JURNAL PAJAK INDONESIA
(Indonesian Tax Journal)
www.jurnal.stan.ac.id/index.php/JPI

OECD/G20 TWO-PILLAR SOLUTION: DOES IT PROMOTE INTER-NATION EQUITY?

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INFORMASI ARTIKEL

Diterima Pertama
[10 11 2022]

Dinyatakan Diterima
[24 11 2022]

KATA KUNCI:
Inter-nation equity, Pillar One, Pillar Two, OECD, income redistribution, developing countries

KLASIFIKASI JEL:
H24

ABSTRACT

International tax reform through Pillar One and Pillar Two aims to address BEPS issues, in addition to the 15 BEPS Actions previously recommended by the OECD and G20. In this regard, the two-pillar solution is expected to bring global tax justice into reality by ensuring MNEs pay a fair share of taxes. Within an international context, redistribution through achieving inter-nation equity is as crucial as the other aspects of equity despite the little attention received. Therefore, as a mix of doctrinal research and reform-oriented research, this study seeks to investigate whether the two-pillar solution promotes inter-nation equity. Based on the analysis of the entitlement approach and the differentiation approach, Pillar One seems to contribute better to the inter-nation equity than Pillar Two. However, the complexities surrounding Pillar One are likely to set back its positive impact. Meanwhile, a lot more efforts are needed to direct Pillar Two closer to inter-nation equity, having regard to the relatively more benefit of it for developed countries than the developing ones.

ABSTRAK

Reformasi perpajakan internasional melalui Pilar Satu dan Pilar Dua bertujuan untuk mengatasi masalah BEPS, di samping 15 Aksi BEPS yang direkomendasikan sebelumnya oleh OECD dan G20. Dalam hal ini, solusi dua pilar diharapkan dapat mewujudkan keadilan pajak global dengan memastikan MNE membayar bagian pajak yang adil. Dalam konteks internasional, redistribusi melalui pencapaian kesetaraan antar negara sama pentingnya dengan aspek-aspek keadilan lainnya meskipun hanya sedikit perhatian yang diterima. Oleh karena itu, penelitian yang mengombinasikan riset doktrinal dan riset berorientasi reformasi/perbaikan ini berusaha untuk menyelidiki apakah *two-pillar solution* mempromosikan kesetaraan antar negara. Berdasarkan analisis pendekatan *entitlement* dan pendekatan diferensiasi, Pilar Satu tampaknya memberikan kontribusi yang lebih baik terhadap pemerataan antarnegara daripada Pilar Dua. Namun, kompleksitas seputar Pilar Satu cenderung menghambat dampak positifnya. Sementara itu, diperlukan lebih banyak upaya untuk mendekatkan Pilar Dua kepada pemerataan antarnegara, mengingat manfaatnya yang relatif lebih besar bagi negara maju daripada negara berkembang.

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1. INTRODUCTION

Base Erosion and Profit Shifting (BEPS) has been the central issue of the international tax regime for decades. In 2015, the efforts to tackle has received global attention and resulted in massive works by the Organisation for Economic Co-operation and Development (OECD), through the delivery of 15 BEPS Action Plans. Unfortunately, there are still gaps in taxing cross-border transactions, which have not been solved after the release and implementation of those plans.

The OECD, mandated by the G20, then sought proposals to overcome those issues. And, as of November 2021, 137 jurisdictions have joined a statement on a two-pillar solution to address tax challenges arising from the digitalization of the economy (OECD, 2021a). Pillar One has a particular mechanism to allocate the taxing right to market jurisdiction. Even though it initially targeted the highly digitalized business, the current design of Pillar One has not been limited to such. Pillar Two, with a focus on addressing the remaining BEPS issue, includes tools to ensure multinational enterprises (MNEs) wherever they operate pay corporate income taxes of 15% at a minimum. The two-pillar solution operates to ensure for a fairer distribution of profits and taxing rights between countries with respect to largest MNEs (OECD, 2021c), thus curbing the BEPS issue within the international context.

As the key issue over the past few years (Hemmels, 2015), fairness is multi perspectives (Navarro, 2021). The first perspective is inter-taxpayer equity, which refers to the ability-to-pay principle. Second is inter-nation equity, in which the economic allegiance paradigms, the benefit principle, and the value creation concept would support the allocation of taxing rights. Corresponding to the latter, Musgrave and Musgrave (1972, as cited in Infanti, 2013), who discuss four different approaches to justify taxation in the source jurisdiction, also emphasize the redistribution approach, in addition to benefit taxation, source-based taxation, and national rental charges. Concerning the redistribution approach, they emphasize the possibility of inter-nation equity becoming an instrument for international redistribution.

Further, as a representation of the equity principle, which forms a good international tax policy feature, there are several reasons why inter-nation equity is crucial. Li (2009) emphasizes its superiority as a policy framework over the neutrality principle, and its absence is hardly justified. Meanwhile, Ozai (2020) highlights its concern toward redistribution that is relevant to domestic resource mobilization initiatives (Ozai, 2020). This is because all states are not equal and tend to vary significantly when it comes to resources and power (Ring, 2009, as cited in Infanti, 2013).

Recent research of the two-pillar solution has discussed the fairness issues of Pillar One and/or Pillar Two (i.e. de la Feria, 2022; Latif, 2022; Kanervo, 2021; Apriliasari, 2021; Vella, et al., 2021; Rootsma, 2021; Voorhoeve, 2021; Castro, 2020). However, only a limited number of which has also evaluated the inter-nation equity aspect, which mostly turned out to focus on Pillar One by focusing on the aspect of entitlement to tax (Navarro, 2021; Lubis & Rahayu, 2021; Sydänmaanlakka, 2021). While also focusing on Pillar One, Ozai (2020) has made valuable contributions by revisiting the inter-nation equity concept that comprises two normative components, the entitlement approach and the differentiation approach. To the best of my knowledge, the only research on the inter-nation equity aspect of Pillar Two has only been conducted by Titus (2022), in which he asserts that without particular exemption for developing countries, Pillar Two implementation would cause them to unjustly bear the cost of the proposed international tax reform. Even though asserting that "international taxation should not be overwhelmed with expectations as to its suitability for the task of compensating for global inequality and poverty", Stark (2022) argues that international tax law is one of the strategies to find a solution to such problems.

Against this background, this study discusses the features of the Two-Pillar solution and its conformity to inter-nation equity. More particularly, this study aims to further explore from the perspective of developing countries as net capital importers in general while being committed to the Two-Pillar solution. The emphasis on both Pillar One and Pillar Two is motivated by the fact that both are designed as a package to address the targeted BEPS issues. In addition, their impacts on developing countries are critical, not only in terms of fairness (de la Feria, 2022), but also in other aspects such as efficiency (Navarro, 2021; Wardell-Burrus, 2022a; Kanervo, 2021), and administrability (Navarro, 2021; Riccardi, 2021; Kanervo, 2021; Castro, 2020). In doing so, this study adopts the dual conception of inter-nation equity as suggested by Ozai (2020), which will be looked at further in both Pillar One and Pillar Two context.

Hearson (2017) indeed argues that efforts to reform international tax rules in favour of developing countries should not only fix the loophole in the existing rules but should also concern with its distributive impact, which according to Falcão (2018) is in line with UN Sustainable Development Goals (SDGs). This is due to the significant gaps between developing countries and developed ones, in terms of administrative capacity, national interests, and so forth (Li, 2009). Likewise, Magalhaes and Ozai (2021) suggest that the explicit and ex-ante connection between global tax reform projects and SDGs is essential to ensure that such a reform benefits developing countries.

