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IMPLEMENTING AN INTERNATIONAL EFFECTIVE MINIMUM TAX IN THE EU

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Implementing an International Effective Minimum Tax in the EU

Joachim Englisch, Johannes Becker

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Zusammenfassung

Zurzeit verhandeln 139 Staaten in dem von OECD und G20 mandatierten Inclusive Framework über eine grundlegende Reform des Systems der internationalen Besteuerung. Die Reform soll aus zwei Säulen bestehen (den sogenannten „Pillars“). Pillar 1 impliziert eine Verlagerung von Besteuerungsrechten in die Marktstaaten (also dorthin, wo die Endkunden der Unternehmen ansässig sind). Pillar 2 sieht eine effektive Mindeststeuer auf die Gewinne multinationaler Unternehmen vor (genannt GloBE für „global anti-base erosion“).

GloBE besteht im Wesentlichen aus zwei neuen Kategorien von Zusatzsteuern. Sie sollen immer dann zur Anwendung kommen, wenn bei multinationalen Unternehmen die Steuerquote der Gewinneinkommen von Unternehmenseinheiten in einem bestimmten Staat unter den Mindeststeuersatz fällt. Die Income Inclusion Rule (IIR) gibt dem Staat des Mutterunternehmens das Recht, den Steuersatz des zu gering besteuerten Unternehmensteils bis zum Mindestsatz aufzustocken. Technisch ähnelt sie einer erweiterten Hinzurechnungsbesteuerung. Die Undertaxed Payment Rule (UTPR) verleiht den Quellenstaaten das Recht, die Abzugsfähigkeit von Zahlungen an andere Unternehmensteile zu verweigern, bis die effektive Steuerlast des niedrig besteuerten Unternehmensteils den Schwellenwert erreicht hat. Die IIR ist im Verhältnis zur UTPR prioritär anzuwenden.

Eine breite und effektive Anwendung der neuen Steuerinstrumente würde eine wirksame Untergrenze für den internationalen Steuerwettbewerb implizieren, sie würde die Steuerspar-Modelle multinationaler Unternehmen, wie sie zurzeit praktiziert werden, deutlich unattraktiver machen und vor allem den Produktions- und Heimatstandorten der Unternehmen steuerliche Mehreinnahmen bescheren.

Für die Mitgliedstaaten der EU stellen sich dabei aufgrund der in den EU-Verträgen vereinbarten Regeln und Standards besondere Herausforderungen, die bei einem Konsens über die Anwendung der neuen Regeln in der EU aber beherrschbar sind. Eine harmonisierte Anwendung von GloBE in der EU könnte durch eine auf Art. 115 AEUV basierende Mindeststeuerrichtlinie erreicht werden. Dabei ist die zentrale Frage, ob die EU-Grundfreiheiten durch die Mindeststeuer verletzt werden. Eine mit den Grundfreiheiten konforme Mindeststeuer kann jedenfalls dann gelingen, wenn die IIR und die UTPR innerhalb der EU durch eine alternative Erhebungsform ersetzt werden, die auf dem „Avoider Pays“-Prinzip basiert. Nach diesem Prinzip obliegt die Steuerpflicht direkt der niedrigbesteuerten Unternehmenseinheit, sodass weder sie noch andere Unternehmenseinheiten im Vergleich zur Regelbelastung im Land des Steuergläubigers mehrbelastet werden – und die EU-Grundfreiheiten gewahrt bleiben. Die Steuererhebung könnte durch einen One-Stop-Shop erleichtert werden, wie er auch schon in der Mehrwertsteuer zur Anwendung kommt. In gewissem, aber überschaubarem Maße notwendig wären außerdem Anpassungen der bereits existierenden Steuergesetzgebung der EU.

Executive Summary

Currently, the 139 countries organised in the OECD/G20 Inclusive Framework are negotiating a fundamental reform of the international system of taxing multinational firm profits. The reform consists of two main parts, so-called “pillars”. Pillar One focuses on the re-allocation of taxing rights to the market economies, Pillar Two sets out an effective minimum tax on the profits of multinational firms, the so-called “global anti-base erosion” proposal (GloBE). This report discusses the implementation of GloBE-style effective minimum taxes in the EU.

The GloBE is a set of rules that prevent the effective tax rate on MNE affiliates’ local profits from falling below a certain threshold (i.e. the effective minimum tax rate) independent of where the MNE is active. It mainly relies on two rules. The income inclusion rule (IIR) gives the ultimate parent’s jurisdiction (or, if necessary, some other parent’s jurisdiction down the ownership chain) the right to top up the effective tax rate of low-taxed affiliates abroad. The undertaxed payment rule (UTPR) gives the right to source countries to deny deductibility of payments made to related parties within an MNE that has low-taxed entities. The IIR has priority over the UTPR.

Effective implementation of the GloBE rules by a sufficiently large number of countries would set a lower bound on tax rates on MNE profits everywhere in the world. From an economic perspective, such a lower bound is attractive since it, first, curbs profit shifting that implies a gain of zero from a social point of view and a substantial cost that is social waste. Second, it improves the international allocation of capital that is currently distorted by large tax rate differentials. Third, it secures the tax base in non-havens and production locations and, thus, allows them to raise revenue and provide public goods. Finally, a lower bound mitigates tax competition even at tax rate levels above the minimum threshold. The downside of effective minimum taxes is an increase in compliance and administration cost and the fact that they indirectly constrain the tax policy choices of sovereign countries. The latter may be justified, though, given that excessively low tax rates in some jurisdictions effectively constrain the tax policy choices of non-havens and production locations.

The effects of a global effective minimum tax crucially depend on whether carve-outs are granted that partially exempt the low-taxed profit from minimum taxation. The currently discussed plan involves carve-outs on tangible assets and personnel cost. Such an exemption does not only limit the effectiveness of a minimum tax, it also prevents it from mitigating tax competition for tangible assets (or, more generally, substantive activity) and introduces a range of margins along which MNE can make choices to avoid minimum taxation.

For the Member States of the European Union, the implementation of an effective minimum tax – whether with or without an agreement in the Inclusive Framework – will affect common EU rules and standards. From a political perspective, a comprehensive implementation will

presumably be easier to achieve if it is based on a global agreement in the Inclusive Framework. The legal and administrative obstacles are, however, almost the same – and depend much more on the question whether there is unanimity among the EU Member States or not.

For a harmonised implementation of GloBE by all EU Member States, the EU could adopt a minimum tax directive based on the internal market competence of Art. 115 TFEU. While the general principles of subsidiarity and proportionality would not stand in the way of harmonisation, the crucial challenge is that GloBE may be incompatible with EU fundamental freedoms in intra-EU relations. In order to avoid this incompatibility, we propose replacing the IIR and UTPR within the EU by a mechanism based on the “avoider pays” principle. According to this principle, the undertaxed MNE entity itself is liable to pay top-up tax. In this case, the non-discrimination standards inherent to the EU fundamental freedoms could be met. A carve-out for substance-based activities would then not be necessary for legal reasons, either.

Tax collection by the Member State entitled to levy the top-up tax from the under-taxed entity could be assisted by a One-Stop-Shop, as already in use for VAT purposes. This approach would also facilitate an alternative revenue allocation formula or the use of the revenue as an EU own resource.

Finally, to avoid a treaty override, the Member States’ tax treaties with third countries would have to be amended with a switch-over rule (SOR) and a subject-to-tax rule (STTR). While it is disputed whether treaty changes would be required for applying the IIR and the UTPR to foreign entities, it seems advisable to clarify the relevant tax treaties in this regard, too. All necessary amendments could be carried out via a multilateral convention under the auspices of the OECD/G20.

A European effective minimum tax would, to a certain extent, overlap with existing EU business tax legislation. In particular, the more targeted anti-BEPS measures of the Anti-Tax Avoidance Directive (ATAD) could generally co-exist with the IIR and the UTPR. The only exception are CFC regimes, for which it should be clarified that they have priority over the IIR since the latter is less targeted and less far-reaching in its effects. Moreover, it would be necessary to create carve-outs in certain tax directives so as to allow for the application of the STTR.

While there are alternative concepts to the currently negotiated GloBE proposal, it seems that, with respect to political prospects for a broad-based agreement, the GloBE proposal is without alternative. The reason is that the current situation, with a public pushing for political change and governments willing to cooperate in the Inclusive Framework, offers a window of opportunity that, if missed, may not come back anytime soon.

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1. Introduction

Currently, the 139 countries organized in the OECD/G20 Inclusive Framework are negotiating a fundamental reform of the international system of taxing multinational firm profits. The reform consists of two main parts, so-called “pillars”. Pillar One focuses on the re-allocation of taxing rights; in short, the reform would partially shift the right to tax profit to the ‘market economies’, i.e. to those jurisdictions where multinational firms sell their product or where clients use their services. Pillar Two proposes an effective minimum tax on the profits of multinational firms, the so-called “global anti-base erosion proposal” (GloBE). The GloBE is a set of rules that prevent the effective tax rate on local profits from falling below a certain threshold (i.e. the effective minimum tax rate) independent of where the MNE is active.

If the negotiations are successful – and, as of today, there is reason to be optimistic that they will be –, there will be multilateral agreement in which countries pledge to implement the new rules in national law. For the Member States of the European Union, the implementation will also affect common EU rules and standards. In case that the negotiations fail, there will likely be an EU initiative to introduce an effective minimum tax similar to the GloBE proposal as a unilateral measure by the EU Member States. That is, in any case, the implementation of new tax rules will be high up on the agenda, this summer or autumn at the latest. This report discusses the implementation of effective minimum taxes in the European Union. From a political perspective, a comprehensive implementation will presumably be easier to achieve if it is based on a global agreement in the Inclusive Framework. The legal and administrative obstacles are, however, almost the same – and depend much more on the question whether there is unanimity among the EU Member States or not. In the absence of unanimous agreement on a minimum tax directive, enhanced cooperation (Art. 20 TEU) could provide a viable alternative to unilateral action of individual Member States. However, according to the Treaty, this procedure may only be relied on as a last resort after attempts to reach the necessary agreement have failed. Moreover, there is considerable legal uncertainty regarding its prerequisites and limits due to a lack of relevant case law of the Court of Justice. Therefore, this report explores the possibilities of an EU-wide implementation of the GloBE.

The report has different chapters that may be read as stand-alone pieces depending on the reader’s interest and time limit. The following **Chapter 2** starts with a brief history of reform that puts the current reform negotiations into context. We then describe the GloBE proposal in detail, as it is presented in the October 2020 Blueprint. Specifically, we show in nine steps how the effective minimum tax is levied. For each step, the Blueprint details are complemented by information on recent developments both inside and outside of the Inclusive Framework negotiations and a discussion of critical features of the proposal with regard to an eventual implementation in the EU. **Chapter 3** presents an economic analysis of the GloBE proposal. It

starts with a problem diagnosis on BEPS and continues with a summary of theoretical arguments that build the rationale behind the proposal. We review past experience with minimum taxes and reports on impact assessment of the current proposal with regard to tax revenue and investment. Finally, we discuss theoretical accounts that are critical of the effective minimum tax. **Chapter 4** begins with the question whether the EU has the necessary legal competence for adopting an effective minimum tax directive. It continues with analysing how and to what degree the GloBE proposal interferes with the EU/EEA fundamental freedoms. Finally, the section discusses potential conflicts with existing tax treaties of the EU Member States. **Chapter 5** identifies potential overlap between existing Union legislation in tax matters and the introduction of an EU minimum tax regime modelled after the GloBE proposal. It discusses the Anti-Tax-Avoidance Directive (ATAD), the Interest and Royalties Directive (IRD), the Parent-Subsidiary Directive (PSD), and the Merger Directive with regard to what extent, if any, those instruments would interact with a harmonised GloBE minimum tax directive. Moreover, we briefly discuss the relationship between a harmonised GloBE-style minimum tax and the soft law standards established by the Code of Conduct for Business Taxation. The final **Chapter 6** discusses how the GloBE relates to alternative reform proposals, such as the recently announced EU Commission initiative for reforming the system of business taxation in the EU (BEFIT), the Tax Justice Network proposal METR and a couple of other alternative reform concepts.

2. The GloBE proposal

This section describes the GloBE proposal as it is presented in the Blueprint (OECD 2020) from October 2020 with complementary information on the ongoing discussions (as far as they are available). It starts with a short history of the ongoing reform initiative, since the two Pillars need to be seen in the context of an eight-year long reform movement that was initiated in 2013 by the OECD. After that, this section presents the details of the Pillar Two GloBE proposal and focuses on crucial design features as proposed by the Blueprint and potential alternatives.

2.1. How did we get here? A short history of reform

The two-pillar reform proposal currently debated is the latest step in a series of coordination measures that started in 2012, when the G20 States tasked the OECD to prepare a report on base erosion and profit shifting (BEPS). The report (“Addressing Base Erosion and Profit Shifting”) was published in early 2013 and gave rise to the BEPS initiative, a 15-point action plan that proposed a wide range of measures to fix loopholes, introduce substance requirements and improve transparency. The G20 States agreed to the measures of the BEPS Action Plan in late 2015. Starting in 2016, the BEPS standards needed to be adopted into national tax law. For this purpose, the introduction of the multilateral instrument (MLI) that serves to implement BEPS related adjustments to double tax treaties was proposed and negotiated. The MLI was formally introduced in July 2018 and subsequently adopted by more than 90 countries.

In order to facilitate international tax coordination beyond the group of the OECD/G20 States and to allow for a formal representation of emerging and developing countries, the “Inclusive Framework on BEPS” was established in 2016. The Inclusive Framework has currently 139 Member States and proved to be crucial in the negotiations on the two-pillar reform.

While the BEPS program has generally been described as successful, it quickly became clear that it is not sufficient to substantially reduce lawful BEPS activities – and that this problem was especially urging in the digital economy. Several countries introduced special taxes targeted at digital firms (like the ‘Google tax’ in France, the ‘diverted profit tax’ in the UK, the ‘equalization levy’ in India), which raised concerns about a surge in compliance cost due to a patchwork of unilateral tax measures and highlighted the need for a coordinated approach.

In 2018, the OECD summarized the ongoing talks in an Interim Report, considering a re-allocation of taxing rights (among others, by redefining the concept of permanent establishment) and the use of “equalization levies” (that were later coined *digital services taxes*). Almost at the same time, the EU Commission launched two proposals for council directives:¹ First, as an ‘interim measure’, a common rule set for a digital services tax was

¹ EU Commission (2018a). Time to Establish a Modern, Fair and Efficient Taxation Standard for the Digital Economy, 21 March 2018, COM(2018) 146 final.

intended to harmonise the patchwork of unilateral digital taxes in Europe.² Second, as a long-term solution, a taxable nexus based on a “significant digital presence” was supposed to serve as the equivalent of a permanent establishment for tax purposes.³ Under the impression of the major tax reform in the US that introduced an effective minimum tax in the form of the GILTI regime, the German Ministry of Finance started circulating a proposal on an effective minimum tax. It started as an unpublished non-paper in late 2018, but gained momentum after France agreed to make the proposal part of a Franco-German initiative. In early 2019, the members of the Inclusive Framework agreed to negotiate two pillars of reform: a re-allocation of taxing rights in Pillar One and “remaining BEPS issues” in Pillar Two. The core of the latter was the “Global Anti-Base Erosion Proposal” (GloBE), i.e. an effective minimum tax that tackles the main incentive for base erosion: the tax rate differential.

In May 2019, a “Programme of work”⁴ was adopted, and in June 2019, the G20 Summit officially endorsed the initiative. The outbreak of the Covid-19 pandemic slowed the process down, but in October 2020, two blueprints were presented that were subject to public consultation until January 2021 and are now subject to further negotiations.

Although the reform documents still stress that the reform is intended to tackle the challenges due to the digitalization of the economy, it seems fair to say that, from 2018 onwards, the reform plans have evolved to be more broadly based, i.e. to be targeted at large multinational firms in general (instead of just at the digital economy). With regard to Pillar Two, the rationale of the GloBE proposal has been broadened from fighting BEPS to curbing excessive tax competition (although this shift in focus is still subject to debate, see below).

2.2. How does the effective minimum tax work? (Four rules)

The effective minimum tax prevents the effective tax rate paid by a multinational firm from falling below a certain threshold (i.e. the effective minimum tax rate) in each jurisdiction where the MNE is established. That is, the GloBE rules only apply if the effective tax payments measured as a fraction of profits attributable to a particular jurisdiction are below the GloBE minimum threshold. In this case, a jurisdiction may make use of the GloBE rules in two cases.

In the first case, the jurisdiction hosts the ultimate parent of an MNE that owns a low-taxed entity abroad, i.e. the ETR on the foreign entity’s profit income is below the GloBE minimum

² EU Commission (2018b). Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services COM(2018) 148 final.

³ EU Commission (2018c). Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, 21 March 2018, COM(2018) 147 final.

⁴ OECD Inclusive Framework (2019). Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy. Accessible online at <http://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf>.

threshold. Then, the *income inclusion rule* (IIR) allows the parent’s jurisdiction to top up the effective tax on the foreign entity’s profit income up to the GloBE threshold. Since the application of the IIR on the profits of foreign branch structures might violate specific provisions in double tax treaties, the *switch-over rule* (SOR) forms an integral element of the GloBE proposal. The SOR permits to levy a top-up tax on the profits of foreign PEs and applies where an income tax treaty otherwise obligates a country to use the exemption method for such profits.

In the second case, the jurisdiction hosts an entity owned by a foreign MNE that has at least one low-taxed entity abroad. The foreign-owned entity in the host jurisdiction makes payments to other entities of the firm. The MNE parent’s jurisdiction does not apply an IIR. Then, the *undertaxed payment rule* (UTPR) allows the host country to deny deductibility of the base-reducing payments such that the effective tax paid on the payment increases the effective tax payment on the low-taxed profit abroad up to the GloBE minimum rate. The subject-to tax rule (STTR) gives source countries the right to levy a withholding tax in case that the payment recipient's income is insufficiently taxed.

Ultimate Parent’s Jurisdiction		Foreign-Owned Entity’s Jurisdiction	
IIR	“Levy top-up tax on low-taxed income of foreign subsidiaries“	“Deny full tax deductibility for payments to related parties“	UTPR
SOR	“Tax foreign PE although DTT stipulates exemption“	“Allow for withholding tax although DTT says otherwise“	STTR

A priority rule is needed to avoid a conflict between the IIR and the UTPR. The OECD blueprint from October 2020 proposes to prioritize the IIR. That is, the UTPR can only be applied if the undertaxed payment is not part of income subject to the IIR.

Independent of the application of the IIR, the STTR serves as a simplified anti-BEPS instrument for source countries, especially ones with limited administrative capacities. It enables the withdrawal of treaty benefits for certain deductible intra-group payments made to jurisdictions with a low (adjusted) nominal tax rate (i.e. the more challenging task of calculating a taxpayer’s ETR is not necessary in this case). Any tax levied by virtue of the STTR is included in the ETR calculation for GloBE purposes, which gives the STTR *de facto* priority over both, the IIR and the UTPR. In other words, applying the STTR may make the application of the IIR or UTPR obsolete, if the resulting tax payments lift the taxpayer’s ETR above the GloBE threshold.

The implementation of the GloBE rules raises a large number of design questions that the Blueprint discusses in detail. Some of those design questions are already settled, others are still being negotiated in the Inclusive Framework. We will discuss the most important of them in the following by summarizing the Blueprint and adding complementary information on the current state of negotiations where available. For more details, we refer the interested reader to the Blueprint (OECD 2020), to Englisch/Becker (2019) and to Englisch (2021).⁵

2.3. Implementation

For the effective minimum tax to work, the rules have to determine who is subject to the tax (i.e. which firms are taxpayers). They have to specify how to calculate the ETR that – if it is below the threshold – triggers the GloBE minimum tax. Finally, the rules must clarify who (i.e. which jurisdiction) implements the effective minimum tax, at which rate and using which method.

In the following, we briefly report what the Blueprint from October 2020 proposes and how the negotiations have proceeded since then. The latter information is usually based on informal exchanges with people close to the process and therefore needs to be read with caution. We then add some discussion on how the proposals are to be evaluated and in which regard they may serve as a blueprint for implementation in the EU.

Step 1: Identify MNE groups subject to GloBE (scope)

The Blueprint proposal: The GloBE rules apply to those MNEs⁶ that are subject to CbCR obligations (BEPS Action 13),⁷ i.e. to MNE groups with a consolidated group revenue of more than 750 million EUR. The threshold is calculated based on consolidated financial accounts (see Step 2 below). Excluded from the application of the GloBE rules are investment funds, pension funds, sovereign wealth funds, government bodies, international organizations and non-profit organizations. International shipping companies are also excluded.

Recent modifications/developments: It is currently analysed whether the exclusion of investment funds and pension funds needs to be qualified in order to address the risk that these investment vehicles could be used to partially circumvent GloBE.

⁵ Englisch, J., Becker, J. (2019). International effective minimum taxation – The GLOBE proposal, *World Tax Journal* 11(4): 483-529. Englisch, J. (2021). International Effective Minimum Taxation – OECD/G20 Pillar Two (“GloBE”), in Haase, F., Kofler, G. (eds.): *OUP Handbook of International Tax Law*, Oxford University Press (forthcoming).

⁶ An MNE group consists of an ‘ultimate parent entity’ and other ‘constituent entities’. The ultimate parent entity owns a sufficiently large share of the other constituent entities (and is therefore required to prepare consolidated financial statements). The Blueprint provides a detailed discussion of cases in which either the ultimate parent or other constituent entities are joint operations, tax transparent entities, hybrid entities etc.

⁷ The close link to the BEPS Action 13 obligations has the advantage to reduce compliance cost (since an important part of the necessary data is already collected).

Discussion: Adopting the relatively high threshold of the CbCR regime is justified for reasons of administrative feasibility – at least at the initial stage of implementing the GloBE rules. The Blueprint estimates that the MNE within the scope of the CbCR account for more than 90 percent of global corporate tax revenue. This implies that any lowering of the threshold is presumably not associated with large revenue gains, but may imply a substantial increase in compliance and administration cost. Notably, the Biden Plan to strengthen the GILTI minimum tax rules and align them with the GloBE concept of an IIR does not (yet) provide any size threshold.

Step 2: Identify all profit income of each entity

Under source taxation, a jurisdiction has the right to tax a firm's profit if the firm has sufficient *nexus* in this jurisdiction. A nexus is taken as given if the firm is resident in this jurisdiction or if it has a substantial physical presence, i.e. a permanent establishment (PE), in it. With a nexus, the part of the firm's profit that is allocated to the taxable entity is taxed under the jurisdiction's tax law. How much of it is taxed, though, depends on the jurisdiction's tax accounting rules that determine the tax base.

The GloBE rules apply if the Effective Tax Rate (ETR) in a given jurisdiction is below a certain threshold. The ETR is calculated dividing all relevant tax payments ("covered taxes", see step 3) by all relevant profit income. The latter needs to be determined in a standardized way, since BEPS is mostly enabled by manipulating the tax base (next to shifting IP).

The Blueprint proposal: The calculation of all relevant profit income is based on financial accounting data. The Blueprint puts only mild constraints on which accounting standards are acceptable: "The relevant financial accounting standard for calculating the GloBE tax base is the financial accounting standard used by the parent in the preparation of its consolidated financial statements." (p. 51). These are the IFRS (as used by most publicly listed companies outside the US), IFRS-equivalent GAAP and other standards "provided the use of that standard will not result in material competitive distortions." Specifically, the item used for determining the ETR is the *profit (or loss) before tax* in the relevant financial accounting standard.

The Blueprint does not propose any book-to-book adjustments, and only a very limited number of generalized book-to-tax adjustments for typical permanent deviations between financial and tax accounting. In particular, dividends are excluded if the MNE holds a sufficiently large percentage of the equity, and bribes and penalties are treated as non-deductible.

In addition, the Blueprint contemplates a few flexible book-to-tax adjustments for certain temporary deviations in order to reduce volatility in the ETR. In particular, adjustments are considered where the calculation of the ETR based on commercial accounting standards would reduce the effectiveness of certain investment tax incentives that have been deemed to

constitute legitimate economic policy instruments. For example, the GloBE rules allow for taking into account local tax provisions that incentivize investment like immediate expensing and accelerated depreciation of assets. These provisions shift the tax burden over time (and, thus, only reduces it via the interest rate effect). In a similar vein, the Blueprint contemplates flexible book-to-tax adjustments in cases where national accounting standards (equivalent to the IFRS) differ anyway and do not raise concerns under the GloBE policy objectives, e.g. with regard to the recognition of self-created intangible assets and the level of interest rates for the valuation of pension plans.

Despite not being permanent, the Blueprint suggests to exclude deferred taxes from the GloBE tax base (as usual in national tax laws). Finally, the Pillar One measures may require an adjustment of the income to be included in calculating the ETR (“Pillar One applies before Pillar Two.”).

Simplification measures are discussed after Step 4.

Recent modifications/developments: After the publication of the Blueprint, the work on technical issues puts a strong focus on book-to-tax adjustments. In order to better target only those tax law rules that are susceptible to being devised or exploited for international tax planning, IP shifting and BEPS, the number of book-to-tax adjustments is being expanded. In contrast, merely temporary deviations might be accommodated by accounting for deferred tax payments in the numerator. Initially, the Inclusive Framework member jurisdictions were very reluctant with regard to this alternative approach, not least because they feared manipulations in the calculation of deferred taxes. However, it emerged in the public consultation of January 2021 that business representatives would strongly prefer the inclusion of deferred tax payments in the numerator, in order to reduce compliance costs. Therefore, the issue is back on the agenda of the Inclusive Framework again for further deliberation. Finally, anti-abuse rules to combat eventual manipulations of consolidated financial accounts as the starting point for the ETR calculation are being considered.

Discussion: The definition of the tax base is at the heart of the BEPS problem – and therefore played a central role in the negotiations on the GloBE proposal. Before settling on using financial accounting data, the Inclusive Framework considered using the tax accounting standards used by the ultimate parent entity’s jurisdiction. It was estimated, however, that the resulting compliance cost would be too high. The main advantage of using financial accounting standards as the IFRS is that the firms (potentially) subject to the GloBE rules collect the data anyway. Most of these firms are publicly traded and are therefore obligated to provide the data to shareholders. Moreover, the Pillar One measures (“Amount A”) use a similar base, which may help to save compliance cost.

The disadvantage is that there are good reasons for tax accounting standards to differ from financial accounting standards. Loosely speaking, tax accounting data is more conservative or cautious when it comes to profit determination. Using financial accounts to determine the effective tax rate risks increasing the denominator without affecting the numerator – and, thus, to yield artificially low effective tax rates. Then, the GloBE rules are triggered although the ‘true’ effective tax rate may be above the threshold.

The fact that the relevant tax payment is determined by the tax accounting rules in the jurisdiction under consideration and the ETR profit income is based on financial accounting data, even provides opportunities for tax planning. De Wilde (2021)⁸ discusses the use hybrid financial instruments for intra-group financing, for which payments are treated as interest under IFRS (and, thus, deflate the profit income) but as dividends from the viewpoint of the local tax system. By reducing the measured profit income (i.e. the ETR denominator) without affecting the tax payments (i.e. the ETR numerator) in a given jurisdiction, the ETR is increased – which may help to escape the application of the GloBE rules. Other possible schemes are based on accounting discretion to reduce the GloBE base (and, thus, inflate the ETR).

These issues suggest that the list of mandatory book-to-tax adjustments may have to be revised in order to discourage tax planning. While this makes the compliance with the GloBE rules potentially more burdensome, the resulting system of tax-adjusted financial accounting may serve as a useful benchmark for other tax coordination purposes as well.

A clean and straightforward solution would be to implement a harmonized tax accounting standard from the start. However, its obvious advantages notwithstanding, an international agreement on common benchmark tax accounting rules will be hard to reach given the divergent traditions and policy preferences in the involved countries. Even within the EU, such an agreement does not seem to be too likely – as the failed attempts to harmonize the corporate tax base show. Taking international financial accounting standards like the IFRS as a point of departure and introducing appropriate adjustments might offer the best chance of success.

Allowing for specific provisions in the local financial accounting standards, e.g. adjusting the ETR for deferred tax payments, may increase the scope for manipulation by both, tax paying MNEs and jurisdictions, within the GloBE rules. Accounting for investment incentives should be clearly defined and restricted to specific types of (tangible) investment.

Similarly, the use of government grants and tax incentives – in particular, investment tax credits – that may, depending on certain conditions outlined in the Blueprint, be counted as a reduction in covered taxes (a smaller numerator of the ETR) or an increase in income (a larger denominator) should be monitored with caution. The impact of the first alternative on the ETR

⁸ De Wilde, M. (2021). Is There a Leak in the OECD’s Global Minimum Tax Proposals (GLOBE, Pillar Two)?, Kluwer International Tax Blog, 1 March 2021.

is much greater⁹; this could result in an incentive for governments to convert non-refundable tax relief that is treated as a reduction of covered taxes into tax refunds or into direct subsidies that are merely accounted for as (untaxed) income. This problem may, however, be smaller in practice than in theory, because the two forms of subsidies are not easily interchangeable given the different budgetary effects and the transparency rules for direct subsidies such as the EU State aid rules or the WTO Agreement on Subsidies and Countervailing Measures. Non-refundable tax credits only have a budgetary impact to the extent that the taxpayer would otherwise have paid taxes, whereas refundable tax credits are potentially more expensive for the state. Direct subsidies, in turn, can be limited as to the available amount, but they usually receive stricter scrutiny in parliament and in the general public because, unlike tax expenditures, their nature and amount is not masked as a reduction in tax revenues.

Step 3: Identify all relevant taxes paid by each entity of MNE group (covered taxes)

The Blueprint proposal: Covered taxes that increase the ETR are all taxes paid on an entity's income or profit including taxes on distributed profit, on retained earnings and corporate equity. Importantly, taxes on profit or net income imposed that state or local levels are included.¹⁰ In contrast, taxes that are clearly not related to any measure of net income, like consumption and sales taxes, excise taxes, payroll taxes and social security contributions etc. are not counted, and neither are digital services taxes.

With respect to the interference with existing anti-avoidance rules, taxes paid under CFC rules in other jurisdictions are included. This step is guided by the principle “taxes follow profits”, i.e. it does not matter which jurisdiction levies the tax; if it is levied on profit assigned to an entity, the associated tax is assigned to the same entity. As a caveat, income tax on non-deductible intra-group payments is assigned to the entity that has incurred the expenses, because, technically, the denial of deduction increases the profits of the latter entity.

Simplification measures are discussed after *Step 4*.

Recent modifications/developments: There are ongoing efforts to resolve technical issues regarding the calculation of covered taxes paid in a jurisdiction other than the country for which the ETR is to be determined. While this is relatively straightforward in case of foreign

⁹ While the firm should be indifferent between one Euro of lower tax payments and one Euro of higher net income, the consequences for calculating the ETR are substantially different. With $ETR = (\text{covered taxes})/(\text{net income})$, it can be shown that a reduction in covered taxes decreases the ETR by $-1/(\text{net income})$ whereas an increase in net income decreases the ETR by $-(\text{covered taxes})/(\text{net income})^2$. With an ETR of less than 10 percent, this implies that the reduction in ETR in case that net income is increased is less than 10 percent of the ETR reduction in case that covered taxes are reduced. The targeted use of ITCs or government grants therefore is one means of tax competition under a GloBE rule.

