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Pillar Two: Effects on Canadian Multinationals

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I. OVERVIEW

This article examines three of the many situations that can arise where the OECD-sponsored/brokered 136-country agreement (dated October 8, 2021) respecting a 15% minimum tax (under the rubrique "Pillar Two") will affect Canadian-based multinational enterprises (MNEs) with foreign operations.[1] The objective of this examination is to identify the key relationships between the "Model Rules" — issued by OECD this past December 20, to implement the Pillar Two part of the October 8 agreement[2] — and Canada, which has undertaken to legislatively adopt the Model Rules.[3] Reference, where necessary, will also be made to the Commentary on the Model Rules ("Commentary") issued on March 14, 2022.[4]

Pillar Two — intended to see multinationals with at least €750 million of revenue pay tax of at least 15% on their foreign profits — stems from the project hatched by OECD and the G-20 in 2013 under the rubrique "Base Erosion Profit Shifting" (BEPS) to counter MNEs' international tax planning. A 15-step ("Action") plan (to be studied) was issued in mid-2013,[5] the very first Action of which was to developed tax rules for the "Digital Economy" (and in particular massively expand taxation of the digital giants). But firm proposals for Action 1 were not arrived at by October 2015 when the 15-step Action plan was otherwise completed and released,[6] and it (Action 1) was deferred for further study, culminating in the October 8, 2021, agreement to (1) extend, under "Pillar One," tax nexus (not arising under current domestic and treaty law) of countries in which multinationals have at least €1 million of revenue, to such multinationals if they have at least €20 billion of worldwide revenue and at least a 10% of sales profit margin, and (2) impose the Pillar Two 15% minimum tax, noted above.

As detailed below, the December 20 Model Rules deal with the two main (out of three) methods of imposing the minimum tax. One sees the country of the parent of the group impose the tax under the so-called "Income Inclusion Rule" (IIR) and the second, which only comes into play if the IIR is not effectuated, sees the countries where foreign subsidiaries operate impose the tax under the so-called "Undertaxed Payment Rule" (UTPR). These will be discussed below in

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[1] OECD/G-20 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).

[2] OECD, Tax Challenges Arising from the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two), Inclusive Framework on BEPS (OECD, Paris 2021).

[3] This discussion will not deal with the policy issues raised by Canada's decision to support and implement Pillar Two. For that, see Nathan Boidman, *OECD Minimum Tax Deal Will See Canada Reduce or Cannibalize Its Own GDP*, Tax Notes Int'l, Nov. 15, 2021, p. 775.

[4] OECD, Tax Challenges Arising from the Digitalisation of the Economy — Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two) (OECD, Paris 2022).

[5] *See* Nathan Boidman and Michael Kandev, *BEPS: The OECD Discovers America?*, Tax Notes Int'l, Dec. 16, 2013, p. 1017.

[6] *See* Nathan Boidman and Michael Kandev, *BEPS: A Spent Force or Radical Change?*, Tax Notes Int'l, Dec. 7, 2015, p. 837.

the Canadian context. The third (treaty-related) method, tailored to the needs of underdeveloped countries — the ''Subject to Tax Rule'' — is not dealt with in the December 20 release or below.

Finally, by way of overview, four factors should be noted.

First, Pillar One is a perfectly relevant approach to the mandate raised in Action 1 in 2013 and should serve to avoid a war of competing digital sales tax regimes such as Canada plans to implement if Pillar One is not in force by January 1, 2024. But, second, its final design set out in the October 8, 2021, agreement is not restricted to digital companies; it will apply to any group with the numbers just noted. Third, Pillar Two is a perfectly *irrelevant* approach to the mandate raised in Action One in 2013 and may have been promoted to dissolve initial opposition to Pillar One. Fourth, as reflected and underscored in a January 6 letter from the BIAC (Business and Industry Advisory Committee) to OECD[7] and seen in the discussion below, the December 20 Model Rule release is complex, dense and infected by design or drafting errors — yet, its Meccano set[8] approach, once penetrated, makes the principal effects and operation of the rules (if not the myriad endless minor/obscure ones), in relation to a set of facts (not in a vacuum) relatively easy to determine and see. Furthermore, the just-issued Commentary and a forthcoming Implementation Framework may ameliorate some of the issues on the table.

