Chairman Whitehouse, Ranking Member Grassley, and members of the committee, thank you for the opportunity to testify today.

My testimony today will focus on the importance of protecting the U.S. tax base as it relates to cross-border income, the ways in which the Tax Cuts & Jobs Act, through a combination of carrots and sticks, strengthened those protections, and the ways in which the OECD agreement known as the 2-pillar project puts the U.S. tax base at risk. I conclude with some thoughts on what Congress might be able to do to address that risk.

For a mix of both foreign policy and domestic economic reasons, Congress has since the early days of the income tax provided favorable treatment for the taxation of foreign earnings.[1] The primary way it does so is by allowing a credit for foreign taxes paid (rather than a deduction, as allowed for most other types of expenses).[2] Because the U.S. tax and legal systems respect corporations as separate entities, and because the United States (like all other tax systems) generally doesn't tax the income of corporations to their shareholders in the year earned, the earnings of foreign corporation historically have not been subject to U.S. tax until repatriated by way of a dividend.[3] That principle, known as deferral, provides some offset to the fact that the U.S. has a worldwide system of taxation, whereas most other countries have adopted territorial systems, which exempt – either wholly or partially -- foreign earned income from tax in the shareholder's or owner's hands.[4]

At various times over the past 100 years, Congress has imposed limits on this treatment of foreign earnings in response to profit shifting or economic policy concerns.[5] The most far-reaching of these (prior to 2017) was enactment of the subpart F regime in 1962, pursuant to which certain income of foreign corporations viewed as presenting a high risk of profit shifting is taxed currently to the company's U.S. shareholders.[6] Congress also acted to impose an exit tax when U.S. persons transferred assets or entities overseas,[7] and in 2004, broadened that exit tax to apply additional tax penalties to inversion transactions.[8]

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[1] *See* Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 Duke L. J. 1020 (1997).
[2] 26 U.S.C. § 901.
[3] *See, e.g.,* Jane G. Gravelle, *Moving to a Territorial Income Tax: Options and Challenges*, CRS Rep. 42624 (2012).
[4] *Id.*
[5] *See generally* Mindy Herzfeld, *How to Think About How the US Congress Thinks About International Tax Reforms*, 5 Brit. Tax Rev. 504 (2022).
[6] Revenue Act of 1962, Pub. L. 87–834, 76 Stat. 960; 26 U.S.C. §§ 951-965.
[7] 26 U.S.C. § 367; Treas. Reg. § 1.367(a)-1, -3.
[8] American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418; 26 U.S.C. § 7874.

Beginning in the 1990s, a number of trends combined to place additional pressure on this long-standing system.

One, the globalization of the economy meant that U.S. companies expanded their operations – and correspondingly, their profits, derived from foreign markets, while developments in logistics and transportation made it easier for companies to engage in supply chain manufacturing processes in multiple countries.[9]

Second, other countries became more aggressive in competing for foreign investment with tax incentives.[10] Corporate tax rates worldwide went down sharply (while the U.S. rate remained static) while at the same time countries enacted other incentives such as patent boxes to lure both real investment in intangible property and IP developed elsewhere to their jurisdictions.[11]

As a result, the U.S. international tax system came under significant pressure, manifested by a rising trend in inversions,[12] foreign takeovers of U.S. companies, transfers of valuable IP offshore,[13] and the increasing pile of cash that U.S. companies held overseas, rather than repatriating to the U.S. as a dividend that would be subject to a full 35 percent rate.[14]

The TCJA addressed these concerns with provisions that adopted many of the bipartisan proposals that had been made over the prior decade.

- Reducing the rate to 21 percent released a significant amount of pressure in the system. Inversions have essentially stopped.[15]
- A strengthened limitation on interest expense deductibility reduced incentives for inbound base erosion.[16]

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[9] Daniel Vaughan-Whitehead, Behind the Rise of Global Supply Chains (Cambridge Scholars Publishing 2022).
[10] Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 Harv. L. Rev. 1573 (2000).
[11] See Cristina Enache, *Corporate Tax Rates around the World, 2022*, The Tax Foundation (Dec. 13, 2022) (discussing general decline in corporate tax rates since the 1980s). Available at https://taxfoundation.org/data/all/global/corporate-tax-rates-by-country-2022/#_ftn15; Marko Koethenbuerger, Federica Liberini & Michael Stimmelmayr, *(Un)Intended Effects of Preferential Tax Regimes*, EconPol WP 29 (2019).
[12] U.S. Department of the Treasury, *Corporate Inversion Transactions: Tax Policy Implications* (May 2002).
[13] Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, CRS Rep. 40623 (2022).
[14] Harry Grubert & Rosanne Altshuler, *Fixing the System: An Analysis of Alternative Proposals for Reform of International Tax*, 66 Nat'l Tax J. 671 (2013).
[15] Donald J. Marples & Jane G. Gravelle, *Corporate Expatriation, Inversions, and Mergers: Tax Issues*, CRS Rep. 43568 (2021).
[16] 26 U.S.C. § 163(j).

