The Justification and Structure of the GloBE Model Rules

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ABBREVIATIONS AND ACRONYMS

ACE	Allowance for Corporate Equity
AGI	Allowance for Growth and Investment
ALS	Arm's Length Standard
Art.	Article
ATAD	Anti-Tax Avoidance Directive (EU)
BEFIT	Business in Europe: Framework for Income Taxation (EU)
BEPS	Base Erosion and Profit Shifting
BEPS 2.0	Pillar One and Pillar Two, jointly considered
BFH	*Bundesfinanzhof* (German high tax/finance court)
BILMOG	*Bilanzrechtsmodernisierungsgesetz* (German legislation)
BR	Brazil
BRICS	Brazil, Russia, India, China and South Africa
BVerfG	*Bundesverfassungsgericht* (German constitutional court)
CCCTB	Common Consolidated Corporate Tax Base (EU)
CCTB	Common Corporate Tax Base (EU)
CE	Constituent Entity
CEN	Capital Export Neutrality
CFC	Controlled Foreign Company
ch.	chapter
CIN	Capital Import Neutrality
CIT	Corporate Income Tax
CON	Capital Ownership Neutrality
DE	Germany
DEBRA	Debt Equity Bias Reduction Allowance (EU)
DST	Digital Services Tax
DStJG	*Deutsche Steuerjuristische Gesellschaft* (German association)
DTC	Double Tax Convention
e.g.	*exempli gratia* (for example)
EATLP	European Association of Tax Law Professors
ECJ	European Court of Justice
ES	Spain
EStG	*Einkommensteuergesetz* (German income tax law)
et al.	*et alia* (and others)
ETR	Effective Tax Rate
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
fn.	footnote
G20	Group of Twenty
GAAP	Generally Accepted Accounting Principles
GILTI	Global Intangible Low-Taxed Income (US)
GLOBE	Global Anti-Base Erosion
i.e.	*id est* (in other words)
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IBDT	*Instituto Brasileiro de Direito Tributário* (Brazilian Institute of Tax Law)
IBFD	International Bureau of Fiscal Documentation

IF	Inclusive Framework
IFA	International Fiscal Association
IFRS	International Financial Reporting Standards
IIR	Income Inclusion Rule
JZ	*Juristenzeitung* (German law review)
KStG	*Körperschaftsteuergesetz* (German CIT law)
LTCE	Low-Taxed Constituent Entity
MNE	Multinational Enterprise
NE	Number of Employees
n.	note
no.	number
OECD	Organisation for Economic Co-operation and Development
OECD-MC	OECD Model Tax Convention on Income and on Capital
p.	page
para.	paragraph
PE	Permanent Establishment
PEa	meaning (a) of PE in Art. 10.1 of the GLOBE MODEL RULES
PEb	meaning (b) of PE in Art. 10.1 of the GLOBE MODEL RULES
PEc	meaning (c) of PE in Art. 10.1 of the GLOBE MODEL RULES
PEd	meaning (d) of PE in Art. 10.1 of the GLOBE MODEL RULES
POPE	Partially-Owned Parent Entity
QDMTT	Qualified Domestic Minimum Tax
SAAR	Special Anti-Avoidance Rule
sec.	section
SOR	Switch-Over Rule
STJ	*Superior Tribunal de Justiça* (Brazilian high court)
STTR	Subject to Tax Rule
TCJA	The Tax Cuts and Jobs Act of 2017 (US)
TP	Transfer Pricing
tvTA	total value of Tangible Assets
UK	United Kingdom
UN	United Nations
UN-MC	UN Model Double Taxation Convention
UNCTAD	United Nations Conference on Trade and Development
UPE	Ultimate Parent Entity
US	United States of America
UTPR	Undertaxed Payments/Profits Rule
VAT	Value-Added Tax
v.	*versus*
vol.	volume
WHT	Withholding Tax
ZEW	*Zentrum für europäische Wirtschaftsforschung* (German institute)

SHORT FORM CITATIONS

For ease of reference, the following terms are used in the thesis to identify specific GLOBE-related documents:

2021 IF STATEMENT – OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Base Erosion and Profit Shifting Project, Paris, OECD, October 2021.

ECONOMIC IMPACT ASSESSMENT – OECD, Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, Paris, OECD, 2020.

GLOBE COMMENTARY – OECD, *Tax Challenges Arising from the Digitalisation of the Economy* – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), Paris, OECD, 2022.

GLOBE EXAMPLES – OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples*, Paris, OECD, 2022.

GLOBE MODEL RULES – OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, Paris, OECD, 2021.

PILLAR TWO BLUEPRINT – OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, Paris, OECD, 2020.

POLICY NOTE – OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, as approved by the Inclusive Framework on BEPS on 23 January 2019.

POW – OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, 28 May 2019.

PUBLIC CONSULTATION DOCUMENT – OECD, Public Consultation Document, Global Anti-Base Erosion Proposal (“GloBE”) - Pillar Two, 8 November 2019- 2 December 2019.

RELEVANT MATERIAL – POLICY NOTE, POW, PUBLIC CONSULTATION DOCUMENT, ECONOMIC IMPACT ASSESSMENT, PILLAR TWO BLUEPRINT, GLOBE COMMENTARY and GLOBE EXAMPLES, jointly considered.

INTRODUCTION

1. BACKGROUND

International tax law is currently going through very interesting times. As a body of law, it is generally perceived to be "in shambles"[1]. Particularly after the 2008 financial crisis, a lot of attention has been drawn to corporate taxation. Multinational Enterprises ("**MNEs**") have been accused of being "imoral", even when complying with applicable legislation[2]. The analysis of their global effective tax rate led to the conclusion that they were not paying their "fair share" of Corporate Income Tax ("**CIT**")' and bringing them to pay their fair share has become the *leitmotiv* of the reforms of the CIT in the last decade[3]. The challenge has demanded the fast development of new ideas and proposals, to which academia had to quickly react.

The OECD/G20 Base Erosion and Profit Shifting ("**BEPS**") Project was substantially grounded on the idea of "value creation", which was unheard of in international tax literature[4]. Despite the brief mention to "creation of value" in the 2010 OECD Transfer Pricing ("**TP**") Guidelines in the context of allocation keys for the profit split[5], "value creation" would not be discussed with the aspiration to be a "principle" before 2012[6]. The whole OECD Action Plan was grounded on an *ad hoc* term, which had never been submitted to intellectual scrutiny by tax scholarship, and whose actual meaning still remains unclear[7]. Academia was taken by storm by thousands of pages of final reports based on such expression, which, to a great extent, is still controversial.

Only a few years after the enactment of the BEPS final reports, expressing "a lack of confidence in the BEPS 1.0 coherence-related rules"[8], the OECD presented proposals on

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[1] Mitchell Kane, "A Defense of Source Rules in International Taxation," *Yale Journal on Regulation* 32 (2015): 312.

[2] See UK Public Accounts Committee, HC 716, House of Commons, 2012 (Matt Brittin's statement and reply by chair Q485). As phrased by the Chair of the Committee: "*We are not accusing you of being illegal; we are accusing you of being immoral*".

[3] For an academic account of the topic, see Stan A. Stevens, "The Duty of Countries and Enterprises to Pay Their Fair Share," *Intertax* 42, no. 11 (2014): 702–8.

[4] See Philip Baker, "The BEPS 2.0 Project Over the Coming Months," *Intertax* 48, no. 10 (2020): 846. (stating that the BEPS Project began "with only a vague notion of what the problem was in terms of the taxation of MNEs").

[5] See OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, Paris: OECD, 2010, para. 2.136.

[6] On this development, see Clair Quentin, "Gently Down the Stream: BEPS, Value Theory and the Allocation of Profitability along Global Value Chains," *World Tax Journal* 13, no. 2 (2021): 184.

[7] Among many others, discussing the issue, see Wolfram F. Richter, "Aligning Profit Taxation with Value Creation," *World Tax Journal* 13, no. 1 (2021): 3–23; Adolfo Martín Jiménez, "Value Creation: A Guiding Light for the Interpretation of Tax Treaties?," *Bulletin for International Taxation* 74, no. 4/5 (2020): 197–215; Conrad Turley and Khoon Ming Ho, "GloBE - Overriding the Value Creation Principle as Lodestone of International Tax Rules?," *Intertax* 47, no. 12 (2019): 1070–76; Johanna Hey, "'Taxation Where Value Is Created' and the OECD/G20 Base Erosion and Profit Shifting Initiative," *Bulletin for International Taxation* 72, no. 4/5 (2018): 203–8; Stanley I. Langbein and Max R. Fuss, "The OECD/G20-BEPS-Project and the Value Creation Paradigm: Economic Reality Disemboguing into the Interpretation of the Arm's Length Standard," *International Lawyer* 51, no. 2 (2018 2017): 259–410.

[8] Turley and Ho, "GloBE - Overriding the Value Creation Principle," 1076. Similarly, see Magdalena Schwarz, *The OECD GloBE proposal – a decisive step towards uniform global minimum taxation?* (Baden-Baden: Nomos, 2022), 27–28.

the same issues addressed by the BEPS Project, questioning some of the foundations of international business taxation. Despite the efforts to tweak[9] the "value creation principle" and explore its vagueness and lack of clear content, the new proposals hardly resemble it[10]. Pillar One and Pillar Two – often referred jointly as "**BEPS 2.0**"[11] – "dwarf the modest changes made by the OECD/G20 BEPS Project"[12]. Pillar Two in particular is expected to have far-reaching consequences even for countries that have not implemented the relevant rules[13]. Labelled as a solution to the remaining BEPS issues[14], Pillar Two has already been described as one of "the most important international tax proposals in many decades"[15]. Despite the significant technical and administrative challenges inherent to the design of such rules[16], model legislation has been developed in a very short time frame[17], providing for a framework for a minimum tax.

2. OBJECT: THE GLOBE MODEL RULES AS A CLOSED SYSTEM

The object of the present thesis is a set of written model rules which is expected to be implemented by Inclusive Framework ("**IF**") states in the forthcoming years[18]: the GLOBE MODEL RULES. They have been conceived within Pillar Two, which seeks to introduce a global minimum effective rate of corporate taxation at an agreed Minimum Rate of 15%. Pillar Two consists of the Global anti-Base Erosion ("**GLOBE**") rules and the Subject to Tax Rule ("**STTR**").

The GLOBE rules essentially provide for two interlocking domestic rules, which complement each other, namely: (i) the Income Inclusion Rule ("**IIR**"), which imposes a Top-up Tax on a Parent Entity in respect of income taxed below the 15% minimum agreed Effective Tax Rate ("**ETR**"); and (ii) the Undertaxed Payment Rule ("**UTPR**"), which is a supporting rule that denies tax deductions or requires an equivalent adjustment to the extent the low tax income of a Constituent Entity ("**CE**") is not subject to tax under an IIR[19].

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[9] For a critical view on the "tweaking of rules" in the BEPS Project, see Yariv Brauner, "What the BEPS?," *Florida Tax Review* 16, no. 2 (2014): 70; Andrés Báez Moreno and Yariv Brauner, "Taxing the Digital Economy Post BEPS... Seriously," *Columbia Journal of Transnational Law* 58, no. 1 (2019): 126.

[10] See Turley and Ho, "GloBE - Overriding the Value Creation Principle," 1076. Stating that the value creation principle has been "completely disregarded" by Pillar Two, see Schwarz, *The OECD GloBE proposal*, 28.

[11] See, *e.g.,* Baker, "The BEPS 2.0 Project Over the Coming Months," 845; Reuven Avi-Yonah, Young Ran Kim, and Karen Sam, "A New Framework for Digital Taxation" (forthcoming in Harvard International Law Journal 63 (manuscript), 2022), 13.

[12] Brian J. Arnold, "The Ordering of Residence and Source Country Taxes and the OECD Pillar Two Global Minimum Tax," *Bulletin for International Taxation* 76, no. 5 (2022): 219.

[13] Arnold, 219.

[14] For an overview, see Francesco De Lillo, "Introducing Pillar Two: Towards a Global Minimum Effective Tax Rate," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), sec. 1.1.2.3.

[15] Arnold, "The Ordering of Residence and Source," 219.

[16] Turley and Ho, "GloBE - Overriding the Value Creation Principle," 1075.

[17] Referring to the "frantic" pace of the BEPS Project since 2012, see Baker, "The BEPS 2.0 Project Over the Coming Months," 846.

[18] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (Paris: OECD, 2021). (hereinafter "**GLOBE MODEL RULES**").

[19] OECD, "Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy," January 2020. (hereinafter the "**2021 IF STATEMENT**"), p. 3.