Therefore this research seeks to answer the following question:

a. To what extent does Pillar One promote inter-nation equity?
b. To what extent does Pillar Two promote inter-nation equity?

2. THEORETICAL FRAMEWORK

2.1. The Concept of Inter-Nation Equity

Within the context of cross-border transactions, fairness or equity is considered as crucial as in the domestic setting. According to Smith (1776, as cited in Alink & van Kommer, 2015), equity in taxation means imposing the most proportionate tax burden on each person to his ability to pay. Such a principle is commonly applicable in the domestic context. As it is interpreted based on each country's domestic law, the concept of equity mentioned previously is likely to oversee the inter-individual equity based on the domestic law of either residence or source jurisdiction notwithstanding the presence of the cross-border element (Abbas, 2016).

Taking the international context into account, Musgrave and Musgrave (1972, as cited in Ozai, 2020) raised the idea of inter-nation equity. Despite its relation to inter-individual equity, inter-nation equity is more into economical and political fairness, instead of juridical fairness. With the emphasis on national wealth, Musgrave (2002, as cited in Rose, 2007) underlines that inter-nation equity talks about how national gain and loss should be allocated. They then explain that national wealth is an aggregate of the state treasury wealth, and also the wealth of juridical and natural persons within the jurisdiction. As such, inter-nation equity seems to be an instrument of international redistribution, which according to Musgrave and Musgrave (1972, as cited in Infanti, 2013), focuses on the allocation of tax base between countries with different capital importing-exporting balance. Likewise, Brooks (2008) mentions that inter-nation equity focuses on the gain and loss acquired by two or more countries, and more specifically relates to the extent to which source jurisdictions may impose a tax on income arising in their jurisdiction.

On the other hand, Abbas (2016) defines inter-nation equity as an outcome of the equity in tax revenue distribution between countries in a cross-border transaction. In addition to ensuring that international juridical double taxation is prevented, Abbas (2016) underlines that inter-nation equity should concern with the taxing right allocation which achieves the desired redistribution. In the established understanding of inter-nation equity, the socio-economic status of respective countries does not seem to be considered, unlike in domestic taxation. In this regard, Infanti (2013) highlights that in addition to per capita income, the discussion of inter-nation equity should incorporate a human development approach, which seems multidimensional. Accordingly, Ozai (2020) who revisited inter-nation equity concludes that such a principle should be applied by involving not only the norm of taxing right entitlement but also the norm of differentiation. In a situation where the parties involved are not on the same level, different treatment is necessary to address inequality. Indeed, differential approach as elaborated by Ozai (2020) is necessary to address the insufficiency of entitlement approach, which is an irrefutable attribute of the currently established international tax system. As such, both the entitlement and differential approaches form a dual conception of the inter-nation equity.

To promote international distributive justice, Ozai (2020) asserts that differentiation can be operated if the following requirements are satisfied:

a) universality, which reflects horizontal equity in the inter-jurisdictional world. For example, such a differentiation applies where an international tax policy uses a differentiating factor that includes some and excludes others in the absence of such. The problem is that an equally poor country without such an attribute would be out of the differentiation scope.
b) granularity, which is built on the ground of vertical equity. This approach prevents treating countries under a particular group (such as developing countries, least developed economies, transition economies, newly industrialized countries, or small island developing states) similarly while they may possess inequality. However, that approach is more practical than the other one looking at each country individually, notwithstanding its normative superiority.
c) consistency, which would ensure that the inequality targeted (be it economic, political, or geographical) for differentiation should direct the mechanism to differentiate and the choice of differentiating factor.

2.2. Challenge to Inter-Nation Equity

There are several areas where inter-nation equity is likely considered, such as in allocating taxing rights between source and residence jurisdictions through a tax treaty, in regulating tax competition between countries, and in reallocating taxing rights to countries where value creation occurs (Ozai, 2020). In principle, inter-nation equity is one of the reasons why cooperative rules are crucial (Musgrave, 2001). Being a widely accepted principle, inter-nation equity, however, has not been yet optimally employed as one of the international tax policy evaluation criteria (Brooks, 2008).

The issue of inter-nation equity becomes more problematic when there are imbalances in goods and capital flows between one country and others, more importantly, those occurring between developed and developing countries (Abbas, 2016, Brooks, 2008). Nonetheless, efforts to bring inter-nation equity into reality are not as simple as improving the situation of disadvantaged countries according to Ozai (2020). He adds that a further challenge is political constraints concerning redistribution from more benefited countries. For example, more affluent countries as capital exporters may contribute to the change in the international tax system to achieve inter-nation equity by adopting a territorial tax system or providing tax-sparing credits (Li, 2009).

As the key to inter-nation equity, the role of international tax cooperation is crucial. In this regard, Hearson (2017) argues that the more aware people of the situation that weakens inter-nation equity, the more impetus for countries to cooperate. Correspondingly, according to Rosenbloom, et al. (2015), informal forums seem important as coordination platforms for those countries.

With all those challenges to attain inter-nation equity, Brooks (2008) however points out that inter-nation equity could not be the only answer to the question of "how internationally redistributive the tax system should be". Inter-nation equity indeed is a beginning to answer such a question (Brooks, 2008).

2.3. OECD/G20 Two-Pillar Solution and the Perspective of Developing Countries

Recently, the international taxation landscape has received growing concern toward the efforts to curb international tax avoidance, which is known as base erosion and profit shifting (BEPS), through the Two-Pillar solution. The proposal has been built by involving 137 countries under the Inclusive Framework on BEPS, which represents both developed and developing economies (OECD, 2021b).

In principle, it consists of two interlocking rules, in which Pillar One is designed to define new nexus and profit allocation rules for in-scope MNEs while Pillar Two is expected to address the remaining BEPS issue due to corporate tax rate competition. In this regard, OECD (2021c) claims that Pillar One will reallocate more than USD 125 billion of residual profit to market jurisdictions and Pillar Two will raise about USD 150 billion of additional revenue.

Pillar One was developed from a series of proposals, of which a unified approach by the OECD secretariat was the latest. It was initially built to address the difficulties in taxing highly digitalized businesses. However, the recent design of Pillar One confirms that it would not be possible to ring-fence the digital economy, and thus Pillar One would apply to all businesses except qualifying extractive industries, and regulated financial services. With the new nexus and profit allocation rules, Pillar One is projected to raise the same tax revenue for 49 developing countries if compared to the potential of 3%-rate Digital Service Tax (DST) implementation (Jacobs, 2022). However, Jacobs (2022) points out the unworthy administration costs for the implementation of Pillar One than that of the DST. Meanwhile, Eden (2020), who estimates the gains of several groups of countries from Pillar One implementation both as residence and source jurisdictions, concludes that Pillar One seems to put middle-income countries as winners either as residence or source jurisdictions, with East Asia and the Pacific amount the largest. The result for other low and middle-income countries however is different and likely mixed, with South Asia countries suffering losses. Eden (2020) also investigates the impact of Pillar One on some investment hubs, in which 10 European hubs gain tax base both as residence and source jurisdictions. She argues that such gains are due to their status as developed economies and as portals for market-seeking FDI, regional MNEs' headquarters, and centers for R&D and marketing.

