Taxing Multinationals in the Era of the Return of Unilateralism

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The globalization of the economy and the absence of a common tax framework allows multinational enterprises to artificially locate their profits in low-tax jurisdictions, which reduces public revenues and fuels international tensions. Over the past fifteen years, a multilateral dynamic had taken shape, raising hopes for a global-scale regulation of multinational corporate taxation. The recent return to unilateral policies jeopardizes the construction of this new equilibrium.

■ Introduction

Since the mid-2010s, the international economic order has been marked by a gradual return to unilateral policies, breaking with the multilateral dynamic that dominated previous decades.[1] The regulation of multinational companies – particularly their taxation – fits squarely with this shift, as it is a key determinant of states' economic sovereignty in a globalized economy. By allowing these companies to artificially locate their profits in low-tax jurisdictions, through artificial transactions or manipulating their amounts, their tax strategies distort trade balances, reduce public revenues, and fuel trade tensions.

In terms of international taxation, the early 21st century marked a shift towards multilateral regulation, driven by the realization that the decentralized system in place since the 1920s massively favored tax avoidance. This awareness was heightened after the 2008 financial crisis, following which governments sought to mobilize new fiscal resources. In response, the OECD and the G20 proposed multilateral reform in 2019: the establishment of a minimum tax on multinationals, known as Pillar Two (see Box 1). This reform aims to guarantee an effective level of taxation of profits, regardless of where they are booked,

in order to contain the erosion of tax bases. This need is explained by the rapid globalization of economies and the structuring of low-tax jurisdictions at the end of the 20th century, which compressed public revenues and forced governments either to increase borrowing or to raise taxes on less mobile bases, at the risk of increased social and political tensions.[2]

The implementation of the reform remains incomplete, and its effectiveness is weakened by two dynamics. The first concerns the gradual extension of exemptions, which reduces the effective scope of the minimum rate. Mechanisms such as the substance-based exemption – which excludes profits linked to real activity (measured by capital and employment) – or refundable tax credits (qualified refundable tax credits, QRTC) allow certain companies to bring their effective rate below the 15% threshold, as long as the profits are accounted for as related to productive activity.

The second limitation is political. While EU countries began implementing Pillar Two in 2024, several major states remain outside the framework, signaling a return to unilateral policies. In January 2025, the United States announced the suspension of its participation in the agreement.[3] The Trump administration rejects the principle of

1. Aiyar, S., Chen, J., Ebeke, C. H., Garcia-Saltos, R., Gudmundsson, T., Ilyina, A., Kangur, A., Kunaratskul, T., Rodriguez, S.L., Ruta, M., Schulze, T., Soderberg, G. & Trevino, J. P. (2023). Geo-economic Fragmentation and the Future of Multilateralism. *International Monetary Fund*.

2. Egger, P. H., Nigai, S. & Strecker, N. M. (2019). The Taxing Deed of Globalization. American Economic Review, 109(2), pp. 353-390. See also: Laffitte, S. (2024). The Market for Tax Havens. *EU Tax Observatory Working Paper*, no 22, March.

3. It is important to note that the measure has not yet been approved by the United States. Thus, this announcement primarily reflects the unilateral intentions of the US administration rather than a genuine legal change.

Box 1 – How Pillar Two works

Pillar Two of the OECD, through the Global Anti-Base Erosion (GloBE) model, aims to ensure that large multinational companies are subject to a minimum effective tax of 15% in each country where they operate. It operates according to the following principles:

1. Calculation of the Effective Tax Rate (ETR):
   In each jurisdiction, the effective tax rate (ETR) of each group entity is calculated. If this rate is below 15%, a supplementary tax is due.
2. Tax Base of the Supplementary Tax:
   The supplementary tax applies to "excessive" profits defined as GloBE income minus an allowance for personnel expenses and tangible assets. The GloBE income corresponds to the accounting result of an entity, adjusted according to common rules defined by the OECD to establish a harmonized tax base.
3. Qualified Domestic Minimum Top-up Tax (QDMTT):
   A country can adopt a national minimum tax rule (QDMTT) in line with GloBE standards. It allows the supplementary tax to be collected locally, thus reducing the intervention of international rules. The QDMTT may also apply to purely domestic groups.

4. International Rules: IIR and UTPR

   • The IIR (Income Inclusion Rule) imposes the supplementary tax at the level of the parent entity, on the low-taxed profits of its subsidiaries, if it is not already collected through the QDMTT.
   • The UTPR (Under-Taxed Profits Rule) applies if the IIR is not used. It allows the countries where the subsidiaries are located to collect the minimum tax based on the company's workforce and assets located in their territory, in proportion to the company's total workforce and assets located in UTPR countries.