Despite not being mentioned in the 2021 IF STATEMENT, the Qualified Domestic Minimum Top-up Tax ("**QDMTT**") is also an important part of the Pillar Two solution. The QDMTT is essentially a domestic minimum tax that is included in the domestic law of a jurisdiction and that determines the Excess Profits of the CEs located in the jurisdiction in a manner that is equivalent to the GLOBE MODEL RULES[20]. It is a mechanism that allows jurisdictions which are potentially taxing jurisdictionally blended CEs below the ETR to tax the Excess Profits themselves, instead of letting them become subject to the IIR and the UTPR – thus adding revenue to other states.

The STTR is a treaty-based rule that allows source jurisdictions to impose source taxation on certain controlled payments subject to tax below the Minimum Rate. The STTR shall be creditable as a Covered Tax under the GLOBE rules[21]. The STTR can only be implemented through changes to the existing bilateral treaties, either by means of bilateral negotiations or as part of a multilateral convention[22], and is outside the scope of the thesis[23].

2.1. The Pillar Two solution

In January 2019, the IF, working through its Task Force on the Digital Economy ("**TFDE**")[24], issued a policy note on the tax challenges of the digitalization of the economy[25]. Under the POLICY NOTE, the IF agreed to undertake work on Pillar One and Pillar Two. Following consultation with external stakeholders on the specific proposals examined under Pillar One and Pillar Two[26], the IF further agreed on a Program of Work[27]. Under the Pillar Two of the POW, the IF agreed to explore issues and design options in connection with the development of a coordinated set of rules aimed at introducing a system of minimum taxation, specifically mentioning the IIR, the UTPR, and the STTR.

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[20] See ch. V, sec. 3.4, *infra.*

[21] 2021 IF STATEMENT, p. 3.

[22] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD, 2020). (hereinafter "**PILLAR TWO BLUEPRINT**"), para 21.

[23] On the topic, see Heydon Wardell-Burrus, "Pillar Two and Developing Countries: The STTR and GloBE Implementation," *Intertax* 51, no. 2 (2023): 118–33; Victoria Perry, "Pillar 2, Tax Competition, and Low Income Sub-Saharan African Countries," *Intertax* 51, no. 2 (2023): 110–11; Schwarz, *The OECD GloBE proposal*, 41–56; Mery Alvarado and René Offermanns, "The Subject-to-Tax Rule," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), 167–98.

[24] The TFDE was established in 2013 and has conducted independent scientific research on tax issues related to the digitalised economy. See Pasquale Pistone et al., "The OECD Public Consultation Document 'Global Anti-Base Erosion (GloBE) Proposal – Pillar Two': An Assessment," *Bulletin for International Taxation* 74, no. 2 (2020): 62.

[25] OECD, "Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note" (as approved by the Inclusive Framework on BEPS on 23 January, 2019). (hereinafter "**POLICY NOTE**").

[26] OECD, Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, 13 February – 6 March 2019.

[27] OECD, "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy" (28 May, 2019). (hereinafter "**POW**").

The TFDE further issued a public consultation specifically dedicated to the GLOBE proposal[28]. The PUBLIC CONSULTATION DOCUMENT contains input on core issues of the GLOBE proposal, including the implications of using financial accounts as a possible simplification to determining the tax base and approaches to neutralizing differences in financial accounts and taxable income, as well as the issues of blending, carve-outs and thresholds. The OECD Secretariat also assessed the economic impact of the Pillars One and Two[29]. The ECONOMIC IMPACT ASSESSMENT was issued at a stage where not all features of the GLOBE MODEL RULES were completely settled and served as a decision-making tool for the stakeholders to consider the possible policy choices.

The work went on with the PILLAR TWO BLUEPRINT, according to which an important element to ensure the consistent, comprehensive and coherent application of the GLOBE rules would be the enactment of model legislation, which would serve "as a template that jurisdictions could use as the basis for domestic legislation"[30]. The enactment of a multilateral convention would not be a "prerequisite", but it would be the only way to ensure rule coordination in a legally binding form. Therefore, a proposal of multilateral convention on the GLOBE rules is also foreseen[31].

Under the 2021 IF STATEMENT, IF jurisdictions agreed to a two-pillar solution to address the tax challenges arising from the digitalization of the economy, whose components are broadly described in the document. According to the 2021 IF STATEMENT, the GLOBE rules are intended to have the status of a "common approach". This means that IF members: (i) are not required to adopt the rules, but if they choose to do so, the enacted rules must be consistent with model rules and guidance agreed to by the IF; and (ii) accept the application of the GLOBE rules by other IF members, including agreement as to rule order and safe harbors[32]. The implementation of the GLOBE rules is intended not to require any changes to the bilateral treaties and be applied merely by means of amendments to domestic legislation[33]. It was therefore assumed by the 2021 IF STATEMENT that the GLOBE rules would be compatible with the existing international tax framework – an assumption whose detailed analysis is outside of the scope of the thesis[34].

2.2. The GLOBE MODEL RULES and the RELEVANT MATERIAL

As a form of model legislation, the GLOBE MODEL RULES were released on December 20th, 2021, as part of OECD's Two Pillar solution to address the tax challenges arising

[28] OECD, "Public Consultation Document, Global Anti-Base Erosion Proposal ('GloBE') - Pillar Two" (8 November 2019- 2 December, 2019). (hereinafter "**PUBLIC CONSULTATION DOCUMENT**").
[29] OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD, 2020). (hereinafter "**ECONOMIC IMPACT ASSESSMENT**").
[30] PILLAR TWO BLUEPRINT, para 699.
[31] PILLAR TWO BLUEPRINT, p. 178, para 705.
[32] 2021 IF STATEMENT, p. 3.
[33] PILLAR TWO BLUEPRINT, para. 21.
[34] See, critically, on the relationship between Pillar Two and DTCs, Luís Eduardo Schoueri, "Some Considerations on the Limitation of Substance-Based Carve-Out in the Income Inclusion Rule of Pillar Two," *Bulletin for International Taxation* 75, no. 11/12 (2021): 543–48; 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," *World Tax Journal* 14, no. 1 (2021): 3–50; Betty Andrade and Luis Nouel, "Interaction of Pillar Two with Tax Treaties," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), 235.

from the digitalization of the economy. They were agreed on by 136 members of the IF on October 8th, 2021[35], along with the expectation to be brought into law in 2022, with the IIR becoming effective in 2023, and the UTPR as from 2024[36].

On March 14th, 2022, the OECD published commentary[37] to the GLOBE MODEL RULES. The GLOBE COMMENTARY "explains the intended outcomes under the rules and clarifies the meaning of certain terms", and is intended to "promote a consistent and common interpretation of the GloBE Rules that will facilitate co-ordinated outcomes for both tax administrations and MNE Groups", also including examples aiming at illustrating the application of the GLOBE MODEL RULES to certain fact patterns[38].

Additionally, on a separate document, the OECD Secretariat provided a series of examples, which illustrate the application of the GLOBE MODEL RULES[39]. The GLOBE EXAMPLES are "intended to be used for illustrative purposes only" and are not part of the GLOBE COMMENTARY[40]. The future development of further examples to illustrate the application of the GLOBE MODEL RULES and the explanations given in the GLOBE COMMENTARY is also foreseen[41].

The object of the present thesis are the GLOBE MODEL RULES. In order to fully comprehend such rules in their context, the thesis also takes into consideration elements from the IF and the OECD work on the topic, including the POLICY NOTE, the POW, the PUBLIC CONSULTATION DOCUMENT, the ECONOMIC IMPACT ASSESSMENT, the PILLAR TWO BLUEPRINT, the GLOBE COMMENTARY and the GLOBE EXAMPLES (hereinafter referred jointly as "**RELEVANT MATERIAL**").

The GLOBE COMMENTARY, which was approved by the IF on March 11th, 2022, and prepared for publication by the OECD Secretariat[42], is essential for the GLOBE MODEL RULES. "Commentary" is a defined term[43], which is further used to define a "Qualified IIR", a "Qualified QDMTT" and a "Qualified UTPR". All three mechanisms must be "implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Commentary, provided that such jurisdiction does not provide any benefits that are related to such rules"[44]. This is a very broad requisite, whose importance cannot be understated. After all, the ultimate goal of the GLOBE MODEL RULES is to set forth rules for the implementation and administration of the IIR, the QMDTT and the UTPR. Any deviation on the definition of Adjusted Covered Taxes[45] or

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[35] They were agreed on by 136 members of the IF on 8 October 2021. Mauritania and Azerbaijan also joined the Inclusive Framework, and the number of committed jurisdictions increased to 138. Only Kenya, Nigeria, Pakistan and Sri Lanka have not approved the agreement, out of the 142 IF members.
[36] GLOBE MODEL RULES, p. 5.
[37] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)* (Paris: OECD, 2022).(hereinafter "**GLOBE COMMENTARY**").
[38] GLOBE COMMENTARY, para. 3.
[39] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples* (Paris: OECD, 2022). (hereinafter "**GLOBE EXAMPLES**").
[40] GLOBE EXAMPLES, para. 2.
[41] GLOBE EXAMPLES, para. 2.
[42] GLOBE COMMENTARY, p. 3.
[43] GLOBE MODEL RULES, Art. 10.1.1: "Commentary means the Commentary to the GloBE Rules as developed by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting".
[44] This phrasing is repeated in the definitions of Qualified IIR, Qualified QMDTT, and Qualified UTPR.
[45] On the definition of Adjusted Covered Taxes, see ch. II, sec. 4, *infra.*

GLOBE Income or Loss[46], for example, will, at the end of the day, impact how the IIR, the QMDTT and the UTPR are implemented and administered.

There are several situations in which one jurisdiction shall analyse whether another jurisdiction's implementation and application of domestic rules is in accordance with the GLOBE MODEL RULES and the GLOBE COMMENTARY and conclude whether it meets the definition of Qualified IIR, UTPR or QMDTT. In such cases, a comparison shall be made between the domestic legislation *vis-à-vis* the GLOBE MODEL RULES and the GLOBE COMMENTARY. A comparison between domestic legislations is irrelevant: the reference shall be the GLOBE MODEL RULES and the GLOBE COMMENTARY, which are taken as a standard, from which "a harmonized international approach should result"[47].
Besides the GLOBE COMMENTARY, there is another important source of law for the interpretation of the GLOBE MODEL RULES. The GLOBE MODEL RULES set forth the obligation of the tax administration of the jurisdiction implementing them to, subject to any requirements of domestic law, apply the GLOBE MODEL RULES in accordance with any Agreed Administrative Guidance[48]. The term "Agreed Administrative Guidance" is defined as "guidance on the interpretation or administration" of the GLOBE MODEL RULES issued by the IF[49].

The GLOBE MODEL RULES are therefore built to provide for a strong version of model rules, not allowing the states any substantive leeway for cherry-picking upon their implementation[50]. In doing so, they shall inevitably provide for a significant amount of autonomous concepts, as remitting to domestic legislation does not suffice for the intent of harmonization. As summarized by ARNOLD, the GLOBE MODEL RULES "cannot, and do not, rely on domestic law definitions because those definitions differ widely, and the Pillar Two global minimum tax is intended to produce the same outcome in all participating countries"[51].

The autonomy of the concepts raises the question of who has the authority to interpret and further regulate the GLOBE MODEL RULES. If the goal is to provide for harmonization, the relevant rules should ideally be included into a multilateral convention, along with an *ad hoc* binding dispute prevention and resolution mechanism to solve disputes related to their application[52]. In the case of the GLOBE MODEL RULES, which shall be transposed by states in the form of domestic legislation, no specific dispute resolution mechanism is available[53]. While the rules will inevitably be subject to interpretation by multiple domestic courts, they also expressly set forth the centrality of the GLOBE COMMENTARY and of the Agreed Administrative Guidance to their interpretation. Despite this clarity of

[46] On the definition of GLOBE Income or Loss, see ch. II, sec. 2, *infra.*
[47] Arnold, "The Ordering of Residence and Source," 220.
[48] GLOBE MODEL RULES, Art. 8.3.
[49] GLOBE MODEL RULES, Art. 10.1.1.
[50] See, on the importance of the uniform application of the GLOBE MODEL RULES for their justification, sec. 5.1., *infra.*
[51] Brian J. Arnold, "An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax," *Bulletin for International Taxation* 76, no. 6 (2022): 275.
[52] See Robert Danon et al., "The OECD/G20 Global Minimum Tax and Dispute Resolution: A Workable Solution Based on Article 25(3) of the OECD Model, the Principle of Reciprocity and the GloBE Model Rules," *World Tax Journal* 14, no. 3 (2022): 489.
[53] Exploring the possibilities to deal with GloBE disputes under the current international tax framework and without the need for a multilateral convention, see Danon et al., 489–515.

intentions, there is no reason to expect the elimination of the traditional debate of whether a certain part of the commentary would go beyond the content of the rules[54].

