE, *supra* note 16, at 11. The 10% deduction is "aimed at approximating income from tangible investments" by subtracting an estimated 10% of returns on physical assets, apparently targeting the extensive profit shifting that MNCs achieve with intangible goods. *Id.*

129 *IRC 59A Base Erosion Anti-Abuse Tax Overview*, IRS (Aug. 9, 2021), https://www.irs.gov/pub/irs-utl/irc59a-beat-overview.pdf [https://perma.cc/5BFZ-M8J8]. A U.S. MNC's BEAT tax rate is dependent on the MNC's base erosion payments, or the amount paid in a taxable year to a related foreign entity for royalties, interest, and services. *Id.* Base erosion payments under the BEAT tax also include "amount[s] paid or accrued . . . to [a foreign related party] in connection with the acquisition of depreciable or amortizable property" and payments for reinsurance premiums. *Id.*

130 Kimberly Clausing, *Options for International Tax Policy After the TCJA*, CTR. FOR AM. PROGRESS (Jan. 30, 2020), https://www.americanprogress.org/article/options-international-tax-policy-tcja/ [https://perma.cc/8QJY-YDQS].

certain related-party payments as COGS," reducing their BEAT tax liability.[131]

The recent evolution of the United States' treatment of foreign income illustrates an equivocating approach regarding MNC profit shifting. Again, a GILTI tax of 10.5% on haven income that before was taxed as little as 0% is a step toward strengthening the U.S. corporate tax base and combating profit shifting more effectively.[132] At the same time, though, the foreign credits allowed under GILTI create an incentive to attribute more MNC income to foreign rather than U.S. branches and, therefore, still encourage the foreign accumulation of profits.[133] The BEAT's COGS exception similarly leaves profit shifting incentives on the table for many MNCs.

This incremental and sometimes contradictory approach to disincentivizing MNC profit shifting raises questions about the United States' position on these kinds of MNC tax behaviors. The TCJA implements essentially a minimum tax on MNCs to discourage many profit shifting behaviors, including manipulative transfer pricing. Such a move is a significant departure from the United States' steadfast obedience to the arm's length principle, which has been, until recently, the United States' and the OECD's preferred method of tackling transfer pricing abuses.[134] But the gaps left open by GILTI and BEAT, and the United States' indecisive position regarding the two-pillar solution,[135] also indicate that the United States has not resolved its internal struggle between its desire for fair corporate taxation and unbridled tax competition. Considering the United States' influence on the international approach to profit shifting, its unsettled position threatens international cohesion in resolving the power imbalance between MNCs and the governments that tax them.

C. Delaware

The profit shifting behavior discussed so far has focused on transnational intra-firm transactions and the global and domestic attempts at regulating them. The same tax behavior, however, is also observable within the United States' borders. State

131 Jeff Hoopes, *Did the BEAT Work?*, UNC TAX CTR. (Apr. 8, 2021), https://tax.unc.edu/index.php/news-media/did-the-beat-work/ [https://perma.cc/DS6K-NSY9].

132 *See supra* notes 126–130 and accompanying text.

133 Clausing, *supra* note 130.

134 *See supra* notes 103–110, 117–125 and accompanying text.

135 *See infra* Part V.A.

governments face their own set of barriers in attempting to restrain profit shifting from their states to states with low or zero corporate tax rates. Historically, Delaware was not "known as [a] center [for] technological innovation and creation."[136] Despite this and its size and population being smaller than many other states, Delaware has evolved into a hub for *holding* valuable intellectual property assets that contribute to corporate profit margins in a major way.[137] Delaware is attractive to MNCs and multistate corporations ("MSCs") because of its 0% state tax rate on profits derived from intellectual property held within its borders.[138]

Not unlike MNCs that benefit from holding trademarks or patents in foreign tax haven countries,[139] MSCs can develop intellectual property outside of Delaware, sell it to its Delaware-incorporated subsidiary, and then generate profits from the intellectual property by charging non-Delaware affiliates royalties to use it.[140] Instead of paying corporate income tax in the state where the intellectual property was developed, is frequently used, or where most of the MSC's profit-generating activity takes place, the Delaware branch of the MSC pays 0% tax in Delaware.[141] The non-Delaware affiliates have historically been allowed to deduct from their state taxable income those payments of royalties to the Delaware subsidiary and "thus avoid a large share of the state income taxes it would have otherwise owed."[142]

As a result of attracting intellectual property holding companies, Delaware's state government benefits by receiving substantial incorporation and franchise fees.[143] Delaware officials have asserted that the state can afford not to tax profits from intangibles *because of* the significant revenue it generates from these fees.[144] But these claims ignore the fact that Delaware's 0% tax on intellectual property holding income is, in large part, *why*

136 Nguyen, *supra* note 79, at 719.

137 *See id.*

138 *Id.*

139 *See supra* notes 44–46 and accompanying text.

140 Nguyen, *supra* note 79, at 719.

141 *Id.* at 719–20 ("The parent essentially parks its income within the subsidiaries in Delaware, free from other states' taxation. Whenever the parents need access to the parked monies, they can obtain 'loans' or 'dividend payments' from the subsidiaries. Often the parents don't pay back the loans.").

142 Alana Semuels, *Loose Tax Laws Aren't Delaware's Fault*, ATLANTIC (Oct. 5, 2016), https://www.theatlantic.com/business/archive/2016/10/dont-blame-delaware/502904/ [https://perma.cc/QXF7-N89F].

143 Nguyen, *supra* note 79, at 739.

144 *Id.* at 746.

Delaware is able to generate this revenue in the first place. MSCs choose to incorporate their holding affiliates in the state and are willing to pay capped fees and franchise taxes[145] to preserve what they see as critical tax benefits.

Delaware burgeoned as a tax haven as MSCs (and MNCs) acquired and developed an increasing amount of valuable intangible assets.[146] As a measure of its share of national GDP, "Delaware dominates all other states in U.S. firm subsidiary incorporations."[147] Delaware is also home to "more than four times the number of patents" than what would be expected from states with a similar share of national GDP.[148] Toys "R" Us took advantage of Delaware's laws in the 1980s, not long after they went into effect.[149] The company had its stores in different states pay Geoffrey LLC, a Delaware-incorporated subsidiary, to use the company's logo as well as "trade names such as the store's mascot, Geoffrey the Giraffe."[150] Toys "R" Us had sold the intellectual property to Geoffrey LLC and arranged for its stores to pay royalties to the Delaware affiliate calculated as a percentage of the stores' sales.[151]

The South Carolina Tax Commission subsequently taxed Geoffrey LLC's royalty income earned from Toys "R" Us in its state, prompting Geoffrey LLC to sue the tax commissioner for a refund.[152] The South Carolina Supreme Court held that it was proper for the state to tax the "portion of Geoffrey's income generated within its borders," considering the relationship, or nexus, between South Carolina stores and the Delaware subsidiary.[153] Despite this ruling, however, the company could

145 Sandra Feldman, *Delaware Corporations' Annual Franchise Report and Tax Is Due March 1*, WOLTERS KLUWER (Feb. 6, 2023), https://www.wolterskluwer.com/en/expert-insights/delaware-corporations-annual-franchise-report-and-tax-requirement [https://perma.cc/8UWH-XLHD] (explaining that "[l]arge corporate filers" pay a flat $250,000 franchise tax and others pay a maximum of $200,000).

146 Nguyen, *supra* note 79, at 721.

147 Scott D. Dyreng, Bradley P. Lindsey & Jacob R. Thornock, *Exploring the Role Delaware Plays as a Domestic Tax Haven*, 108 J. FIN. ECON. 751, 760 (2013).

148 *Id.*

149 Nguyen, *supra* note 79, at 733; *see also* Geoffrey, Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13, 15 (1993).

150 Semuels, *supra* note 142.

151 *Geoffrey Inc.*, 437 S.E.2d at 15.