Pillar Two, on the other hand, has gained attention for its capability to generate far more additional tax revenue for developed countries than the developing ones (Barake, 2021). With many more MNEs' headquarters residing in developed countries, a top-down approach would give priority to them to impose an additional tax, called a top-up tax, on profits not sufficiently taxed (effective tax rate of below 15%) by other jurisdictions where MNEs operate. This is how the Income Inclusion Rule (IIR) works. The Other rule, the Undertaxed Payment Rule (UTPR) provides a backstop in the absence of IIR implementation by ultimate parent entity (UPE) and intermediate parent entity (IPE) jurisdictions. As such, the application of UTPR is conditioned by the other superior rule, IIR. And, lastly, Pillar Two also includes the Subject to Tax Rule (STTR), which would deny deduction or impose an additional tax on payment made by an MNE in the host jurisdiction but not sufficiently taxed in the hand of its recipient (below a certain agreed rate). All things considered, Hearson (2020) concludes that the rule order would play an important role in creating the distributive impact of Pillar Two. Further, due to the data limitation and analytical capacity of the tax administration, he argues that predicting the revenue impact of Pillar Two for developing countries is quite challenging.

Although the proposal has addressed several concerns about developing countries' interests, Kurian (2022) believes that "the negotiating table was far from equitable". In addition to the revenue concern, Kurian (2022) highlights several unresolved issues to the Two-Pillar solution, such as the tax administration capacity of low-income countries, its high reliance to tax incentives to attract FDI, the 15% global minimum tax agreed that does not accommodate the interest of developing countries, which in average have a higher corporate income tax rate that developed countries.

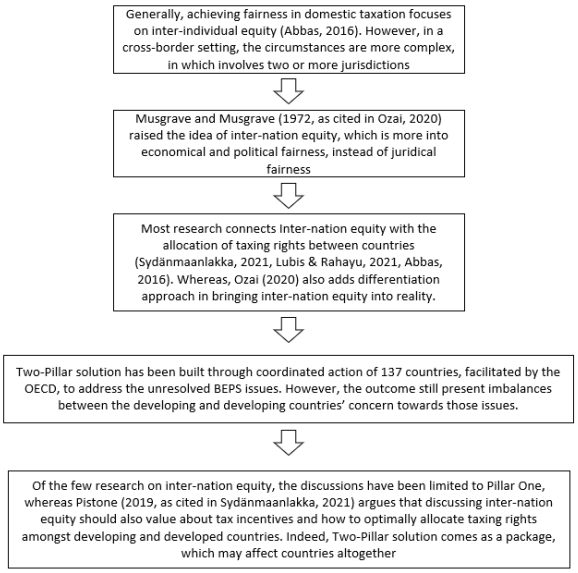
2.4. Inter-Nation Equity Concern Toward Two-Pillar Solution

Concerning the investigation of fairness issues in the design of the Two-Pillar solution, limited research has focused on inter-nation equity. Lubis and Rahayu (2021) identify the three areas of profit allocation under Pillar One that should embrace inter-nation equity, which are the terms of residual profit, the threshold for profitability, and the percentage for reallocation purposes. In terms of profit allocation, Ozai (2020) asserts the unclear distributive impacts of the "unified approach" (later developed as Pillar One), having regard to the use of a formulaic approach, which seems in favour of countries with larger markets. In addition, he emphasizes the absence of a differentiation approach and sole dependence on an entitlement approach would cause lacking economic rationale and, as reckoned by Avi-Yonah and Benshalom (2011), thus being largely arbitrary. Correspondingly, Martínez (2021) highlights that the OECD has not put serious concern over inter-nation equity, given the historical development of that "unified approach".

In this regard, inter-nation equity seems to be seen traditionally, which focuses on the nexus and entitlement of taxing rights and thus concentrates only on Pillar One. However, Pistone (2019, as cited in Sydänmaanlakka, 2021) contends that discussing inter-nation equity should also value tax incentives and how

to optimally allocate taxing rights amongst developing and developed countries.

Figure 1. Theoretical Framework



Source: Summarized by the Author

3. RESEARCH METHODOLOGY

This study combines both doctrinal research and reform-oriented research. According to Hutchinson (2012), 'doctrine' is a result of synthesizing various rules, principles, norms, interpretive guidelines and values. In addition, doctrine "can be more or less abstract, binding or non-binding" (Mann, 2010, as cited in Hutchinson & Duncan, 2012). In this regard, the Pillar One progress report and Pillar Two model rules including their commentaries would be the primary sources. Meanwhile, reform-oriented research will focus on the evaluation of rules and recommend changes (Hutchinson, 2015). To do so, this study will concentrate on the analysis based on the inter-nation equity principle, which was made popular by Musgrave and Musgrave, then further revisited by Abbas (2016) and recently by Ozai (2020). Thus, it is the dual conception of inter-nation equity (Ozai, 2020) that will be utilized as the basis of analysis. Further, relevant published statistics will be incorporated to highlight any disparities "between the law, social policy, and the existing social evidence base" (Hutchinson, 2015).

This study is outlined as the following. First, the analysis is focused on the main elements of both Pillar One and Pillar Two, which comprise the Two-Pillar solution. In this regard, the main source of data regarding both pillars is the latest publication by the OECD Secretariat. Second, those elements are further evaluated on the ground of inter-nation equity requirements, as suggested by Ozai (2020). And, finally, the conclusion is drawn to reflect the conformity of the Two-Pillar solution to the inter-nation equity principle, with the emphasis on the developing countries' interest.

4. DISCUSSION

4.1. Main Elements of Pillar One

Pillar One consists of a set of rules to extend the taxing right of business profit to market jurisdictions in the absence of permanent establishment. The biggest portion of effort has been put in place for the design of Amount A, which comprises: (1) covered MNE group; (2) nexus and revenue sourcing rules; (3) profit determination and allocation; and (4) elimination of double taxation. In addition, Pillar One also rules out the application of the streamlined arm's length principle to remuneration for routine market and distribution activities, which the OECD (2021b) is concerned with the needs of low-income countries. This second part of Pillar One is called Amount B. Lastly, a tax certainty mechanism has been designed to prevent and resolve a dispute on Amount A, with an option to elective binding dispute resolution mechanism for developing countries eligible for deferral of their BEPS Action 14 peer review and having no or low levels of Mutual Agreement Procedure (MAP) disputes.

To investigate further the rules on Amount A, I will identify their essential elements based on the latest publication by the OECD Secretariat entitled "Progress Report on Amount A of Pillar One", which has sought public comments until 19th of August 2022. Meanwhile, the elaboration of Amount B is based on the Pillar One blueprint released in October 2020.

4.1.1 Who would be subject to Pillar One?

4.1.1.1 Amount A

From the perspective of market jurisdictions, to charge Amount A to a non-resident MNE, the first requirement to satisfy is concerning the personal scope, I would say. Unlike the normal provision under the currently established tax treaties, Amount A operates multilaterally. It actually considers a group of MNEs as one integrated operation as Cooper (2021) said that Amount A abandons the separate entity concept. In this regard, the revenue threshold applies to the group (on a consolidated basis), which is above EUR 20 billion (called the revenue test). Also, the pre-tax profit margin of the group should be greater than 10%, both in the period test and some prior periods (called the profitability test). Had the latter test failed, Amount A may still apply to the segment of the group's consolidated financial statements, provided that such a segment meets both the revenue test and profitability test. The additional coverage based on the fulfillment of segments to both tests has just been included in the latest publication. To some extent, this personal scope tends to cover and tax only large businesses.

Nevertheless, generally, there are two industries excluded from the scope of Amount A application, the qualifying extractive groups and regulated financial services (RFS). The exclusion of extractive industries reflects the goal of taxing location-specific economic rents only in the source jurisdiction (OECD, 2022a). Meanwhile, the RFS subject to risk-based capital measures is considered to book profits in a location that is aligned with the market (OECD, 2022b).