- The participation exemption (combined with the lower rate) addressed the lockout effect.[17]
- The FDII deduction – which introduces parity to the tax rates that apply to profits from foreign-and U.S.-owned IP - has incentivized companies to repatriate their intellectual property back to the U.S.[18]
- Incentives for profit shifting have been reduced due to enactment of GILTI, which subjects to U.S. tax essentially all income of controlled foreign corporations to their U.S. shareholders on a current basis.[19]

But the TCJA was mostly about strengthening secondary U.S. taxing rights. Shortly after its enactment, the OECD kicked off the second phase of its BEPS project, the results of which grant other countries primary rights over profits that the U.S. has historically taxed.[20]

With the active participation of the U.S. Treasury, this project has had 2 outcomes:

Pillar 1 represents a reallocation of historical taxing rights from the U.S. to "market economies," primarily focused on U.S. tech companies. The OECD has released a text of an agreed-upon multilateral convention to bring this agreement into effect.[21]

Under pillar 2, the global minimum tax agreement, the U.S. has encouraged other countries to adopt minimum taxes of 15 percent – and over 40 countries have already done so.[22] The U.S. essentially subsidizes these taxes through the foreign tax credit.[23]

The Joint Committee on Taxation has estimated that Pillar 2 could cost the U.S. hundreds of billions in revenue – essentially, taxes on the foreign income of U.S. companies now collected as GILTI will instead be collected by other countries, with the U.S. providing a credit.[24] The revenue loss occurs regardless of whether or

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[17] 26 U.S.C. § 245A. Data from the Bureau of Economic Affairs indicates that the amount of quarterly repatriations is structurally higher post-TCJA. See BEA International Data, International Transactions, International Services, and International Investment Position Table 4.2 (U.S. International Transactions in Primary Income on Direct Investment) (Released Dec. 20, 2023).

[18] 26 U.S.C. § 250. *See* Martin A. Sullivan, *Irish Data Confirm Tech IP Shift From Havens to the United States*, 105 Tax Notes Int'l 281 (2022).

[19] 26 U.S.C. § 951A. *See* Javier Garcia-Bernardo, Petr Janský & Gabriel Zucman, *Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?* NBER WP No. 30086 (2022).

[20] OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy* (Oct. 2021).

[21] OECD, *The Multilateral Convention to Implement Amount A of Pillar One* (October 2023); OECD, *Explanatory Statement to the Multilateral Convention to Implement Amount A of Pillar One* (October 2023).

[22] *See* PwC, *OECD Pillar Two Country Tracker*, available at https://www.pwc.com/gx/en/services/tax/pillar-two-readiness/country-tracker.html.

[23] Notice 2023-80; 2023-52 IRB 1583.

[24] Jt. Cmte. on Tax'n, *Possible Effects of Adopting the OECD's Pillar Two, Both Worldwide and in the United States* (2023). See also Alan Cole & Cody Kallen, *Risks to the U.S. Tax Base from Pillar Two*, Tax Foundation (Aug. 30,

not the United States adopts the Pillar 2 regime. The OECD, meanwhile, has estimated that the primary beneficiaries of pillar 2 are likely to be "investment hubs" – jurisdictions with preferential tax regimes.[25] There have not been any estimates for the cost to the U.S. of pillar 1.

The global minimum tax agreement also has opened the door for other countries to impose taxes on a U.S. domestic income tax base, through the Undertaxed Profits Rule, or UTPR.[26] Under this provision, U.S. business tax credits effectively become subsidies for other countries' revenue collection. Tax benefits intended by Congress to encourage certain taxpayer behavior in the United States end up being paid to other countries, undermining the intended policy outcome and enriching foreign coffers.

