# CHAPTER 7 – GLOBE RULES: Current status and issues[309]

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## Part 1: Analysis of the GloBE rules: the search for an international framework

### 1. Background

The growth of globalisation experienced in the last half century has allowed a considerable increase in cross-border relations across the globe.

There are several reasons for this phenomenon. The fact that since the Second World War we have lived in relatively peaceful times - something that may, unfortunately, be reversed - enabled many States to conclude trade agreements, integration treaties as well as tax treaties, typically concluded to develop their economic relationships, and therefore intensifying relations between them. Furthermore, the emergence of digitalisation and new technologies, namely in communication, information and transport has allowed a greater openness and connection between people, cultures, and economies, and as a consequence we can state that today we live in a true global village (T. Gibson et al., 2012, 312-313).

However, as a result of this same globalisation and digitalisation, we find ourselves in a crisis of national state sovereignty, and in particular a crisis of the fiscal state (Dourado, 2018, p. 27).

The existing international tax system is threatened by tax competition, tax planning and there is a true race to the bottom of the corporate income taxes (van Dam et al., 2021, p. 164). Ending it would be a game changer (Devereux et al., 2021, p. 1) since it is calling into question the functions of taxes in different states and unbalance the international tax order (Dourado, 2018, p. 30).

Taking into account all these challenges, the OECD released in 2013 the Action Plan on Base Erosion and Profit Shifting in which it put forward 15 major actions "covering elements used in corporate tax-avoidance practices and aggressive tax-planning schemes" (Remeur, 2019, p. 1).

Following this plan, the OECD/G20 Inclusive Framework ("IF") on Base Erosion and Profit Shifting continued its work, this time attempting to address the tax problems arising from the digital economy as a priority (van Dam et al., 2021, p. 164) since the rules as they currently stand, do not effectively address the tax gap (Brokelind, 2021, p. 212), due to being "inadequate to deal with tax base erosion

occasioned by state aid practices and advantageous tax rulings" (Das et al., 2022, p. 44).

To answer this problem, the question was divided into two policy goals, creating on one hand Pillar 1 and on the other Pillar 2. The former proposes a partial re-allocation of taxing rights towards market jurisdictions, while the latter aims to introduce minimum effective taxation for large multinational groups.

With regard to Pillar 2, which is the object of this article, and in order to cease or attenuate this problem, the OECD has devised a set of rules to ensure that Multinational Enterprises ("MNE") pay a fair amount of tax wherever they operate, in an ongoing attempt to put a stop to tax practices that allow them to move profits to jurisdictions where they are subject to no or low taxation. This action is significant, but it is also raises questions.

Through the establishment of a global minimum level of taxes, this important reform intends to set a floor on competition over corporate income tax rates. In theory, the global minimum tax reform will level the playing field for businesses worldwide by removing a significant portion of the benefits of transferring profits to countries with no or low taxation, and will allow jurisdictions to better safeguard their tax bases.

On 8 October 2021, 136 jurisdictions (currently counting 137) reached an agreement under the Statement on a Two-Pillar Solution to Address The Tax Challenges Arising from the Digitalisation of the Economy (hereinafter "Global Agreement"), which has then been translated into the Global Anti-Base Erosion Model Rules (hereinafter "GloBE Model Rules") approved on 14 December 2021 by the OECD/G20 Inclusive Framework on BEPS.

## 2. General Issues

### 2.1. Object

As previously stated, the GloBE rules intend to impose a minimum taxation on MNE groups on the income arising in each jurisdiction where they operate, which was agreed to be at 15% effective tax rate[310].

To get a clear understanding of this reform, it is essential to grasp and define a few concepts put forward in the GloBE Rules.

The first one is the concept of a "Group", which, for the purposes of the GLoBE Rules, means a collection of Entitiesthat are related through ownership or control such that the assets, liabilities, income, expenses and cash flows of those Entities: i) are included in the Consolidated Financial Statements of the Ultimate Parent Entity[311] ("UPE"), or ii) are excluded based on size or materiality grounds or on the grounds that the Entity is held for sale[312].

The concept of a Group also includes any Entity located in a jurisdiction which has one or more Permanent Establishments ("PE") located in other jurisdictions as long as they do not meet the above criteria to be considered a group[313].

In turn, a MNE group means any group that includes, at least, one entity or PE which is not located in the jurisdiction of the Ultimate Parent Entity ("UPE")[314].

Finally, it must be mentioned that the UPE stands at the heart of the system, since it is considered to be the entity in the best position to guarantee that the group's jurisdictional taxation level meets the agreed minimum rate.[315]

According to the GloBE rules, an UPE encompasses an Entity that:

a. owns directly or indirectly a Controlling Interest in any other Entity, and it is not owned, with a Controlling Interest, directly or indirectly by another Entity,[316] or
b. the Main Entity of a Groupis located in one jurisdiction and has one or more Permanent Establishments located in other jurisdictions provided that the Entity is not a part of another Group.[317]

Pillar two and its effectiveness depends on the proper application of three main rules:

1. The Income Inclusion Rule ("IIR")
2. The Undertaxed Payments Rule ("UTPR")
3. Subject to Tax Rule ("STTR")

Under the IIR, a parent entity (primarily the UPE) of an MNE group is charged a top-up tax "on a parent entity in respect of the low taxed income of a constituent entity"[318].

The UTPR acts as a backstop to the IIR, denying deductions or requiring an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR.[319]

Together these two two interlocking domestic rules are known as the GloBE rules[320], with the former becoming effective in 2023, and the latter having effect from 2024 onwards.

Regarding the STTR, it consists in a treaty-based rule that "allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate"[321] and is not subject to analysis in this article.

### 2.2. Scope

The GloBE rules apply to Constituent Entities that are members of MNE groups with an annual revenue (as determined under applicable Consolidated Financial Statements of the UPE) of at least 750 million EUR, in no less than two of the four

consecutive preceding fiscal years[322]. If the fiscal year does not correspond to a period of 12 months, a pro rata will be applied[323].

Smaller groups than the value agreed upon and purely domestic groups (unlike under the proposed EU framework discussed under part 2) are not subject to these rules.[324]

Furthermore, certain entities due to their intrinsic nature and object pursued are excluded from the scope of application of the GloBE rules, namely governmental entities, international or non-profit organizations, pension funds, investment entities or real estate investment vehicles that are ultimate parent entities[325].

Moreover, entities that present the following criteria are also excluded from the scope:

a. where at least 95% of the value is owned by Excluded Entities[326];
b. where an entity acts solely (or virtually solely) for the advantage of Excluded Entities by holding assets or investing funds[327];
c. where an entity only performs activities that are ancillary to those performed by an Excluded Entities[328];
d. where at least 85% of the value of the Entity is owned by an Excluded Entity provided that substantially all of the Entity's income is Excluded Dividends or Excluded Equity Gain or Loss that is excluded from the computation of GloBE Income or Loss.[329]

Excluded Entities are not considered for the purposes of the computations under GloBE rules, except for the application of the revenue threshold[330].

## 3. Income Inclusion Rule

### 3.1. Application of Income Inclusion Rule

The main rule[331] for the application of the IIR in the UPE jurisdiction establishes that the UPE of an MNE group that owns (directly or indirectly) an Ownership Interest in a Low-Taxed Constituent Entity at any time during the Fiscal Year shall pay a tax in an amount equal to its Allocable Share of the Top-Up Tax of that Low-Taxed Constituent Entity (LTCE) for the Fiscal Year[332].

That being said, the UPE is the entity that, as a general rule, is required to apply the IIR. Indeed, if the UPE *"is in a jurisdiction where a Qualified IIR is in effect for the Fiscal Year and none of the LTCEs of the MNE Group are held by a POPE [partially owned parent entity] required to apply a Qualified IIR, then the IIR will only be applied by the UPE in the UPE Jurisdiction"*.[333]

On the contrary, *"if the UPE is located in a jurisdiction where it is not required to apply a Qualified IIR for the Fiscal Year, then under the top-down approach the next Intermediate Parent Entity down the ownership chain is required to apply the IIR to its Allocable Share of the Top-up Tax for an LTCE in which it holds a direct or indirect Ownership Interest"*.[334]

In the scenario that low taxed constituent entities are more than 20% owned by a minority interest holder outside the MNE Group regardless of where the UPE is located, the top-down approach will not be followed, and instead partially owned parent entities (POPE) are bound to apply the IIR, proportionally, to their allocable share of top-up tax.[335]

### 3.2. Allocation of the IIR top-up tax

The amount of tax due by the Parent Entity on a Low-Taxed Constituent Entity depends on its allocable share of top-up tax[336].