4.1.1.2 Amount B

Unlike Amount A, the rule under Amount B applies to members of MNE groups performing routine marketing and distribution activities. Therefore, the implementation of Amount B rule would not be limited to MNEs subject to Amount A. To satisfy the scope of Amount B application, such MNEs have to perform: (1) the purchase of products from their foreign related parties, to independent buyers in the residence jurisdiction of such MNEs and the connected performance of defined routine distribution activities; and (2) the baseline marketing and distribution activities (BMDA).

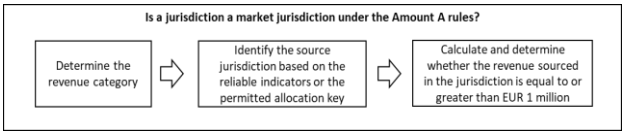
BMDA, in principle, is determined by considering a list of typical functions performed, assets owned and risks assumed at arm's length by routine distributors. However, there is also a negative list of disallowed functions, assets, and risks, which should also be taken together with the positive list. In addition to those qualitative indicators, the Amount B design would also put quantitative indicators to determine members of MNEs within the scope of Amount B application.

4.1.2 How would market jurisdictions gain tax revenue from Pillar One?

4.1.2.1 Amount A

Before answering this question, the Amount A proposal defines which jurisdictions are qualified as market jurisdictions for the allocation of taxing rights. Such a qualification relies on two parameters. First, the nexus test requires that the amount of group revenue arising in source jurisdiction is equal to or greater than EUR 1 million. This threshold is then replaced with EUR 250 thousand if the Gross Domestic Product (GDP) of a jurisdiction is less than EUR 40 billion. Second, that source jurisdiction is determined by a quite rigid rule concerning the revenue categories, and the reliable method (either based on reliable indicators or an allocation key). For example, revenue from online advertising services has its source in the jurisdiction where their viewers are located, whereas that from advertising services other than online ads arises in the location of display reception. Further, the reliable indicator for location of the viewers is the user profile information, the geolocation of the viewers, the IP address, or the other reliable indicators. Meanwhile, the determination of source based on an allocation key is limited to the relevant revenue sourcing rule.

Figure 2. Determining Market Jurisdiction under Amount A Rules



Source: Summarized by the Author

Once a jurisdiction is identified as the market jurisdiction and has satisfied the nexus test, the group's profits would only be allocated to that jurisdiction if the adjusted profit before tax[1] of the group (P) exceeds 10% of the group revenue in the respective period (R). As such, the amount of profit allocated to market jurisdiction is only so much as 25% of the excess of adjusted profit before tax of the group from 10% of group revenues, then multiplied by the proportion of group revenues arising in that market jurisdiction (L) out of the total group revenues. This formula for the group profit allocated to market jurisdiction (Q) is as follow:

$$Q = (P - R \times 10\%) \times 25\% \times L / R$$

Meanwhile, if the market jurisdiction has initially been allocated taxing rights under the business profits article of the applicable tax treaty, the marketing and distribution profit safe harbour would apply. This mechanism aims to prevent the double allocation of group profit to market jurisdiction.

4.1.2.2 Amount B

Amount B is designed to set a simplified mechanism for determining the remuneration for baseline marketing and distribution activities. Therefore, each jurisdiction will need to amend its domestic tax law to regulate the profit level indicator allowed (transaction net margin method, return on sales, or earnings before interest and tax); the possible differentiation (i.e. by region and industry); and other details for the benchmarking.

4.1.3 What would be the implication for the other jurisdictions concerning the application of Pillar One?

As a consequence of profit allocation to a market jurisdiction, which then taxes such profits, Amount A rules require each specified jurisdiction to eliminate double taxation. Those specified jurisdictions are then allocated to the obligation to such elimination according to a four-tier approach. In principle, if such an obligation is not completely allocated to the specified jurisdiction under the first tier, the remaining unallocated obligation would be distributed to the specified jurisdiction under the second tier, and so on.[2] Therefore, the allocation of taxing rights to market jurisdiction leads to other jurisdictions giving up theirs (allocation of taxing rights under the existing system) by providing relief through profit elimination.

Meanwhile, concerning the implementation of Amount B, the risk of double taxation will be reduced through a coordinated and uniform application of Amount B rules. Otherwise, the dispute arising would need to be resolved under the applicable tax treaty provision (mutual agreement procedure).

4.2. Main Elements of Pillar Two

To complement Pillar One rules, and the other previous BEPS measures, Pillar Two has been proposed by the OECD to address the remaining BEPS issues (OECD, 2020). Basically, a set of rules are designed to curb corporate income tax (CIT) competition by determining the agreed minimum CIT rate. Further, the ordering rule determines which rule should be applied first and which one should be conditioned in the

[1] The adjusted profit before tax is calculated by making necessary adjustments and deducting any net losses from the Financial Accounting Profit (or Loss).

[2] The use of tiers is to determine which jurisdiction should be given the first obligation, etc.

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absence of the prevailing rule. In this regard, the Income Inclusion Rule (IIR) represents the former, while the Undertaxed Payment Rule (UTPR) reflects the latter. Those two rules (called the Global anti-Base Erosion Rules or GloBE rules) are applicable under the domestic tax law of each jurisdiction intending to implement them. In that, unlike the Amount A rules, which are all treaty-based rules, both IIR and UTPR are set as a common approach for countries.

However, Pillar Two also contains the Subject-to-Tax Rule (STTR), which operates to impose a top-up tax or deny deduction on payment to low-tax jurisdictions (below the agreed rate of 9%). To be applicable, such a rule requires an amendment of the currently established tax treaties.

4.2.1 Who would be subject to Pillar Two implementation?

Corresponding to the Amount A mechanism, GloBE rules would only apply to constituent entities,[3] members of an MNE group having global annual revenue of EUR 750 million or more in at least two out of four fiscal years immediately preceding the year under assessment. This threshold is likely to conform with that of the Country-by-Country reporting requirement according to the OECD BEPS Action 13. As with Pillar One, Pillar Two also excludes a range of entities, such as a governmental entity, an international organization, a non-profit organization, a pension fund, an investment fund that is an ultimate parent entity (UPE), or a real estate investment vehicle that is a UPE.

4.2.2 Which jurisdictions would be affected by Pillar Two implementation? How could it be?

Basically, the common approach of Pillar Two implementation seems to result in varying outcomes for each jurisdiction. However, the top-down approach applicable to the IIR may lead to the implementation of IIR by the jurisdiction of an Intermediate Parent Entity (IPE), in the absence of IIR application by the relevant UPE jurisdiction.

From the perspective of additional tax revenue generated through the IIR implementation, the UPE jurisdiction will be the priority, and subsequently followed by the IPE jurisdiction. To impose the top-up tax through applying the IIR, the following requirement should be met to result in additional tax revenue for UPE or IPE jurisdiction:

a) the effective tax rate (ETR) for each jurisdiction where an MNE group operates is below 15%;
b) the net GloBE income[4] in that jurisdiction deducted by the substance-based income exclusion (called the excess profit) shows a positive amount;
c) the domestic top-up tax (if applicable) is below the sum of the top-up tax calculated.

Therefore, the formula to calculate the additional tax that may be imposed by UP or IPE jurisdiction is:

(Top-up percentage x excess profit) + Additional current top-up tax[5] – domestic top-up tax.