II. APPLYING PILLAR TWO TO CANADIAN MULTINATIONALS

A. The Illustrative Structure

The hypothetical Canadian multinational structure/situation used herein to illustrate the operation of the Model Rules for Pillar Two and how they can adversely affect Canadian-based MNEs doing business abroad and at present — prior to Pillar Two coming into effect — paying less than 15% tax (anywhere, including Canada under its foreign affiliate system — see also Note 7) on portions of their pre-tax foreign income is as follows.

A widely held Canadian formed and based corporation (CanPubco): (1) directly owns a Bermuda subsidiary (that owns and operates auto dealerships in Bermuda, paying no Bermuda tax in its annual profit of $200) and (2) indirectly owns (through a Canadian wholly owned subsidiary (CanSubco)) a USA group (USA Holdco and USA Opco) that is partially funded by a Third Country finance company that is also owned by CanSubco and which receives $100 of interest that reduces USA taxable profits of USA Opco, attracts no withholding tax under the Third Country USA treaty and incurs 10% tax in Third Country. USA Opco also owns a Bahamian distribution/trading company that pays no tax in Bahamas on its $300 profit but which attracts, in the hands of USA Opco, U.S. tax of 10.5% tax under the current U.S. Global Intangible Low-Tax Income (GILTI) rules, with President Biden trying to increase that rate above 15% to comport with Pillar Two. (The related assumption here is that the Bahamian profit does not comprise Subpart F Income under the U.S. Code that would attract, under current law, 21% U.S. tax in the hands of USA Opco — not 10.5%.) Finally, it is assumed that the group's annual revenue is €750MM or more.

B. Initial Factors and Nomenclature

In general terms, it is well understood that Pillar Two is supposed to increase the 10% tax on Third Country interest income to 15%, increase the 0% tax on the Bermuda profits to 15% and the 10.5% tax on the Bahamian profits to 15%.

The object here is to see how the dense rules put out on December 20 would lead to that. That the rules are dense may become apparent by reviewing the multiple nomenclature given to the players. In the illustrative structure, CanPubco is accorded three titles:

- ''Ultimate Parent Entity'' (UPE), as defined in article 1.4.1(a) of the Model Rules;
- ''Parent Entity'' (PE), as defined on page 62 of the rules; and
- ''Constituent Entity'' (CE), as defined in article 1.3.

And its subsidiary CanSubco is accorded three titles:

- ''Intermediate Parent Entity'' (IPE), as defined on page 58;
- PE; and
- CE.

The Third Country finance sub is simply a CE as are the two offshore subs. That they are also apparently ''Low-Taxed Constituent Entities'' seems, as explained below, meaningless.

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[7] Michael Rapoport and Isabel Gottlieb, *OECD Rules on Minimum Tax Are Too Complex, Advisory Group Says*, Bloomberg Daily Tax Rpt. (Jan. 6, 2022). See also Isabel Gottlieb,*Companies Eager to See Details on Minimum Tax Simplifications*, Bloomberg Daily Tax Rpt. (Mar. 23, 2022).

[8] Meccano is a brand of model construction system created in 1898 by Frank Hornby in Liverpool, United Kingdom. The system consists of reusable metal strips, plates, angle girders, wheels, axles and gears, and plastic parts that are connected using nuts and bolts. Wikipedia.

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The two USA subs are both IPE and CE.

The hypothetical group is subject to the Pillar Two rules because:

(1) It comprises a ''MNE Group'' as defined in article 1.2.1, because it has at least one non-Canadian member; and

(2) (We are assuming) the group's aggregate revenues (without intercompany sales, that is as shown on ''the Consolidated Financial Statements'' (as defined on Model Rules page 53) of the UPE of the group (Canadian Pubco in schematic)) meets the minimum €750mm threshold (see article 1.1.1).

There is an ostensibly pivotal term (referred to above) — ''Low-Taxed Constituent Entity'' (page 60) (not to be confused with little-used term ''Low-Tax Entity'') — which would ostensibly apply to the two tax-haven subs and the Third Country sub. It is defined as ''a Constituent Entity of the MNE Group that is located in a Low-Tax Jurisdiction [defined on page 60 as ''a jurisdiction where the MNE Group has Net GloBE [Global Anti-Base Erosion] Income and is subject to an Effective Tax Rate (as determined under Chapter 5). . .that is lower than the Minimum Rate'' [also defined on page 60, as 15%]]. . .has GloBE Income and is subject to an Effective Tax Rate. . .that is lower than the Minimum Rate.'' (The duplication of the wording is inexplicable.) But, as discussed below, this term (LTCE) is not used and/or needed in applying the key rules discussed and appears to be a design/drafting error.