The allocable share is *the amount of Top-up tax owed in respect of an LTCE, determined by reference to the Parent Entity's Ownership Interest in the income of the LTCE*[337]. It can be reached *by multiplying the Top-up Tax of the LTCE by the Parent Entity's Inclusion Ratio*[338].The Parent Entity's Inclusion Ratio, in turn, represents *the ratio of the Parent Entity's share of an LTCE's GloBE Income to its total GloBE Income for the Fiscal Year*[339].

The Parent Entity's Inclusion Ratio for a Low-Tax Constituent Entity for a Fiscal Year translates into the following formula:

> Parent Entity's Inclusion Ratio for a Low-Taxed Constituent Entity for a Fiscal Year =
> (GloBE Income – GloBE Income allocable to Ownership Interests held by the other owners) / Total GloBE Income of the Entity[340].

### 3.3. Offset mechanism

The offset mechanism applies where any parent entity owns an ownership interest in a Low-Taxed Constituent Entity indirectly through an Intermediate Parent Entity or a Partially-Owned Parent Entity[341].

In this case, if the intermediate parent entity or the partially owned parent entity, are subject to a qualified IIR, the top-up tax due by parent entity is reduced by an amount equal to the portion of their allocable share in the top-up tax that is due by the referred entities, under the qualified IIR[342].

### 3.4. The IIR in scholarly literature

The IIR has been analysed by scholars from different perspectives since it has been conceptualized under the Pillar Two Blueprint. Primary focus has been given to analysis under international law principles, comparison and relationship with CFC rules, design issues, and interaction with tax treaties. Some examples will follow.

One of the points raised is how the application of a rule such as the IIR affects sovereignty. Schmidt (2020, p. 996) considers that the IIR can be seen as an "infringement of other states' fiscal self-determination" since the source States's decisions on their own tax system become conditioned by the IIR. The author considers, therefore, that the income inclusion rule can be in conflict "with some of the most fundamental principles of international taxation as the proposed rule may in fact lead to taxation in the jurisdiction of a parent company of income that has exclusively been generated through genuine economic activities in another state (conflict with the source principle) by solely obtaining benefits in that other state (conflict with the benefits principle)."

In parallel Silva (2020, p. 123), advocates that the Pillar Two rules may express a "significant encroachment on the sovereignty of jurisdictions". Tax systems are designed to suit on the particularities and needs of each country and as long as they are linked to a substantive-based business wherever the income is generated, tax competition emerges as a valid option.

The IIR and subsequently the Pillar Two rules are not restricted to counter abuse practices. On the contrary, they target every MNE's whose constituent entities in a given jurisdiction that are taxed below the 15 % ETR. However, the IIR has been described by scholars as a "super-CFC" (Hey, 2020). And curiously, even before the first steps were taken towards the implementation of Pillar Two, Avi-Yonah (Avi-Yonah, 2016, p. 155), already described the CFC rules "as a de facto worldwide system with a minimum tax".

This relationship is also noted when Silva (2020, p. 141) argues to favour the adoption of CFC regulations instead of the implementation of Pillar Two by alternative jurisdictions, since there is already a wide familiarity with those rules, therefore avoiding uncertainty and duplication of additional legislation.

On what the design options are concerned, Arnold (2022, pp. 5–6) pointed out the unclarity around the allocation of the initial right to impose the top-up tax, to resident countries instead to source countries. The author considers this option is "largely a formality that does not really determine whether residence or source country tax has priority".

Regarding the IIR and its relationship with the OECD Model, Schoueri (2021, p. 7) states that a Pandora Box may be open given the fact that this "could lead to a taxation according to the unitary approach". In other words, extending the application of the IIR to profits derived from value creation in the other state, not only distorters the logic of the economic allegiance, but also contradicts article 7 (1) of the OECD Model. An eventual application of the article 3 (1) of the OECD Model may seem the solution, however a contradiction to the idea of value creation would still prevail.

## 4. Undertaxed Payments Rule

As stated above the UTPR acts as a backstop of the IIR. This mechanism was put in place to guarantee that the minimum tax is paid even if no top-up tax is collected under a qualified IIR, or not all of the top-up tax is allocable to the UPE is collected under the IIR (Dietrich & Golden, 2022).

Therefore, the UTPR allows for an adjustment in respect of the Top-up Tax calculated for a low-taxed constituent entity, *to the extent that such Top-up Tax is not brought within the charge of Qualified IIR*[343].

The UTPR may take one of two forms:

a. The denial of deduction, according to which the Constituent Entities of an MNE Group will not be allowed to deduct otherwise deductible expenses *"in an amount sufficient to result in the Constituent Entities located in the UTPR Jurisdiction having an additional cash tax expense equal to the UTPR Top-up Tax Amount allocated to that jurisdiction"*.[344] The amount of tax payable as a result of the denial of a deduction is "*equal to the taxpayer's rate of tax multiplied by the amount of the payment for which the deduction was denied*".[345]
b. An adjustment that is equivalent to the denial of a deduction, but for which the Model Rules do not prescribe any specific mechanism: the design and implementation of adjustment mechanisms is left to the domestic law of the UTPR jurisdictions.

In any case, the UTPR results in an additional cash tax expense, increasing the amount of tax that the Constituent Entities would otherwise have paid under the domestic law, and therefore is applied after any domestic law provisions affecting the deductibility of expenses.[346] Even though the additional cash tax expense is determined in respect of the fiscal year, if certain adjustment is insufficient to result

in enough additional cash tax expense to equal the UTPR Top-up Tax Amount allocated to the jurisdiction for the fiscal year (because, for example, there is a limited amount of deductible expenses), the difference is carried forward to the following years.[347]

The determination of the ETR and the amount of top-up tax follows the same computation rules as the IIR, notably the GloBE income or loss, the covered taxes, and the application of the substance-based exclusion[348].

The *Total* UTPR top-up tax amount in a certain fiscal year is the sum of the top-up tax calculated for each of the low taxed constituent entities, i.e., those located in a jurisdiction where the MNE's jurisdictional effective tax rate is below the Minimum Rate. [349] Consistently, the jurisdictional UTPR top-up tax is determined by multiplying the total UTPR top-up tax amount by the jurisdiction's UTPR percentage.

The jurisdiction's UTPR percentage, on its turn, is computed taking into account the following quantitative factors[350]:

- Dividing the number of Employees in the jurisdiction by the number of employees in all UTPR jurisdictions and then sum up 50% of the value reached
- Dividing the total value of tangible assets in the jurisdiction by the total value of tangible assets in all UTPR jurisdictions and then sum up 50% of the value reached.
- Summing up both values.

After determined the UTPR top up-tax and the jurisdictions' UTPR percentage, both values are multiplied to reach the UTPR top-up tax levied by a jurisdiction.

## 5. Computation and Allocation of Qualifying Income or Loss

### 5.1. Computation of GloBE Income or Loss

The starting point for the computation of GloBE income or loss is the Financial Accounting Net Income or Loss of each of the Constituent Entities[351], meaning that the first step towards determining the GloBE income or loss is calculating the *net income or loss of the Group Entity before making any consolidation adjustments that would eliminate income or expense attributable to intra-group transactions*[352].

In principle, the consolidated financial statements are the financial statements prepared by a UPE in accordance with an acceptable financial accounting standard[353]. In the case that the UPE does not have financial statements prepared consonantly one of the acceptable financial accounting standards an adjustment would be necessary to prevent material competitive distortion using an Authorised Financial Accounting Standard[354].