At the same time, by making clear that the GLOBE EXAMPLES are not part of the GLOBE COMMENTARY, the OECD Secretariat acknowledges that the GLOBE EXAMPLES are not intended to have the same force as the GLOBE COMMENTARY. In other words, IIR, QMDTT and UTPR shall be implemented and administered according to the GLOBE COMMENTARY, but not necessarily according to the GLOBE EXAMPLES.

It is indeed possible that examples are provided in the form of Agreed Administrative Guidance. The GLOBE COMMENTARY acknowledges that the IF "may develop further examples on the application of the rules through Administrative Guidance provided under Article 8.3"[55]. However, the GLOBE EXAMPLES do not have the nature of Agreed Administrative Guidance, because they have not been approved by the IF, and were issued by the OECD Secretariat.

In any case, it is evident that the OECD Secretariat is not able to provide for binding provisions on the interpretation and implementation of the GLOBE MODEL RULES and only the IF has such authority. Both the issuance of Commentary and Agreed Administrative Guidance demand specific approval by the IF.

In summary, the thesis takes the GLOBE COMMENTARY and Agreed Administrative Guidance as a source of law, based on Art. 8.3 and Art. 10.1 of the GLOBE MODEL RULES. The thesis does not take the other RELEVANT MATERIAL as a source of law, but merely resorts to them in order to find non-binding discussions and clarifications with regard to potential application examples and policy decisions. It is therefore implicit to the methodology of the thesis that the GLOBE MODEL RULES are intended to bring forward a "strong form" of minimum tax[56].

The object of the thesis are the GLOBE MODEL RULES, and not its (potential) implementation by any specific jurisdiction. The thesis refrains from making assertions regarding the binding nature of the GLOBE MODEL RULES and the GLOBE COMMENTARY under the domestic legislation of any specific jurisdiction. In the present thesis, the GLOBE MODEL RULES are treated as "a closed system, largely independent of other aspects of a country's domestic law"[57]. At the same time, as the GLOBE MODEL RULES are not applicable as such, being merely model rules, the reference to the GLOBE MODEL RULES in the thesis is commonly a metonymy to refer to the adoption of domestic rules patterned after the GLOBE MODEL RULES[58].

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[54] This sort of discussion is frequent with regard to double tax conventions. For a systematization on the topic, see Jasper Bossuyt, *The Legal Status of Extrinsic Instruments for the Interpretation of Tax Treaties* (Amsterdam: IBFD, 2021), 583–758. For a critical approach, Aitor Navarro, "International Tax Soft Law Instruments: The Futility of the Static v. Dynamic Interpretation Debate," *Intertax* 48, no. 10 (2020): 848–60.

[55] GLOBE COMMENTARY, p. 8, para. 3.

[56] Michael Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal* (Oxford: Oxford University Centre for Business Taxation, 2020), 2–3.

[57] Arnold, "An Investigation into the Interaction," 275.

[58] A similar use of the metonymy is also common in case of Double Tax Convetion ("**DTC**") models. When it is asserted that a certain provision is "in breach of Art. 7 of the OECD-MC", one is not stating that the model is being violated (which is a meaningless assertion), but rather that an Art. 7 of a DTC patterned after the OECD-MC would be violated.

3. THE RESEARCH QUESTION

The present thesis is aimed at answering a single question, which may be phrased as follows:

What are the justifications of the GLOBE MODEL RULES and how are such justifications expressed in the structure of the rules?

The initial impulse for the research was the astonishment with the claim that the GLOBE MODEL RULES were able to provide for a tax on economic rents[59], with all the allocative and distributive gains arising therefrom[60]. The rules only burden Excess Profits[61], which, according to the GLOBE COMMENTARY, would mean that they avoid "*any tax induced distortions of investment decisions*"[62]. Such statement is very controversial and its evidentiation is far from clear. Nevertheless, the legal framework that had to be built to examine whether the taxation of economic rents is a possible justification for the rules was very complex, and it could also be used as means to enlighten further elements of the GLOBE MODEL RULES. As a result, the choice for a broader research question has been made, and the thesis also sheds light on the lack of anti-abuse justification of the rules, on their inability to ensure single taxation, on the enthronement of the goal of setting a floor to tax competition, and on the sense in which the reference to the ability-to-pay can be understood as a justification for the rules. Ultimately, the thesis provides for a comprehensive account of the justifications of the GLOBE MODEL RULES, with reference to their actual content, by means of a systematization effort. In order to achieve this outcome, the thesis examines the structural elements of the GLOBE MODEL RULES.

Within the intent of answering the research question, six sub-questions have been conceived. They relate to general features of the GLOBE MODEL RULES, and aim at their systematic comprehension. The six sub-questions are taken as steps to answer the research question, providing for a more analytical approach towards the topic and assisting in the structuring of the chapters. The sub-questions have been designed to clarify why the GLOBE MODEL RULES have been enacted (what is their justification), how they operate (which are the mechanisms that ensure taxation), whose income do they burden (what is the relevant entity for the purpose of calculating the Top-up Tax and whose income is subject to taxation), what they burden (which income is subject to taxation), where it is burdened (which assignment and charging rules are applied) and when it is burdened (what is the relevant period for calculating the Top-up Tax, and which are the mechanisms dealing with temporal differences).

3.1. The justification of the GLOBE MODEL RULES (WHY?)

The first sub-question that the thesis shall answer is: "*why were the GLOBE MODEL RULES enacted*?" The thesis investigates the "stated and implied policy goals"[63] of the GLOBE

[59] See, ch. I, sec. 4.3, *infra.*
[60] See, on the superiority of economic rent taxation *vis-à-vis* traditional CITs, ch. I, sec. 3.4, *infra.*
[61] As a defined term, not to be confused with the excess profits from economic theories. See, on this disambiguation, ch. IV, sec. 3.
[62] GLOBE COMMENTARY, para. 26, p. 120.
[63] Pasquale Pistone and Alessandro Turina, "The Way Ahead: Policy Consistency and Sustainability of the GloBE Proposal," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*,

MODEL RULES, taking into account the many arguments that have been presented in the RELEVANT MATERIAL and in international tax scholarship. In order to answer this sub-question, the thesis also articulates the justifications of the GLOBE MODEL RULES with the broader justification of CIT, and provides for a contextualization of Pillar Two within the work developed by the IF.

3.2. The mechanism of the GLOBE MODEL RULES (HOW?)

The second sub-question is: "*how are the GLOBE MODEL RULES intended to burden*?". In order to investigate the consistency of the GLOBE MODEL RULES, it is necessary to understand the relevant mechanisms which ensure the intended minimum taxation. The GLOBE MODEL RULES present several autonomous concepts and defined terms to calculate the ETR and the Jurisdictional Top-up Tax, as means to determine the amount of IIR and UTPR that can be charged by each jurisdiction. Answering this question requires a description of the general mechanisms of the GLOBE MODEL RULES, as means to evidence how the minimum tax is imposed.

3.3. The subjects of the GLOBE MODEL RULES (WHO?)

The third sub-question is: "*whose income are the GLOBE MODEL RULES intended to burden*?". In order to answer the research question, it is necessary to investigate which is the relevant entity whose income is subject to the GLOBE MODEL RULES, which are the relevant entities for calculating the ETR, and which are the relevant entities in relation to which the Top-up Tax is calculated. An analytical investigation of the subjects is of paramount importance for the thesis, because it is necessary to understand whose profits and losses are taken into consideration by the GLOBE MODEL RULES at the different steps of its application, and which forms of blending of entities are allowed under the rules.

Answering this sub-question requires examining the notion of MNE Group, which is important to define which subjects are within the scope of the GLOBE MODEL RULES. It is also necessary to examine the relevance of blended Entities in a jurisdiction to calculate the ETR and eventually trigger the Top-up Tax. After the Top-up Tax is triggered, the GLOBE MODEL RULES provide for the determination the Top-up Tax to each of the CEs, thus abandoning the blending and the broader reference to the Group, to embrace the notion of separate entity.

3.4. The objects of the GLOBE MODEL RULES (WHAT?)

The fourth sub-question is: "*what are the GLOBE MODEL RULES intended to burden*?". The sub-question essentially deals with the issue of how income is defined for GLOBE purposes. The starting point for calculating the GLOBE Income or Loss is the Financial Net Income or Loss of a CE, but the GLOBE MODEL RULES also create book-to-tax differences, considered "common" within IF jurisdictions[64], building on the notion a "typical CIT"[65]. The GLOBE MODEL RULES also provide for a carve-out on substantive activities. This carve-out is examined in detail, as its design choices is important to understand which income the design of the rules is able to actually capture.

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ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), sec. 14.2.1.

[64] GLOBE COMMENTARY, p. 46, para. 17.

[65] GLOBE COMMENTARY, p. 47, para. 20.

The thesis is particularly concerned with the policy choices that have been made, and answering this sub-question is essential to establish whether and to what extent the Substance-Based Income Exclusion provides for the taxation of economic rents, as it is argued in some excerpts of the RELEVANT MATERIAL.

3.5. Spatial elements of the GLOBE MODEL RULES (WHERE?)

The fifth sub-question is: "*where are the GLOBE MODEL RULES intended to burden*?". The rules related to the location of the Entities, as well as the special rules for PEs, Tax Transparent Entities and Investment Entities, are fundamental to determine whether the ETR has been achieved in each jurisdiction – and thus to trigger the Top-up Tax. The identification of the location of the CEs deviates from the location of the CE which will charge the IIR and the UTPR.

Even though there is some inspiration in legislation formerly enacted in the US, the GLOBE MODEL RULES expand the jurisdiction to tax of some states, which are allowed to tax income derived in other states in an unprecedented form. For a proper systematization of the GLOBE MODEL RULES it is necessary to exam both assingment rules and nexus rules. The GLOBE MODEL RULES, despite assigning income to a certain Entity, allows the taxation of such income by another state, burdening another Entity, thus demanding an in-depth investigation of the relevant allocation and nexus rules, in case of application of the QDMTT, the IIR and the UTPR.

3.6. Temporal elements of the GLOBE MODEL RULES (WHEN?)

The sixth and last sub-question is: *when are the GLOBE MODEL RULES intended to burden*? The thesis examines what is the relevant period for calculating the Top-up Tax, and which are the mechanisms dealing with intertemporal differences. Like CITs in general, the GLOBE MODEL RULES have a clear need to draw on temporal elements, but there are also other particular elements that do not rise in cases of CITs in general.

The GLOBE MODEL RULES aim not only at attributing revenues and expenses to a certain calendar-year and dealing with the complications of periodization, as all CITs are expected to do. The GLOBE MODEL RULES also present additional challenges, as they aim to prevent the taxation of jurisdictionally blended Entities at a level below the ETR in every Fiscal Year, also taking loss carry-forwards into account to a certain extent. They also have to deal with situations where the Top-up Tax could not be charged in a Fiscal Year and must be carried forward, as well as to provide for mechanisms to deal with adjustments to a past Fiscal Year where necessary.

This analysis is of particular importance for the examination of the tax treatment of losses and the extent to which the losses affect the calculation of the ETR in future periods. In order to answer this sub-question, the examination of two mechanisms within the GLOBE MODEL RULES is necessary: the mechanism to address temporary differences (Art. 4.4) and the GLOBE Loss Election (Art. 4.5).

4. METHODOLOGY

The present thesis certainly benefits from interdisciplinary work and from the dialogue between law and other fields. But it is, in essence, a dogmatic thesis, in the traditional sense, engaging in what is often termed as "doctrinal research"[66]. It aims at examining a set of positive rules and contributing to its interpretation and systematization, while also making suggestions to its improvement[67].

The research aims primarily at describing the GLOBE MODEL RULES as a normative system, but an evaluative effort is also undertaken. The legal rules are evaluated against legal standards, which are derived from the RELEVANT MATERIAL and from legal scholarship. The thesis does not evaluate the GLOBE MODEL RULES against the normative framework of any specific state. Nor does it build an ideal framework for a minimum tax, against which the rules could be examined. Instead, it examines the rules against legal principles and policy objectives, such as the ability-to-pay and the purported need to combat tax competition, to the extent that these legal principles and policy objectives are evoked as justifications for the GLOBE MODEL RULES. The thesis takes into account that there may be a lot of indetermination in the way such terms are used in legal and economic scholarship, and provides for the relevant delimitations where necessary.

