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**Research Report**

## Toward unitary taxation of MNEs

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### **Toward unitary taxation of MNEs**

by

Sol Picciotto\*

The international tax system is in the throes of major transformations. In 2013, the G20 [gave its support](#) to the OECD-led project on base erosion and profit shifting (BEPS), calling for reforms to ensure that MNEs can be taxed on their profits “where economic activities occur”. Measures recommended in 2015 only patched up the system, and in 2016, participation was widened to include all willing states through the [Inclusive Framework on BEPS](#). In 2021, the OECD [announced a package](#) captioned as the Two Pillar Solution. However, [closer analysis shows](#) that the actual measures fall short of a fair and comprehensive solution. A new initiative is needed that could build on the principles and detailed technical standards that have been agreed.

A turning point in the BEPS project was the [proposal from the G-24 group of](#) developing countries in 2019, arguing that MNEs should be taxed in every country where they have a “significant economic presence”, by apportioning their global profits. This would replace the outdated physical concept of a “permanent establishment” for a taxable nexus, as well as the traditional dysfunctional approach under which countries attempt to tax MNE affiliates within their jurisdiction, using the fictitious principle that they are independent entities transacting with each other at “arm’s length”. Instead, MNEs should be taxed in accordance with the economic reality that they operate as unitary enterprises, by apportioning their consolidated profits for taxation according to their real activities in each country based on the factors that generate profits: employees, physical assets and sales.

This was accepted in Pillar One, which allows countries to tax a share of MNEs’ global profits based on sales, regardless of physical presence. However, this so-called “Amount A” would apply to only a small share of the profits of fewer than 100 of the largest and most profitable MNEs, leaving in place the current defective arm’s length rules for all other purposes. Layering this new approach on top of the existing rules, instead of replacing them, creates additional

complexity, while resulting in a relatively low reallocation of MNE profits. Implementation would require ratification of the [multilateral convention for Amount A](#) by a critical mass of states. Agreement has not been reached on a final version at this time, and there are serious doubts over the likelihood of US ratification, which is essential for its adoption.

What is now needed is a concerted initiative by willing states to move toward taxing MNEs as unitary enterprises based on formulary apportionment. Coherence could be ensured by adopting the standards already agreed in the two Pillars:

- A simple quantitative threshold of sales revenue for taxable nexus.
- Defined adjustments for tax purposes of MNEs' global consolidated accounts.
- Rules defining the source of sales revenues and for defining and valuing physical assets and employee remuneration.

The initiative could therefore build on the work already done, while going beyond it, to achieve a more comprehensive reform, in line with the 2013 G20 mandate. It would [ensure](#) that all MNEs can be taxed on their global profits only once—but at least once—by the countries where their real activities occur, satisfying the single tax principle that for a century has been the aim of international tax rules. This has not been achieved in practice under the arm's length approach, as [some have pointed out](#); but since it refers to the income of the same person or entity, it can only be effectively achieved by the unitary taxation of MNEs.

Unitary taxation would:

- be relatively easy to administer and provide certainty for both MNEs and tax administrations;
- provide a balanced and fair allocation of rights to tax MNE profits among countries where they have real activities;
- boost revenues from corporate tax that are important for the sustainable development of all—especially developing—countries; and
- ensure tax equality between MNEs and local business entrepreneurs.

These ambitious aims cannot be achieved in one step, or through a single multilateral agreement. Recent experience shows that progress is possible through a coordinated initiative by like-minded governments. There would be wide support from public opinion around the world for effective reforms that could ensure fair taxation of large and powerful MNEs, which is essential to restoring confidence in the legitimacy of taxation.

This could be an early priority for the global tax body that many hope will result from the [current negotiations](#) to agree on a UN Framework Convention on International Tax Cooperation. This unprecedented initiative has resulted from the series of existential crises the world has faced: a financial crash, worldwide evidence of oncoming environmental catastrophes and a viral pandemic revealing the weaknesses and inequalities of healthcare around the world.

International cooperation, including an effective way to tax MNEs, is essential to support states' capacity to mobilize the resources needed for global survival as well as to achieve the sustainable development goals. We may hope for a rapid success for this process, so that a truly global tax body can take up the many urgent needs to support states and coordinate their efforts to ensure effective taxation in today's globalized economy.

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