152 *Id.*

153 *Id.* at 22–24. Notably, the court described MSCs' strategy of holding intangibles in Delaware by stating "[t]he net effect of this corporate structure has been the production of 'nowhere' income that escapes all state income taxation." *Id.* at 17 n.1 (citation omitted).

continue using this practice in other states.[154] Some state courts followed South Carolina's lead and employed a similar "substantial nexus" approach. Courts in Louisiana, Massachusetts, and Oklahoma allowed their state tax authorities to collect tax from Toys "R" Us's Delaware affiliate on profits made from intellectual property used in those states.[155]

Delaware's role as an intellectual property holding mecca has contributed to an uneven apportionment of tax liability on MSCs among U.S. states. One study found that MSCs likely to implement the Delaware tax strategy reduce their state income taxes by $3 to $4 million annually compared to companies that do not employ such strategies.[156] But the Delaware strategy and its effect on other states' revenues cannot be entirely attributed to Delaware's choices.[157] These strategies "are effective only because of the tax policies in other states."[158]

Generally, if a state has separate filing requirements, then the Delaware affiliate's royalty income is not taxable income in that state simply because the Delaware affiliate is not physically present there and is considered a wholly separate entity.[159] Separate filing states may enforce taxation on certain intangible-created income if their tax authority can successfully argue in court that the nexus between the holding company and the affiliates operating in their jurisdiction is sufficient.[160] But such a piecemeal method of enforcement is costly and inefficient for tax authorities.

III. PROFIT SHIFTING IN THE CASE OF DEVELOPING COUNTRIES

Some U.S. states may rely on corporate tax revenue more than others, and thus, those states may suffer more in fiscal terms when

154 *See* Semuels, *supra* note 142.

155 *See* Dyreng et al., *supra* note 147, at 768; *see also* Bridges v. Geoffrey, Inc., 984 So. 2d 115, 128–29 (La. Ct. App. 2008); *cf.* Robinson v. Jeopardy Prods., Inc., No. 2019 CA 1095 (La. Ct. App. Oct. 21, 2020) (finding no nexus between a holding company and the businesses operating in Louisiana because the Louisiana entities were merely contracted third-parties)

156 *See* Dyreng et al., *supra* note 147, at 763. By incorporating the effects of states implementing combined reporting and economic nexus rules, Dyreng concluded these state actions reduced the tax savings of MSCs through the Delaware strategy. *Id.*

157 *Id.* at 769.

158 *Id.*

159 *See* Bradley P. Lindsey et al., *Delaware and the Passive Investment Company*, CPA J. (Oct. 2016), https://www.cpajournal.com/2016/10/01/delaware-and-the-passive-investment-company/ [https://perma.cc/TQB3-JHXR].

160 *See* Michael J. McIntyre et al., *Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana*, 61 LA. L. REV. 699, 707–08 (2001).

firms operating in their state use Delaware as a tax haven. U.S. states can, however, implement certain judicial and legislative rules to curtail tax-motivated profit shifting.[161] On the other hand, there are countries that lack the tax infrastructure and institutional support that U.S. states and the United States as a nation enjoy. These countries are at a heightened financial risk when MNCs operating within their borders use profit shifting tax strategies, and they are the most in need of substantial changes in international tax rules. This Part explores some of the major drivers for this inequity, including tax competition and developing countries' historically unequal bargaining position within the international tax regime.

A. Tax Competition Pressures in Developing Countries

Countries with less-developed economies are in a precarious position when dealing with MNCs operating within their borders. If these tax authorities assess the transfer prices of MNCs with too much scrutiny, they risk losing much-needed MNC investment.[162] Alternatively, failing to scrutinize transfer prices of intangibles that are used in the industries making up developing countries' economies undercuts these countries' ability to fairly tax the MNCs that operate there.

Because corporate tax revenue constitutes a large percentage of developing countries' government revenues, these countries rely more on corporate tax revenue than developed countries.[163] When less developed countries provide incentives or low tax rates to MNCs because of "pressures from tax competition," the constriction of their tax revenues is exacerbated.[164] Not only are these countries compelled to treat MNCs operating in their jurisdiction favorably in terms of tax enforcement, but tax treaties

161 *See infra* Part V.

162 Charles R. Irish, *Transfer Pricing Abuses and Less Developed Countries*, 18 U. MIA. INTER-AM. L. REV. 83, 91 (1986).

163 Ivan Ozai, *Two Accounts of International Tax Justice*, 33 CAN. J.L. & JURIS. 317, 323 (2020); Isaac Agyiri Danso et al., *The Future of Resource Taxation: A Roadmap*, INTERGOVERNMENTAL F. ON MINING, MINERALS, METALS, AND SUSTAINABLE DEV. 5–6 (2020), https://www.iisd.org/system/files/2020-10/future-resource-taxation-roadmap.pdf [https://perma.cc/QD28-PDVB] (describing how corporate income tax "represents almost 19% of all tax revenues in Africa and 16% in Latin America and the Caribbean, compared to 9% in developed nations").

164 Ozai, *supra* note 163, at 323–24 ("Most estimates of the revenue losses suffered by developing countries due to tax avoidance and tax competition exceed by some distance the amount these countries receive in development aid.").

with developed countries often induce developing countries "to forgo taxing economic activity in their country."[165]

There is an ongoing tension between capital-importing (developing) and capital-exporting (developed) economies in terms of corporate taxation.[166] Developed countries were at the center of the creation of the international tax system as it exists today, at a time when most developing countries were under colonial rule "or had not yet been penetrated by significant amounts of foreign investment."[167] Upon decolonization, the governments of developing countries had tax systems driven by colonial rules, donors, lenders, and foreign aid.[168] These external factors influenced government choices about how "to raise and spend revenue."[169] Foreign aid, for example, may make a developing government feel less pressured to raise tax revenue from its citizens.[170] Further, "there is a lower capacity to raise revenue through the taxes used by higher-income countries: a much smaller proportion of their population is in formal employment and earning enough to pay personal income tax, the main source of revenue for higher-income countries."[171] While developing countries often have higher statutory corporate tax rates than developed countries, to attract investment, lower-income countries routinely provide tax incentives to MNCs, making the effective tax rate much lower.[172] In spite of their goal, the OECD concluded that such incentives do not attract more investment than what "would have been undertaken even without them."[173]

B. Unequal Footing in the International Tax System

To understand the current impact that international tax treaties have on developing countries, it is helpful to understand the origins of perhaps the most influential tax treaty: the OECD model treaty. In the League of Nations' early years, the United

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165 Eric M. Zolt, *Tax Treaties and Developing Countries*, 72 TAX L. REV. 111, 119–20 (2018).

166 MARTIN HEARSON, IMPOSING STANDARDS: THE NORTH-SOUTH DIMENSION TO GLOBAL TAX POLITICS 31 (Cornell Univ. Press ed., 2021).

167 *Id.* at 35.

168 *Id.*

169 *Id.* at 35–36.

170 *See id.* at 37.

171 *Id.*

172 *Id.*

173 OECD et al., *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment*, at 3 (Oct. 15, 2015), https://www.oecd.org/tax/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment.pdf [https://perma.cc/HP7J-N6KQ].

Kingdom was exporting capital to post-World War I mainland Europe.[174] Around this time, the League of Nations was drafting reports on issues of international taxation, and the United Kingdom successfully influenced these reports to include the U.K.'s preferred residency-based approach, rather than a source-based system desired by the other indebted European countries.[175] The OECD—then the Organisation for European Economic Co-operation (OEEC)—initially "began to elaborate the basis of the modern consensus on international tax," and it eventually adopted the League of Nations' residence-based approach when it established the OECD Model Tax Convention in 1963.[176] Despite periodic opposition to the residence-based approach by lesser developed, "source" economies, the OECD continued to prefer this approach with some caveats.[177] The OECD's goal of cooperation manifested when, by 1963, "around two hundred bilateral tax treaties had been signed."[178]

A study of 2,200 treaties where at least one party was a lower-income economy revealed that OECD-model, residence-focused provisions were implemented more frequently than the United Nations' provisions, despite the latter being "explicitly designed" for agreements between higher and lower-income economies.[179] This is not surprising because as "the OECD model reflects the preferences of OECD states, it [also] reflects the power balance in negotiations: greater asymmetries in capabilities and investment

174 HEARSON, *supra* note 166, at 39.

175 *Id.* at 39–40.

176 *Id.* at 42–43; *see 75th Anniversary of the Creation of the OEEC*, OECD, https://www.oecd.org/about/history/oeec/ [https://perma.cc/DH3V-ER4T] (last visited Nov. 10, 2023).