To calculate the ETR, the adjusted covered taxes in a jurisdiction is divided by the net GloBE income in that jurisdiction. In this regard, top-up tax paid under Pillar One is added to the computation of the covered taxes. Meanwhile, within the calculation of excess profit, the substance-based income exclusion is applicable. Such an exclusion is designated to minimize the impact of Pillar Two on genuine business activities. Therefore, it comprises the payroll-carve out and the tangible asset-carve out, which are equal to 5% of eligible payroll costs of eligible employees and the carrying value of eligible tangible assets.

Further, in the absence of an IIR application by UPE or IPE jurisdiction, a jurisdiction of a constituent entity making payments to other constituent entities with ETR lower than the global minimum tax may impose a top-up tax or deny the deduction of such payment. This would be applicable under the UTPR.

In addition to the GloBE rules, the payer jurisdiction may also implement the STTR to base eroding payments, such as interests and royalties, which are subject to no or low nominal tax rates in the payee jurisdiction. As such, the impact of STTR would be considered in calculating the ETR during the implementation of IIR or UTPR.

4.3. Conformity to the Inter-Nation Equity Principle

To assess the conformity to inter-nation equity principle, each element of the two pillars will be investigated in the context of both developed and developing countries. However, as according to Musgrave and Musgrave (1972, as cited in Ozai, 2020) that source-based taxation is more relevant to inter-nation equity than residence-based taxation, the first perspective to look at is of the developing countries as in general they tend to be the source jurisdictions.

4.3.1 Entitlement to Tax

4.3.1.1 Pillar One

Under Pillar One rules, the market jurisdictions would also be referred to as source jurisdictions. There would be a new allocation of such a right in addition to the existing rules, such as the business profits article of the relevant tax treaty. This seems to create a new opportunity for a jurisdiction to get the allocation of the right to tax on income arising in it since the currently applicable treaties still rely on a physical presence.

However, the extent to which a jurisdiction would be regarded as a market jurisdiction and thus be allocated a taxing right is subject to the fulfillment of the revenue test, profitability test, and also the threshold for each particular business activity. Those criteria are likely considered as a measurement for the level of the economic significance of certain business

[3] entities whose financial statements are consolidated in an MNE group.

[4] MNE in that jurisdiction should book net GloBE income, which is calculated by aggregating profits and losses of all constituent entities within a jurisdiction.

[5] Additional top-up tax resulted from the recalculation of ETR and top-up tax of the prior fiscal year

activities carried on by non-resident MNEs in other jurisdictions.

If such a rule is compared to the rule under the business profits article that requires the existence of a permanent establishment (PE) to get the allocation of taxing right on income derived from digital business, it seems that Pillar One provides more opportunity for market jurisdictions as physical presence requirement is replaced by those significant economic presence indicators. However, Amount A rules are likely to present challenges for developing countries. This is due to the fact that, for certain developing countries, satisfying the criteria for being a market jurisdiction is arguably as difficult as meeting the PE threshold. A jurisdiction must be a sufficiently large market for a non-resident MNE, given the EUR 1 million threshold (or replaced by EUR 250 thousand for jurisdictions with lower GDP) of the group revenue arising in the market jurisdiction. Those within the middle to low market level tend to be precluded from a market jurisdiction status, except their GDP is less than EUR 40 billion. This definitely would be combined with the revenue test applicable to the group of MNEs, the EUR 20 billion revenue threshold on a consolidated basis. Corresponding to this, Sydänmaanlakka (2021) argues that CIT should not only be designed as an instrument for jurisdictions with large markets.

Having regard to the top 100 digital MNEs in 2021 as listed by Trentini et al. (2022), there are 10 MNEs with a global revenue of above EUR 20 billion (see Table 1). As such, only 10% of those listed would be subject to Amount A rules, if all of them meet the profitability test of 10% pre-tax profit margin. Then, the global revenue should be broken down for each jurisdiction and be further assessed whether the nexus test for being a market jurisdiction is satisfied. However, the market jurisdiction's entitlement to tax would also depend on the group profitability and the amount of residual group profit. As a consequence, a large contribution of such jurisdiction would not always guarantee a significant taxing right following the Amount A application if the MNE group profitability is just above the 10% threshold. At this point, this formulaic approach gives no option for the said jurisdiction and thereby limiting its ability to tax despite its large market base.

Table 1. Top 10 Digital MNEs by Sales

Rank	Company name	Headquarters	Classification	Total Sales (EUR million)
1	Amazon.com	United States	Internet retailer	479.218
2	Alphabet	United States	Search engine	262.790
3	Meta Platforms	United States	Social network	120.288
4	Alibaba Group	China	Internet retailer	111.670
5	Tencent Holdings	China	Games	88.569
6	Walt Disney	United States	Digital media	68.766
7	Netlix	United States	Digital media	30.292
8	Salesforce.com	United States	Other digital solutions	27.022
9	PayPal	United States	Electronic payments	25.878
10	DiDi Global	China	Other platforms – shared economy	22.156

Source: Adapted from Trentini, et al. (2022)

Meanwhile, the impact of Amount A rules on the other businesses, which are also covered by Pillar One, is quite interesting. More particularly, the allocation mechanism to a jurisdiction that has been granted taxing rights under the established tax treaty provision, such as the business profits article upon satisfying the PE requirement. The marketing and distribution profit safe harbour adjustment, which would be applicable in that situation, is likely to affect the entitlement to tax to such a market jurisdiction under Amount A. Given the complete profit elimination by the safe harbour adjustment, the outcome for the market jurisdiction after Pillar One application seems no different, if compared to the allocation of taxing rights under the existing tax treaty. Further, to relieve double taxation, a complex procedure with the "multi-tier approach" is proposed. In principle, Amount A only reallocates taxing rights to market jurisdiction. Therefore, there would be a reduction in the taxing rights of other jurisdictions based on residence taxation. This seems the consequence of using a "non-separate entity approach" which makes the Pillar One far more complicated. In this regard, the entitlement to tax of those relieving jurisdictions is to be affected.

On the one hand, the impact of Amount A on the market jurisdiction on the entitlement to tax seems positive despite the degree of positivity. As there is potential manipulation of Amount A through tax games by MNEs and governments, there would likely be winners and losers, thus affecting the net gain/loss in each jurisdiction (Eden, 2021). On the other hand, the Amount A mechanism still involves complexities in several areas, such as potential interaction between Amount A rules and the existing business profit provision under the relevant tax treaties and the arm's length principle (Latif, et al., 2022) as well as the revenue sourcing rules.[6] As a result, it is likely that the effort of market jurisdictions in implementing Amount A rules would not always produce a positive result for them. At this stage, corresponding to the use of the PE threshold to tax business profits,[7] to some extent, Amount A seems to similarly restrict source-based taxation, thus preventing the improvement to inter-nation equity.

Unlike what happens to Amount A, the entitlement to tax under Amount B basically relates to the issue of economic double taxation more than the juridical one. As Amount B aims to set a simplified method by determining fixed returns for baseline marketing and distribution activities. From the perspective of developing countries, this mechanism would better assist them in dealing with many challenges about the implementation of the Arm's Length Principle (ALP). Developing countries find the lack of publicly available data on comparables (Cottani, 2016 as cited in Oats and Rogers, 2019), and also the limited capacity of domestic tax administrative controls

[6] According to Kanervo (2021), the ease of administration is the most highlighted area within Pillar One. However, as the progress report on Amount A developed better by eliminating the activity test, which initially only targets automatic digital services and consumer facing business, the administrative burden of Pillar One seems reduced.