¹⁰ In addition, the Blueprint lists a number of specific taxes that are included, e.g. taxes in lieu of a generally applicable income tax (such as a tax on the number of units produced or commercial surface area) and taxes based on multiple components (that are applied e.g. in Saudi-Arabia).

withholding taxes, it can be trickier for CFC taxes, head office country taxes on foreign PE profits, taxes on profits generated by hybrid entities, etc.

Discussion: The definition of covered taxes has not proven to be a critical point during the negotiations. One might make the case that DST should be part of covered taxes since many DSTs are intended to replace (in an admittedly blunt way) profit taxes that are not (or cannot be) raised elsewhere. If the DST payments contribute to the ETR in the jurisdiction that levies the DST, this will probably not make a big difference, since jurisdictions that levy DST will only rarely be subject to the effective minimum tax. In contrast, if the principle “taxes follow income” stipulates that the DST increases a low ETR somewhere else, the DST may prevent the GloBE rules from being applied. Therefore, from a political point of view, excluding DST would give some incentive to abolish this kind of tax instrument (after all, a global agreement on the two-pillar reform is intended to make DSTs redundant). In any case, given that accounting for DST would increase compliance cost, it seems best to follow the Blueprint proposal and exclude them.

An interesting question is how to account for taxes paid on Amount A from Pillar One. The principle “taxes follow profit” requires accounting for tax payments on Amount A in the jurisdiction where the latter counts as ‘relevant profit income’ in the sense of Step 2. In fact, the Blueprint states: “Tax paid on net income allocated to a jurisdiction under Pillar One would be treated as a covered tax under the GloBE” (p. 80).¹¹ With respect to political incentives, this seems to be a straightforward choice: A jurisdiction should have full control over the tax parameters that determine the ETR. However, given the special rules of allocation, an alternative is to completely ignore Amount A (i.e. both in terms of income, i.e. the denominator, as well as in terms of tax payments, i.e. the numerator) for the ETR calculation.¹²

Step 4: Aggregate covered taxes and profit income of all entities within a jurisdiction (blending) and calculate jurisdictional ETR

The Blueprint proposal: The covered taxes and the profit income of all entities within a jurisdiction are pooled to calculate a jurisdictional ETR. This requires that all entities are assigned to a particular jurisdiction. In line with CbCR rules, this would essentially be done based on tax residence or location in case of PEs. The Blueprint provides specific rules for transparent, reverse-hybrid and stateless entities.

Simplification measures are discussed after this subsection.

¹¹ The Blueprint stresses, though, that the adjustments due to Pillar One will depend on the actual design choices: “Pillar One applies before Pillar Two. Depending upon the final design of Pillar One, an adjustment may be required to the GloBE tax base of one or more jurisdictions to properly reflect Pillar One outcomes. Covered taxes associated with that income would need to be assigned accordingly.” (p. 65)

¹² As with any carve-outs, an exclusion of Amount A and the associated tax payments reduces the firm’s opportunities to compensate low taxed income elsewhere.

Discussion: The Blueprint proposes a jurisdictional blending (where taxes and income from all entities within a given jurisdiction are pooled). Alternatively, the GloBE rules could be applied on an entity basis or, as the US GILTI regime, allow for the blending of all foreign entities' profits. With more than one entity in a given jurisdiction, jurisdictional blending implies that a higher ETR on one entity's income may compensate for the lower ETR on another entity's income. This somehow limits the effectiveness of the minimum tax and restores some room for jurisdictions to offer preferential regimes or specific provisions like IP boxes with effective tax rates below the GloBE threshold. Note, though, that this only works if the average ETR is at or above the GloBE threshold.¹³ Moreover, an entity-level calculation of the ETR would typically not effectively tackle such averaging, either, because firms would then tend to bundle all their activities in a given jurisdiction in just one entity. For some simplification measures, the jurisdictional approach is facilitated by the availability of CbCR data that provides the tax authorities with effective tax rates on a jurisdictional basis. By contrast, GloBE would lose much of its effectiveness under a global blending approach.¹⁴ Note that the Biden Administration plans to reform its GILTI regime and introduce jurisdictional blending (instead of global blending).

Simplification measures for steps 2, 3 and 4

The Blueprint proposal: Since steps 2 and 3 may imply substantial compliance cost, the Blueprint (Ch. 5) proposes a number of simplification measures. First, MNEs could be allowed to calculate an ETR based on the CbCR data. If this ETR (after some adjustments) is well above the GloBE minimum threshold, a “safe-harbour” rule may apply that exempts the MNE from calculating entity-specific ETRs in this jurisdictions. Second, the obligation to calculate ETRs may only apply to jurisdictions that have more than a certain percentage of the MNE's total pre-tax profit (the Blueprint mentions 2.5 percent as an example). Alternatively, the *de minimis* measure could be based on an absolute pre-tax profit amount (e.g. 100,000 EUR, according to the Blueprint). Third, after calculating the entities' ETRs in one year, the MNE could be freed from calculating them in those jurisdictions that exceeded the GloBE threshold significantly for a certain “grace period” (3 to 5 years). The Blueprint itself admits, though, that if the ETR calculation has a fixed cost, the saving of compliance cost may rather be limited. Fourth, so-called “low-risk jurisdictions” could be identified by tax administrations (via the Inclusive Framework) in which the tax base does not significantly deviate from the GloBE tax base and in which the tax rate is sufficiently high. The MNE would then be relieved from calculating the ETRs in these low-risk jurisdictions. Alternatively, in case that ETRs differ significantly

¹³ The same argument speaks against the blending of all foreign entities. For instance, US GILTI rules allow for blending of low taxes affiliates in tax havens with high-taxed affiliates in e.g. Germany. See also Shay, S.E., Clifton Jr. Fleming, J., Peroni, R.J. (2015). Designing a 21st Century Corporate Tax – An Advance U.S. Minimum Tax on Foreign Income and Other Measures to Protect the Base, Fla. Tax Rev. 17: 669-723 (at 706).

¹⁴ See Englisch/Becker (2019) for a detailed discussion about the pros and cons of the different approaches to calculating the ETR.

between sectors, there could be “low-risk sectors” within a given jurisdiction. This kind of “administrative guidance” seems to be the preferred choice by businesses according to the OECD public consultations documents.

Recent modifications/developments: At the public hearing, business representatives expressed a strong preference for the option of country-specific guidance (“low-risk jurisdictions”). Accordingly, efforts have now focused on devising and testing an approach that would permit to identify jurisdictions where the ETR will not normally be below the minimum rate, or where this might happen only under specific circumstances to which a simplified and preliminary ETR analysis could be limited. In particular, rather than drawing up a list of low-risk sectors for which the ETR never needs to be calculated, country reports would identify tax accounting rules and preferential regimes that are susceptible to significantly reducing the domestic tax base as compared to the GloBE base and require a simplified calculation of a provisional ETR on this basis. The MNE would thus initially only have to carry out very few, if any, calculations in addition to the existing local tax profits and loss statement, and would have to make the effort to calculate the exact GloBE ETR only if the provisional one flags an undertaxation risk.

The main benefit of this approach consists in significantly reducing compliance and administrative costs, while being more targeted and less over- or under-inclusive than other simplification options such as the *de minimis* approach. Moreover, country reports would increase the transparency of potentially problematic rules and regimes in a participating jurisdiction, thereby possibly increasing political pressure for their abolition or modification¹⁵. However, there are also inherent political risks. Obviously, the exemption from applying the GloBE rules due to such a list of low-risk sectors is of large value for both, the MNEs and the jurisdictions hosting the MNE entities. In order to avoid political bargaining and coalition building, the questions of how to organize the assessment of individual countries and of who decides on the list are of crucial importance. Accordingly, the current debate focuses on how to shape the governance structure tasked with assessing participating jurisdictions. Another concern is how to calculate the ETR based on information from the past (in order to account for loss carry-overs etc.) in case that a firm has benefited from simplification measures in the past (and therefore lacks the data on past income and taxes) and is now required to provide income and tax data for GloBE purposes.

Discussion: The use of country-specific guidance identifying low-risk jurisdictions (with the option for a simplified approximate ETR test within a low-risk jurisdiction) is a promising way to reduce compliance cost. Note, though, that details on the procedure on how to determine

¹⁵ Being on the low-risk sector list benefits all MNE entities in a jurisdiction, not only those that have an ETR below the minimum threshold. In this sense, a low-risk sector list may generate political pressure by all entities (especially by those with above-threshold ETRs) to adjust the tax system in order to secure a place on the list.

“low-risk” jurisdictions have not yet been determined; in particular, it is still under discussion whether only government representatives would be involved in making those assessments. Such guidance could be combined with a *de minimis* rule that further reduces the burden of collecting data for the MNEs. Country-specific guidance should be periodically reviewed and updated *ad hoc* in case of significant changes in legislation, case law or administrative practice. As a side effect, such a rule would increase the incentive for all jurisdictions to get onto the list of low-risk jurisdictions in order to reduce the implicit tax (due to increased compliance cost).

Step 5: Adjust jurisdictional ETR for tax and loss carry-forwards.

There are several reasons why income accrual and tax payments may not take place in the same period. This gives rise to fluctuations in the ETR that may trigger the GloBE rules although the medium-term ETR is above the GloBE threshold.

The Blueprint proposal: The GloBE rules allow for three kinds of intertemporal shifting of taxes and accounting losses. First, loss carry-forwards are granted indefinitely, which ensures that minimum taxes are only paid if taxes paid on income net of previous losses fall below the threshold. Losses carried forward from previous periods are used to reduce the taxable income in this period, i.e. reduce the ETR denominator and, thus, eventually lift the ETR above the threshold. Second, taxes paid in excess of the minimum threshold in previous periods can be used to prop up the ETRs in the current period in order to avoid the application of the GloBE rules. This tax carry-forward is limited in the number of years; the Blueprint states “a period of seven years may, (...), be a reasonable period” (p. 88).¹⁶ Third, if a firm has paid top-up tax for a jurisdiction in one period and the ETR for this jurisdiction is above the minimum tax rate in a subsequent year, the local “excess tax” gives rise to an IIR tax credit, that can be used to reduce IIR liabilities in future periods. The firm’s ability to build up an IIR tax credit for IIR payments in the past is limited in time, too; the Blueprint suggests again a seven-year “lookback period”. The use of an existing IIR tax credit is not limited in time, though. Moreover, the IIR tax credit may be used by the MNE in all other jurisdictions to reduce their IIR liabilities. This provision should not be misunderstood as an element of global blending; the credit is given since IIR taxes have been overpaid in a given jurisdiction. Instead of repaying the excess tax payments, the ultimate parent’s jurisdiction allows for using a credit – which comes down to the same consequence.

The local-tax carry-forward and the IIR carry-forward are linked. To see this, consider an MNE entity with a constant profit of 100 over three periods. Local tax payments in periods 1, 2 and 3 are 7, 25 and 5, respectively; the minimum rate is 15 percent. The firm has no local-tax credits or IIR credits from previous periods. In period 1, an IIR payment of 8 tops up the ETR. In

¹⁶ If it were not limited, a jurisdiction that has had an ETR above the threshold for a number of years could become a low-taxed jurisdiction without falling under the GloBE rules (since it benefits from local tax credits built-up previously).

period 2, local tax payments exceed the GloBE threshold by 10, implying that the IIR payment from the previous period was unjustified; consequently, the IIR payment from period 1 is accounted for as an IIR credit. The remaining excess tax of 2 is counted as a local tax credit¹⁷. In period 3, local tax payments are 10 below the GloBE threshold. The firm may now use its local tax credit of 2 to top up the ETR. The remaining IIR liability of 8 is reduced to zero by using the IIR credit (assuming that it was not already used to offset an IIR liability in another jurisdiction in period 2). Therefore, no actual IIR tax payment is made in this period.

¹⁷ See OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 311 and Annex, example 4.2.1B, point 4.

Period	1	2	3	1-3
Profit	100	100	100	300
Local tax payments	7	25	5	37
<i>GloBE threshold</i>	<i>15</i>	<i>15</i>	<i>15</i>	<i>45</i>
IIR payment	8	0	0	8
<i>Local tax credit</i>	<i>0</i>	<i>2</i>	<i>0</i>	<i>0</i>
<i>IIR credit</i>	<i>0</i>	<i>8</i>	<i>0</i>	<i>0</i>

Adding the three periods up (right hand column) shows that the firm paid 45 in tax (37 to local tax authorities, 8 as an IIR payment) while the GloBE threshold is also at a payment of 45. Consequently, the firm starts into period 4 with neither an IIR credit nor a local tax credit.

Recent modifications/developments: It is currently discussed whether the local loss carry-forward could be substituted by integrating deferred taxes into the ETR calculation. However, most members of the Inclusive Framework are still reluctant to regard deferred taxes estimated under financial accounting rules as equivalent to actual tax payments. Under the premise that the GloBE-specific loss carry-over will be maintained, the technical discussion focuses on a transition regime and on rules against tax planning relying on loss-making shell companies.

Discussion: Using tax and loss carry-forwards is in line with the GloBE rules targeted at jurisdictions that offer ETRs that are permanently below a certain threshold. Temporary volatility should not trigger any complementary minimum taxation. Therefore, the Blueprint proposals make sense since they allow to “smooth-out” the ETR time series and to avoid the triggering of GloBE rules only due to temporary drops in the ETR. In order to limit strategic incentives for jurisdictions to become temporary tax havens, the local-tax carry-forwards should be limited to at most seven years.

Step 6: Adjust jurisdictional ETR for carve-outs

The Blueprint proposal: The GloBE tax base, i.e. the part of the income that is subject to a top-up tax in case that the ETR is below the minimum threshold, is reduced by so-called *substance-based carve-outs*. These carve-outs have a *payroll component* and a *tangible asset component*. The payroll component is a fixed percentage (yet to be determined) of the payroll cost, the tangible component is a fixed percentage (again, yet to be determined) of the (deemed)

depreciation of property, plant and equipment, land and natural resources. The tangible component can be interpreted as an imputed return (“normal return”) that is not subject to minimum taxation. Specific provisions apply to the case of leasing. In order to avoid that firms invest in tangible assets, e.g. in land and buildings, just to increase the tangible component carve-out, it is denied for property that is just held to earn rental income or for capital appreciation. Again, using financial accounting helps in this case, as e.g. the IFRS separately accounts for this kind of property (“Investment Property”).

Recent modifications/developments: The tangible asset component of the carve-out is inspired by the carve-out for tangible assets (so-called “qualified business asset investment”, QBAI) provided for in the US GILTI minimum tax regime. Under the Biden Tax Plan, the QBAI exception would be abolished. This has led some members of the Inclusive Framework to suggest that the idea of a substance-based carve-out should be rejected for the purposes of GloBE, too. While a full elimination is unlikely considering that the carve-out represents a compromise after protracted negotiations between major members of the Inclusive Framework, modifications should be expected in the light of the new US position.

Discussion: The allowance of carve-outs has been a contentious issue in the Inclusive Framework negotiations. A minimum tax without carve-outs addresses *abstract* profit shifting risks and therefore covers arrangements that do not actually involve any “aggressive” tax planning. Such a minimum tax would not only target profit shifting opportunities but also “excessive” competition for real investment. Moreover, the dividing line between “artificial” tax-motivated profit shifting and acceptable tax-motivated investment decisions might become increasingly blurred in the future, due to of technological developments and the ever-increasing role of IP as the main driver for value creation.¹⁸ Therefore, it would have been better to make the minimum tax future-proof by avoiding any substance criterion and only referring to tax outcomes of business organisation. In contrast, a minimum tax with carve-outs, as currently planned in the Blueprint, only applies to “above-normal” or “excess” income. On the one hand, this limits the effectiveness of the minimum tax in establishing a floor for international tax competition, especially if one takes into account that due to the generous tax and loss carry-forwards, the GloBE only come into effect, if a firm permanently earns above-normal income in a given jurisdiction. On the other hand, it may be argued that most of the BEPS is associated to the use of intangible asset (that does not allow for a carve-out) and, thus, GloBE would still

¹⁸ The proliferation of cyber-physical systems, robotic process automation, and other artificial intelligence applications could imply that fewer human employees will be needed to carry out core business functions that contribute significantly to value creation, and allow for further centralisation of business processes. As a consequence, the factors that matter for an arm’s length assessment of transfer prices could become even more mobile than they already are, and transaction costs for shifting profits by way of a relocation of functions and risks would become substantially lower. For a more detailed discussion, see Becker, J., Englisch, J., Schanz, D. (2019). Re-Allocation of Taxing Rights for Big Data Business Models, Working Paper.

be an effective anti-BEPS instrument (and curb tax competition) for income earned on this kind of asset.

As mentioned above, the US GILTI regime allows for a carve-out of a fixed return (10 percent) on specifically defined tangible assets (QBAI). The Biden administration now plans to get rid of the carve-outs. These carve-outs have been criticized since they allow for too much sheltering of low-taxed income within the rules (especially in combination with global blending). Moreover, carve-outs add another decision margin that may be distorted by the tax. For instance, investing in tangible assets becomes more attractive if this helps avoiding the (application of the) GloBE rules. As indicated above, the GloBE rules as proposed by the Blueprint have some countervailing measures (e.g. not allowing for buildings and properties that are only held for rental income); however, it does not need much imagination to see that carve-outs increase the scope for tax planning.

Carve-outs may also have disadvantages for MNEs (apart from the obvious downside of higher complexity and compliance cost). Carve-outs may imply that there is less high-taxed income to compensate for preferentially taxed income (e.g. IP income). One option is to make carve-outs optional. With the Biden Administration being increasingly sceptical about the carve-outs in its own GILTI system, a clean complexity-reducing step could be to abolish all kinds of carve-outs. It seems, though, that some Inclusive Framework Member States insist on some substance-related exemption.

It is sometimes argued that carve-outs make the GloBE a genuine tool to fight BEPS and, thus, closer to the existing traditional CFC regimes. Therefore, the GloBE might have the potential to replace the CFC regimes. However, due to the high thresholds applying to the GloBE rules, it seems more adequate to let the CFC rules coexist.

Step 7: Calculate the top-up tax rate

The Blueprint proposal: The top-up tax rate is the difference between the GloBE minimum rate and the adjusted jurisdictional ETR (as calculated in steps 2 through 6). The GloBE minimum rate has not yet been determined.

Recent modifications/developments: So far, there has not been any official statement on the level of the effective minimum tax rate (up to which the IIR and the UTPR top up the effective tax rate on profit). Pascal Saint-Amans, Director of the OECD Centre for Tax Policy and Administration, is on record stating “that he “wouldn’t be surprised” if something close to the (Irish) State’s 12.5 per cent rate emerged as a benchmark.”¹⁹ During a debate in the French

¹⁹ C. Taylor: Time for ‘aggressive tax behaviour’ is over, says OECD reform director, in: Irish Times vom 30.7.2019, <https://www.irishtimes.com/business/economy/time-for-aggressive-tax-behaviour-is-oversays-oecd-reform-director-1.3970058> (22.8.2019).

Parliament in April 2021, French Finance Minister Bruno LeMaire said that he could imagine a tax rate of 16 to 18 percent.²⁰ The Biden Tax Plan calls for a minimum rate of 21 percent with only jurisdictional instead of global blending under a revised GILTI regime.²¹ On 20 May 2021, the Biden Administration issued a statement that it would back a 15 percent global minimum tax rate.²² While this may not be the last word in the current debate, it is noticeable that, in internal debate and external statements, the range of minimum rates deemed adequate for GloBE purposes has shifted from previously 10 to 12.5 percent to now 15 percent or above. In particular, at their June 5 meeting in London, G7 Finance Ministers declared that they “commit to a global minimum tax of at least 15 percent on a country by country basis.”

Discussion: The importance of the GloBE tax rate choice also depends on other design choices, like the size of the carve-outs. For the prospects for a global agreement, it seems crucial that the tax rate choice accounts for the number of countries that would actually be affected by the GloBE rules. From this viewpoint, it seems worthwhile to have a look at the current level of corporate tax rates. The two graphs²³ below depict the 2020 statutory corporate tax rates (including subnational taxes on corporate profits) for OECD countries (unweighted average: 23.7 percent) and a sample of non-OECD countries (unweighted average: 19.2 percent) and compare it to a GloBE minimum rate of 15 percent. These 109 countries have an (unweighted) average statutory corporate of 20.7 percent. Among them, 21 countries have a statutory rate that is strictly below 15 percent.

Importantly, statutory tax rates are only a vague approximation of the effective tax rates that are in the centre focus of the reform. Statutory tax rates are applied to the tax base that is determined by local tax accounting rules. If these rules allow for generous deductions, the ETR may be substantially lower than the statutory rates. In principle, it is possible to calculate the effective average tax rates for typical investment projects (the Appendix to this Chapter provides the numbers available in the OECD Tax Statistics Database), but this kind of indicator is still incomplete. On the one hand, the rules that allow for a narrowing of the tax base often differ significantly across types of investment and across sectors of the economy. On the other hand, forward-looking effective tax indicators measure, in most cases, the tax burden in the absence of any manipulation or use of specific tax saving structures. From this perspective, the EATR (e.g. 12 percent for Ireland) may paint a misleading picture of the actual tax burden of MNEs (that have access to structures like the Double Irish Dutch Sandwich, to name just the most notorious one). However, even the forward-looking tax indicators capture some of the tax saving provided by specific tax provisions. The ZEW Digital Tax Index²⁴ measures the (forward-looking) effective average tax rate for digital business models in the year 2018 and

²⁰ The quote is recorded here: <https://twitter.com/QParrinello/status/1382617766939791365?s=20>

²¹ <https://www.nytimes.com/2021/04/05/business/yellen-global-minimum-corporate-tax-rate.html>

²² New York Times (2021). U.S. Backs 15% Global Minimum Tax to Curb Profit Shifting Overseas, 20 May 2021.

²³ All data is taken from <https://www.oecd.org/tax/beps/corporate-tax-statistics-database.htm>

²⁴ https://ftp.zew.de/pub/zew-docs/gutachten/Digital_Tax_Index_2018.pdf

shows that the EATR is below 10 percent in a majority of 19 out of 33 – mostly European – countries²⁵, according to another study. Most of these countries have preferential regimes for IP income (“patent boxes”). These and other preferential regimes (e.g., super-deductions for R&D expenditure) are responsible for an average drop of almost 9 percentage points in the effective average tax rates. Thus, a relatively large number of jurisdictions might be affected by an international minimum tax regime, even if the minimum rate is relatively moderate.

²⁵ Included are the 28 EU Member States as well as Japan, Canada, Norway, Switzerland and the US. ZEW, Digital Tax Index 2018.

Step 8: Identify the jurisdiction with the right to apply IIR, then apply IIR

The Blueprint proposal: The ultimate parent's jurisdiction applies the income inclusion rule.²⁶ If this jurisdiction does not implement an IIR in conformity with GloBE standards, the next intermediate parent's jurisdiction down the ownership chain has the right to apply the IIR. If there is no intermediate parent's jurisdiction applying an IIR, the source countries that allow for deduction of payments to low-taxed jurisdictions have the right to deny deductibility under the UTPR (see below).

The Blueprint also covers the use of preferential regimes for ultimate parent entities to compensate for additional IIR payments. A jurisdiction that uses its tax system to reduce liability depending on IIR payments (in order to become attractive as a location for ultimate parent entities) is treated as having no IIR in place. In this case, the right to apply the IIR would be given to a jurisdiction further down the ownership chain.

Recent modifications/developments: With regard to Step 8, there are no important modifications discussed, apart from some technical issues related to tax optimization opportunities with dual residence parent jurisdiction and related to split ownership rules.

²⁶ From a technical viewpoint, profits could either be taxed separately at a reduced rate ("schedular" model), or be partially included in the regular income of the parent company ("partial exemption" model) where they would be taxed at the normal tax rate. The effective tax burden would be the same.

Discussion: The priority rule in favour of the IIR has obvious advantages in terms of simplicity and compliance/administration cost. As a downside, the resulting revenue gains will exclusively accrue to the ultimate parents' residence locations. This feature of the reform has been criticized especially by developing and emerging economies. While the critique seems to be justified from a general point of view, at least two reasons may be put forward in favour of sticking to the priority rule. First, source countries with ETRs above the minimum threshold profit from the IIR application since it curbs profit shifting from source countries to tax havens and low-tax jurisdictions. Second, even if a global agreement recognizes the revenue needs of developing and emerging economies, it may still be optimal to let the residence countries collect the revenue and, then, via a clearinghouse redistribute the revenue to the source countries. Such a proposal is admittedly optimistic with regard to the degree of international tax cooperation – but a general priority rule for the UTPR would be no less demanding in terms of international tax coordination. Moreover, if GloBE were implemented within the EU by way of Union legislation, a different top-up tax collection and revenue allocation would be administratively feasible, at least with respect to undertaxed entities domiciled in the EU itself. We explain this in further detail in chapter 3.

Step 9: Without IIR jurisdiction, apply UTPR

The Blueprint proposal: The IIR has priority over the UTPR, i.e. the latter is applied to an entity's income only if no parent jurisdiction applies the IIR. Typically, this will be the case where the jurisdiction(s) in which the ultimate parent company or other parent companies are resident did not implement the IIR; in this sense, the UTPR acts as a backstop to the IIR. However, the role of the UTPR goes beyond this function: It ensures a sufficient level of taxation in the ultimate parent jurisdiction, regardless of whether the latter implements the IIR or not. Since the IIR never applies to any local low-taxed income, the UTPR is used to top up the tax on this income in case of the ultimate parent jurisdiction. UTPR taxpayers are all those entities with an ETR above the GloBE minimum rate. The top-up tax determined in steps 2 through 7 is calculated for each low-taxed entity. The UTPR taxpayers collect the tax. For this purpose, the Blueprint proposes two allocation keys. First, if the UTPR tax payers make tax deductible payments to a low taxed entity, they pay the top-up tax in proportion to the deductible payments made to the low-taxed entity under consideration.²⁷ Since the tax is deducted by denying tax deductibility of direct payments, there is an upper limit to what the UTPR taxpayer can collect this way. Second, if the top-up tax exceeds this limit or if there are no direct payments by UTPR taxpayers to the low-taxed entities, the UTPR taxpayers collect the top-up tax in proportion to their net intra-group payments (UTPR taxpayers with net intra-group

²⁷ For instance, with two UTPR tax paying entities making tax deductible payments of 4,000 and 8,000, respectively, to the low-taxed entity and with a top-up tax of 900, UTPR tax payer 1 pays one third ($4,000/(4,000+8,000)$) of the top-up tax (i.e. 300) and UTPR taxpayer 2 pays two thirds (i.e. 600).

receipts do not pay a tax). Again, limit applies, since the UTPR taxpayer can only deny tax deductibility for all gross payments made to other parts of the MNE group.

Recent modifications/developments: Again, there are no important modifications considered with regard to Step 9. It is noteworthy, however, that an agreement on the UTPR part has become more likely since the Biden Administration revealed plans to reform the BEAT regime into an UTPR (under the label SHIELD).

Discussion: In contrast to the IIR, the application of the UTPR may require the coordination of potentially competing tax claims of UTPR countries, which might entail an extension of international exchange of information (EoI) agreements and other forms of cooperation. It seems that, currently, the international tax system is not well equipped for this challenge. It should therefore be considered to at least expand CbCR standards to include more GloBE-relevant information, and to strengthening ICAP and joint audits.

Appendix

This Appendix provides the effective average tax rates (EATR) for OECD and non-OECD countries compared to a GloBE minimum rate of 15 percent. The suitability of the EATR as an approximation of actual ETRs paid on MNE profits is discussed above. The EATR is a composite measure that indicates the tax payments in percent of profit income resulting from a typical investment (i.e. with a typical asset structure) with a pre-tax rate of return of 20 percent. The EATR accounts for asset-specific depreciation allowances and makes stylized assumptions on real interest and inflation rates (the numbers below show the low interest and inflation scenario, with 3 percent real interest and a 1 percent inflation rate).

3. Economic analysis of effective minimum taxation

3.1. Extent of BEPS

The current rules of the international tax system require that the allocation of taxable profit within an MNE group is in line with the arm's length principle (ALP). This means that the transfer prices used for intra-firm transactions have to be comparable to those used for transactions between unrelated parties, and the (relative) profit rates of a given entity must be comparable to a stand-alone entity of similar function.

Within these rules, MNEs have substantial room for tax planning, some of which has been due to inconsistencies of the involved national source tax systems. The OECD BEPS initiative (2013-15) has tackled a number of these inconsistencies and loopholes. As a consequence, profit shifting has been made more difficult and costly, especially after the revision of the OECD Transfer Pricing Guidelines based on BEPS Actions 8-10. IP ownership must now be matched with real people functions, and contractual risk allocation must be accompanied with real risk management as well as risk bearing capacities, for these factors to be taken into account for profit allocation²⁸. However, a large range of profit shifting opportunities remain. First, the majority of BEPS recommendations does not have the status of minimum standards, and many MLI signatories seem reluctant to embrace the additional BEPS outcomes²⁹. Second, some BEPS recommendations intend to only "limit" but not eliminate certain profit shifting opportunities, such as the interest deduction barrier recommended in BEPS Action 4. Third, the new substance requirements (BEPS Actions 8-10) can often be met by making only modest investments, and therefore do not establish a strong link between value creation and taxing rights allocation. Finally, the importance of intellectual property continues to be on the rise, especially in the digitalised economy. IP is, in most cases, firm-specific and therefore unique. There are no observable market prices, and comparables are often unreliable or outright missing (e.g. there is no comparable to the Google search algorithm). Thus, arm's length transfer prices (i.e. prices that would have been set between unrelated parties) are hard to come by, and significant margins of appreciation have to be accepted by the tax authorities, which can be exploited by multinational firms for tax planning strategies.³⁰ Profit concentration in low-tax IP holding jurisdictions can be further enhanced by stripping routine activities in high-tax production or market jurisdictions from risk, thereby reducing the arm's length price charged

²⁸ See OECD, *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Reports*, esp. para. 6.48.

²⁹ For an overview, see the OECD MLI matching database, at <https://www.oecd.org/tax/treaties/mli-matching-database.htm>.

³⁰ See, e.g., Sullivan, M.A. (2019). *Fixing GILTI, Part 3: Substance Exception?*, *Tax Notes Int'l*, 930-933 (at 932).

for them under the classical transfer pricing methods of the OECD Transfer Pricing Guidelines.³¹

Altogether, MNEs still have significant profit shifting opportunities in the post-BEPS era³² and there is ample evidence that they make use of them. MNEs shift profits³³ to low-tax jurisdictions and tax havens via transfer pricing³⁴, financing schemes³⁵ or by relocating IP³⁶ and risk³⁷. Recent studies show that, despite ongoing measures against BEPS, firms are able to shift enormous amounts into low-tax jurisdictions and tax havens.³⁸ An especially well designed study by Bilicka (2019) shows that the taxable profit (measured as a fraction of total assets) reported by subsidiaries of foreign multinational firms in the UK is only one half that of comparable standalone firms.³⁹ Gravelle (2015) finds that the US loses 0.6 percent of GDP in

³¹ Similar points have been raised recently by the IMF and by the TAX3 Committee of the European Parliament. IMF Policy Paper (2019). Corporate Taxation in the Global Economy, p. 10. European Parliament, Special Committee on financial crimes, tax evasion and tax avoidance (“TAX3”) (2019). Report on financial crimes, tax evasion and tax avoidance, para. 22.