Pillar 2's rules are so complex that many U.S. taxpayers are indicating that the cost of compliance will be greater than any tax that will be owed.[27] Complex tax laws almost always tilt in the taxpayer's favor, because they have more resources to find the gaps in the law than administrators do to close them.[28] Moreover, excessively complex systems are rarely stable, and so a project premised that conformity will bring about greater stability will likely result in anything but.

One of the most concerning aspects of pillar 2 is the extent to which the OECD has stepped into the shoes of Congress and Treasury in writing rules that directly impact U.S. taxpayers, without any of the oversight mandated by the legislative process or as required by the Administrative Procedure Act.[29] The lack of oversight should concern members of Congress of both parties.

Congress can address the process concerns related to the OECD project by putting in place mechanisms for greater oversight over international tax rulemaking, perhaps looking to the Trade Promotion Authority as a model. And it could address underlying problems with the U.S. international tax system that the project has

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2023) (estimating that foreign countries' adoption of pillar 2 would increases U.S. corporate tax revenues by $34.9 billion over 10 years, but also that modifying U.S. international rules accordingly does not necessarily increase revenues, and that pillar 2 also would likely result in significantly lower post-corporate-tax incomes for U.S. shareholders, reducing U.S. collection of individual income taxes).

[25] Felix Hugger, Ana Cinta González Cabral, Massimo Bucci, Maria Gesualdo & Pierce O'Reilly, *The Global Minimum Tax and the Taxation of MNE Profit*, OECD Taxation Working Papers No. 68 (Jan. 9, 2024). Emma Agyemang, *Global Minimum Tax Will Boost Revenues for Tax Havens, Says OECD*, FT (Jan. 10, 2024).

[26] See Jane Gravelle & Mark P. Keightley, *The Pillar 2 Global Minimum Tax: Implications for U.S. Tax Policy,* CRS Rep. 47174 (Sept. 22, 2023) (noting that "GLoBE could reduce the benefit of domestic tax incentives such as tax credits").

[27] National Foreign Trade Council, *Written Testimony of Anne Gordon, the House Committee on Ways and Means Subcommittee on Tax Hearing on Biden's Global Tax Surrender Harms American Workers and Our Economy* (July 2023).

[28] National Taxpayer Advocate, *2022 Annual Report to Congress*.

[29] Mindy Herzfeld, *OECD Rulemaking, the APA, and Chevron Deference*, 182 Tax Notes Federal 403 (2024).

exposed by better defining the U.S. tax base to ensure primary taxing rights over profits from U.S. created intangibles.

Thank you again for inviting me to testify. I would be happy to answer any questions you may have.

Disentangling the OECD's New Estimates of Pillar 2 Effects

POSTED ON JAN. 16, 2024

Pillar 2 could increase global corporate tax revenue by more than 8 percent, reduce low-taxed profit in tax havens by more than 80 percent, and — even in developed economies with high average rates — raise corporate revenue by more than 7 percent.

But wait! Before our mathphobic brains overload with statistics from the just-released OECD economic impact statement on pillar 2, let's try to convey the gist of this 84-page report with a stylized story. (Felix Hugger et al., "The Global Minimum Tax and the Taxation of MNE Profit," OECD Taxation Working Papers No. 68 (Jan. 9, 2024).)

In Plain English

In our simple tale the world has only two sets of countries. The L countries are relatively small and relatively few, their levels of economic substance are well below the norm, and average single-digit tax rates generally prevail across the board. The low rates serve those small economies well because they have had magnetic effects on multinational profit and occasionally even on some real investment.

> ***The low rates serve those small economies well because they have had magnetic effects on enormous sums of multinational profit.***

The H countries are larger, more numerous, and more economically substantive. Average tax rates are high, but there are some pockets of low-taxed profit from targeted exceptions to the high-tax rules that can attract (and retain) multinational profit and investment.

We can estimate the incentive to shift profit from H countries to L countries by the disparity between their tax rates. Most folks — especially at the OECD and in H country governments — consider low rates in L countries a problem because they thwart the ability of H countries to raise taxes in the manner they deem necessary for domestic reasons (such as overall revenue goals and the proper distribution of the tax burden) and because it is unfair to purely domestic corporations.

And it is economic gospel that disparities in tax rates across jurisdictions can distort the efficient allocation of capital across international borders, allowing investment to flow to the lowest-tax locations rather than the most profitable (before tax) locations. Analogous to the great debates on free trade, what may be economically and politically advantageous from one nation's point of view can be seriously detrimental to global economic growth.