Simplified example: A company from country A produces in countries A, B, and C (one-third of its production is carried out in each country) and locates all its profits in a country where they are taxed at 10%. The IIR allows country A to collect a supplementary tax of 5%. The QDMTT gives priority to country D to collect this supplementary tax itself. If countries A and D do not participate in the global minimum tax, the UTPR allows countries B and C to each collect 50% of the supplementary tax (2.5% each).

extraterritorial taxation at the heart of Pillar Two's architecture, which rests on three mechanisms: the income inclusion rule (IIR), which allows the parent country to collect the minimum tax; the under-taxed profits rule (UTPR), which allows the countries of presence to collect their share if the IIR is not applied; and the qualified domestic minimum top-up tax (QDMTT), which allows low-tax jurisdictions to apply the minimum rate themselves. This structure is intended to ensure full coverage of profits, including in the event of non-cooperation by a state. It is precisely this logic that Washington contests, considering the UTPR an infringement of its fiscal sovereignty and threatening retaliatory measures should it be applied to U.S. groups. This opposition calls into question the coherence of the multilateral framework and revives the temptation of unilateral responses.

In this context, this Letter relies on the model developed by Ferrari *et al.* (2024) to analyze the redistributive effects of Pillar Two, the limits linked to its partial implementation, as well as possible alternatives. The proposed framework models the trade-off of multinational firms between reporting profits in the place of production or shift them to a low-tax country, depending on tax differentials and the cost of shifting the tax base. It thus provides a tool for assessing the comparative impacts of different international tax rules on the location of production, tax revenues, and profits shifted toward low-tax jurisdictions.

■ Tax arbitrage, production and reforms

To analyze the effects of international tax reforms, Ferrari *et al.* (2024) develop a general equilibrium model in which multinationals choose jointly where to produce and where to declare their profits. These choices depend on both tax differentials and other economic determinants such as trade costs, multinational activity, market access, wages, etc. The model allows studying how international tax rules reshape the geographical distribution of production, profits and, ultimately, tax revenues.

The minimum corporate tax affects tax revenues in two distinct ways. First, tax revenues increase mechanically when governments levy the minimum tax. Second, the overall amount of profits shifted to tax havens decreases because the rate differential between production countries

and tax havens decreases: some companies no longer find it profitable to shift their profits. This effect depends on the elasticity of shifted profits with respect to tax. One of the key results is that companies reallocate their profits more easily than their production: the elasticity of profits to the tax rate is about three times higher than that of real activity. Indeed, it is easier to artificially shift profits than to shift productive activity. These two effects are also mitigated by the reaction of companies to the tax, which adjust their production choices after the implementation of the minimum tax. Ferrari *et al.* (2024) also propose a new methodology to estimate profit-shifting flows based on a gravity model, calibrated on rich macroeconomic data. Their results are summarized in Box 2.

The model simulations show that the establishment of a global minimum tax rate substantially increases tax revenues. A global adoption of Pillar Two would reduce the artificial shifting of profits to tax havens by 44% (equivalent to a 2.4% increase in global tax revenues), with marked redistributive effects: tax havens concentrate most of the gains through the application of QDMTT, while producing countries, although less affected, still increase their tax revenues thanks to the reduction in tax avoidance behaviors by companies.

In terms of overall efficiency, the reform results in a slight rebalancing of productive location, without major disruption of value chains. Indeed, one of the little-discussed virtue of the reform is that, by reducing the global dispersion in the corporate tax rate, taxation becomes a less decisive factor in location choices, thereby reducing distortions. Ferrari *et al.* (2024) estimate that the economic cost associated with the marginal relocation of profits remains lower than the net fiscal gains for most of the countries involved.

Beyond Pillar Two, a more ambitious reform would consist of a destination-based cash-flow tax (DBCFT), aligning profit taxation with consumption rather than production or legal location. Ferrari *et al.* (2024) also simulate these effects. Although economically robust against tax evasion, the DBCFT remains hypothetical due to its redistributive effects between countries and the political difficulties it implies.

Current debates focus on Pillar Two, the concrete implementation of which already raises issues of international coordination. In this context, the withdrawal of the United States constitutes an important turning point.

Box 2 – The Geography of Tax Avoidance: Gravity Rules

The estimates of Ferrari *et al.* (2024) are based on a structural gravity model of declared profits, in which multinationals arbitrate between different declaration locations based on tax differentials and bilateral frictions. This model, inspired by international trade approaches, allows quantifying the extent and global distribution of profit shifting. The model allows estimating shifted profits on a disaggregated scale, at the level of residence/production/tax-haven country triplets.

