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The UTPR Disregards the Need for Nexus

To the Editor:

Professor Picciotto, in his most recent letter to the editor,[1] appears to have entirely missed the point that Nathan Boidman and I were making in our earlier letters on the issues raised by the UTPR (now known as the undertaxed profits rule) under international law and tax treaties.[2] We were simply pointing out that the UTPR could (and probably would, in practice) involve the collection of tax by a country on income from business activities and sales having no economic connection to the taxing country. It seems obvious to us that this would be a problem as a matter of principle, especially if the business activities in question were those of a resident of a treaty partner.

For example, let us assume that Germany and France proceed to enact the global anti-base-erosion (GLOBE) rules next year, as their finance ministers say they will do, and no other country enacts the GLOBE rules. A multinational enterprise not having a German or French parent entity, but having annual global turnover exceeding €750 million and having wholly owned subsidiaries in Germany, France, and other countries, including, say, the United States, would find that under the UTPR, Germany and France could impose top-up tax on the German and French subsidiaries on income of the U.S. subsidiary if its effective tax rate was less than 15 percent (because of nonrefundable tax credits available under U.S. law). This would be true regardless of whether the U.S. subsidiary's business had any connection with Germany or France (remember, the parent company of the group is neither German nor French). Indeed, the German and French subsidiaries might have relatively small operations, and the U.S. company's business might be much larger and might be in a completely different line of business.

Thus, the UTPR would allow each of Germany and France to tax a resident on income of a nonresident having no economic connection to either country. The only legal connection would be that the German, French, and U.S. subsidiaries had a common parent company (in a country other than Germany or France).

The concept of formulary apportionment of an MNE's global income does not extend this far. One need only read the articles of professor Picciotto and his coauthors on the topic[3] to see that some sort of nexus between the apportioned income and the taxing jurisdiction is required — either sales, assets, payroll, or perhaps economic risk associated with the earning of the income. Common ownership alone does not confer taxing rights under any theory.

As for article 9 of tax treaties, I think it should be obvious to the readers of *Tax Notes International* that article 9 does not permit a treaty partner to adjust the profits of a resident enterprise to collect top-up tax on low-taxed income of an affiliate resident in the other contracting state whose business has no economic connection of any kind with the entity being taxed or with anything else in the taxing jurisdiction. Again, the mere fact of common ownership is not sufficient to bring article 9 into play.

It is worth noting that, contrary to professor Picciotto's assertion that the UTPR involves an adjustment of the accounts of the taxed entity, the commentary on the GLOBE model rules indicates

[1] *See* Sol Picciotto, "Formulary Approach: The Last Best Hope for MNEs," *Tax Notes Int'l*, Oct. 24, 2022, p. 437.

[2] *See* Nathan Boidman, "No Rational Role for the UTPR," *Tax Notes Int'l*, Oct. 17, 2022, p. 287; and Jefferson VanderWolk, "The UTPR Is Flawed: A Response to Prof. Picciotto," *Tax Notes Int'l*, Oct. 17, 2022, p. 285.

[3] *See* Picciotto et al., "For a Better GLOBE: A Minimum Effective Tax Rate for Multinationals," *Tax Notes Int'l*, Feb. 15, 2021, p. 863; and Picciotto and Jeffery M. Kadet, "The Transition to Unitary Taxation," *Tax Notes Int'l*, Oct. 24, 2022, p. 453.

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that top-up tax can be imposed under the UTPR in any way the taxing jurisdiction wishes, including by way of a simple assessment of tax on the resident entity. ■

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Squire Patton Boggs
Oct. 24, 2022

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