Kluwer Arbitration Blog

Duel of the Giants: Global Minimum Tax v Global Investment Regime

Blazej Kuzniacki (PwC Netherlands; Lazarski University) · Thursday, January 4th, 2024

Some of the largest arbitral awards rendered in favour of investors have been based on tax-related (mis)conduct of host states towards investors, e.g., a series of *Yukos and others v Russia* – US$ 50 billion (the largest award ever rendered), *Occidental v Ecuador (II)* – US$ 1.77 billion, *Cairn v India* – excess of US$ 1.2 billion, and *Stati and others v Kazakhstan* – US$ 497 million. Recently, however, investor-state dispute settlement (ISDS) tax-related cases face existential risk from the side of important actors such as world's major economies (e.g., the India's new BIT Model) and international organisations (e.g., the UNCTAD, pp. 26-27 and the EU here, here and here), to name a few. Most recently, a new blow against ISDS tax-related claims comes from the world's leading international organization in shaping global tax policy – the OECD – under the umbrella of the landmark reform to the international tax system, which is called the Pillar Two (below as P2). It aims to ensure that multinational enterprises (MNEs) in scope of that reform (i.e. with consolidated revenues of EUR 750 million in at least two out of the last four years, see more here) will be subject to at least 15% effective minimum tax rate (global minimum tax).

This post first presents P2 interlocking mechanism in a nutshell and explains how it may negatively impact investment protection under existing international investment agreements (IIAs). It will then traverse to the newest OECD Administrative Guidance on P2 (OECD Guidance) to demonstrate that the OECD implicitly aims to eliminate ISDS proceedings against P2. The final point of the post is two-fold: 1) although the OECD's attempt to eliminate P2-related ISDS claims could be seen as an act encouraging states to commit an internationally wrongful act under international law; 2) it should not discourage investors from seeking the investment protection under IIAs against the negative impacts of global minimum taxation.

Interlocking Mechanism of P2 – 'Devilish logic'

GloBE aims to be implemented as domestic legislation in accordance with the OECD P2 Model Rules by more than 140 states and jurisdictions, Members of the Inclusive Framework (IF) on base erosion and profit shifting (BEPS) committed to such implementation politically (no international treaty regulates that commitment). EU Member States will implement P2 via the EU P2 Directive, which, apart from small amendments, replicate the OECD P2 Model Rules. P2 operates via an interlocking mechanism consisting of three rules: (1) Qualified Domestic Minimum Top-Up Tax (QDMTT); (2) Income Inclusion Rule (IIR); and (3) Undertaxed Profits Rule (UTPR). The

mechanism is interlocked via those rules and is called 'devilish logic' by scholars because no state can escape its logic – if not QDMTT then IIR or UTPR. That is to say,

- if a state which can impose minimum 15% of global tax on in-scope MNEs fails to do so despite the effective tax rate (ETR) of that MNE is below 15%, i.e. did not introduce QDMTT;
- then another state will apply IIR to tax the MNE's income up to 15% (in principle, a state in which ultimate parent entity (UPE) has tax residence, or a state where the next intermediate parent entity in the ownership chain has tax residence), and if that state also fails to tax the MNE's income up to 15%; and
- then another state (wherever there is any entity in the MNE's group) will do so via UTPR in accordance with the politically agreed fixed formula based on the share of total employees and tangible asset (see Article 2.6.1 here).

Negative Impact of P2 Rules on Investment Protection under IIAs

As of now, it is unclear how stakeholders will deal with P2, but it is already clear that it may have a significantly negative impact on investment protection under IIAs (see e.g., here and here).

In brief, QDMTT is likely to fall under IIAs due to alleged violations of fair and equitable treatment (FET) by premature revocation of promised tax incentives (*cf. Micula v Romania*, para. 872). Such allegations may have the greatest chances to prevail whenever states applying QDMTTs (host states) promised tax incentives in specific agreements with investors (constituencies of MNE group) such as tax stabilization agreements, investment agreements, or similar agreements. In that regard, so-called umbrella clauses may also be of relevance insofar as they oblige the host states to keep their promises (including tax incentives) given to investors either via specific agreements or legislation (see here, p. 126; *cf.* UNCTAD study, p. 36; *Eureko v Poland*, para. 246; *Paushok v Mongolia*, para. 370; Weeghel, sec. 26.2.5).