However if it is not reasonably practicable for the Constituent Entity to use the UPE's financial accounting standard to compute the Constituent Entity's Financial Accounting Net, it may use an alternative accounting standard, depending on the fulfilment of three criteria:

- the financial accounts of the Constituent Entity are maintained based on that accounting standard[355]
- the information contained in the financial accounts is reliable; and[356]
- permanent differences in excess of EUR 1 million that arise from the application of a particular principle or standard to items of income or expense or transactions that differs from the financial standard used in the preparation of the Consolidated Financial Statements of the Ultimate Parent Entity are conformed to the treatment required under the accounting standard used in the Consolidated Financial Statements of the Ultimate Parent Entity[357].

### 5.2. Adjustments to determine GloBE Income or Loss

There are differences between each Inclusive Framework jurisdiction's financial accounting net income or loss since each of them has its own combination of additions to and exclusions to reach the taxable income under its domestic tax law[358].

Considering that the financial accounting net income is the jumping-off point to determine the GloBE Income or Loss for all Constituent Entities wherever located, discrepancies may arise as a result.

To avoid these discrepancies, a set of adjustments to the financial accounting net income was put in place by the following amounts[359]: net tax expense; excluded dividends; excluded equity gain or loss; included revaluation method gain or loss; gain or loss from disposition of assets and liabilities excluded; asymmetric foreign currency gains or losses; policy disallowed expenses; prior period errors and charges in accounting principles; and accrued pension expense.

Furthermore, given the specific characteristics of certain sectors, activities and features, the GloBE rules provides some exceptions for the computation of the qualifying income or loss, namely: special rules for intragroup financing arrangements[360]; exclusion of certain insurance company income[361]; additional tier one capital[362]; exclusion of international shipping income[363]; special rules for the allocation of income or loss between a main entity and a permanent establishment[364]; special rules for the allocation of income or loss from a flow-through entity[365].

## 6. Computation of Adjusted Covered Taxes

In order to effectively calculate if a constituent entity is a low-taxed entity and to know if the application of this regime is needed, firstly we have to set *the amount of taxes that are to be associated with that GloBE Income or Loss for purposes of calculating the ETR.*[366]

For the purposes of the GloBE Rules, covered taxes comprise *taxes imposed on a Constituent Entity's income or profits as well as Taxes that are functionally equivalent to such income taxes and Taxes on retained earnings and corporate equity*[367], including for that matter, taxes on income, profits or its share of the income or profits[368]; taxes on profit distributions or deemed distributions[369], taxes imposed in lieu of a generally applicable corporate income tax[370], taxes levied by reference to retained earnings and corporate equity[371].

On the other hand, the GloBE Rules exclude from its covered taxes any Top-up tax or UTPR applied[372], disqualified refundable imputation taxes[373] and taxes paid by an insurance company in respect of returns to policyholders[374].

After all tax expenses relating to covered taxes are summed up, a number of adjustments are made, to *arrive at adjusted covered taxes*[375].

## 7. Computation of the Effective Tax Rate and the Top-Up Tax

### 7.1. Determination of the jurisdictional effective tax rate

The Effective Tax Rate ("ETR") is a key piece of the GloBE Rules, considering that it's applied to determine *whether in a Fiscal Year, the MNE Group is subject to a minimum level of tax on its income arising in a particular jurisdiction and, if the jurisdiction's ETR is below the minimum rate*[376], which stands at 15%.

As a general rule, the ETR is computed on a jurisdictional basis, which protects the applicability of the regime from "shifting income and taxes between Constituent Entities located in the same jurisdiction and avoids potential distortions caused by particular features of the domestic tax system"[377]. There are only three exceptions to this rule: Investment Entities and Insurances Investment Entities[378]; Constituent Entities in which the UPE holds 30% or less of the Ownership Interests but nonetheless, it has a Controlling Interest in the Entities[379]; stateless Constituent Entities[380].

The calculation of the ETR of an MNE Group translates into the following formula[381]:

ETR = The sum of the Adjusted Covered Taxes of Each Constituent Entity located in the jurisdiction for the Fiscal Year / Net GloBE Income of the jurisdiction.

The Adjusted Covered Taxes of Each Constituent Entity shall be calculated as stated in the previous section. On the other hand, the Net GloBE Income of the jurisdiction is the difference between the Income and the Loss of all Constituent Entities of a Jurisdiction calculated as explained in section 5.

### 7.2. Computation of the top-up tax payable in a jurisdiction

To correctly quantify the Top-up Tax due in a particular jurisdiction and its allocation to the Low-Taxed Constituent Entity Constituent Entities located in that jurisdiction, the following steps are to be followed:

The first step is to calculate the Top-up Tax Percentage, as the rate needed to bring the tax rate on the Excess Profit of the low-taxed jurisdiction up to the Minimum Rate. A jurisdiction *is considered Low-Taxed Jurisdiction in respect of the MNE Group and the Constituent Entities located in the jurisdiction are considered LTCEs when the ETR is below the Minimum Rate*[382]. The Top-up Tax Percentage can be reached by the following formula:

Top-up tax percentage = Minimum Rate (15%) – Effective Tax Rate[383].

Subsequently, it is necessary to calculate the amount of Excess Profit that is subject to the Top-up Tax Percentage. It shall be determined through the following formula:

Excess profit = Net GloBE Income – Substance based Income Exclusion[384].

Two notes must be pointed out about the excess profit. The first one is that the taxpayer may choose not to apply the Substance-base Income Exclusion. In that case, the amount of Excess profit is the same as to the Net GloBE Income for the jurisdiction[385]. The second one is that if the Substance-based Income Inclusion is equal or above the Net GloBE Income, there will be no *Top-up Tax computed for that year unless there is Additional Current Top-up tax for that Fiscal Year*[386].

As for the Jurisdictional Top-up tax, its formula is composed by four elements: Jurisdictional Top-up tax[387] = (Top Up tax Percentage x Excess Profit) + Additional Current Top-up Tax – Domestic Top up Tax. The element of the formula that has not been explained so far, the Additional Current Top-up Tax, refers to the *amount of Top-up Tax added to the current year that is attributable to certain re-calculations of the Top-up Tax in previous years*[388]. On what concerns the Domestic Top up tax there is no obligation by a jurisdiction to adopt it under the common approach. However, if adopted, the Top-up tax may be brought down to nil.[389]

Finally, and after the jurisdictional top-up tax is determined, the Top-up tax should be allocated to the Constituent Entities located in the respective jurisdiction in accordance with the following formula[390]:

Top up Tax of a Constituent Entity = Jurisdictional Top up Tax x (Globe Income of the CE/ Aggregate GloBE Income of all CEs).

### 7.3. Substance-based Income Exclusion

The policy rationale based on this exclusion, a substance-based cave-out, is built on the premise that the use of payroll and tangible assets *as indicators of substantive activities is justified because these factors are generally expected to be less mobile and less likely to lead to tax-induced distortions*[391]. Its application in the calculation of Excess Profit was explained in the previous section.

This topic is one of the most discussed in scholarly literature and It might be because of the unclarity and possible incompatibility between the objectives of the rules and the proposed mechanisms for implementation.

Agianni et. Al.(2020, p. 18) have also noted the ambiguous position of the OECD on the topic. quantitative substance-based carve out chosen, "can be seen as a reflection of the reticence about carve-outs", since no carve out was foreseen under the Second Public Consultation Document because it could bias the goal of the proposal. According to Das and Rizzo (n.d., p. 50) the substance based exclusion, applicable to active business, hinders the objective of preventing tax competition.

According to Schoueri, the substance exclusion is key to ascertain the lengths of the parallel between the IIR and CFC rules. Also in the author's view (2021, pp. 5–7) the substance-based carve out is the "touchstone" to ensure that "value created in a jurisdiction is not be subject to taxation in the ultimate parent´s jurisdiction". Yet the scope of the substance-based carve out, as it stands, is quite restricted, and consequently may be subject to the IIR in profitable activities related to a jurisdiction, which puts in question both the principles of sovereignty and value-creation.

The limited character of the substance-based exclusion is also ambiguous regarding the objectives and it raises efficiency concerns. Pistone and Turina (2020, p. 6) expressed reservations on the carve-out in a proposal aiming to implement a global minimum tax since its effects in tax neutrality and increase complexity of tax systems may outturn its benefits. Indeed, Chand and Lembo (2020, p. 42) had already pointed that in order to achieve "a simpler system in which compliance costs would be lower for both MNE's and tax administrations" an approach with no carve-outs should be pursued.