177 *See* HEARSON, *supra* note 166, at 43. For example, in 1943, Latin American countries, the United States, and Canada met in Mexico to agree on the "Mexico Draft" convention which was modeled after the League of Nations model, "but gave much stronger taxing rights to source countries." *Id.* at 40. The first draft of the OECD Model Tax Convention on Income and Capital, completed in 1963, rejected the stronger source country rights considered in the Mexico Draft and instead advocated for shared taxation over dividends and interest payments, and residence taxation over royalty payments. *Id.* at 42–43. The U.N. Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries published its own model tax treaty in 1980. *Id.* at 43. Originally, the U.N. model was "closely based on the OECD model," but its 2017 version demonstrates a divergence from the residency approach. *Id.* Lower-income countries have advocated for this recent U.N. approach, "seeking to upgrade it to an intergovernmental body and agreement," an idea OECD members have staunchly opposed. *Id.* at 44.

178 *Id.* at 44. Recent estimates show that about one hundred new treaties are entered into each year. *Id.*

179 *Id.*

positions lead to more OECD-type treaties."[180] What is more surprising is that in 46% of agreements between non-OECD members, OECD model provisions still prevailed, demonstrating the organization's broad influence.[181]

Both lower and higher-income countries desire cooperation to ensure non-resident businesses operating within their borders are adequately taxed.[182] But MNCs are most often headquartered in higher-income countries, giving these countries better access to MNC financial information.[183] This helps explain why wealthy countries prefer the residence-based approach—capital-exporting MNCs are disproportionately domiciled in their jurisdictions, and residence-favored taxation attributes MNC tax revenue to the resident jurisdiction. Higher-income countries also have more bargaining power when requesting cooperation from tax havens.[184] Lower-income countries "that lack this coercive power must piggyback on initiatives designed by others" or concede to treaty provisions that limit their overall taxing ability.[185]

One way developing countries have felt compelled to limit their taxing ability in treaty negotiations is by decreasing or removing withholding tax on MNC income generated in their jurisdictions.[186] Waiving a withholding tax on payments for interest, dividends, and royalties benefits MNC subsidiaries that make these payments out of the source-developing country in which they operate and, at the same time, reduces the developing country's tax base.[187] Treaty provisions requiring the abdication of withholding taxes on nonresident MNCs reflect the OECD model's residence-preferred approach and, conversely, its repudiation of source taxation.[188] Developing countries receive "more capital inflows from non-resident taxpayers" than developed countries and, therefore, rely on withholding taxes to a greater extent.[189]

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180 *Id.*

181 *Id.*

182 *Id.* at 47.

183 *Id.* at 47–48.

184 *Id.* at 48.

185 *Id.*

186 Diane Ring, *Developing Countries in an Age of Transparency and Disclosure*, 2016 BYU L. REV. 1767, 1801 (2016).

187 *See id.* at 1795, 1801 (explaining "source country taxation" as the ability of a country to "tax multinationals and others doing business" in its jurisdiction, which matters for the taxing country especially if it does not have many tax residents earning income).

188 *See id.*

189 *Id.* at 1800.

While these concessions benefit MNCs adept at tax-motivated profit shifting, they also benefit the highly developed countries that have established the prevailing residence-focused approach. For example, under the United States' GILTI framework, profits of a U.S. parent-MNC that are generated in a developing country and not subject to a source withholding tax may then be taxed by the United States under GILTI. As the next section will discuss, the global minimum tax under the OECD's two-pillar solution mimics GILTI and its commitment to a residence-based system. International cooperative efforts that do not readjust this source-residence divide are doomed to perpetuate the power imbalance between developing and wealthier countries in terms of their authority to tax MNCs.

IV. THE BEPS TRAJECTORY AND ITS IMPACTS ON DEVELOPING COUNTRIES

The OECD's BEPS project is a major global tax cooperation initiative aimed at controlling harmful profit shifting behaviors. Part IV first details the OECD's two-pillar solution and one of its foundational elements, country-by-country reporting. It then discusses how the two-pillar solution, despite embodying some truly significant shifts in the OECD's approach, will likely not improve developing countries' position in terms of addressing profit shifting harms.

A. BEPS

1. Country-by-Country Reporting

A major achievement of the BEPS project has been significant global participation in the required exchange of financial information through country-by-country reporting ("CbCR"). CbCR is a tool for increasing transparency around MNC transactions so that tax authorities are better equipped to determine where taxable income is being generated and the extent it is being taxed.[190] Tax Justice Network, a progressive think tank, advocated for CbCR as early as 2003.[191] The Extractive Industries Transparency Initiative, a nongovernmental organization focused on

190 *See* Nicholas Shaxson, *Corporate Taxation – Momentum is Building*, SOC. EUROPE (Dec. 21, 2020), https://www.socialeurope.eu/corporate-taxation-momentum-is-building [https://perma.cc/Q7XC-QHQT].

191 *Id.*

resource-rich developing countries, backed CbCR starting in 2002.[192] Around this time, the OECD was promoting information exchange by request through Tax Information Exchange Agreements ("TIEAs") between OECD states and haven jurisdictions.[193]

But one of the characteristics that make tax havens appealing to MNCs is their anonymity. So, a tax authority seeking information under a TIEA is hamstrung because it "do[es] not have sufficient information to request the relevant taxpayer information in the first place."[194] The OECD's promotion of TIEAs was a feature of the organization's overall tepid approach during that era. Concerned about pushback from wealthy member states[195] and the MNC community, the OECD, for a long time, extolled voluntary cooperation and transparency over compulsory commitments and disclosures. Eventually, the OECD, acknowledging the need for the latter, began to shift course.

The 2016 BEPS recommendations included guidelines for CbCR, a concept OECD members eschewed as utopian just a decade prior.[196] The CbCR subverts the separate entity approach that has been deeply entrenched in international tax policy decisions. CbCR requires MNCs to report "to home and foreign tax *authorities* their tax and other payments in every country where they operate."[197] In 2022, more than 100 tax jurisdictions had CbCR rules in place.[198] The United States adopted CbCR in 2016, reflected in T.D. 9773.[199] The final U.S. rule provides that CbCR data "will be used for high-level transfer pricing risk identification and assessment," but cannot be used as the sole means to trigger the adjustment of suspect transfer prices.[200]

In 2021, the European Union took CbCR a step further by enacting a *public* reporting requirement for EU-based MNCs *and*

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192 *See* Arthur J. Cockfield, *How Countries Should Share Tax Information*, 50 VAND. J. TRANSNAT'L L. 1091, 1105–06 (2017).

193 *Id.* at 1104.

194 *Id.*

195 *See supra* notes 64–65 and accompanying text.

196 *OECD Releases Additional Guidance on Implementation of Country-by-Country Reporting*, EY (Jun. 29, 2016), https://globaltaxnews.ey.com/news/2016-1157-oecd-releases-additional-guidance-on-implementation-of-country-by-country-reporting [https://perma.cc/K74Z-CKT6]; Shaxson, *supra* note 190.

197 Cockfield, *supra* note 192, at 1107 (emphasis added). The reporting requirement applies to MNCs with consolidated revenues of greater than $850 million. *Id.*

198 Susanne Verloove, Peter Hoving, & Roberto Aviles Gutierrez, *European Union: EU Public Country-by-Country Reporting*, 29 INT'L TRANSFER PRICING J. 1, 2 (2022).

199 *See* Clausing, *Five Lessons*, *supra* note 47, at 926 n.2.

200 *Id.*

non-EU-based MNC affiliates operating in the EU that have consolidated revenues above a specified threshold.[201] Since 2015, the EU has required European financial firms to publicly report country-by-country data, and one study found that firms complying with the reporting requirement had a 3.7% higher effective tax rate than those not in compliance.[202] This suggests that public reporting, rather than the OECD's CbCR, which is limited to tax authorities, may increase MNC accountability in terms of tax planning. The impending public CbCR mandate for MNCs operating in the EU is set to take effect in the 2024 fiscal year, with a public reporting deadline of December 31, 2026.[203]

A separate non-government-directed method to increase MNC tax transparency may be through internal pressure from MNC shareholders. Certainly, in financial terms, shareholder appeasement is a primary driver of tax-motivated profit shifting decisions. But these decisions may conflict with shareholder demands that MNCs commit to principles of corporate social responsibility.[204] Indeed, shareholders of some of the largest MNCs have proposed resolutions to require public reporting of the MNCs' country-by-country data.[205] In 2022, nearly one-quarter of Amazon shareholders voted in favor of requiring public disclosure of the enterprise's country-by-country financials.[206] Although the resolution did not pass, "achieving 21 [percent] shareholder support paved the way for investors in other companies to be more vocal about what information they want made publicly available."[207]

It is possible that shareholder pressure on MNCs to commit to more socially responsible practices could eventually make voluntary public CbCR the norm rather than the exception. And in light of the increased tax compliance of European financial firms under the EU's mandate, a public reporting standard may very well result in similarly stronger compliance. In addition,

201 Verloove et al., *supra* note 198, at 4.

202 Mary McDougall, *Cisco Urges Shareholders to Reject Tax Transparency Proposal*, FIN. TIMES (Sept. 22, 2022), https://www.ft.com/content/93e030e7-f70a-46f7-9853-1972f791a1da [https://perma.cc/C875-JQ4K].

