G7 Deal Shields U.S. Firms From Some Pillar 2 Minimum Tax Rules

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The United States' G7 counterparts have agreed to not apply their pillar 2 global anti-base-erosion (GLOBE) rules to U.S.-parented groups, but those companies would still be in scope of qualified domestic minimum top-up taxes (QDMTTs).

In a joint statement issued June 28, the G7 said its members have agreed that the U.S. tax system and pillar 2 of the OECD's two-pillar global tax reform plan will sit "side-by-side."

Under the arrangement, which the United States proposed earlier this year, the domestic and foreign profits of U.S.-parented groups won't be subject to income inclusion rules and undertaxed profits rules because those groups are already subject to existing U.S. minimum tax rules, according to the statement. Canada, France, Germany, Italy, Japan, and the United Kingdom have implemented pillar 2.

The GLOBE rules, which consist of the IIR and the UTPR, are the main charging provisions under pillar 2. Most members of the inclusive framework on base erosion and profit shifting, including the United States, agreed in principle to the plan in October 2021.

The GLOBE rules create a top-up taxation framework that ensures that large multinational groups pay an effective tax rate of at least 15 percent in all jurisdictions in which they operate. Governments can also adopt domestic minimum top-up taxes that are qualified as in line with the GLOBE rules under a peer review process.

The U.S. global intangible low-taxed income regime inspired the design of the IIR but differs in that it applies on a blended worldwide basis, while the IIR applies on a jurisdictional basis. U.S.-headquartered companies are already subject to GILTI rules.

After analyzing the U.S. minimum tax regime and the pillar 2 system, "there is a shared understanding that a side-by-side system could preserve important gains made by jurisdictions in the Inclusive Framework in tackling base erosion and profit shifting and provide greater stability and certainty in the international tax system moving forward," the statement says.

G7 discussions on the "shared understanding" took into account amendments to the U.S. international tax system as proposed in the U.S. Senate's version of the reconciliation bill, the withdrawal of proposed section 899, and the implementation of QDMTTs, according to the statement.

"Work to deliver a side-by-side system would be undertaken alongside material simplifications being delivered to the overall Pillar 2 administration and compliance framework," the statement says.

The G7 will also consider aligning pillar 2's treatment of substance-based nonrefundable tax credits with the treatment of refundable tax credits, the statement adds.

"Delivery of a side-by-side system will facilitate further progress to stabilize the international tax system, including a constructive dialogue on the taxation of the digital economy and on preserving the tax sovereignty of all countries," the statement says.

The statement follows Treasury Secretary Scott Bessent's June 26 announcement that the G7 countries had reached a "joint understanding" under which pillar 2 taxes won't be levied on U.S. companies. In exchange, top Republican taxwriters agreed to scrap a controversial proposal to create section 899, which had been included in the tax-heavy reconciliation bill moving through Congress.

Section 899 would have allowed the U.S. government to retaliate against jurisdictions that enforce what it views as discriminatory taxes, including digital services taxes and UTPRs, by gradually increasing tax rates on individuals and businesses based in those jurisdictions.

All Aboard?

The G7 will discuss and develop its agreement with the broader inclusive framework "with a view to expeditiously reaching a solution that is acceptable and implementable to all," the statement says. The withdrawal of section 899 is key to the deal and will create a more stable environment for inclusive framework negotiations, it adds.

The constructive dialogue within the G7 aimed to lay the basis for a common path forward in both the inclusive framework and the EU, a German Finance Ministry spokesperson told *Tax Notes*.

The G7 agreement isn't perfect, but it's a good thing, a French official said. "The withdrawal of section 899 and the fact that the U.S. is engaging in the OECD process is excellent news," the official said.

Manal Corwin, director of the OECD's Centre for Tax Policy and Administration, pointed to the inclusive framework's statement following its April 7-10 meeting in Cape Town, South Africa, in which members said they recognized the importance of security, certainty, and stability, particularly in relation to pillar 2 implementation.

"Obviously, there was a recognition that a conversation needed to be had to move this forward," Corwin told *Tax Notes*. There is now an opportunity for the G7 to share with the inclusive framework how it reached its agreement to see if there is a path forward, she said. The first opportunity for those discussions could be during the July 9 inclusive framework steering group meeting, she added.

"I think everybody recognizes it's essential to move quickly," Corwin said, adding there are some pragmatic issues to address, including the expiration dates for pillar 2 safe harbors.

The G7 agreement provides a starting point for further talks in the inclusive framework, according to Corwin. That "allows for optimism that we can move forward to some form of agreement here, more broadly that really seals certainty and allows conversations to move on to other issues," she said.

The agreement provides much-needed certainty for British businesses, according to U.K. Chancellor of the Exchequer Rachel Reeves. "The G7 agrees there is work to be done in tackling aggressive tax planning and avoidance and ensuring a level-playing field," she said in a June 28 release. "The right environment for this work to happen is without the prospect of retaliatory taxation hanging over these talks, so the removal of Section 899 is welcome."