³² In 2018, the OECD Forum on Harmful Tax Practices (FHTP) has started developing a “new global standard on the resumption of the substantial activities factor for no or only nominal tax jurisdictions” (see OECD, 2018 Progress Report on BEPS Action 5). This new approach would require a substantial presence to steer clear of an eventual OECD blacklist. Although the procedure merely relies on peer review and peer pressure, the new standard could considerably limit profit shifting schemes that involve haven jurisdictions. However, the territorial scope of this measure is arguably much more limited than the potential territorial scope of the minimum tax initiative, because the former only addresses jurisdictions with a zero or “near zero” level of corporate income tax. It does not cover countries with a very low but not entirely negligible level of taxation, nor countries with preferential regimes that offer very low effective tax rates. Moreover, in contrast to the minimum tax, the FHTP initiative interferes *directly* with the tax sovereignty of the haven jurisdictions with respect to the design of their national legislation.

³³ Overesch/Heckemeyer (2017) provide a meta-study of 27 profit shifting studies and report a semi-elasticity of subsidiary profits with respect to tax rate of -0.8. That is, a ten percentage point increase reduces reported profits in a given subsidiary by 8 percent. Beer et al. (2020) present another meta-study of 37 profit shifting studies and find a semi-elasticity of -1 and, for more recent years, even close to -1.5. Recent approaches that consider non-linear models (Dowd et al., 2017) find larger tax effects on profit shifting for low tax rates and lower effects for high tax rates (up to semi-elasticities of -4.7 at corporate tax rates of 5 percent and -0.7 at tax rates of 30 percent). Heckemeyer, Jost H. and Michael Overesch (2017). Multinationals’ Profit Response to Tax Differentials: Effect Size and Shifting Channels. Canadian Journal of Economics 50(4): 965–994. Beer, S., De Mooij, R., and Liu, L. (2020). International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots, Journal of Economic Surveys 34(3): 660-688. Dowd, T., Landefeld, P., Moore, A. (2017). Profit shifting of U.S. multinationals’, Journal of Public Economics 148: 1-13.

³⁴ See e.g. Cristea, A. and D. Nguyen (2016). Transfer pricing by multinational firms: New evidence from foreign firm ownerships. American Economic Journal: Economic Policy 8(3): pp.170-202. Davies, R., Martin, J., Parenti, M., Toubal, F. (2018). Knocking on tax haven's door: multinational firms and transfer pricing, Review of Economics and Statistics, forthcoming.

³⁵ See e.g. Huizinga, H., Laeven, L., Nicodeme, G. (2008). Capital structure and international debt shifting, Journal of Financial Economics 88(1): 80-118.

³⁶ See e.g. Griffith, R., H. Miller and M O'Connell (2014). Ownership of intellectual property and corporate taxation. Journal of Public Economics 112, pp. 12-23.

³⁷ See Becker, J., N. Johannesen, N. Riedel (2020). Taxation and the Allocation of Risk inside the Multinational Firm, Journal of Public Economics.

³⁸ For a survey of the empirical literature on BEPS before the implementation of the BEPS outcomes, see Dharmapala, D. (2014). What Do We Know about Base Erosion and Profit Shifting? A Review of the Empirical Literature, Fiscal Studies 35(4): 421-448; as well as Riedel, N. (2018). Quantifying International Tax Avoidance: A Review of the Academic Literature, Review of Economics / Jahrbuch für Wirtschaftswissenschaften. 2018, Vol. 69(2): 169-181

³⁹ Bilicka, K. (2019). Comparing UK Tax Returns of Foreign Multinationals to Matched Domestic Firms, American Economic Review 109(8): 2921-2953.

revenue to tax havens.⁴⁰ Bruner et al. (2018) estimate, based on US national accounts data, that without profit shifting US GDP would be 1.5 percent higher, and US operating surplus would be 3.5 percent higher.⁴¹ Tørsløv et al. (2018) measure an excess profit in tax havens of US\$600bn.⁴² A more recent study by Garcia-Bernardo/Jansky (2021) estimates excess profits of 1 trillion USD in tax havens.⁴³ Cobham/Jansky (2018) as well as Johannesen et al. (2020) show base erosion and profit shifting mostly harms low- and middle-income countries.⁴⁴

The main losers of profit shifting, according to the estimates by Tørsløv et al. (2018), are European non-havens and developing countries, the main winners are US owned multinationals. In a counterfactual scenario, they show that, if all countries had the same tax rate as Germany, corporate tax revenue in the EU would be 20 percent higher than today (which is interpreted as a rough measure of the revenue losses due to tax competition).^{45,46} Garcia-Bernardo et al. (2020) use the newly available CbCR data to identify the countries to which most of the profit is shifted (with Netherlands, the UK Caribbean (incl. Cayman Islands etc.), Bermuda, Switzerland and Ireland at the top of the list) and the countries from which most profit is shifted (with Canada, the UK, Germany, Australia and France at the top of the list).⁴⁷

3.2. Policy rationale

The main problem of the international tax system is, in short, that MNEs have (i) strong incentives and (ii) ample opportunities to engage in BEPS. As discussed in Sect. 2, the OECD

⁴⁰ Gravelle, J. (2015). Tax Havens: International Tax Avoidance and Evasion. CRS Report for Congress. Washington DC: Congressional Research Service.

⁴¹ Bruner et al. (2018) use counter-factual formula apportionment to assign overall profits to domestic and foreign locations (assuming that this represents a situation without profit shifting). Bruner, Jennifer, Dylan G. Rassier, and Kim J. Ruhl. (2018). Multinational Profit Shifting and Measures throughout Economic Accounts, Working paper.

⁴² Tørsløv et al. (2018) use a similar method as Bruner et al. (2018). Tørsløv, T., Wier, L., Zucman, G. (2018). The Missing Profits of Nations, NBER Working Paper 24701. There is an ongoing argument about empirical methods used in studies based on aggregate data, see Blouin, J., Robinson, L. (2021). Double Counting Accounting: How Much Profit of Multinational Enterprises Is Really in Tax Havens?, <https://ssrn.com/abstract=3491451>. The updated Tørsløv et al. (2018) study discusses the critique. At the time of writing, the paper is still in the second round of review at one of the leading economic research journals.

⁴³ Garcia-Bernardo, J., Jansky P. (2021). Profit Shifting of Multinational Corporations Worldwide: Evidence from Country by Country Reporting, ICTD Working Paper 119.

⁴⁴ Cobham, Alex; Jansky, Petr (2018). Global Distribution of Revenue Loss from Corporate Tax Avoidance: Re-estimation and Country Results, *Journal of International Development* 30(2): 206-32. Johannesen, N., Tørsløv, T., Wier, L. (2020). Are less developed countries more exposed to multinational tax avoidance? Method and evidence from micro-data. *The World Bank Economic Review* 34(3): 790-809.

⁴⁵ Crivelli et al. (2016) have a similar focus on aggregate data on over a hundred countries. They measure a revenue loss of around 1 percent of GDP for developed countries due to profit shifting and of 1.3 percent for developing countries (which is, due to low tax ratios in these countries almost 10 percent of all tax revenue). Crivelli, E., de Mooij, R., Keen, M. (2016). Base Erosion, Profit Shifting and Developing Countries. *FinanzArchiv: Public Finance Analysis*, 72(3): 268–301.

⁴⁶ Alvarez-Martinez et al. (2021) use a computable general equilibrium model to estimate the revenue losses due to base erosion and profit shifting and find that the EU loses more than 7 percent, whereas the US loses more than 10 percent of total corporate tax revenues. Alvarez-Martinez, M. T., S. Barrios, D. d'Andria, M. Gesualdo, G. Nicodème, J. Pycroft (2018). How large is the corporate tax base erosion and profit shifting? A general equilibrium approach, *Economic Systems Research* (forthcoming).

⁴⁷ Garcia-Bernardo, J., Jansky, P., Tørsløv, T. (2021). Multinational Corporations and Tax Havens: Evidence from Country-by-Country Reporting', *International Tax and Public Finance*.

BEPS initiative (2013-15) aimed at closing loopholes, increasing transparency and coordinating the use of preferential regimes – which turned out to be insufficient to make a dent in the MNEs’ BEPS activities.

The two-pillar reform that is currently discussed approaches both aspects of the problem. Pillar One reduces BEPS opportunities by allocating part of the MNE profit to the market economies; it thus reduces the mass of profit that can be shifted to low-tax jurisdictions. Pillar Two (the GloBE) tackles the incentive side of the problem.

In a pure source based tax system, i.e. in the absence of any domestic tax on foreign profit, the “return” to shifting one EUR to a zero-rate tax haven is equal to the statutory corporate tax rate (including all subnational components and surcharges). At the top of the list (see the statutory tax rate graph in Sect. 2), France has a corporate tax rate of 32 percent. Hence, shifting one million EUR to a tax haven increases after-tax profit by 320.000 EUR. At the margin, a profit-maximizing firm is willing to incur a cost close to this sum to enable the shifting of profit. The social value of this transaction, however, is zero since the firm’s gain in after-tax profit exactly equals the French State’s loss in revenue. And if profit shifting comes at a real resource cost (e.g. legal counselling, renting of property in tax havens etc.), there is a net social loss due to profit shifting.⁴⁸ Reducing profit shifting implies that talent and human capital is freed for other, socially productive use.

It follows from the above that the most important determinant of the profit shifting incentive is the tax differential. With uniform effective tax rates everywhere, the incentive to shift profit is equal to zero. The higher the tax rate differential, the stronger the pressure on the tax base due to BEPS. And the evidence cited above suggests that the pressure is high and rising over time. The GloBE reduces the tax rate differential between high-/normal-tax jurisdictions on the one hand and low-tax jurisdictions on the other hand – and, thus, lowers the pressure. Consequently, profit shifting is expected to decrease. This assumption is supported by empirical research, which has shown that decisions of multinationals about where to allocate profits to are sensitive to income inclusion under traditional CFC regimes.⁴⁹

The reduction of the tax differential has, moreover, the effect of improving the international allocation of capital, i.e. it makes investment more efficient. From a global efficiency point of view, firms should invest where the before-tax return is highest. Firms, however, maximize

⁴⁸ Such activity is called “rent-seeking” that does not increase total income, but has a cost that is pure waste.

⁴⁹ Ruf, M., Weichenrieder, A. (2012). The Taxation of Passive Foreign Investment: Lessons from German Experience, *Canadian Journal of Economics* 45/4, 1504-1528. Ruf, M., Weichenrieder, A. (2013). CFC Legislation, Passive Assets and the Impact of the ECJ’s Cadbury-Schweppes Decision, CESifo Working Paper No 4461. Egger, Peter H., Wamser, G. (2015). The impact of controlled foreign company legislation on real investments abroad. A multi-dimensional regression discontinuity design, *Journal of Public Economics* 129 (Supplement C): 77-91. Clifford, S. (2019). Taxing multinationals beyond borders: Financial and locational responses to CFC rules, *Journal of Public Economics* 173: 44-71.

after-tax returns, instead of before-tax returns. If source based taxes differ, they may be inclined to invest in locations where the gross return is lower, but due to lower taxes, the net return exceeds the net return elsewhere. Empirical evidence demonstrates that taxes are an important determinant of asset allocation (see e.g. Barrios et al. 2012)⁵⁰ which suggests that tax rate differentials are prone to distort the international allocation of capital and production. A minimum tax reduces these tax differentials and, thus, lowers the distortion induced efficiency loss. The tax system thus would get closer to capital export neutrality (a state in which taxes do not distort the decision where to invest). In principle, a system of worldwide taxation with credits for foreign tax payments (Richman 1963, Musgrave 1969)⁵¹ could achieve full capital export neutrality. In fact, the GloBE rules may be understood as a system of *partial* worldwide taxation.⁵² Since it stops short of equalizing the tax burden of domestic and foreign investment, it does not fully achieve capital export neutrality; however, it significantly reduces the most extreme distortions of the international capital allocation. In this sense, an impact of the minimum tax on real investment is an explicitly desired feature of the minimum tax, not just a collateral damage of an anti-BEPS measure.⁵³ Note, though, that the beneficial effect of GloBE on investment efficiency is severely limited if carve-outs for substantive activity allow for lower tax rates on the normal (or routine) return to capital.

By reducing effective tax rate differentials and, thus, profit shifting and capital flight, the GloBE rules effectively secure the tax base of non-havens and production locations and help to stabilize the corporate tax as a revenue source for the government. From a dynamic perspective, GloBE may be expected to mitigate tax competition.⁵⁴ It does so in two ways. First, it allows for higher

⁵⁰ Barrios, Salvador; Huizinga, Harry; Laeven, Luc; Nicodème, Gaëtan (2012). International taxation and multinational firm location decisions, *Journal of Public Economics* 96(11/12): 946-958.

⁵¹ Richman, P.B. (1963), *Taxation of Foreign Investment Income: An Economic Analysis* (Johns Hopkins Press, Baltimore). Musgrave, P. B. (1969). *United States Taxation of Foreign Investment Income: Issues and Arguments*. Cambridge, 1969.

⁵² However, the GloBE rules avoid the shortcomings that have ultimately led to the abolishment of the worldwide tax system in the UK, Japan and, recently, the US. Most importantly, the opportunity to defer tax payments until repatriation led some firms to hold vast amounts of liquid assets abroad. A minimum tax would be levied upon accrual and would thus make deferral of profit repatriation irrelevant from a tax perspective.

⁵³ In the OECD proposal, the minimum tax is supposed to curb what is considered “excessive” international tax competition for real investment (see para. 90 of the OECD public Consult consultation document). It seeks to establish a lower ceiling for this strategic game and thus to prevent a presumed “race to the bottom” (Keen M., and K. Konrad (2013). *The Theory of International Tax Competition and Coordination*, in *Handbook of Public Economics*, 5, pp. 259-330, edited by Alan Auerbach, Raj Chetty, Martin Feldstein, and Emmanuel Saez, Elsevier). Thus, its effect on real investment decisions is not to be regarded as collateral damage, and the lack of a substantial activities escape clause is not a design deficiency. Accordingly, the proposal refers to effective (average) tax rates as a measure of excessively low taxation, rather than nominal rates that are usually associated with being the main indicators of pure profit shifting incentives. Devereux, M., Griffith, R., 1998. Taxes and the location of production: evidence from a panel of US multinationals. *Journal of Public Economics* 68, 335–367.

⁵⁴ This effect may be expected in a standard model of asymmetric tax competition. However, economic theory provides a couple of arguments why the opposite may also be true. For instance, Konrad (2009) and Kiss (2012) argue that, in a Stackelberg tax competition game, the introduction of minimum taxes may actually exacerbate tax competition. The reason is that the Stackelberg follower is limited in its tax rate response; anticipating that the Follower cannot decrease the rate below a certain threshold, the Stackelberg Follower has no more reason to keep its own rate high. Konrad, K. A. (2009). Non-binding minimum taxes may foster tax competition. *Economics Letters*, 102(2), 109-111. Kiss, Á. (2012). Minimum taxes and repeated tax competition. *International Tax and*

tax rates in non-haven countries. The reason is that the minimum tax effectively curbs profit shifting; as a consequence, the tax base becomes less elastic. A tax rate increase therefore has a lower efficiency cost in terms of tax base loss. Second, in a situation where a sufficiently large number of non-havens levy minimum taxes, tax havens or low-tax jurisdictions may costlessly increase their tax revenue by increasing the tax rate up to the minimum rate. Such a tax rate hike does not increase the firms' tax burden since they pay the minimum tax rate anyway. It just shifts revenue from the non-havens to the (former) havens (the classical 'treasury transfer' argument⁵⁵). Since minimum taxes are, so far, missing, there is no available evidence for the impact on tax competition. We review the available evidence for minimum thresholds for other tax types or with subnational tax instruments in the subsection below.

The beneficial effects of the effective minimum tax on international capital allocation and tax competition are crucially constrained by the substance-based carve-outs for routine returns on certain investments and jobs proposed in the 2020 Blueprint. It is therefore no coincidence that the language in the Blueprint has been toned down and, different from earlier discussion papers, now only stresses the anti-BEPS qualities of GloBE.⁵⁶ To be sure, the envisaged carve-outs would shield routine returns on real investments and wage costs from minimum taxation, while "excess profits" (such as from IP) would continue to be subject to the minimum tax. In particular, low-tax regimes in the form of IP boxes would fall within the scope of GloBE even if they respected the requirements of the modified nexus approach of BEPS Action 5. A carve-out for IP was ultimately rejected by the Inclusive Framework, because it would undermine the "regulatory objectives and effectiveness" of GloBE.⁵⁷ If GloBE were designed as a pure anti-BEPS instrument, this reasoning would make no sense, because compliance with the modified nexus approach should already limit or avoid BEPS.⁵⁸ In this sense, the 2020 GloBE Blueprint still pursues the purpose of establishing a floor for international tax competition, now limited to competition for IP holding companies and for investments in research and development.

There are, thus, important arguments in favour of a minimum tax (with the critique being discussed in Sect. 3.5). It is, therefore, an interesting question why individual countries do only

Public Finance, 19(5), 641-649. A related argument is made by Marceau et al. (2010) and Johannesen (2010) who consider asymmetric equilibria in tax competition. If tax havens manage to attract the largest part of profits, the tax competition between the production locations may be mitigated. Therefore, a partial shutdown of tax havens through the minimum tax may foster tax competition. Marceau, N., Mongrain, S., Wilson, J. D. (2010). Why do most countries set high tax rates on capital? *Journal of International Economics*, 80(2): 249-259. Johannesen, N. (2010). Imperfect tax competition for profits, asymmetric equilibrium and beneficial tax havens. *Journal of International Economics*, 81(2): 253-264.

⁵⁵ See also Blum, D.W. (supra note 80), 518.

⁵⁶ In a recent joint newspaper article (that appeared in the *Frankfurter Allgemeine Zeitung*, the *Washington Post* and other newspapers worldwide), the finance ministers of the US, Germany, Mexico, Indonesia And South Africa emphasized, though, that the goal of the minimum tax is to set a lower bound on tax competition. ("Durch diese Mindestbesteuerung wird der Steuerwettbewerb nach unten begrenzt und gewährleistet, dass Unternehmen angemessen besteuert werden." *Frankfurter Allgemeine Zeitung*, 11 June 2021)

⁵⁷ See also Draft Report to Pillar Two (CTPA/CFA/WP11/NOE(2020)21), Summer 2020, para. 285.

⁵⁸ Cf. *Cipollini*, *World Tax Journal* 2020, 217 (235); *da Silva*, *Frontiers of Law in China* 2020, 111 (124).

rarely implement minimum taxes unilaterally (with the US introducing GILTI in 2018 being an important exception). To be sure, many CFC rules are similar to effective minimum taxes on certain (mostly “passive”) kinds of income. It is still worthwhile to ask what keeps countries from unilaterally imposing effective minimum taxes – as it will not be the lack of interest in additional revenue.

An effective minimum tax on foreign affiliates of a domestic parent reduces the price competitiveness of these entities.⁵⁹ In contrast, refraining from levying a tax on foreign profits and, thus, letting the firm make full use of tax haven services to shield the firm’s foreign income against foreign tax helps the firm to gain market shares on foreign markets; it is thus an act of strategic trade policy (see Becker 2014⁶⁰ for a theoretical account of this argument). However, as is well-known from the strategic trade policy, if all involved parties engage in strategic trade policy through the tax system, the resulting equilibrium is inefficient (Brander and Spencer 1985).⁶¹ The reason is that policies targeted at increasing one’s own firms’ market shares have a negative externality on foreign firms. This is especially true if the profit shifting-induced cost advantage is used to establish a (quasi-)monopoly position on foreign markets. Consequently, countries that consider the introduction of (minimum) taxes on foreign profits are in a kind of social dilemma situation: From an individual perspective, the minimum tax is not desirable whereas a coordinated increase would make all countries better off.⁶²

A second reason to shy away from implementing effective minimum taxes unilaterally is that it may drive firms to switch residence, i.e. to move their headquarters abroad (corporate inversion) in order to avoid the minimum tax. This effect is well-known from traditional CFC regimes⁶³, and it is a potential concern for the Income Inclusion Rule (IIR) as well. The GloBE therefore complements the IIR with the Undertaxed Payment Rule (UTPR) as well as the Subject to Tax Rule (STTR) act as a deterrent against corporate inversions. These two rules, firstly, decrease the potential tax savings from switching the headquarters locations and, secondly, increase the burden of tax compliance – provided that the firm continues to do business with related parties in their former HQ jurisdiction.

⁵⁹ This argument has played a prominent role in the abolishment of the system of worldwide taxation in the UK and the US.

⁶⁰ Becker, J. (2014). Strategic trade policy through the tax system, *World Economy* 37(9): 1237-1246.

⁶¹ Brander, J. A., Spencer, B. J. (1985). Export Subsidies and International Market Share Rivalry, *Journal of International Economics* 18(1): 83-100.

⁶² It fits in this picture that each of the large production countries (like the US, UK, Germany) has its “own” small number of tax havens that are usually close by (Cayman Islands for the US, Jersey for the UK, and Luxemburg for Germany), i.e. MNEs from these countries prefer using these tax havens. And despite the large asymmetries in size, political and economic power, there has only been reluctant action to curb tax haven activities. Thus, similar to the introduction of minimum taxes, a “crack-down” on tax havens is likely to be more successful if done in a coordinated, multilateral approach.

⁶³ Voget, J. (2011). Relocation of Headquarters and International Taxation, *Journal of Public Economics* 95: 1067-1081; Desai, M.A., Hines, J.R. (2002). Expectations and Expatriations: Tracing the Causes and Consequences of Corporate Inversions, *National Tax Journal* 55: 409-440.

A third, more straightforward reason is that an effective minimum tax increases the compliance and administrative burden of the tax system. The tax authorities in some countries may simply be lacking the administrative capacity to enforce such a tax. Even with a multilateral approach, introducing a new regime almost inevitably adds another layer of complexity to the already highly complex framework of international taxation, see Sect. 2 for a detailed discussion. The minimum tax requires generating, communicating and verifying large quantities of tax-relevant information (e.g., on effective tax rates in a given jurisdiction), as well as additional safeguards to prevent its circumvention. Some of the additional compliance costs could be compensated for by abolishing certain more targeted anti-BEPS measures, such as anti-hybrid rules, interest deduction barriers, or CFC regimes. Nevertheless, an international minimum taxation, due to its broad coverage, could potentially still lead to a net increase in compliance burdens for business. It is therefore all the more important that a coordinated approach aims for simplifications that limit the increase in compliance/administration cost without constraining the effectiveness of the minimum tax.

3.3. Past experiences with (effective) minimum taxes

So far, there is no international model for a minimum tax on multinational firm profits. Internationally coordinated minimum taxes exist, among others, in the EU system of value-added taxation (VAT) where the minimum tax rate is 15 percent for the standard VAT rate and 5 percent for the reduced rate.⁶⁴ An important difference to the system of corporate taxation is, however, that the VAT base in EU Member States is harmonized. Minimum tax thresholds are also applied to some excise taxes, e.g. Diesel excise taxes in the EU.⁶⁵ Evers et al. (2004) show that a minimum excise tax level positively affects excise tax rates in a number of EU countries – including those where the minimum threshold is not binding.⁶⁶ Lyytikäinen (2012) analyses minimum thresholds for local property and residential building taxes in Finland, but finds no significant effects on tax policy choices of neighbouring jurisdictions.⁶⁷

In national business tax systems, minimum taxes that serve as anti-avoidance measure alongside the conventional business tax are frequently used in developing countries (see Aslam/Coelho 2021 for a recent review), but less so in OECD countries.⁶⁸ As an exception, the US used to

⁶⁴ See Art. 97 and 99 of Directive 2006/112/EC on the common system of value added tax; see also Kanbur, R., Keen, M., 1993. *Jeux sans frontières: tax competition and tax coordination when countries differ in size*. *American Economic Review* 83(4): 877–892. Hvidt, M., Nielsen, S.B., 2001. *Non-cooperative vs. minimum-rate commodity taxation*. *German Economic Review* 2(4): 315–326.

⁶⁵ The West African Economic and Monetary Union applies minimum taxes on certain goods, see Mansour and Rota-Graziosi (2013). Mansour, M., Rota-Graziosi, G (2013). *Tax Coordination, Tax Competition, and Revenue Mobilization in the West African Economic and Monetary Union*, IMF Working Paper.

⁶⁶ Evers, M., Vollebergh, H.R.J., de Mooij, R.A. (2004). *Tax Competition under Minimum Rates: The Case of European Diesel Excises*, CESifo Working Paper Series 1221.

⁶⁷ Lyytikäinen, T. (2012). *Tax competition among local governments: Evidence from a property tax reform in Finland*, *Journal of Public Economics* 96(7-8): 584-595.

⁶⁸ Aslam, A., Coelho, M. (2021). *A Firm Lower Bound: Characteristics and Impact of Corporate Minimum Taxation*, IMF Working Paper 21/161.

levy a corporate alternative minimum tax (now abolished under the TCJA⁶⁹) that was determined independently of the firm's profitability (see Shaviro 2020 for a detailed discussion⁷⁰).

Some countries with subnational business taxes apply a minimum threshold rate. For instance, in 2004, Germany introduced a minimum tax for the local business tax (Gewerbesteuer). The research on the reform effects is ongoing, but the results so far are inconclusive. Von Schwerin/Büttner (2016) show that, in response to a minimum tax introduction, jurisdictions have increased their tax rates even if they were not directly affected by the minimum tax (i.e. they had tax rates above the minimum threshold before the reform).⁷¹ Boning, Slemrod and Ullmann (2018) conclude that, “[i]n contrast to the literature on global business tax competition, our preferred specifications, which leverage the minimum tax rate imposition for identification, find no evidence of competition in business tax rates.” (p. 1)⁷² In a more recent study, Büttner/Pöhlmann (2021) find that “most municipalities did not change their tax policy in response to a law-induced tax rate change in their local neighbourhood. Only municipalities that had set a relatively high tax rate are found to have (...) set lower tax rates in response.” (p. 22)⁷³

In international corporate taxation, there have been repeated attempts to coordinate on a minimum tax rate. For instance, the Ruding Committee (1992) proposed setting a minimum corporate tax rate of 30% in the EU.⁷⁴ Initiatives for coordination have failed so far, however.⁷⁵ Instead, many countries implement unilateral measures like controlled foreign company (CFC) rules which may be interpreted as ensuring a minimum level taxation on (certain kinds of) foreign income of domestic firms. Clifford (2019) shows that CFC rules have been successful in reducing profit shifting to low-tax jurisdictions and an effective policy tool to discourage multinationals from opening tax haven subsidiaries.⁷⁶ Similarly, countries levy withholding taxes on outgoing payments (usually, however, without crediting foreign tax payments), at least

⁶⁹ Tax Cuts and Jobs Act (TCJA), signed into law as Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018 on December 22, 2017.

⁷⁰ Shaviro, D. (2020). What Are Minimum Taxes, and Why Might One Favor or Disfavor Them? NYU Law and Economics Paper Series No. 20-38.

⁷¹ Von Schwerin, A., Büttner, T. (2016). Constrained Tax Competition – Empirical Effects of the Minimum Tax Rate on the Tax Rate Distribution, Working Paper.

⁷² Boning, W., Slemrod, J., Ullmann, R. (2018). Norderfriedrichskoog! Tax havens, Tax Competition and the Introduction of a Minimum Tax Rate, mimeo. For the abstract, see <https://www.willboning.com/research>.

⁷³ Büttner, T., Pöhlmann, M. (2021). Tax Competition Effects of a Minimum Tax Rate: Empirical Evidence from German Municipalities,

⁷⁴ Ruding Committee (1992). Report of the committee of independent experts on company taxation, Commission of the European Communities.

⁷⁵ Osterloh/Heinemann (2013) present a survey among members of the European Parliament which allows them to shed some light on the reasons why tax coordination within the EU is so hard to achieve. Osterloh, S., Heinemann, F. (2013). The political economy of corporate tax harmonization – Why do European politicians (dis)like minimum tax rates?, *European Journal of Political Economy* 29: 18–37.

⁷⁶ Clifford, S. (2019). Taxing multinationals beyond borders: Financial and locational responses to CFC rules, *Journal of Public Economics* 173:44-71.

in the absence of double tax agreements that often include agreements not to levy this kind of tax. Most importantly, the United States tax reform of 2017 has introduced international minimum tax elements in the national tax system for both, controlled foreign companies (GILTI⁷⁷) and outbound payments to related parties (BEAT⁷⁸). Since their introduction, both GILTI and BEAT have served as a model for the internationally coordinated reform efforts as well as unilateral reform plans to implement minimum taxes on MNE profits.⁷⁹ However, critics point to the many technical flaws of the US minimum tax regimes⁸⁰, and the Biden Administration has recently announced to reform both GILTI and BEAT.

3.4. Impact assessments

What are the expected quantitative effects of GloBE on tax revenue and investment? Who are the winners, who are the losers? These questions are in the centre focus of the public debate, but the answers are especially difficult to come by. This has several reasons.

First, as the preceding section has shown, we do not have suitable historical experience with broad-based global effective minimum taxes that can be used to estimate the effects of a multilateral introduction of GloBE. Second, the size of the two-pillar reform is too large to apply the conventional ‘ceteris paribus’ assumption; in other words, the reform (if fully implemented) may change the rules of the tax competition game for good which makes predictions about its effects more elusive. Third, even static analyses (i.e. ignoring any behavioural adjustments both on the side of the firms and of the governments) require data that is, in its necessary scope and range, not available. To estimate the revenue effects alone, total low-taxed profit per jurisdiction of all MNEs subject to the GloBE rules must be known with exact (ultimate) ownership ties. These data do not exist on their own and must be constructed and inferred from various data sources (which unavoidably implies a large error margin). Any impact assessment therefore needs to be read with caution.

There are only a few attempts⁸¹ at an impact assessment, among which – to the best of our knowledge – the OECD Impact Assessment (2020) is the most comprehensive and careful one.

⁷⁷ Global intangible low-taxed income included in gross income of United States shareholders, Section 951A IRC.

⁷⁸ Tax on base erosion payments of taxpayers with substantial gross receipts, Section 59A IRC.

⁷⁹ A similar development took place when the United States introduced CFC legislation in the 1960s, and the concept then spread to dozens of other jurisdictions in the following decades. See Koerver-Schmidt, P. (2016). Taxation of Controlled Foreign Companies in Context of the OECD/G20 Project on Base Erosion and Profit Shifting as well as the EU Proposal for the Anti-Tax Avoidance Directive – An Interim Nordic Assessment, *Nordic Tax Journal*: 1-26; Blum, D.W. (2018). Controlled Foreign Companies: Selected Policy Issues – or the Missing Elements of BEPS Action 3 and the Anti- Tax Avoidance Directive, *Intertax* 4: 296-312 (at 297-298).