203 Verloove et al., *supra* note 198, at 5.

204 *See* Jacqueline Lainez Flanagan, *Holding U.S. Corporations Accountable: Toward a Convergence of U.S. International Tax Policy and International Human Rights*, 45 PEPP. L. REV. 685, 731 (2018).

205 *See* McDougall, *supra* note 202.

206 *Amazon Investors Push Company on Global Tax Transparency*, FACT COAL. (May 27, 2022), https://thefactcoalition.org/amazon-investors-push-company-on-global-tax-transparency/ [https://perma.cc/E9YH-9FS4].

207 McDougall, *supra* note 202.

public CbCR would serve to balance the power differentials both between citizens and their representative governments as well as between governments and the MNCs operating within their jurisdictions. Better access to MNC tax information allows citizens to organize and vocalize specific concerns to their governments, thereby creating political motivation to address obvious gaps in tax policies. If public CbCR indeed results in better MNC tax compliance, national governments stand to benefit from a reassertion of their taxing authority, bringing their taxing relationship with MNCs back into balance.

2. Two-Pillar Solution

More recently, BEPS 2.0, the newest phase of the BEPS Project, established a two-pillar solution to implement BEPS Action 1—the action addressing tax challenges in the age of digitalization.[208] Action 1, now Pillars One and Two, seeks to address the conundrum of taxing large tech-focused MNCs based on physical presence as well as the continuing difficulties in applying the arm's length standard to intangible assets.[209] Pillar One, the implementation of which was originally forecast to be 2023 but has been pushed to 2024, significantly upends the principles of residence-based taxation so engrained in the OECD model.[210] Pillar One does this by proposing the reallocation of taxing rights to jurisdictions where certain goods and services are sold and used, made effective through a multilateral treaty.[211] Certain industries, including natural resource extraction and financial services, are exempt from Pillar One, as are MNCs with profit margins and global revenue turnovers below a fixed threshold.[212] Pillar One establishes taxation over MNCs engaged in digital businesses "that do not have any physical presence in market countries," ostensibly targeting major technology MNCs

208 Reuven Avi-Yonah, Young Ran (Christine) Kim, & Karen Sam, *A New Framework for Digital Taxation*, 63 HARV. INT'L L.J. 279, 289 (2022); *see also* Grant Wardell-Johnson, *OECD'S Pillar One and Pillar Two – A Question of Timing*, BLOOMBERG TAX (June 14, 2022 12:00 AM), https://www.bloomberglaw.com/product/tax/bloombergtaxnews/daily-tax-report-international/XC2A5EIG000000?bna_news_filter=daily-tax-report-international#jcite [https://perma.cc/RMM9-TXTK]; *Action 1: Tax Challenges Arising From Digitalisation*, OECD https://www.oecd.org/tax/beps/beps-actions/action1/ [https://perma.cc/3SK5-P9LH] [hereinafter Action 1].

209 *See* Action 1, *supra* note 208.

210 Wardell-Johnson, *supra* note 208.

211 Avi-Yonah et al., *supra* note 208, at 294, 298.

212 *Id.* at 294.

that have come under intense scrutiny in recent years for their intricate and successful tax planning methods.[213]

Where Pillar One strengthens source taxation rights, Pillar Two reinforces residence taxation.[214] Pillar Two proposes a global minimum tax embodied in the Global Anti-Base Erosion ("GloBE") rules, which would apply to MNCs with at least €750 million in annual revenue.[215] The framework operates through "two interlocking domestic rules"—the income inclusion rule ("IIR") and the undertaxed payment rule ("UTPR").[216]

The IIR requires an MNC's residence country to apply a top-up tax on the MNC's "ultimate parent entity" that has subsidiaries operating in jurisdictions subject to a less than 15% tax rate.[217] The IIR takes effect only if the jurisdiction of incorporation implements a sub-15% rate (like a tax haven) and declines to raise its rate to the minimum of 15%. The jurisdiction where an entity is incorporated has the first claim under the GloBE rules to tax the entity; this taxing privilege is the qualified domestic minimum top-up tax ("QDMTT").[218] For example, if a U.S.-based MNC has a subsidiary in a country with 0% corporate income tax, the United States would be required to impose at least a 15% top-up tax to meet the global minimum under the IIR, assuming the 0% country does not exercise the QDMTT.[219]

The UTPR, now often called the undertaxed *profit* rule, serves as a backstop to the IIR by allowing the source jurisdiction wherein an MNC subsidiary operates to collect a "top-up tax equivalent" if the residence country collects no IIR tax.[220] This "equivalent" tax may be levied by refusing deductions for payments made to an affiliate in a low-tax jurisdiction or by taxing the payment at its source.[221] The aforementioned deductions would ordinarily be allowed in, for example, developing countries

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213 *Id.* at 293; *see also* Hirschel-Burns, *supra* note 23, at 174–75.

214 Avi-Yonah et al., *supra* note 208, at 297.

215 Reuven Avi-Yonah & Young Ran (Christine) Kim, *Tax Harmony: The Promise and Pitfalls of the Global Minimum Tax*, 43 MICH. J. INT'L L. 505, 530–31 (2022).

216 *Id.* at 530.

217 *Id.* at 531.

218 *See* Allison Christians & Tarcísio Diniz Magalhães, *Undertaxed Profits and the Use-It-or-Lose-It Principle*, TAX NOTES (Nov. 7, 2022), https://www.taxnotes.com/featured-analysis/undertaxed-profits-and-use-it-or-lose-it-principle/2022/11/04/7f9n0 [https://perma.cc/RW4S-5YHR].

219 *See id.*

220 *Id.*

221 *Id.*

that have entered bilateral treaties that oblige them to forgo taxing such payments.[222]

As of February 2023, 142 countries have agreed to enact Pillar Two.[223] Not all these countries agreed to implement *their own* minimum tax, but they have agreed "not to introduce inconsistent rules."[224] Thus, the GloBE tax's success "does not rely on all countries agreeing to a minimum tax," but just that enough do so.[225] The GloBE tax is a significant achievement, and, as the GILTI and BEAT taxes are predicted to grow U.S. tax revenue, it is expected to do the same for non-U.S. resident jurisdictions. Indeed, "[t]he OECD estimates that pillar 2 would generate about $220 billion in global revenue gains based on 2018 data."[226]

The GloBE rules, therefore, would establish a corporate tax floor for the largest MNCs. A global minimum tax essentially removes the incentive to use tax havens, at least for MNCs with global revenues above GloBE thresholds.[227] The GloBE rules also properly abandon the separate entity-arm's length approach to a large extent. The assumption made decades ago that related entities behave like unrelated entities instead of behaving in a way that benefits the ultimate parent entity was never a sound basis for fair transfer pricing policy. The minimum tax circumvents the need to directly address transfer pricing manipulation by

222 *See supra* Part III. There is much debate surrounding whether the UTPR, in practice, would violate existing bilateral tax treaty provisions. *See, e.g.*, Peter Hongler et al., *UTPR – Potential Conflicts With International Law?*, TAX NOTES (July 10, 2023), https://www.taxnotes.com/special-reports/digital-economy/utpr-potential-conflicts-international-law/2023/07/07/7gy40 [https://perma.cc/ZMQ8-GXHN] (arguing that the UTPR is an income tax and therefore subject to tax treaty constraints); *cf.* Allison Christians & Stephen E. Shay, *The Consistency of Pillar 2 UTPR with U.S. Bilateral Tax Treaties*, TAX NOTES (Jan. 23, 2023), https://www.taxnotes.com/featured-analysis/consistency-pillar-2-utpr-us-bilateral-tax-treaties/2023/01/20/7fvmc [https://perma.cc/5DBW-STUS] (characterizing the UTPR as "not in nature an income tax" and "excluded from the scope of taxes covered by existing U.S. bilateral income tax treaties"). Nonetheless, given the likelihood that MNC parent jurisdictions will implement the IIR, and thus prevent triggering any UTPR tax, and the flexible methods allowed for implementing a UTPR equivalent tax, UTPR-related treaty restraints may be "of secondary importance" in the Pillar Two debate. Avi-Yonah & Kim, *supra* note 215, at 553.