What happens when we impose a 15 percent pillar 2 minimum tax on all profits in this simple world? There are four main effects. First, the increase in the L country tax rates from low single digits to the 15 percent pillar 2 minimum tax rate induces some (highly uncertain) amount of profit to shift back from the L countries (where it shouldn't be) to H countries (where it belongs).

Second, a lot of pillar 2 minimum tax revenue will be collected on the not insubstantial amount of low-taxed profit in H countries, and there will be a not insubstantial amount of pillar 2 revenue collected on low-taxed profit not shifted out of L countries.

> ***Once you get into quantitative estimates, massive uncertainty and controversy abound, and politics (unfortunately) plays a big role.***

Third, as always, reduced tax differentials from the minimum tax will improve the allocation of capital. Qualitatively, this conclusion is easy, basic, and uncontroversial economics. But once you get into quantitative estimates, massive uncertainty and controversy abound, and politics (unfortunately) plays a big role.

Fourth, probably — depending on collection ordering rules and on governmental decisions about implementing rules — much of the new pillar 2 minimum tax revenue will accrue to governments under which affiliates of multinationals already have their low-taxed profit booked.

Now the Numbers

OK, that was a stylized, non-quantitative fictional story loosely based on the January 9 report. Now let's venture closer to reality, at least as best we can see it through estimates created mostly with the available country-by-country report data from 2017 to 2020. Table 1 focuses on low-taxed profits and how pillar 2 could affect those profits. Table 2 is about some possible revenue effects of the pillar 2 minimum tax.

Table 1. Estimated Total (Net) Profit and Low-Taxed Profits Before and After Pillar 2, 2017-2020 Annual Average, by Income Category (dollar amounts in billions)

		High Income	Upper-Mid	Lower-Mid	Low Income	Investment Hubs	Total
(1)	Total profit (net of losses)	$2,968	$1,643	$191	$10.5	$1,117	$5,929
(2)	Total net profit as % (across categories)	50.1%	27.7%	3.2%	0.2%	18.8%	100%
(3)	Low-taxed profit as % total profit	38.6%	18.3%	1.6%	0.1%	41.4%	36.1%
(4)	Low-taxed profit before pillar 2 ($)	$826	$392	$34	$2	$886	$2,140
(5)	Low-taxed profit before pillar 2 (% of category profit)	27.8%	23.8%	18%	20.4%	79.3%	36.1%
(6)	Low-taxed profit after	11.7%	10.3%	6.5%	4.8%	10.9%	11%

		High Income	Upper-Mid	Lower-Mid	Low Income	Investment Hubs	Total
	pillar 2 (% of category profit)						
(7)	Low-taxed profit after pillar 2 ($)	$347	$169	$12	$1	$122	$651
(8)	Reduction in low-taxed profit ($)	$479	$222	$22	$2	$764	$1,489
(9)	Reduction as % low-taxed profit in category	58%	57%	64%	77%	86%	70%
(10)	Reduction as % of total reduction	32.2%	14.9%	1.5%	0.1%	51.3%	100%

Sources: Column 1: Felix Hugger et al., "The Global Minimum Tax and the Taxation of MNE Profit," OECD Taxation Working Papers No. 68, at para. 11 (Jan. 9, 2024); Column 2: Author's calculations. Column 3: Category percentages from Hugger, fig. 7 (in section 6); Total percentage from Hugger, para. 11, then used to calculate total dollar amount of low-taxed profit in column 4. Column 4: Author's calculations. Column 5: Category percentages calculated by author, starting with total low-taxed profit calculated from data in Hugger,

	High Income	Upper-Mid	Lower-Mid	Low Income	Investment Hubs	Total
para. 11. Column 6: Percentages are from Hugger, para. 84. Columns 7-10: Author's calculations corroborated with estimates (when available) discussed in text.						

For readability and because of publication time constraints, we are skipping over a lot of details, but let's make at least a few observations. Total average annual profits net (that is, including losses) of large ("in scope" is the OECD lingo) multinationals worldwide is about $5.9 trillion. (Perspective: A somewhat comparable figure for foreign profit of U.S. multinationals in 2019 was $511 billion.) Of the $5.9 trillion total, about 36 percent was low-taxed (here that means taxed at a rate of less than 15 percent), so it could be caught in the pillar 2 net.

