The New US Administration Has the European Union Navigating Between Scylla of Pillar 2 and Charybdis of US Retaliation

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On 20 January 2025, Inauguration Day in the United States, newly sworn in President Donald Trump issued a presidential memorandum declaring that commitments made by the Biden Administration in the context of the OECD's two-pillar solution had no continued force in the United States. While the memo did not withdraw the United States from the OECD or even the Inclusive Framework's continued discussions, it did send a clear signal that the new US Administration has little, if any, interest in the contents of the deal or in seeing it incorporated into US law. This note provides an overview of the status quo both at EU and US level and looks into the US position going forward in the aftermath of Mr. Trump's announcement.

1. Where are we now?

In response to the release of the Pillar 2 rules by the OECD in late 2021, many countries proceeded with implementation. The European Union negotiated and enacted the Minimum Taxation Directive (2022/2523) requiring Member States to implement the rules, including both the income inclusion rule (IIR) and the undertaxed profits rule (UTPR), the two backbones of the system. As of early May 2025, all EU Member States have implemented the rules save for five states (Estonia, Latvia, Lithuania, Malta and Slovak Republic) that elected to delay implementation until no later than 2030, as permitted by the Minimum Taxation Directive (2022/2523).

Administrative guidance from the OECD issued in February and July 2023 provided a UTPR safe harbor, exempting from UTPR any entity with an ultimate parent located in a jurisdiction with a nominal tax rate of at least 20% as well as rules for the allocation of taxes under blended CFC regimes, such as the US GILTI. The OECD aimed the guidance at avoiding friction between the United States and those countries that had progressed to implementation. Both the allocation rules and the safe harbor expire at the end of 2025.

The US GILTI regime was a source for the IIR included in Pillar 2, but works on a blended global basis, rather than the country-by-country basis that is required under Pillar 2. The United States also maintains certain significant non-refundable tax credits – such as the credit for research and development – that are not Pillar 2 compliant and so serve to reduce a taxpayer's effective tax rate (ETR) to below the required 15% minimum. Rebecca Burch, the US Treasury official responsible for negotiations with the OECD has stated that the United States will not implement Pillar 2.

2. Where do we go from here?

Several business groups in the European Union have suggested that the bloc take a step back and reassess whether to continue with Pillar 2 implementation, with at least one group suggesting a suspension of the Minimum Taxation Directive (2022/2523). Although the idea of a suspension received positive comment from certain German state finance ministers, Hungary is so far the only member state to endorse such an idea. The Polish Presidency of the EU Council has tabled three options for moving forward: an amendment of the Minimum Taxation Directive (2022/2523) to extend or make permanent the UTPR safe harbor, alterations to the Pillar 2 rules on tax credits – particularly the refundability requirement – in order to minimize the likelihood that US companies will have an ETR lower than the 15% that triggers top up taxes, and a decision to deem the US GILTI regime as Pillar 2 equivalent such that US companies would not be subject to the rules in other jurisdictions.

The options presented are generating considerable debate in the European Union. Parties of the political left in the EU Parliament have signaled opposition to an extension of the UTPR safe harbors. The European People's Party appears to favour a preservation of the larger OECD deal than the particulars of the Minimum Taxation Directive (2022/2523). Business groups have suggested that a combination of the three options would work. Various EU and Member State officials have opined on the relative complexity of the various options.

And of course, there is the US position. Burch has said that the United States may not consider the options presented as being enough. The US position is that the GILTI regime should be permitted to exist side-by-side with the Pillar 2 regime such that US companies would not be subject to the Pillar 2 rules at all, avoiding the need for US multinationals to file Pillar 2 information returns or report top up taxes in any jurisdiction. Comments from Burch suggest that the permanent safe harbor option, if structured well, could satisfy US demands.

This leaves a narrow opening to get to a satisfactory solution. Although the European Union appears willing to address concerns through amendments to the Minimum Taxation Directive (2022/2523), an approach that applies only within the bloc has the potential to create friction with economically significant non-EU nations like Canada, Australia, Brazil, India and Japan. Those countries would not be party to any EU processes that lead to a Directive-based solution and would not necessarily have the buy-in to follow the European Union's lead.