On a positive note, Schmidt, argues that the substance-based carve out mitigated the sovereignty infringement that is an inherent part of the income inclusion rule, as discussed in section. 3.4. However, we are uncertain if such mitigation is relevant, considering the low threshold proposed.

### 7.4. De minimis exclusion

In cases where the Constituent Entities are located in a jurisdiction where the Average GloBE revenue of such jurisdiction is less than EUR 10 million and the average GloBE income or Loss of such jurisdiction is a loss or is less than EUR 1 million, the Top-up Tax respecting those Constituent Entities shall be deemed to be zero.[392]

### 7.5. Minority – Owned Constituent Entities

Respecting the Minority-Owned Constituent Entities there are two possible regimes applied.

The first one concerns to the Minority-Owned Constituent Entities that are members of a Minority-Owned Subgroup, and *states that the computation of the ETR and Top-up Tax for a jurisdiction (…) shall apply if they were separate MNE Group*[393]. As a result, an *MNE Group could have two or more computations with respect to Constituent entities located in a jurisdiction*[394].

The second one relates to the Minority-Owned Constituent Entity is not a member of a Minority-Owned Subgroup. Regarding this group, the ETR and Top-up Tax of the Entity is computed on an entity basis[395].

## 8. Conclusion

The world is undergoing profound changes. The economy, heavily influenced by digital innovations, has shifted the paradigmand so international tax rules must keep up with the changes.

As a result of those changes, the international tax scene may see a new order as the Pillar Two and the GloBE rules are increasingly emerging as a feasible reality and no longer as a distant ideal.

Notwithstanding, many doubts have been raised and some questions marks arise from the implementation of this reform. To name a few: 1) The effectiveness of Pillar Two to reduce tax competition and to change the race to the bottom mindset "given that it targets tax arrangements that are seen as allowing multinational corporations to move profits to countries with no or low taxes" (Screpante, 2021, p. 8), having quite a limited scope; 2) The circumstance that the race to the bottom mindset may be overcome to a race to the average (Chand et al., 2020, p. 37); 3) The possibility that we may find ourselves legitimizing profit shifting (da Silva, 2020, p. 121) as long as the EFT stays above 15%; 4) The increase in complexity and the loss of sovereignty; 5) The interconnection with the CFC rules; 6) The concerns regarding the substance-based carve out triggering the system; 7) Leveraging asymmetries between developing and developed countries.

Despite all the doubts, one thing is certain. This proposal will not end tax planning or tax competition overnight, however a reduction of profit shifting, and an increase of tax revenue are expected.

IMF researchers estimate that the implementation of global minimum tax of 15% may raise corporate tax revenues by 5.7% through the top-up tax and potentially by 8.1%, through reduced tax competition (IMFBlog, 2022). Accordingly, the effect of a worldwide implementation of Pillar 2 could lead to almost 14% more in corporate income taxes annually.

Thus, Pillar Two rules emerge as one of the most ambitious tax projects of the last decades, which will increase the States' tax revenues, combat tax planning and implement a global taxation standard.

# Part 2: Implementation of the GloBE in the European Union: the search for compatibility

## 1. Introduction

This section highlights the issues raised under EU law by the implementation of Pillar 2 GloBe Rules in the European Union, as well as the main differences between Globe Model Rules, adopted by the OECD/G20 Inclusive Framework as a follow-up to the Global Agreement, and the Proposal for a directive on corporate minimum taxation,[396] and provides insights on the reasoning behind such differences. This section has scholarly literature and relevant international organizations' publications as a basis for the review.

## 2. GloBe Rules and EU law

At the time of the writing of this article, most scholars that have addressed the issue of compatibility between GloBE rules and EU law based their analysis on the Blueprint (OECD, 2020), hence before the publication of the Model Rules, the Commentary, and the adoption of the Proposal for a Directive. And, although the IIR was kept quite stable, the UTPR has a different configuration under the Model Rules than what was initially planned (Johnston, 2022, p. 2). On what concerns the Directive, some features of the rules have been polished with the objective of aligning it with EU law.

## 3. The choice of instrument: A Directive

The adoption of a Directive at EU level requires unanimity under Article 115 TFEU and, at the moment of writing of this article, is still under negotiation in the Council. A month away before the end of the French Presidency of the Council, it is still uncertain whether Poland will embark on the adoption of Pillar Two without a legal link to pillar One (Valerio, 2022)

The adoption of a Directive has several political, economic, and technical advantages.[397] The assessment by the ECJ of the compatibility of measures with EU law depends on the means of implementation, and it has been noted that Directives enjoy a presumption of compatibility with primary EU law, when comparing to domestic measures (Szudoczky, 2020). That being considered, the implementation of the GloBe Rules through a Directive would enjoy a more lenient analysis by the ECJ, notably taking into account the unanimity that was reached (Broe & Massant, 2021, pp. 95–98; Nogueira, 2020, pp. 494–495).

On what concerns the duplication of instruments, notably at international and EU level, European Tax Advisers Federation (ETAF) pointed that the still ongoing work at the OECD level may lead to divergences between OECD rules and the Directive, as well as lack of clarity and uncertainty, if the OECD work is not duly taken into account by the Council and the Commission (ETAF, 2022, p. 4).

Also with this in mind, the European Parliament recommended the inclusion in the Directive of powers to the Commission to adopt delegated acts to keep the Directive up to date with the foreseeable upcoming "refinements" of GloBE Model rules.[398]

When analysing this topic, some questions may pop to mind: Is this directive a minimum standard? Will Member States be able to go beyond? In which provisions? Is "going beyond" the directive and the Model Rules desirable? And will there be a three-layer regime? What are the effects of such multiplication for legal certainty? The Directive states on recital 4 that "it is crucial that the global minimum tax reform is implemented in a sufficiently coherent and coordinated fashion", but is

coherence and coordination enough for the implementation of the GloBE Rules, or do we need a harmonized, single text?

## 4. Compatibility with EU law: Which Freedom?

When analysing the compatibility of a certain framework with primary EU law, it is firstly necessary to identify the relevant freedom. The major point of relevance lies in the scope of the applicable freedom: where the free movement of capital applies, the prohibition of discriminatory treatment is extended in relation to third states investors, on worldwide scope, and unilaterally. Any other freedom, such as the freedom of establishment, is applicable only to intra-EU relations.

Under *FII 2*[399] case law, legislation designed to apply to portfolio investment and generic legislation (unless it regulates market access) can be tested under the free movement of capital. Contrarily, legislation governing situations of definite influence, especially group measures, are outside the scope of the free movement of capital (Wattel et al., 2018, p. 114). Hence, Article 63 TFEU may be used to render inapplicable generic tax measures not targeting intra-group relations nor regulating market access, if they limit the free movement of capital rights. If that is not the case, then freedom of establishment provided under Article 49 TFEU applies.

According to scholars who have expressly addressed this topic, the freedom of establishment is applicable hereto, since the rule applies only to situations of definite influence (Schmidt, 2020, p. 987).

Admittedly, this topic would have a higher importance if the Model Rules were not implemented through a Directive, which is yet to be confirmed. This is because the domestic rules, enacted unilaterally by a Member States legislature, would be analysed under a stricter approach then the implementing measures of an EU Directive (see section 1.2). Indeed, the implementing measures of a Directive would be analysed in light of secondary law, while the rules under the Directive itself would enjoy a presumption of legality.

Secondly, the relevance of this discussion also depends on the existence of a restriction or discrimination, which would require justification. In such sense, the fact that the Directive drove its way out of the path of discrimination through the extension of scope to purely domestic situations, could mitigate the concerns on the compatibility of the GloBE rules, as implemented through the Directive, with primary EU law.

However, and in any case, an analysis in light of the actual rules proposed under the Directive is still lacking in scholarly literature, and this gap should be addressed.

## 5. Compatibility with EU law: specific issues

### 5.1. Can IIR + substance-based carveout = CFC's out-of-jail card?

This section is aimed at grasping the possible compatibility issues of the IIR with EU law, while also considering the existence of a substance-based carveout and, to a certain extent, the precedent of the CFC rules.