Of the $2.1 trillion in low-taxed profit, 70 percent (about $1.5 trillion) will be subject to tax. But that doesn't easily translate into a revenue estimate for two big reasons. First, the pillar 2 tax base must be reduced by a substance-based income exclusion (which is generally low for investment hubs, but nevertheless it varies widely). Second, the substance-reduced, low-taxed profit must be multiplied by a top-up tax rate, which also varies widely.

Table 2. Estimated Pillar 2 Revenue Effects

	High Income	Upper-Mid	Lower-Mid	Low Income	Investment Hubs	Total
Pillar 2 effect (lower bound %)	7.2%	3.5%	4%	4.5%	18.5%	6.5%
Pillar 2 effect	15.2%	4.8%	7.8%	10%	37%	8.1%

	High Income	Upper-Mid	Lower-Mid	Low Income	Investment Hubs	Total
(upper bound %)						
Pillar 2 effect (lower bound $)	NA	NA	NA	NA	NA	$155
Pillar 2 effect (upper bound $)	NA	NA	NA	NA	NA	$192

Source: Total amounts and percentages from Felix Hugger et al., "The Global Minimum Tax and the Taxation of MNE Profit," OECD Taxation Working Papers No. 68, at para. 17 (Jan. 9, 2024). Percentages for categories are approximations based on images presented in Hugger, Appendix B, fig. B.5. Dollar amounts are not available by category because nowhere in the report (as best we can tell) are data available on tax revenue by category before or after imposition of pillar 2.

The report is a little less generous on details when it comes to revenue effects. But here's the headline: Pillar 2 will increase somewhere between $155 billion and $195 billion, which is between 6.5 and 8.1 percent of the worldwide total. Perspective: U.S. average corporate revenue over 2017 to 2020 was $269 billion. If the United States were like the average, corresponding revenue gains would be between $18 billion and $22 billion. In 2022 corporate revenue jumped to $425 billion. Corresponding revenue gains would be between $28 billion and $34 billion (not directly taking into account likely offsetting increases in foreign tax credits from increased foreign taxes).

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OECD Rulemaking, the APA, And *Chevron* Deference

by Mindy Herzfeld

Since issuing the pillar 2 model rules in 2021, the OECD has released a commentary to those rules, three tranches of administrative guidance — the latest on December 18, 2023 — and an implementation guide. Although the United States appears unlikely to adopt the pillar 2 model rules into law, Treasury officials have played a key role in negotiating them and the interpretive guidance. Regardless of U.S. adoption, the rules will have a direct impact on U.S. corporate taxpayers that fall within the scope of the global minimum tax regime.

Many countries have enacted the OECD model rules, but the method by which the OECD's interpretive guidance may take effect as domestic law is less clear. And although an extensive body of U.S. law applies to the domestic rulemaking process engaged in by administrative agencies, there is no directly applicable law — and no judicial oversight — for the rulemaking process of international organizations.

That means the global minimum tax — adopted with great fanfare in 2021 through an eight-page outline of an agreement — is being implemented around the world via a process far removed from the political and judicial oversight that generally applies to tax legislation. Some might celebrate this as a victory for tax lawmaking that is independent of corporate lobbying. But the administrative rulemaking process exists for a reason, and a lack of oversight and political review puts democracy at risk.

The APA and *Chevron*

In the United States, administrative agencies must follow requirements laid out in the Administrative Procedure Act, enacted in 1946 in response to the New Deal's expansive lawmaking and accompanying grants of power to executive agencies. Among its mandates, the APA requires that federal agencies follow a notice and comment period when promulgating rules (5 U.S.C. section 553). Affected persons who believe that the proposed rules are unduly burdensome or unfair can ask the courts to review the agency's process. In considering those complaints, courts have looked to whether the agency provided adequate opportunities for comment. (For a general description of APA requirements, see Todd Garvey, "A Brief Overview of Rulemaking and Judicial Review," Congressional Research Service, R41546 (2017).) The tax rulemaking process generally also requires the IRS to provide estimates of the costs and benefits of a proposed rule, and to estimate the paperwork burden on taxpayers.

A person seeking judicial review under the APA must be able to demonstrate that they have suffered a legal wrong or otherwise been harmed by agency action. An agency, as defined by the APA, includes "each authority of the Government of the United States," excluding Congress, federal civilian and military courts, and the D.C. and territorial governments (Jonathan M. Gaffney, "Judicial Review Under the Administrative Procedure Act (APA)," CRS, LSB10558 (2020)).