[7] As mentioned by Vann (2010), notwithstanding the initiation of using the PE principle to reflect source taxation of business profits, the PE concept has no longer relevant to ensure a fair share of tax on business profits for developing countries.

and enforcement systems when facing aggressive transfer pricing arrangement, disadvantaged (Oats and Rogers, 2019). Therefore, any efforts to streamline the mechanism as proposed under Amount B are likely beneficial. As mentioned by Pepper, et al. (2022), Amount B will benefit developing countries by providing greater certainty regarding the pricing of routine marketing and distribution activities (Pepper, et al., 2022). However, as further work is needed to develop the mechanism, it is important to ensure that those concerns of developing countries are not left behind. Therefore, Amount B would lead to an effective and efficient implementation of ALP, thus minimizing transfer pricing disputes.

4.3.1.2 Pillar Two

In contrast with Pillar One, Pillar Two does not necessarily deal with allocating taxing rights for certain income. Rather, it generally operates as an anti-avoidance measure incorporated in the domestic law of each country of residence of the parent entity of an MNE group. The concept of Pillar Two stems from the single tax principle, in which income should be taxed once, no more and no less. The other principle that is also relevant in the case of Pillar two is residence-based taxation. This is due to the entitlement to tax profits not adequately taxed by the countries where an MNE operates to the residence jurisdiction of the ultimate parent entity or immediate parent entity.

As a consequence of implementing the IIR under Pillar Two, it is likely that the right to tax an MNE's profit would be shifted to the other jurisdiction (UP or IPE jurisdiction) if the effective tax rate of such profit is below 15%. If this is to happen to the tax haven countries that intentionally impose low taxes to facilitate profit shifting, the impact of the IIR on achieving inter-nation equity seems to create less of an issue.

From the developing countries' viewpoint, this is not always the case. Many developing countries tend to set higher statutory corporate income tax (CIT) rates than the worldwide average of 23,54% (Bray, 2021). If the effective tax rate (ETR) of MNEs operating in developing countries is still above the global minimum tax of 15%, the IIR is unlikely to affect developing countries. Nonetheless, there are situations where the ETR of MNEs located in developing countries is below 15%, or even zero. For example, having been granted tax incentives, such as tax holidays, an MNE could get a tax reduction of half or even 100%. As a result, granting such tax incentives may lead to the shift of CIT revenue from host jurisdiction to the UPE or IPE jurisdictions. According to Barake, et al. (2021), 66% of the 2,000 largest MNEs are headquartered in developed countries, with the United States predominating by 28%, in the context of revenue distribution, Pillar Two seems to weigh developed economies more than developing ones. Therefore, the inter-nation equity within Pillar Two implementation seems an issue.

To encounter such a situation, a substance-based income exclusion (SBIE) has been put in place with the purpose of minimizing the unwanted impact of Pillar Two on genuine business activities in a jurisdiction. Through such an exclusion, the net income used in the calculation of the ETR would be reduced by 5% of the eligible payroll costs of eligible employees performing activities for the MNE Group in such jurisdiction and the carrying value of Eligible Tangible Assets located in such jurisdiction. This would result in a slightly greater ETR. Nonetheless, in a situation where real business activities have triggered the granting of tax incentives, SBIE would not be adequate to reduce the negative impact of Pillar Two to host countries.[8]

Then, the latest model rules for Pillar Two implementation allow such countries to impose a domestic top-up tax (QDTT), which is excluded from the covered tax to compute ETR but could be deducted from the top-up tax calculated. As the tax base under the QDTT is not as much as that applicable in the normal calculation, this development tends to provide a better option for developing countries. In the absence of such a provision, developing countries need to increase their CIT rate or abolish their tax incentives if they do not want to let their tax revenue flow to other countries, most likely to the developed economies. While QDTT would help to improve the inter-nation equity by keeping the additional tax revenue in the host countries, SBIE seems to prevent the negative impact of Pillar 2 on real business activities. In this regard, even though Pillar Two is not explicitly a reflection of taxing right entitlement of a type of income, unlike Pillar 1, such a coordinated anti-avoidance measure would result in determining which jurisdiction is allowed to impose an additional tax or top-up tax.

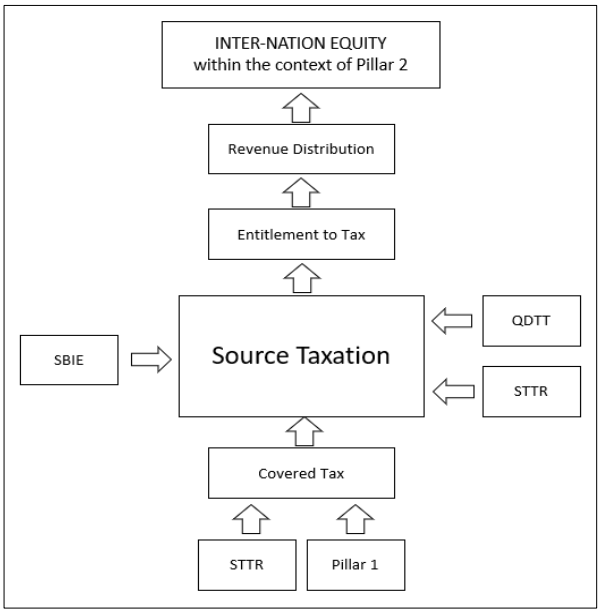
The top-down approach in the anti avoidance mechanism tends to put residence taxation as the heart of Pillar Two. Therefore, it naturally does not mainly concern the source taxation. Musgrave (2006) indeed mentions that inter-nation equity is affected by source taxation, not residence taxation. However, as there are situations where source jurisdiction can respond and influence the level of top-up tax imposed by the residence jurisdiction (as illustrated in Figure 3), the impact of Pillar Two on inter-nation equity seems apparent.

As can be seen in Figure 3, under Pillar Two, the source taxation of business income earned by an MNE is reflected by the domestic taxation (CIT) imposed by the host jurisdiction. The level of taxation would be manifested as 'covered tax' according to Pillar Two Model Rules. Being a nominator in the computation of ETR, the amount of covered tax would also depend on the tax imposed by the host jurisdiction as a result of STTR implementation. Further, the taxes paid under Pillar 1 application would also be included in the amount of covered tax. The higher the covered tax, the lower possibility of the tax revenue on such business income flowing to the other jurisdiction, that is the residence jurisdiction of UPE or IPE. Meanwhile, SBIE

[8] Those granting tax incentives.

would affect the ETR in the source jurisdiction by reducing the amount of income as the denominator in the ETR calculation. A positive impact on the ETR of an MNE would result in less possibility of its profit being taxed in the hands of the UPE or IPE. On the other hand, QDTT operates differently by reducing the amount of top-up tax that could be imposed by UPE or IPE jurisdiction, even possibly reaching zero. Thus, QDTT would preserve the taxation of the business profit of an MNE for source jurisdiction.[9]

Figure 3. Inter-nation Equity within the Context of Pillar Two



Source: Author

The other attribute of Pillar Two, STTR, however, would directly reflect the issue of inter-nation equity. This is due to the STTR mechanism, which aims to extend source taxation by allowing the source jurisdiction (payer jurisdiction) to impose additional withholding tax on base eroding payment of up to 9% (the top-up tax rate will be reduced by the adjusted nominal tax rate in the payee jurisdiction). In this case, the gap in withholding tax rates among the existing tax treaties seems reduced. From the perspective of taxing right entitlement of the source jurisdiction, the contribution of STTR to improve inter-nation equity would depend on the following factors:

a) The allocation of taxing right of base eroding payment under the currently established tax treaty.
b) How the payee jurisdiction's domestic law is amended to prevent the implementation of STTR by the payer jurisdiction.

