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UTPR — Potential Conflicts With International Law?

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In this article, the authors examine the many facets of the UTPR (formerly known as the undertaxed payments rule) debate through the lens of an international law assessment.

The views expressed in this report are solely the authors' and do not necessarily reflect those of any other person or institution.

Over the past weeks and months, several articles have been published regarding whether the UTPR (formerly known as the undertaxed payments rule) infringes international law obligations. These contributions mainly cover the question of compatibility with tax treaties and whether the UTPR is at odds with customary international law.[1] A recent article also assesses the potential conflicts with EU law.[2] In this article, we briefly address the potential infringement of treaty law and customary international law and assess two additional areas of conflict:

- whether the UTPR infringes the right to property; and
- whether the UTPR infringes bilateral investment treaties.

Lastly, we cover whether the introduction of the UTPR (together with other pillar 2 elements, like the income inclusion rule and the qualified domestic minimum top-up tax (QDMTT)) is, and should be, part of the EU tax good governance practice. We will analyze whether states can refuse to introduce the UTPR, as suggested in the model rules, based on a common fact pattern as described in Section I.

I. Facts

Recent articles have already discussed the technical specifics of the UTPR intensively.[3] We will not explain its functioning in detail. However, it is worthwhile to use an actual case to allow a more precise discussion; in our example, four countries are involved:

[1] Reuven S. Avi-Yonah, "The UTPR and the Treaties," *Tax Notes Int'l*, Jan. 2, 2023, p. 45; Tarcisio Diniz Magalhães and Allison Christians, "Why Data Giants Don't Pay Enough Tax," *Harvard L. & Pol'y Rev.* (forthcoming); Rita Szudoczky, "Does the Implementation of Pillar Two Require Changes to Tax Treaties?" 2 *SWI* 144 (2023); Jefferson VanderWolk, "The UTPR Disregards the Need for Nexus," *Tax Notes Int'l*, Oct. 31, 2022, p. 545; Robert Goulder, "Confessions of a UTPR Skeptic," *Tax Notes Int'l*, Nov. 14, 2022, p. 907; VanderWolk, "The UTPR: Taxing Rights Gone Wild," *Tax Notes Int'l*, Dec. 12, 2022, p. 1369; VanderWolk, "The UTPR, Treaties, and CFC Rules: A Reply to Avi-Yonah and Schler," *Tax Notes Int'l*, Jan. 9, 2023, p. 187. *See also* Vikram Chand, Alessandro Turina, and Kinga Romanovska, "Tax Treaty Obstacles in Implementing the Pillar Two Global Minimum Tax Rules and a Possible Solution for Eliminating the Various Challenges," 14(1) *World Tax Journal* 3-50 (2022).

[2] *See* Sjoerd Douma et al., "The UTPR and International Law: Analysis From Three Angles," *Tax Notes Int'l*, May 15, 2023, p. 857.

[3] *See, e.g., id.* at 859.

- In Country A, the Ultimate Parent Entity (UPE) of the multinational enterprise is resident, and the effective tax rate under the global anti-base-erosion (GLOBE) model rules is 20 percent. The GLOBE income is €1,000, and the adjusted covered taxes are €200. The country has not implemented an IIR.
- In Country B, the MNE has various operations. The overall jurisdictional ETR according to the model rules is 10 percent. The GLOBE income is €10,000, whereas the adjusted covered taxes are €1,000. Country B has not implemented a QDMTT.
- In Country C, the MNE has minor activities through a company called Smith Corp. The GLOBE income is €100, and the adjusted covered taxes are €20. Therefore, the jurisdictional ETR is 20 percent. Country C has, however, implemented a UTPR.
- In Country D, an investor (Mr. Smith) is a resident who owns 30 percent of Smith Corp. There is a bilateral investment treaty between Country D and Country C.

The top-up tax to be levied in Country C is €500 (assuming there is no substance-based income exclusion), which equals five times the GLOBE income of Smith Corp. and 25 times its adjusted covered taxes. The model rules do not foresee a compensation mechanism. Therefore, we assume the additional tax burden of the top-up tax is borne by Smith Corp.

II. Breach of International Law Obligations?

In this section, we will briefly assess whether the UTPR is a prohibited extraterritorial tax. We assume that this would be the case if there is not a sufficient link between the income of foreign entities and the state of residence of the entity subject to the UTPR — that is, state C.

It is widely accepted that states do not have unlimited jurisdiction to prescribe laws.[4] Moreover, regarding the enforcement jurisdiction, there is a common understanding that states are not allowed to physically act on other states.[5] The focus in the following is, however, only on prescriptive jurisdiction.

If we agree that jurisdiction is limited, how do we assess potential infringements? This limit is traditionally defined by reviewing whether there is a sufficient (or genuine) link to a territory. If there is not a sufficient link, a state shall not have the jurisdiction to legislate. Moreover, it is important to understand that each link might justify jurisdiction only to a certain extent. For instance, in tax matters, residency seems to justify worldwide taxation, whereas the fact that income is sourced in a country (at least traditionally) justifies only limited jurisdiction.