- In 2017, about 33% of the foreign profits of multinationals were declared in low-tax jurisdictions, equivalent to $350 billion.
- •This profit shifting artificially inflates the trade surpluses of tax havens (Laffitte and Toubal, 2022) and reduces tax revenues in producing countries.
- The flows of shifted profits follow a gravitational structure: they are more significant when the effective tax rate differential is high, the geographical distance is short, and the bilateral economic ties are deep.
- The average implicit cost of profit shifting is estimated at 12% of the transferred amount. This figure reflects both compliance costs, risks, and structural requirements (e.g., setup, intellectual property rights, etc)
- These estimates are aligned with other available estimates in the literature, made with different data (see Tørsløv, Wier and Zucman, 2020, who find that 36% of the foreign profits of multinationals are shifted to tax havens).

■ The withdrawal of the United States: A test for international coordination?

The effectiveness of Pillar Two relies on a cooperative architecture designed to limit incentives to deviate. The IIR, UTPR and QDMTT rules ensure full coverage of the global tax base. The mechanism is based on an incentive principle: every state has an interest in applying the agreement, otherwise another country will collect the top-up tax in its place.

The decision of the United States to withdraw from the framework illustrates a break with the logic of multilateral cooperation embodied by Pillar Two in favor of a unilateral response based on fiscal deterrence mechanisms. This withdrawal is accompanied by the threat of targeted retaliatory measures against countries applying the UTPR to U.S. groups. Qualifying these rules as "unfair foreign taxes", section 899 of the US tax code allows a progressive surtax up to an additional 20 percentage points, on passive income (interest, dividends, royalties) paid to entities located in "discriminatory" jurisdictions.

This escalation was defused at the end of June 2025 by a political agreement: in exchange for the withdrawal of section 899, the G7 members agreed to exclude U.S. groups from the scope of Pillar 2. Announced by Treasury Secretary Scott Bessent, this agreement seeks to ensure temporary coexistence of the U.S. minimum tax regime, the Global Intangible Low-Taxed Income (GILTI), and the GloBE standards. The main difference between these regimes is that GILTI applies a minimum rate to the group's overall effective tax rate, while the GloBE standard applies jurisdiction by jurisdiction. The GloBE standard is thus more stringent as it does not allow for compensation of tax rates between different countries of activity. This agreement remains fragile: limited to the G7, with no binding legal value and little economic justification, it opens the way to other requests for exemption and weakens the universality of the framework.

For the future, two trajectories are possible. The first would be to indefinitely extend the transitional derogation to the UTPR for the United States. This path would preserve the transatlantic relationship but weaken the universality of the GloBE framework. Conversely, the European Union and other promoters of the global minimum tax could choose to return to the strict application of the adopted framework, by applying the UTPR to U.S. firms. This position would strengthen the internal coherence and credibility of the multilateral agreement, but at the cost of a higher risk of political and commercial confrontation with the United States.

In Figures 1 and 2, we evaluate the two scenarios, assuming that the United States deviates from the multilateral agreement by applying, under the GILTI mechanism, a minimum tax of 10% or 13%, instead of the planned 15%. The analysis focuses on the macroeconomic impact of these choices, particularly on Gross Domestic Product (GDP). In the absence of clear information on possible US sanctions following the application of the UTPR, our analysis does not model such sanctions.

In a scenario of full participation in the reform, with a minimum rate of 15% and application of the UTPR, the United States would record a significant increase in tax revenues, at the cost of a moderate decrease in its real GDP (-0.155%). In the case of deviation, i.e., with a rate below 15% and without the application of the UTPR by other countries, the GDP loss would be mitigated: the contraction would be reduced by 18% (from -0.155% to -0.127%) in the case of a 10% rate. With a rate of 13%, the reduction in the loss would be 7%. These results illustrate a classic policy trade-off between tax revenues and economic activity. A lower rate limits the impact on production, but at the cost of reduced revenues. This compromise seems consistent with Donald Trump's stated priority: to favor employment and domestic competitiveness, even if it means giving up part of the tax revenues from multinationals.