The business sector cheered the G7 deal, as well. The agreement "is a practical solution which acknowledges the comprehensive nature of the U.S. tax system and protects the interests of US business," the U.S. Council for International Business said in a June 27 statement.

"This development sets the stage for productive US engagement with the OECD and the Inclusive Framework to develop sound global tax policies that seek to eliminate double taxation and facilitate trade and investment," the council added.

The statement is a welcome development, Scott Levine of Baker McKenzie, told Tax Notes. G7 countries are acknowledging that the U.S. tax system is robust enough to address BEPS while ensuring a level playing field between U.S. and non-U.S. multinational enterprises, said Levine, who is a former Treasury deputy assistant secretary for international tax affairs.

"Such a system would turn off the intermediate IIR and UTPR on U.S. MNEs and their controlled foreign subsidiaries—something U.S.-parented groups were hoping for," Levine said. "It does, however, leave open the application of these rules to non-U.S.-parented groups including so-called sandwich structures."

The statement may also require that the final version of the reconciliation bill include the elimination of the qualified business asset investment exemption for GILTI purposes and the reduction of the section 250 GILTI deduction from 50 percent to 40 percent, Levine added.

"The commitment to ensure that U.S. MNEs are not given a strategic advantage over their foreign competitors may be leaving open potentially contentious issues relating to the treatment of QDMTTs on the foreign subsidiaries of U.S.-parented groups," Levine said. The statement suggests that the G7 is committed to the permanent safe harbor that is supposed to minimize compliance burdens associated with filing GLOBE information returns, according to Levine.

"The G7 also appears committed to level the playing field on incentives such that similar incentives are treated similarly and, thus, no longer using refundability as the essential characteristic for qualified status," Levine added.

Across the Atlantic

Bessent's June 26 announcement took observers in non-G7 EU countries by surprise. A recent tax conference in Washington "gave the impression that [section] 899 will be implemented no matter what," Krister Andersson, a member of the European Economic and Social Committee, told *Tax Notes* via text message.

Tove Maria Ryding of the European Network on Debt and Development also expressed surprise. She pointed out that the U.N. had just adopted an outcome document with a commitment to include developing countries in the tax decision-making process. "Who can believe that when we're at the same time receiving news that the G7 is making deals on global tax rules again!" she said.

However, the abandonment of section 899 is good news, according to Andersson. "It would have truly hurt investments and growth," he said.

Section 899 was worrisome for many European businesses based in countries with UTPRs and DSTs because it might be difficult to withdraw those measures, according to Grégory Jullien, Deloitte's EU tax policy director.

But questions remain about the deal's impact on the bloc's competitiveness and on the EU directive.

"We look forward to hearing more details and hope that resolving these international tensions will enable lawmakers to simplify tax policy in the EU to support Europe's competitiveness and provide space for transatlantic lawmakers to work together to deepen our economic ties," a spokesperson for the American Chamber of Commerce to the European Union said .

It will be particularly interesting from a legal standpoint to assess whether the implementation of the G7 agreement necessitates amendments to the EU pillar 2 directive (Council Directive (EU) 2022/2523), according to Jean-Philippe Van West of PwC Belgium.

"Such amendments require unanimity among all 27 Member States, and an agreement within the G7 does not automatically imply unanimity at the EU level," Van West said , recalling the challenges EU member states faced while trying to reach unanimity on adopting the EU pillar 2 directive. "Hence, implementation of the provisional joint understanding via changes to the EU pillar 2 directive could present a potential obstacle."

If implementation happens not through a revision of the pillar 2 directive but through, for example, updates to the OECD commentary on the GLOBE model rules, "questions may arise regarding the legal status of such changes," Van West added.

If the G7 agreement qualifies the GILTI regime as an IIR, "that would not be difficult to integrate into national legislations as there is a hook in the directive in relation to such recognitions, which should be automatically applied in member states," Jullien said.

Article 52 of the pillar 2 directive, which grants IIR equivalence to non-EU countries, relies on country-by-country blending, whereas the GILTI regime relies on global blending. A Dutch official said in April that an amendment to the directive would be needed if the GILTI regime in its current form was granted equivalence to the IIR. An extension of the UTPR safe harbor would be easier from the EU's perspective, the official said.

The European Parliament is negotiating a resolution on simplification that calls on the EU to protect the integrity of pillar 2. Kira Marie Peter-Hansen, a Danish member of the EP from the

Greens/European Free Alliance, urged the European Commission to stick to its commitment to pillar 2.

"It should stand firm on the agreement that all OECD jurisdictions, including the U.S., have negotiated and signed," Peter-Hansen said . "Changing the rules or exempting jurisdictions would undermine the whole foundation for international governance and cooperation," she added. "We need to be confident that when we do international agreements and rules, we also stick to them."

Elodie Lamer contributed to this article.