The rationale is that jurisdiction is limited because unlimited jurisdiction would destabilize the international law order, which is based on sovereignty and self-determination of states. Therefore, if we fully ignore that prescriptive jurisdiction is limited, we would question the international law system of sovereign states. This is important to understand and a key argument in favor of limited jurisdiction.

Consequently, from an international tax law perspective, jurisdiction is a highly normative question, and we must understand the effect a disputed rule has on the fiscal self-determination of states. In other words, it is a gray area in which it is particularly important to discuss the normative justification for why one believes a certain jurisdiction is justified and whether this definition of jurisdiction collides with the sovereignty of other states. However, the fact that it is a gray area should not undermine the key role limited jurisdiction plays for a stable international law system and global governance in general.

The understanding that jurisdiction is limited has, in tax matters, been (at least implicitly) confirmed by several supreme courts[6] around the world. However, as far as it can be observed, the International Court of Justice (ICJ) has not yet

[4]From a tax perspective, see Gadžo Stjepan, "Nexus Requirements for Taxation of Non-Residents' Business Income," IBFD, section 2.1.4 (2018). From an international law perspective, see, *e.g.*, Bernard H. Oxman, "Jurisdiction of States" in *The Max Planck Encyclopaedia of International Law* (online edition), at para. 10.

[5]*See France v. Turkey (SS Lotus)*, PCIJ Ser. A No. 10 (1927).

[6]*See, e.g.*, German Federal Constitutional Court, 2 BvR 475/78, BVerfGE 63, 343 (Mar. 22, 1983); Supreme Court of India: *GVK Industries Ltd. & Anr. v. Income Tax Officer*, Civil Appeal No. 7796 of 1997 (Mar. 1, 2011); Supreme Court of Pakistan: *Imperial Tobacco Co. of India Ltd. v. Commissioner of Income Tax South Zone, Karachi*, 1958 SCC 37 (Jan. 30, 1958); Supreme Court of the United States: *Cook v. Tait, Collector of International Revenue*, 265 U.S. 47 (1924).

developed any clear guiding decisions in tax matters.[7]

Before reviewing the legality of the UTPR, it is important to note that traditionally, the source of the prohibition of unlimited jurisdiction is customary international law,[8] which requires sufficient state practice and an *opinio juris*. We will not discuss the former requirement in detail as the next months will show whether this is the case. There is still not a single state that has implemented a UTPR into its applicable tax laws, though several states have announced that they will introduce it. The focus in the following should be on the *opinio juris*.

Opinio juris is the belief that a certain rule (in our case, that having an entity in a certain state justifies worldwide taxation of the whole group) is accepted as law. In the words of the ICJ: There is a "belief that this practice is rendered obligatory by the existence of a rule or law requiring it."[9] There are two issues with the UTPR and the *opinio juris* that must be addressed:

- First, so far there has not been a genuine agreement from which an *opinio juris* could be derived. There has only been a political decision by the inclusive framework.[10] These decisions of international organizations can indeed be a sign of an *opinio juris*, but we must be careful to accept that because there may be negative votes and abstentions. Moreover, an *opinio juris* might hardly exist if states were factually coerced to consent to a decision or were unable to state their opinion at the international organization level.[11] For the UTPR, this seems partly true. There has not been a genuine agreement (multilateral convention) at the inclusive framework level, and several states will implement it only because they fear losing tax revenue, not because they genuinely believe that this rule should be accepted as law.
- Second, it is decisive to assess how states react to a certain rule to determine whether there is an *opinio juris*. If states persistently object to[12] or at least publicly oppose it, this might be harmful to the creation of customary international law.

To sum up, we do not yet see a clear *opinio juris* justifying an extraterritorial jurisdiction as intended by the UTPR. Moreover, the following months and years will show whether states unable or unwilling to implement the UTPR will publicly oppose it as infringing international law. This would be a strong sign that the UTPR has crossed the limits of the justifiable jurisdiction to tax. Of course, if states are unwilling or unable to introduce the IIR and the QDMTT, they should publicly oppose the UTPR to not be bound by custom (the U.S. Republican Party seems to do this, even though, admittedly, they do not represent the U.S. government). This brings us back to the normative justification.

For the UTPR, it is evident that the effect on other states is significant. We have seen recently that several states have announced changes in their domestic tax and/or incentive systems to avoid UTPR application abroad. To demonstrate this significant effect, we assume that a developing state has signed dozens of stability agreements (fiscal stabilization agreements) in the extractives sector for the application of tax incentives. The country is now forced to change its tax incentive system to align it with the model rules; that is, introduce either a qualified refundable tax credit or pure subsidies. States are de facto forced to change their domestic tax incentives even if they did not agree. This has a severe effect on a country's fiscal self-determination.

A last way of justifying such a severe effect on tax sovereignty could the justification to claim that jurisdiction be based on a common interest,

[7]Regarding diplomatic protection in the Nottebohm case, see, *e.g.*, *Liechtenstein v. Guatemala*, 1955 ICJ 4 (Apr. 6, 1955).