Therefore, the normative framework against which the GLOBE MODEL RULES are analysed is built with reference to the RELEVANT MATERIAL – the "stated and implied policy goals"[68] of the GLOBE MODEL RULES. The thesis engages in the examination of whether the goals attributed to the rules are in fact translated in the GLOBE MODEL RULES' structure. The thesis is not intended to engage in a discussion on how the ideal minimum tax should look like, or on whether a minimum tax should be adopted in the first place. Instead, it unveils the justifications behind its adoption, as stated in the RELEVANT MATERIAL, and examines whether the structure of the GLOBE MODEL RULES is able to achieve the intended objectives, and to what extent. The approach is also justified by the political importance attributed to the matter, which often blurs a more rational debate. Considering the "ambiguity of the Pillar Two objectives"[69], contrasting the justifications with the actual content of the rules is essential to understand what the implementation of the rules could be expected to achieve.

As the GLOBE MODEL RULES include several defined terms, additional caution is needed for the sake of clarity of the thesis. The defined terms from the GLOBE MODEL RULES are

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[66] See Jan M. Smits, "What Is Legal Doctrine?: On The Aims and Methods of Legal-Dogmatic Research," in *Rethinking Legal Scholarship: A Transatlantic Dialogue*, ed. Edward L. Rubin, Hans-W. Micklitz, and Rob van Gestel (Cambridge: Cambridge University Press, 2017), 207–28; Sanne Taekema, "Methodologies of Rule of Law Research: Why Legal Philosophy Needs Empirical and Doctrinal Scholarship," *Law and Philosophy* 40, no. 1 (2021): 33–66.

[67] The effort is well described as "a desire to place the prevalent sources of law (including legislation and case law) in a system and to develop this system further", which is also an approach whose creative nature (as opposed to merely descriptive) cannot be denied. See Jan M. Smits, *The Mind and Method of the Legal Academic* (Cheltenham: Edward Elgar Publishing, 2012), 13.

[68] Pistone and Turina, "The Way Ahead," sec. 14.2.1.

[69] Johanna Hey, "The 2020 Pillar Two Blueprint: What Can the GloBE Income Inclusion Rule Do That CFC Legislation Can't Do?," *Intertax* 49, no. 1 (2021): 10. See also Turley and Ho, "GloBE - Overriding the Value Creation Principle," 1076; Johanna Hey, "Von Anti-Hybrids-Regeln zur Globalen Mindeststeuer (GloBE)," in *Festschrift für Jürgen Lüdicke*, ed. Dietmar Gosch, Arne Schnitger, and Wolfgang Schön (München: Beck, 2019), 261–62.

capitalized[70], and capitalization of other terms is avoided whenever possible throughout the thesis. For instance, while "entity" shall be understood within the context in which it is written in the thesis, "Entity" is a defined term in the GLOBE MODEL RULES.

Finally, an important methodological limitation must be pointed out. Pillar One and Pillar Two in general, and the GLOBE MODEL RULES in particular, are certainly very complex[71]. Much of the complexity of the rules derives precisely from the autonomous nature of the relevant concepts[72]. The outcome of the design of Pillar Two is essentially "an elaborate accumulation of competing and potentially conflicting taxing rights"[73]. It will take time for tax officials and taxpayers to fully understand the GLOBE MODEL RULES and periodical amendments to them will certainly become necessary as unforeseen outcomes are detected[74]. This leads one to question whether the rules would not be too complicated for most IF countries, which could struggle with institutional capacity to implement and administer them[75]. After all, "developing countries need tax rules that as far as possible can be administered easily, without the need for specialist and highly-trained staff applying subjective judgements"[76].

Due to a methodological limitation, the present thesis does not address the argument of (excessive) complexity of the GLOBE MODEL RULES. More broadly, the thesis does not address arguments of institutional capacity as a whole. This limitation does not mean that the topic is unimportant. On the contrary, discussing the ability of states to implement and administer the GLOBE MODEL RULES is essential for a sober policy debate[77]. However, in order to satisfactorily address the topic, which is empirical in nature (as opposed to normative), one would have to examine a series of elements (*e.g.,* data on the capacity of public and private sector in relevant countries, estimates of costs related to capacity building related to the adoption of the rules…) with a series of tools that are not of a legal nature. How many hours will it take for tax authorities to learn how to apply the rules? How much should be invested in capacity building in order to ensure their proper application? How many people would a state need to administer the rules in its

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[70] As they are in the GLOBE MODEL RULES. The EU Proposal does not use capitalization for defined terms. See, for an overview of the EU proposal, Marco Dietrich and Cormac Golden, "Consistency versus 'Gold Plating': The EU Approach to Implementing the OECD Pillar Two," *Bulletin for International Taxation* 76, no. 4 (2022): 183.

[71] See, on the complexity of the measures, Hey, "The 2020 Pillar Two," 13; Sol Picciotto et al., "For a Better GLOBE: A Minimum Effective Tax Rate for Multinationals," *Tax Notes International* 101 (2021): 864; Sol Picciotto, "Formulary Approach: The Last Best Hope for MNEs," *Tax Notes International* 108 (2022): 438.

[72] Arnold, "An Investigation into the Interaction," 275.

[73] Sol Picciotto and Jeffery Kadet, "The Transition to Unitary Taxation," *Tax Notes International* 108 (2022): 458.

[74] See Arnold, "The Ordering of Residence and Source," 219. (reputing the characterization of the GLOBE MODEL RULES as complex as "an understatement"); Picciotto and Kadet, "The Transition to Unitary Taxation," 458. (arguing that the GLOBE MODEL RULES "*will increase complexity, confusion, and conflict*").

[75] See Adriana Sánchez Castro, "Administrative Capability Analysis of OECD Proposals from the Perspective of Developing Countries," *Intertax* 48, no. 2 (2020): 218–32; Sabrine Marsit, "The Pillar Two Initiative and Developing Countries," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), sec. 12.2.2.2.

[76] Sol Picciotto, "The Current Context and a Little History," in *Taxing Multinational Enterprises as Unitary Firms* (Brighton: Institute of Development Studies, 2017), 5.

[77] See, for an interesting simplification proposal, Cedric Döllefeld et al., "Tax Administrative Guidance: A Proposal for Simplifying Pillar Two," *Intertax* 50, no. 3 (2022): 231–46.

jurisdiction? Could these people be allocated more efficiently to other tax-related tasks? Are there other more fundamental parts of the tax system which would benefit more from the allocation of resources? These are not legal questions, despite the legal relevance of the answers. After all, tax rules should be designed to be fair not only when considered as abstract norms, but also when the actual functioning of the system is taken into account[78].

At the same time, there are no specific studies in other areas addressing the topic, from which the thesis could simply draw conclusions and present as empirical arguments[79]. The ECONOMIC IMPACT ASSESSMENT is sufficient evidence of how incipiently the issue is contemporarily addressed[80]. On the topic of "compliance costs", the OECD Secretariat refers to existing literature to acknowledge that complex taxes are more difficult to administer for tax administrations and CIT is among the most complex taxes to audit and investigate. With regard to developing countries, it reports that they "may suffer more from the burden of administering complex taxes" and "are less able to bear the costs of complex tax enforcement". It further suggests that there is evidence that "investments in tax administrations often yield benefits well in excess of their costs", which is observed "especially in low-capacity contexts" and the "implementation of simplified tax regimes may reduce costs for tax administrations"[81]. No further detail is provided. Subsequent work on the topic within the OECD has been dedicated to further assist developing countries in implementing the rules, and the adequacy of such rules to their reality is taken for granted[82].

In fact, recent studies have argued that developing countries lack the institutional capacity even to properly take part in complex deliberations on international tax – which has led to the questioning of their ability to actually stand for their interests in international fora, ultimately maculating the very legitimacy of such sort of decision-making process[83]. However, there is still a gap in the literature on how developing countries are dealing with the increasingly complicated tax rules to whose implementation they have agreed.

This thesis is unable to fulfil the gap. Despite the general impression that the rules are not fit for the reality of most countries, the thesis is not able to rationally ground the argument. Without rational evidence, the thesis and its author lack in authority to simply assert the

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[78] See, on the importance of actual and uniform enforcement of tax legislation for the principle of equality, Roman Seer, "Der Vollzug von Steuergesetzen unter den Bedingungen einer Massenverwaltung," in *Steuervollzug im Rechtstaat*, ed. Werner Widmann, vol. 31, DStJG (Köln: Otto Schmidt, 2008), 7–36; Johanna Hey, "Vollzugsdefizit bei Kapitaleinkommen: Rechtsschutzkonsequenzen und Reformoptionen," *Der Betrieb* 14 (2004): 724–30; Dieter Birk, "Das Gebot des gleichmäßigen Steuervollzugs und dessen Sanktionierung," *Steuer und Wirtschaft*, 2004, 277–82.

[79] As it is done, *e.g.,* with data on economic incidence of CIT (see ch. I, sec. 3, *infra*), and with regard to the accounting research on the principle-based approach to the definition of group for consolidation purposes (see ch. III, sec. 4.1.2, *infra*).

[80] ECONOMIC IMPACT ASSESSMENT, 158-161.

[81] ECONOMIC IMPACT ASSESSMENT, p. 161.

[82] See OECD, Developing Countries and the OECD/G20 Inclusive Framework on BEPS: OECD Report for the G20 Finance Ministers and Central Bank Governors, October 2021, Italy, OECD, Paris, 2021.

[83] Documenting "the perception that IF negotiations are structured around the needs, priorities and agendas of larger economies and that lower income countries have little option but to acquiesce", see Rasmus Corlin Christensen, Martin Hearson, and Tovony Randriamanalina, "At the Table, Off the Menu? Assessing the Participation of Lower-Income Countries in Global Tax Negotiations" (Institute of Development Studies (IDS), 2020), 14. See also Yariv Brauner, "Serenity Now!: The (Not So) Inclusive Framework and the Multilateral Instrument," *Florida Tax Review* 25, no. 2 (2022): sec. IV.

complexity of the rules and sustain the incapacity of most states to satisfactorily implement and administer them. The absence of such analysis is a significant limitation of the thesis – and of the international tax debate as a whole.

5. JUSTIFICATION

The thesis examines soft law provisions as a closed system[84]. There is clearly a leap of faith inherent to the choice of the object[85]. After all, there is no guarantee that the rules will be implemented by the jurisdictions as designed, as the diplomatic efforts within the IF do not make the adoption of the rules binding for the states[86]. Despite the absence of a binding agreement, there are positive initiatives that might contribute to advancing a more uniform approach towards the topic. Only two days after the GLOBE MODEL RULES were published, the European Comission issued a directive proposal[87], whose content is very similar to that of the GLOBE MODEL RULES[88] – which has been interpreted as a translation of the commitment of the EU with their implementation[89]. Other jurisdictions outside the EU have also initiated proceedings to adopt rules that resemble the GLOBE MODEL RULES[90].

In any case, Pillar Two can only be deemed as successful if a strong form is provided, which, on its turn, is only possible if there is clarity of purposes. The doctrinal approach is essential for the successful achievement of this goal. The thesis, by unveiling the justifications and structural elements of the GLOBE MODEL RULES, aims to contribute to a rational discussion on their implementation by states[91], as well as to reduce the gap between the alleged goals and the actual content of the rules.

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[84] In fact, there is nothing new to such choice of object. In the case of DTC model conventions, which are also soft law instruments, it is a common scientific approach to discuss them as such, without reference to DTCs actually signed. See, for a recent contribution in this sense, Kees van Raad, "A Blueprint for Restructuring the OECD Model's Distributive Rules," *Bulletin for International Taxation* 75, no. 10 (2021): 541. Discussing the role of the GLOBE MODEL RULES as soft law, see Chris Noonan and Victoria Plekhanova, "Compliance Challenges of the BEPS Two-Pillar Solution," *British Tax Review*, no. 5 (2022): 534–39.

[85] On the difficulties in implementing the GLOBE MODEL RULES, see Francesco De Lillo, "The Implementation of Pillar Two," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), 395–414.

[86] See, critically on the 2021 IF STATEMENT, Yariv Brauner, "Agreement? What Agreement? The 8 October 2021, OECD Statement in Perspective," *Intertax* 50, no. 1 (2022): 2.

[87] European Commission, Proposal for a Council Directive on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union, Brussels, 22 Dec. 2021 COM(2021) 823 Final.

[88] See, comparing the GLOBE MODEL RULES and the directive proposal, Dietrich and Golden, "Consistency versus 'Gold Plating': The EU Approach to Implementing the OECD Pillar Two," 183–96.

[89] See Ana Paula Dourado, "Is There A Need for A Directive on Pillar Two?," *Intertax* 50, no. 6/7 (2022): 521.

[90] UK, Canada, New Zealand and Japan have issued consultations and reports on the implementation of the GLOBE MODEL RULES. See Noonan and Plekhanova, "Compliance Challenges of the BEPS Two-Pillar Solution," 526–27.

[91] On the importance of an adequate implementation of Pillar Two as means to achieve the intended goals, see Aitor Navarro, "Jurisdiction Not to Tax, Tax Sparing Clauses, and the OECD Minimum Taxation (GloBE) Proposal," *Nordic Tax Journal* 2021, no. 1 (2021): 18.