Article 10.3 provides for ''Location of an Entity and a Permanent Establishment.'' Under article 10.3.1., all entities in the illustrative structure apparently would be considered located in the named jurisdiction. That article reads:

> The location of an Entity [which is defined at page 56 as any legal person other than a natural person or an arrangement that prepares separate financial statements, such as a partnership or trust] that is not a Flow-through Entity [a defined term] is determined as follows:
>
> (a) if it is a tax resident in a jurisdiction based on its place of management, place of creation or similar criteria, it is located in that jurisdiction; and
>
> (b) in other cases, it is located in the jurisdiction in which it was created.

Finally, by way of overview, note that the analysis through sections C, D, and E is based on the assumptions that Canada does fully enact Pillar Two and there is no change in current tax law in the Bahamas, Bermuda, and Third Country. But section F deals with the alternate assumptions.

C. Applying the Rules in Respect of Bermuda Subsidiary

Of the new tax liabilities raised by Pillar Two for the group, the simplest to follow through the Model Rules is the liability respecting the Bermuda sub: $30 (15% of its profit of $200 without regard to permitted deductions (explained below) calculated by reference to payroll and tangible property) to be paid by CanPubco to Canada (if Canada has adopted Pillar Two).

To arrive at that $30 tax liability, the Model Rules require the following steps.

First is using chapter 3 to compute the relevant (''GloBE'') income of Bermuda sub as a Constituent Entity, with article 3.1.1 specifying the basic rule that the group's net income (determined under Financial Accounting rules) is defined in article 3.1.2 as the amount determined for the Consolidated Financial Statements of the UPE (CanPubco) adjusted for nine items in article 3.2.1. But none of these references appear to be relevant here. Article 3.2.2 deals with an election for stock-based compensation, assumed away here as are narrow adjustments under articles 3.2.3 to 3.2.11. Article 3.3 deals with excludible international-shipping income; 3.4 with branch matters; and 3.5 with flow-through entities.

Therefore, in this scenario, the chapter 3 income is $200, and chapter 3 does not purport to reduce that amount by reference to certain deductions for payroll and tangible property of Bermuda sub. That is brought up in chapter 5 as explained below. Note that if there were more than one subsidiary in Bermuda, the chapter 3 rules would be run for each subsidiary.

Second, a computation is to be made in chapter 4 of the amount of tax incurred by Bermuda sub in respect of its chapter 3 income of $200. Obviously, given Bermuda law and the inapplicability of FAPI (see note 9 and related text) here, that will be zero. The main mechanics are as follows.

Article 4.2 sets out the kind of taxes that would be taken into account, termed ''Covered Taxes.'' The principal type (under article 4.2.1(a)) is ''taxes recorded in the financial accounts of a Constituent Entity with respect to its income or profits or it's share of income or profits of a constituent entry in which it owns an equity interest.'' Then article 4.1.1 calculates the ''Adjusted Covered Taxes'' of the Constituent Entity as being ''equal to the current tax expense accrued in its Financial Accounting Net Income (see definition on page 56, referring back to article 3.1.2, described above) with respect to Covered Taxes (as adjusted by a number of discreet factors including deferred taxes set out in 4.1.2 to 4.1.5).

Naturally, none of this gives any amount of Adjusted Covered Taxes in Bermuda. Nor does article

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4.3, dealing with ‘‘allocation of Covered Taxes from one Constituent Entity to another Constituent Entity’’ — because no FAPI-related Canadian taxes should arise in the assumed situation.[9] Nor does article 4.4 dealing with ‘‘mechanism to address temporary differences or its elective substitute in 4.5 dealing with ‘‘the Globe Loss Election’’ apply. Nor does article 4.6 dealing with ‘‘Post-Filing Adjustments and Tax-Rate Changes’’ which relates to reductions of tax rates apply. Therefore, the chapter 4 taxes of Bermuda sub are zero.

That leads to chapter 5, which brings together chapter 3 income (here $200) and chapter 4 taxes (here zero) — again, that would be done for each subsidiary in Bermuda if there were more than one, aggregating the numbers — and which computes the amount of Pillar Two taxes that the group will have to pay after reducing the chapter 3 income by reason of a deduction in respect of payroll and tangible property.