[8]For a slightly different view, see Peter Hongler, "Justice in International Tax Law," IBFD, at 64 (2019).

[9]ICJ, "North Sea Continental Shelf Cases, Judgment (Federal Republic of Germany/Denmark; Federal Republic of Germany/Netherlands)," at 3 et seq. and 44 (Feb. 20, 1969).

[10]*See* OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy" (Oct. 8, 2021).

[11]Referring to the case law of the ICJ, see Hongler, *supra* note 8, at 156.

[12]The persistent objector doctrine says that if a state consistently refuses the application of a certain rule of customary international law, this state is not bound by this rule. However, the requirements for the application (and the application itself) of the doctrine are disputed among scholars. *See, e.g.*, Patrick Dumberry, "Incoherent and Ineffective: The Concept of Persistent Objector Revisited," 59(3) *Int'l & Comp. L. Q.* 779-802 (2010).

like a "pure cosmopolitan jurisdiction," or a universal jurisdiction?[13] For example, for gross human rights violations (like genocide) or environmental protection, this cosmopolitan jurisdiction could be justified. The normative justification of pillar 2 is to limit tax competition or to simply raise more tax revenue; however, this is not aligned with a global common interest. The situation could be different if a global minimum tax on carbon dioxide emissions is implemented through similar mechanisms. This regulation could be justified by the global need to fight climate change, but with the current design of the UTPR, this is difficult.

Finally, the drafters and proponents of the UTPR should also be careful about what they wish for. If the UTPR aligned with international law, many other tax rules would also need to be aligned with international law. It is important to note that public international law serves the purpose of protecting the sovereignty of states so that states can decide what they want. Jurisdiction in tax matters evolves, as does jurisdiction in other fields. We see that, for instance, regarding digital activities. Offering digital services is sufficient for a state to regulate these activities in general and potentially to tax digital activities without physical presence. There, it is unsurprising that the topic of sufficient nexus has not been intensively discussed over the past century because we have had a rather stable system; however, the UTPR, with its excessive reach, challenges the system developed by the OECD.

III. Infringement of Double Tax Treaties?

This section enumerates and assesses the possible points of friction between the UTPR and the existing tax treaty framework.[14] We will discuss whether top-up taxes are covered taxes for the purpose of tax treaties and whether the UTPR is compatible with articles 9, 7, and 10(5) of the OECD model.

If we return to our example, it should be noted that B Co's GLOBE income/profit in Country B (€10,000) is subject to normal corporate income taxes in Country B (€1,000). Under the pillar 2 domestic law rules — QDMTT, IIR, or UTPR (up to the extent they are enacted in national law) — B Co's ETR is 10 percent. Moreover, its income/profit (€10,000) is exposed to an additional tax of 5 percent. Thus, B Co's income is subject to a top-up tax of €500 (€10,000 * 5 percent).

If this top-up tax is not collected by Country B (through the QDMTT) or Country A (through the IIR), then it is collected by Country C under the UTPR. Essentially, €500[15] — which represents a 5 percent tax on the income/profit of B Co, which is €10,000 — is allocated to Country C based on Country C's UTPR percentage (which we assume to be 100 percent in our case[16]). Country C can effectively collect this tax either by denying a deduction to the Country C taxpayer or through another equivalent mechanism.[17]

Put differently, Country C is levying a tax of 5 percent on B Co's income/profits but is collecting this tax from its local taxpayer. The local taxpayer could be either a separate company (a separate tax resident of Country C) or a permanent establishment of a company that is a tax resident of another country (a PE is a separate constituent entity).

We will now move to the treaty analysis and assume that the treaty between Country B and Country C follows the 2017 OECD model.

Are top-up taxes covered by article 2? In our view, it is obvious that top-up taxes levied under the GLOBE rules (including the UTPR) would be covered by tax treaties[18] because they represent "taxes on income."[19] This is because top-up taxes in Country C are levied on income/profits of B Co, which has been subject to low tax. Arguing that it is not a tax on income/profits of B Co is a stretch.

[13] On this interesting claim of "pure cosmopolitan jurisdiction," see Cedric Ryngaert, *Selfless Intervention: The Exercise of Jurisdiction in the Common Interest* 64 (2020).

[14] *See* Chand, Turina, and Romanovska, *supra* note 1. *See also* Luc De Broe, "Some EU and Tax Treaty Law Considerations on the Draft EU Directive on Global Minimum Taxation for Multinationals in the Union," 50(12) *Intertax* 874-887 (2022); Filip Debelva and De Broe, "Pillar 2: An Analysis of the IIR and UTPR From an International Customary Law, Tax Treaty Law and European Union Law Perspective," 50(12) *Intertax* 898-906 (2022).

[15] The UTPR top-up tax amount. *See* OECD GLOBE model rules, article 2.6.

[16] *Id.* at article 2.5.

[17] *Id.* at article 2.4.

[18] OECD model tax convention, article 2.

[19] *Id.* at article 2(1).

Even if these taxes are introduced after the conclusion of a tax treaty, they would still be covered under article 2 as they would be "identical or substantially similar"[20] to "taxes on income."