⁸⁰ A similar conclusion is drawn regarding the US BEAT regime by Herzfeld, M. (2019). Can GILTI + BEAT = GLOBE? 47 *Intertax*, 504-513 (at 513); and regarding the US GILTI regime by Blum, D.W. (2019). The Proposal for a Global Minimum Tax: Comeback of Residence Taxation in the Digital Era?: Comment on Can GILTI + BEAT = GLOBE? *Intertax* 5: 514-522 (at 516).

⁸¹ Laffitte et al. (2019) find positive revenue effects and negligible losses of location attractiveness due to the Pillar Two reforms. Devereux et al. (2020) are more critical in this regard. Fuest et al. (2020) only consider the Pillar One reform. All three studies predate the October 2020 Blueprint. Laffitte S., M. Parenti, B. Souillard and F.

It uses aggregate CbCR data to calculate the international profit allocation from the viewpoint of each ultimate parent's jurisdiction (e.g. profit of French MNEs across jurisdictions) and unconsolidated financial accounting data from the ORBIS database to calculate the international profit allocation from the viewpoint of each source country (e.g. MNE profits in France, for MNEs owned by ultimate parents at home and abroad). These two data sets have good coverage for 25 and 24 countries, respectively. The remaining data is imputed via extrapolation using macroeconomic data (on bilateral foreign direct investments).

Since the GloBE rules only apply to low-taxed income, the impact assessment needs data on ETR. Due to the lack of firm-specific tax data, the jurisdictional ETRs are calculated using data from Tørsløv et al. (2018) and from the US Bureau of Economic Analysis (BEA) on US MNEs. The data is complemented by ETR estimates from anonymized and aggregated CbCR reports.⁸²

It provides different scenarios, starting with a static one in which no MNEs' or governments' response to the GloBE implementation is considered. The revenue effects are calculated assuming no carve-outs and a carve-out of 10 percent of payroll and tangible assets.⁸³ Scenario 2 considers the interaction with the Pillar One reforms. Specifically, the reallocation of Amount A changes the amount of profit accounted for in low-tax jurisdictions and, therefore, the GloBE tax base. Consequently, the revenue estimates are smaller. In Scenario 3, an adjustment of the MNE's profit shifting behaviour is considered. Importantly, a reduction in profit shifting does not necessarily benefit the ultimate parent's jurisdiction (since profits may be shifted between foreign affiliates owned by the ultimate parent).⁸⁴ Scenario 4 allows for tax policy adjustments by low-tax jurisdictions. The revenue estimates are based on the assumption that half of all jurisdictions with non-zero ETRs increase their tax rates to the GloBE minimum threshold whereas the other half does not adjust its tax system. Jurisdictions with a zero corporate tax rate are assumed to not respond (since they usually do not have a corporate tax system in place)

Toubal (2019a): Quantifying the Effects of International Tax Reforms, Mimeo; Devereux, M. P., Bares, F., Clifford, S., Freedman, J., Güçeri, I., McCarthy, M., Simmler, M., Vella, J. (2020). The OECD Global Anti-Base Erosion Proposal, Oxford University Centre for Business Taxation, Report; Fuest, C., Hugger, F., Neumeier, F., Stöhlker, D. (2020) Nationale Steueraufkommenswirkungen einer Neuverteilung von Besteuerungsrechten im Rahmen der Grenzüberschreitenden Gewinnabgrenzung, Studie im Auftrag des Bundesministeriums der Finanzen.

⁸² Each of these measures has its own weaknesses (e.g. the Tørsløv et al. (2018) data does not allow distinguishing ETRs of profit- and loss-making MNEs, the CbCR data does not exclude intra-company dividends etc.) that can only be imperfectly be accounted for. For 81 jurisdictions (mainly lower income countries), none of these data sources is available.

⁸³ Calculating the carve-out requires data that is only available for a subset of countries. For all other countries, the carve-out is imputed.

⁸⁴ The OECD Impact Assessment accounts for recent evidence that profit shifting may respond to tax rate differentials in a non-linear way by considering different behavioral assumptions. The resulting revenue differences are not quantitatively decisive; therefore, the table here only shows the baseline scenario (in which the relationship between profit shifting intensity and tax rate differentials is linear).

	Scenario 1 Baseline	Scenario 1 Adding carve-outs	Scenario 2 Accounting for Pillar One	Scenario 3 Profit shifting reduced	Scenario 4 Tax rates increased
	Without carve-outs	With carve-outs (10 percent on payroll and tangible assets)			
Global low-taxed profit (in bn USD)	604	574	566		
Revenue at 12.5 percent GloBE rate	28 – 50	27 – 45	27 – 43	38 – 60	38 – 60
In % of global CIT revenue	1.3 – 2.3 %	1.2 – 2.1 %	1.2 – 2.0 %	1.7 – 2.8 %	1.7 – 2.8 %

The revenue estimates in the above table are for all multinational firms excluding those with an ultimate parent in the US. The reason is that, at the time when the Impact Assessment was made, it was expected that the GILTI regime would coexist next to the GloBE rules. The OECD estimates that GILTI would add 0.4 to 0.8 percent of global corporate income tax revenue such that the total gains are expected to be between 45 and 78 billion USD.

The estimated range of revenue effects for each scenario includes a ± 10 percent uncertainty range to account for data uncertainty and an increase of the upper bound of revenue effects due to ‘pockets’ of low-taxed income in jurisdictions with otherwise above-threshold ETRs.

Unfortunately, the OECD Impact Assessment does not provide country-specific revenue estimations (for presumably political reasons). Devereux et al. (2020) provide some cautious country-specific estimates. According to their estimates, the countries most affected by the GloBE rules are the British Virgin Islands (where the GloBE raises almost 3 billion USD) followed by Puerto Rico, Ireland, Bermuda, Cayman Islands and Luxembourg. The countries with the highest absolute revenue gains are China, the USA, Hong Kong, Panama, France and Germany. And the countries with the highest revenue gains relative to their total taxes on profits are Estonia, Latvia, Hungary, Slovakia, Czech Republic, Slovenia and Poland – it seems that Eastern Europe would greatly benefit from the GloBE.

The OECD Impact Assessment also has a whole chapter on the investment effects of the two-pillar reform. The same caveat as before with regard to data availability and extrapolation applies here. The reform increases the effective tax rates on multinational firm profits, as intended; most of the increase in investment cost is due to Pillar Two. A GDP-weighted average increase in effective marginal tax rates is estimated to be around 1.4 percentage points. Since the two-pillar reform mainly affects highly profitable MNEs and since entities in highly profitable MNEs display a relatively low user cost elasticity of investment⁸⁵ (as shown by empirical studies), the resulting negative effect on investment is small. The OECD Impact

⁸⁵ The user cost of capital is the minimum pre-tax return that an investment must have to cover the (tax-inclusive) cost of investment. Corporate taxes increase the user cost of capital. The user cost elasticity of investment measures how the firms’ investment react to a change in the user cost; it indicates the percentage change of investment in response to a one percent increase in the user cost of capital.

Assessment rightly argues that, in order to estimate the reform effects on investment, a comparison with the status quo is presumably misleading. The reason is that a failure of the two-pillar reform would likely trigger a wave of unilateral reforms that have hard-to-predict effects on international investment and probably imply a higher compliance cost than the measures of Pillar One and Two.

3.5. Critique

A globally coordinated effective minimum tax has obvious advantages (as discussed above): it is growth enhancing by improving the international allocation of capital, it saves cost by making inefficient avoidance activities less attractive, and it mitigates tax competition and, thus, allows for a more efficient level of public goods provision.⁸⁶ These advantages notwithstanding, there are disadvantages. The technical shortcomings of the GloBE proposal have been intensively discussed in Sect. 2. Some other negative consequences of a unilateral introduction are mentioned above in Sect. 3.2. In this subsection, we address more fundamental points of criticism of a multilateral introduction of an effective minimum tax.

Objection 1: The GloBE is designed for the ultimate parents' residence countries (that are, often, rich capital exporting countries) and leaves many source countries empty-handed.

The fact that the GloBE gives the IIR priority over the UTPR implies that the ultimate parents' jurisdictions (as long as they implement GloBE) have the priority right to collect the top-up tax. Only if none of the parents' jurisdictions down the ownership chain applies the IIR, the source countries are entitled to use the UTPR. The priority rule (see also Step 9 in Sect. 2.3) can be justified by the IIR having lower transaction cost. However, since MNE ultimate parents are not evenly distributed across countries, the priority rule benefits some countries more than others (to be specific, high-income countries over low-income countries). That said, it should be kept in mind that, first, source countries also benefit from a reduction in profit shifting induced by the IIR implemented by third countries. In fact, the empirical evidence (see Sect. 3.1) shows that developing countries are among the biggest losers from BEPS. Second, the STTR is an instrument specifically designed for serving source countries to tackle obvious cases of base erosion and profit shifting (see Sect. 2.2). The STTR has priority over the IIR (and the UTPR). Third, applying the UTPR demands administrative capacity and involves administrative and enforcement cost. With UTPR income being lower than IIR income in most cases, the benefit from implementing an UTPR may eventually fall short of its cost, especially if undertaxed payments are small. Nonetheless, there is the case for adjusting the GloBE rules to account for the revenue needs of developing countries and especially the LDC. This may be

⁸⁶ It is a priori unclear whether all involved countries are positively affected by a minimum tax. Peralta/van Ypersele (2006) provide an example in which a minimum tax cannot be introduced without making at the low-tax jurisdiction worse off. Peralta, S., van Ypersele, T. (2006). Coordination of capital taxation among asymmetric countries, *Regional Science and Urban Economics*, 36(6), 708-726.

attained by allowing for more generous carve-outs for countries below a certain GDP per capita threshold or by redistributing GloBE revenue via a clearinghouse to the source locations among the low-income jurisdictions.⁸⁷

Objection 2: A minimum tax limits the sovereignty of other nations in an illegitimate way.

It is true that if a sufficiently large number of countries levy the minimum tax, a low-tax jurisdiction is effectively stripped of its means to set an effective tax rate below the minimum threshold. To the extent that taxation is understood as a sovereign right, a minimum tax regime may be interpreted as an overreach, especially when the minimum tax applies to non-domestic firms. However, this view is based on the questionable premise of an absolute primacy of the sovereign right to use the national tax system as a means to attract and stimulate investment in the national economy. Unfettered sovereignty can only be claimed in purely internal situations. In an international context, there are externalities, i.e. other sovereign nations' interests are affected by those tax policies as well. In the status quo, the tax sovereignty of the potential "losers" in the tax competition game – high-tax jurisdictions and many developing and emerging economies⁸⁸ – is being undermined by the policy choices of tax havens and other countries that pursue "beggar thy neighbour" tax strategies. An international effective minimum tax might be used to strike a balance between these conflicting interests. It still permits countries to compete for foreign investments through low levels of effective taxation, but establishes a lower floor for this competition and thereby protects high-tax countries from having to completely abandon their own tax policy preferences.

Objection 3: A minimum tax stifles welfare-enhancing forms of tax competition.

In theory, tax competition may be welfare enhancing through three distinct channels. First, the "taming the Leviathan" channel: Tax competition reduces excessive government consumption by giving the taxpayers the option to move to a location with lower taxes. The threat of losing tax base incentivizes countries to provide productive public input goods like infrastructure, educated workers etc. Second, the "learning" channel: By competing with each other, governments learn about what is good policy, since the latter is rewarded by an influx of firms, capital and households. Third, the "redistribution" channel: Tax competition offers to individual countries the means to attract foreign direct investment (FDI)⁸⁹ in order to account for positive

⁸⁷ It is true that a clearinghouse would require international coordination efforts (as well as a pledge by the residence countries to give away the IIR income). The alternative, a priority of the UTPR over the IIR, would likely imply more coordination efforts, though, especially because it relies on micro-economic data, whereas a clearinghouse approach could use macro-economic data points.

⁸⁸ Regarding the latter, see Collier, R., Riedel, N. (2018). The OECD/G20 Base Erosion and Profit Shifting Initiative and Developing Countries, Bulletin for International Taxation: 704-717.

⁸⁹ See e.g., Andersson, K. (2018). The OECD/G20 Base Erosion and Profit Shifting Initiative and Developing Countries, Bulletin for International Taxation: 684-689 (at 688).

spill-overs (especially in the case of small economies at the periphery that lack other locational advantages).

To start with, it is certainly true that, if the government is assumed to be corrupt and its spending to be wasteful, a minimum tax regime cannot be welfare-enhancing. In this sense, the whole BEPS initiative and the two-pillar reform currently discussed are based on the assumption that governments play an important, productive role in the economy.

With regard to the incentivizing and learning effect, it must be noted that the current mode of tax competition is not so much about offering productivity-enhancing infrastructure and good conditions for production but to offer clever schemes to attract profits that have been created elsewhere. A minimum tax curbs the latter while still allowing for competition on the expenditure side (infrastructure, education). With tax havens effectively out of business, the international tax competition for real investment may even increase.⁹⁰

Finally, the above arguments need to be weighed against the downsides of tax competition. On the one hand, if countries are forced to lower the corporate tax, its function as a backstop to the personal income tax may be incapacitated. Consequently, tax competition may undermine a country's ability to fund public goods and to redistribute income in line with its citizens' preferences. On the other hand, tax competition may prevent countries to collect revenue that reflects at least the location-specific benefits for foreign investors. This may discourage the provision of public input provision.

To conclude, a moderate minimum tax that curbs the most extreme forms of tax competition via zero-rate tax havens and still allows for differentiated policy profiles across locations seems to be defensible. With regard to the "redistribution channel", it may be necessary to modify the minimum tax rules with respect to the special dependency of least developed countries (LDCs)⁹¹ on FDI. In particular, minimum taxation of affiliates in LDCs could be subject to special carve-outs, i.e. to be limited to profits that exceed a normal return on investments.⁹²

Objection 4: Minimum taxes violate the principle of capital import neutrality.

Multinational firms that sell products or services in a jurisdiction where the effective tax rate is below the minimum threshold might be at a competitive disadvantage vis-à-vis local businesses if their residence country levies a minimum tax. To start with, this is presumably not a major

⁹⁰ See also Schreiber, U., Fell, L.M. (2017). International Profit Allocation, Intangibles and Sales-Based Transactional Profit Split, *World Tax Journal*: 99-115 (at 102); Sullivan, M.A. (supra note 30), at 931;

⁹¹ As defined by the UN Economic Analysis and Policy Division, see <https://www.un.org/development/desa/dpad/least-developed-country-category/ldc-criteria.html>.

⁹² Above-normal profits in LDCs will either be location-specific rents (e.g. from the exploitation of natural resources) or a result of pure profit shifting. In the former case, minimum taxation would not lead to a relocation of investment (since other locations would equally be affected by minimum taxation). In the latter case, profits should not be spared from minimum taxation, because it does not contribute to the growth of the national economy.

concern in practice if the agreed minimum rate is at 15 percent or lower. Most countries with such a very low level of taxation are small markets⁹³, and thus of relatively minor importance for the profitability of multinationals. Moreover, minimum taxes restore capital import neutrality in countries with average or above-average taxes on business profits. Multinational firms currently tend to benefit from competitive advantages over local firms that do not have access to tax havens. Since almost all large economies have above-minimum-threshold tax rates, efficiency gains from levelling the playing field there can be expected to outweigh the negative effects of the distortions created by a minimum tax in low-tax jurisdictions.

⁹³ Cf. OECD, Corporate Tax Statistics (2019), accessible online at www.oecd.org/tax/tax-policy/corporate-tax-statistics-database-first-edition.pdf.

4. Legal issues of EU minimum tax legislation

4.1. Union competence for adopting a minimum tax directive

The EU Commission has already declared its intention to transpose an eventual political agreement by the members of the Inclusive Framework on the GloBE effective minimum tax concept into hard Union law by way of EU legislation⁹⁴. Moreover, in the past, Commission representatives have indicated that they would table a proposal for an international effective minimum tax regime that is broadly aligned with the GloBE Blueprint even in the absence of an agreement on Pillar Two in the Inclusive Framework. It is therefore necessary to assess whether the EU would have the competence under the relevant Treaty provisions to adopt a directive to this effect.

4.1.1. Internal market competence

In contrast to the harmonization of indirect taxes, there is no competence clause in the TFEU that vests the Union with a general competence to legislate in the field of direct taxation. In the past, most direct tax directives were therefore adopted based on the internal market competence of Art. 115 TFEU. In particular, this was also the case with the ATAD⁹⁵. Absent any viable alternative, the Commission would therefore have to table its proposal for an effective minimum tax directive on this treaty provision, too⁹⁶. Pursuant to Art. 115 TFEU, the Council shall, acting unanimously in accordance with a special legislative procedure, “issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.” The provision does therefore not confer upon EU institutions a general power to regulate trade and commerce in the internal market, but authorizes Union legislation only where the approximation of national laws (also) serves the narrower objective of promoting the internal market and its characteristic features⁹⁷.

The scholarly literature has doubted whether the Commission and Council could rely on Art. 115 TFEU as a legal basis for adopting the ATAD⁹⁸. The skeptics argue that, with the ATAD,

⁹⁴ See EU Commission, Communication on Business Taxation for the 21st Century, 18 May 2021, COM(2021) 251 final, p. 8.

⁹⁵ See the preamble to the Council Directive (EU) 2016/1164, of 12 July 2016.

⁹⁶ Likewise Broe, L., Massant, M. (2021). Are the OECD/G20 Pillar Two GloBE-rules compliant with the fundamental freedoms?, EC Tax Review 2021/3: 86-98 (at 94).

⁹⁷ See, by analogy, CJEU 5 October 2000, Case C-376/98, Germany / Parliament and Council, ECLI:EU:C:2000:544, paras. 83-84.

⁹⁸ See Bizioli, G. (2017). Taking EU Fundamental Freedoms Seriously: Does the Anti-Tax Avoidance Directive Take Precedence over the Single Market?, 26 EC Tax Review 3: 167-175 (at 171); Lazarov, I., Govind, S. (2019). Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD Under EU Law, 47 Intertax 10: 852-868 (at 862). For a different view, supporting the Commission’s position that Art. 115 TFEU constituted the appropriate legal basis for ATAD, see Braun Binder, N. (2017). Rechtsangleichung in der EU im Bereich der direkten Steuern, Mohr Siebeck, pp. 92-94.

the Union legislator stipulates several broad anti-avoidance measures that specifically target cross-border situations⁹⁹ and go beyond the narrow range of anti-abuse rules accepted as proportionate justification for the ensuing restriction of the EU free movement rights¹⁰⁰. Thus, the Union legislator did not remove but instead create obstacles for the functioning of the EU internal market. The same objection might be brought forward against an effective minimum tax directive, because one of its key objectives would be to curb corporate tax avoidance through a rather generic approach that goes beyond the targeted measures traditionally accepted by the CJEU and might infringe the internal market freedom of establishment, depending on its design¹⁰¹. Moreover, the twin objective of GloBE to establish a floor for international tax competition, at least with respect to competition for mere book profits and for the development and exploitation of intangibles, has been held to directly contravene the internal market idea, too¹⁰².

Against this background, it is pertinent to analyse the relevant case law of the CJEU on the notion of “the establishment or functioning of the internal market”. While the Court has not yet dealt with those criteria in the context of Art. 115 TFEU, there exists an extensive body of case law on the similar terminology used in Art. 114 (1) TFEU. Despite minor textual differences of the two provisions, it is generally acknowledged that the jurisprudence on the latter provision should also guide the interpretation of the former¹⁰³. Pursuant to the CJEU, disparities between the national legal frameworks of different Member States are not, by themselves, sufficient in order to allow the Union legislator to approximate the divergent laws under Art. 114 TFEU¹⁰⁴. However, the legislator may have recourse to Art. 114 TFEU where such disparities either create obstacles for the free circulation of goods, services or persons in the internal market¹⁰⁵, or where the disparities are liable to create or maintain appreciable – i.e. significant – distortions of competition¹⁰⁶. In particular, distortions in the conditions of competition are more than marginal, and may thus be addressed by harmonization based on Art. 114 (1) TFEU, where they are susceptible to have a major influence on the location of business activities within the internal market¹⁰⁷.

⁹⁹ For details, see below at 5.1.

¹⁰⁰ For details, see below at 4.2.

¹⁰¹ For a detailed discussion, see below at 4.2.

¹⁰² See De Broe, L., Massant, M. (2021). Are the OECD/G20 Pillar Two GloBE-rules compliant with the fundamental freedoms?, *EC Tax Review* 2021/3: 86-98 (at 95 and 97).

¹⁰³ See, e.g., Schröder, M. (2018), Commentary on Art. 115 TFEU, in: Streinz, R. (ed.), *EU/VAEU*, 3rd edn., Beck, Art. 115 para. 8; Lazarov, I., Govind, S. (2019). Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD Under EU Law, 47 *Intertax* 10: 852-868 (at 860).

¹⁰⁴ See, e.g., CJEU 5 October 2000, Case C-376/98, Germany / Parliament and Council, ECLI:EU:C:2000:544, para. 84.

¹⁰⁵ See, e.g., CJEU 4 May 2016, Case C-358/14, Poland / Parliament and Commission, ECLI:EU:C:2016:323, paras. 36 and 56.

¹⁰⁶ See CJEU 11 June 1991, Case C-300/89, Commission / Council, ECLI:EU:C:1991:244, para. 14; 5 October 2000, Case C-376/98, Germany / Parliament and Council, ECLI:EU:C:2000:544, paras. 106-108.

¹⁰⁷ See, by analogy, CJEU 5 October 2000, Case C-376/98, Germany / Parliament and Council, ECLI:EU:C:2000:544, paras. 110-111. Likewise Kofler, G. (2020). EU power to tax: Competences in the area of

An international effective minimum tax modelled after the GloBE would not necessarily facilitate trade and free movement within the internal market, because one of its objectives is to render cross-border transactions less attractive where they seek to exploit BEPS opportunities or to benefit from excessive tax competition. However, these objectives relate directly to the aim of a reduction of significant distortions of competition within the internal market. Currently, the nominal rates of direct taxes on business profits imposed by EU Member States diverge by more than 20 percentage points¹⁰⁸. A similar disparity can be observed with respect to the effective tax rates¹⁰⁹. This disparity is not merely a reflection of a different degree of provision of public goods, services and infrastructure to the benefit of the respective taxable businesses or, more generally, of different local conditions for economic activities¹¹⁰. To a large extent, they are also the manifestation of tax competition, where low corporate tax rates or special low-tax regimes are employed by certain Member States to attract book profits, foreign direct investment, or IP and management holdings at the expense of other Member States. The different effective tax burdens do therefore not merely represent different cost benefit ratios for economic agents doing business within the EU, and consequently, they are not neutral as to the internal market ideal of an efficient allocation of resources (see also our economic analysis in chapter 3). Instead, the discrepancy in nominal and effective tax rates as between Member States significantly distorts location decisions of businesses in the internal market and thereby reduces overall welfare in the EU. Moreover, it distorts competition between large multinational firms that can engage in international tax arbitrage, and smaller local firms that cannot (or only to a limited degree).

In this sense, an international effective minimum taxation directly – and positively – affects the establishment and functioning of the internal market within the meaning of Art. 115 TFEU. Moreover, assuming a relatively modest effective minimum rate, EU Member States would still have considerable liberty to set their preferred balance between the provision of public benefits for businesses and the taxes levied on them to cover for the cost of those benefits, and would still have an incentive to increase government efficiency to offer lower tax rates.

A directive that transposes a political agreement on GloBE into hard Union law would not merely cover intra-EU scenarios. It would also establish the relevant measures to be implemented by EU Member States vis-à-vis third countries. However, this does not preclude the use of the internal market competence enshrined in Art. 115 TFEU, provided that the status

direct taxation, in Research Handbook on European Union Taxation Law, in Panayi, C., Haslehner, W., Traversa, E. (eds.), Research Handbook on European Union Taxation Law, Edward Elgar, pp. 11-50 (at 20).

¹⁰⁸ See OECD (2020), Corporate Tax Statistics, 2nd Ed., accessible at <https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-second-edition.pdf>, pp. 10.

¹⁰⁹ See OECD (2020), Corporate Tax Statistics, 2nd Ed., accessible at <https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-second-edition.pdf>, pp. 19.

¹¹⁰ For a different opinion, see Broe, L., Massant, M. (2021). Are the OECD/G20 Pillar Two GloBE-rules compliant with the fundamental freedoms?, EC Tax Review 2021/3: 86-98 (at 97).

quo also distorts the flow of investments and competition in the internal market¹¹¹. Arguably, this is currently the case due to an unfettered tax competition for foreign direct investment and for intermediate holdings from firms that are headquartered outside the EU. An international effective minimum tax would reduce this kind of external repercussions of distorted competition within the internal market, too.

4.1.2. Subsidiarity

As laid down in Art. 4 (2) (a) TFEU, the internal market competence of Art. 115 TFEU is a shared competence within the meaning of Art. 2 (2) TFEU. This implies that Union legislation in this area must comply with the principle of subsidiarity, enshrined in Art. 5 (3) TEU¹¹². This applies also for tax legislation to be adopted on this legal basis¹¹³. Consequently, a proposal for a directive on effective minimum taxation would have to observe the subsidiarity principle, too¹¹⁴ – irrespective of the fact that the directive would also govern, to a certain extent, the external relations of EU Member States, as explained above. The external dimension of the coordination of the tax systems of EU Member States does not transform the competence of the Union into an exclusive one covered by Art. 2 (1), 3 TFEU¹¹⁵.

It is settled case law of the CJEU that the principle of subsidiarity is subject to judicial review¹¹⁶, but that the Court will exercise considerable judicial restraint regarding its substantive conditions¹¹⁷. The latter consist of a two-stage test: First, the EU institutions must satisfy themselves that they are acting only if and as far as the objectives of the proposed action cannot be sufficiently achieved by the Member States (*negative component* of the test). Second, action by the Union is permissible only if and as far as the objectives of the proposed action can be better achieved at Union level (*positive component* of the test)¹¹⁸. Pursuant to Article 5 of the Protocol on the application of the principles of subsidiarity and proportionality (annexed to the

¹¹¹ See Smit, D. S. (2017). The Influence of EU Tax Law on the EU Member States' External Relations, in: Haslehner, W., Kofler, G., Rust, A. (eds.), *EU Tax Law and Policy in the 21st Century*, Kluwer, pp. 215-230 (at 224).

¹¹² See, regarding the internal market competence of Art. 114 TFEU, AG Kokott, C-358/14, para. 139.

¹¹³ See Kofler, G. (2020). EU power to tax: Competences in the area of direct taxation, in *Research Handbook on European Union Taxation Law*, in Panayi, C., Haslehner, W., Traversa, E. (eds.), *Research Handbook on European Union Taxation Law*, Edward Elgar, pp. 11-50 (at 27).

¹¹⁴ See De Broe, L., Massant, M. (2021). Are the OECD/G20 Pillar Two GloBE-rules compliant with the fundamental freedoms?, *EC Tax Review* 2021/3: 86-98 (at 94).

¹¹⁵ See, by analogy, Brokelind, C. (2019). The Anti-Tax Avoidance Directive under Scrutiny: A Matter of Competence?, in Monsenego, J., Bjuvberg, J. (eds.), *International Taxation in a Changing Landscape*, Wolters Kluwer, pp. 45-56 (at pp. 48-50).

¹¹⁶ See, e.g., CJEU 4 May 2016, Case C-358/14, Poland / Parliament and Council, ECLI:EU:C:2016:323, para. 113.

¹¹⁷ Cf. CJEU 10 December 2002, Case C-491/01, British American Tobacco, ECLI:EU:C:2002:741, paras. 177-185; 4 May 2016, Case C-358/14, Poland / Parliament and Council, ECLI:EU:C:2016:323, para. 111-121. See also Haslehner, W., The general scope of the ATAD and its position in the EU legal order, in Haslehner, W., Pantazatou, K., Kofler, G., Rust, A. (eds.), *A Guide to the Anti-Tax Avoidance Directive*, Edward Elgar, para. 2.22.

¹¹⁸ See CJEU 8 June 2010, Case C-58/08, Vodafone, ECLI:EU:C:2010:321, para. 72; AG Kokott, C-358/14, para. 142.

Treaty of Amsterdam), the existence of transnational aspects that cannot be satisfactorily regulated by action of Member States indicates that the negative component of the subsidiarity test is satisfied.

If political agreement on Pillar Two was reached within the Inclusive Framework, member countries that choose to implement it would politically commit to follow the OECD guidance on GloBE¹¹⁹. One might therefore wonder whether individual Member States would not, by honouring this political commitment, achieve the same kind of streamlined implementation of an effective minimum tax as the harmonization by way of an EU directive, since the latter would be guided by the GloBE agreement, too. At first sight, it could therefore be argued that even though the Union legislation would deal with transnational aspects, this affair could nevertheless also be satisfactorily regulated by Member States alone. If all of them implemented a version of GloBE that is a faithful representation of the internationally agreed compromise, there would hardly be a need for Union law micromanagement of this endeavour to reach the relevant internal market objectives.

However, these objections ignore an important limitation of the Pillar Two work by the Inclusive Framework. Different from Pillar One, the work on Pillar Two does not aim for a political commitment of all of its member countries to implement the GloBE rules. It merely seeks to ensure that, where an international effective minimum tax is implemented, it follows the GloBE guidance and is – therefore – accepted and facilitated by all other member countries. One might therefore expect certain EU Member States to not implement GloBE rules in their domestic tax systems. Moreover, Cyprus is an EU Member State but not a member country of the Inclusive Framework. It might therefore opt for a different version of an effective minimum tax if acting on its own. Absent a comprehensive and uniform coverage, distortions of competition within the internal market would not be remedied to the same extent as under a harmonization approach¹²⁰; moreover, distortions regarding the location of MNE headquarters or intermediate holdings within the EU might intensify. The collection of top-up tax via the UTPR in the Member States with a GloBE-style effective minimum tax would act as a backstop and would thus mitigate the aforementioned negative effects but could not fully eliminate or neutralize them in all situations.

With regard to the added value of Union action, i.e. the positive component of the subsidiarity test, it follows from the above that Union legislation that is legally binding for all Member

¹¹⁹ The only exception is the United States which has so far reserved the right to continue to operate its GILTI regime, but this is irrelevant in the present context.

¹²⁰ See also Kofler, G. (2020). EU power to tax: Competences in the area of direct taxation, in Panayi, C., Haslehner, W., Traversa, E. (eds.), *Research Handbook on European Union Taxation Law*, Edward Elgar, pp. 11-50 (at 29): "... subsidiarity may also exclude Union action when action is already being taken at international level and proving just as effective as Union action, but it does not seem that this would exclude the implementation of internationally agreed or discussed standards (such as in the OECD BEPS project) into Union law ...".

States would remedy the deficiencies of uncoordinated unilateral action. Moreover, individual Member States could hardly expect to implement GloBE in conformity with the requirements of the CJEU case law on restrictions of free movement rights, unless they extended the scope of the minimum tax to purely internal situations (see below at 4.2). This would create unnecessary compliance and administrative burdens and thus reduce the economic efficiency of the measure. By contrast, as will be discussed in the following, no such need would arise under a harmonized Union law approach.