5.1. The need for a strong form

In order to effectively combat tax competition, without raising the problem of double or over taxation, the GLOBE MODEL RULES need to be adopted by all or most countries, guarantee sufficient harmonization of details, and bring forward a "strong form" of minimum tax[92]. The rules have been designed to be implemented consistently in every jurisdiction and are intended to operate in a way that produces the same overall result regardless of the place where the MNE is headquartered, aiming at setting a floor to tax competition, without giving rise to the risk of double or over taxation[93]. In such context, the space for cherry-picking is expected to be very limited, and the dogmatic approach of the thesis allows for the proper comprehension of the structure of the GLOBE MODEL RULES. The approach is expected to contribute not only to the critical exam of rules enacted by individual states, but also to the evaluation of the EU directive proposal, as well as to the drafting of a multilateral convention on the topic[94].

5.2. The need for clarity of purposes

A strong form of model legislation, however, is only possible if there is clarity of purposes. Without such clarity, the design of the rules becomes arbitrary, and interpretative controversies are also increased. There is one example where the interpretation of a provision is not even possible without regard to teleological (purposive) elements. In order to determine whether a certain jurisdiction has a QDMTT, a Qualified IIR or a Qualified UTPR, one has to examine, among other elements, whether such rules are "implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Commentary"[95]. Consistency with the outcomes can only be evaluated if it is minimally clear what the outcomes of the application of such rules should be. While this is an extreme example of indetermination in the GLOBE MODEL RULES, the clarity of purposes can also be important in other milder cases. The approach of the thesis allows for a further refinement of the theoretical goals and justifications underlying the rules, also connecting them with the concepts embedded in the relevant provisions.

6. STRUCTURE

Besides this introduction, the thesis has six chapters and a conclusion. The chapters are dedicated to identifying the general elements of the GLOBE MODEL RULES, and each one of them answers one of the research sub-questions, in the order they were presented in this introduction. The last section of each chapter briefly answers the respective subquestion. The conclusion presents assertions aimed at the systematization of the GLOBE MODELS RULES, drawing on the elements obtained in the previous chapters, in the form of individual theses.

[92] Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal*, 2–3.
[93] PILLAR TWO BLUEPRINT, p. 112, para. 411.
[94] As foressen within Pillar Two. See PILLAR TWO BLUEPRINT, p. 178, para 705.
[95] GLOBE MODEL RULES, Art. 10.1.1.

CHAPTER I
THE JUSTIFICATION OF THE GLOBE MODEL RULES

1. INTRODUCTION

Significant efforts have been dedicated to the discussion and reform of CIT systems in the last decades[96]. A new set of concepts has been created to deal with mismatches, complex transfer pricing cases, excessive debts of companies and taxation of controlled foreign companies ("**CFC**"), as well as other conducts perceived as abusive[97]. Correspondingly, significant compliance costs have been created to ensure the proper functioning of CIT[98].

Despite being on the spotlight, CIT itself is still controversial on its core justification. There is no clear and unanimous reason for the critical policy decision to separately tax corporate earnings. AVI-YONAH claimed that there would be no convincing defence of the CIT in the academic literature[99], and this problem seems to remain unsolved[100], even after the discussions carried out under the BEPS Project[101]. BEPS 2.0 is even more ambitious than its predecessor, thus forcing scholars and policy makers to deal with issues that were formerly discarded as "tax theology"[102], and with topics of inter-state justice which were out of the scope of BEPS 1.0[103].

Discussing the justification of CIT is essential to the present thesis, considering the goal of analysing the justifications of the GLOBE MODEL RULES. The lack of a convincing justification for CIT also allows one to portray CIT measures as a "pure revenue grab"[104], turning the scholarly effort to find a consistent treatment in the GLOBE MODEL RULES into a methodological impossibility. The chapter takes into account that economists and lawyers usually have different meanings in mind when they refer to a "justification" – and also lawyers from different backgrounds may resort to different concepts. The ambiguity of the term has become particularly problematic in the context of international tax policy discussions, where they are all expected to interact. Additionally, both areas are not as segregated as they used to be, and the ambiguity is detrimental to interdisciplinary academic debates as well.

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[96] See Luís Eduardo Schoueri, "The BEPS Project: Still a Military Approach," in *The Implementation of Anti-BEPS Rules in the EU: A Comprehensive Study* (Amsterdam: IBFD, 2018), 15–34; Brauner, "What the BEPS?," 55–115.

[97] For an overview, see Michael Devereux et al., *Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021), 106–30; Brauner, "What the BEPS?," 55–115.

[98] See Romero Tavares, "Country-by-Country Over-Reporting? National Sovereignty, International Tax Transparency, and the Inclusive Framework on BEPS," in *Tax Sovereignty in the BEPS Era*, ed. Sergio André Rocha and Allison Christians (Alphen aan den Rijn: Kluwer Law International, 2017), 201–42.

[99] Reuven Avi-Yonah, "Corporations, Society, and the State: A Defense of the Corporate Tax," *Virginia Tax Review* 90, no. 5 (2004): 1210.

[100] This assertion is discussed in detail in sec. 3 and 4, *infra*.

[101] Devereux et al., *Taxing Profit in a Global Economy*, 57.

[102] The expression has been used by SURREY to describe the debate on the ability-to-pay of legal entities. See Stanley S. Surrey, "Reflections on 'Integration' of Corporation and Individual Income Taxes," *National Tax Journal* 28, no. 3 (1975): 335.

[103] See OECD, Action Plan on Base Erosion and Profit Shifting, Paris, OECD, 2013, p. 11.

[104] Avi-Yonah, "Corporations, Society, and the State," 1200.

The chapter is structured as follows. The second section of the chapter presents the traditional legal justifications. After explaining the irrelevance of the benefit principle for justifying the CIT, it examines the legal entity-based justifications, which perceive legal entities as "real", provided with their own ability-to-pay. It also addresses the "aggregate view", according to which the CIT would have a "withholding function", being actually aimed at taxing the income of the shareholder. Based on contemporary scholarship on the topic, the section also discusses a middle-ground justification, according to which the ability-to-pay of legal entities would have only a "provisory nature". This position takes into account the relevance of the reference to the ability-to-pay of legal entities for the purpose of building legal arguments, but, at the same time, acknowledges that the ability-to-pay of shareholders is the one ultimately aimed by a CIT. In summary, legal entities would have a provisory ability-to-pay, which only becomes definitive at the level of the shareholder.

The third section examines the ability-to-pay justification through the lenses of economic scholarship, and evidences why economists and some lawyers might disagree with the withholding function. Essentially, they argue that there would be no evidence that CIT actually burdens shareholders. There are both theoretical and empirical accounts of the real incidence of the CIT over labour (reduced wages) and consumption (higher prices). After examining a closed-economy and an open-economy model, the section presents empirical studies on the topic, which explain the scepticism of economists with regard to CIT, considering its efficiency and distributive distortions. Such studies also explain the trend towards the investigation of alternatives to CIT, whose economic inefficiencies and distributive issues would turn it into an unjustifiable tax.

There is, in fact, a contradiction between the arguments made by legal scholars on the incidence of the CIT and its real incidence, as evidence by economic studies[105]. For the purpose of the present thesis, the ability-to-pay (of the shareholders) and the real incidence of the CIT do not need to be reconciled. The thesis does not present a solution to this relevant theoretical problem. Instead, it shows that the reference to "economic rents" has significantly influenced the conclusions with regard to the economic incidence and has dominated contemporary corporate taxation debates. A CIT that is aimed exclusively at economic rents has been reputed as a "painless tax"[106], which in fact burdens capital owners and does not present the distortions inherent to CIT. In such cases, the contradictions between the legal theories on ability-to-pay and the economic evidence on real incidence disappear – or only occur to a lesser extent. Such elements are also presented in the third section.

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[105] Tax legal scholarship has already dealt, to a certain extent, with the problem of tax incidence, and of the transfer of the tax burden to individuals other than those intended by the legal system. See, on the topic, Klaus Tipke, *Steuerrechtsordnung*, 2nd ed., vol. II (Köln: Otto Schmidt, 2003), 584. (according to whom the transfer of the burden does not excuse from the effort to fairly allocate the tax burden); Johanna Hey, *Harmonisierung der Unternehmensbesteuerung in Europa* (Köln: Otto Schmidt, 1997), 243–44. (describing the challenges regarding the data on tax incidence and stating that there would not be enough evidence of the shifting of CIT incidence at that time); Johanna Hey, "Das Individualsteuerprinzip in Einkommen-, Körperschaft- und Gewerbesteuer – Auflösungstendenzen personal gebundener Steuerpflichten," in *Gedächtnisschrift für Christoph Trzaskalik*, ed. Klaus Tipke and Hartmut Söhn (Köln: Otto Schmidt, 2005), 225–26. (making the case that intended and predictable transfers should be considered by the legislator for the purposes of justification of the tax).

[106] For the expression, see Stephen Shay, "The Deceptive Allure of Taxing Residual Profits," *Bulletin for International Taxation* 75, no. 11/12 (2021): 1.

Hence, in the fourth section, it is possible to finally examine the justification of the GLOBE MODEL RULES. The section evidences that the ultimate goal of the GLOBE MODEL RULES is to combat tax competition among states, by means of the introduction of a minimum tax – therefore taking the justification of CIT for granted. The section also evidences that the GLOBE MODEL RULES have been significantly influenced by the literature on the taxation of economic rents. It is shown that the GLOBE MODEL RULES and the other relevant material make implicit and explicit references to such literature. Multiple references to "economic rents" and the corresponding terminology are made throughout the RELEVANT MATERIAL. Theories on the incidence of a tax on economic rents have influenced the proposal to a great extent and the GLOBE MODEL RULES have been designed to capture economic rents of MNEs – at least according to the RELEVANT MATERIAL. Besides, the single tax principle and anti-abuse reasoning as potential justifications are also addressed.

The chapter makes an important delimitation. It deals essentially with the fundamental decision to tax corporate income and examines how this fundamental decision has been expressed in the GLOBE MODEL RULES. Of course, there are several other specific policy choices of the GLOBE MODEL RULES which also demand justifications: the choice of subjects, of the tax object, the allocation and nexus rules, the criteria for the allocation of income, and so on. These other justifications are dealt with in subsequent chapters. In essence, this first chapter is aimed at clarifying the role of the GLOBE MODEL RULES as a minimum tax, which establishes a "floor" for corporate taxation. It only justifies the GLOBE MODEL RULES in a very general level, considering the lack of clarity of purposes that has been present from the beginning of the project[107].

More specific issues are left open for further chapters. The approach is partially incomplete, in particular, because it does not go into further discussion regarding issues such as territoriality and worldwide taxation, as such topics are relevant for debating nexus rules. The incompleteness is merely provisory, as nexus rules are addressed in chapter V. In the present chapter, ability-to-pay is discussed without reference to nexus rules and without any reference to inter-nations equity, since in its pure form, ability-to-pay and the real incidence of a tax are not concerned with any of those issues[108]. The conclusions with regard to the legal justification and the economic rent justification are also provisory in a certain sense, as an in-depth analysis of such topics can only be obtained after specifically examining the subjective (ch. III) and objective (ch. IV) elements of the GLOBE MODEL RULES.

2. LEGAL JUSTIFICATIONS OF THE CIT

2.1. Tax legal theories and the justification of a tax

Why do states tax corporate income? "Because they can", "because the states need revenue" and "because it is practical" are all possible explanations, but none of them is a justification in the sense intended in legal scholarship[109]. The question of how the total

[107] See Hey, "Von Anti-Hybrids-Regeln," 261–62.

[108] At a more fundamental level, ability-to-pay is not restrained by geographical or political borders. See Wolfgang Schön, "International Tax Coordination for a Second-Best World (Part I)," *World Tax Journal* 1, no. 1 (2009): 72.

[109] For the distinction between explanation and justification, see Aulis Aarnio, *The Rational as Reasonable: A Treatise on Legal Justification* (Dordrecht: Kluwer, 1987), 22.

tax burden should be divided among taxpayers can only be answered according to principles of individual justice[110]. Such justification, which is fundamental for both tax law and tax policy, is ultimately based on moral criteria (often dressed as constitutional arguments), over which a certain level of consensus can be reached[111].