The second question is: Can the provisions of the B-C tax treaty prohibit Country C from levying a tax of 5 percent on the income of B Co (€10,000) under the UTPR, given that B Co has no connection or link with Country C? Does this answer change if the tax was levied and collected not from B Co but rather from a related Country C taxpayer or constituent entity (local resident or a PE belonging to the MNE group)?

Article 7(1)[21] provides that the profits of B Co are subject to tax in Country C only if B Co maintains a PE therein. In our case, B Co does not have a PE in Country C. Thus, article 7(1), possibly, restricts Country C from applying the UTPR.

Similarly, article 10(5)[22] states that Country C cannot tax either the undistributed profits of B Co or the distributed profits of B Co to non-Country C shareholders. In our case, Country C is applying the UTPR and collecting taxes on either the undistributed profits of B Co or distributed profits of B Co to non-Country C shareholders. Thus, Country C is engaging in extraterritorial taxation, which is prohibited by this provision.[23] Thus, article 10(5), possibly, restricts Country C from applying the UTPR.

Does the above hold good even if the tax is levied and collected from a related Country C taxpayer? Of course, one may try to extend the OECD's/U.N.'s position in the commentary or the position of some courts that controlled foreign corporation rules — which levy CFC taxes on a country's own resident — do not breach article 7(1)[24] or article 10(5)[25] to the UTPR debate. Moreover, it could be argued that the saving clause[26] (to the extent it is present in the treaty) could be used to preserve a state's right to tax its residents under the rules provided in the domestic laws, notwithstanding any provisions of the tax treaty.[27]

However, it should be stressed that the OECD's/U.N.'s position does not seem to represent the universal view of all countries, as some countries have made observations to the OECD commentary (in the past) and some courts (in particular, from Brazil, Canada, and France) have also held that CFC rules (or similar national attribution provisions) are contrary to tax treaties. Moreover, many states have reserved the right not to include the saving clause in their tax treaties (for example, France, Germany, Hungary, Ireland, Luxembourg, and Switzerland).[28] Further, the saving clause did not gain traction in the multilateral instrument because many states did not opt for this optional provision in their bilateral relations.

That said, coming back to our case and assuming that the B-C tax treaty had a saving clause, Country C could argue that it can tax its own residents, notwithstanding any provisions of the tax treaty. However, our view is that the discussion made in the context of CFC rules cannot be extended to the UTPR. This is because there are huge differences between CFC rules and the UTPR.

Essentially, CFC rules follow a top-down approach and allocate additional income to the shareholder based on the shareholder's ownership interest in the CFC. However, the UTPR allocates income to Country C because it is merely affiliated with B Co. The creators of the saving clause never contemplated this outcome in which, because of a mere affiliation, a country can tax its own residents on the income/profits of residents of other countries.

Moreover, if the local taxpayer is a PE in Country C, then the saving clause may not come to the rescue of Country C.

It should also be noted that article 9(1),[29] like other treaty provisions, restricts national law (although opinions differ on this). A main purpose of this article is to ensure that tax administrations are restricted from making

[20] *Id.* at article 2(4).

[21] *Id.* at article 7(1).

[22] *Id.* at article 10(5).

[23] *Id.* at commentary of article 10(5), para. 34.

[24] *Id.* at commentary of article 7(1), para. 14.

[25] *Id.* at commentary of article 10(5), para. 37.

[26] *Id.* at article 1(3).

[27] *Id.* at commentary of article 1, para. 17 and para. 81.

[28] *Id.* at commentary of article 1, para. 117.

[29] *Id.* at article 9(1).

arbitrary income/profit allocation adjustments among associated enterprises. In other words, this article can restrict the application of domestic formulary apportionment rules among related parties (even in residence-residence situations).

Regarding the UTPR, which applies only in related-party settings, arguably these rules recapture arm's-length profits that have been allocated to another state. The mechanism used to recapture the profits, although unique, consists of the following key steps.

First, the adjusted GLOBE income and covered taxes in the low-taxed jurisdiction are determined to compute the jurisdictional ETR. Second, if the jurisdictional ETR is lower than the minimum rate, then the top-up tax is determined. Third, the top-up tax is allocated to the UTPR taxpayer under the formulas linked to people and assets in Country C. Fourth, the top-up tax is collected by Country C — for example, by denying the deduction from the local tax base or adding additional income to the local tax base. Clearly, the adjustments in steps three and four to the local tax base of a Country C taxpayer are linked to profits of an enterprise in a low-taxed state (B Co). Thus, one could indeed strongly argue that article 9(1) could restrict application of these rules, which allocate taxes (indirectly profits) to UTPR countries based on a formula.

Of course, one may question whether the UTPR (a national law provision) needs to be tested with article 9. In our opinion, it does because the GLOBE rules (IIR or UTPR) apply only to related parties — that is, various constituent entities of an MNE group.

Given the fact that the possibility of conflict is high (including tax treaty overrides[30]), how do we solve this problem? If policymakers wish to end the debate on potential conflicts and ensure that national courts of their countries do not rule against the UTPR, we propose that a safeguard clause, which authorizes the application of the GLOBE rules, be implemented in tax treaties. Obviously, bilateral implementation of these safeguard clauses will take a long time. Thus, we propose that this issue be tackled through a multilateral convention.