The proposal of a directive on effective minimum taxation would therefore meet the substantive requirements of the subsidiarity principle. It can be assumed to pass eventual scrutiny by the CJEU, especially considering the light touch review constantly practiced by the Court in this regard¹²¹.

4.1.3. Proportionality

Finally, all Union legislation must respect the general principle of proportionality. In particular, the choice of legal instrument and the extent of EU harmonization must also be proportionate, as laid down in Art. 5 (4) TEU.

According to settled case law, the principle of proportionality requires that acts of the EU institutions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and do not exceed the limits of what is necessary in order to achieve those objectives. When there is a choice between several appropriate measures, recourse must be had to the least onerous provided that it is equally suitable. Moreover, the disadvantages caused must not be disproportionate to the aims pursued¹²². However, it is also settled case law that “the EU legislature must be allowed broad discretion in an area [...] which entails political, economic and social choices on its part, and in which it is called upon to undertake complex assessments. Consequently, the legality of a measure adopted in that area can only be affected if the measure

¹²¹ Likewise De Broe, L., Massant, M. (2021). Are the OECD/G20 Pillar Two GloBE-rules compliant with the fundamental freedoms?, *EC Tax Review* 2021/3: 86-98 (at 95-96).

¹²² See, e.g., CJEU 10 December 2002, Case C-491/01, *British American Tobacco (Investments) and Imperial Tobacco*, C-491/01, EU:C:2002:741, para. 122; 9 March, 2010, Cases C-379/08 and C-380/08, *ERG and Others*, EU:C:2010:127, para. 86; and 16 June 2015, Case C-62/14, *Gauweiler and Others*, EU:C:2015:400, paras. 67 and 91; 4 May 2016, Case C-358/14, *Poland / Parliament and Council*, ECLI:EU:C:2016:323, paras. 78 and 92.

is manifestly inappropriate having regard to the objective which the competent institutions are seeking to pursue”¹²³. This is typically also the case with respect to tax legislation¹²⁴.

Regarding the choice of legal instrument, Art. 115 TFEU only allows to approximate national legislation through the adoption of directives, so that the Union legislator has no choice in this regard. As to the extent of harmonization, it is clear that the core ruleset of GloBE would have to be prescribed as mandatory for Member States to implement in order to ensure the desired effect, i.e. curbing BEPS and establishing a floor for tax competition in a coordinated fashion so as to avoid both, loopholes that could undermine those objectives and an overkill in the form of double (minimum) taxation. By contrast, it might not be necessary to prescribe all the details of the collection mechanism. However, even in this regard, should all 27 Member States unanimously unite behind a minimum tax proposal as would be necessary for its adoption, it is highly unlikely that the CJEU would reject their political judgement to this effect, provided that it would not be *manifestly* unreasonable. Finally, as regards an eventual interference with EU fundamental freedoms and the need for proportionate justification in this specific context, we refer to the following section 4.2.

4.1.4 Impact Assessment

According to an Interinstitutional Agreement, the Commission should normally prepare an impact assessment before proposing any complex new legislation¹²⁵. However, as the CJEU has recently clarified, this Agreement does not create a legally binding obligation for the Commission, nor does a failure to carry out an impact assessment necessarily imply that the proposed measure must be presumed to be disproportionate due to a lack of information as to its effects. In particular, a breach of the principle of proportionality cannot be assumed where the EU legislature is in a particular situation requiring to proceed without an Impact Assessment, and where it has moreover sufficient information enabling it to assess the proportionality of an adopted measure¹²⁶.

¹²³ See, e.g., CJEU 10 December 2002, Case C-491/01, British American Tobacco (Investments) and Imperial Tobacco, C-491/01, EU:C:2002:741, para. 52; 4 May 2016, Case C-358/14, Poland / Parliament and Council, ECLI:EU:C:2016:323, para. 79; 21 June 2018, Case C-5/16, Poland / Parliament and Council, ECLI:EU:C:2018:483, para. 170; 13 March 2019, Case C-128/17, Poland / Parliament and Council, ECLI:EU:C:2019:194, paras. 95-96; CJEU 3 December 2019, Case C-482/17, Czech Republic / Parliament and Council, ECLI:EU:C:2019:1035, para. 77; CJEU 8 December 2020, Case C-626/18, Poland / Parliament, ECLI:EU:C:2020:1000, para. 95.

¹²⁴ See CJEU 78 March 2017, Case C-390/15, RPO, para. 54; see also see Braun Binder, N. (2017). *Rechtsangleichung in der EU im Bereich der direkten Steuern*, Mohr Siebeck, pp. 93-94. For a different opinion, see rov, I., Govind, S. (2019). *Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD Under EU Law*, 47 *Intertax* 10: 852-868 (at 862).

¹²⁵ Interinstitutional Agreement between the European Parliament, the Council of the European Union and the European Commission on Better Law-Making of 13 April 2016, OJ 2016 L 123, p. 1, points 12-15.

¹²⁶ See CJEU 3 December 2019, Case C-482/17, Czech Republic / European Parliament and European Commission, ECLI:EU:C:2019:1035, paras. 82 et seq.

When the EU Commission proposed the ATAD, it had not previously carried out an impact assessment, citing the urgent need for action and the fact that extensive research on the effects of the proposed measures had already been conducted at the level of the OECD and by EU institutions¹²⁷. Similar circumstances could also be claimed to exist with respect to an implementation of an effective minimum tax that is guided by the GloBE proposal discussed within the OECD/G20 Inclusive Framework, regardless of whether it will eventually be agreed upon by this international political forum or not. In particular, the OECD has carried out and published an Economic Impact Assessment on the already detailed Blueprint version of GloBE, and it has organized several public consultations where several hundred stakeholders have submitted their views and concerns. Moreover, the Commission and EU Member States have been actively involved in the negotiations at OECD level at all times.

This notwithstanding, we strongly recommend to carry out an impact assessment before proposing a minimum tax directive in order to improve the quality of legislation, especially with a view to any eventual modifications of the GloBE concept so as to better fit it into the EU legal framework.

4.2. Compatibility with EU/EEA fundamental freedoms

It is sometimes assumed that EU Member States cannot lawfully implement GloBE unless the European Court of Justice (CJEU) were to relax its strict requirements of compliance with fundamental freedom rights. And according to settled CJEU case law, the Treaty free movement guarantees must not only be observed by Member States but also by the Union legislator¹²⁸, and also in the field of taxation¹²⁹. In the following, we will therefore discuss how the GloBE would have to be designed, and thus how the concept of the Blueprint might have to be modified, for the Union legislator to be confident that the measures would pass fundamental freedom scrutiny¹³⁰. We will focus our analysis on the two core top-up tax collection mechanisms, i.e. the IIR and the UTPR. Subsequently we also briefly address the STTR.

4.2.1. Third country scenarios are out of scope – no requirements apply

The personal scope of the core GloBE collection mechanisms (i.e. the IIR and the UTPR) is limited to MNE groups. According to the Blueprint, the term “group” means a collection of

¹²⁷ See COM(2016) 26 final, p. 6. For critical comments on this approach, see rov, I., Govind, S. (2019). Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD Under EU Law, 47 Intertax 10: 852-868 (at 863-864).

¹²⁸ See, e.g., CJEU 25 June 1997, Case C-114/96, Kieffer and Thill, ECLI:EU:C:1997:316, para. 27; 26 October 2010, Case C-97/09, Schmelz, ECLI:EU:C:2010:632, para. 50; and the comprehensive analysis of CJEU case law by Zazoff, J. (2011). Der Unionsgesetzgeber als Adressat der Grundfreiheiten, Nomos, pp. 70 et seq.

¹²⁹ See, e.g., CJEU 26 October 2010, Case C-97/09, Schmelz, ECLI:EU:C:2010:632.

¹³⁰ The following deliberations are based on earlier publications of one of the authors, see Englisch, J. (2021). Designing a Harmonized EU-GloBE in Compliance with Fundamental Freedoms. EC Tax Review 2021/3: 136-142; Englisch, J. (2021). Is an METR Compatible With EU/EEA Free Movement Guarantees?, 102 Tax Notes Int'l 2: 219-232.

enterprises related through ownership or control such that it is required to prepare consolidated financial statements for financial reporting purposes under applicable accounting principles¹³¹.

Arguably, the ownership and control criteria that are established in the relevant IFRS 10 and equivalent standards would always enable a parent company in the MNE Group to “exert a definite influence on the controlled company’s decisions and to determine its activities”, so that the GloBE rules would fall within the ambit of the freedom of establishment (Article 49 TFEU / Article 31 EEA)¹³². The literature has pointed out that an investor may have a controlling interest and therefore be required to prepare a consolidated financial statement under IFRS 10 even with less than a majority shareholding, if additional, contractual arrangements allow him to exert influence over the subsidiary’s economic activities¹³³. However, even in such scenarios the shareholding will normally exceed the relevant threshold for a holding conferring “definite influence”; the Court does not require a majority shareholding to this effect¹³⁴. It can moreover be inferred from the case law that the level of entrepreneurial control exercised by a parent company within a group of companies does not need to be based exclusively on the shareholding in the subsidiary in order to come within the purview of the freedom of establishment¹³⁵.

The minimum tax rules would therefore *by design* fall within the substantive scope of the freedom of establishment. Unlike the EU Treaty guarantee of free movement of capital (Article 63 TFEU), the freedom of establishment cannot be invoked in third country scenarios. It only governs national measures that restrict the freedom of companies that are registered or domiciled within the EU/EEA to set up and manage dependent undertakings or branches in another EU/EEA Member State. The freedom of establishment therefore requires that both, parent and subsidiary or head office and branch, are established in an EU/EEA Member State¹³⁶. Furthermore, according to settled CJEU case law, the freedom of capital movements is not applicable in parallel to the guarantee of freedom of establishment, where the tax regime at issue concerns only relationships and transactions between affiliated entities in the above sense.

¹³¹ OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, paras. 12 et seq.

¹³² Cf. CJEU 13 April 2000, Case C-251/98, Baars, ECLI:EU:C:2000:205, para. 22; 20 September 2018, Case C-685/16, EV, ECLI:EU:C:2018:743, para. 34.

¹³³ See Nogueira, J. F. P., Turina, A. (202-1). Pillar Two and EU Law, in: Perdelwitz, A., Turina, A. (eds.). Global Minimum Taxation?, pp. 283-312 (at 288), who therefore consider it likely that the CJEU would assess the IIR and the UTPR as to its compatibility with the Treaty guarantee of free movement of capital.

¹³⁴ See, e.g., CJEU 21 January 2010, Case C-311/08, SGI, ECLI:EU:C:2010:26, paras. 34-35; 20 December 2017, Joined Cases C-504/16 and C-613/16, Deister Holding and Juhler Holding, ECLI:EU:C:2017:1009, para. 82.

¹³⁵ See, e.g., CJEU 13 March 2007, Case C-524/04, Test Claimants in the Thin Cap GL, ECLI:EU:C:2007:161, paras. 30-31 and 33; and, e contrario, CJEU 20 September 2018, Case C-685/16, EV, EU:C:2018:743, para. 35.

¹³⁶ Likewise de Broe, L., Massant, M. (2021). Are the OECD/G20 Pillar Two GloBE-rules compliant with the fundamental freedoms?, EC Tax Review 2021/3: 86-98 (at 89).

Instead, the free movement of capital would be superseded by the geographically more limited freedom of establishment.¹³⁷

This means that in relation to countries that are not Member States of the EU/EEA, the core GloBE collection mechanisms (IIR and UTPR) could in principle be applied without any limitations imposed by the respective Treaty's free movement guarantees.

4.2.1. Restriction of the freedom of establishment in intra-EU/EEA scenarios

The *modus operandi* of the IIR would resemble a CFC regime that the CJEU has repeatedly held to restrict the relevant fundamental freedoms¹³⁸. In particular, the CJEU assesses whether a difference in tax treatment exists at the level of the individual company that enjoys the protection of the free movement rights – here, the parent company that incurs an additional top-up tax liability – rather than at group level. The fact that the combined tax burden of parent company and subsidiary would still be higher in a purely domestic situation, because resident subsidiaries are still subject to higher levels of domestic taxation than the top-up tax levied on the profits of the foreign subsidiary, is immaterial in the Court's view¹³⁹.

As for the undertaxed payments rule (UTPR) as the designated back-up mechanism, it would only exceptionally be applied in intra-EU situations under the premise of a harmonized, mandatory implementation in all Member State, namely where the ETR of the ultimate parent entity jurisdiction is too low. But in this case, this rule would fully or partially deny the deductibility of intra-group payments or otherwise link those payments to a top-up tax liability, and do so in case of cross-border transactions only. This kind of disadvantage for cross-border payments has almost consistently been regarded as restrictive by the CJEU¹⁴⁰.

Among the core GloBE collection mechanisms, only the switch-over clause for foreign low-taxed PE profits would raise little concern as to its compatibility with the EU/EEA fundamental freedoms. A switch-over that overrides the exemption method for PE profits does not normally imply any detrimental treatment of the cross-border scenario, because local PE profits would

¹³⁷ See, e.g., CJEU, 13 November 2012, Case C-35/11, Test Claimants in the FII Group Litigation, EU:C:2012:707, paras. 90 et seq., esp. para. 99; 3 October 2013, Case C-282/12, Itelcar, EU:C:2013:629, paras. 16 et seq.; 24 November 2016, Case C-464/14, SECIL, EU:C:2016:896, paras. 31 et seq.; 20 September 2018, Case C-685/16, EV, EU:C:2018:743, paras. 34 et seq.

¹³⁸ See, e.g., CJEU 12 September 2006, Case C-196/04, Cadbury Schweppes, ECLI:EU:C:2006:544; 23 April 2008, Case C-201/05, Test Claimants in the CFC and Dividend GL, ECLI:EU:C:2008:239, paras. 70 et seq.; 26 February 2019, Case C-135/17, X GmbH, ECLI:EU:C:2019:136.

¹³⁹ Cf. CJEU 12 September 2006, Case C-196/04, Cadbury Schweppes, ECLI:EU:C:2006:544, para. 45.

¹⁴⁰ See, e.g., CJEU 26 October 1999, Case C-294/97, Eurowings, ECLI:EU:C:1999:524; 26 June 2003, Case C-422/01, Skandia, ECLI:EU:C:2003:380; 5 July 2012, C-318/10, SIAT, ECLI:EU:C:2012:415; 20 January 2021, Case C-484/19, Lexel, ECLI:EU:C:2021:34. The only exception was the Schempp decision, see CJEU 12 July 2005, case C-403/03, Schempp, ECLI:EU:C:2005:446, which did not, however, concern a linking rule for the purposes of compensatory taxation.

also be taxed in a purely internal situation, moreover without any foreign tax credit¹⁴¹. It therefore does not constitute a restriction of the freedom of establishment under the standard approach of “vertical” comparison of the cross-border situation and the purely internal one¹⁴², as confirmed by the *Columbus Container* decision of the CJEU¹⁴³. Moreover, the Court also clarified in its *Columbus Container* judgement that it does not object to a difference in treatment between foreign establishments in different Member States, if the switch-over depends on the level of taxation in the respective Member State of establishment¹⁴⁴.

4.2.2. Sufficiently justified?

The IIR and the UTPR would thus be in need of justification for an infringement of the freedom of establishment. This is problematic due to the limited number of justifications accepted by the Court so far and the strict standards of proportionality that it routinely applies in case of restrictive national tax measures. Under the premise that the Court applied its restrictive approach on admissible justifications and its relatively strict scrutiny also to Union legislation, the aforementioned collection mechanisms for the GloBE could not be justified¹⁴⁵.

In particular, while the Court has acknowledged that the need to counter tax avoidance is a legitimate reason in the public interest for a restriction of fundamental freedoms, it has considered national CFC rules to be proportionate only if limited to situations where the foreign subsidiary has no economic substance¹⁴⁶. The Court has furthermore insisted that the taxpayer must be given the possibility to demonstrate that a particular firm structure was chosen for commercial reasons¹⁴⁷. Recently, the CJEU has confirmed that anti-BEPS measures that do not meet this test and rely on broad assumptions of abuse cannot be justified¹⁴⁸. To comply with

¹⁴¹ In the context of GloBE, foreign PE profits would potentially be taxed on a different base and at a different (minimum) rate than local PE profits; but in any event, only partially so due to the top-up tax concept. For a detailed discussion of this aspect, see below at 4(b).

¹⁴² See also Devereux, M. P. et al. (2020). The OECD Global Anti-Base Erosion Proposal, p. 51; Nogueira, J. F. P. (2020), *World Tax Journal* 2020: 465-498 (at 473); Koerver Schmidt, P. (2020). An General Income Inclusion as a Tool for Improving the International Tax Regime – Challenges Arising from EU Primary Law, 48 *Intertax* 11: 983-997 (at 988).

¹⁴³ CJEU 6 December 2007, Case C-298/05, *Columbus Container Services*, ECLI:EU:C:2007:754.

¹⁴⁴ CJEU 6 December 2007, Case C-298/05, *Columbus Container Services*, ECLI:EU:C:2007:754, paras. 50-51.

¹⁴⁵ Likewise Blum, D. W. (2019). The Proposal for a Global Minimum Tax: Comeback of Residence Taxation in the Digital Era?: Comment on Can GILTI + BEAT = GLOBE?, 47 *Intertax* 5, pp. 514-522 (at 521); de Broe, L., Danon, R., Chand, V. (2019). Comments to Public Consultation Document: Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two, paras. 28 and 33; Nogueira, J. F. P. (2020). GloBE and EU Law: Assessing the Compatibility of the OECD’s Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, *World Tax Journal* 2020: 465-498 (at 482 et seq.); Koerver Schmidt, P. (2020). An General Income Inclusion as a Tool for Improving the International Tax Regime – Challenges Arising from EU Primary Law, 48 *Intertax* 11: 983-997 (at 989 et seq.).

¹⁴⁶ See CJEU 12 September 2006, Case C-196/04, *Cadbury Schweppes*, ECLI:EU:C:2006:544, paras. 54 and 67-68; 23 April 2008, Case C-201/05, *CFC and Divided Group Litigation*, ECLI:EU:C:2008:239, para. 79; EFTA Court 9 July 2014, Cases E-3/13 and E-20/13, *Olsen*, paras. 166 et seq.

¹⁴⁷ See, e.g., CJEU 20 December 2017, Cases C-504/16 and C-613/16, *Deister Holding und Juhler Holding*, ECLI:EU:C:2017:1009, paras. 70 and 97; 14 June 2018, Case C-440/17, *GS*, ECLI:EU:C:2018:437, paras. 79 and 56; 20 September 2018, Case C-685/16, *EV*, ECLI:EU:C:2018:743, paras. 98-99.

¹⁴⁸ See CJEU 20 January 2021, Case C-484/19, *Lexel*, ECLI:EU:C:2021:34, para. 53.

this standard, the “substance-based” carve-out envisaged for GloBE would have to be expanded to intangible assets and, furthermore, be converted into a mere presumption of abuse¹⁴⁹. However, this would reduce the very concept of GloBE as an instrument against *abstract* BEPS risks and against tax competition for IP holdings to absurdity.

The only other relevant justification accepted so far by the CJEU, the need to preserve a balanced allocation of taxing rights between Member States, could not be invoked successfully either. The Court considers restrictive tax measures to be justified on this ground where they are “designed to prevent conduct capable of jeopardising the right of a Member State to exercise its powers of taxation in relation to activities carried out in its territory”¹⁵⁰. However, GloBE does not seek to ensure that States can effectively tax income or gains that have been generated through economic activities carried out within their own territory. The minimum tax would target profits that have materialized “offshore”, i.e. in another (Member) State. One might try to argue that those profits have presumably often been siphoned off to the low tax jurisdiction, and at least potentially so (also) from the jurisdiction collecting the top-up tax. But the Court has found that the mere prevention of the “erosion of the national tax base which could result from tax planning [...] cannot be confused with the need to preserve the balanced allocation of the power to impose taxes between the Member States.”¹⁵¹

Admittedly, it is unlikely that the Court would judge Union legislation prescribing a GloBE-type minimum tax by the above strict standards. Earlier decisions on the compatibility of Union legislation with the free movement rights suggest that the Court would apply a lower standard of proportionality review¹⁵² and that it might also accept additional grounds of justification¹⁵³. In particular, it should not be excluded *a priori* that the Court would accept a justification based on the perceived need to reduce certain negative aspects of (“excessive”) international tax competition as legitimate where it is not invoked unilaterally by individual Member States, but instead reflects an international consensus (at least) among EU/EEA Member States. However, it is ultimately unclear whether the CJEU would be accommodating enough to allow for an

¹⁴⁹ In a similar vein, Devereux, M. P. et al. (2020). The OECD Global Anti-Base Erosion Proposal, pp. 52-53.

¹⁵⁰ See, e.g., CJEU 26 February 2019, Case C-135/17, X GmbH, ECLI:EU:C:2019:136, para. 72, with further references.

¹⁵¹ See CJEU 20 January 2021, Case C-484/19, Lexel, ECLI:EU:C:2021:34, para. 67.

¹⁵² For a comprehensive analysis, see Szudoczky, R. (2014). The sources of EU law and their relationships, pp. 255 et seq. and 450 et seq.; Szudoczky, R. (2020). The relationship between primary, secondary and national law, in Panayi et al. (eds.), Research Handbook on European Taxation Law: 93-118 (at 102 et seq.). See also Kofler, G., The relationship between the fundamental freedoms and directives in the area of direct taxation, *Diritto e pratica tributaria internazionale* 2009, 471 et seq.; Dourado, A. P. (2010). The relationship between primary and secondary EU law in tax law: the legitimacy of different interpretation criteria applied to EU and national legal sources, in Weber, D. (ed.), *Traditional and Alternative Routes to European Tax Integration*, 171 et seq.; *Brokelind, C., Wattel, P. J. (2019). Free Movement and Tax Base Integrity, in Terra, B. J. M., Wattel, P. J. (eds.), European Tax Law 2019/1: 655 et seq.* See also Kokott, J. (2018). Das Steuerrecht der Europäischen Union, § 2 para. 81, regarding the justification on grounds of fighting abusive tax planning in particular. Regarding tax measures in general, see also CJEU 7 March 2017, Case C-390/15, RPO, ECLI:EU:C:2017:174, para. 54.

¹⁵³ See, e.g., CJEU 14 October 2004, Case C-299/02, Commission/Netherlands, ECLI:EU:C:2004:620, para. 24.

effective implementation of GloBE within the EU¹⁵⁴, and any predictions to this effect are speculative. An unmodified transplant of an international blueprint for GloBE into Union law is therefore a risk that the Union legislator might not wish take, and even less so if the corresponding revenue became part of the Union's own resources, as reportedly contemplated by some Member States and the Commission.

4.2.3. *Could extending GloBE to internal situations be a solution?*

It would therefore appear preferable to modify the GloBE for the purposes of its application to intra-EU situations, so as to avoid the problematic restrictive effects of the collection of top-up tax from the outset. There would then be no need for debilitating curtailments that might otherwise undermine the effectiveness of GloBE in order to meet the strict proportionality requirements established by the CJEU. In its recent Communication on Business Taxation for the 21st Century, the Commission, too, acknowledged that conceptual adjustments may be necessary to fit GloBE into the EU legal framework¹⁵⁵.

In this context, it is important to point out that the Court has traditionally shown significant judicial restraint regarding the notion of “restriction” of a free movement rights specifically when testing *tax* measures on their compatibility with the Treaty's free movement rights. The CJEU has almost never found tax measures to infringe a fundamental freedom in the absence of detrimental treatment of a cross-border situation. Instead, the Court normally – albeit often only tacitly – requires an element of discrimination, different from its jurisprudence in other areas of law¹⁵⁶.

Against this backdrop, a rather obvious solution that has already been discussed in literature¹⁵⁷ would be an extension of GloBE to purely internal situations. This means that the GloBE ETR calculation would be applied, and top-up tax would eventually be collected by way of an IIR or UTPR also in purely internal situations. Admittedly, such a strategy might fail if it nevertheless entailed *de facto* discrimination of an exercise of the freedom of establishment, especially in high-tax jurisdictions where the domestic application of GloBE would almost never result in

¹⁵⁴ Regarding the limits of the usually broad discretion of the Union legislator with respect to the proportionality of its measures, see, e.g., CJEU 3 December 2019, Case C-482/17, *Czech Republic / European Parliament and Council*, ECLI:EU:C:2019:1035, paras. 76-81; 8 December 2020, Case C-626/18, *Poland / European Parliament*, ECLI:EU:C:2020:1000, paras. 94-99; see furthermore the relatively detailed review regarding the proportionality of a restriction of a free movement right in CJEU 26 October 2010, Case C-97/09, *Schmelz*, ECLI:EU:C:2010:632.

¹⁵⁵ See EU Commission, Communication on Business Taxation for the 21st Century, 18 May 2021, COM(2021) 251 final, p. 9.

¹⁵⁶ See, e.g., AG Kokott, Opinion of 2 June 2016, Case C-122/15, “C”, ECLI:EU:C:2016:65 para. 66; AG Bobek, Opinion of 14 December 2017, Case C-382/16, *Hornbach Baumarkt*, ECLI:EU:C:2017:974, paras. 39 et seq.; Cordewener, A. (2006), in Vanistendael, F. (ed.), *EU Freedoms and Taxation*, 2006, 1 (26 et seq.); Bizzioli, G. (2017). *Taking EU Fundamental Freedoms Seriously: Does the Anti-Tax Avoidance Directive Take Precedence over the Single Market?*, 26 *EC Tax Review* 3: 167-175 (at 168 et seq.).

¹⁵⁷ See the extensive analysis by Koerver Schmidt, P. (2020). *An General Income Inclusion as a Tool for Improving the International Tax Regime – Challenges Arising from EU Primary Law*, 48 *Intertax* 11: 983-997 (at 993-994), with further references.

the levy of top-up tax¹⁵⁸. However, the Court’s case law suggests that certain collection techniques might escape such a verdict¹⁵⁹. Moreover, the CJEU has recently been more reluctant to qualify a national tax measure as a covert *de facto* restriction where it does not display any protectionist tendencies¹⁶⁰. If the *de facto* greater impact of the disadvantageous tax treatment on cross-border situations is merely “fortuitous, if not a matter of chance” rather than inherent to the design of the measure, the Court held that it cannot be regarded as restrictive¹⁶¹. Arguably, this would be the case from the perspective of the Union legislator when prescribing a generalised GloBE for all Member States, high-tax and low-tax.

The more serious objection against this solution is therefore another one¹⁶²: In the now famous words of late Advocate General *Geelhoed*, an extension of cross-border tax regimes to domestic situations merely in order to avoid a conflict with the free movement rights would cause “considerable extra administrative burden for domestic companies and tax authorities, is quite pointless and indeed counterproductive for economic efficiency. As such, it is anathema to the internal market.”¹⁶³ Member States might not favour such an approach for those reasons.

4.2.4. A better alternative: the avoider pays principle

However, there is another alternative. For the purpose of intra-EU application of GloBE, the IIR and UTPR could be replaced by a different top-up tax collection mechanism. Instead of making a parent company or other affiliated companies within the MNE group liable to pay the top-up tax, the entity with “undertaxed” profits could itself become the GloBE taxpayer. The IIR and – exceptionally – the UTPR would be reduced to mere rules on the allocation of taxing rights. They would no longer determine who collects the top-up tax, but only where it is collected. Consequently, the role of the EU/EEA resident parent company that would normally collect top-up tax under the GloBE IIR top-down approach would be limited to calculating the ETR for each Member State, in order to determine whether a top-up tax liability has arisen there. If so, it would provide the taxpaying group entity established in the respective low-tax jurisdiction with this information to facilitate the minimum tax compliance of the latter.

¹⁵⁸ See, e.g., de Broe, L., Danon, R., Chand, V. (2019). Comments to Public Consultation Document: Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two, para. 30; Devereux, M. P. et al. (2020). The OECD Global Anti-Base Erosion Proposal, pp. 50-51.

¹⁵⁹ For a detailed discussion, see Englisch, J., Becker, J. (2019), International Effective Minimum Taxation – The GLOBE Proposal, *World Tax Journal* 2019: 483-529 (at 526).

¹⁶⁰ See CJEU 3 March 2020, Case C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2020:139, in particular paras. 49, 52, and 54.

¹⁶¹ See CJEU 3 March 2020, Case C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2020:139, para. 52. In a similar vein, AG Kokott, Opinion of 10 January 2019, Case C-607/17, *Memira Holding*, ECLI:EU:C:2019:8, paras. 35-36. See also Nogueira, J. F. P., Turina, A. (2021). Pillar Two and EU Law in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at pp. 307-308).

¹⁶² See also Devereux, M. P. et al. (2020). The OECD Global Anti-Base Erosion Proposal, p. 51.

¹⁶³ AG Geelhoed, 29 June 2006, C-524/04, *Test Claimants in the Thin Cap GL*, ECLI:EU:C:2006:436, para. 68

In case of a unilateral implementation of GloBE by individual EU/EEA Member States or third countries, this approach would usually not be a viable option. Extending national taxation powers to foreign-sourced profits of a non-resident corporation is then normally not feasible, due to tax treaty limitations and possibly also with respect to the “genuine link” requirement of customary public international law¹⁶⁴. However, in case of a harmonized implementation of GloBE through EU legislation, public international law would no longer stand in the way. Since the “genuine link” requirement has been developed to protect the sovereignty of Nation States¹⁶⁵, it can be waived where all States that are affected by the taxation measure collectively agree to do so¹⁶⁶. Moreover, existing bilateral tax treaties between individual EU Member States would not hinder such a solution, either, because they would be overridden by EU legislation¹⁶⁷.

Compliance with this new form of tax liability could be facilitated by a One Stop Shop (OSS) approach, such as it has already been enacted in EU VAT legislation¹⁶⁸, and as it had i.a. been proposed for the EU Digital Services Tax¹⁶⁹. The entity with “undertaxed” profits could then file its GloBE return in its home State, and possibly make the respective tax payments there. The home State would subsequently forward the declarations and, possibly, the corresponding tax revenue to the Member State(s) entitled to collect the top-up tax. This procedure could be further backed up by joint audit arrangements, such as now also foreseen for the VAT OSS in Art. 7(4a) of Regulation 904/2010.

This solution would avoid virtually any disadvantageous tax treatment of cross-border situations. If a jurisdiction is entitled to collect top-up tax, because it is the country of residence of the (ultimate) parent company of the low-taxed MNE entity, this parent company would not incur any additional tax liability, because the top-up tax would no longer be collected from it. It would therefore not be confronted with a higher tax burden than a parent company with only local subsidiaries. This is different from the operation of an IIR, which would rely on the same collection techniques as a conventional CFC regime and might thus run afoul of the *Cadbury Schweppes* criteria established by the CJEU. In a similar vein, if the top-up tax had to be (exceptionally) collected by the source country jurisdiction(s) under the allocation rules of the UTPR (without however implementing also the UTPR *collection* mechanism), the top-up tax

¹⁶⁴ Regarding the latter, see, e.g., Gadžo, S. (2018). The Principle of ‘Nexus’ or ‘Genuine Link’ as a Keystone of International Income Tax Law: A Reappraisal, 46 Intertax 3: 194-209 (at 194 et seq.); and more in general, The American Law Institute (2018). Restatement of the Law Fourth, § 407. For a critical analysis, see Sternberg, C. (2019), Die extraterritoriale Besteuerungsgewalt des Staates, pp. 198 et seq.