Pietro (2021, p. 221) analysed the relationship between the IIR and EU tax law, referring to the case law of the ECJ on abuse of law. In the author's view, the IIR conflicts with EU fundamental freedoms because the substance-based carve-out does not target exclusively instances of abuse. The author reads in the IIR the core elements of CFC legislation "application of a top-up tax at the level of the parent entity (...) in proportion to its participation in a Constituent Entity located in a low-tax jurisdiction in order to assure a minimum level of taxation in that jurisdiction", and therefore analyses its compatibility based on the Cadbury Schweppes[400] leading judgement dealing with CFC rules. Since the restriction to the freedom of establishment was justified only when domestic anti-abuse provisions specifically targeted wholly artificial arrangements that do not reflect economic reality, and the existing carve-outs applicable to the IIR do not exclude genuine arrangements, the author proposes to solve the conflict based on the introduction of a facts and circumstances carve-out, which would allow to target only wholly artificial arrangements.

Similarly, Englisch (2021b, p. 210) argues that the threshold for the justifications based on the need to counter tax avoidance is so high under Cadbury Schweppes (situations where the foreign subsidiary has no economic substance), that the "modest and formulary carve-out" would not be able to meet it. On the other hand, the reverse situation would also entail a negative consequence: a substance based carve-out which is able to meet the wholly artificial arrangement standard would undermine the policy intent of the GloBE rules, that is not only to tackle profit shifting but also to mitigate excessive tax competition for genuine business activities (Schmidt, 2020, p. 995).

Arrived at this point, we wonder: is that why we are stuck in the middle, with a timid substance based carve-out? Is the European legislator trying to achieve a balance, where a mid-way position brings mostly unclarity?

It should be noted that CFC regimes are considered to be against the freedom of establishment because they treat differently domestic and cross-border payments. However, a parallel reasoning might not apply to the IIR under the Directive, since the UPE has to charge top-up tax also in a domestic setting.

It seems that, for this argument to proceed, the IIR needs to be justified with the prevention of tax avoidance. The IIR would have to hold its *ratio legis* (and any purposive interpretation) in the prevention of abusive practices, but that is not even remotely clear and needs to be confirmed through further research. Indeed, according to Pillar Two Blueprint, "*Pillar Two addresses remaining BEPS challenges and is designed to ensure that large internationally operating businesses pay a minimum level of tax regardless of where they are headquartered or the jurisdictions they operate in*" (OECD,

2020, p. 15). In October 2021, the Global Agreement did not mention the objective of Pillar Two. Later the same year, in December, the Model Rules left the BEPS concerns behind, stating that the GloBE rules intend "to ensure large multinational enterprise (MNE) groups pay a minimum level of tax on the income arising in each of the jurisdictions where they operate" (OECD, 2022b, p. 7). The Proposal for a Directive, published the same week, refers to fairness and to efforts "to put an end to tax practices of MNEs which allow them to shift profits to jurisdictions where they are subject to no or very low taxation" in the recitals (see recitals 1 and 2). The meaning of these not only technically ambiguous but also inconsistent mentions might result in difficulties arguing the possibility of purposive interpretation.

This unclarity was also addressed by Dourado in her preliminary comments on the Proposal for a Directive (2022, p. 201). According to the author, the substance-based income exclusion rule, based on payroll costs and tangible assets, "introduced an inadequate element of abuse in the purpose of minimum taxation", since it "suggests a relationship with genuine activities which would not be the object of aggressive tax planning (and abuse)". The author proposes its exclusion from Pillar Two rules, as it may create difficulties in the interpretation of the Directive by the ECJ: "In other words: Is the regime about minimum taxation or antiabuse rules? In the latter case, irrebuttable presumptions cannot be used, and, for example, automatic application of the income inclusion rule (IIR) to the covered entities could be challenged." (Dourado, 2022, p. 201). As a final note, it is submitted that CFC regimes are considered to be against the freedom of establishment because they treat differently domestic and cross-border payments. However, a parallel reasoning might not apply to the IIR under the Directive since, under the proposed rules, the UPE also has to charge top-up tax in a domestic setting.

All this considered, it should be questioned: is there a relationship between minimum taxation and anti-abuse frameworks? If so, is it a direct link? Specifically on what concerns GloBE rules, what is the purpose and the effects of the anti-abuse characteristics? This topic demands further research, notably the possible relationship between GloBE rules and anti-abuse frameworks.

Another possibility would be to ground a possible restriction to the Fundamental freedoms on the need to preserve a balanced allocation of taxing rights between the Member States. However, according to Englisch, this justification could not be invoked successfully (2021b, p. 210).

### 5.2. Interaction between Model Rules and EU law

On what regards the interpretation, the model rules and the commentary may be used as an interpretative element by the ECJ, but the Directive will not have such role for the interpretation of the Model Rules (Dourado, 2022, p. 205). Moreover, Dourado sees a risk of future incompatibility between the Directive and the Model rules since, as mentioned, model rules are easily updated while the Directive is not.

The duplication of provisions and concepts is neither necessary nor advisable (Dourado, 2022, p. 205). According to ETAF (2022, p. 4), the Commentary to Model Rules as well as the Implementation Framework should be incorporated in the Directive, and should not be left to the choice of the Member States.

To avoid the implementation of minimum exclusively in the European Union, probably putting away investors in a moment where the EU critically needs it, the inclusion of a sunset clause has also been suggested by ETAF. With such a sunset clause, if a significant number of international (third state) jurisdictions does not comply with the global agreement, the Directive would cease to apply (ETAF, 2022, p. 5). This has not been considered by the European Union legislators, either out of trust that the rest of the UPE jurisdictions will embark on Pillar Two as well, or out of fear of sending the wrong signal to the international community. In either case, the implementation of Pillar Two only in the European block could have damaging effects in the economy, which would need to be studied in future research.

## 6. Implementation – Proposal for a Directive

### 6.1. Introductory remarks

On 22 December 2021, the European Commission adopted a proposal for a Directive on ensuring a global minimum level of taxation for multinational groups in the Union. This Proposal is aimed at implementing the GloBE rules one Pillar Two of the OECD Inclusive Framework Global Agreement (hereinafter the Global Agreement) as described in section 1, in the European Union.

The Model Rules were published two days before the adoption of the Directive, suggesting that the European Union was intensely involved in the decision-making and drafting process of the Model Rules.

A general analysis of the framework in the Proposal for a Directive can be found in Valério (2022). In this section, we will focus on the main differences between the Proposal and the Model Rules, the impact of such differences, and other selected issues.

### 6.2. Main differences

The main differences between the Model Rules and the Proposal for a Directive aim to ensure compliance with EU law. They include:

- The application of the Directive not only to MNE groups, but also to large-scale domestic groups (Art. 2, para. 1 and art. 3, para. 5 Directive, Art. 49.), aiming to avoid discrimination between domestic and cross border situations (Dourado, 2022, p. 203; Nogueira, 2020, sec. 4.6; Valério, 2022, p. 157). This point of divergence has been considered by the European Tax Adviser Federation as the only admissible departure from OECD Model Rules (ETAF, 2022, p. 3).
- The application of the IIR where a low taxed constituent entity is located in the same jurisdiction as the parent entity – under the Directive, the IIR applies to all entities in the parent entity's jurisdiction (to the parent entity itself and other constituent entities located in the low-taxed Member State) (arts. 5(2), 6(2), 7(2)) (Valério, 2022, p. 157).

  However, according to Dietrich & Golden (2022, p. 188), the Directive does not clarify what amount of top-up tax is allocated to the parent entity in that scenario. Specifically, in the case where an intermediate parent entity is the one required to collect the top-up tax in respect of itself, "it is not clear whether this relates to 100% of the top-up tax computed or whether it should be limited to the UPE's allocable share of the top-up tax for that entity". According to the same authors, the rule allowing for parent entities to collect top-up tax in the jurisdiction where it is located, in theory, reduces "the number of instances in which the UTPR can apply to cases in which the UPE is located outside the European Union and a) the UPE, together with its subsidiaries located in that same jurisdiction, are low-taxed (i.e. no top-up tax collection under the IIR); or b) the UPE's jurisdiction of residence has not implemented a qualified IIR and not all of the top-up tax that is allocable to the UPE is collected under the IIR, as the UPE holds more interest in the low-taxed Constituent Entity than any other IPEs that are subject to a qualified IIR." (Dietrich & Golden, 2022, p. 188). Dourado (2022, p. 204) sums it up: "There is no need for a UTPR within the EU because the IIR is binding and, therefore, the UTPR is to be applicable only by a Member State in relation to third countries."
- The option to offset income and losses arising from the disposal of tangible assets located in the Constituent Entity's jurisdiction to third parties is exclusive to immovable assets (Art. 3.2.6 Model Rules and art. 15, para. 7 Directive).