3. What happens without agreement?

If agreement cannot be found, it is clear that the US Administration is not afraid to use retaliatory measures, even where those measures may create difficulties in terms of US economic conditions. Of course, the Administration has already shown its willingness to impose tariffs on imports. There is no reason to think that such action would not be on the table in response to perceived tax discrimination against US companies.

In addition, the 20 January presidential memo directed the US Treasury to examine whether the OECD rules are consonant with the existing bilateral tax treaties the United States is party to, suggesting that the Administration is willing to invoke treaty remedies. The question of whether the UTPR in particular violates existing tax treaties is at times hotly contested among academics and commentators, but to date there has not been an official government statement taking the "treaty violation" side of the argument.

Finally, US law currently allows for retaliation against "discriminatory" and "extraterritorial" taxes. Under section 891 of the US Internal Revenue Code (IRC), the US President can proclaim that a foreign country is subjecting US taxpayers to discriminatory or extraterritorial taxes, resulting in the doubling of tax rates (but not to exceed 80%) on individuals and companies from that foreign country. This would be a significant issue, as the statute does not define the terms discriminatory or extraterritorial so as to meaningfully constrain the President's authority. However, section 891 was enacted in the 1930s, and canons of construction in the United States generally require that a later-signed treaty takes precedence over a pre-existing statutory provision absent a clear indication that the earlier provision controls. All of the United States' tax treaties were signed after the enactment of section 891, meaning that it could be a "dead letter" when it comes to US treaty partners.

To combat this potential issue with section 891, members of Congress have introduced legislation (H.R. 591 – The Defending American Jobs and Investment Act) to create a new section 899, which would serve a very similar purpose – to automatically increase taxes on foreign taxpayers from countries deemed to be imposing extraterritorial or discriminatory taxes. Unlike section 891, the new section 899 would provide definitions for "discriminatory" and "extraterritorial." Generally, the definitions are written with the UTPR as well as digital services taxes in mind, but are not limited to those levies. Like section 891, it would be up to the President, through the Secretary of the Treasury, to submit a list of countries with such taxes to Congress every 6 months.

If the Treasury identifies a country as imposing discriminatory or extraterritorial taxes, the tax rates on individuals who are citizens of said country and corporations created and organized under the laws of that country will increase by 5 percentage points over statutory levels for each year that the country continues to impose such taxes, up to a maximum increase of 20 percentage points. Section 899 would also provide that withholding taxes would be determined without regard to treaty obligations, meaning the increases would be from the 30% statutory base rather than any reduced treaty rate, resulting in a far higher increase in taxes than the stated 5 to 20 percentage points.

If the provision passes – which is much more likely given the political composition of both houses of the US Congress – and is invoked, the results could be significant, to understate the case. With tax rates jumping from 0% in the case of many withholding tax provisions of treaties between the United States and EU Member States to as much as 50% (should the "discriminatory" or "extraterritorial" tax be kept in place for 4 years), it would be impossible for the European Union and other countries not to respond. The form such a response might take would of course depend on the tools that domestic laws make available, but every country would at the very least have the option of withdrawing from its bilateral tax treaty with the United States, instantly increasing rates on US individuals and companies. The result would be an uncertainty spiral and economic shock that could rival the disruptions recently caused by the US Administration's moves in the tariff and trade realm.

4. Conclusion

The new US position, or at least its maximalist version, creates a dangerous situation for Europe, coming on top of several other US-created disruptions. We can only hope that a modern-day Odysseus emerges to bring the European Union through it, finding a solution that satisfies the political needs on both sides of the Atlantic without undoing the work that the European Union has done to date on Pillar 2 and the larger project of tax harmonization among Member States. But it would not take much to find the international tax ship dashed on the rocks or sucked into the whirlpool.

IBFD references:

- EU tax law developments are reported on the daily IBFD Tax News Service page.
- For an overview of the worldwide developments on Pillar Two and their implementation across the globe, *see* the Pillar Two Dossier.
- I. Grinberg, Klaus Vogel Lecture 2024: The Future of Global Minimum Tax Enforcement, 79 Bull. Intl. Taxn. 2 (2025), Journal Articles & Opinion Pieces IBFD.
- Katerina Ilieva, *The US-EU Tariff War: From Cooperation to Confrontation*, EU Tax Focus (10 April 2025), IBFD.