The pursuit of a legal justification for CIT implies attributing legal scholarship with the task of formulating (constitutionally grounded) normative discourses on tax fairness. Legal theories thus aim at justifying taxes by reference to the values acknowledged by a certain constitution[112], or even broader considerations on tax justice[113] - sometimes blurring the border between law and other fields, as well as between law and policy. Within this intent, a multitude of theories is possible, ranging between two extremes. On the one hand, one could imagine a tax legal theory that emphasizes the freedom of the parliament in formulating tax legislation (no matter how inconsistently)[114], without attributing any powers of material revision to any court and significantly restricting the creative role of the courts on the interpretation of legislation[115]. On the other hand, one could conceive a theory strongly grounded on general clauses (such as "equality", "ability-to-pay", or even the fundamental freedoms), deriving very specific commands regarding a tax by means of deductive reasoning, while also arguing for the corresponding duty of the parliament to comply with such commands and the duty of the courts to enforce them if parliament fails to do so[116].

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[110] Klaus Vogel, "The Justification for Taxation: A Forgotten Question," *American Journal of Jurisprudence* 33 (1988): 57.
[111] Vogel, 23.
[112] Ekkehart Reimer, "Die sieben Stufen der Steuerrechtfertigung," in *Demokratie und Wirtschaft: eine interdisziplinäre Herausforderung*, ed. Boris Gehlen and Frank Schorkopf (Tübingen: Mohr Siebeck, 2013), 131.
[113] This approach is very common in international tax law. There are interesting theses that take economic principles and/or philosophical ideas as a normative reference. See, *e.g.,* Maarten Floris de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market* (Doctoral Thesis: Erasmus Universiteit Rotterdam, 2015), 23. (clarifying that "*the sole axiom appreciated in this study is the notion that equal economic circumstances should be treated equally for tax purposes*" and stating clearly that the thesis "*is the product of a deduction from the principle of equality as I understand it*"); See also Antony Ting, *The Taxation of Corporate Groups under Consolidation: An International Comparison*, Cambridge Tax Law Series (Cambridge: Cambridge University Press, 2013), 8.(examining group regimes "*critically against generally accepted tax policy objectives including simplicity, neutrality and competitiveness*").
[114] Often due to the belief that consistency would not even be possible in tax law. Illustratively: "*Even the astrophysicist probing the secrets of the universe knows that it is at least theoretically possible that one day someone will find the ultimate answer to the laws of nature. But the tax lawyer knows that the ultimate answers in taxation can never be found*" (John Prebble, "Why Is Tax Law Incomprehensible?," *British Tax Review*, no. 4 (1994): 393.)
[115] Courts sometimes adhere to such sort of view when resorting to a more literal interpretation of a statute. As stated in a court decision quoted by PREBBLE: "*... in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing implied. One can only look fairly at the language used.*" (Prebble, 390.)
[116] The defense of a "constitutional concept of income", for instance, is very common in the Brazilian doctrine. For a critical view on this sort of reasoning, see Luís Eduardo Schoueri, "O mito do lucro real na passagem da disponibilidade jurídica para a disponibilidade econômica," in *Controvérsias Jurídico-Contábeis*, ed. Roberto Quiroga Mosquera and Alexsandro Broedel Lopes, vol. 1 (São Paulo: Dialética, 2010), 246.

Tax legal theories are necessarily situated somewhere within this spectrum, and they will vary according to each legal system[117] and legal tradition within each system[118]. These theories mix deductive and inductive reasoning in order to either build a system, which parliament should respect and the courts should enforce, or argue that there is only chaos, and no consistency can be expected from the parliament – nor any interference from the courts[119]. Conscious of the insufficiency of semantics, they will ultimately present different levels of balance between idealism and realism, pragmatically maintaining that in some cases the consistency of the system shall be pursued, while in other cases the unfairness of the system is an inevitable outcome[120]. Dogmatic mechanisms are developed to distinguish one case from the other[121].

While it is not the aim of the thesis to sustain any specific tax law theory, a mildly optimistic perspective on tax legal scholarship is naturally implicit to its content, as a certain level of coherence is pursued. In summary, the thesis as a whole rejects the position according to which a statute is legitimate merely because it is positive law. Even though the law as such has a special role in the justificatory basis for legal interpretation, "justification refers and has to refer to different types of substantial reasons, either goal reasons or rightness reasons", which in practice means that "the law has to be connected with values and evaluations"[122]. Likewise, in the sense intended here, the GLOBE MODEL RULES cannot be justified solely on the basis that it has been agreed to by the IF, or that it has been adopted as legislation by a certain jurisdiction.

More specifically, the thesis also rejects the idea that a tax is legitimate solely on the basis of the state's financial needs – which is, at the end of the day, also a source of irrationality. The primary purpose of any tax is to raise revenue for the government, in order to ensure the financing of public goods: a tax that raises no revenue is useless[123]. Such statement is neither controversial nor helpful for justifying CIT – or the GLOBE MODEL RULES. Stating that a tax must raise revenue says very little about how such a tax should be. It is self-evident that the ultimate goal of taxation is to fulfil the financial needs of the state[124],

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[117] Comparing the Brazilian and the German constitutional tax systems, see Humberto Ávila, *Sistema Constitucional Tributário*, 5th ed. (São Paulo: Saraiva, 2012). Comparing the German and the Swiss systems, see Christian Waldhoff, *Verfassungsrechtliche Vorgaben für die Steuergesetzgebung im Vergleich Deutschland-Schweiz* (München: Beck, 1997).
[118] Comparing the different schools of thought in German tax law, see Christian Waldhoff, "Die 'andere Seite' des Steuerverfassungsrechts," in *Zukunftsfragen des deutschen Steuerrechts* (Berlin-Heidelberg: Springer, 2009), 125–60.
[119] On the importance and limitation of the inductive and deductive arguments in the construction of systematic arguments, see Michael Rodi, *Die Rechtfertigung von Steuern als Verfassungsproblem* (München: Beck, 1994), 69–72.
[120] VOGEL's description of the legal system as a "wild garden" is particularly illustrative of this idea. Neither the legislature nor the interpreter would be able to perfectly take care of the "garden", which would inevitably present some inconsistencies that would possibly not be eliminated by a court grounded on equality considerations. See Klaus Vogel, "Die Abschichtung von Rechtsfolgen im Steuerrecht," *Steuer und Wirtschaft* 54 (1977): 104.
[121] The extensive theorization on legal gaps is an example thereof. See *e.g.* Rainer Barth, *Richterliche Rechtsfortbildung im Steuerrecht* (Berlin: Duncker & Humblot, 1996). Another example is the development of anti-avoidance theories – which also deal with legal gaps, and with the level of interference of the interpreter in ensuring the consistency of the legal system. For comparative perspectives on the topic, see Christine Osterloh-Konrad, *Die Steuerumgehung. Eine rechtsvergleichende und rechtstheoretische Analyse* (Tübingen: Mohr Siebeck, 2010); Markus Seiler, *GAARs and Judicial Anti-Avoidance* (Wien: Linde, 2016).
[122] Aarnio, *The Rational as Reasonable: A Treatise on Legal Justification*, xv.
[123] Devereux et al., *Taxing Profit in a Global Economy*, 34.
[124] Tipke, *Steuerrechtsordnung*, 2003, II:578.

but, under the rule of law, such needs must be attended by means of a fair repartition of the burden among the relevant subjects. The imposition of a tax is ultimately justified by its fairness, and the mere financial need of the state is not sufficient to justify burdening a subject[125].

Therefore, the present section aims at describing the most common legal justifications for CIT. It explores the benefit theory and the ability-to-pay argument. While it rejects the possibility of justifying CIT based on the benefit theory, it further explores the possible meanings and the limitations of the ability-to-pay argument.

The section makes particular reference to the German literature on the subject, because this topic has deserved significant attention from German scholars in the last decades[126]. Nonetheless, the section is not intended to be restricted to any particular system, as similar debates are also found in other systems – and occasionally mentioned throughout the section. Also in other traditions the fundamental decision to separately tax corporate income has been discussed, and, in fact, the justification of CIT is debated in very similar terms in those systems. Therefore, instead of examining legal norms, the section focuses on the practical reasoning that underlies the potential justifications for CIT. The section evidences that it cannot be rationally maintained that CIT remunerates benefits provided by the state, and also presents the limitations and possibilities of the ability-to-pay argument.

2.2. The benefit argument

There are several accounts of the benefit theory for justifying the CIT. The approach varies according to what each author deems as being the "benefit" which the CIT remunerates. German scholarship has consistently rejected the justification of CIT based on the benefit principle ("*Äquivalenzprinzip*")[127], in any of its forms. It has been argued that the CIT could be viewed as consideration for particular state activities and many variations of this argument may be found – but none of them is convincing.

2.2.1. Consideration for the legal capacity

The first version of the argument it is to sustain that CIT would be paid in *consideration for the legal capacity* of the corporate entity[128]. Under this argument, the corporate entity would own its very existence, its ability to operate economically and its legal capacity to the State. Therefore, also the State could participate in the profits of the entity, which were only possible in the first place due to the recognition of the legal capacity of the relevant economic unity.

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[125] Tipke, II:579. See also Rainer Wernsmann, "§ 4," in *AO FGO Kommentar*, ed. Hübschmann, Hepp, and Spitaler (Köln: Otto Schmidt, 2018), 229; Wolfgang Schön, "The Odd Couple: A Common Future for Financial and Tax Accounting?," *Tax Law Review* 58, no. 2 (2005): 128.

[126] See, on the importance of the discussion in the German system, Johanna Hey, in *Steuerrecht*, by Klaus Tipke and Joachim Lang, 23rd ed. (Köln: Otto Schmidt, 2018), 249.

[127] See, on the topic, Hey, 256–62.

[128] Examining the argument in a comparative context, see, Domingo Jesús Jiménez-Valladolid de L'Hotellerie-Fallois and Félix Alberto Vega Borrego, "Legal Personality, Limited Liability and CIT Liability," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 20.

The incorporation of the entity takes places only once and cannot lead to the perennial charge of a tax. Besides, the profits of the entity are not a proper measure for the privilege of legal capacity. A loss-making company would otherwise receive the privilege for free, while it would also cost different prices for corporations which present different profit amounts. There is no equivalence between the tax and the attribution of legal capacity.

2.2.2. Consideration for the limitation of liability

The second version of this argument is that the CIT would be paid in *consideration for the privilege of limitation of liability*[129]. Acknowledging the legal personality and the legal capacity of an entity would be, under a certain perspective, merely putting corporations in equal footing with natural persons, which are not subject to CIT. The relevant privilege of a corporation would be the limitation of liability, which would justify the existence of a separate CIT[130]. The limitation of liability and the subsequent ability of the corporation to raise large amounts of capital would justify the separate charging of a CIT[131].

The objection against this argument also takes into account that the CIT is not a proper measure for calculating how much the limitation of liability is worth. The limitation of liability is not a benefit whose value can be precisely calculated. The example of a loss-making company also would remain without an explanation in this case: for a loss-making company, the liability limitation is even more relevant, but it does not pay any amount "in consideration for" the privilege. Besides, the state cannot force negotiating private parties to acknowledge the limitation of liability of a corporation: a party with sufficient bargaining power is always able to negotiate further guarantees. At the end of the day, the limitation of liability is irrelevant in cases where the other contracting party is not willing to acknowledge the sufficiency of the assets of the company and negotiate with it, accepting all the consequences of the limitation of liability. The state alone cannot make the limitation of liability effective and parties can often agree on contractually making the partners of an entity also liable. As a consequence, CIT cannot be seen as consideration for the utilization of a certain legal form[132].

2.2.3. Consideration for general state benefits

The third version of this argument is that CIT would be paid as *consideration for general State benefits*. The state generally provides for social order, infrastructure, and other societal elements from which corporations benefit, and which play a significant role in their profitability[133]. Under this line of reasoning, CIT could deemed as a consideration

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[129] Even though in another context, speaking of the CIT as the price for liability limitation, in a more figurative sense, see Ulrich Schreiber and Wojciech Stiller, "Ökonomische Anforderungen an eine Reform der Gruppenbesteuerung," *Steuer und Wirtschaft* 91, no. 3 (2014): 217. Examining the argument in a comparative context, see, L'Hotellerie-Fallois and Borrego, "Legal Personality, Limited Liability and CIT Liability," 20.

[130] The German Constitutional Court has rejected the view according to which the CIT would be paid as consideration for the limitation of liability. See BVerfGE 13, 331 (352).

[131] On the relevance of this argument for the 1920 German legislation of CIT, see Wolfgang Schön, "Die Funktion des Unternehmenssteuerrechts," in *Erneuerung des Steuerrechts*, ed. Monika Jachmann, DStJG 37 (Köln: Otto Schmidt, 2014), 230; Marc Desens, "Einführung zum KStG," in *Einkommensteuer- und Körperschaftsteuergesetz Kommentar* (Köln: Otto Schmidt, 2014), K-32.

[132] Schön, "Die Funktion des Unternehmenssteuerrechts," 231.