The Supreme Court decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837 (1984), stands for the proposition that so long as a federal agency, in applying and interpretating a statute, is doing so in a reasonable manner, its interpretation is entitled to judicial deference. The standard of deference courts should grant to the administrative rulemaking process articulated by *Chevron* is being reconsidered by the Supreme Court. (See *Loper Bright Enterprises v. Raimondo*, No. 22-451; and *Relentless Inc. v. U.S. Department of Commerce*, No. 22-1219.)

Two recent tax cases have considered IRS compliance with the APA. In 2022 the U.S. District Court for the District of Colorado upheld a taxpayer's claim that temporary regulations issued by the government with a retroactive effective date, to address what it considered abusive transactions undertaken to take advantage of inconsistent effective dates in the Tax Cuts and Jobs Act, were invalid because they improperly ignored the APA's notice and comment requirement (*Liberty Global Inc. v. United States*, No. 1:20-cv-03501-RBJ (D. Colo. 2022)). (The court subsequently held for the government on other grounds. *Liberty Global*, No. 1:20-cv-03501 (D. Colo. 2023).) The government had argued in a 2021 brief that "absent immediate action, imminent, significant, and irreversible

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harm to the public fisc would have occurred." But the court rejected that claim, agreeing with the taxpayer that there had been sufficient time to issue temporary regulations after a notice and comment period.

In *Altera Corp. v. Commissioner*, 145 T.C. 91 (2015), the Tax Court struck down an IRS regulation governing the sharing of stock compensation expenses in cost-sharing arrangements. The court found that the IRS rule was arbitrary and capricious, lacked a basis in fact, and reflected administrative agency errors in the rulemaking process, including failing to adequately respond to comments. Although the Ninth Circuit ultimately overturned the Tax Court decision (926 F.3d 1061 (2019)), the processes that the Tax Court laid out as mandatory for the IRS to follow remain a cautionary reminder for the agency. (Prior coverage: *Tax Notes Int'l*, Nov. 22, 2021, p. 947.)

The reasoning used by the district court in *Liberty Global* and by the Tax Court in *Altera* is relevant in considering Treasury's pillar 2 negotiations at the OECD.

Global Administrative Due Process

Parliamentary systems don't have the separation of powers among branches that the U.S. legal system incorporates, and few countries offer direct parallels to the APA. But many other countries have rules that agencies are required to follow in issuing the type of informal guidance that doesn't receive the legislative debate and political oversight that parliamentary enacted laws do.

Yale Law School professor Susan Rose-Ackerman has written extensively on comparative administrative law. In "Policymaking Accountability in Nation States and International Bodies," a November 2022 opinion piece published in *The Regulatory Review*, she surveys some of the reasons underlying countries' adoption of due process requirements in administrative rulemaking: Granting individuals due process rights protects them against state overreach, and such procedures enhance the democratic accountability of policymaking that takes place outside legislative bodies. Rose-Ackerman contrasts the strict rulemaking procedures mandated by the APA with the processes followed by other countries and describes how the lack of notice and comment requirements in some other jurisdictions is tied to different political structures.

In her book *Democracy and Executive Power: Policymaking Accountability in the US, the UK, Germany, and France* (2021), Rose-Ackerman emphasizes the importance of public participation, reason-giving, and transparency in rulemaking, as well as of judicial oversight. She describes commonalities in the rulemaking processes among those four countries, including requirements for unelected bureaucrats to involve the public in decision-making. This is important in ensuring agency accountability, given that administrative agencies can't rely on voters for legitimacy (Ludivine Petetin, "Book Review: *Democracy and Executive Power: Policymaking Accountability in the US, the UK, Germany, and France*," 14(3) *Eur. J. Risk Reg.* 631 (Sept. 2023)).

Others have considered how due process requirements may apply to international institutions. In his book *Due Process of Law Beyond the State: Requirements of Administrative Procedure* (2016), Giacinto Della Cananea describes how regional and global regulatory regimes have adopted procedural requirements similar to those mandated by many domestic laws — processes he suggests are grounded in concerns about protecting of individual interests against abuse of power and about good governance values. Jochen von Bernstorff notes "a growing uneasiness about the way public power is exercised beyond the national realm," and he has argued that "if formalized procedural constraints for the exercise of public authority are important at the national level they are all the more so at the international level since conflicts over substantive legal standards and disagreement over community values are usually more acute" ("Procedures of Decision-Making and the Role of Law in International Organizations," 9(11) *German L.J.* 1939 (2008)). That appears uniquely applicable to international tax rulemaking.