  The Directive does not include a safe harbour election (Art. 8.2 Model Rules).

  The Directive provides penalties in case of failure to provide the top-up information return (art. 44), while there is no parallel provision in the Model Rules.

The first two points of departure aim at limiting the distinction between domestic and cross border situations. Indeed, the ECJ finds that a measure is discriminatory if

it treats cross-border situations in a less favourable manner than purely domestic situations. However, the additional layer of administrative burden (Schmidt, 2020, p. 996) resulting from the extension of the GloBE rules to purely domestic situations, without concrete benefits is not peripheral.

Apart from the noted differences, the Commission has included in the Proposal the possibility for the Member States to implement in the qualified domestic minimum top up tax (QDMTT) (Arts. 3, para. 23 and 10 Directive). This provision subjects constituent entities in the implementing jurisdiction to a GloBE compliant ETR – if the ETR is not complied with it is the jurisdiction where the entity is located that applied the top-up tax. Accordingly, Member State may collect top-up taxes in respect of excess profits of low-taxed Constituent Entities located in its jurisdiction in priority to the IIR top-up tax collection mechanism, which means that it may prevent the triggering of the GloBE rules in other jurisdictions (and the respective tax collection).

There are still to be noted different wordings between the Model Rules and the Directive, which may create ambiguity and complexity (Dourado, 2022, p. 204).

### 6.3. Are the differences innocuous?

Dietrich & Golden have identified, through case studies examples, practical differences and outcomes that arise from the application of the Model Rules and the Directive, notably:

- Regarding the application of the IIR at UPE level under the Directive where the UPE is in a EU low-taxed jurisdiction, and unlike what is provided under the Model Rules, the UTPR will not apply (Dietrich & Golden, 2022, p. 191). Only where the UPE is located in a low taxed third country, the UTPR top-up tax will apply.
- Where the top up tax is collected by an EU based IPE (as the UPE is located in a third country that does not apply the IIR) and low taxed constituent entities are not wholly held by a parent entity, full relief may be unavailable under article 13 of the Directive. As the IPE applies the IIR and UTPR relied is only available where the low-taxed Constituent Entities are wholly held by a UPE that applies the IIR or via an IPE that applies the IIR, and partial relief is only available where the top-up tax has been collected in a third country that applies a qualified IIR, the top-up tax may be collected twice, both under the IIR and the UTPR, possibly leading to double taxation (Dietrich & Golden, 2022, pp. 193–194).

The authors conclude that the broadening of the scope of the UTPR results in inconsistencies on how both rules interact, possibly giving rise to risks of double taxation and double non-taxation (Dietrich & Golden, 2022, p. 195)

In our view, there is scope to further the research about the necessity and the impact of the broadening of the scope of the IIR. The divergent outcomes resulting from the application of the GloBE rules and the Directive, where confirmed, may be explored from different perspectives:

- the common approach of the GloBE rules does not impose its implementation by the jurisdictions that have adopted the Global Agreement. But, if that is the case, it should be in accordance to what has been agreed by the OECD/IF. It must be questioned if such differences are still compatible with the Global Agreement and what would be such threshold in respect with EU law.
- possible restrictions to the fundamental freedoms and, therefore, incompatibilities with EU law, including vis a vis third countries,
- if the taxing powers of developing countries would be negatively affected by the prevalence of IIR rules over the UTPR rules, under the Directive. (see EP resolution)

### 6.4. Alternative proposals

Some scholars have been debating alternative ways to implement Pillar Two in the European Union.

Even though Englisch considers that the extension of the proposed GloBE regime to domestic situations would be a viable option to avoid restrictions to the freedom of establishment (since it would not be discriminatory, *de iure* or *de facto*), the author proposes an alternative: the creation of a new taxpayer only for GloBE purposes, i.e., the group itself (Englisch, 2021b, pp. 217–218). This would convert GloBE in a form of "unitary (minimum) taxation" and, according to the author, would ensure a minimum level of effective taxation in each jurisdiction in which large groups have such a physical presence. The main features of this proposal are:

- liability of qualifying groups to pay top-up tax for each jurisdiction that has an ETR below the minimum rate (which could arise in respect of domestic and MNE groups),
- the territorial link would be residence by a group or a presence under the form of a PE,
- one of the entities would be designated as the one declaring and paying the top-up tax.
- The top-up tax would be calculated under GloBE rules.

Besides the advantage of avoiding the restriction to the freedom of establishment, the author points out others, from which we highlight the possibility of collecting top-up tax without a resident UPE or lower-tier resident parent company and a mitigated risk of double taxation (Englisch, 2021b, p. 218).

Englisch offers an additional alternative proposal, which he calls "the avoider pays" principle (Englisch, 2021a, pp. 139–141), including in a paper co-authored with the economist Becker (Becker & Englisch, 2021, pp. 54–56). According to this proposal, the entity with undertaxed profits would be the "minimum tax taxpayer", instead of parent companies within the MNE. In this case, the IIR and the UTPR would serve exclusively to determine the allocation of taxing rights (where it is collected, but not who collects the top-up tax). The undertaxed entity would pay taxes in the parent company's jurisdiction, but the parent entity would not incur in additional tax liability. There is a 'piercing the territorial veil' for the collection of top-up tax which would, according to the author, altogether follow the logic of a switch-over clause, as it has been accepted by the CJEU in Columbus Container (Becker & Englisch, 2021, p. 56; Englisch, 2021a, p. 140).

Another proposal aimed at ensuring compatibility with EU law while foregoing of the substance based carveout and the extension of scope to purely domestic situations, would be to "explain the policy rationale of the income inclusion rule in a manner that makes it possible to argue that the income inclusion rule could be justified on new grounds, e.g. the need for establishing a fair and balanced situation for domestic and foreign activities" (Schmidt, 2020, p. 996). The author is looking here at the introduction of a new justification that would allow the realization of the policy objectives of the GloBE, notably the curbing of international tax competition.

### 7. Forward look

Scholars have referred to the opportunity that the implementation of GloBE rules in the European Union, under an EU legislative instrument, represents. Notably, the coordination of tax bases in corporate income tax among Member States (Dourado, 2022, p. 200), brings back to life the dream of a common consolidated tax base for corporations.

Indeed, it might be the case that the BEFIT proposal, a proposal for a new framework for income taxation for businesses in Europe, planned for 2023 - and which will include "key features of a common tax base" (European Commission, 2021, p. 11) -, will not only incorporate the options followed under the Minimum Taxation Directive but also take advantage of the momentum and the work laid out at international level.

## Part 3: Implementation of the GloBE rules in developed and developing countries: the search for asymmetries

### 1. Developed and developing countries - main differences

Collected data on taxation policies show that developed countries are able to assemble higher shares from income taxation than developing countries, whilst developing countries' tax revenues tend to come more from trade taxes and taxes on consumption (Ortiz-Ospina & Roser, 2016).

Developed countries are perceived as "*advanced economies*", demonstrating a high level of industrialization, a well-established export base, integration within the global financial system and "capability for a government to implement its policies effectively and efficiently" (Corporate Finance Institute, 2021, p. 5). Such factors constitute interesting characteristics for companies to establish on.

On the other hand, developing countries are often deemed as emerging markets or frontier markets, with much lower capital market liquidity and low to middle income per capita percentages (Investopedia, 2022, p. 4).

Whilst developed countries, as a rule, offer stable policies and economies, developing countries may be struggling with political instability and, in consequence, economic and financial volatility.

Such investment risks within developing countries affect their ability to attract foreign direct investment and naturally lead businesses to establish themselves in developed countries. Developed countries' state budgets rely mostly on tax revenues and indeed, many of the world's largest multinational companies are established in developed countries.[401]

Developing countries remain in different circumstances, since they still do not pose as that attractive for companies to establish on - in such a way, a considerable amount of their tax revenues does not arise from income-related taxes[402].