Concerning the first factor, STTR would apply to base eroding payments, which means that if the payments are already subject to sufficient source taxation, STTR seems not applicable. For instance, given the withholding tax rate under the currently applicable tax treaty is limited to 10%, there would be no top-up tax allowed. In principle, the payer jurisdiction would be given the choice to impose the higher rate under the tax treaty or the top-up tax under STTR (OECD, 2020). Thus, if the current tax treaty network has set a maximum withholding tax rate of above 9%, the implementation of STTR would not add value to the source jurisdiction. Meanwhile, regarding the second factor, as STTR only allows the source jurisdiction to impose the additional tax comparable to the excess of the adjusted nominal tax rate of payee jurisdiction up to the 9% STTR rate, its consequence for the source jurisdiction may not be equal for each base eroding payment. If the payee jurisdiction amends its domestic law to increase its nominal tax rate on the relevant type of income or abolish the foreign income exemption, the additional tax that may be imposed by the payer jurisdiction would be lower. As such, the extent to which the STTR improves the inter-nation equity would condition the extent to which the residence jurisdiction of the payee discharges its residence-based taxation.

In the wider scope of Pillar Two, countries' responses would also be a relevant consideration to assess the impact of Pillar Two on the inter-nation equity between countries. The varying responses of each country which are possible in the context of Pillar Two rules tend to influence each country's sovereignty, too. Countries may want to see the response of others before deciding on any responses toward their existing corporate tax policy. Meanwhile, from the perspective of investors (MNEs), this issue is somewhat related to the potential distortions of the new tax regime on investment decisions. In this regard, Wardell-Burrus (2022a) predicts that several features of Pillar Two, covered taxes and SBIE, seem to affect both the ownership and the investment location. However, given the different outcomes of imposing QDTT, I would argue that such distortions would also be caused by the introduction of QDTT.

All those sources of potential distortion considered, governments may react differently to Pillar Two. They may focus on adjusting their CIT up to the minimum tax and giving up on their tax incentives[10] while others may consider introducing a certain policy, such as QDTT, that is still in conformity with Pillar Two model rules, thus resulting in another form of tax competition. On the one hand, it is somewhat contradictory to the spirit of tax coordination, which seeks to improve the tax systems quality across jurisdictions (Musgrave, 2006). On the other hand, Pillar Two does not aim to eliminate tax competition but mitigate the harmful effect of BEPS (Englisch, 2021) by setting the floor for tax competition (Vella, et al., 2022).

Further, Musgrave (2006) states that in well-designed coordination, 'mutual gains' should be achieved. Once the mutual gains are accomplished, the inter-nation equity across jurisdictions is likely better off. To achieve such mutual gains, Pillar Two seems to face challenging situations. As it is built on the ground of domestic law implementation, called the common

[9] In line with this, Wardell-Burrus (2022b) proposes a scenario for developing countries to respond to Pillar Two by utilizing QDTT as an instrument.

[10] Developing economies tend to face challenges of shifting from tax incentives to direct subsidies or incentives through social security taxes as they may not have sufficient capacity to provide those (Dourado, 2022)

approach, it will be up to each jurisdiction to opt-in to Pillar Two. If it is to be applied, there are possible choices provided, which thus tend to create disharmony in international tax systems. Whereas the available options to retain source taxation may be a positive development to the inter-nation equity, the potential of behaviour changes of MNEs tend to affect the outcomes of Pillar Two rules. In this regard, they seem to raise another issue in the revenue distribution, which is predominated in the context of developing countries.[11]

4.3.2 Differentiation

Concerning the countries' development, Ozai (2020) suggests that differentiation should be put in place to embrace inequality between countries. In the following analysis, each pillar of the Two Pillar Solution will be investigated whether it involves differentiating factors within its rules, which should reflect universality, granularity, and consistency.

4.3.2.1 Pillar One

Within Pillar One's rules, Amount A and Amount B, there are several elements to be investigated. The analysis of Amount A involves the mechanism of determining MNEs in scope, performing the nexus test, identifying the market jurisdiction and calculating the profit allocated to that jurisdiction. Meanwhile, the Amount B analysis comprises a set of rules to determine fixed remuneration for routine marketing and distribution activities.

Concerning the first two requirements, Table 2 illustrates the extent to which each mechanism includes differentiating factors. Based on the analysis conducted, the only part of Pillar One conforming to the two differentiating factors is the nexus test. This is due to the different revenue thresholds applicable to determining the economic significance of an MNE to a (market) jurisdiction. The universality is met as all countries with a GDP of less than EUR 40 million would be subject to the same threshold for the nexus test. Meanwhile, when it comes to the granularity requirement, those different thresholds reflect a different treatment for the less affluent countries. In that, those with lower GDP would enjoy a lower threshold and thus making it easier for them to bring the MNEs into the tax net. The use of GDP as the differentiating factor seems to correlate to the need of reflecting inequality between jurisdictions with different market sizes. Indeed, GDP, a measure of consumption in a country, seems the most feasible differentiating factor to reflect the market size of each jurisdiction. In this regard, the "consistency" requirement for the nexus test under Pillar One rule (Amount A) would be satisfied.

Table 2. Identification of Differentiating Factors of Pillar One Rules

Mechanism	Differentiating Factor	Requirement Satisfied
Amount A		
MNEs in scope	No. Both the revenue threshold and the profitability test apply equally to all MNEs.	N/A
Nexus test	Yes. Two different nexus tests (the amount of revenue arising in a source jurisdiction) apply based on the size of a jurisdiction's GDP.	Universality Granularity
Market jurisdiction test	No. Certain reliable indicators or allocation keys apply to each income category. However, no specific differentiation based on the characteristic of each jurisdiction is involved.	N/A
Profit allocation	No. The same formula applies to all the MNEs when the nexus test and the market jurisdiction test are satisfied. The only different treatment is the use of safe harbour aiming at preventing double taxation in a certain situation, which is not connected to a specific characteristic of a jurisdiction.	N/A
Amount B		
Formulaic approach	No (Not yet). Further work on Amount B component would determine whether the differentiating factors are present.	N/A

Source: Author

According to Ozai (2020), the limitation of the entitlement component should be offset by the differentiation component since those two form a dual conception of inter-nation equity. Having regard to the result of the above analysis, the differentiation component of Amount A seems inadequate to offset several entitlement issues arising, such as regarding the whole requirements for determining a market

[11] Wardel-Burrus (2022b) also mentions that STTR in fact may not allow developing countries to gain additional revenue due to the predicted behaviour of MNE and their treaty partners in preventing STTR to apply. This is to complement the previous analysis on the other Pillar Two components.

jurisdiction. Other differentiating factors to capture inequality could also be considered, for example, to reduce the administrative burden and complexities associated with Amount A rules implementation in developing countries or lower income countries, as market jurisdictions or relieving jurisdictions.

The other part of Pillar One rules (the Amount B), as described in Table 2, has not included any differentiating factors to fulfill the three requirements. Nonetheless, as Amount B has not been fully developed yet, its future elaboration may also include possible differentiation, i.e. based on region, industry, and so on. If this is included in the model for Amount B and has the potential to differentiate outcomes between jurisdictions concerning the redistribution of income, further analysis would be needed to determine whether the use of such differentiating factors would meet the universality, granularity, and consistency.