223 Press Release, U.S. Dep't of the Treasury, Treasury Welcomes Clear Guidance on Pillar Two Glob. Minimum Tax, Tax Credit Prots. (Feb. 2, 2023), https://home.treasury.gov/news/press-releases/jy1243 [https://perma.cc/7H7B-QGGD].

224 Wardell-Johnson, *supra* note 208.

225 *Id.*

226 Nana Ama Sarfo, *OECD Sets the State for Two-Pillar Tax Reform Revenue Estimates*, FORBES (Jan. 30, 2023, 1:46 PM), https://www.forbes.com/sites/taxnotes/2023/01/30/oecd-sets-the-stage-for-two-pillar-tax-reform-revenue-estimates/?sh=cba06e912de5 [https://perma.cc/D2ZE-F6M2].

227 *See* Avi-Young & Kim, *supra* note 215, at 548.

establishing a matrix of incentives for tax authorities that nearly guarantee covered MNCs will be taxed at the minimum rate.[228]

Under Pillar Two, the OECD acknowledges that properly assessing the tax liability of individual subsidiaries requires an examination of the MNC's tax behaviors at a global level.[229] Despite this notable break with the past, however, Pillar Two continues the OECD's legacy of preferring residence taxation over source taxation to the detriment of many developing countries.[230] In addition, even though Pillar One strays from this residence approach by authorizing source country taxation of non-resident tech companies, this milestone of the BEPS project is likely to have a minimal impact because of staunch opposition from the United States.[231] The probable fate of Pillar One illustrates the continuance of the United States' decisive role in determining the direction and scope of international corporate tax reforms.

B. Post-BEPS Reality for Developing Countries

Without the OECD's support for public CbCR and an international consensus on Pillar One, developing countries are in a similar position compared with where they stood before the BEPS project. Considering the OECD's historically wealthy membership, when developing model treaties, combatting tax competition, and endorsing tax standards, it has, for the most part, prioritized the concerns of developed countries.[232] As BEPS 1.0 took shape, the OECD and G20 members acknowledged the need for non-member country participation in order to make meaningful progress.[233] This led to the creation of the Inclusive Framework in 2016 to include developing and other non-OECD countries in the reform effort.[234]

CbCR is one of the four minimum standards to which Inclusive Framework members are required to commit.[235] However, because CbCR is not public and its use is limited to risk

228 *Id.* at 530.

229 *Id.* at 555.

230 *Id.*

231 *See infra* notes 265–271 and accompanying text.

232 *See* Shu-Yi Oei, *World Tax Policy in the World Tax Polity? An Event History Analysis of OECD/G20 BEPS Inclusive Framework Membership*, 47 YALE J. INT'L L. 199, 209 (2022).

233 *See* Yariv Brauner, *Serenity Now! The (Not So) Inclusive Framework and the Multilateral Instrument*, 25 FLA. TAX REV. 1, 25–26 (2022).

234 *See* Oei, *supra* note 232, at 11.

235 *Id.* at 11–12.

assessment and auditing by tax authorities, its benefits for developing countries are limited.[236] The country-by-country data provided to developing country tax authorities cannot "be directly used for tax calculations and imposition," which would effectively be formulary apportionment.[237] Formulary apportionment is a form of taxation that generally favors the country where economic activity occurs. A tax authority, applying formulary taxation, would assess a corporate taxpayer's payroll, assets, and sales and determine a portion of the MNC's profits attributable to its jurisdiction.[238] The tax authority would then impose its corporate tax rate on that portion of profits.

Outside of Pillar One, which would implement a type of formulary taxation on a defined set of digital-related businesses, the OECD has opposed adopting such a system for remaining MNCs.[239] This rejection of formulary apportionment on a broader scale clearly follows from the OECD's longstanding allegiance to residence taxation. But as Professor Brauner queried, "[i]t is difficult to understand, normatively, why would the OECD resist formulary taxation by source or market economy beyond the digital context?"[240] In light of the OECD's radical shift *toward* source taxation for a portion of MNCs, it is conceivable that it may extend support for formulary taxation to all industries in the future. However, the path to Pillar One implementation is uncertain at best,[241] which further reduces the likelihood that OECD members will support a formulary system in the foreseeable future.

Because of its preference for residence taxation, Pillar Two's benefits are mostly going to be received by wealthy developed countries where MNCs are headquartered. Formally, the UTPR gives source countries the authority to tax payments made to related parties or to refuse deductions for such payments. But "the

236 *See* Brauner, *supra* note 233, at 20–21. Public CbCR would likely help level the playing field for developing countries as it would invite better-informed scrutiny by the "public, media and independent experts." *Id.* at 20.

237 *Id.*

238 THORNTON MATHESON ET AL., FORMULARY APPORTIONMENT IN THEORY AND PRACTICE 283, 284 (IMF, 2021).

239 *See* Brauner, *supra* note 233, at 20–21.

240 *Id.* at 21.

241 *See infra* notes 266–271 and accompanying text.

country trying to enforce UTPR does not have first dibs."[242] In effect, the UTPR is more likely to encourage the jurisdictions of incorporation and residency to implement their own minimum tax so as not to lose the chance to collect tax revenue to the UTPR jurisdiction.[243] The United States' progress toward implementing its own domestic GloBE rules—though their mechanics are not entirely fleshed out—demonstrates that MNC-heavy resident countries are keen to participate and collect top-up taxes on their globetrotting MNCs.

A global minimum tax is an effective tool against MNC profit shifting because it reduces the incentives to engage in convoluted tax planning in order to receive favorable tax treatment in low or no-tax jurisdictions. Because wealthy countries, including the United States, are concerned about the gaps in the international tax system that have cost them corporate tax revenue, they are eager to exercise the IIR and collect top-up taxes not collected by tax havens. Therefore, this residence-focused approach of the GloBE rules, an approach founding OECD members have been faithful to for nearly a century, makes the imminent achievement of a global minimum tax one that maintains the power dynamic between wealthy and developing countries.

V. THE U.S. PATH FORWARD AND SOLVING INTERSTATE PROFIT SHIFTING

A. The United States in a Two-Pillar World

The base protection measures in the TCJA are essentially the United States' GloBE rules. In fact, the TCJA's GILTI and BEAT provisions served as a model from which Pillar Two was drawn and demonstrated to the OECD that unilateral measures by member countries could achieve the goal of combatting profit shifting and tax competition.[244] But as it stands, the GILTI tax rate of 10.5% does not satisfy the Pillar Two 15% minimum.[245] And if the United States does not implement its own GloBE rules, it risks losing the opportunity to impose top-up tax on its MNCs to

[242] Robert Goulder, *Defending the Undertaxed Profits Rule*, FORBES (Jan. 11, 2023, 3:38 PM), https://www.forbes.com/sites/taxnotes/2023/01/11/defending-the-undertaxed-profits-rule/?sh=36fbda255bc3 [https://perma.cc/VP7W-PG5X].

[243] *See id.*

[244] *See* Avi-Yonah & Kim, *supra* note 215, at 509, 529.

[245] *Id.* at 543.

source countries that would be next in line to collect those taxes under the UTPR.[246]

The Build Back Better ("BBB") Act, a major Democrat-led spending bill, was passed in the House of Representatives in late 2021 and proposed several spending initiatives ranging from childcare accessibility to climate change investment.[247] The BBB Act also proposes several corporate tax reform measures "represent[ing] the United States' plan to implement Pillar Two."[248] The proposed reform built on the TCJA's GILTI and BEAT framework by raising the GILTI rate to 15% and the rate on applicable BEAT payments to 15% starting in 2024.[249] GILTI would also be amended to be imposed on a country-by-country basis, rather than its current worldwide basis, to align with GloBE requirements.[250] This iteration of the BBB Act passed in the House has not been passed in the Senate; however, the Senate did agree on a significantly curtailed version of the bill in August 2022 when it passed the Inflation Reduction Act.