IV. Infringement of the Right to Property?

One area that is under-researched is the compatibility of the rules set forth in pillar 2 with the right to property. Article 1 of the First Additional Protocol to the European Convention on Human Rights establishes that every individual has a right to property, subject to limitations, including the right of the state to collect taxes or other payments. The European Court of Human Rights (ECtHR) has maintained that taxes represent a prima facie violation of the right to property, which can be justified only by satisfying the ECtHR's three-pronged test:

- First, there must be a legal basis to impose a tax, which is not simply a formal requirement, but also necessitates that the measure be foreseeable and precise. This criterion is deemed crucial by the ECtHR, and any tax measure that fails to meet this standard would constitute a breach of this right, obviating the need for a proportionality analysis (see below).
- Second, the tax measure must serve a public interest, which is readily satisfied in most cases. The ECtHR has endorsed various public interest grounds for levying taxes, including financial and monetary reforms, countering tax avoidance, and ensuring the payment of taxes and collection of tax arrears.
- The final element of the three-pronged test requires that the measure be proportionate so that it achieves a just equilibrium between the taxpayer's interests and the general interest. In determining proportionality, the ECtHR applies a fair balance test and deems a measure to be disproportional if it imposes an *excessive and individual burden* on the taxpayer. This aspect of the analysis is pivotal, as it ensures that the interests of both the taxpayer and the public are adequately weighed and balanced.

A. Is the UTPR a Proportional Measure?

In assessing whether a "fair balance" has been attained between the interests of taxpayers and the

[30] For a detailed discussion on tax treaty overrides, see Chand, Turina, and Romanovska, *supra* note 1, at 33-37.

public, several criteria must be considered. Legal uncertainty is also, under the proportionality test, a crucial factor to consider, particularly when rules are intricate and unclear. The pillar 2 rules are undoubtedly complex, making it challenging for taxpayers to comprehend their implications fully. A comprehensive understanding of the pillar 2 rules requires the taxpayer to consult and understand hundreds of pages of rules, commentaries, and examples. But this is not necessarily an issue. The analysis has a subjective nature, meaning that the status or nature of the taxpayer can have an effect on determining whether a fair balance was struck.[31] One should note that the pillar 2 rules are applicable only to large MNE groups that have access to more resources than individual taxpayers and can seek assistance from tax consultants and other advisers to understand the rules. Therefore, their ability to comply with the rules may differ from individual taxpayers', potentially influencing the fair balance analysis.

Even if the rules are clear, a minimal degree of foreseeability is essential in assessing their effects. This includes identifying the party responsible for paying taxes within the jurisdiction, which depends on the amount of taxes paid by the low-taxed constituent entity. These situations of "chronic uncertainty" are another relevant factor that must be considered when evaluating whether a fair balance was struck.[32]

Another relevant factor under this test is whether the measure has a discriminatory character. This must also be evaluated, particularly in light of article 14 of the European Convention on Human Rights. For an issue to arise under that article, there must be a difference in the treatment of persons in relevantly similar situations. One could question whether the entity that is liable to pay the UTPR top-up tax is placed in a worse position than other group entities in the UTPR jurisdiction that are not paying the tax. Alternatively, one could also assess this criterion broadly, by asking whether the entity that pays the UTPR is worse off than non-group entities not subject to GLOBE rules in the UTPR jurisdiction. Clearly, there is a difference in tax treatment between these cases, and the entity paying the top-up tax might be subject to an individual and excessive burden in this respect. Nonetheless, a broad margin of appreciation exists when applying these criteria, especially in tax cases. The ECtHR has ruled that systems of taxation "inevitably differentiate between groups of tax payers and . . . the implementation of any taxation system creates marginal situations."[33] Therefore, it will be difficult to demonstrate that the pillar 2 rules amount to discrimination in the sense of the ECHR.

Another important element in the proportionality analysis is the tax burden itself. The higher the tax burden, the more likely that the tax measure will infringe upon the right to property. Several factors must be considered when evaluating the tax burden imposed under the pillar 2 rules. While a top-up tax rate of 15 percent may seem low, it is calculated based on the profits of low-taxed entities and imposed subject to the UTPR. This approach can lead to a disproportionate tax burden for the entity itself. Relevant elements are whether the tax measure will allow the taxpayer to continue its activities and earn a profit. In this respect, one can refer to the principle of *minimum vitale*. This principle ensures that taxpayers have access to sufficient means of subsistence and that the tax burden does not prevent them from continuing their activities.[34] The fact that taxpayers may be required to sell (vital) assets to pay the tax is a relevant element.[35] Therefore, the qualification of the taxpayer as a large enterprise can affect the tax burden assessment. When assessing the fair balance between taxpayers and the public interest, it is crucial to consider whether the evaluation should be conducted at the level of the MNE group or the individual entity. It is our view that, in general, the ECtHR would respect the legal personality of the entity and evaluate this criterion at the entity level. However, if there are

[31] European Court of Human Rights, *OAO Neftyanaya Kompaniya Yukos v. Russia*, Application no. 14902/04 (Sept. 20, 2011).