[133] For the origins of the benefit theory, see Peter Hongler and Pasquale Pistone, "Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy" (IBFD White Papers, 2015), 19–22. Discussing benefit theories in the context of nexus rules, see Kane, "A Defense of Source," 314–15; Stephen

for such general state framework, from which corporations benefit. Considering that the state would be a "silent partner" of the business enterprise, which makes its contribution in the form of infrastructure, RASENACK sustains that the profit of the entity would be a proper base for applying the benefit theory[134]. Accordingly, equivalence would be attended in this case, because if the participation of the State, by means of its factors of production (infrastructure), has not yielded profits, than the tax should not be due.

The problem of this argument is that corporations are not the only ones that benefit from the general state benefits. Also, there is no correlation between the enjoyment of such benefits and the profits of the enterprise. RASENACK'S proposal has also been deemed as an "unsustainable fiction"[135]. The state alone determines its participation on the profits of the entity, regardless of the relevance of its supposed contribution. Business which are much more dependent on the State's infrastructure will often be subject to the same CIT rate as, *e.g.,* service providers, which rely much less on the alleged production factors.

2.2.4. Conclusion: the irrelevance of the benefit argument

In summary, all these benefit principle-based arguments can be discarded on the grounds that there is no relation between the CIT and the granting of the alleged benefits or privileges by the State: CIT is not paid "in consideration of" such benefits or privileges. CIT is not a proper basis for calculating how much such benefits or privileges are worth. In the German system they are further rejected under the argument that they mix up the elements for justification of a tax ("*Steuer*") with those related to the enactment of a fee ("*Gebühr*") – which is an argument that can also be transposed to other systems which contain a similar distinction between taxes and fees[136]. Besides, in most of these cases, the state does not incur in any costs to grant the relevant benefits or privileges, and it is doubtful whether in such circumstances even a fee could be charged[137].

The justification grounded on the benefit principle has also been widely rejected in the US doctrine. MCLURE JR., considering that the benefits in question would be those of "incorporation", rejects the justification: incorporation would cost substantially less than the amount collected by a CIT. The costs of incorporation would be essentially the same for a large or a small corporation, and the costs of incorporation would bear no relation with the income of the company[138]. This view makes even less sense today, because the state plays only a minimal role in the creation of the corporation, and shareholders are often spread around the globe[139].

Shay, J. Clifton Fleming Jr., and Robert Peroni, "What's Source Got to Do with It - Source Rules and U.S. International Taxation," *Tax Law Review* 56 (2002): 90.

[134] Christian Rasenack, *Die Theorie der Körperschaftsteuer* (Berlin: Duncker & Humblot, 1974), 300.

[135] Hey, *Harmonisierung der Unternehmensbesteuerung*, 261; Dieter Schneider, "Körperschaftsteuerreform und Gleichmäβigkeit der Besteuerung," *Steuer und Wirtschaft*, 1975, 106.

[136] Including the Brazilian system. See Luís Eduardo Schoueri, *Direito Tributário*, 11th ed. (São Paulo: Saraiva, 2022), 196.

[137] Schneider, "Körperschaftsteuerreform und Gleichmäβigkeit der Besteuerung," 105.

[138] Charles McLure Jr., "The Case for Integrating the Income Taxes," *National Tax Journal* 28, no. 3 (1975): 258.

[139] Avi-Yonah, "Corporations, Society, and the State," 1232.

The benefit principle is therefore not able to justify the existence of a tax on the profits of corporations[140]. Denying the relevance of the benefit theory to justify the CIT is not the same as denying the relevance of the benefit theory to justify the existence of a nexus. The question "*How are the resulting revenues [from cross-border transactions] to be divided among taxing jurisdictions?*"[141] is often answered with reference to a "benefit principle"[142]. Access to market and to general infra-structure, for example, may be relevant to justify the jurisdiction to tax. But this sort of argument is not able to justify the fundamental decision to tax corporate income, in the sense intended here. These are two separate questions: justification of the tax is different from the justification of the nexus.

2.3. The ability-to-pay argument

Many systems refer to the ability-to-pay as a measure for sharing the tax burden[143]. The ability-to-pay guides the transfer of resources from the taxpayer to the state, and every deviation from the measure must be justified[144]. Taxation according to the ability-to-pay does not mean that everyone should pay the same tax, but rather that subjects shall be burdened according to their economic capacity[145].

General references to the ability-to-pay imply a significant level of abstraction[146]. The reference to the ability-to-pay demands further concretization, which will vary according to each system and each theory[147]. Ultimately, lawyers may use it to develop more specific and technical principles, which become relevant for the interpretation of certain parts of the legal system[148]. Such kind of deductive reasoning is contingent, and does not

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[140] Schön, "Die Funktion des Unternehmenssteuerrechts," 231; Desens, "Einführung zum KStG," K-32; Johanna Hey, "Verfassungsrechtliche Maβstäbe der Unternehmensbesteuerung," in *Unternehmensbesteuerung: Festschrift für Norbert Herzig zum 65. Geburtstag*, ed. Wolfgang Kessler, Guido Föster, and Christoph Watrin (München: C.H. Beck, 2010), 10–11; Hey, *Harmonisierung der Unternehmensbesteuerung*, 262; Hans-Jürgen Pezzer, "Rechtfertigung und Rechtsnatur der Körperschaftssteuer," in *Besteuerung der GmbH und ihrer Gesellschafter Grundfragen des Körperschaftsteuerrechts*, ed. Siegfried Widmann (Köln: Otto Schmidt, 1997), 14.

[141] See Reuven Avi-Yonah, "International Taxation of Electronic Commerce," *Tax Law Review*, no. 52 (1997): 517.

[142] A possible answer to the question according to this principle: "*The Benefits Principle states that the residence jurisdiction has the primary right to tax passive (investment) income, while the source jurisdiction has the primary right to tax active (business) income*". See Avi-Yonah, 520.

[143] See Christian Waldhoff, "Grundzüge des Finanzrechts des Grundgesetzes," in *Handbuch des Staatsrechts*, ed. Josef Isensee and Paul Kirchhof, 3rd ed., vol. V (Heidelberg: C. F. Müller, 2007), 880. Discussing the ability-to-pay in the context of nexus rules, see Shay, Fleming Jr., and Peroni, "What's Source Got," 94; Kane, "A Defense of Source," 315.

[144] Dieter Birk, *Das Leistungsfähigkeitsprinzip als Maβstab der Steuernormen* (Köln: Peter Deubner Verlag GmbH, 1983), 153.

[145] See Paul Kirchhof, "Die Steuern," in *Handbuch des Staatsrechts*, ed. Josef Isensee and Paul Kirchhof, 3rd ed., vol. V (Heidelberg: C. F. Müller, 2007), 1040–41.

[146] For criticism on the topic, Wolfgang Gassner and Michael Lang, "Die mangelnde Leistungsfähigkeit des Leistungsfähigkeitsprinzips," *Österreichische Steuerzeitung* 22 (2000): 643; Wolfgang Gassner and Michael Lang, "Das Leistungsfähigkeitsprinzip im Einkommen- und Körperschaftsteuerrecht," in *14. Österreichischer Juristentag*, vol. III/1, 2000, 7. (maintaining that the reference to the ability-to-pay would be both superfluous and harmful, since it would hide the actual arguments that stand behind a certain solution).

[147] See, on teleological argumentation and concretization, Franz Reimer, *Verfassungsprinzipien: ein Normtyp im Grundgesetz* (Berlin: Duncker & Humblot, 2001), 476; Robert Alexy, *Theorie der juristischen Argumentation*, 2nd ed. (Frankfurt: Suhrkamp, 1991), 299.

[148] See Rolf Eckhoff, *Rechtsanwendungsgleichheit im Steuerrecht* (Köln: Otto Schmidt, 1999), 311.

allow one to find a single answer that could be portrayed as the only possible and fair one[149]. The reasoning will often be supported by arguments obtained by inductive reasoning, referring to valid legislation and systematic choices made by the parliament[150].

For the purpose of this section, it is sufficient to state that, in general, for the taxation of the business enterprise, the ability-to-pay principle is deemed to be the central measure for sharing the tax burden, being the net income of the business enterprise an objective indicator of the economic ability-to-pay[151]. There is one specific part of this reasoning that is particularly relevant for the thesis and can be discussed without any further commitment with the norms of a specific legal system. The debate on the legal justification of the CIT deals essentially with the topic of the economic double taxation of distributed profits, both at the level of the legal entity, and of at the level of individuals as shareholders[152].

The question is, therefore, whether the corporate entity would present an ability-to-pay which is separate and distinct from that of its owners. This section presents three main theories on the topic, according to which (i) legal entities would have their own ability-to-pay, separate from its owners, which would justify the incidence of CIT; (ii) legal entities would not have their own ability-to-pay, and CIT would be aimed at burdening the shareholders; and (iii) legal entities' ability-to-pay would be merely of a "provisory nature", and it should ultimately be considered in conjunction with the ability-to-pay of its owners, which are the only ones that have an ability-to-pay with a "definitive nature".

2.3.1. The autonomous ability-to-pay of legal entities

PEZZER refers both to the 1920 and the 1977 German CITs' explanatory memoranda to sustain the autonomous ability-to-pay of legal entities[153]. Both legislations would be ultimately based not only on the formal legal status of the legal entities, but also on the fact that the corporation would be economically independent. The existence of corporations would be fundamentally independent of the change in the natural persons behind them. They can acquire assets in their own name that are legally attributable to them alone. These private law elements would also shape the economic facts to which taxation is linked. He therefore sustains that income generated by non-physical persons should not be assessed differently than that of natural persons, because both participate in the legal and economic life in the same way[154]. He goes further and even questions the possibility of submitting individuals and corporations to different income tax rates[155]. The 1920 explanatory memorandum, in particular, also refers to the increased creditworthiness, the ability to raise capital, and the efficiency of the corporation as justifications for the double taxation of the profits[156].

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[149] Rodi, *Die Rechtfertigung von Steuern als Verfassungsproblem*, 69.
[150] See Clemens Höpfner, *Die systemkonforme Auslegung* (Tübingen: Mohr Siebeck, 2008), 208.
[151] Hey, "Verfassungsrechtliche Maβstäbe," 10. See also, maintaining that "*the ability-to-pay principle represents a limited international consensus on the definition of the tax base*", Schön, "The Odd Couple," 129.
[152] Desens, "Einführung zum KStG," K-32.
[153] Pezzer, "Rechtfertigung und Rechtsnatur der Körperschaftssteuer," 13–14.
[154] Pezzer, 13–14.
[155] Pezzer, 15.
[156] On the topic, see Schön, "Die Funktion des Unternehmenssteuerrechts," 230; Hey, *Harmonisierung der Unternehmensbesteuerung*, 251–52; Pezzer, "Rechtfertigung und Rechtsnatur der Körperschaftssteuer," 5–18.

These elements are, however, unable to justify the existence of a separate CIT. Creditworthiness cannot be taken for granted merely based on the legal form and, in many cases, the limitation of liability actually limits the ability of the entity to have access to credit, because contracting parties will often require additional guarantees from limited liability entities. The increased ability of the corporate form to raise capital is also not immediate. Even if the entity has an increased creditworthiness and an increased ability to raise capital, it is not clear how this would translate into an increased ability-to-pay. Such advantages alone cannot lead to the conclusion that the entity has its own separate ability-to-pay[157]. SCHÖN considers this kind of reasoning as an "empty formula", which only means that the equity of the corporation may be increased by its effective administration, without actually allowing for any conclusion with regard to the allocation of the profits or the justification of its double taxation[158].

The argument based on private law elements is also not convincing. The corporation is only a legal construction that allows for the organization of investors and managers, in a nexus of contracts that may bring efficiency gains. In cases where such synergies allow for the earning of greater income, they will also be taxed, but there is no justification for the multiple taxation of such profits[159]. PALM also affirms that another problem of attributing ability-to-pay to any entity with legal capacity is that it would lead to the conclusion that they should all be treated in principle equally for income tax purposes, being subject to the same tax regime. Legal persons should be subject to the same progressive regime as individuals, and a subsistence level should also be granted to legal entities[160].

Many observers seem to believe that the enactment of a corporate tax in the US has also been inspired by the view that the corporation was itself a separate taxable entity[161]. BANK argues, however, that the CIT was originally adopted in the US as a proxy for taxing shareholders directly, or as a "necessary mechanism for enforcing a comprehensive scheme of individual taxation"[162].

In summary, the legal argumentation for a separate ability-to-pay of legal entities is based on the idea that such entities have the ability to earn income which is separate and independent from the income of the shareholders. The income earned by the entity would justify the increased tax burden, with no regard to the subsequent distribution and taxation of such profits at the level of the shareholder[163].