4.3.2.2 Pillar Two

Regarding Pillar Two, there are several rules to be investigated. The analysis will comprise whether the differentiation approach has been included in the design of those rules. Based on the result of the entitlement approach analysis, I would argue that Pillar Two rules, either directly or indirectly, affect the source taxation (taxation in the host jurisdiction). However, it seems that their design does not necessarily result in a sufficiently fair tax entitlement, especially for the host jurisdiction, in which the majority of developing countries fall.

Concerning the universality and granularity requirements, Table 3 describes the extent to which each rule satisfies them. Nonetheless, there is no particular mechanism under Pillar Two involving any differentiating factors. Having regard to the characteristics of Pillar Two rules (IIR and UTPR) and the guiding principle behind them, it is likely that such rules do not necessarily promote source-based taxation, unlike those of Pillar One. In this regard, one may think that the differentiation approach seems irrelevant in the context of Pillar Two.

Table 3. Identification of Differentiating Factors of Pillar Two Rules

Mechanism	Differentiating Factor	Requirement Satisfied
Determining MNEs in scope	No. The global annual revenue threshold is applicable for all cases	N/A
Income Inclusion Rule	No. The same IIR is applicable in UPE or IPE jurisdiction despite the potential of different outcomes due to the differences in taxation level in the host jurisdiction (ETR and QDTT) and the genuine business activities reflected by payroll and tangible assets carve-out. However, this is not a differentiation based on factors that reflect the inequality between jurisdictions.	
Undertaxed Payment Rule	No. The level of taxation in the payee jurisdiction will determine the applicability of the UTPR. However, this is not a differentiation based on factors that reflect the inequality between jurisdictions.	N/A
Subject to Tax Rule	No. The level of taxation in the payee jurisdiction will determine the applicability of the STTR. However, this is not a differentiation based on factors that reflect the inequality between jurisdictions.	N/A

Source: Author

However, when the entitlement approach is significantly ineffective, the use of differentiating factors may act as a catalyst to achieving inter-nation equity by influencing the mechanism and outcomes of the entitlement to tax. For example, as in the case of Pillar Two, there are several rules that may affect the level of source taxation (taxation by the host jurisdiction), a differentiating factor may be put in place to influence the outcomes of Pillar Two implementation by the UPE or IPE jurisdiction. This corresponds to the statement of Ozai (2020) that:

> [s]tates are entitled to the wealth generated in their territories or arising from the resources they control and that the distribution of rights over that wealth should allow for a differential regime that favors less affluent economies.

In this regard, if the host jurisdiction of an MNEs group is situated in that less affluent economy, preserving the wealth distribution to such would help to achieve inter-nation equity. Therefore, within the context of Pillar Two, particularly the IIR and UTPR, the use of a differentiation approach that minimizes the tax revenues flowing to the residence jurisdiction of the UPE or IPE jurisdiction [12] needs to be taken into account.

The QDTT a jurisdiction introduces can reduce the amount of top-up tax that the UPE or IPE jurisdiction imposes. However, it does not necessarily mean that such a measure is a differentiating factor. This is considering the aim of differentiation to address a particular type of inequality be it economic, political, or geographical (Ozai, 2020). In this regard, a QDTT does not specifically target any of those types of inequality.

[12] which generally is the developed countries.

Instead, it aims to provide an option for jurisdictions, thus preventing the shifting of tax revenue to the UPE or IPE jurisdiction. Such an option would be available for any jurisdiction, regardless of their economic, political, or geographical issue.

Adding a differentiating factor within the IIR and UTPR mechanism indeed faces an issue. As Pillar Two operates as a common approach, the decision is on each jurisdiction. This is apparently true from the perspective of the residence jurisdiction of UPE or IPE as it would be the one that is entitled to impose an additional tax when applicable. On the other hand, from the host jurisdictions' point of view, this is not always the case. A problematic situation seems to appear when they provide tax incentives aiming to boost their economy but end up letting their tax revenue go to other jurisdictions.

As a coordinated action between countries, it is possible for Pillar Two model rules to advocate countries adopting a kind of measure that involves a differentiating factor. However, in the context of Pillar Two, ensuring that such a factor meets the three requirements is rather complicated. A GDP level may not fit those purposes. First, different GDP level seems to correspond to the necessary revenue distribution. On the contrary, since Pillar Two aims to address the remaining BEPS issues, relying on GDP level would preclude tax haven countries with low GDP from Pillar Two coverage. Second, as there are two concerns, in this case, the revenue distribution and the BEPS prevention, determining the most appropriate differentiating factor appears troublesome. All things considered, when it comes to the IIR and UTPR design, the differentiation approach does not seem compatible.

Meanwhile, regarding the other rule under Pillar Two, STTR, there is no differentiating factor applicable. Even, it sets out the minimum tax rate of 9%, which does not seem to offer additional tax revenue for source jurisdiction with withholding tax rates currently applicable under tax treaties above 9%. As such, there is no specific minimum tax rate for jurisdictions with different levels of development. Rather, according to the OECD (2020), the 9% rate is proposed to align with the global minimum tax rate that would be applicable under IIR or UTPR, thus mitigating the risk of over-taxation.

5. CONCLUSION AND RECOMMENDATION

Fairness or equity has been one of the key issues that would be resolved by addressing BEPS challenges through the two pillar solution, Pillar One and Pillar Two. As in the global context, fairness or equity does not only deal with inter-individual equity, but also inter-nation equity, both pillars also face the income redistribution concern between more and less affluent countries. Based on the analysis of the two normative components of inter-nation equity, it is arguably that Pillar One is more directly connected to the inter-nation equity issues due to its focus on the reallocation of taxing rights between jurisdictions. Meanwhile, Pillar Two affects inter-nation equity through the impacts of each rule on the source-taxation.

According to the entitlement approach, whereas implementing Pillar One would create more opportunities to tax MNEs for developing countries as market jurisdictions, the complexities associated to the mechanism and formula of Amount A appear to still negatively affect the inter-nation equity despite the better developed proposal according to the progress report on Amount A. Meanwhile, the fiscal fail-safes and the more potential benefits for residence jurisdiction than the source jurisdiction under Pillar Two becomes the most critical issue to inter-nation equity.

Given those inadequacies of the entitlement approach to enhance inter-nation equity, Pillar One has added a differentiating factor, the different threshold for lower GDP, which seems to meet the universality, granularity, and consistency criteria. Yet, arguably, it does not completely offset the shortcomings of the entitlement approach. On the other hand, there is no differentiating factor applicable for Pillar Two. Actually, Pillar Two has offered the options that the host jurisdiction could adopt to prevent the shift of taxing rights to the other jurisdiction. However, the status of Pillar Two rules as a common approach and an anti-avoidance measure has made it even more difficult to guarantee the outcomes that maintain inter-nation equity. With less emphasis on source taxation, Pillar Two has the potential to lower inter-nation equity.

Therefore, as a coordinated action between countries, it is suggested that redistribution through pursuing inter-nation equity should be one of the key concerns. In the spirit of coordination and cooperation, the more affluent countries should endeavour to facilitate and raise more awareness to help the less affluent, thus achieving global welfare through taxation.

6. LIMITATION

As the discussion in this research is in fact part of a larger discussion in achieving global justice of taxation, the approach to pursuing inter-nation equity should be holistic, too (Sydänmaanlakka, 2021). However, since the focus of this study is only on income taxes, there would be other areas that should be investigated to bring inter-nation equity into reality, for example, the indirect tax entitlement for market jurisdiction, which may also reflect a contribution to its welfare and SDGs' achievement.

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