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Senator Rob Portman's Inadvertent, Profound Criticism of OECD's 15% Global Minimum Tax

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OVERVIEW

One of the major concerns with the OECD's Pillar Two project that seeks to see more than 100 countries impose a global 15% minimum tax on corporate groups with €750mm or more of gross revenues[1] is the central role accorded financial statement income in the architecture of the rules.

This commentary examines the significant support for those concerns provided (seemingly without intention) by Senator Rob Portman (R-Ohio) — in writing on the recently enacted Inflation Reduction Act — and in particular the new alternative 15% minimum tax on corporate groups with $1 billion or more of book (financial statement) net profit before tax.[2]

PILLAR TWO — BASIC PURPOSE AND THE PROBLEM WITH THE ARCHITECTURE

On December 21 of last year, the OECD issued draft "model rules" to implement an October 8, 2021 agreement (Pillar Two) of 136 countries to take steps to legislatively adopt a minimum tax of 15% on worldwide income.[3]

Pillar Two's primary notion (backed up where necessary by a secondary notion) is that, for example, if a foreign subsidiary of a Canadian multinational pays no local tax on its local income (say $100) the Canadian parent will pay to the Canadian government the excess of 15% of a modified portion of that local income (say $95) over the local tax which in this example is nil.

> The key mechanic in carrying out that illustrative determination is to identify the income amount ($100) by reference to the consolidated financial statements (with certain modifications). In particular, chapter 3 of the December 21, 2021 draft model rules stipulates:
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> Article 3.1.1 — The Globe income or loss of each Constituent Entity is the Financial Accounting Net Income or Loss determined for the Constituent Entity for the Fiscal Year adjusted.. . .
>
> Article 3.1.2 — Financial Accounting Net Income. . .is the net income. . .determined. . .in preparing Consolidated Financial Statement of the Ultimate Parent Entity.

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[1] For prior comments by this writer on Pillar Two, see Nathan Boidman, *Pillar Two: Effects on Canadian Multinationals*, 51 Tax Mgmt. Int'l J. No. 4 (Apr. 1, 2022), and *Pillar Two: Effects on Canadian Multinationals — Part 2*, 51 Tax Mgmt. Int'l J. No. 5 (May 6, 2022).

[2] Inflation Reduction Act, Pub. L. No. 117-169, §10101 (Aug. 16, 2022).

[3] OECD/G20 Base Erosion and Profit Shifting Project, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Oct. 8, 2021) and related *Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two)* (Dec. 21, 2021).

Furthermore, ''Consolidated Financial Statement'' is defined in chapter 10 as involving ''Acceptable Financial Accounting Standards,'' which in turn is defined as International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Practices (GAAP) of a great number of countries, including Canada and the United States.

There are, then, multiple subsidiary/supplement/supporting rules and definitions to flesh out the financial statement-based determination.

This approach generally has no place in Canada and at least several other countries including (generally) the United States, as discussed below. In Canada, for example, the Supreme Court wrote many years ago that: ''. . .courts have been reluctant to posit a. . .test based upon 'generally accepted accounting principles' (G.A.A.P). . . . Any reference to G.A.A.P connotes a degree of control to professional accountants which is inconsistent with a legal test for profit (under the Income Tax Act).[4] That, together with more general concerns that GAAP objectives differ from those underlying determining profits for tax purposes, comprise key aspects of the global concern about using financial statements to calculate the 15% obligation. Interestingly, these concerns were acknowledged as recently as August 9 by Canada's Department of Finance in a Consultation Paper issued on Canada's general anti-avoidance rule: ''. . .accounting standards are in constant evolution and subject to pressures of their own, standards may vary across jurisdictions and as between public and private firms, their application is based on professional judgment and, most importantly they are not legislated by Parliament.''[5]

INFLATION REDUCTION ACT AND SEN. PORTMAN'S CRITICISM

Relevance of the Inflation Reduction Act Book Income Tax

The Inflation Reduction Act that was enacted by Congress and signed by President Biden in August is relevant to the Pillar Two use of the book profit issue noted above because the central piece of the tax change portion of the Inflation Reduction Act is the use, as in Pillar Two, of book (financial statement) income as the base for levying an alternative minimum tax of 15% on companies with at least $1 billion of book (financial statement) income.