As we will see further below, developing countries are fighting to stop being perceived as non-attractive jurisdictions by implementing tax incentives, granting preferential tax treatments offered to a group of taxpayers to "*promote a particular economic goal*" (Chen et al., 2018).

And even so, developing countries are also victims of tax avoidance practices, exacerbated by globalization and digitalization, losing "*substantial revenues*" (Lammers, 2020, p. 1).

Furthermore, collecting the "*billions of dollars in MNE tax avoidance*" that would have entered developing countries' tax safes to finance their modernization and development policies and activities for the upcoming years (Mccarthy, 2022, p. 27).

As Pillar Two targets profit shifting, with its main losers being European non-havens and developing countries (Englisch & Becker, 2019), it will impact income-related taxes. So how will Pillar Two affect the developing countries tax systems?

## 2. Sharing (but not dividing) the minimum tax pie: GloBE rules for developed and developing countries

The IIR and the UTPR, the two interlocking GloBE rules, were explained in Part 1 of this Article. The first imposes a top-up tax on the ultimate parent entity of a low-taxed entity of a multinational group and the latter seeks to deny deductions or require an equivalent adjustment where the low taxed entities are not subject to tax under an IIR (OECD, 2021, p. 12).

From the abstract description of how the rules operate, we can take a step further and consider what will be the outcome from the perspectives of the states, particularly where the differences between the states, might have a direct impact in the minimum tax revenues.

### 2.1. Income Inclusion Rule (IIR): which countries will be entitled to implement the top-up tax?

The IIR top-up tax is to be applied in headquarters jurisdictions, where the ultimate parent entity is located. It is the primary GloBE rule, holding priority over the UTPR, and is based on a residence criterion (residence of the UPE).

The countries where the IIR will apply are mainly the G7 countries "and to a lesser extent the G20 countries" (de Wilde, 2022, p. 3). Englisch goes further, arguing that "developing countries will hardly ever be able to generate revenue from the prioritized IIR", which favors "*developed industrialised countries and classic holding locations*", and Fedan states that developing countries are "unlikely to receive IIR tax and could end up with no GloBE tax allocation at all" (2021, p. 399).

Since developed countries still headquarter most multinational companies, extra revenue from the global minimum tax rate would be "*unequally distributed across the globe*", as developed countries will gain more than developing countries (Barake et al., 2021, p. 18).

### 2.2. Undertaxed Payments Rule: a way for developing countries to obtain tax revenues?

Whilst the IIR ends up benefiting residence countries (Sundaravelu, 2021), the UTPR should be typically of the interest of source countries, and it is applied by "the other countries, the operational jurisdictions, the smaller countries with smaller economies" (de Wilde, 2022, p. 3).

However, the UTPR will only kick in if the parent jurisdiction does not apply the IIR. The IIR has a priority over the UTPR, and therefore favours the taxing rights of the jurisdictions where the UPE are established.

The existence of a priority of the IIR over the UTPR, in this order, unbalances the GloBE tip towards developing countries interests.

It would have been possible to design a framework taking the interests of developing countries seriously, but it seems that the Global Agreement designers did not do so in the distribution of the potential additional GloBE revenues, not in

the treatment of tax incentives (which are, as we'll see below, a very important tool for developing countries) nor on their administrative capacity, which may "*entail negative consequences from a developing country perspective*" (Riccardi, 2021, p. 29).

Moreover, when looking at the Model Rules Commentaries, one can see a difference also when it comes to the "side rules" of the IIR and the UTPR. In particular, whilst the countries entitled to apply the IIR appear to be given the chance to broaden the scope of the measures, the same does not seem to apply to the UTPR.

In fact, the Commentary states that if a jurisdiction would set a lower revenue threshold for the application of the UTPR, "this would cause the UTPR to operate as the primary rule for those MNE Groups that were above this domestic threshold but below the agreed GloBE threshold", which would result not only in inconsistent outcomes but "undermining the expected outcomes for MNEs headquartered in jurisdictions that have adopted a Qualified IIR" (OECD, 2022a, p. 11).

However, as noted by de Wilde (2022, p. 2), it seems that (any) jurisdiction is allowed to apply their own IIR below the GloBE's threshold, and that "would not be contrary to the design of the GloBE Rules or undermine the rule order that had been agreed as part of the common approach" (OECD, 2022a, p. 11).

It has been noted that the complexity of the GloBE proposal and the Model Rules will impose a heavy administrative burden, not only for the in-scope MNEs but also for the tax administrations (Chowdary, 2021, p.3). Taking the perspective of a developing country, there may even be technical difficulties and one can foresee the necessity of technical assistance to implement these rules.

Hence, even with the UTPR favouring developing countries, these countries may have difficulty in administering this measure, for it requires "*more coordination with countries and more risks of double taxation*". Indeed, developing countries' tax authorities might not have the means and the resources to handle all necessary information (Sundaravelu, 2021) leading "*to increased administrative burden on tax authorities in these countries*" (Wamuyu, 2021), of rules that are complex.

Furthermore, the question poses: is it beneficial for developing countries to let go of their leeway to adopt other measures to implement the Undertaxed Payments rule? Since developing countries are highly keen on tax incentives, would they benefit from disregarding these incentives and activate the Undertaxed Payments rule?

## 3. Developing countries and tax incentives

### 3.1. An overview of the tax incentives adopted by developing countries to attract foreign investment

Multinational companies determine the countries in which they invest taking into account several circumstances, such as labour legislations, availability of workforce, infrastructure opportunities, political stability and, of course, tax policies.

As tax policies pose as one determining factor in choosing the place for investment, developing countries often adopt corporate tax incentives to attract and retain foreign direct investment, asserting their right to low tax or to not tax certain types of income (Navarro, 2020, p. 5). The FDI is the holy grail and an investment tool (Marsit, 2020, p. 17) of developing countries, which is seen as a boost to the development of the economy, generating more employment, industrialisation and, more recently, digitalisation.

Examples of tax incentives on domestic terms and within the exercise of the countries' tax sovereignty, include exempting investors from taxes or offering large periods of tax holidays within investment contracts (Bernasconi-Osterwalder et al., 2021, p. 2).[403]

To ensure the effectiveness of such tax incentives, developing countries often adopt tax sparing clauses – which grant a notional credit at the country of residence, "*namely a discount on the taxes due, even if no or lower taxes were paid at source*" (Navarro, 2020, p. 1). This ensures that the MNE is not taxed in the residence state on the measure that has benefited from the incentive on the source state – otherwise, the tax incentive would represent absolutely no benefit for the taxpayer and would undermine the objective of attracting the investment to the country offering the incentive.

Although it is unclear for some that the loss of tax revenues pays off for the adoption of these incentives, others have found that agreements including tax sparing clauses "*are associated with up to 97% higher*" foreign direct investment (Navarro, 2020, p. 5). Thus, one could see the importance of these measures for the developing countries' economies, which rely heavily on tax incentives, as they seek to attract and retain foreign direct investment and to compete with the developed world.

### 3.2. Can GloBE Rules affect existing tax incentives?

Although the Cover Statement by the OECD/G20 Inclusive Framework on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two states that jurisdictions are free to determine their own tax systems, and whether they will even have a corporate income tax, one can only foresee that Pillar Two will imply thorough revisions of existing domestic tax rules, which were built in a pre-BEPS world (Bernasconi-Osterwalder et. al, 2021, p. 2). As Schoueri puts it, "This idea (…) is immediately contradicted by the statement that other jurisdictions would have the right to apply the remedies envisaged in Pillar Two where income is taxed below the agreed minimum rate" (Schoueri, 2021, p. 2)

By establishing a global minimum effective tax rate and entitling other jurisdictions to "*tax back*" income arising from foreign entities when its correspondent country of source does not tax it at the minimum level, within the scope of the Income Inclusion rule, Pillar Two can compromise developing countries' decisions on setting their own tax incentives policies and end up limiting their tax sovereignty, since these "*jurisdictions may be taken away the right to not to tax or grant tax incentives on income generated domestically*" (Riccardi, 2021, p. 23)

On the other hand, the global minimum effective tax rate, as currently defined, is actually "far lower" than the ones established at the moment within several developed countries' jurisdictions (McCarthy, 2022, p. 20)

Hence, it may be difficult for developing countries to maintain their tax holidays[404] and other incentives if another country can be entitled to tax what the tax benefits have purposedly left untaxed, ie. when the IIR interacts with "*developing countries' treaty policies*" (Marsit, 2020, p. 17).