The Inflation Reduction Act did not include the Pillar Two compliant minimum tax rate, though it did implement a corporate alternative minimum tax ("CAMT"). The CAMT applies to far fewer MNCs than GILTI because it only applies to MNCs that have an average annual profit of more than $1 billion calculated over a three-year period.[251] The GILTI tax applies to *all* U.S.-based MNCs, and the proposed GloBE rules would apply to MNCs with *revenues* exceeding $770 million.[252] Because of the CAMT's high threshold requirement and other exemptions, it is "expected to apply to fewer than 150 corporations."[253] Senior Specialist in Economic Policy, Jane G. Gravelle stated that, with respect to the new CAMT and the unchanged GILTI and BEAT rules, "[i]t is unclear how these taxes would interact with GloBE."[254] The

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246 *See id.*

247 *Build Back Better Act*, BALLOTPEDIA, https://ballotpedia.org/Build_Back_Better_Act [https://perma.cc/7UUT-FZQY] (last visited Jan. 31, 2024).

248 Avi-Yonah & Kim, *supra* note 215, at 535.

249 *Id.* at 535–36, 540.

250 JANE G. GRAVELLE, CONG. RSCH. SERV., R47328, THE 15% CORPORATE ALTERNATIVE MINIMUM TAX 8 (2023).

251 *Id.* at 9.

252 *Id.*

253 Michelle P. Scott, *Corporate Alternative Minimum Tax (CAMT): What It Requires, How It Works*, INVESTOPEDIA (Jan. 17, 2023), https://www.investopedia.com/corporate-alternative-minimum-tax-7092893 [https://perma.cc/8VHS-FLZU].

254 GRAVELLE, *supra* note 250, at summary.

CAMT, as adopted in the Inflation Reduction Act, is yet another revelation of the United States' oscillating role in international corporate tax cooperation. It simply adds to the unilaterally implemented GILTI framework, leaving the United States out of step with the OECD's attempt at conformity.

To assess the likelihood of the United States' eventual approval of Pillar Two, the policy motives behind the United States' recent shifting treatment of international corporate taxes are instructive. One of the driving political forces behind the territorial shift in the United States' treatment of foreign income established by the TCJA was to preserve U.S. MNCs' competitiveness in foreign markets.[255] Cutting the corporate tax rate to zero for U.S.-MNC foreign source income—or to around 10.5%, assuming the MNC is subject to the GILTI tax—presumably put U.S. MNCs at an economic advantage compared to foreign MNCs with higher tax burdens. The GloBE tax significantly undercuts this argument because, under Pillar Two, the largest and most competitive MNCs across the globe would be "subject to the same minimum tax rate."[256]

Some U.S. lawmakers have, therefore, shifted their attacks from targeting the supposed competitive harms of taxing foreign income to vilifying any U.S. involvement in an international agreement that stands to shore up *foreign countries'* tax bases.[257] Senator Mike Crapo and Representative Jason Smith released a statement equating the Biden Administration's commitment to eventual Pillar Two implementation with "hand[ing] each foreign country a model vacuum to suck away tens of billions from our tax base."[258] Providing some necessary context to this position, economist Kimberly Clausing pointed out that "[w]hen foreign governments also tax lightly taxed income, that will unsurprisingly, and mechanically, lower GILTI revenue."[259] It is unrealistic to believe that foreign countries will not "also protect their own corporate tax bases from international tax avoidance" when the United States exercises that same right through

255 Avi-Yonah & Kim, *supra* note 215, at 546–47.

256 *See id.* at 547.

257 *See JCT: U.S. Stands to Lose Revenue Under OECD Tax Deal*, U.S. SENATE COMM. ON FIN. (June 20, 2023), https://www.finance.senate.gov/ranking-members-news/jct-us-stands-to-lose-revenue-under-oecd-tax-deal [https://perma.cc/S37C-GTPN].

258 *Id.*

259 Kimberly A. Clausing, *The Revenue Consequences of Pillar 2: Five Key Considerations*, 180 TAX NOTES FED. 555, 557 (2023) [hereinafter, Clausing, *The Revenue Consequences of Pillar 2*].

GILTI.[260] It is also hypocritical for U.S. lawmakers to endorse the use of GILTI[261] and, at the same time, effectively deny the legitimacy of other countries using their own minimum taxes.[262]

This pushback on U.S.-international collaboration most likely will not completely thwart the United States' participation in Pillar Two, primarily because the United States will not want to give away the opportunity to tax U.S. MNCs to countries eager to apply the UTPR. Notwithstanding this reality, the congressmen's message illustrates the continuing command that tax competition has over the United States' policy moves in the realm of international corporate tax. This criticism of international cooperation because of its supposed threat to U.S. tax sovereignty[263] does not take into account the long-term benefits of raising the corporate tax floor on the integrity of the global tax system.[264] In a globalized economy where MNCs wield substantial power through their highly evolved tax planning strategies, this floor must also be globalized if profit shifting is ever to be controlled.

The United States' reticence surrounding Pillar Two implementation threatens the integrity of the U.S. corporate tax base and the United States' role as an international tax leader as other Pillar Two countries move forward. Moreover, with presidential and congressional elections looming in late 2024, the United States' role at this juncture of momentous international tax reform hangs in the balance. While the Trump Administration expressed interest in eventual Pillar Two implementation, it strongly opposed Pillar One because of concerns about the competitiveness of U.S. tech MNCs.[265] If former President Trump is elected again in 2024, it is unclear whether his administration's position toward the two-pillar solution will be more conciliatory, considering that "few think a global compromise is possible without an agreement on both pillars."[266]

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260 *Id.*

261 *See JCT: U.S. Stands to Lose Revenue Under OECD Tax Deal*, *supra* note 257.

262 *See* Clausing, *The Revenue Consequences of Pillar 2*, *supra* note 259, at 557.

263 *See JCT: U.S. Stands to Lose Revenue Under OECD Tax Deal*, *supra* note 257.

264 *See* Clausing, *The Revenue Consequences of Pillar 2*, *supra* note 259, at 557 ("The one instance in which tax sovereignty is impaired is when the policy desire is to have rock-bottom effective tax rates on the most profitable companies in the world.").

265 *See, e.g.*, Avi-Yonah et al., *supra* note 208, at 292; *see also* Sam Fleming , Jim Brunsden, Chris Giles & James Politi, *US Upends Global Digital Tax Plans After Pulling out of Talks with Europe*, FIN. TIMES (June 17, 2020), https://www.ft.com/content/1ac26225-c5dc-48fa-84bd-b61e1f4a3d94?desktop=true&segmentId=d8d3e364-5197-20eb-17cf-2437841d178a [https://perma.cc/ZAJ6-TFNQ].

266 Fleming et al., *supra* note 265.

Pillar One's assigning tax liability on digital businesses in the locations where digital goods and services are purchased and used has been highly disfavored by the United States. Of the 100 companies that would be subject to Pillar One, more than half are U.S.-based.[267] The United States, therefore, has stalled Pillar One progress because of concerns that the new taxing right unfairly discriminates against U.S. tech companies.[268] Because Pillar One would be implemented by a multilateral treaty and its provisions would conflict with existing bilateral treaties between the United States and other countries, its adoption by the United States depends on a two-thirds ratification by the U.S. Senate.[269] Some have suggested a possible treaty override to implement Pillar One; however, such action would be a "double-edged sword for proponents of international tax law" as it would undermine the overall integrity of international cooperative agreements.[270] U.S. Pillar One adoption is thus unlikely to move forward due to the necessary but improbable bipartisan support for the multilateral treaty.[271]

These potential impediments to U.S.-international cooperation may not prevent the United States from acting unilaterally to protect its tax base. However, the United States' failure to participate in both pillars would have deleterious effects on both individual countries and the overall cohesion of international tax reform. Because a substantial portion of MNCs affected by Pillar One are U.S. firms, Pillar One's intended effect—to essentially level the playing field between source and resident jurisdictions—would be significantly watered down without U.S. participation. Moreover, countries that have agreed to suspend digital service taxes on large tech firms as a condition of Pillar One will almost certainly pull out of the agreement and instead

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267 *See* Tax Notes Staff, *Bringing Order to Chaos? Digital Service Taxes and Pillar 1*, FORBES (Mar. 14, 2023, 3:50 PM), https://www.forbes.com/sites/taxnotes/2023/03/14/bringing-order-to-chaos-digital-services-taxes-and-pillar-1/?sh=6d95c7152638 [https://perma.cc/XK9M-9Z6C].