How Sen. Portman's Criticism of the Inflation Reduction Act Relates to Pillar Two

In a Wall Street Journal opinion piece on the Inflation Reduction Act, Sen. Portman appears to unintendedly support concerns about Pillar Two reliance on financial statements.

In particular, one of his key criticisms of the Schumer-Manchin (Inflation Reduction Act) proposal to levy a 15% alternative minimum tax on companies with book (finance statement) income of $1 billion or more should (apparently unintendedly) provide significant support to those in the United States (including Republican members of Congress) and those abroad who are opposed to Pillar Two.[6]

That key criticism is foreshadowed in the subtitle of Portman's piece: ''In the 1980s Congress realized the dangers of mixing reporting for tax and financial purposes. The Inflation Reduction Act repeats that old mistake.''

Portman goes on to explain that:

> The U.S. tried a minimum book tax in the 1986 tax reform, and Congress repealed it in 1989 because lawmakers realized the dangers of mixing reporting for tax and financial purposes. Two such dangers is that it creates an incentive for companies to alter their financial statements to reduce taxes and risks politicizing the body in charge of setting accounting standards, the Financial Accounting Standards Board, which should be kept free from lobbying.[7]

Well obviously without having Pillar Two in mind, Portman's concern in respect of the Inflation Reduction Act can and should be transported and raised as equally applicable to Pillar Two because as explained above, it, as in the case of the Inflation Reduction Act proposal, intends to determine the base, to which the global minimum tax is to apply, by reference to financial statement income.

Ironically, while it is not clear whether present obstacles (in both the United States and abroad) to con-

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[4] See *Canderel Ltd v Canada* [1998] 1 SCR 147 at para. 31. *See also The Queen v Friedberg* [1993] 2 C.TC. 306.

[5] *See Department of Finance of Canada: Modernizing and Strengthening the General Anti-Avoidance Rule — Consultation Paper* under the heading Different Accounting Treatment.

[6] *See* Rob Portman, *Schumer-Manchin Throws the Book Tax at U.S. Companies*, Wall St. J. (Aug. 4, 2022).

[7] For similar comments to Portman and in line with the Canadian Supreme Court and Department of Finance concerns noted above, see in this issue of TMIJ Jim Tobin's commentary, *Corporate Alternative Minimum Tax (CAMT) — International Aspects*, 51 Tax Mgmt. Int'l J. (Sept. 2, 2022). He writes in his opening paragraph, in this respect: ''Just too bad an idea! As discussed below, it is a minimum tax based on financial statement/book income, which I thought was acknowledged to be a bad idea — see the letter signed by 264 accounting professionals, see the repeal of the BURP adjustment in the 1980s, see the commentaries by Colleen O'Neill and Craig Hillier in this journal in 2021 etc., etc.''

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cluding the design of Pillar Two will be dissolved, it is likely that U.S. companies would be exempted from using financial statement income to fulfill their Pillar Two obligations because present negotiations indicate the United States will be able satisfy its Pillar Two obligations by using a modified version of its Global Intangible Low-Taxed Income rules (added by the 2017 Tax Cuts and Jobs Act) which are *not* based on book income.[8]

CONCLUDING COMMENT

Inadvertent or not, Sen. Portman's profound criticism of the book income part of the Inflation Reduction Act should resonate with, and provide support to, those who are opposed to Pillar Two in general or its reliance on financial statements in particular.

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[8] But that is not to say that, as detailed by Tobin (prior note), the Inflation Reduction Act book income rule will not apply to CFC income of in-scope U.S. groups (which, as noted earlier, is a much smaller number of groups than those to which Pillar Two would apply).

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