In response to this deviation, several jurisdictions could choose to activate the UTPR clause to tax the under-taxed profits of U.S. groups operating on their territory. Figure 2 presents the results of this strategy, based on a sample of countries that have initiated the implementation of Pillar Two. If the United States applied a minimum rate of 10% without the activation of the UTPR by other countries, these jurisdictions could, by activating the clause, recover up to 15% of additional tax revenues compared to a situation where it would not be activated. If the rate chosen by the US was 13%, the gain would be reduced to 5.5%. These simulations highlight the strategic interest of the UTPR as a corrective mechanism in the event of non-cooperation. However, its effectiveness depends on close political coordination among the participating states, as well as on their legal capacity to enforce this rule with respect to foreign groups.

This option remains politically sensitive, as it could lead to retaliatory measures by the United States, which rejects the application of the UTPR on the grounds that it constitutes extraterritorial taxation infringing on its fiscal sovereignty.[4]

Finally, a paradox deserves to be highlighted: U.S. tax revenues are higher when the UTPR is applied. This result, counterintuitive at first

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4. According to Avi-Yonah (2025), the UTPR is similar to the widely recognized CFC-type rules (Subpart F, GILTI) and is part of a logic of unitary taxation of multinational groups.

Figure 1 – Effect of a deviation from Pillar Two on US GDP, when the UTPR is not applied
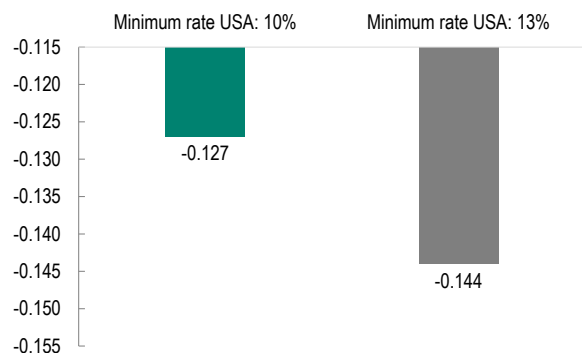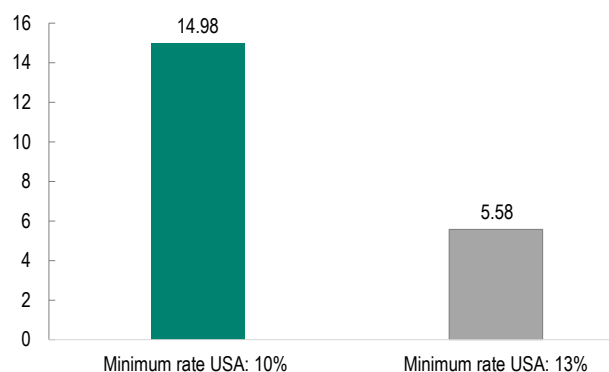

Source: Calculations based on the model developed by Ferrari *et al.* (2024). This figure shows the percentage change in US GDP depending on the minimum rate it applies.

Figure 2 – Tax revenue gains after UTPR application (as a % of the gain in the absence of application)n)

Source: Calculations based on the model developed by Ferrari *et al.* (2024).

sight, is explained by a central element of the model of Ferrari *et al.* (2024): the consideration of firms' behavioural reactions to taxation. When the UTPR is activated, it becomes less advantageous for U.S. companies to artificially locate their profits in low-tax jurisdictions. Indeed, the UTPR imposes an effective rate of 15% even in these territories, which neutralizes their fiscal attractiveness. In response, companies choose to repatriate a larger share of their profits to the United States, where they are now relatively less disadvantaged fiscally. In other words, the UTPR improves the domestic tax base of the United States, despite its extraterritorial origin. This result highlights the underlying policy trade-off: should the priority be to increase tax revenues or to limit the effects of taxation on national economic activity (GDP)?

The episode of U.S. withdrawal highlights the structural tension that runs through Pillar Two: the more credible the collective discipline, the more it compresses the margins of unilateral competitiveness; conversely, each derogation expands these margins but weakens the global tax base and the coherence of the reform. The simulations showing the corrective effect of the UTPR (profits repatriation and strengthening of the taxable base) confirm that the effectiveness of the framework depends on a symmetrical acceptance of the constraints by the major economies.

■ Conclusion

In the short term, the European Union must arbitrate between preserving multilateral cooperation in tax matters and the consequences of a geo-economic confrontation with the United States. At a time when the European Union seeks to exist as an economic and political power, its ability to build a common and coherent tax base will condition the effectiveness of its industrial policies, its strategic autonomy and its place in the global economy.

Indeed, corporate taxation is not an autonomous field: fiscal instruments will be essential to building an ambitious industrial policy, as illustrated by the U.S. example with the Inflation Reduction Act. The existence of a common, credible and predictable tax framework appears necessary. In this perspective, integrating all companies operating on its territory into the GloBE standard seems essential.

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