Legal Status of Administrative Guidance

Due process concerns aside, a separate series of questions revolves around the legal status of the OECD administrative guidance in different jurisdictions. A brief look at just a few countries'

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pillar 2 legislation and how those countries are incorporating the OECD guidance into law highlights the wide variability in approaches.

United Kingdom

The U.K. pillar 2 legislation implementing a multinational top-up tax doesn't specifically reference OECD administrative guidance. But it grants HM Treasury the power — as it deems necessary for ensuring consistency with the pillar 2 framework — to "make further provision" on the application of the OECD guidance to the law via "regulations made by statutory instrument." The law defines the pillar 2 framework to include not just the OECD model rules, but the commentary and any further commentaries or guidance published by the OECD relevant to the implementation of the model rules.

Last September, the United Kingdom made good on its commitment to incorporate OECD administrative guidance into law by publishing draft legislation with amendments to the initial minimum tax law (F(No.2)A 2023). The 2023 draft amendments appear to adopt the OECD's first two tranches of administrative guidance (issued in February and July of 2023) — including rules on tax equity partnerships and transferable credits — but were released too early to incorporate the OECD's December 2023 guidance. Moreover, whether the draft legislation — when ultimately enacted — will be retroactive to January 1, 2024, is not clear from the text.

EU Member Countries

EU member countries were required to transpose into law EU Council Directive 2022/2523 on the global minimum tax by December 31 of last year. The directive generally replicates the OECD pillar 2 model rules but has not been amended to take any administrative guidance into account. The European Council and the European Commission have attempted to reconcile that discrepancy with the need for consistent interpretation.

In a draft statement accompanying a note issued October 30, 2023, the council said that it "welcomes and supports the agreement reached by the Inclusive Framework on the clarifications concerning application of Pillar Two contained in the administrative guidance endorsed by the Inclusive Framework in December 2022, in February 2023 and in July 2023." (Given the timing, the statement doesn't mention the December 2023 administrative guidance.) It also welcomed the commission's view that the OECD administrative guidance (issued through July 2023) is compatible with the EU pillar 2 directive and said that EU member states needed to "ensure consistency" with this guidance when applying pillar 2, "in order to avoid non-alignment or applicability of diverging standards." And it noted "the intention of the EU Member States to follow this guidance when transposing the Pillar Two Directive into their national law in order to avoid divergences and inconsistencies in interpretation of the provisions of that Directive."

A separate statement from the commission, attached as an annex to the council's statement, emphasizes its "view that the administrative guidance endorsed by" the inclusive framework on base erosion and profit shifting in December 2022, February 2023, and July 2023 "is compatible with" the EU directive.

But those statements merely affirm the council's and the commission's beliefs that countries should interpret their domestic pillar 2 regimes in a manner consistent with the OECD guidance, and don't appear to have the force of law in any EU country. A caveat on the commission's webpage says that the information provided in its FAQs on pillar 2 "represents the outcome of informal reflections of the Commission Services and should, as such, not be interpreted as binding on the European Commission and the Member States."

The Netherlands

The Netherlands was the first EU country to introduce draft legislation implementing the pillar 2 directive, with an amended version introduced last May. In its explanation of the legislation, PwC noted that "the bill does not seem to comprehensively include the administrative guidelines" published by the OECD (PwC, "Pillar Two Bill Submitted to Dutch Parliament" (June 2023)). According to PwC, the Dutch explanatory memorandum on the law "refers to the guidance in a general sense, but the content of the

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guidelines cannot be comprehensively found throughout the legislative proposal."

Ireland

As part of its 2023 Finance Bill (No. 2) introduced last October, Ireland implemented pillar 2 by transposing the EU directive into Irish law.

Section 90 of the bill inserts a new Part 4A into the Irish tax law. The explanatory memorandum to the bill states that "a mechanism to incorporate reference to future iterations of OECD Pillar Two guidance by order of the Minister for Finance is also included."

The Irish bill doesn't have a definition of administrative guidance. But it does include a section (111B) on "principles for construing rules in accordance with OECD Pillar Two guidance." That section states that in calculating and administering the minimum top-up tax, the law is to be construed so as to ensure, as far as practicable, consistency between the effect that is to be given to the Irish minimum tax law and the effect that would be given if the OECD model rules were to be applied, in accordance with the OECD pillar 2 guidance, to the calculation and administration of those taxes.