[32] European Court of Human Rights, *Intersplav v. Ukraine*, Application no. 803/02 (Jan. 9, 2007).

[33] European Court of Human Rights, *Pearson v. the United Kingdom*, Application no. 8374/03 (Aug. 22, 2006).

[34] European Court of Human Rights, *Orion Břeclav S.R.O. c. Republique Tcheque*, Application no. 43783/98 (Jan. 13, 2004).

[35] European Court of Human Rights, *Imbert de Tremiolles c. France*, Application no. 25834/05 (Jan. 4, 2008).

indications of abuse, like using the corporate veil to engage in tax avoidance, then the ECtHR may consider piercing the veil and assessing the situation at the group level. Ultimately, the determination depends on the specific circumstances of each case.

In conclusion, the ECtHR will conduct a holistic analysis when assessing the compatibility of the pillar 2 rules with the right to property. Several criteria need consideration, including legal uncertainty, the discriminatory character of the rules, and the tax burden's effect on taxpayers.[36] If a violation of property rights is found, the ECtHR may award compensation reasonably related to the value of the property lost. However, the ECtHR has been hesitant to make specific calculations in cases where the tax levies are disproportionate.

B. Is the UTPR a Lawful Measure?

Even though the proportionality test is the most common route for a legal analysis involving tax measures in the light of the right to property, one can also wonder if the UTPR complies with the first criterion (that is, lawfulness). There are several ways to determine whether it has been breached. One possibility is to examine whether the relevant rules lack clarity or consistency, which is in line with the proportionality analysis.

Another way to the lawfulness criterion could be breached is to assess whether there has been a breach of a written or customary rule. If the UTPR would indeed infringe the nexus principle of customary international law, a levy resulting from the UTPR would not comply with the lawfulness criterion (see also Section III). This would have two consequences. First, in this case, a lawfulness analysis would be sufficient for determining whether property rights have been violated, and a proportionality analysis would no longer be required. The levy would be deemed to infringe the taxpayers' property rights, irrespective of the quantitative tax burden. Second, in cases in which property rights have been violated because of a lack of the lawfulness criterion being fulfilled, the procedure before the ECtHR could involve compensation in the form of full restitution of the taxes paid.

V. Infringement of Bilateral Investment Treaties?

Investment law plays a critical role in the realm of cross-border investments and MNEs, as these investments are frequently governed by investment treaties that afford certain protections, including fair and equitable treatment, protection against expropriation, and access to dispute resolution mechanisms.[37] The UTPR in pillar 2 has the potential to influence the profitability and viability of cross-border investments, possibly resulting in disputes between investors and host states. The investor-state dispute settlement mechanism has the potential to resolve disputes arising from the implementation of the UTPR. Foreign investors have employed this system in many instances to contest domestic tax-related measures,[38] including windfall profits tax,[39] tax investigations,[40] VAT,[41] import taxes,[42] corporate income tax,[43] duty-free regimes and special economic zones,[44] tax stamps on cigarettes,[45] tax on power generators' revenues,[46] and more.

The hypothetical situation described in Section II illustrates the potential ramifications of the UTPR on cross-border investments. In this

[36] Debelva, *International Double Taxation and the Right to Property* 274 et seq. (2019).

[37] Ricardo García Antón and Toni Marzal, "Proportionality and the Fight Against International Tax Abuse: Comparative Analysis of Judicial Review in EU, International Investment and WTO Law," 31(1) *Asia Pacific L. Rev*. 253-267 (2023).

[38] Julien Chaisse, "Investor-State Arbitration in International Tax Dispute Resolution — A Cut Above Dedicated Tax Dispute Resolution?" 41(2) *Va. Tax Rev.* 149-222 (2016).

[39] *E.g.*, *ConocoPhillips Petrozuata B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30 (2019).

[40] *E.g.*, *Hulley Enterprises Ltd. (Cyprus) v. Russia*, Permanent Court of Arbitration Case No. 2005-03/AA226 (2014).

[41] *E.g.*, *Teinver S.A. v. Argentine Republic,* ICSID Case No. ARB/09/01 (2017).

[42] *E.g.*, *BSG Resources Ltd. v. Republic of Guinea*, ICSID Case No. ARB/14/22 (2022).

[43] *E.g.*, *Cairn Energy PLC v. Republic of India*, Permanent Court of Arbitration Case No. 2016-07 (2020).

[44] *E.g.*, *Zhongshan Fucheng v. Nigeria*, UNCITRAL (2021). *See* Chaisse, "Dangerous Liaisons: The Story of Special Economic Zones, International Investment Agreements, and Investor-State Dispute Settlement," 24(2) *J. Int'l Econ. L.* 443-471 (June 2021) (emphasizing the importance of striking a balance in public policy between the interests of host countries and foreign investors to maintain the appeal of special economic zones for substantial foreign investment).