268 *See* Avi-Yonah et al., *supra* note 208, at 292.

269 *See id.* at 299.

270 *Id.* at 304.

271 *See* Reuven S. Avi-Yonah, *After Pillar One*, 247 L. & ECON. WORKING PAPERS 1, 1 (2022) ("But despite the support of the Biden administration, since the Republicans are adamantly opposed, an MTC implementing Pillar One cannot be ratified by the Senate (which requires 67 votes) or enacted as a Congressional Executive Agreement (which requires passage in the Republican controlled house).").

unilaterally impose digital taxes.[272] The United States has threatened tariffs in the past on countries that impose digital service taxes on U.S. tech companies, and a lack of international consensus on Pillar One makes U.S. trade retaliation more likely, especially if a Republican president is elected in 2024.[273] Finally, a failure to implement Pillar One would have an especially negative impact on developing countries that stand to benefit more from Pillar One than from Pillar Two.

B. U.S. States' Successes in Fighting Interstate Profit Shifting

Many U.S. states have acted to reinforce their corporate tax base in response to multistate businesses using the Delaware strategy. As discussed in Part II.C, some U.S. states, including South Carolina and Louisiana, successfully reclaimed corporate tax revenue from Toys "R" Us's Delaware-based holding company that should have been collected on profits derived from activity in their states. The North Carolina Supreme Court subsequently adhered to the *Geoffrey* court's reasoning to find an economic nexus with a Delaware intellectual property holding company, as did courts in New Jersey and Oklahoma.[274]

One problem with states using economic nexus arguments against taxpayers in court is that different state courts resolve challenges by corporate taxpayers differently.[275] Furthermore, "with the assistance of specialist state tax litigators, [MSCs] are not hesitant to litigate all the way [up] to the state's highest court," resulting in high costs on both sides of the dispute.[276] Some states, notably West Virginia, have taken nexus too far, finding grounds for taxation of a non-resident intellectual property holding company that had virtually no connection with the taxing jurisdiction.[277] The Supreme Court has not directly analyzed the

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272 *See id.* Digital Service Taxes ("DSTs") are unilateral taxes applied to both free and paid-for digital services used in the taxing jurisdiction. *See* Avi-Yonah et al., *supra* note 208, at 282.

273 *See* Samantha Handler & Chris Cioffi, *Global Tax Deal Moves Ahead Sparking New Republican Resistance*, BLOOMBERG TAX (Mar. 24, 2023, 9:16 AM), https://news.bloombergtax.com/daily-tax-report-international/global-tax-deal-moves-ahead-sparking-new-republican-resistance [https://perma.cc/X92C-9KBV].

274 *See* JEFFREY A. MAINE & XUAN-THAO N. NGUYEN, THE INTELLECTUAL PROPERTY HOLDING COMPANY: TAX USE AND ABUSE FROM VICTORIA'S SECRET TO APPLE 96–98 (Lionel Bently et al. eds., 2017).

275 *See id.* at 92.

276 *Id.*

277 *Id.* at 127 ("These cases represent a new frontier of state taxing power that has rather attenuated constitutional support.").

constitutional limits of a state's authority to impose corporate income tax based on economic nexus.[278] This leaves state economic nexus rules vulnerable to constitutional challenges.

Because of these limits on nexus and economic substance rules, many states have enacted combined reporting requirements. From this perspective, U.S. states that have enacted combined reporting are motivated by principles like those inherent in the OECD BEPS framework. Mandatory CbCR, for example, increases transparency and benefits countries' tax authorities by allowing them to audit related-party transactions more effectively. Combined reporting requirements by U.S. states similarly benefit state tax authorities by giving them a more complete picture of MSC profit-generating activities as well as any red flags indicating tax-motivated profit shifting. Generally, under state combined reporting rules, an MSC group that is a "unitary business" is assessed, for tax purposes, as a single enterprise rather than as separate entities.[279] States that implement combined reporting assess the group's total income, including income recorded in their state and income recorded elsewhere, like in Delaware, and determine the appropriate taxable income attributable to their state.[280] In this respect, U.S. states go further than the OECD's CbCR, as CbCR rules prohibit tax authorities from determining tax liability based on CbCR data alone.[281]

However, because not all combined reporting states define unitary business the same, an MSC may be subject to combined reporting in one state and not in another, even though both states have combined reporting rules in place.[282] There are also constitutional limits on how liberally states may define a unitary

278 *See generally* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018); *see* Joe Garrett, et al., *Income Tax Nexus Limitations in a Post-Wayfair World*, 100 TAX NOTES STATE 787, 788 (2021). However, the *Wayfair* decision's erasure of the physical presence requirement for sales tax might have implications for states' ability to tax intangible income earned by affiliates that lack a physical presence inside a state's borders. Indeed, "most tax professionals that specialize in state taxes feel that the implication is that Wayfair does support economic nexus for corporation tax/income tax as well." Brian Gordon, *The Wayfair Decision and Its Effect on Income Tax Nexus*, NYSSCPA (Jan. 1, 2019), https://www.nysscpa.org/most-popular-content/the-wayfair-decision-and-its-effect-on-income-tax-nexus#sthash.ezRJ8T6b.dpbs [https://perma.cc/943J-C75D].

279 *See* MAINE & NGUYEN, *supra* note 274, at 92; Bret N. Bogenschneider & Ruth Heilmeier, *Google's "Alphabet Soup" in Delaware*, 16 HOUSTON BUS. & TAX'N L.J. 1, 16–17 (2016).

280 *See* Bogenschneider & Heilmeier, *supra* note 279, at 16–17.

281 *See* Brauner, *supra* note 233, at 515.

282 *See* Bogenschneider & Heilmeier, *supra* note 279, at 12–15.

business.[283] Furthermore, the benefits of combined reporting may be circumscribed because such required reporting often reaches only the "water's edge," meaning firms are only required to report the income of their affiliates *within U.S. borders*.[284] The water's edge limitation allows both MSCs and MNCs to move income to foreign tax havens while remaining in compliance with state combined reporting rules. Notwithstanding these limitations, the trend is that more and more states are moving toward combined reporting. In early 2023, twenty-nine states and the District of Columbia had combined reporting rules in effect.[285] As more states enact combined reporting to protect their tax bases, the number of separate filing states decreases, as do the opportunities for interstate profit shifting.

The next step for states that want to reinforce their corporate tax base is worldwide combined reporting, which would involve eliminating the water's edge limitation. While "[c]ombined reporting with a water's edge election is still an excellent idea for combatting income stripping within the United States," firms may respond to more states requiring combined reporting by moving profits beyond U.S. borders.[286] In *Container Corp. of America v. Franchise Tax Board*, the Supreme Court upheld the constitutionality of California's then-existing tax code, which gave the state's tax authority access to the worldwide tax information of MNCs considered a unitary business under the state's laws.[287] Despite this favorable constitutional ruling, however, states' attempts at enacting worldwide reporting have been futile in the face of extreme corporate and political backlash. In the years following *Container Corp.*, California faced pressure from MNCs and MSCs, the U.S. Treasury Department, and foreign

283 *See* DARIEN SHANSKE, WHITE PAPER ON ELIMINATING THE WATER'S EDGE ELECTION AND MOVING TO MANDATORY WORLDWIDE COMBINED REPORTING 4 (2018). Bogenschneider & Hellmeier, *supra* note 279, at 24. The Multistate Tax Commission has created a model unitary business definition "up to the constitutional limit." *Id.* at 13, 24.

284 Aidan Davis, Matthew Gardner & Richard Phillips, *3 Percent and Dropping: State Corporate Tax Avoidance in the Fortune 500, 2008 to 2015*, INST. ON TAX'N & ECON. POL'Y (Apr. 27, 2017), https://itep.org/3-percent-and-dropping-state-corporate-tax-avoidance-in-the-fortune-500-2008-to-2015/ [https://perma.cc/KZ8Y-8XP8].

285 *See* Angélica Serrano-Román, *Combined Corporate Tax Reporting on the Table Again in Maryland*, BLOOMBERG TAX (Feb. 8, 2023, 4:00 AM), https://news.bloombergtax.com/daily-tax-report-state/combined-corporate-tax-reporting-on-the-table-again-in-maryland [https://perma.cc/SK3F-492E].