IIR and UTPR may also violate IIAs. Depending on the circumstances, they can be at odds with FET, umbrella clauses, national treatment (NT) clauses or even the prohibition of expropriation. The allegation regarding the expropriation will be particularly relevant to UTPR, which encourages states to engage in non-customary extraterritorial (and possibly discriminatory) taxation (see here, p. 1370 and here, p. 750). The UTPR allocation of income also threatens the existing tax policy in many states insofar as it can capture deliberately untaxed income generated in their territories (see here, p. 6).

The OECD's Attempt to Eliminate P2-Related ISDS Claims

The OECD Guidance on "QDMTT payable" (paras 73-81) boils down to the conclusion that any direct or indirect challenge in a judicial or administrative proceeding to any amount of QDMTT by the MNE group "*based on constitutional grounds or other superior law or based on a specific agreement with the government of the QDMTT jurisdiction limiting the MNE Group's tax liability, such as a tax stabilization agreement, investment agreement, or similar agreement*" shall not be treated as QDMTT payable under Article 5.2.3 of the OECD P2 Model Rules. It means that the global minimum top-up tax of 15% payable by a MNE group under the QDMTT in a host state will not reduce the top-up tax to zero in other states. Thus, it may be collected by another jurisdiction

under the P2 rules, i.e., IIR or UTPR.

Undeniably, the OECD Guidance on QDMTT payable aims to discourage MNE Groups from legally challenging QDMTT via sources external to P2 rules by apparently making such challenges economically unviable, i.e., the challenge will simply lead to inevitable taxation under IIR and UTPR. Although in that regard the OECD did not refer to IIAs explicitly, in practice, the mentioned challenges of QDMTT may mainly arise out of relevant IIAs due to their scope of investment protection and international investment treaty arbitration case law (here UNCTAD, p. 6), as presented in the preceding section.

An Internationally Wrongful Act

Pressuring other states to violate IIAs via the interlocking rules of QDMTT, IIR and UTPR may be seen as an unacceptable state practice under international law, i.e. IIAs and general principles of law (GPLs) under Article 31(1)c) of the ICJ Statute such as principles of good faith, non-discrimination, and non-expropriation (see the relevant analysis here, pp. 164-171). It is therefore not inconceivable that the interlinking mechanism of P2 rules and the OECD "solution" in the form of its Guidance on "QDMTT payable" may trigger shared responsibility under international customary law (see ILC articles here and here, which codify rules binding under customary law on states' responsibility and the responsibility of international organisations such as the OECD for internationally wrongful acts). The violation of IIAs and pressuring of other states to do so constitute such acts because it "*is a principle of international law that States may not negate such agreements in reliance on their municipal laws*" (*Cairn v India*, para. 820), such as domestic laws implementing P2. In that regard, more research is welcomed by international and tax law scholars to determine whether the IF's members and the OECD meet the prong of shared responsibility.

Conclusion

The OECD's Guidance on QDMTT payable sends a glaring signal to investors (MNE groups): do not challenge QDMTTs via IIAs because even if you prevail (arbitral awards in favor of investors), you will gain nothing due to the obligation to pay global minimum tax anyway under IIR or UTPR. However, the taxation under IIR and UTPR after challenging QDMTT via IIAs is neither certain nor conclusive for investor's decisions and ISDS tribunal's reasoning (see here, p. 174). Even if payments of compensation in ISDS P2 related cases may raise difficulties in the operation of those rules and determination of the final benefit for investors, such difficulties are of little bearing to successful ISDS claims and motivation of investors to do so (*Marfin v Cyprus*, paras 596-597). This analysis implies that investors will likely use their rights to arbitrate whenever the impact of P2 rules on their financial situations is significant, unless their position is weak (e.g., their claims are not supported with relevant evidence and jurisprudence of arbitral tribunals). Investors may also "*utilize IIAs as a bargaining chip to bring governments to the negotiating table to partially replace corporate income tax incentives with economically similar benefits, while officially being taxed at the effective minimum rate*" (UNCTAD, p. 3). States, by contrast, could delay the implementation of P2 until "*governments have had a chance to consider the risks that implementation poses under their investment treaties*" (see here, p. 206).

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Access 17,000+ data-driven profiles of arbitrators, expert witnesses, and counsels, derived from Kluwer Arbitration's comprehensive collection of international cases and awards and appointment data of leading arbitral institutions, to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.

Newly updated
Profile Navigator and Relationship Indicator Tools
Wolters Kluwer
Request your free trial now →

This entry was posted on Thursday, January 4th, 2024 at 8:15 am and is filed under International arbitration, International Award, Investment Disputes, Investment protection, Taxation
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.