[45] *E.g.*, *Philip Morris Brand Sàrl (Switzerland) v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7 (2016).

[46] *E.g.*, *BayWa r.e. Renewable Energy GmbH v. Spain*, ICSID Case No. ARB/15/16 (2021).

case, a foreign investor holds 30 percent of the subsidiary's shares, and the application of the UTPR has a significant effect on the investment. This could result in a potential breach of the relevant investment treaty and require an examination of international investment law and arbitration procedure.

To establish the jurisdiction of an international investment tribunal, the foreign investor must demonstrate their nationality, qualifying investment, treaty coverage, subject matter, and adherence to dispute resolution provisions. If jurisdiction is established, potential breaches of substantive investment law must be examined. Assuming an applicable investment treaty is in place, there is a reasonable likelihood of establishing jurisdiction over the dispute, allowing the examination of potential breaches of substantive investment law to proceed. Various types of allegations could support a foreign investor's challenge against a state implementing the UTPR.

First, the foreign investor must contend that the UTPR's implementation significantly and persistently undermines the investment's value, amounting to de facto expropriation. The foreign investor must also demonstrate that the state's measures lack a legitimate public purpose, proportionality, or nondiscriminatory application.

Second, the fair and equitable treatment standard may be breached because of the state's adoption of the UTPR. The foreign investor can present evidence emphasizing the absence of transparency or consultation during the UTPR's implementation, as well as proof that the state disregarded the investor's interests when enacting the measure. Legal arguments can assert that the state's UTPR implementation disrupted the foreign investor's legitimate expectations, lacked transparency, was disproportionate, and did not provide adequate due process or procedural fairness.

Third, the foreign investor might also argue that the UTPR enforcement unfairly targets the subsidiary investment, violating the national treatment principle. To claim a national treatment breach, the foreign investor must show that the foreign investment in the subsidiary is comparable to domestic investments, the UTPR's implementation disproportionately affects the subsidiary compared with similar domestically owned entities, and the state cannot justify the differences based on legitimate policy objectives or objective criteria.

If the foreign investor can prove the state's treaty breaches, they may seek compensation or restitution as a remedy. Compensation usually entails monetary damages for the investor's losses, while restitution concentrates on restoring the investment. In determining the appropriate remedy, the foreign investor can reference previous cases in which tribunals have granted similar remedies. For example, if the investor's 30 percent stake in the subsidiary was initially worth $300,000 (assuming the subsidiary's net assets were $1 million), and the UTPR's implementation led to a 50 percent decline in the subsidiary's net assets, the investor's share would be worth $150,000. In this situation, the compensation could be at least the difference between the initial and diminished values ($300,000 - $150,000 = $150,000). Also, the investor might claim compensation for lost profits and other financial damages resulting from the breach, increasing the total amount of compensation sought.

In conclusion, the implementation of the UTPR presents a multitude of substantial challenges for states. There is a genuine risk of facing lawsuits under investment treaties, not just from a single foreign investor but from multiple investors. It is important to recall the instance when the Indian Parliament enacted an amendment to a specific tax law with a retroactive effect, addressing indirect transfers by nonresidents.[47] This legislative action resulted in two similar yet distinct cases filed by foreign investors, Cairn and Vodafone, ultimately leading to India's losing both cases and being obligated to pay over $3.2 billion in compensation (plus interest and costs) to the foreign investors. The situation should serve as a cautionary example for states implementing the UTPR and the potential legal implications under international investment law.

[47] Prabhash Ranjan, "Investor-State Dispute Settlement and Tax Matters: Limitations on State's Sovereign Right to Tax," 31(1) *Asia Pacific L. Rev.* 219-234 (2023).

VI. Can Countries Oppose Implementation?

The discussion above shows that countries implementing the UTPR may infringe international law obligations (tax treaties, investment treaties, human rights conventions, and so forth).[48] Therefore, countries should carefully assess whether they can, and should, implement the UTPR.

However, we will briefly assess whether there are any other consequences for not implementing these rules besides losing tax revenue under the global minimum tax and potentially infringing international law obligations.

In 2008 the European Commission, with the aim to play a more important role in the international tax developments vis-à-vis non-EU countries, introduced the EU standard of tax good governance as part of the External Strategy for Effective Taxation.[49] This standard included transparency, exchange of information, and fair taxation. Since 2018, it has also included the four BEPS minimum standards, including a positive peer review of the implementation of those minimum standards.

This standard has been introduced in *formal trade and partnership agreements* and as a condition for a country to receive EU development funds.[50] Crucially, this condition is applied not only for countries participating in the BEPS inclusive framework but for all countries. Thus, even if countries decide not to participate in the inclusive framework, because of the introduction of the EU standard of tax good governance, these countries may participate in the inclusive framework, or at least be reviewed, to receive a positive review of the implementation of the BEPS minimum standards.[51]

A positive review provides access to EU funds, facilitates the implementation of EU trade and partnership agreements, and prevents countries being on the gray list or blacklist of noncooperative jurisdictions.[52] In 2021 the European Commission mentioned that pillar 2 will be introduced in the EU standard of tax good governance.[53] If pillar 2 is included in this standard, this will mean that non-EU countries can be required to implement pillar 2 (and also UTPR rules), to obtain economic/trade benefits, to receive EU funding, and to be excluded from the blacklisting exercise.