That amount of Pillar Two taxes is called a ‘‘Top-up Tax.’’ Here, ignoring the deduction for payroll and property, the Top-up Tax is $30. The exact way of getting to that $30 is discussed next.

First, article 5.1.2 requires that the chapter 3 incomes or losses of all Constituent Entities in Bermuda be aggregated into one number. Here, there is only one Bermuda entity and the number is $200.

Second, article 5.11 requires the calculation of the ‘‘Effective Tax Rate’’ (ETR) for Bermuda by dividing the aggregate chapter 4 Adjusted Covered Taxes (here zero) by aggregate income computed in article 5.1.2 ($200).

That gives rise to a 0% ETR.

Third, article 5.2.1 requires the calculation of a ‘‘Top-up Tax Percentage’’ (TTP) which is simply the excess of the 15% minimum tax over the ETR, which here is zero. Therefore, the TTP is 15% which will be applied to the Relevant Income Amount (in our case $200 where we ignore deductions for payroll and for tangible property) to arrive under article 5.2.3 at the ‘‘Jurisdictional Top-up Tax’’ of $30. That is then allocated by article 5.2.4 to each constituent entity in Bermuda to arrive at the Top-up Tax for each Constituent Entity based on their respective chapter 3 income.

Here, since there is only one Bermuda sub, we arrive under article 5.2.4 at $30 as the Top-up Tax of the Bermuda subsidiary in this illustrative situation.

Not noted above is the following. In the third point above, there is reference to the ‘‘Relevant Income Amount.’’ The actual text, in article 5.2.2, refers to the ‘‘Excess Profit.’’ That is the excess of the aggregate incomes described in the first point above (from 5.1.2) over the deductions allowed for payroll and tangible property to which there is reference above but which were ignored in the illustrative calculation. Those deductions are provided in article 5.3, ‘‘Substance-Based Income Exclusion.’’ Article 5.3.1 calls for a reduction (that takes place in 5.2.2) of the chapter 3 income by the ‘‘Substance-Based Income Exclusion.’’ Article 5.3.2 says that is the aggregate of the ‘‘Payroll Carve-Out’’ and the ‘‘Tangible-Asset Carve-Out,’’ which are defined respectively in article 5.3.3 as 5% of eligible payroll and in 5.3.4 as 5% of the carrying value of eligible assets incurred in and used in carrying on the Bermuda sub's auto dealership business. The percentage is initially 10% of local payroll, and 8% of tangible assets reducing steadily over 10 years down to 5% of each.

Finally, chapter 5 has a variety of assessor rules not relevant to this illustrative situation.

That leads to the last piece, chapter 2 determining which member of the group will pay the $30 Top-up Tax and to whom.

The answer is obvious — if Canada has legislatively adopted the rules. They will lead to CanPubco being the Obliger. (The answer will not necessarily be so obvious when the USA/Third Country situation is dealt with.)

In looking at the rules, bear in mind that the only owner of Bermuda sub is CanPubco, which has the status of being both Ultimate Parent Entity and Parent Entity of Bermuda sub. As with many of these rules, the chapter 2 rules are circular, redundant, and confusing.

According to article 2.1.1, the UPE will pay its ‘‘Allocable Share’’ of the Top-up Tax (of $30).

But the article 2.2 rules for ‘‘Allocation of Top-Up Tax under the IIR’’ make no reference to a UPE. (The reference to IIR requires reference to the Model Rules, page 58, which says, in a circular fashion, the ‘‘IIR means the rules set out in Article 2.1 to Article 2.3.’’ IIR is the acronym for ‘‘Income Inclusion Rule,’’ words last seen in the October 8 agreement and seen nowhere in the December 20 Model Rules.) Instead, Model Rules article 2.2 deals with allocating to Parent Entities, which is also status of the CanPubco — and article 2.1.6 brings us full circle by providing that ‘‘a Parent Entity located in [Canada] shall apply the provisions of Articles 2.1.1 to 2.1.5 with respect to a Low-Taxed Constituent Entity that is not located in [Canada].’’ That will take us back to articles 2.2.1 and 2.2.2, which will allocate to CanPubco as ‘‘Parent Entity’’ an ‘‘Inclusion Ratio’’ of 100% of the

[9] FAPI (standing for Foreign Accrual Property Income) is the Canadian counterpart (under §95 of the *Canadian Income Tax Act*) to Subpart F income under the U.S. Internal Revenue Code and, like the latter under Code §954(c)(6), does not (by reason of §95(2)(a)(ii) of the *Canadian Act*) include foreign intercompany interest payments stemming from the active business profits of the paying party.