¹⁶⁵ See, e.g., Ryngaert, C. (2008). Jurisdiction in International Law, p. 6.

¹⁶⁶ See, e.g., Crawford, J. (2012). Brownlie’s Principles of Public International Law, 8th ed. 2012, p. 457.

¹⁶⁷ See, by analogy, CJEU 8 September 2009 – C-478/07, Budějovický Budvar, ECLI:EU:C:2009:521, paras. 98 et seq.; likewise Panzeri, I. (2021). Tax Treaties Versus EU Law: Which Should Prevail?, 61 Eur. Taxn. 4: 147-155.

¹⁶⁸ See, e.g., Merks, M. M. W. D. (2020). The wizard of OSS: effective collection of VAT in cross-border e-commerce.

¹⁶⁹ See Chapter 3 of the proposed Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM(2018) 148 final.

would no longer be levied from any of the MNE entities domiciled in the respective jurisdiction(s). As a consequence, there would be no need for potentially discriminatory limitations of deductibility of cross-border intra-group payments or other forms of additional tax burdens for local MNE entities, as required by the UTPR collection mechanism.

Instead, in all the aforementioned scenarios the avoider pays principle would allow the jurisdiction entitled to collect top-up tax to levy this tax directly from the (foreign-based) low-taxed MNE entity itself. As a consequence, it would then also be the top-up tax burden of this low-taxed entity that would have to be compared to the tax treatment of a purely internal situation in the jurisdiction that collects top-up tax from the low-taxed entity, corresponding to the vertical comparison typically carried out by the CJEU. It should then normally be found that the top-up tax burden of the low-taxed MNE entity is still lower than the regular corporation tax burden of a company that is domiciled in the jurisdiction collecting the top-up tax. Hence no discrimination of the cross-border scenario arises. This could normally be expected to be the case even where the local ETR of this jurisdiction were lower than the minimum rate, because foreign covered taxes would reduce the amount of top-up tax liability. While outlier cases are theoretically conceivable, it is very unlikely that the CJEU would consider them relevant when assessing an eventual minimum tax directive. The alternative collection mechanism would therefore normally be devoid of any restrictive elements, essentially because by “piercing the territorial veil” it follows the same logic as the type of switch-over clause accepted by the CJEU in its *Columbus Container* judgement.

What would admittedly remain in terms of a restriction of the freedom of establishment is an additional tax compliance burden for the ultimate EU/EEA parent entity tasked with calculating the ETR and conveying this information to the GloBE taxpayer entity. However, this restriction could be justified as proportionate measure to ensure the functioning and effectiveness of the minimum tax system¹⁷⁰.

4.2.5. Possible design modifications

Under the above approach, it would even be conceivable to modify the revenue allocation effects inherent to the GloBE collection rule order for the purpose of its intra-EU implementation. The priority accorded to the application of the IIR with top-down approach in the GloBE Blueprint is primarily inspired by pragmatic reasons of ease of revenue collection, which would no longer be relevant under the alternative collection approach – especially if it were flanked by a procedural OSS regime. The top-up tax revenue allocation could for example also be determined by formulaic apportionment closer aligned with the paradigm of “taxation

¹⁷⁰ See, by analogy, CJEU 7 September 2006, Case C-470/04, “N”, ECLI:EU:C:2006:525, para. 51.

where value has been created”, such as the formula proposed for the CCCTB¹⁷¹ (or, now, the recently announced BEFIT).

As a caveat, this would add certain complexity to the GloBE mechanism, and could potentially intensify tax competition for real investment within the internal market. Moreover, if a new revenue allocation formula would entitle the Member State with low ETR to collect a portion of the top-up tax, this might in itself give rise to a new kind of restriction of the freedom of establishment: Resident companies that form part of an MNE group would then bear a higher (combined) local tax burden than resident companies that belong to a purely domestic group. The collection mechanism would then be less certain to pass CJEU scrutiny than in case of an implementation of the avoider pays principle that follows the IIR and UTPR allocation rules. A trade-off between those disadvantages and an eventual improvement of inter-nation equity in revenue allocation is therefore required. In this context, it will also have to be taken into account whether, and if so to what extent, the GloBE revenue should become an EU own resource. At least if a significant portion of revenue ultimately had to be transferred to the EU, the disadvantages and risks of a modification in the revenue allocation rules would outweigh eventual benefits.

4.2.6. The subject-to-tax rule

So far, we have not discussed the complementary subject-to-tax rule (STTR)¹⁷². If applied only with respect to cross-border payments, minimum withholding taxes enabled by the STTR would very likely have to be classified as restrictions of the relevant fundamental freedom¹⁷³.

A justification might be possible on grounds of the need to ensure the effectiveness of fiscal supervision, depending on the design of the STTR and the minimum withholding tax. At least where the recipient is resident in another EU/EEA Member State, the CJEU would normally require that corresponding business expenses can be deducted upon sufficient proof, and that the non-resident payee ultimately does not incur a higher tax burden than resident payees¹⁷⁴. Any eventual remaining cash flow disadvantages would have to be kept to the administratively

¹⁷¹ See Art. 28 of the Commission Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), 25 October 2016, COM(2016) 683 final. The Proposal will now be withdrawn and replaced by BEFIT (that seems to be very similar in nature, though). Such an approach could also find inspiration in the recent METR minimum tax proposal, see Cobham, S., Faccio, T., Garcia-Bernardo, J., Janský, P., Kadet, A., Picciotto, J. (2021). For a better Globe – METR: a minimum effective tax rate for multinationals, accessible at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3796030.

¹⁷² See OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, pp. 147 et seq.

¹⁷³ Likewise Nogueira, J. F. P. (2020). GloBE and EU Law: Assessing the Compatibility of the OECD’s Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, *World Tax Journal* 2020: 465-498 (at 474 et seq.), in the context of the UTPR.

¹⁷⁴ See, e.g., CJEU 10 May 2012, Case C-338/11, *Santander Asset Management*, ECLI :EU:C:2012:286, paras. 43-44, with further references.

unavoidable minimum¹⁷⁵. These requirements could be accommodated for in the design of the minimum withholding tax, but they would cause higher administrative and compliance costs.

However, the rationale of the STTR consists essentially in balancing out the revenue effects of the conventional GloBE rules, allowing source countries to protect their base by imposing a minimum withholding tax with *de facto* priority over the application of the IIR or UTPR¹⁷⁶; moreover, its simplified approach towards identifying low-taxed income caters for lower administrative capacities of developing countries¹⁷⁷. The latter aspect should be of little or no concern for EU Member States, and revenue allocation considerations would be of lesser importance, too, if part or even all of the revenue were to be earmarked as EU own resources.

An obvious solution to the aforementioned fundamental freedom issues of the STTR would therefore consist in altogether abstaining from implementing the STTR, or at least limiting its scope of application to payments made to third country recipients. If the latter option were constrained by fundamental freedoms at all – for this, the free movement of capital would have to be applicable – it can be expected that the CJEU would accept a harmonized minimum withholding tax on gross income, at least where the information on corresponding expenses cannot be verified with reasonable efforts and reliability¹⁷⁸.

4.3. Compatibility with existing tax treaties of EU Member States

Notwithstanding an eventual harmonisation by way of an EU directive, a minimum tax regime would essentially have to be implemented at the level of national legislation of each EU Member State. This raises the question as to which amendments to existing double tax conventions concluded between a Member State and third countries might be required in order to ensure tax treaty compatibility. This is particularly relevant in jurisdictions where a treaty override is unconstitutional. While an action of unconstitutionality could probably not be brought against the minimum tax if the requirement to collect it is imposed by European tax legislation, because the latter takes precedence over domestic law including the constitutional law of a Member State¹⁷⁹, any such obligation could then still give rise to serious political and tax policy concerns. By contrast, the tax treaties that individual Member States have negotiated

¹⁷⁵ Cf. CJEU 26 February 2019, C-115/16, N Luxembourg 1, ECLI:EU:C:2019:134, para. 165.

¹⁷⁶ See OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 671.

¹⁷⁷ See OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 576.

¹⁷⁸ Cf. CJEU 12 December 2006, Case C-446/04, FII Group Litigation (I), ECLI:EU:C:2006:774, paras. 170-171; 10 April 2014, Case C-190/12, Emerging Markets Series of DFA Investment Trust Company, ECLI:EU:C:2014:249, paras. 86 et seq.; see also Blum, D. W. (2019), *supra* n. 145, at p. 522.

¹⁷⁹ See, e.g., CJEU 17 December 1970, Case C-11/70, Internationale Handelsgesellschaft, ECLI:EU:C:1970:114, para. 3.

bilaterally between themselves would simply be overridden by EU legislation, as stated above (at 4.2.4.). Moreover, most of the issues discussed in the following would not arise if a different collection mechanism were chosen, making the undertaxed entity pay the top-up tax itself (see also at 4.2.4). However, this option is available only for intra-EU relationships, so it does not provide a remedy for eventual conflicts regarding tax treaty concluded with third countries.

The Blueprint itself does propose some treaty amendments, most notably the switch-over rule (SOR) for the purpose of applying the IIR to foreign PE profits and the subject-to-tax rule (STTR) for a minimum withholding tax on selected payments. We will therefore discuss whether such amendments are necessary and sufficient¹⁸⁰. It should moreover be mentioned that the following analysis is premised on the assumption that the collection of top-up tax via the IIR and the UTPR comes within the substantive scope of a bilateral tax treaty. While this should normally be the case in treaties that use the wording of Article 2 OECD MC or UN MC¹⁸¹, it might be different in treaties that define their scope of application differently¹⁸².

4.3.1. Collection top-up tax by way of an IIR

The primary collection mechanism for GloBE top-up tax would be the IIR for undertaxed profits of foreign subsidiaries. According to the Blueprint, the IIR should generally be compatible with existing tax treaties at least where the latter are based on the OECD Model¹⁸³.

From a tax treaty perspective, the IIR raises similar issues as traditional CFC regimes¹⁸⁴. The latter also imply an additional tax burden for domestic parent companies with reference to profits earned by a subsidiary in the other contracting State. With respect to treaty articles inspired by article 7(1) MC, this could be regarded as incompatible with the requirement that profits of an enterprise shall be taxed only in the State where the enterprise – here: the subsidiary – is resident or has a permanent establishment.

¹⁸⁰ The following deliberations build on an earlier publication, see Englisch, J., Becker, J. (2019), International Effective Minimum Taxation – The GLOBE Proposal, *World Tax Journal* 2019: 483-529 (at 517 et seq.).

¹⁸¹ Unless otherwise indicated, all further references to Articles of a Model Convention refer to both the OECD-Model and the UN Model.

¹⁸² For an extensive analysis, see Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at pp. 236-238). It should be added that in some cases, it could then also matter how exactly the top-up tax collection mechanism is designed; e.g. in case of the UTPR, as a (partial) denial of deductibility of payments or as a separate tax.

¹⁸³ OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, paras. 679-680 and 683.

¹⁸⁴ OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 681; Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at 240).

However, the predominant position in national case law¹⁸⁵ rejects such an argument. Since the 2003 revision of the OECD Model, this is also reflected in the commentary on article 7(1) OECD MC regarding CFC legislation¹⁸⁶. In this and all subsequent versions of the commentary,¹⁸⁷ it has been stated that CFC rules should generally not be assumed to be in conflict with article 7(1) of the OECD Model, even though they impose an additional tax burden on parent companies with reference to profits earned by a non-resident subsidiary. The reason given is that a “tax so levied by a State on its own residents *does not reduce the profits* of the enterprise of the other State and may not, therefore, be said to have been levied on such profits.”¹⁸⁸ It should be noted, however, that some OECD member countries have declared their disagreement with this rather formalistic interpretation in an observation to the commentary on the OECD MC¹⁸⁹.

In 2017, the restrictive interpretation endorsed by the great majority has been confirmed in the model conventions themselves by the insertion of a new article 1(3), the so-called “saving clause”¹⁹⁰. It clarifies¹⁹¹ that in principle and unless otherwise specified, a tax treaty shall not affect the taxation, by a contracting state, of its own residents.¹⁹² Moreover, the 2017 revision of the OECD Model commentary explicitly stated that this also covers CFC legislation¹⁹³. Until today, only few tax treaties contain a saving clause, however.

In the light of the above, an IIR that technically operates like a conventional CFC rule can be expected to be considered compatible with Article 7(1) MC, too, in the great majority of bilateral tax treaty relationships. This notwithstanding, it is recommended to insert an explicit

¹⁸⁵ See the overview given by Dahlberg, W. (2013). The Taxation of Foreign Passive Income for Groups of Companies – General Report, 98a Cahiers de droit fiscal international: 16-56 (at 42-43); and the country reports in this volume. See also Blum, D. W., *supra* n. 145, at p. 519, with further references. The most notable exception in case law is the *Schneider* judgement of the French supreme court (Conseil d’État), see FR: CE, 28 June 2002, case no. 232276, *Schneider Electric*, RJF 10/02, no. 1080, accessible online at <https://www.legifrance.gouv.fr/affichJuriAdmin.do?idTexte=CETATEXT000008092462>. However, it should also be mentioned that the CE dealt with a particular version of a CFC regime that attributed the subsidiary’s profits directly to the parent company, and which has since been replaced by a deemed dividend concept that could no longer be challenged under article 7(1), even under its broad interpretation by the CE.

¹⁸⁶ Regarding the prior, more skeptical position of the OECD model commentary, see da Silva, B. (2020). 15 *Frontiers of Law in China* 2: 111-141 (at 129-130).

¹⁸⁷ The commentary on Art. 7 OECD MC is furthermore echoed in para. 8 of the commentary on Article 7 UN MC.

¹⁸⁸ See para. 10.1 of the Commentary on Article 7 OECD MC (2003) (now para. 14 of the Commentary on Article 7 OECD MC (2017)); emphasis added.

¹⁸⁹ See Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at 241).

¹⁹⁰ The savings clause has furthermore been included in Art. 11 (1) of the Multilateral Instrument (MLI) to facilitate its insertion in bilateral tax treaties.

¹⁹¹ As to the merely clarifying nature of Art. 1 (3) OECD MC according to the view of OECD member countries, see para. 81 of the commentary on Article 1 OECD MC.

¹⁹² See, e.g., Kofler, G. (2016). Some Reflections on the ‘Saving Clause’ 44 *Intertax* 8 & 9: 574-589 (at 580 and 588).

¹⁹³ See also OECD/G20 (2015), BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, 2015 Final Report, para. 61, with further reference to para. 6.1 of the commentary on Art. 1 OECD MC 2014.

statement to this effect in tax treaties that do not feature a saving clause. This should remove any eventual uncertainty that might arise from the aforementioned differences in legal opinions¹⁹⁴, especially in case of treaties concluded before the 2003 revision of the OECD Model.

By contrast, it is obvious that applying the IIR to the profits of foreign PEs that are established in a low-tax jurisdiction would contravene tax treaty law where the relevant treaty provides for the exemption of foreign PE profits¹⁹⁵. It is therefore necessary to amend such treaties, either by inserting the switch-over clause (SOR) proposed by the Blueprint, or by generally replacing the exemption method with the credit method¹⁹⁶.

All expedient or necessary treaty amendments could be made either through bilateral negotiations or by virtue of a multilateral convention. Under the premise of a global agreement on GloBE by all 139 member countries of the Inclusive Framework, third countries that have concluded an affected tax treaty with an EU Member State should be willing to agree to such amendments, even if they do not wish to implement GloBE themselves.

4.3.2. Collection top-up tax by way of an UTPR

In the GloBE Blueprint, it is stated that the UTPR, too, should normally be compatible with tax treaty law¹⁹⁷. In this context, it is first important to point out that the Blueprint does not specify how exactly the top-up tax shall be collected by the UTPR jurisdiction. The most likely approach is a limitation or denial of a deduction for intra-group payments; however, it would also be possible to levy an equivalent amount by way of a separate tax¹⁹⁸. Therefore, the following considerations cover both options. Nevertheless, it is noteworthy that if the EU were to adopt a directive that requires Member States to implement GloBE, it could also specify the exact collection mechanism to be applied vis-à-vis payments whose recipients are domiciled or established in third countries.

¹⁹⁴ In this regard, we agree with da Silva, B. (2020). 15 *Frontiers of Law in China* 2: 111-141 (at 132); and Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at 242).

¹⁹⁵ See Blum, D. W., *supra* n. 145, at p. 520. For a different opinion, see da Silva, B. (2020). 15 *Frontiers of Law in China* 2: 111-141 (at 133).

¹⁹⁶ See Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at 247).

¹⁹⁷ See OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, paras. 679-680.

¹⁹⁸ See OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 687.

4.3.2.1. Articles 9(1) and 7 (2) MC

First, it is necessary to address objections that have been raised against the UTPR with respect to Article 9(1) MC. The provision deals with commercial or financial relations between two associated enterprises, one of which is resident in a contracting State and the other is resident in the other contracting State. According to Article 9(1) MC, any profits that have not accrued to one of the associated enterprises due to a deviation from the arm's length principle in the dealings between the two enterprises, "may be included in the profits" of that enterprise and "taxed accordingly". According to the predominant view in case law and scholarly literature, Article 9(1) MC does not merely have a "permissive" or declaratory function. Instead, it is interpreted as confining the discretion of the residence state in determining the "right" amount of profits of an associated enterprise for income tax purposes to precisely this kind of adjustment. In other words, the profits allocated to an enterprise of a Contracting State due to its dealings with an associated enterprise of the other Contracting State must not exceed the amount of profit that would result from arm's length transactions. This position is also supported by the OECD Model¹⁹⁹. Arguably, this is the correct understanding, because Article 9(1) MC would otherwise be redundant.

However, the above does not necessarily imply that collecting top-up tax by virtue of the UTPR conflicts with Article 9(1) MC. In case of a deduction barrier, the latter conclusion could only be drawn assuming that Article 9(1) MC prohibits any kind of restriction on the deduction of arm's length payments regardless of its objectives and design. Under these circumstances, any denial of deduction would be considered an adjustment of the profits generated by transactions between associated enterprises, which therefore falls in the substantive scope of Article 9(1) MC²⁰⁰. By the same token, the collection of top-up tax as a separate tax in order to compensate for an under-taxation of the profits accrued to an associated enterprise of the other Contracting State would then have to be regarded as inconsistent with Article 9(1) MC.

However, this broad reading of Article 9(1) MC is not convincing. Its wording and context suggest a more restrictive understanding²⁰¹. The scope of application of Article 9(1) MC is limited to adjustments that increase the taxable profits of an associated enterprise because intra-

¹⁹⁹ See para. 2 of the Commentary on Article 9 of the OECD Model: "*No re-writing of the accounts of associated enterprises is authorised if the transactions between such enterprises have taken place on normal open market commercial terms (on an arm's length basis)*"; emphasis added.

²⁰⁰ See, e.g., Rust, A. (2015). Commentary on Art. 24, in Reimer, E., Rust, A. (eds.), *Klaus Vogel on Double Taxation Conventions*, Vol. 2, 4th ed., para 93, Kluwer Law International; Rust, A. (2015). Commentary on Art. 24, in Vogel, K., Lehner, M. (eds.), *Doppelbesteuerungsabkommen*, 6th ed., para. 139; possibly also Kofler, G., *Commentary on Art. 9*, in Reimer, E., Rust, A. (eds.), *Klaus Vogel on Double Taxation Conventions*, Vol. 2, 4th ed., para 15, Kluwer Law International).

²⁰¹ Likewise Marres, O. (2020). Interest Deduction Limitations: When To Apply Articles 9 and 24(4) of the OECD Model?, in Weber, D., Pistone, P. (eds.), *Non-Discrimination in Tax Treaties: Selected Issues from a Global Perspective*, 39-70 (at 41); da Silva, B. (2020). 15 *Frontiers of Law in China* 2: 111-141 (at 135). For a detailed discussion with further references, see Englisch, J., Becker, J. (2019), *International Effective Minimum Taxation – The GLOBE Proposal*, *World Tax Journal* 2019: 483-529 (at 519 et seq.).

firm transactions have inappropriately reduced those profits. Its underlying logic therefore implies that the profits of the other enterprise have been unduly inflated.²⁰² Consequently, Article 9(1) MC does not cover scenarios where the deduction of payments to an associated enterprise is denied for reasons other than claiming a larger share in the profit contribution potential of the commercial relationships between the two enterprises.

Thus, the UTPR should not be regarded as an infringement of treaties that follow Article 9(1) MC. While this form of effective minimum taxation makes levying an additional tax on the resident payer enterprise contingent upon the taxation of a non-resident associated enterprise's profits, it does not question the profit accrual. It rather claims that the non-resident enterprise's profits should have been taxed at a higher rate.

In a similar vein, Art. 7(2) MC does not hinder the collection of top-up tax from a PE established in a UTPR jurisdiction based on its deemed or notional payments to other Constituent Entities of the MNE²⁰³ (the head office, or another foreign PE of the same company). In this context, too, tax treaties following the modern OECD and UN Models require the application of the arm's length principle for the purpose of determining the amount of profit to be attributed to a particular PE. However, as clarified in the Commentary on Article 7(2) OECD MC, this provision imposes no limitations on the discretion of a Contracting State to declare certain expenses as non-deductible for the purpose of computing the taxable income²⁰⁴.

4.3.2.2 Article 24 MC

More serious concerns exist regarding the compatibility of the UTPR with the non-discrimination standards of Art. 24 MC.

In particular, if the UTPR were implemented in the form of a limitation or denial of deduction of intra-group payment, it must be assessed whether such an approach would be compatible with the non-discrimination clause of Article 24(4) OECD MC²⁰⁵. The provision stipulates that "[...] disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State." A similar non-discrimination standard is enshrined in article 24(4) UN MC. Both also

²⁰² Cf. Wassermeyer, F. (2018). Commentary on Art. 9, in Wassermeyer, F. (ed.), *Doppelbesteuerung: DBA*, para. 16.

²⁰³ Regarding the inclusion of such deemed or notional payments in the allocation formula of the UTPR, see OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 497.

²⁰⁴ See para. 30 of the Commentary on Art. 7 OECD MC; see also OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 689.

²⁰⁵ Since the UTPR could imply the (partial) denial of deductibility on grounds of the residence of the recipient of the payments in the other Contracting State if the MNE has a low ETR in this State.

contain a carve-out for, i.a., transfer pricing adjustments, which is however of no relevance in the context of an international effective minimum tax, as explained above.

Most commentators doubt that the collection of top-up tax by way of a limitation in the deductibility intra-group payments, as envisaged under the UTPR, can be reconciled with Article 24(4) MC²⁰⁶. The objections are similar to those that have been voiced with respect to the US BEAT regime²⁰⁷. By contrast, the Blueprint argues that Art. 24(4) MC, properly construed, does not hinder the collection of top-up tax by way of a (partial) denial of deduction for intra-group payments²⁰⁸. In the subsequent paragraphs, the most relevant aspects and arguments will be briefly discussed²⁰⁹.

However, it is pertinent to note at the outset that it is only the first step under the two-step process of determining the UTPR jurisdiction entitled to collect top-up tax that raises concerns with respect to Art. 24(4) MC, because under the first-step top-up tax would be apportioned and collected exclusively with respect cross-border intra-group payments from high-tax to low-tax jurisdictions. As stated in the Blueprint²¹⁰, “[u]nder the second step [...], deniability can arise in respect of any net related party expenditure, whether the payment is made to a domestic or foreign member of the group. [...] Under this step, therefore, the UTPR will apply in the same way to intra-group payments made to domestic and non-resident group entities without any distinction.” As a consequence, there is no discrimination on grounds of the residence of the recipient of the payment, and the second step of the UTPR is not susceptible to collide with Art. 24(4) MC²¹¹.

Clearly, the first step of the UTPR distinguishes between intra-group payments made to non-resident entities and similar payments made to resident entities of the MNE; only the former can attract a top-up tax liability. However, to find an infringement of the deductibility non-discrimination standard of Art. 24(4) MC, it would furthermore be necessary to establish that the denial of deductibility by virtue of the UTPR in a concrete case is prescribed by the GloBE rules *on grounds of* the residence of the recipient. The discrimination must be based on the

²⁰⁶ See da Silva, B. (2020). 15 *Frontiers of Law in China* 2: 111-141 (at 139-140); Blum, D. W., *supra* n. 145, at p. 520. See furthermore, by analogy, Marres, O. (2020). Interest Deduction Limitations: When To Apply Articles 9 and 24(4) of the OECD Model?, in Weber, D., Pistone, P. (eds.), *Non-Discrimination in Tax Treaties: Selected Issues from a Global Perspective*, 39-70 (at 55-57).

²⁰⁷ See, in this regard, Rosenbloom, H. D., Shaheen, F. (2018). The BEAT and the Treaties, 92 *Tax Notes Int'l* 1: (at 53-63).

²⁰⁸ See OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, paras. 690 et seq.

²⁰⁹ For a more extensive discussion, see *Englisch/Becker*, WTJ 2019, 483 (at 521 et seq.).

²¹⁰ OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 692.

²¹¹ See Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at 245).

residence, whereas other differentiation criteria are still permissible²¹². However, the necessary analysis is not straightforward and disputed in scholarly literature.

The predominant opinion in scholarly literature prefers a test that relies on a comparison with the counterfactual scenario of a hypothetical resident enterprise receiving the payment, all else being equal. To this effect, reference is made to the requirement of Article 24(4) MC that a deduction of disbursements should be granted “as if they had been paid to a resident”. If a presumed domestic residence of the payment recipient automatically implied that the restriction to the deduction of expenses would no longer apply, the criterion triggering the deduction can be assumed to be “inextricably linked” to the residence criterion. According to this view, the measure should then be regarded as violating Article 24(4) MC.²¹³ If this standard was applied to the first step of the UTPR, it would not pass scrutiny under Article 24(4) MC. As stated above, intra-group payments to an entity that is a resident of the UTPR jurisdiction would not attract any top-up tax and would thus still fully qualify for deduction. This would be the case regardless of the ETR of the UTPR jurisdiction.

However, the wording of Article 24(4) MC could also support a more restrictive interpretation. It could be assumed that a disadvantageous treatment of cross-border payments constitutes a discrimination *on grounds of* the residence of the recipient only where this criterion, in itself, triggers the denial of deduction²¹⁴. In a case where the non-deductibility of payments made to non-residents is contingent on additional criteria, the relevant counterfactual could thus also be whether the conditions, under which deductibility for cross-border payments is denied, could also be fulfilled in a purely internal scenario, so that it is only the residence of the recipient that causes the difference in treatment. Under such an approach, which is the one apparently underlying the reasoning in the Blueprint, the first step of the UTPR could not be found to be in violation of Art. 24(4) MC. A jurisdiction can only qualify as UTPR jurisdiction if the MNE profits that are attributable to it are taxed at an ETR at or above the minimum rate²¹⁵. By contrast, cross-border intra-group payments to entities that are domiciled or established in another State can only be affected by the first step of the UTPR if this other State is a low-tax jurisdiction for the MNE with an ETR below the minimum rate. As a consequence, the hypothetical case of a similar intra-group payment to a domestic entity would never meet the criteria for the collection of top-up tax.

²¹² See, e.g., Rust, A. (2015). Commentary on Art. 24, in Reimer, E., Rust, A. (eds.), *Klaus Vogel on Double Taxation Conventions*, Vol. 2, 4th ed., para 98, Kluwer Law International.

²¹³ See, e.g., Bammens, N., Vanistendael, F. (2021). Commentary on Art. 24, sec. 1.1.2.2., in Pistone (ed.), *Global Tax Treaty Commentaries*, IBFD; Rust, A. (2015). Commentary on Art. 24, in Reimer, E., Rust, A. (eds.), *Klaus Vogel on Double Taxation Conventions*, Vol. 2, 4th ed., para 93, Kluwer Law International.

²¹⁴ See also Rust, A. (2021). Commentary on Art. 24, in Ismer, R. (ed.), *Doppelbesteuerungsabkommen*, 7th ed., para. 132.

²¹⁵ See OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 488.

Considering that it is disputable which of the aforementioned approaches is the correct one, it would in any event be desirable to have a clarification in the respective commentary on the OECD Model and the UN Model, and if considered necessary, a modification of tax treaties with a corresponding non-discrimination clause.

Finally, it should be added that there would be no infringement of Art. 24(3) MC in a case where the UTPR applied to the deemed payments made by a PE to its foreign head office. Article 24(3) requires that the taxation on a PE shall not be less favourably levied than that on resident enterprises carrying on the same activities. However, the UTPR does not distinguish between a PE of a foreign MNE entity and a resident MNE entity²¹⁶.

4.3.3. Withholding taxes levied by virtue of the STTR

It is evident that the levy of withholding taxes on certain payments on grounds of their low nominal taxation in the country of the recipient would run counter to tax treaties that either do not allow for any withholding taxes on the relevant category of income at all, or only at a lower rate. In particular, this concerns tax treaties guided by Articles 11 and 12 OECD MC regarding interest and royalty payments. Therefore, the Blueprint acknowledges the need to amend the relevant treaties with a stand-alone STTR²¹⁷.

²¹⁶ See Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at 246).

²¹⁷ For an extensive discussion, also regarding the interaction with Art. 23 MC, see Andrade Rodríguez, B., Nouel, L. (2021) in: Perdelwitz, A., Turina, A. (eds.). *Global Minimum Taxation?*, pp. 283-312 (at 250 et seq.).

5. Overlap with existing EU legislation and standards

In this section, we identify potential overlap between existing Union legislation in tax matters and the introduction of an EU minimum tax regime modelled after the GloBE proposal. To this effect, we discuss the Anti-Tax-Avoidance Directive (ATAD), the Interest and Royalties Directive (IRD), the Parent-Subsidiary Directive (PSD), and the Merger Directive. We will analyse to what extent, if any, those instruments would interact with a harmonised GloBE minimum tax directive. Where appropriate, we will furthermore point out which clarifications or amendments are needed either in eventual Union legislation on GloBE or in the existing tax legislation. Moreover, we also briefly comment on the relationship between a harmonised GloBE-style minimum tax and the soft law standards established by the Code of Conduct for Business Taxation²¹⁸.

5.1. Anti-Tax Avoidance Directive (ATAD)

The Anti-Tax Avoidance Directive was inspired by the BEPS 1.0 project²¹⁹; it was adopted in July 2016 (ATAD I²²⁰) and amended a year later (ATAD II²²¹). It stipulates minimum standards for certain anti-abuse measures that Member States must apply as from 1 January 2019. As acknowledged by the Commission in its Communication on Business Taxation for the 21st Century, implementation of GloBE would have implications for existing rules under the ATAD²²². In the following, each of the measures contained in the ATAD is therefore examined with respect to any eventual overlap with a GloBE minimum tax.