For non-EU countries, not aligning with pillar 2 (including UTPR) can result in not being able to receive EU funding or possibly being blacklisted. This would, however, be a delicate result as the EU would push states into infringing their treaty obligation, and bilateral investment treaties in particular create financial risk of being forced to repay top-up taxes.

The situation is different in pillar 1 because, unlike the UTPR that will be introduced by all countries that have committed to the 2021 political statement, the rules to tax digital activities may differ among countries. For instance, in addition to the OECD secretariat proposal to tax highly digitized business that has been adopted in the 2021 political statement by most of the countries of the BEPS inclusive framework, countries have introduced unilateral rules to tax digital activities, like digital services tax and significant economic presence.

One of these rules — the DST — has been regarded by the United States as an obstacle to trade, and therefore, the United States has asked countries to repeal it.[54] In 2020 the U.S. trade representative initiated trade investigations

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[49] European Commission, Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation, COM/2016/024 final, Annex II (Jan. 28, 2016).

[50] *See* Irma Johanna Mosquera Valderrama, "The EU Standard of Good Governance in Tax Matters for Third (Non-EU) Countries," 47(5) *Intertax* 454-467 (2019).

[51] This was the case of the Philippines, which was peer reviewed by the OECD on the base erosion and profit-shifting action 5 mainly regarding harmful tax regimes, even though it decided not to participate in the BEPS inclusive framework. *See also* art. 44 of the EU-Philippines Framework Agreement on Partnership and Cooperation.

[52] *See* Mosquera Valderrama, *supra* note 50.

[53] As mentioned by Benjamin Angel at the 2021 Global Tax Symposium (Dec. 8-9, 2021).

[54] *See* Mosquera Valderrama, "Trade Digitalization and Taxation" in *Elgar Companion to the WTO* (forthcoming 2023).

under section 301 and called countries to repeal the DST. These investigations could lead to tariffs being imposed on these countries' exports to the United States.[55] This situation resulted in countries' reconsidering introducing a DST.

More recently, in addition to the threat of trade tariffs, the United States has used economic incentives (trade agreements) to ask countries to repeal the DST, which may result in countries' not being able to make their own choices. For instance, Kenya has a DST, so in 2021 its policymakers did not consider that the country should commit to the 2021 political statement. Instead, Kenya continued with its DST. However, the United States, in the framework of the negotiations of a trade agreement, has asked Kenya to repeal it. Kenya's government has recently expressed that it will repeal its DST.[56]

VII. Conclusion

The past months have shown that there are strong arguments that states infringe various international law obligations while introducing the UTPR. Similar positions can be justified regarding the IIR.[57] A potential multilateral convention would help to mitigate several potential conflicts (but may not necessarily solve all the issues). However, so far the drafters of the model rules have not initiated this process of drafting a multilateral convention. This is surprising.

One reason why the drafters seem reluctant to address the concerns (at least partly) through a binding international agreement seems that they are afraid of going through the ordinary process of direct or indirect democratic approval of international treaties.

If policymakers were confident that the current proposal of a global minimum tax is sufficiently persuasive, they would not fear the additional burden of an approval process of a multilateral convention.

Instead, using the UTPR as a threat to noncompliant states seems a dangerous path. International law is there to curb excessive and imperialistic proposals, so international policymakers should pay particular attention to the discussed frictions.

Advancing the project without assessing how, and whether, the above infringements can be mitigated jeopardizes one of the OECD's main achievements of the last century, namely that international treaties — especially double tax treaties — must be respected. Through the publication of the model rules and the support of national implementation of the minimum tax, the OECD and the member states of the inclusive framework risk losing this achievement of the binding force of international law obligations. This is a high price. Whether the additional tax revenues, a reasonable estimate of which is simply not possible, outweigh these costs is highly questionable.[58]

These are unusual and strong words, but we are at a turning point of international tax policy, and it is more crucial than ever that the OECD embeds its work in the existing international law framework. As stated in the Preamble of the Convention on the OECD as of December 14, 1960, governments are determined to pursue the goals of the OECD "in a manner consistent with their obligations in other international organisations or institutions in which they participate or under agreements to which they are a party." ■

[55]"Initiation of Section 301 of Digital Services Tax," 85 F.R. 34709-34711 (June 5, 2020).

[56]Kepha Muiruri, "President Ruto Drops Digital Service Tax Against Multinationals," *Business Daily Africa*, Mar. 31, 2023.

[57]At least regarding customary international law, see Hongler, "Is the Pillar 2 Agreement Infringing International Law Obligations?" GLOBTAXGOV, Nov. 12, 2021. Regarding tax treaties, see Chand, Turina, and Romanovska, *supra* note 1, at 5-20.

[58]The calculation of additional tax revenues without considering the planning opportunities created by the inclusion of deferred taxes and various options in the model rules is not persuasive.