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Top-up Tax calculated in chapter 5 because it owns all of Bermuda sub.

If Canada has not enacted the rules, will the UTPR somehow apply? See II.F., below.

When the balance of the structure is examined, there will be two competing Parent Entities and how article 2.3 (IIR Offset Mechanism) will resolve that overlap remains to be seen.

Finally, in the chapter 2 rules for allocating the Top-up Tax, there appears to be a fundamental design or drafting error, but one that, ironically, does not affect the operation of the rules, if ignored. Given that the Top-up Tax allocated in chapter 2 is calculated in chapters 3 to 5 by rules that never refer to ''Low-Taxed Constituent Entity'' or ''Low-Tax Jurisdiction,'' it appears that the chapter 2 references to ''Low-Taxed Constituent Entity'' are neither necessary nor have any effect. And, wherever chapter 2 refers to ''Low-Taxed Constituent Entity,'' it could have merely referred to ''Constituent Entity.''

If that is correct, it may be explained by fact that, like the term ''Controlled Foreign Corporation'' in the United States or ''Controlled Foreign Affiliate'' in Canada, the two Pillar terms are ''*vis-à-vis*'' terms — not standalone terms — as they both depend upon the term ''Effective Tax Rate,'' which also is a *vis-à-vis* notion (not a standalone notion) and also depends solely on the personal facts dealt with in chapters 3 and 4. This is not picked up in the Commentary.

D. Applying the Rules in Respect of the Third Country Finance Subsidiary

This section will deal with the Third Country finance subsidiary and its intercompany interest income of $1,000 received from the USA Holdco, which is assumed deductible for USA tax purposes, not subject to USA withholding tax by reason of the USA-Third Country treaty, subject to 10% tax in the Third Country, and not subject to taxes in Canada at any point in time, including when the net $900 is distributed to CanSubco.

The objective of Pillar Two is to raise the group's overall taxes on that $1,000 from $100 to $150 so that it meets the 15% minimum.

This section will examine how the Model Rules lead to that result, borrowing where possible from the prior discussions.

The starting point is the chapter 3 rules seen previously for computing the ''GloBE Income'' of $1,000. No new complexity here.

Then the Adjusted Covered Tax would be determined under the same chapter 4 rules, comprising $100. The discussion above in note 9 and related text would be relevant here.

The analysis then goes to chapter 5 to (1) compute the Effective Tax Rate of 10% [$100 divided by $1,000], (2) compute the Top-up percentage of 5% [the minimum tax of 15% less the ETR of 10%], and (3) compute the Top-up Tax in respect of the finance sub of $50 [the 5% times the $1,000]. Note it is assumed that the sub has no eligible and/or material payroll or tangible property for purposes of reducing the $1,000 under article 5(3) as previously discussed.

This then leads to chapter 2 to determine who will pay the $50. Will it be CanSubco paying to Canada applying the rules explained earlier if Canada has enacted these rules? If Canada hasn't done so, will it be the USA sub paying to the USA as discussed below?

Having regard to the prior discussion, if Canada has enacted these rules, the $50 will be allocated to and paid (to Canada) by the Canadian Parent Entity. See chapter 1 and articles 2.1.6 and 2.2. But there are two Parent Entities *vis-à-vis* the Third Country sub: the two Canadian corps.

How is this duplication resolved? Article 2.3 makes CanSubco the relevant parent by invoking its status as an Intermediate Parent Entity *vis-à-vis* the Third County sub and it is CanSubco that will pay the $50 Top-up Tax.

E. Applying the Rules in Respect of the Bahamian Trading Subsidiary

This section considers the operation of the Model Rules in respect of the last of the three scenarios, namely the earnings (of $300) by the Bahamian trading subsidiary of the USA Opco which is not taxed in the Bahamas but is taxed in the hands of USA Opco on an attribution basis under the USA Global Intangible Low-Taxed Income (GILTI) rules as originally enacted under President Trump in 2017 at the rate of 10.5% (on $300, producing $31.50 of tax). The bill that President Biden is trying to enact, but is stuck in legislative traffic, would increase the rate to just above 15% (the Pillar Two target which ironically was inspired by GILTI).