This is one of the points where the so called "infringement of tax sovereignty" may be more damaging for developing countries (Schmidt, 2020, p. 996).

If countries implement the GloBE rules as they stand, several scenarios may unfold. There might be a tax treaty between the countries, with or without tax sparing clauses, or there might not be a tax treaty. These scenarios require further study, as it should be understood if tax treaties can limit the application of the GloBe rules and, specifically, if tax sparing clauses can resist to such far reaching rules.

One must note that countries relying on tax incentives are already giving up tax revenues to attract FDI and, the loss of that possibility to might create a wider gap between the North and the South.

Furthermore, as Dourado states, developing countries do not hold the same financial possibilities and the same means as the developed countries to concede to MNEs tax benefits through other mechanisms, such as allowances or incentives on social security contributions, for example, which can be implemented as key to attract the MNEs investment (2022, p. 4). So far, this approach seems to be insufficient.

### 3.3. Will the Subject to Tax rule respond to the developing countries' current concerns?

The Subject to Tax rule (STTR) is part of Pillar Two but is not included in the GloBE rules. It consists of a standalone treaty-based rule under which a jurisdiction can impose limited source taxation when certain payments between related parties are taxed below the agreed rate of 9% (OECD, 2021, p. 3). If a gross payment would be taxed at a lower rate than 9% according to the applicate CIT tax rates, the STTR imposes taxation until it reaches 9%: the taxing right is the difference between those two rates.

It seems that the Subject to Tax rule will only be effective in case of profit-shifting for payments from developing countries to tax havens, "*as other states can simply increase the tax on the payment up to*" the 9% rate (Fedan, 2021, p. 6).

As this rule will come first in the order of the GloBE rules, and does not depend on the IIR's effective application, it seems that developing countries might be able to collect revenues by imposing a withholding tax on a particular set of intragroup payments that would end-up under tax havens jurisdictions (BEPS Monitoring Group, 2022, p. 3).

But, in practical terms, if there is already an existing tax treaty in place where the withholding tax rates are above the proposed STTR range, this rule per se would not give rise to additional taxing rights, unless the existing rates are amended or cancelled (BEPS Monitoring Group, 2021, p. 9).

So, one can wonder what will be the effectiveness of such rule if it is necessary a tax treaty between the developing country and the tax haven, if only adhering Inclusive Framework jurisdictions will be implementing this rule, and "when requested to do so".

As the Subject to Tax Rule specifically targets profit shifting to tax haven jurisdictions, which affect the tax revenues of several developing countries, one can admit that if developing countries have the capacity to administer this rule, there can be margin for a "*moderate benefit*" for these countries resulting from the Subject to Tax rule (Fedan, 2021, p. 21).

## 4. Are there any other options?

Tax organisations working on behalf of developing countries' interests suggest a change in the Pillar Two's order of rules, so that countries on both sides can reach a compromise and not give priority to the Income Inclusion rule alone, allowing the countries of source to effectively allocate to their jurisdictions additional tax rights (Sundaravelu, 2021, p. 2).

Future research should be focusing on options to balance the developed and developing countries positions, both in the context of Pillar Two rules, and outside of that context (v,.g., in the coordination between Pillar One and Pillar Two, or through domestic and treaty based solutions).

## 5. Final remarks

It is not clear that Pillar Two will result in additional tax revenues for developing countries. Strong criticism has been voiced on this matter, with the view that developing countries "*are likely to gain close to nothing*" by adopting those rules, whilst being at the same time precluded on their tax sovereignty (Jacobs, 2022).

Again, we could be reviving the discussions of the legitimacy of the OECD rule making, even under an "Inclusive Framework". According to scholars, it seems that developing countries concerns have failed to be prioritised by the Inclusive Framework's table of work (Riccardi, 2021, p. 29). In fact, developing countries might be disregarding their own needs if they implement the Global Agreement.

One could also verify that the non-participation of developing countries in the "Inclusive Framework" negotiation process made it rather difficult to address or even identify the impact of Pillar Two within the upcoming revenues for developing countries (2022, p. 20).

Furthermore, Pillar Two model rules are extremely complex and, specially for developing countries, simplification is key for implementation. Developing countries continuously urge for simplification measures within the international tax framework (OECD, 2021, p. 24), and frequently report that cooperation measures and the obligation to introduce domestic legislation in correlation is a "*significant burden*" (OECD, 2021, p. 26)

But one must note that since the IIR (and even the UTPR, despite being triggered in a residual manner) extends the power to tax income that is taxable by other jurisdictions, under international tax law rules, there might be a point where developing countries do not have to implement Pillar Two. As the UPE jurisdictions will tax, it does not matter what these countries, on other end of the line, will do. They will be *subject to other countries' tax*.

One could state that this relationship should also be a focus of future interdisciplinary research, as so many issues are still uncertain. How many States will have to *implement* Pillar Two for it to be a truly global minimum tax? Would UPEs be willing to relocate to developing countries outside the IF to avoid the minimum tax? (In that case, at least EU countries would be able to tax in their jurisdictions up until the ETR, a qualified domestic minimum top up tax is being implemented). Does agreeing to a Global Agreement mean that developing countries are bound to implement (except what is common approach)? Does it mean that they have to let other countries implement it as agreed and cannot affect their effects? How were developing countries convinced to agree to it? And how can jurisdictions opt-out of the global agreement? Will the reforms on the "Inclusive Framework" deal add further transparency and participation from the developing countries perspective? Can these issues be solved by a United Nations Tax Convention?

In fact, one can conclude that developing countries could only be entitled MNE constituent entities that meet the agreed threshold if the IIR has not been implemented by the UPE jurisdiction, by adopting the Undertaxed Payments rule (de Wilde, 2021, p. 3).

On the other hand, the Subject to Tax rule only seems to be effective on certain intragroup payments from developing countries to tax havens. In fact, it seems that

it is not solving the need for developing countries to still be competing with developed countries to attract foreign investment and obliging the first to thoroughly review their tax policy preferences, even with a much inferior administrative capacity to do so.

As the system enters on a new era of further developments for the adoption of a global minimum effective tax rate, with, for example, the European Union adopting a directive on this subject, it will be interesting to see if one can count on existing tax-treaty new negotiations and new tax-treaties being entered into between developed and developing countries to address the latter's' concerns on their tax revenues and sovereignty[405].

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401. For instance, in the United States of America (companies like Walmart, Amazon and Apple), Japan (home to companies like Panasonic, Son and Toshiba) and European Countries (in 2020, 116.497

multinational companies had their headquarters in an European Union Member State). For this last data, see (Pârjoleanu, 2020, pp. 109–126)

402. Some exceptions can be found within developing countries that present as fast-growing economies, such as China, which is currently home to several multinational companies' headquarters such as Huawei Technologies and Alibaba Group.

403. As did the Guinea Republic in a contract with a large mining project, conceding the investor "*a 10-year tax holiday, for 25 years*". Please refer to Bernasconi-Osterwalder et. al., 2021, p. 2, and to the Convention de base entre La République de Guinée et Winning Consortium Simandou SAU-SAU pour l'Exploitation du Mineral de Fer des Blocs I et II de Simandou, dated January 9th, 2020.

404. Several developing countries have implemented tax holidays for certain industries, such as Bangladesh, Cambodia, Indonesia, Malaysia, Thailand and many more. Furthermore, studies have concluded that more than 40 tax incentive regimes across the Asia Pacific region will most likely be impacted by Pillar Two measures. For this data, please refer to "*The impact of BEPS on tax incentives in Asia Pacific*", KPMG, September 2021.

405. Since, as it seems, they could be deprived of maintaining their tax incentives' effect and, on the other hand, there won't be much additional taxing rights allocated to their jurisdictions.