5.1.1. General Anti-Avoidance Rule (GAAR)

The measure: Art. 6 ATAD lays down a general anti-avoidance rule (GAAR). If certain criteria indicating an artificial arrangement that defeats the object or purpose of the applicable tax law in order to obtain a tax advantage are met, the arrangement is ignored “[f]or the purposes of calculating the corporate tax liability”.

Potential overlap: In principle, there is no problematic interference between the general anti-avoidance rule (GAAR) of Article 6 ATAD and GloBE. Both instruments are complementary: Where the application of the GAAR leads to the imposition of a higher corporate tax liability, because tax optimisation arrangements are ignored, this will increase the ETR of the jurisdiction to which the additional covered tax is attributable for GloBE purposes.

²¹⁸ OECD/G20 (2013), Action Plan On Base Erosion And Profit Shifting, p. 14.

²¹⁹ See recitals (1) to (3) of the preamble to Directive EU/2016/1164.

²²⁰ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ 193/1.

²²¹ Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, OJ L 144/1.

²²² EU Commission, Communication on Business Taxation for the 21st Century, 18 May 2021, COM(2021) 251 final, p. 8.

However, it is unclear whether Article 6 ATAD would require EU Member States to implement the harmonised GAAR also with respect to artificial arrangements that seek to circumvent the GloBE minimum tax itself. This depends on whether the top-up tax to be collected through the IIR or UTPR qualifies as a “corporate tax liability”. The October 2020 Blueprint does not explicitly designate the top-up tax as an additional corporate income tax, which also reflects the fact that the “covered” taxes to be taken into account when calculating the ETR include taxes levied “in lieu of a generally applicable corporate income tax”²²³.

Recommendation: Unless the top-up tax revenue was to fully become an own resource of the EU, it should be left at the discretion of each Member State whether it characterises the top-up tax as an additional corporate income tax or as a separate *sui generis* tax. In some Member States with fiscal federalism, this might have implications for the internal allocation of tax revenue, with which Union legislation should not interfere. In order to ensure a uniform approach against eventual attempts to circumvent the GloBE minimum tax regime, a GAAR that could be modelled after Art. 6 ATAD should be included in the GloBE legislation itself. In terms of legal certainty, this would moreover also be preferable to a mere reliance on the general principle of prohibition of abuse of Union law, as established in settled case law of the CJEU²²⁴.

5.1.2. Interest Limitation Rule

The measure: Art. 4 ATAD transforms the BEPS Action 4 recommendations on the limitation on interest deductions into Union law. Net interest payments that exceed 30 percent of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA) must not be deducted from the tax base if the taxpayer is a member of a consolidated group of companies. By virtue of an escape clause, interest payments are fully deductible if the payor company can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group to which it belongs. Borrowing cost that exceeds 30 percent and is therefore non-deductible in a given period can be carried forward or backward depending on the detailed rules of each Member State.

Potential overlap: Intra-group interest payments between members of an MNE group within the personal scope of GloBE can trigger the application of the *subject to tax rule* (STTR) contemplated in Chapter 9 of the October 2020 Blueprint, if the payments benefit from low nominal rates of taxation in the jurisdiction of the payee. Based on corresponding domestic legislation, this may result in the levy of a minimum withholding tax on the interest payments. The STTR is conceived as a measure that specifically targets risks to source jurisdictions posed

²²³ OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 139.

²²⁴ See, e.g. CJEU, 22 November 2017, Case C-251/16, Cussens, ECLI:EU:C:2017:881, paras. 30 et seq.; CJEU, 26 February 2019, Cases C-115/16, C-118/16, C-119/16, C-299/16, “Danish cases”, ECLI:EU:C:2019:134, paras. 95 et seq.

by BEPS structures relating to intragroup payments²²⁵. Its objective thus overlaps with the purpose of the Interest Limitation Rule, which seeks to discourage BEPS through “excessive” interest payments²²⁶.

Moreover, deductible intra-group interest payments made by UTPR taxpayer are taken into account for determining the proportion of top-up tax to be collected by a UTPR jurisdiction in case that the IIR does not apply²²⁷. While several different collection techniques could be used to collect top-up tax under the UTPR, the version most likely to be either prescribed in a GloBE minimum tax directive or employed by Member States at their own discretion is the partial denial of deduction of such payments. In this case, both the anti-BEPS objective and the chosen mechanism would overlap with the Interest Limitation Rule. By contrast, no such overlap would occur if a different collection mechanism was devised for the intra-EU application of the GloBE, as discussed above in chapter 4 (collection of the top-up tax directly from the under-taxed entity).

Recommendation: The GloBE concept does not aim at substituting the BEPS 1.0 recommendations and targeted anti-avoidance measures. Instead, it has been conceived as a complementary, broad anti-BEPS measure. This implies that in principle, the application of the Interest Limitation Rule should not be hindered by the application of the UTPR²²⁸. This is also the conclusion drawn in the Blueprint, pursuant to which both regimes should co-exist. In particular, according to the Blueprint, specific limitations on the deductibility of intra-group payments, such as interest limitation rules, should also be disregarded for determining the portion of top-up tax to be collected in the respective UTPR jurisdiction, by deeming affected intra-group payments as deductible²²⁹. Therefore, no amendments to the ATAD are required even if the UTPR was maintained as a top-up tax collection mechanism.

This notwithstanding, it should be re-evaluated whether the Interest Limitation Rule – given its complexity – is still needed as a targeted anti-BEPS instrument once GloBE comes into effect. Its elimination would not run counter to the commitments made by individual EU Member States under BEPS 1.0, because Action 4 is not a BEPS minimum standard.

²²⁵ OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 567.

²²⁶ See recital (6) of the preamble to Directive EU/2016/1164.

²²⁷ OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 480 and 486.

²²⁸ Likewise Nogueira, J. F. P. (2020). GloBE and EU Law: Assessing the Compatibility of the OECD’s Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, *World Tax Journal* 2020: 465-498 (at 490).

²²⁹ See OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 494.

Since the application of the Interest Limitation Rule eliminates any BEPS risks associated with the affected intra-group interest payments that are no longer deductible, it would not be justified to apply an additional anti-BEPS measure that targets the same BEPS risks and payments. The GloBE minimum tax directive should therefore stipulate that the STTR must not be applied to the extent that interest payments are non-deductible pursuant to Art. 4 ATAD. As a caveat, the STTR could be applied to an eventual carry forward or carry back of non-deductible payments. Finally, the escape clause of Art. 4 (5) ATAD should not hinder the application of either, the UTPR or the STTR, because its rationale differs from those of the aforementioned instruments.

5.1.3. Exit Taxation

The measure: Art. 5 ATAD on exit taxation has no parallel in the BEPS 2015 recommendations. The provision requires Member States to levy an exit tax accrued gains on occasion of certain qualifying cross-border transfers of business assets. Notably, the provision also covers the deemed transfer of (usually: intangible) assets due to a corporate relocation. A transfer of asset to another EU/EEA Member State qualifies for a deferral of the tax payment; the exit tax must then be paid in instalments over five years.

Potential overlap: There is no problematic overlap between the rules on exit taxation and the GloBE rules. The exit tax will normally increase the ETR of the jurisdiction where it is levied. Quite the contrary, the exit tax on corporate relocations complements the UTPR in its function as a backstop to the IIR (and to the GloBE in general) by further reducing the incentives for tax driven inversions²³⁰.

Recommendation: There is no need to amend Art. 5 ATAD. Instead, the provision constitutes an important building block for a robust implementation of GloBE, especially if the EU were to be among the first adopters.

5.1.4. Controlled Foreign Company (CFC) Rule

The measure: Broadly in line with the 2015 BEPS Action 3 report that sets out “building blocks” for the design of CFC rules, the ATAD prescribes the adoption of CFC regimes in all EU Member States. As a consequence, the majority of the almost 50 CFC rules enacted by member jurisdictions of the BEPS Inclusive Framework is now operated by EU Member States²³¹. The ATAD creates a minimum standard for CFC regimes that many EU Member States have gone beyond. Pursuant to Art. 7 (1) ATAD, each Member State must apply the CFC rules to low-taxed controlled foreign entities (companies and permanent establishments), at least regarding certain categories of “passive” income or with income from artificial

²³⁰ Regarding this purpose of the UTPR, see OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 457.

²³¹ See OECD (2020), Corporate Tax Statistics, 2nd ed., accessible online at <https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-second-edition.pdf>, p. 49.

arrangements. The foreign entity must be regarded as under-taxed if the “actual corporate tax paid” on its profits is less than half of the tax that would have been levied on similar profits of a domestic entity. The qualifying CFC income is then to be included in the tax base of the parent company in proportion to its participation in the foreign entity, and to be taxed at the regular rate with a foreign tax credit. Member States may provide for certain *de minimis* exceptions, but not for a generous consolidated group revenue threshold as envisaged for GloBE in the 2020 Blueprint. However, in a nod to the case law of the CJEU regarding the compatibility of CFC regimes with EU/EEA fundamental freedoms, Art. 7 ATAD requires to refrain from taxing CFC profits if the company or PE carries out a “substantive economic activity”. Finally, for the purposes of the CFC rule, the income of the foreign under-taxed entity shall be calculated in accordance with the rules of the corporate tax law of the Member State where the CFC taxpayer is resident or situated.

Potential overlap: The potential overlap of GloBE with traditional CFC rules has already been analysed in some detail in scholarly literature²³² and has been emphasized by the EU Commission²³³.

Some commentators suggest that expanding the traditional CFC rules is preferable over the introduction of a GloBE-style international effective minimum tax, especially if the latter contains a carve-out for substance-based activities that, according to this view, broadly reflects the “passive” income approach underlying a classical CFC regime²³⁴. We do not agree with this conclusion, because the concept of an internationally coordinated effective minimum tax entails a number of distinct advantages and pursues additional objectives in comparison to a traditional CFC regime. Having a common base and a common minimum ETR for all participating jurisdictions facilitates the international coordination of GloBE and reduces the risk of international head office competition and tax-driven inversions. Both of those elements, in turn, imply to phase in GloBE with relatively high thresholds, to ensure proportionate compliance and administrative costs²³⁵. Moreover, one key objective of an internationally coordinated GloBE consists in establishing a floor for excessive international tax competition, as recently confirmed by the EU Commission. And while this objective would be somewhat qualified by a substance-based carve-out, it would continue to be an important feature of GloBE as long as the carve-out does not apply to income derived from the exploitation of intangible assets. By

²³² See Arnold, J. B. (2019). The Evolution of Controlled Foreign Corporation Rules and Beyond, 73 Bulletin for International Taxation 12: 631-648 (at 642 et seq.); Hey, J. (2021). The 2020 Pillar Two Blueprint: What Can the GloBE Income Inclusion Rule Do That CFC Legislation Can’t Do?, 49 Intertax 1: 7-13; De Lillo, F. (2021), in: Perdelwitz, A., Turina, A. (eds.). Global Minimum Taxation?, pp. 3-30 (at 14).

²³³ See EU Commission, Communication on Business Taxation for the 21st Century, 18 May 2021, COM(2021) 251 final, pp. 8-9.

²³⁴ See Arnold, J. B. (2019). The Evolution of Controlled Foreign Corporation Rules and Beyond, 73 Bulletin for International Taxation 12: 631-648 (at 642 et seq.); Hey, J. (2021). The 2020 Pillar Two Blueprint: What Can the GloBE Income Inclusion Rule Do That CFC Legislation Can’t Do?, 49 Intertax 1: 7-13.

²³⁵ See OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, paras. 114 et seq.

contrast, unilateral CFC regimes are neither intended nor suited to pursue such an objective. Instead, they provide countries with flexibility for a targeted and stringent approach against a range of clearly defined BEPS risks²³⁶. Against this backdrop, it is more likely – and more adequate – that traditional CFC rules would continue to operate alongside GloBE, at least for a considerable transition period. This is also the solution of the US GILTI regime.

Notwithstanding the above, there is a considerable degree of interaction between the two instruments on a technical level, under the premise that they would co-exist. As a tax collection mechanism, the GloBE's IIR is modelled closely after a classical CFC regime such as the one laid down in Art. 7 and 8 ATAD and operational in all EU Member States. Both approaches imply the imposition of compensatory additional taxes at the level of the (ultimate) parent company when the ETR on profits of foreign controlled entities is too low. In determining the amount of additional tax, the foreign tax paid by the CFC or PE itself and the participation share of the parent company are taken into account, respectively. Also from a technical perspective, there exists thus a broad overlap between CFC rules and the IIR.

Recommendations: CFC rules are generally less comprehensive regarding their substantive scope than the GloBE effective minimum tax regime would be, due to the limitation to certain categories of “passive” income. However, with respect to those specific sources of foreign income, national CFC rules – including the corresponding ATAD minimum standard – represent the stricter, further-reaching approach; this reflects their focus on combating a relatively narrow set of clearly defined BEPS risks and maintaining capital export neutrality for those “passive” investments. The “actual” or effective tax rate is calculated “per entity” without jurisdictional blending, the CFC income eventually included in the tax base of the parent company is taxed at the regular domestic rate, and no group revenue thresholds apply. It would therefore seem reasonable to prioritize this more targeted approach over the application of the GloBE rules²³⁷. This is also the assumption underlying the October 2020 Blueprint on GloBE²³⁸. This relationship should be clarified either in the ATAD or in the Union legislation implementing the effective minimum tax.

Under this premise, it is necessary to decide whether the taxes paid under CFC rules should be assigned to the jurisdiction of the taxpayer (i.e., the parent company jurisdiction) or to the jurisdiction where the low-taxed CFC or PE is resident or established. Furthermore, the same question would also arise, if a collection mechanism different from the IIR was chosen for the

²³⁶ See OECD/G20 (2015). BEPS Action 3: Designing Effective Controlled Foreign Company Rules, 2015 Final Report, pp. 13 et seq.

²³⁷ Likewise Nogueira, J. F. P. (2020). GloBE and EU Law: Assessing the Compatibility of the OECD's Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, *World Tax Journal* 2020: 465-498 (at 490).

²³⁸ See OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 145.

intra-EU implementation of the GloBE, as discussed in chapter 4. According to the Blueprint, “CFC taxes should be assigned, where possible, to the jurisdiction in which the underlying income arises (i.e. to the jurisdiction of the CFC)”²³⁹. This corresponds to the rationale of the two instruments: if the low level of taxation in a particular jurisdiction is already neutralized through the application of a CFC regime, at least regarding certain local activities and entities, there is no – or a correspondingly lesser – need to address associated BEPS risks and excessive tax competition through the levy of a top-up minimum tax. The collection of CFC taxes should therefore be reflected in a higher ETR for GloBE purposes, which can be ensured by adding foreign CFC taxes to the other covered taxes that are attributable to the MNE entities that are resident in the low-tax jurisdiction. At first sight, an alternative could consist in crediting the CFC tax against an eventual GloBE top-up tax in the jurisdiction of the parent company. However, such an approach cannot be consistently pursued, because it is unfeasible where a jurisdiction other than the IIR jurisdiction has collected the CFC tax.

A technical challenge still exists with respect to the determination of the share of CFC taxes in the overall corporate tax liability of the parent company that should be “pushed down” to the subsidiary for calculating its ETR. This requires potentially complex calculations, because the CFC income might not be fully included in the regular tax base in the parent jurisdiction, foreign tax credits might not be strictly limited to the taxes levied on the profits of each individual CFC, etc. The problem is currently discussed in the relevant OECD Working Parties with the objective to develop an accurate but workable approach. It is recommended to assess an eventual proposed solution with a view towards implementing it for an EU effective minimum tax, as well.

Finally, the Union legislator might wish to reconsider the carve-out for substance-based activities currently required by Art. 7 (2) (a) ATAD in the light of eventual modifications of the top-up tax collection mechanism for GloBE purposes. We propose to levy the top-up tax not at the level of the (ultimate) parent company but to designate the undertaxed subsidiary itself as the taxpayer, while the tax liability could still arise in the “IIR”-jurisdiction (see chapter 4). The rationale underlying our proposal is to avoid precisely the kind of far-reaching carve-out for the purposes of applying the IIR that is required for national CFC regimes by Art. 7 (2) (a) ATAD as a concession to the CJEU jurisprudence on the compatibility of conventional CFC tax collection mechanisms with the EU/EEA free movement rights. If the harmonized CFC rules were amended along the same lines, i.e. if the CFC tax were to be collected directly from the EU/EEA-based subsidiary, the “substantial activity test” that currently undermines their effectiveness in intra-EU/EEA scenarios (and which would seriously undermine the effectiveness of GloBE) could also be eliminated.

²³⁹ Ibid.

5.1.5. Hybrid mismatches

The measure: Member States are obliged to neutralise the effects of certain hybrid mismatch arrangements by virtue of Art. 9 ATAD, which is inspired by the recommendations of the report on BEPS Action 2. The provision covers both, mismatches that result in a double deduction (DD) and mismatches that result in a deduction without inclusion (D/Ni); it is furthermore complemented by Art. 9b ATAD addressing tax residency mismatches. Art. 9 ATAD provides a set of priority rules to ensure single taxation in one of the two jurisdictions involved; technically this is supposed to be achieved by either denying a deduction or by including the income, as applicable. Art. 9 (3) ATAD extends the anti-hybrid rules to conduit arrangements.

Potential overlap: The anti-hybrid rules broaden the tax base and thus potentially increase the tax liability of the MNE entity that is affected by the denial of deduction or by the income inclusion. Any such increased tax burden will automatically be reflected in a higher ETR for GloBE purposes in the jurisdiction where the respective entity is resident.

However, there is a potential conflict with respect to the UTPR, if the Union legislator chooses to maintain this collection mechanism also intra-EU. As explained above in the context of the Interest Limitation Rule (at 4.1.2.), the application of the UTPR will likely result in a – partial – denial of deduction for payments made to another MNE entity in the payer jurisdiction. Depending on the applicable priority rule, the same effect of a – full – denial of deduction can occur due to an anti-hybrid rule designed in conformity with Art. 9 ATAD. In this case, the anti-BEPS objective and the chosen mechanism of both instruments would overlap.

Moreover, in a D/Ni scenario, there is also an overlap with the STTR. As we have already outlined, the STTR is conceived as a measure that targets BEPS risks of source jurisdictions posed by specific categories of intra-group payments. However, where the anti-hybrid rule results in a denial of deduction for such payments, any eventual BEPS risks associated with the payment in the payer jurisdiction are already fully neutralized. As a caveat, this need not be the case where the second-order rule prescribed in Art. 9 (2) (b) applies and the mismatch is neutralized by way of an income inclusion in the payee jurisdiction. Depending on the level of taxation in the latter country, incentives to erode the source-country tax base through intra-group payments may be reduced but not fully eliminated.

Recommendation: Our recommendation regarding the rules for the interaction between the anti-hybrid rules and the GloBE effective minimum tax goes in the same direction as our suggestions relating to the Interest Limitation Rule (above at 4.1.2.).

As the more targeted anti-avoidance rule, Art. 9 ATAD and its national implementation should not be pre-empted by the application of the UTPR. This should be explicitly laid down in an amendment to Art. 9 ATAD, because, according to the Blueprint, the eventual non-deductibility of the relevant payments under Art. 9 ATAD will not automatically result in their exclusion

from the formula used for the purpose of determining the allocation of top-up tax to the several UTPR jurisdictions.

In any event, for the same reasons as in the context of the Interest Limitation Rule, the STTR should not apply to the extent that intra-group payments are non-deductible pursuant to Art. 9 ATAD. This should be detailed in the GloBE minimum tax directive.

Since the anti-hybrid rule is directed not only against base erosion and profit shifting, but also seeks to ensure the fundamental principle of single taxation, it is less obvious than in case of the Interest Limitation Rule that it could become obsolete once an effective minimum tax regime is implemented.

5.2. Parent Subsidiary Directive (PSD)

The Parent Subsidiary Directive²⁴⁰ establishes a common system of taxation for cross-border profit distributions within the EU internal market if the shareholding of the parent in the subsidiary reaches a 10 % threshold. Pursuant to its preamble, the objective of the PSD is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company²⁴¹. The PSD is therefore not only concerned with juridical double taxation, but also with economic double taxation. Thus, it addresses both, the taxation of the profit distribution in the source country and its taxation in the jurisdiction where the receiving entity is resident or established.

The relevant provisions: According to Art. 5 PSD, profits that a subsidiary distributes to its parent company shall be exempt from withholding tax.

Pursuant to Art. 4 (1) PSD, each Member State can and must choose between two options for the taxation of dividend income at the level of the parent company²⁴². A Member State can exempt dividend income if the profit distribution was not deductible by the subsidiary; to ensure single taxation, it must then correspondingly include the dividend income in the tax base of the parent where the profit distribution was treated as a deductible payment at the level of the subsidiary. Alternatively, a Member State can also opt for a system of general taxation of intra-group dividend income. It must then provide for an (ordinary) foreign indirect tax credit regarding the corporation tax corresponding to the distributed profits that was paid by the subsidiary and any lower-tier subsidiary.

²⁴⁰ Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345/8.

²⁴¹ Recital 3 of the preamble to Directive 2011/96/EU.

²⁴² See also CJEU, 17 May 2017, Case C-365/16, Association française des entreprises privées and Others, ECLI:EU:C:2017:378, para. 22.

Potential overlap: In principle, there is no conflict between ruling out withholding taxes in Art. 5 PSD and the STTR, because the latter rule would not apply to profit distributions²⁴³. Theoretically, an overlap could occur if the source country treated the return on a hybrid financial instrument as deductible interest payment under its domestic tax law, whereas the payment had to be qualified as “profit distribution” in the context of Art. 5 PSD due to an autonomous interpretation of this Union law concept. However, this is an unlikely scenario. Moreover, it is unclear whether Art. 5 PSD would cover such hybrid payments.

In contrast to the literature²⁴⁴ from before the publication of the October 2020 Blueprint, we do not see any problematic overlap between Art. 5 PSD and the UTPR. First, the application of the UTPR is contingent upon deductible intra-group payments, whereas profit distributions covered by Art. 5 PSD are not normally deductible at the level of the subsidiary. Second, even where this would exceptionally be different and where the dividend payment would be deductible, the UTPR should not result in the levy of a withholding tax. Instead, the source country would then typically collect top-up tax from the subsidiary by partially denying the deductibility of the payment, or through an otherwise increased tax liability of the subsidiary. However, it is settled case law of the Court that, in order for a tax to be classified as a withholding tax within the meaning of Article 5 PSD, three cumulative criteria must be satisfied: (1) The tax must be levied in the State in which the dividends are distributed and its chargeable event must be the payment of dividends; (2) the taxable amount is the income from those shares; and (3), the taxable person is the holder of the shares²⁴⁵. The UTPR is a mere collection mechanism for the GloBE top-up tax liability that arises due to the general under-taxation of certain MNE entities and not in relation to a particular intra-group payment, it is calculated based on the ETR of a particular jurisdiction, and the taxable person is the paying entity, i.e. in case of deductible dividend payments the subsidiary. Therefore, the UTPR fulfils none of the aforementioned three criteria and is therefore not covered by Art. 5 PSD.

By contrast, it is possible that the collection of top-up tax on undertaxed profits of foreign subsidiaries via the IIR would not be fully compatible with the exemption method contemplated in Art. 4 (1) (a) PSD as one of the options for the tax treatment of dividend income. Admittedly, the CJEU has not yet decided whether Art. 4 (1) PSD also governs the tax treatment of profits that have not yet been distributed by the subsidiary and that have thus not yet been received by the parent company, and the wording of the provisions suggests otherwise. However, for reasons of *effet utile* and considering the rationale of the PSD that aims at eliminating economic

²⁴³ See OECD (2020). Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 591.

²⁴⁴ See Nogueira, J. F. P. (2020). GloBE and EU Law: Assessing the Compatibility of the OECD’s Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, *World Tax Journal* 2020: 465-498 (at 491).

²⁴⁵ See CJEU, 17 May 2017, Case C-68/15, “X”, ECLI:EU:C:2017:379, para. 63, with further references.

double taxation, it is now predominant opinion in scholarly literature that a purposive construction of Art. 4 (1) PSD requires to extend this norm at least to deemed profit distributions under a CFC regime²⁴⁶. It has furthermore been argued by some that, for similar reasons, the provision should even apply to any kind of taxation of the profits generated by the subsidiary in the jurisdiction of the parent company, notably also where a CFC regime does not operate on the basis of deemed dividends but merely through income inclusion²⁴⁷. Based on this – albeit controversial – understanding of Art. 4 (1) PSD, CFC taxes are incompatible with the PSD unless they are either justified by the anti-avoidance rule of Art. 1 (4) PSD or provide an indirect foreign tax credit as required by Art. 4 (1) (b) PSD. Against this background, it has recently been assumed that the collection of top-up tax on undertaxed foreign profits via the IIR could collide with Art. 4 (1) PSD²⁴⁸. In particular, while the calculation of the amount of top-up tax takes into account the covered taxes that are attributable to the subsidiaries in the low-tax jurisdiction, this is not equivalent to an indirect tax credit for the corporation tax paid there by the subsidiary, and moreover for the corporation tax paid by any lower-tier subsidiary which might also be domiciled in a third country. And as we have explained in chapter 4, the GloBE concept would not necessarily meet the strict standards of an anti-abuse measure within the meaning of Union law. In addition, it is settled case law that Art. 4 (1) (a) PSD prohibits any form of taxation, irrespective of its classification as a traditional corporation tax²⁴⁹.

Finally, a potential overlap exists between the anti-hybrid rule that has been built into Art. 4 (1) (a) PSD and the application of the UTPR to such hybrid payments. If the source country qualifies them as deductible interest payments, this could give rise to taxation under both instruments: Art. 4 (1) (a) PSD would require the parent company jurisdiction to tax the dividend income, while the source country (i.e. the jurisdiction where the subsidiary is resident) might have to collect top-up tax in proportion to the deductible intra-group hybrid payment, most likely by partially denying deductibility. One might argue that, in the latter case, the anti-hybrid rule of Art. 4 (1) (a) PSD should no longer apply; however, this could lead to rather arbitrary results, depending on the mechanism that the UTPR jurisdiction chooses for collecting

²⁴⁶ See, e.g., Helminen, M. (1999). *The Dividend Concept in International Tax Law*, pp. 209 and 238; Aigner, H.-J., Scheuerle, U., Stefaner, M. (2005). *General Report*, in: Lang, M., Aigner, H.-J., Scheuerle, U., Stefaner, M. (ed.), *CFC Legislation, Domestic Provisions, Tax Treaties and EC Law*, pp. 13-52 (at 49 et seq.); Schönfeld, J. (2005). *Hinzurechnungsbesteuerung und Europäisches Gemeinschaftsrecht*, pp. 406 et seq.; Rust, A. (1993). *Hinzurechnungsbesteuerung*, pp. 112 et seq. For a different opinion, see, e.g., Schön, W. (1993). *Die Auslegung europäischen Steuerrechts*, p. 73; Englisch, J., Schütze, A. (2005). *The Implementation of the EC Parent-Subsidiary Directive in Germany – Recent Developments and Unresolved Issues*, *European Taxation* 2005: 488-499 (at 498).

²⁴⁷ See, e.g., Rust, A. (2007). *Hinzurechnungsbesteuerung*, pp. 115-116. For a different opinion, see, e.g., Advocate General Léger, 2 May 2006, Case C-196/04, *Cadbury Schweppes*, ECLI:EU:C:2006:278, para. 7 (concerning the predecessor version of the current PSD).

²⁴⁸ See Nogueira, J. F. P. (2020). *GloBE and EU Law: Assessing the Compatibility of the OECD's Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market*, *World Tax Journal* 2020: 465-498 (at 491).

²⁴⁹ See CJEU, 17 May 2017, Case C-365/16, *Association française des entreprises privées and Others*, ECLI:EU:C:2017:378, para. 33.

the top-up tax (unless Union legislation were to prescribe the partial denial of deductibility as the only admissible method).

Obviously, no conflict between the operation of the GloBE effective minimum tax and Art. 4 (1) PSD would arise if intra-EU top-up tax was not collected by means of an IIR or UTPR, but directly from the under-taxed subsidiary, as discussed above in chapter 4.

In any event, the waiver of withholding taxes and dividend taxation required by Art. 4 (1), 5 PSD would not reduce the ETR of either the source or the residence country and, thus, would not trigger (additional) top-up tax liabilities. The source country, i.e. the Member State where the subsidiary is resident, is not affected because the dividend income that must be exempt from withholding tax is attributable to the parent company and thus of no relevance for the calculation of the ETR of the source country. The resident country (home of the parent company) will not see its ETR decreased due to the lack of dividend taxation, either, because intra-group dividends will be excluded from the GloBE base.

Recommendations: The Union legislator should clarify whether Art. 5 PSD also applies to hybrid payments that are qualified as deductible interest payments in the source country. In our view, this should not be the case; instead, it should be declared that the prohibition of withholding taxes for interest and royalties pursuant to Art. 1 (1) IRD applies to such payments²⁵⁰. If a different approach was chosen and Art. 5 PSD was considered applicable based on some objective Union law criteria for classifying hybrid instruments as equity, the directive on the EU minimum tax would have to provide for a carve-out with respect to the STTR.

The prescriptions of Art. 4 (1) PSD regarding the treatment of profit distributions in the jurisdiction of the parent company could continue to apply alongside a harmonised effective minimum tax if the collection mechanisms for the top-up tax were modified as suggested in chapter 4. Otherwise, i.e. if the top-up tax was to be collected via the IIR and the UTPR in intra-EU relationships, it should be clarified in the minimum tax directive that the IIR applies “notwithstanding” Art. 4 (1) PSD. Alternatively, a carve-out for the collection of top-up tax could be inserted in Art. 4 (1) PSD itself²⁵¹. In any event, Art. 4 (1) (a) PSD should be amended so as to ensure that its anti-hybrid element will operate independently of an eventual application of the UTPR to payments on hybrid instruments; this is in line with our above suggestion relating to Art. 9 ATAD.

²⁵⁰ Regarding the relationship between Art. 1 (1) IRD, on the one hand, and the STTR and UTPR, on the other hand, see below at 5.3.

²⁵¹ This has been suggested by Nogueira, J. F. P. (2020). GloBE and EU Law: Assessing the Compatibility of the OECD’s Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, *World Tax Journal* 2020: 465-498 (at 491).

5.3. Interest and Royalties Directive (IRD)

The Interest and Royalties Directive²⁵² establishes a common system of taxation for cross-border interest and royalty payments made between associated companies of different Member States. The personal scope of the IRD requires a 25 % minimum holding and thus a higher participation threshold than the PSD. According to the CJEU, it can be inferred from the preamble to the Directive that the IRD aims to avoid (only) “legal double taxation” of cross-border interest and royalty payments²⁵³. Pursuant to Article 1 (1) IRD, this is to be achieved by sparing the interest or royalty income from taxation in the source Member State. In 2011, the Commission has tabled a proposal in order to establish the single tax principle in the IRD by introducing a subject-to-tax clause in Article 1 (1)²⁵⁴. However, the proposal has not been adopted in Council.