Presumably, the December 20 rules would seek to increase the overall tax on the Bahamian sub's income from 10.5% to 15% — an increase of 4.5% (on the $300, from $31.50 to $45.00). That $13.50 increase would presumably be the chapter 5 Top-up Tax for allocation (under the chapter 2 Income Inclusion Rules) to the Canadian owners.

Do the rules work that way?

The $300 income would be picked up under chapter 3, operating as seen previously.

What would be the chapter 4 Covered Income Taxes? Obviously, none is imposed by Bahamas.

But the $31.50 GILTI tax paid to the USA would be added in, as Covered Taxes for chapter 4 by article

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4.3.1 which is an introduction to the ''allocation of CFC taxes from one Constituent Entity to another'' as provided for in Model Rules article 4.3.2, where paragraph (c) reads as follows:

> in the case of a Constituent Entity whose Constituent Entity-owners are subject to a Controlled Foreign Company Tax Regime, the amount of any Covered Taxes included in the financial accounts of its direct or indirect Constituent Entity-owners under a Controlled Foreign Company Tax Regime on their share of Controlled Foreign Company's income are allocated to the Constituent Entity.

The terms ''Controlled Foreign Company Tax Regime'' and ''Constituent Entity Owner'' are defined (at page 54) in such a way as to pick up the USA GILTI rules.

Therefore, under the foregoing, the amount for the chapter 4 Covered Tax rules would be $31.50, and then — applying chapter 5 (and leaving aside the article 5.3 deduction for payroll and tangible assets) in the fashion already seen — the Effective Tax Rate would be 10.5%, the Top-up Tax Rate would be 4.5%, and the Top-up Tax would be $13.50. Under chapter 2 that would, in the fashion seen above, be allocated to CanSubco, which would pay it to Canada, if the rules have been enacted. If they haven't, consideration would be given to the UPTR Regime discussed next.

F. The UTPR Regime and Possible Host Country Tax Impositions or Increases (Domestic Minimum Tax)

In any of the three scenarios discussed above, there are two situations that will not result in minimum tax payments to Canada.

One is where Canada has not enacted the Pillar Two rules so that no Top-up Tax is paid to Canada, and instead all or part of it will be paid by the group to one or more foreign countries under the ''Undertaxed Payment Rules'' referred to in the October 8, 2021, agreement but only by the acronym ''UTPR'' in the December 20 Model Rules.

There is some confusion with the nomenclature that was not addressed by the Commentary which also refers only to the acronym. The confusion arose because of a mysterious statement in paragraph 7.1 of a document issued by the U.K. government[10] respecting its plans to implement Pillar Two — that UTPR now stands for ''Undertaxed Profits Rule.'' This view is also seen in a draft EU directive to implement Pillar Two.[11]

The basic UTPR framework is as follows:

- Article 2.5.1 stipulates that the Top-up Taxes determined in chapter 5 and allocated above to the Canadian parents is also to be treated as a tax to be paid under the UTPR rubrique.
- But then, article 2.5.2 says that if Canada has enacted the rules (and has in a ''Qualified IIR'' as defined) so that the Top-up Taxes have been paid to Canada, the amount for article 2.5.1 will be deemed nil (and there will be no further application of the rules related to UPTR).
- If, however, Canada has not enacted the IIR rules, the article 2.5.1 amounts (which is called the UTPR Top-up Tax Amount) will be dealt with as follows.
- Article 2.6 (titled ''Allocation of Top-up Tax for the UTPR'') says the UTPR Top-up Tax Amount is to be allocated to each jurisdiction that has enacted these rules (a UTPR Jurisdiction) by determining a percentage termed the ''jurisdiction's UTPR percentage'' (to be applied to the Top-up Amount) by the following formula: add (1) 50% of the percentage obtained by dividing the number of employees in the particular jurisdiction by the number of all employees in all UTPR Jurisdictions and (2) 50% of the percentage obtained by dividing the value of the tangible assets in the particular jurisdiction by the aggregate value of tangible assets in all UTPR Jurisdictions.
- That seems to lead back to the basic UTPR rule in article 2.4, which says that in order for the allocated portion of the Top-up Tax (under the 2.6 allocation) to be paid, for example, to the USA, a Constituent Entity in the USA (either USA Holdco or Opco) shall be denied a deduction (or required to make an equivalent adjustment under domestic law) in an amount resulting in those Constituent Entities having an additional Cash Tax Expense equal to the UTPR Top-up Tax Amount allocated to that country (under 2.6).