286 SHANSKE, *supra* note 283, at 4.

287 Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 168 (1983).

governments, leading California and other states to implement water's edge election provisions.[288]

Minnesota's legislature recently considered a mandatory worldwide combined reporting requirement, but like California's experience post-*Container Corp.*, resistance from the MNC and MSC communities made the move politically untenable. Critics of the proposed law argue that such worldwide reporting requirements are not only politically risky, but they may harm states in another way: corporations might respond by "avoid[ing] or decreas[ing] connections with the state," which could result in reduced investments.[289] But if other states can overcome the political barriers to enacting worldwide reporting, this would reduce the opportunities for MNCs and MSCs to simply move their operations to water's edge states because there will be fewer of them available.

Certainly, in an extreme case, MNCs could respond by moving their operations outside of the United States entirely, but this is an unlikely scenario for two reasons. First, notwithstanding valid concerns about increased offshoring and outsourcing in certain industries,[290] U.S.-based MNCs still conduct a significant portion of their operations in the United States and, indeed, rely on U.S. labor and domestic companies for various reasons.[291] U.S.-based MNCs that added to their foreign workforce between 1982 and 2017 "added exactly the same number of workers (9.4 million) to their payrolls in the United States."[292] Over roughly the same time period, U.S. MNCs accounted for about 70% of research and

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288 *See* Stephen P. Kranz et al., *Be Careful What You Wish For: Minnesota May Be on the Precipice of Enacting Worldwide Combined Reporting at the Worst Possible Time*, LEXOLOGY (May 4, 2023), https://www.lexology.com/library/detail.aspx?g=34525d51-22d9-48ef-9830-d26a77040be7 [https://perma.cc/4DGS-Z9GA]; McIntyre et al., *supra* note 160, at 732–33.

289 Kranz et al., *supra* note 288.

290 *See* Arielle Pardes & Vittoria Elliott, *Tech's Offshore Hiring Has Gone into Overdrive*, WIRED (Aug. 12, 2022, 7:00 AM), https://www.wired.com/story/techs-offshore-hiring-has-gone-into-overdrive/ [https://perma.cc/QC9L-GENB] (tech jobs); Kenneth Rapoza, *GM Leads in Shipping Jobs to Mexico; Company Shifting Focus to China*, FORBES (Sep. 1, 2020, 11:44 AM), https://www.forbes.com/sites/kenrapoza/2020/09/01/gm-leads-in-shipping-jobs-to-mexico-company-shifting-focus-to-china/?sh=4aca2aef4dfa [https://perma.cc/Q92A-4ABA] (manufacturing jobs).

291 *See* MATTHEW J. SLAUGHTER, HOW U.S. MULTINATIONAL COMPANIES STRENGTHEN THE U.S. ECONOMY 20 (2009), https://www.uscib.org/docs/foundation_multinationals.pdf [https://perma.cc/84HZ-Y35B].

292 C. FRITZ FOLEY ET AL., MULTINATIONAL CORPORATIONS IN THE 21ST CENTURY ECONOMY 10 (2021), https://www.brookings.edu/wp-content/uploads/2021/04/GG_Ch1_Summary.pdf [https://perma.cc/JZZ8-JKJX].

development conducted in the United States.[293] This data suggests that U.S. MNCs depend on the United States' innovative business infrastructure as well as its workforce. Any cost savings from avoiding taxation by individual states is likely overshadowed by the desire and need to maintain operational strongholds in the United States.

Second, with the existing U.S. GILTI-BEAT framework and a 15% global minimum tax looming, U.S. MNCs have even less of an incentive to move the totality of their operations offshore for tax purposes. The tax savings available to an MNC before GILTI and GloBE may have been tempting because the difference between the total effective U.S. tax rate (state plus federal) where the MNC operates, and some low-tax foreign jurisdictions was likely significant. That difference is made smaller, though, under the GILTI tax on foreign income, which would apply to an MNC that moves most of its activity offshore but maintains its U.S. residency. The gap will be even smaller if most countries adopt the GloBE rules, raising the MNC's foreign income tax liability from 10.5% under GILTI to 15% under GloBE. Even if the MNC were to change its residency, the GloBE minimum tax—whether imposed under the QDMTT, the IIR, the UTPR, or a combination of the three—would almost certainly attach. With these new global minimum taxes, the burden of uprooting an MNC's U.S. presence becomes much greater than any realized tax benefit.

Therefore, it is possible that, in addition to benefitting individual countries, raising the global corporate tax floor may also provide political capital at the state level to eventually allow U.S. states to enact worldwide combined reporting. But the same problems hindering the United States' commitment to standing firm against runaway tax competition arise when states consider stronger anti-profit shifting measures.

CONCLUSION

There are three important ratios of power among stakeholders in corporate income tax policy. First, MNCs (and MSCs) have established a remarkably powerful position over the governments that have the legal authority to tax them. Tax planning has become a crucial factor influencing MNCs' organizational

293 *Id.* at 11; *see also* BUREAU OF ECON. ANALYSIS, ACTIVITIES OF U.S. MULTINATIONAL ENTERPRISES IN 2019 12 (2021), https://apps.bea.gov/scb/issues/2021/12-december/pdf/1221-multinational-enterprises.pdf [https://perma.cc/S4V8-J93V].

decisions, and national and state governments have struggled to create concerted regulatory apparatuses that can keep up with MNC profit shifting strategies.

Second, the OECD and its members have maintained their position of power in determining which countries' priorities deserve the most deference in international tax policy. In the mid-20th century, the OECD solidified residence-focused taxation as the dominant approach in its model treaty, which has pervaded the vast majority of tax treaties to this day despite its troublesome effects on developing countries. These treaties disproportionately benefit wealthier resident countries at the expense of poorer source countries. The launch of the OECD BEPS project and the Inclusive Framework is a start toward curing this historical power disparity between developing and developed countries.

But there is a third relationship of power that seems to be dispositive in the current international struggle for corporate tax fairness. The most recent global corporate tax reforms—aimed at curtailing tax-motivated profit shifting by MNCs—have resulted from an incremental approach over the last several decades. Although this incrementalism is surely a product of a wide variety of geopolitical forces, the United States is one such force that has historically wielded massive influence over the speed and direction of international tax policy reform. Thus, it is critical to consider the United States' preferences when assessing proposed changes to international corporate taxation.

The United States toned down the OECD's progress at the beginning of the 21st century when the organization was evaluating what it initially called "harmful" tax practices. The OECD also adopted and perpetuated the United States' use of the arm's length standard to assess transfer prices, even though the standard relied on the dubious assumption that related entities behave the same way as unrelated parties.

Pillar Two of the BEPS project was modeled after the United States' GILTI and BEAT rules and preserves residence-favored taxation to the detriment of source developing countries.[294] And even though the United States created the framework leading to this global minimum tax, U.S. lawmakers continue to stall full Pillar Two

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294 *See supra* Part III.B.

adoption because of concerns that such a cooperative effort unfairly shares foreign corporate tax revenue with other countries.[295]

Pillar One, the portion of the BEPS project that would balance out this residence focus by giving source countries more taxing authority, has been rejected by the United States because it would affect a large number of U.S.-based companies and transfer part of its taxing authority over these MNCs to other countries. This dismal prognosis for U.S. Pillar One adoption will reduce much of the BEPS project's promised benefits to developing countries. Even on a national level, tax competition pressures U.S. state governments and has undermined state progress toward mandatory worldwide combined reporting.

To the OECD's credit, its abrupt shift away from the arm's length principle and separate entity approach in Pillar Two and from residence taxation in Pillar One has, in a sense, established a more progressive standard for countries seeking to fight base erosion and profit shifting. Such a departure could set in motion greater political will to further balance the power discrepancies between MNCs and their governments and between international tax leaders and developing countries. But even as the United States mirrored some of these radical shifts in the TCJA, its hesitancy toward full international cooperation reflects the continuing influence that tax competition—enforced by the power of MNCs—has over progress. Current goals of fairness in corporate taxation, at the national and even state level, are undermined by a strict adherence to uninhibited tax competition. This adherence continues to shape the United States' position to its and other nations' detriment, undermining the integrity of international tax cooperation.

295 *Id.*