OECD pillar 2 guidance is defined for this purpose to include the model rules, the commentary, and the first two tranches of OECD administrative guidance, plus any additional guidance published by the OECD that the finance minister designates by order "as being comprised in the OECD Pillar Two guidance."

Under Irish law, it appears that the minister of finance can designate any future guidance issued by the OECD as official OECD pillar 2 guidance for purposes of interpreting Irish law, but in the absence of that, the OECD guidance is not incorporated into law automatically.

Switzerland

Late last year, Switzerland decided not to directly enact the OECD model rules. Instead, as Deloitte has explained in a blog post, its minimum tax ordinance "refers statically to the OECD Model Rules" and "dynamically" to the commentary and the administrative guidance, without specifying any particular version of the guidance (Deloitte, "It's Official: Switzerland to Implement Pillar 2 in a Gradual Approach," Tax and Legal Blog, Dec. 22, 2023). According to Deloitte, this means that taxpayers subject to the law must consider any new documents or versions of the commentary that will be released by the OECD.

Ambulatory Theory of Interpretation

In its guidance for interpreting the OECD model treaty, the OECD indicated that it believes the interpretation should reflect not just the law and meaning of terms at the time a treaty was entered into, but how they may have been modified over time. At least some countries' adoption of pillar 2 into law may be incorporating such an ambulatory theory of interpretation.

Article 3(2) of the OECD model treaty provides:

> As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning . . . have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

The commentary to article 3(2) of the OECD model tax treaty states that "the wording of paragraph 2 provides a satisfactory balance between, on the one hand, the need to ensure the permanency of commitments entered into by States when signing a convention . . . and, on the other hand, the need to be able to apply the Convention in a convenient and practical way over time."

Under the ambulatory theory of interpretation, a term has its meaning under domestic law as periodically amended. According to Brian J. Arnold, who provided guidance to the U.N. in this area, the ambulatory approach "allows treaties to accommodate changes in domestic law without the need to renegotiate the treaty" (Arnold, "An Introduction to Tax Treaties"). But he also noted a "drawback" to this approach, namely that it "effectively permits a

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country to amend unilaterally its tax treaty with another country by changing certain parts of its domestic law."

Rebecca M. Kysar — who served as senior counselor at the U.S. Treasury during much of the time the pillar 2 rules were being negotiated — has described how the OECD commentaries to the model treaty provide an extrinsic source of treaty interpretation, while noting that "complex issues arise involving the commentaries since they are ambulatory in nature" (Kysar, "Interpreting Tax Treaties," 101 *Iowa L. Rev.* 1387, 1408 (2016)).

The pillar 2 rules are not a treaty, but applying the OECD's ambulatory theory of treaty interpretation would mean that in interpreting the model rules, tax authorities (and the courts) should be considering current administrative guidance, whether or not it has been formally adopted into domestic law. That approach gives the OECD wide sway over domestic law without the need — or room — for much political input.

Questions Without Answers

In their work on the pillar 2 model rules and interpretive guidance, both the Trump and Biden Treasury departments engaged in the development and negotiation of rules that directly affect U.S. taxpayers, with minimal congressional oversight and without having to follow any of the procedures for domestic rulemaking mandated by the APA, including providing revenue estimates.

That's because the APA does not apply to a process in which the executive branch — which has jurisdiction over foreign policy matters — negotiates rules that directly affect U.S. persons. Although there are suggestions for what due process in rulemaking by international organizations should look like, no specific rules apply now, nor is there a means of judicial review.

Few other countries have an oversight process for nonstatutory rulemaking that is as comprehensive as the APA, although many have similar due process requirements. These vary by country, as do the legal mechanisms that countries are adopting for incorporating the OECD's pillar 2 administrative guidance into domestic law.

The OECD has followed basic due process procedures in implementing the pillar 2 model rules and subsequent guidance. It has held some public consultation (although many believe not nearly enough). But none of that approaches the type of process mandated by the APA, and the organization has deliberately refrained from making public the revenue impacts on any individual country. Nor could it, because it must take into account not just U.S. comments but those from constituencies in countries with very different interests.

The lack of domestic oversight in tax rulemaking was in some sense precisely what the politicians who negotiated the pillar 2 agreement sought as they designed a minimum tax that couldn't be influenced by local constituencies with the ability to negotiate favorable corporate tax breaks. But that absence of oversight severs rulemaking — and in turn, its outcomes — from a public accountability that is key to democratic society. ■

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