Do these rules make much sense? What ''payment'' has been undertaxed? Do the rules specifically point to the interest payments by USA to the Third Country subsidiary? Apparently no. But shouldn't that be the

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[10] HM Treasury, OECD Pillar 2 Consultation on implementation (Jan. 11, 2022).

[11] March 12 amended draft EU directive on Pillar Two, Loyens & Loeff, *Global Minimum Taxation (Pillar 2): OECD Commentary and Consultation and Updated Draft EU Directive* (Mar. 16, 2022).

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nexus seen to be mandated by the October 8, 2021, language? Without that, the UPTR appear to depart from the mandate and produce random and irrational results. For example, consider the Bermuda scenario above where the $30 Top-up Tax would be paid by CanPubco on the assumption that Canada enacts the rules and therefore never considered whether the UTPR could apply. But given the apparent random nature of these rules and their departure from the October 8 mandate, they seem to create a U.S. tax liability respecting activities in Bermuda have absolutely nothing to do with USA. This is very puzzling. Finally, are these inconsistencies and uncertainties reduced if the U.K. and EU initiatives referred to above are adopted by the Inclusive Framework?[12]

The second situation (one that is obvious) where no Top-up Tax will be paid to Canada is where the relevant low-tax country (in our three situations — Bahamas, Bermuda, and Third Country) have enacted taxes or increased their taxes to a 15% level, leaving no room for a Top-up Tax to be imposed by Canada. This could be done through purely domestic legislation or enacting focused rules contained in the December 20 Model Rules.[13]

III. CONCLUDING COMMENTS

The foregoing discussion of the effects of the December 20 Model Rules to implement Pillar Two on Canadian-based multinationals indicates three interrelated points.

First — viewed in a vacuum, the rules are complicated and dense to the point of being unworkable.

Second — when, however, they are applied to a simple set of facts, they appear to provide, accurately, the results intended. This is particularly so where a country, say Canada, has legislatively adopted Pillar Two so that it is the IIR (not the UTPR) that govern the results for, say, Canadian-based multinationals.

Third — reference will be required to the forthcoming guidelines for implementation to confirm the accuracy of the Canadian-related discussion above.

Separately, it should be borne in mind that the foregoing does not touch much of the details in the Model Rules[14] nor whether or how the rules (and in particular the UTPR) will raise tax revenue for Canada from foreign-based multinationals operating in Canada.

[12] A New Zealand delegate to OECD Working Party 11, Casey Plunket (Special Policy Advisor Inland Revenue, New Zealand), writes (in response to Jinyan Li, *The Pillar 2 Undertaxed Payments Rule Departs from International Consensus and Tax Treaties*, Tax Notes Int'l, Mar. 21, 2022, p. 1401) that there is no such uncertainty nor departure at all, that the December 20 Model rules on UPTR were clearly authorized in the October 8 Agreement even though the latter did not address the need to change payments to profits in UPTR in order to conform the name and content of UPTR — although, he says, the matter was discussed but left unresolved. See Casey Plunket, *What's in a Name? The Undertaxed Profits Rule*, Tax Notes Int'l, Mar. 28, 2022, p. 1507.

[13] See element (d) in article 5.2.3 and the definition ''Qualified Domestic Minimum Top up Tax.'' *See* Jeff VanderWolk, *Global Minimum Taxation for Large Multinationals*, Bloomberg, Jan. 3, 2022; and Noam Noked, *The Case For Domestic Minimum Taxes on Multinationals*, Tax Notes Int'l, Feb. 7, 2022, p. 667.

[14] For example, the foregoing refers to but does not discuss the effects where private investment structures are involved. A useful synoptic comment thereon was made by VanderWolk (above note 13) who noted the specific carve-outs (for non-profits, government entities, pension funds, etc.) but that ''there does not appear to be a carve-out for other LLP types of private investment structures, e.g., a trust or foundation for the benefit of a family that holds its investments in special purpose entities.'' Another example is the way in which investment tax credits or incentives may affect the determinations. See the Commentary on '' Qualified IIR'' at page 212 and 213.

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