The relevant provision: Pursuant to Art. 1 (1) and (2) IRD, qualifying interest or royalty payments shall be exempt from any taxes imposed on those payments in the source State, whether by deduction at source or by assessment. The following paragraphs of Art. 1 IRD specify that for the tax exemption to apply, the beneficial owner of the payments must be an associated company or a PE of an associated company that is resident or established in another Member State. Certain hybrid instruments are excluded from the substantive scope of the Directive by virtue of Art. 4 (1) IRD; currently a case is pending before the CJEU whether returns on such investments are then covered by Art. 5 PSD²⁵⁵.

Potential overlap: The literature has assumed that the UTPR could be inconsistent with Art. 1 (1) IRD²⁵⁶. The UTPR could imply the collection of top-up tax with respect to intra-group interest and royalty payments, most likely through the partial denial of deductibility of those payments. However, we do not agree that there is a problematic overlap. As stated above, the CJEU interprets Art. 1 (1) IRD as prohibiting only juridical double taxation of interest and royalty payments. According to the Court, “[t]hat provision thus concerns solely the tax position of the interest creditor.”²⁵⁷ It does not constrain the source State with respect to the tax treatment of the paying entity; in particular, it does not hinder the partial non-deductibility of such payments for determining the tax liability of the payer of the interest or royalties²⁵⁸. Put differently, as interpreted by the CJEU, the IRD does not require that interest and royalty

²⁵² Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157/49.

²⁵³ See CJEU, 21 July 2011, Case C-397/09, *Scheuten Solar*, ECLI:EU:C:2011:499, para. 28.

²⁵⁴ See Proposal for a Council Directive, 11 November 2011, COM(2011) 714 final.

²⁵⁵ Request for a preliminary ruling from the Varhoven administrativen sad (Bulgaria) lodged on 9 June 2020 — *Viva Telekom Bulgaria*, Case C-257/20.

²⁵⁶ See Nogueira, J. F. P. (2020). *GloBE and EU Law: Assessing the Compatibility of the OECD’s Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market*, *World Tax Journal* 2020: 465-498 (at 492).

²⁵⁷ CJEU, 21 July 2011, Case C-397/09, *Scheuten Solar*, ECLI:EU:C:2011:499, para. 28.

²⁵⁸ See CJEU, 21 July 2011, Case C-397/09, *Scheuten Solar*, ECLI:EU:C:2011:499, paras. 30 et seq.

payments remain deductible from the payor's tax base. The IRD merely requires that the income of the recipient resulting from such payments is not subject to withholding tax or any other taxes in the source country. Since the top-up tax would only be collected by the UTPR jurisdiction from the MNE entity that *makes* the relevant payments, and not from the (under-taxed) recipient, no conflict with Art. 1 (1) IRD arises.

It is furthermore noteworthy that no overlap would exist between Art. 1 (1) IRD and a modified collection mechanism for top-up tax as suggested by us in chapter 4, either. While our proposal implies that top-up tax would be collected directly from the under-taxed MNE entity, any eventual top-up tax liability would arise solely because of the overall too low ETR of the jurisdiction where the entity is domiciled or established. It would thus not be related to any specific income streams received by the taxpayer, as required for the application of Art. 1 (1) IRD.

By contrast, Art. 1 (1) IRD would undermine the STTR with respect to interest and royalty payments. It would stand in the way of any withholding taxes irrespective of the level of taxation in the jurisdiction where the recipient is resident or established. This might only exceptionally be different with respect to payments for hybrid instruments that are treated as returns on equity in Art. 4 (1) IRD. However, these payments should then not be deductible in the source State, anyways (and if otherwise, our above deliberations regarding Art. 5 PSD would apply).

Recommendation: There is no need to amend Art. 1 (1) IRD with respect to the standard collection mechanisms of the GloBE effective minimum tax. However, Art. 1 (1) IRD needs to accommodate for the application of the STTR to interest and royalty payments. To this effect, the provision should be qualified by an amendment pursuant to which the source State shall not be obliged to ensure the benefits of the Directive to the extent that the STTR allows for the levy of a minimum withholding tax. This has also already been acknowledged by the EU Commission in its recent Communication on Business Taxation²⁵⁹.

5.4. Merger Directive

The Merger Directive²⁶⁰ establishes a common system of taxation applicable to cross-border reorganisations of companies in the EU. Its overall objective is to ensure the tax neutrality of such operations by requiring a tax deferral.

²⁵⁹ See EU Commission, Communication on Business Taxation for the 21st Century, 18 May 2021, COM(2021) 251 final, p. 9.

²⁶⁰ Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310/34.

The relevant provision: Pursuant to the core provision of Art. 4 (1) Merger Directive, a merger, division or partial division shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes. This is complemented by further neutrality rules in Articles 7 and 8 Merger Directive concerning the tax treatment of the receiving company and the shareholders of the transferring or acquired company. Articles 9 and 10 Merger Directive seek to ensure the tax neutrality of a transfer of assets (as defined in Art. 2 (d) Merger Directive, i.e. a business unit). Articles 12 to 14 Merger Directive concern the transfer of the registered office of an SE or an SCE; however, Art. 12 Merger Directive merely requires to refrain from capital gains taxation of the SE or SCE itself to the extent that unrealized gains are attributable to assets that remain effectively connected with a PE of the SE or of the SCE in its former home State.

Potential overlap: According to the October 2020 Blueprint, the members of the Inclusive Framework consider it appropriate to provide a mechanism to mirror the local tax deferral under the GloBE rules²⁶¹. Consequently, there will be flexible book-to-tax adjustments, the technical details of which are currently still under discussion. There should thus be no interference of GloBE with the tax neutrality of intra-EU reorganisations required by the aforementioned provisions of the Merger Directive.

Notably, the tax neutrality required for a transfer of the registered office of an SE or SCE is not liable to facilitate inversions that could be motivated by the introduction of an international effective minimum taxation by EU Member States. First, it covers only intra-EU transfers, and incentives for minimum tax-driven inversions intra-EU should be minimal under the premise of a harmonized implementation of GloBE. Second, Art. 12 Merger Directive does not require full but only partial neutrality of the transfer of the registered office.

Recommendation: The GloBE concept with flexible and sufficiently broad book-to-tax adjustments with respect to tax neutral reorganisations should accommodate for the standards established by the Merger Directive. There should be no need for additional coordination between the two measures.

5.5. Code of Conduct

In December 1997, the ECOFIN Council adopted a Resolution on a Code of Conduct for Business Taxation (CoC)²⁶². The Code establishes standards and criteria for “harmful tax measures” in order to identify, curb and roll back such regimes in all EU Member States. The

²⁶¹ OECD (2020). Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Accessible online at <https://doi.org/10.1787/abb4c3d1-en>, para. 212.

²⁶² Resolution of the Council and the Representatives of the Governments of the Member States, Meeting Within the Council, of 1 December 1997, on a code of conduct for business taxation, as Annex I to the Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy.

CoC constitutes a legally non-binding soft law instrument that represents a political commitment of all EU Members States and relies on negotiations and peer pressure for its implementation.

The only potential overlap between the CoC and a harmonized GloBE implementation could be assumed to exist with respect to the introductory clause of point B of the Code, which specifies its substantive scope of application as follows: "... tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code."

At first sight, GloBE might be assumed to potentially alter the characterization of a low-tax regime as potentially harmful due to the compensating effect of the collection of top-up tax. Taking Ireland and its IP regime as an example, if the overall effective tax burden incurred by MNE entities that are resident in Ireland and benefitting from its IP regime were increased to a presumed minimum tax rate of 12.5%, the overall level of taxation on IP income would no longer deviate from the general (nominal) Irish taxation level which is also 12,5 %. But in reality, the CoC does not adopt a holistic perspective taking into account the aggregate tax burden of the privileged sources of income, but it instead assesses the relevant tax measure in isolation. Consequently, the levy of top-up tax that compensates for a preferential low level of taxation or even neutralizes it should not have an impact on its assessment of the respective preferential tax regime.

Finally, the CoC would maintain its relevance even after the successful introduction of a harmonized EU effective minimum tax. First, such regimes could still affect the location of business activity and discrete investment projects of MNEs headquartered outside the EU in a jurisdiction that did not implement GloBE. Second, due to the jurisdictional blending inherent to the GloBE concept as presented in the October 2020 Blueprint, preferential regimes would continue to have – albeit limited – "harmful" effects also intra-EU.

6. Reform alternatives and outlook

This section discusses how the current reform proposal for GloBE, as outlined in the Blueprint for Pillars Two, relates to alternative reform proposals. It does so without attempting to provide an exhaustive list of all relevant reform proposals. Since most of the reform proposals share a common problem analysis, it is not surprising that the alternative proposals are not completely contradictory. As will be shown below, in many (but not all) cases, the steps proposed in the two Pillars may be extended and developed to serve as the foundation for a more comprehensive (or: radical) reform.

To be specific, we focus on how the Pillar Two proposal relates to the recent communication by the EU Commission (“Business Taxation for the 21st Century”) and discuss an alternative proposal by a group of authors associated to the Tax Justice Network: the METR. Finally, we briefly discuss other alternatives, like the Destination-Based Corporate Cash-Flow Tax and the Residual Profit Allocation by Income.

6.1. The EU Commission’s proposal for BEFIT

As extensively discussed above, a global effective minimum tax based on the GloBE proposal would undoubtedly alter the conditions for future tax policy-making within the EU. In the preceding sections, we have outlined how the existing treaties, directives and laws interact with the introduction of an effective minimum tax. In this subsection, we discuss how the minimum tax relates to future initiatives (as far as they can be identified today).

In a recent communication to the European Parliament and the Council, the EU Commission outlined a roadmap for future reform within the EU.²⁶³ The Commission explicitly acknowledges and supports the international efforts to reach a global consensus on the two-pillar reform. It emphasizes that any large reform of the business tax system needs to be seen in the context of “wider EU policies such as the European Green Deal, the Commission’s digital agenda, the New Industrial Strategy for Europe and Capital Markets Union.” Many aspects in this reform agenda seem to have no direct relevance for the implementation of the GloBE rules, like the Carbon Border Adjustment Mechanism that is part of the European Green Deal. Others fit well with the two-pillar reform, like the plan to make ETR estimates (following the GloBE method) available to the public in order to increase transparency (Action 1 in the communication) or to propose rules in order to “neutralize the misuse of shell entities for tax

²⁶³ EU Commission (2021). Business Taxation for the 21st Century, Communication from the Commission to the European Parliament and the Council, COM(2021) 251 final, Brussels, 18.5.2021.

purposes.” (p. 10) At least three measures proposed in the communication deserve some discussion.

Allowance for corporate equity (Action 4 in the communication). The Commission announces to reduce the tax-induced incentive to use debt instead of equity by allowing for a deduction of equity financing cost. Details are missing so far; the Commission only adds that there will be anti-abuse measures. Measures that narrow the tax base may be relevant if a GloBE style minimum tax is applied. Assuming that the GloBE does not allow for deduction of equity finance, the minimum tax may effectively eliminate the effect of such a deduction if the ETR is already low. This is not directly speaking against an allowance for corporate equity, but GloBE must be considered as a potential constraint on tax base related reforms.

Digital levy. As announced in the communication, the Commission is going to withdraw the proposals for Digital Services Tax and for a Significant Digital Presence and, instead, make a proposal for a digital levy that serves as an own resource for the EU Commission. Again, there are no details in the communication, the Commission only states that the levy “will be designed in such a way that it is independent of the forthcoming agreement on international corporate tax reform and is compatible with WTO and other international obligations. (...) it will coexist with the implementation of an OECD agreement on sharing a fraction of the taxable base of the largest multinational enterprises, once the latter is ratified and transposed in EU law.” (p. 5) To start with, it is surprising that the Commission has switched to the idea of a permanent digital levy, after it called the former proposal an “interim measure” until a permanent solution is reached within the rules of the source based tax system. Similar conditions were attached to national initiatives for digital services taxes such as in France. The announcement stresses the importance of the question whether digital taxes should be part of the covered taxes (discussed in detail in Sect. 2). While there is no room for a full-fledged discussion on digital levies here, the arguments discussed above to not include digital tax payments in the ETR for GloBE purposes also apply to a permanent digital levy as planned by the Commission.

Consolidation of profits of European MNE entities and apportionment of tax base by formula (BEFIT). The Commission announces to withdraw the proposals for a common consolidated tax base (CCCTB) and to replace it with BEFIT (for *Business in Europe: Framework for Income Taxation*). The communication is too vague to see whether there are substantial differences between the BEFIT proposal and the CCCTB proposal (or whether it is mainly a relaunch under a new acronym). As the CCCTB, the BEFIT would consolidate profits and allocate them to the different locations within the EU according to a formula that is based on sales, tangible assets and personnel/payroll.

How does such a reform interact with a GloBE style minimum tax? The GloBE rules for determining local profit are, if left unchanged, completely different from the BEFIT rules. The GloBE local profit is based on financial accounting that treats the entity as if it were separate

from the rest of the group (separate accounting); the BEFIT rules imply a consolidation of the MNE's profit and apportionment of tax base according to some formula (unitary accounting). BEFIT may be understood as an extension and generalization of Pillar One. The GloBE rules adjust the local profit indicator for Pillar One's Amount A; an equivalent adjustment would be necessary for BEFIT.

Without such an adjustment, the following case may occur: the GloBE identifies a large local profit while the BEFIT formulary apportionment rules allocate most of the income away from the jurisdiction where the entity is resident. Consequently, actual tax payments (that follow BEFIT rules) are low and the ETR, according to GloBE rules, is low. In this case, an entity may be subject to top-up taxation under GloBE although (i) its ETR (measured according to BEFIT rules) is substantially above the minimum threshold, (ii) there is no BEPS activity that is accountable for the low ETR and (iii) the jurisdiction that hosts the entity can hardly do anything about it, because it cannot influence the tax rate applied to the bulk of profits.

To solve this problem, the EU may try to convince non-EU jurisdictions that apply the GloBE rules to let BEFIT govern the determination of ETR within the EU, by way of a flexible book-to-tax adjustment. A GloBE top up tax would then be triggered if the ETR based on BEFIT rules is below the GloBE threshold. In this case, the GloBE sets a lower bound for the ETR (and, since the tax base rules are harmonized, for the statutory tax rate) and, thus, for the tax competition for substantive activities in the EU.²⁶⁴ In this sense, GloBE complements BEFIT. However, since this will, in some cases, imply that GloBE is not applied when it should be in the absence of BEFIT, other jurisdictions may be hard to convince – why should they grant special rights to EU countries? An alternative would be to argue that the EU is a single jurisdiction (a common market) and that GloBE should allow for an EU blending of ETRs. In this case, BEFIT would govern the allocation of profit within the EU, while GloBE governs the profit allocation between the EU and non-EU jurisdictions. Again, it is unclear why non-EU jurisdictions would be willing to grant such special right to EU countries (especially if one recalls the EU countries' outcry facing the US demand for a safe harbour rule for Pillar One).

Apart from this eventual risk of interference, adopting the GloBE rules is presumably good news for any attempt to introduce rules for a common consolidated corporate tax base. Both pillars depend on some kind of harmonized approach to profit determination. This helps the BEFIT initiative for at least three reasons. First, in principle, once the Pillars One and Two are in place, the data used for calculating the ETR under GloBE and amount A under Pillar One can be used for BEFIT purposes as well. Second, the two-pillar reform will entail work to further adjust the financial accounting data for tax purposes in order to close loopholes and to make it more adequate (meaning, in many instances, more cautious) for taxation purposes.

²⁶⁴ With carve-outs, parts of the income allocated according to BEFIT would be exempt from GloBE, which – again – limits its effects on tax competition.

Third, at the same time, countries with stark gaps between the accounting data used for the Pillars One and Two and local tax accounting will be under pressure for reform. An optimistic take on the two-pillar reform is, therefore, that it paves the way for more ambitious multilateral tax reform in the EU.

6.2. METR

A group of authors led by Tax Justice Network chief economist Alex Cobham has published a proposal under the label “METR” (for: minimum effective tax rate) that may be understood as both, a combination of Pillar One and Two elements and an alternative to the current OECD reform proposal (Cobham et al. 2021).²⁶⁵

The proposal diverges from the GloBE proposal in different aspects. Among others, the METR is supposed to apply to a much larger group of multinational firms (i.e. the threshold in Step 1, see Sect. 2, is proposed to be considerably lower) and the minimum tax rate is higher, preferably at 25 percent. However, there are also strong similarities. To be specific, the first four *Steps* of the GloBE, as outlined in Sect. 2, are the same in METR. That is, the affected multinational firms are identified, the relevant income and taxes are calculated and the ETR is derived. The METR proposal then continues with a modified step 5.

Step 5’: **Identification of untaxed income.** If the ETR in a given entity is below the minimum threshold, the METR splits its tax base into (1) a part that is deemed to have been taxed at the minimum rate, i.e. the amount of profit needed for an ETR equalling the minimum rate if all the covered taxes are attributed to this amount; and (2) an untaxed base. This method allows identifying the ‘untaxed’ part of the tax base that is called *non-effectively-taxed profits* (NETs).

Step 6’: **Allocation of ‘untaxed’ income according to formula.** The NETs, i.e. the ‘untaxed’ part of the tax base, are allocated to all entities of the multinational firm according to a formula based on assets, personnel and sales.

Step 7’: **Application of local tax rate.** The preceding step implies that entities with substantive activity have their reported income increased (by the deemed untaxed income from low-taxed entities). The jurisdiction with the primary right to tax these entities applies its own tax rate (that may be above or below the minimum tax rate). With these modifications, the METR makes sure that all income is either taxed at or above the minimum rate or allocated according to a formula. Consequently, income cannot be shifted to a location without substantive activity if it is taxed below the minimum rate. Put differently, income can be taxed below the minimum rate only to the extent to which there is substantive activity in a location. According to the authors

²⁶⁵ Cobham, S., Faccio, T., Garcia-Bernado, J., Jansky, P., Kadet, J., Picciotto, S. (2021). For a better globe – METR: A minimum effective tax rate for multinationals. Working Paper, accessible at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3796030.

of the METR proposal, the proposal has three advantages. First, the right to tax is independent from any notion of residence and, instead, taken by the locations that provide the environment for substantive activity. Second, as a consequence, the resulting revenue is shared in a more equitable way. Third, instead of setting a lower bound for tax competition, the METR allows for unbridled tax competition for substance (which may be an advantage for countries at the periphery, see the “redistribution” effect of tax competition discussed in Sect. 3).

The METR can be understood as a unitary taxation system with formulary apportionment where the sum to be allocated is restricted to the NETs, i.e. the ‘untaxed’ income as defined in Step 5’ above. However, in contrast to a unitary tax system, it leaves the current tax system in place and only “corrects” for it – just like the GloBE.

How does the METR affect the incentives to shift profit and to reallocate investment? As indicated above, the METR only reallocates NETs that are taxed where the substance is. Thus, NETs are taxed at a substance-weighted average tax rate (we label this the NETS ETR). If the NETs ETR is below the minimum rate, the MNE’s incentive is to maximize the amount of NETs such that as much profit as possible is allocated according to formula. Thus, for a given allocation of substance, taxes are minimized by shifting all profit to a zero rate tax haven; in this case, NETs equals total profits. In contrast, if the NETs ETR is above the minimum rate, the MNE has an incentive to shift all profit to an affiliate with an ETR sufficiently close to the minimum rate (ideally: equal to the minimum rate), implying that the NETs are minimized (ideally: eliminated). Compared to the current international tax system, it can be shown that the METR reduces profit shifting incentives (intuitively, because shifted profits do not stay in the zero rate tax haven). However, if the METR is taken as an opportunity to reduce the currently implemented measures against BEPS, the extent of profit shifting may increase. Compared to the GloBE, the incentives to shift profit under the METR may be larger²⁶⁶ or smaller²⁶⁷.

Since the effective tax under METR rules crucially depends on where the firm’s substantive activity is, firms have an incentive to reallocate substantive activity to low-tax jurisdictions (as in any system with asset- or payroll-based formula apportionment). Under the GloBE rules, a similar incentive is created by the carve-outs for tangible assets and personnel.

²⁶⁶ Consider two jurisdictions, each hosting half of the substantive activity of a multinational firm. One location sets its tax rate to the minimum rate, 15 percent, the other location to 7.5 percent. Under the GloBE, all income is taxed at exactly 15 percent. Thus, no profit shifting incentive remains. Under the METR, the NETs (half of the income accounted for in the affiliate with the lower ETR) are allocated in equal shares to both locations (and then taxed at an average of $\frac{3}{4}$ of the minimum rate, i.e. at 11.25 percent). By shifting income to the low-tax jurisdiction, the NETs are increased and the overall tax burden is reduced.

²⁶⁷ Consider an MNE with two affiliates in high-tax jurisdictions with an ETR of 30 percent each and one affiliate in a zero rate tax haven. There is no substance in the tax haven. Shifting profit to the tax haven increases after-tax income since income there is taxed at the minimum rate, 15 percent, instead of 30 percent. Under the METR, all income is taxed at 30 percent, independent of where income is accounted for, i.e. there is no incentive to shift profit.

An interesting question is whether the METR always leads to a more ‘equitable’ distribution of tax revenue compared to the status quo. Assuming that an MNE has two affiliates, one in a high-tax country and another in a low-tax country (say, a developing country with a tax rate of ½ of the minimum rate), both affiliates have the same level of substantive activity. The MNE does not shift profit (by assumption) and reports half of its profit in each location, which – by assumption – is also the ‘equitable’ allocation (since activity is the same in both countries). Now, the METR is introduced. One half of the profit accounted for in the low-tax country (i.e. 25 percent of total profit) is NETs and, thus, redistributed in equal shares. As a result, the high-tax country has 62.5 percent of total profit as a tax base and the low-tax developing country has 37.5 percent – although the level of activity is the same in both locations.²⁶⁸ The unequal distribution of tax base is a consequence of the rule that only low-taxed income is reallocated by formula. As a caveat, the example above does not claim to be typical. In fact, many developing countries have relatively much substance and higher tax rates (see Ch. 2). In this case, the METR successfully reallocates shifted income back to the jurisdictions where the substance is. If the METR stipulated that all reallocated NETs income is to be taxed at the minimum rate, the resulting tax burden for the MNE would be the same as under GloBE. Additional revenue would accrue to the jurisdictions that host the substantive activity of a multinational firm and would therefore, according to the authors, be shared in a more equitable way and independent of the notion of ultimate parent residence. The authors of the METR proposal do not consider this possibility – and rightly so – since this would require all locations to voluntarily apply the minimum tax.

Does the METR concept require more coordination than the GloBE (that can, in principle, be implemented without agreement of low-taxed jurisdictions)? Under the METR rules, every jurisdiction has the right to tax its share of the NETs (in addition to the tax collected under the current system). If a jurisdiction does not collect the tax, its share of the NETs remains untaxed. This is, in principle, not a problem, but it weakens the effect of the tax, exacerbates the competition for substantive activities and undermines the goal of equal treatment of MNEs and local firms.²⁶⁹ Moreover, both the calculation and the allocation of NETs needs a common (accounting) method, which makes it unlikely that, with the METR, “no multilateral convention would be needed” (Cobham et al. 2021, p. 16). Even with a multilateral convention, the METR would likely require considerable dispute resolution efforts, since any uncertainty about ETRs or formula factors would affect all involved countries’ taxing rights. Therefore, the OECD Blueprint on Pillar 2 suggests to prioritize the IIR over the UTPR, because the latter has similar problems.

²⁶⁸ In a more realistic setting, where – due to profit shifting, 60 percent of total profit is accounted for in the low-tax country, 40 percent in the high-tax country, the METR implies that the high-tax country taxes 55 percent of total profit and the low-tax country 45 percent.

²⁶⁹ Cobham et al. (2021) claim that, under the METR, “MNEs would be taxed at the same rate as domestic companies on their profits attributable to activities in the country.” (p. 16)

The METR proposal also claims that it is compatible with DTCs and, in contrast to the GloBE, with EU/EEA fundamental freedoms. Regarding tax treaty law, the METR would primarily have to be tested as to its compatibility with Article 7(1) MC; here, the same considerations apply as were discussed above (at 4.3.1) for the GloBE's IIR. Consequently, it would be advisable to clarify, by way of a treaty amendment or protocol, that the METR is not in conflict with this treaty rule in all DTCs that do not feature a saving clause modelled after Art. 1 (3) OECD MC. If the METR tax on NETs were levied by way of limiting or denying a deduction for intra-group payment, the same issues as discussed for the GloBE UTPR would arise (see above at 4.3.2). As far as the compatibility with the EU/EEA free movement rights is concerned, the METR would indeed be less problematic than an unmodified version of the GloBE, because it would levy additional tax on NETs regardless of their foreign or domestic origin. This notwithstanding, certain discriminatory elements are inherent to the METR, too, because its personal scope is limited to *multinational* groups. In this regard, the METR is in need of justification, too; therefore, the same recommendations with respect to a modification of the collection mechanism as proposed for GloBE (above at 4.2.4.) apply²⁷⁰.

The METR proposal may have some advantages over the GloBE, at least if one believes that tax competition for substantive activity should not be limited. Given the state of negotiations in the Inclusive Framework, it seems unlikely, though, that the proposal gets any international traction soon. However, the GloBE rules are flexible enough to allow for adjustments that attain at least some of the goals pursued by the METR authors. For instance, a more equitable distribution of additional revenue could be attained by letting the ultimate parent's jurisdiction (or, as a back-up, the source locations with above-threshold ETRs) collect the minimum tax and, via a clearing-house, distribute it among the hosts of the firm's substantive activities. At the same time, such an adjustment would break the nexus of revenue gains from GloBE and the status of ultimate parent jurisdiction.

6.3. Other alternatives

In this final subsection, we briefly discuss other reform alternatives that have been around for some time and that are, for various reasons, not in the centre focus of the international debate anymore. The goal of this brief discussion is not (and cannot be) to give a fair and balanced account of the concepts underlying the reform proposals. It is rather to acknowledge that alternatives exist, how they related to the two-pillar reform proposals and to refer the interested reader to more thorough discussions in the literature.

²⁷⁰ For an extensive analysis, see Englisch, J. (2021). Is an METR Compatible With EU/EEA Free Movement Guarantees?, 102 Tax Notes Int'l 2: 219- 232.

The US **corporate alternative minimum tax (AMT)** was introduced 1986 and abolished in the 2017 TCJA.²⁷¹ It was intended to make sure that no corporate taxpayer with gross income above a certain threshold could reduce its taxable income to zero using deductible items. The corporate AMT applied a lower tax rate (20 percent) to a broader tax base than the ‘normal’ corporate income tax (with a rate of 34 percent). In this regard, the corporate AMT shared some similarities with the current GloBE proposal, at least at first glance. However, an important difference is that the corporate AMT was levied by the same government that levied the ‘normal’ corporate income tax. Any application of the AMT thus requires a strong divergence between gross income and taxable income (due to the use of tax deductions that are deemed excessive). In contrast, the GloBE is levied by governments other than those that are responsible for the low ETRs that trigger the application of the GloBE rules. This implies, that GloBE may be applied simply because the foreign statutory tax rate is too low. As discussed in Sect. 2, the GloBE tax base is based on the notion of profitability (and, in fact, a substantial part of its complexity is due to the efforts to avoid taxation in the absence of profits). In contrast, the corporate AMT explicitly disallowed deducting items for tax purposes that, under the corporate tax, were deductible as cost.

The **destination based corporate cash flow tax (DBCFT)**²⁷² is a tax system in which profits are calculated on a cash-flow basis (the ‘cash-flow’ part), exports are exempt and imports are fully taxable (the ‘destination-based’ part). With global introduction of the DBCFT, the incentive to shift profit is zero. With unilateral introduction, the DBCFT gains the same tax attractiveness for foreign investment as a zero rate tax haven (but does not fiscally benefit from foreign investment, either).²⁷³ The DBCFT is equivalent to completely abolishing the corporate income tax (and any other subnational business tax) while increasing the VAT and reducing the payroll tax (or: social security contributions). (It is, from this perspective, not surprising that the DBCFT gained so much attraction in the US, one of the very few developed countries without a VAT system.) Such a tax reform increases taxes on consumption out of all income except for labour income. Thus, the tax increases the ETR on pure profit income provided that it is consumed in the country where the VAT is levied. The DBCFT has a number of problems (not the least of which is that it taxes *all* sorts of income, not only pure profit from investment, e.g. transfer income, income from self-employed work etc.). The most important downside is,

²⁷¹ Shaviro, D. (2020). What Are Minimum Taxes, and Why Might One Favor or Disfavor Them?, NYU Law and Economics Paper Series No. 20-38.

²⁷² See Auerbach/Devereux (2018) and Auerbach et al. (2017) for a discussion of implementation issues. Auerbach, A. J., Devereux, M. P. (2018). Cash-Flow Taxes in an International Setting, *American Economic Journal: Economic Policy* 10(3): 69–94. Auerbach, A. J., Devereux, M. P., Keen, M., Vella, J. (2017). Destination-based cash flow taxation. Oxford University Centre for Business Taxation WP 17/01.

²⁷³ The DBCFT was a hot topic from mid-2016 to mid-2017. In 2016, the US House Republicans adopted the concept in the Ryan Blueprint, a plan for tax reform named after the Speaker of the House, Paul Ryan. After the US election and the win for Republican candidate Donald Trump, it seemed likely for a while that the DBCFT could become law, before the Republican majority dropped it and opted for a more conventional tax reform, the TCJA of late-2017.

however, that the DBCFT fights the undertaxation of (some) MNE profits by abolishing the tax on foreign multinationals.²⁷⁴ Thus, by construction, it is unsuitable to increase the ETR on foreign MNE profits.

The concept of **residual profit allocation by income** introduced by Devereux et al. (2019) is, in its core, similar to the Pillar One measure.²⁷⁵ Part of the MNE's profit is allocated to the market economy. Pillar One's Amount A is calculated by taking a fixed percentage of the above-normal return (with normal return being a fixed threshold for the return measured as a fraction of turnover). In contrast, the residual profit allocated to the market economy in the concept by Devereux et al. (2019) is more closely associated to the notion of arm's length pricing (and, therefore, a more 'natural' extension of the current set of rules). According to this concept, the MNE's profit is split into a 'routine profit' and a 'residual profit'. The routine profit corresponds to the profit that an entity would have that offered the firm's services at arm's length (and without bearing the risk). The residual profit is the difference between total profit and routine profit. The routine profit is allocated to where the associated functions of the firm are – as it is common under current rules that follow the substance approach. The residual profit is allocated to the market economy, i.e. the destination jurisdiction where third-party sales take place. In principle, the Pillar One measures could evolve into a system with residual profit allocation by income. The discussion on the relationship between Pillar One and the GloBE rules in Section 2 equally apply to the more far-reaching concept of residual profit allocation by income.

²⁷⁴ See Becker/Englisch (2020) for an elaboration of this critique. Becker, J., Englisch, J. (2020). Unilateral introduction of destination-based cash-flow taxation, *International Tax and Public Finance* 27(3): 495-513.

²⁷⁵ Devereux, M. P., Auerbach, A. J., Keen, M., Oosterhuis, P., Schön, W., Vella, J. (2019). Residual Profit Allocation by Income, Oxford University Centre for Business Taxation Working Paper WP19/01.

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