The theory, however, does not say anything about the sharing of the tax burden. Who is burdened by CIT after all? Whose ability-to-pay is accessed by a CIT? The view that corporations are real entities with their own ability to pay does not hold in tax law, because the economic burden of taxes ultimately falls on natural persons[164]. If the

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[157] Hey, *Harmonisierung der Unternehmensbesteuerung*, 252.
[158] Schön, "Die Funktion des Unternehmenssteuerrechts," 230.
[159] Schön, 230.
[160] Ulrich Palm, "Juristische Person und Leistungsfähigkeitsprinzip," *Juristenzeitung* 67, no. 6 (2012): 300.
[161] See, critically, Steven Bank, "Entity Theory as Myth in the Origins of the Corporate Income Tax," *William and Mary Law Review* 43, no. 2 (2001): 447–536.
[162] Bank, 452.
[163] See Hey, *Harmonisierung der Unternehmensbesteuerung*, 253..
[164] Avi-Yonah, "Corporations, Society, and the State," 1208; Devereux et al., *Taxing Profit in a Global Economy*, 35.

justification grounded on the ability-to-pay deals with "sharing the tax burden", saying that the entity bears the burden is not an actual answer. Besides, the acknowledgment of the legal and economic independency of the corporation does not lead to the conclusion that the corporation has a separate ability-to-pay, which would be able to justify the double taxation of the income, both in the hands of the corporation and of the shareholder[165].

2.3.2. *The lack of ability-to-pay of legal entities*

Other scholars have argued that legal entities would have no ability-to-pay at all. There are three main theories under which the lack of ability-to-pay of legal entities is sustained: the identity theory, the economic ownership theory and the sacrifice theory.

2.3.2.1. *The identity theory*

In the 19th century, ADOLF WAGNER, in his text book on public finance, already argued for the economic identity of the corporation and the shareholders[166]. He sustained that the corporation could not simply be subject to taxation as an independent economic person. Rather, taxation should also take into account the economic nature of the corporation, which would be only a means of acquisition for its shareholders. The taxation of the corporation should therefore be brought into connection with that of the shareholders, in order to avoid a double taxation of the same income by the same tax[167]. Similarly, for WÖHE, the "enterprise per se" ("*Unternehmen an sich*") is not able to pay taxes since companies do not exist for their own sake, but only because the owners want to use the companies to generate personal income[168].

The main problem of this theory is that it depersonalizes legal entities, treating as the same two or more subjects that are actually separate from each other. The identity theory would lead to the disregarding of legal entities, which could create detrimental effects to the legal system as a whole[169].

2.3.2.2. *The economic ownership theory*

According to this economic ownership theory, a substance over form approach would not allow the separate taxation of the corporate entity, because the corporation, despite legally separate from the shareholders, would be a property of the shareholders. The separation between the entity and the shareholders would be purely formalistic and one could not speak of ability-to-pay of the corporation[170].

SCHREDELSEKER has presented a particularly sharp opposition to this view. He criticizes the use of the economic ownership as a "magic word" and, as a matter of fact, his critiques

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[165] Hey, *Harmonisierung der Unternehmensbesteuerung*, 251.
[166] Adolf Wagner, *Finanzwissenschaft, Zweiter Theil: Theorie Der Besteuerung, Gebührenlehre Und Allgemeine Steuerlehre*, 2nd ed. (Leipzig: C. F. Winter, 1890).
[167] Wagner, 402.
[168] Günter Wöhe, "Grundprobleme der Körperschaftsteuer und Gewerbesteuerreform," *Zeitschrift für Betriebswirtschaftliche Forschung*, 1971, 507; Günter Wöhe, "Zur Reform der Körperschaftsteuer," *Wirtschaftsdienst* 52, no. 8 (1972): 409–15.
[169] Klaus Schredelseker, "Kritik der Köperschaftsteuerreform," *FinanzArchiv* 31, no. 1 (1972): 34.
[170] See Wöhe, "Grundprobleme der Körperschaftsteuer und Gewerbesteuerreform," 507; Wöhe, "Zur Reform der Körperschaftsteuer," 409–15. For an overview, see Desens, "Einführung zum KStG," K-33.

are aimed at the usage of the expression in tax law as a whole. In his view, if there is a separation between ownership in the sense of mere possession of value and the power of disposal – as is systemically necessary in corporations – then there must be a mediation process between the owner of the value and the person entitled to dispose of it. Such mediation is carried out by the internal organs of the entity, and a diversity of interests are taken into account – at least in larger corporations. Hence, the shareholder is not owner of the assets of the company, even under a functional perspective[171].

In fact, one speaks of economic ownership in (German) tax law when the legal status of the owner under civil law is only formal, and the actual content of the property right belongs to someone else, namely the economic owner[172]. In the case of the relation between the corporation and the shareholder, the corporation formally owns the means of production and the profits. The individuals that are behind the corporation do not have a direct access to the corporation's assets and therefore cannot dispose of them. The power to dispose of the assets and of the profits, which is inherent to ownership, is only present after the distribution of the dividends. The shareholder can sell the shares, but she will in this case not be able to influence the future of the corporation anymore, which will develop its activities regardless of the disposition of the shares and change of the position of the shareholders[173].

2.3.2.3. The sacrifice theory

Grounded on economic theory it has also been argued that income would be conceptually connected to individuals, who must decide on the utilization of scarce resources[174]. According to a utilitarian view, rooted on the work of JOHN STUART MILL[175], the tax is a "sacrifice" imposed on individuals to finance the tasks that are attributed to the state, limiting their consumption possibilities[176]. Corporations, however, do not consume, since they do not have their own "personal necessities". Hence, it would not be possible to consider that legal entities present their own ability-to-pay, which would be an inherent attribute of individuals. The application of the sacrifice theory – and, under this argument, also of the ability-to-pay – to legal persons, would not be possible. This would also be reflected in the concept of subjective ability-to-pay, which is clearly tailored to individuals: there is no possibility in the CIT to deduct amounts related to something similar to the entities' "personal necessities". Neither is there such concept as a "subsistence level" for CIT[177].

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[171] Schredelseker, "Kritik der Köperschaftsteuerreform," 31.

[172] See, on the topic, Joachim Englisch, in *Steuerrecht*, by Klaus Tipke and Joachim Lang, 23rd ed. (Köln: Otto Schmidt, 2018), 245.

[173] Hey, *Harmonisierung der Unternehmensbesteuerung*, 251.

[174] Schneider, "Körperschaftsteuerreform und Gleichmäβigkeit der Besteuerung," 102.

[175] On the origins and variations of the theory over the years, see Peyton Young, "Progressive Taxation and Equal Sacrifice," *The American Economic Review* 80, no. 1 (1990): 253.

[176] See, on the sacrifice theory, Vogel, "The Justification for Taxation: A Forgotten Question," 28; Friedrich Hinterberger, Klaus Müller, and Hans-Georg Petersen, "„Gerechte" Tariftypen bei alternativen Opfertheorien und Nutzenfunktionen," *FinanzArchiv* 45, no. 1 (1987): 45–69; Young, "Progressive Taxation and Equal Sacrifice," 253.

[177] See Erik Röder, *Das System der Verlustverrechnung im deutschen Steuerrecht* (Köln: Otto Schmidt, 2010), 171.

Also this view has faced significant opposition from legal scholars[178]. WALZ has opposed the idea of equating the ability-to-pay to the sacrifice theory[179]. As an economic theory, the sacrifice theory would essentially miss the point of the relevance of ability-to-pay for legal reasoning. HEY argues that the concept of ability-to-pay cannot be interpreted so strictly[180]. Even though the subjective component is missing for legal entities, the objective ability-to-pay is still present. TIPKE maintains that the objective ability-to-pay, alone, would be sufficient to justify the taxation of corporate income[181]. The sacrifice-theoretical arguments would therefore be invalid, at least from a legal perspective, because the ability to earn income ("*Ertragskraft*") is, after all, ability-to-pay[182].

However, from a strictly economic perspective, it remains true, also among German scholars, that only natural persons present an ability-to-pay, and the ability-to-pay of a legal person cannot be considered as a relevant normative basis[183]. After all, economically, the ability-to-pay is the normative basis for examining the effects of the allocation of the tax burden among individuals. Under this perspective, only individuals are able to actually earn income, because the business enterprise does not consume[184]. Some clarification is, therefore, necessary to understand the importance and the content of the ability-to-pay for legal reasoning.

2.3.3. The provisory nature of the ability-to-pay of legal entities

Between the lack of ability-to-pay and the autonomous ability-to-pay of legal entities, a middle-ground position is possible as a legal justification. Authors following this view maintain the possibility of making reference to the ability-to-pay when building arguments on the CIT, without stating that the CIT burdens a legal entity.

HEY argues that the corporate entity would have its "own, but only provisional ability-to-pay"[185]. The ability-to-pay of the corporate entity could only be understood as an "intermediate stage", and an isolated consideration of the corporate entity would not be possible. The corporate entity operates as an instrument of the individuals that are behind it, serving their economic endeavors. The earning of profits through a corporate structure does not lead to the duplication of the ability-to-pay. Sooner or later, the capital is expected to return to the shareholders, along with all the profits earned and reinvested by the entity[186]. The "ability-to-pay" of the legal persons would not be an "additional" or "definitive" ability-to-pay, but merely a provisional one. It only remains while profits are reinvested, but vanishes as soon as the profit leaves the sphere of the corporation. In no case is this provisional ability-to-pay able to justify a definitive double taxation of the relevant profits[187].

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[178] Pezzer, "Rechtfertigung und Rechtsnatur der Körperschaftssteuer," 5–18.
[179] Rainer Walz, *Steuergerechtigkeit und Rechtsanwendung* (Heidelberg Decker's Verlag: Decker's Verlag, 1980), 40.
[180] Hey, *Harmonisierung der Unternehmensbesteuerung*, 254.
[181] Klaus Tipke, *Steuerrechtsordnung*, vol. I (Köln: Otto Schmidt, 1993), 1031.
[182] Hey, *Harmonisierung der Unternehmensbesteuerung*, 254.
[183] Clearly contrasting the legal and the economic view, see Schreiber and Stiller, "Ökonomische Anforderungen an eine Reform der Gruppenbesteuerung," 217.
[184] Hey, "Verfassungsrechtliche Maβstäbe," 10.
[185] Hey, *Harmonisierung der Unternehmensbesteuerung*, 254.
[186] Hey, 255.
[187] Hey, 256.

Despite acknowledging the importance of the legal personality for legislation, NEUMARK has treated as a matter of greater importance that behind a "*personne morale*" there are always "*personnes physiques*", which, sooner or later, in one form or another, participate in the profits (or losses) of the legal person[188]. In a similar sense, SCHOUERI and BARBOSA sustain that both the qualification as an individual or as a legal person are "masks" or "*personas*" to which the legal system attributes rights and obligations[189]. According to a material understanding of the ability-to-pay, therefore, only the "*personnes physiques*" can be the "endpoint" of the ability-to-pay[190].

Under this view, similarly to the sacrifice theory, it is acknowledged that only individuals are able to actually earn income, because the business enterprise does not consume[191]. It is also argued that the result of the business enterprise, regardless of the form under which it is carried out (i.e., directly by an individual or through legal entities), would represent the earning of income by individuals. However, the approach acknowledges that CIT cannot be conformed according to principles which are completely different from those to which the taxation of individuals is subject, because CIT is deemed to be the taxation of the individuals who are behind these entities. Also the CIT would therefore be a personal tax, oriented towards the ability-to-pay principle[192]. After all, as SCHÖN clarifies, the function of CIT can only be understood within the more general system of the income tax[193], in relation to which it fills a gap.

Essentially, the CIT reconciles the realization principle and the level playing field within the income tax system. As a consequence of the legal personality of corporations, their profits are not directly attributed to the shareholders[194]. The CIT fills a gap that would otherwise exist in the income tax system. Without a CIT, if one would tax the economic profit of the shareholder in every taxing period, one would have to tax any and every increase of the equity of the corporation, even though no realization has been observed at the level of the shareholder[195]. The taxation of the distributions and liquidation surpluses in their entirety would ensure that corporate profits are fully taxed – following an economic concept of income[196]. The problem, however, is that profits can be realized and retained by the company. Such profits would only appear as unrealized increases in value for the shareholder if the shareholder does not sell his share to a third party[197].

Hence, the taxation of the economic income of the shareholder would eventually demand the taxation of unrealized profits, which, in most systems, is forbidden in principle, for mainly two reasons. Firstly, because the unrealized increase in value of the share based on the company's profit is difficult to measure, since it is not identical to the pro-rata company result for the respective financial year. Secondly, because the shareholder

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[188] Franz Neumark, *Grundsätze gerechter und ökonomisch rationaler Steuerpolitik* (Tübingen: Mohr Siebeck, 1970), 131.
[189] Luís Eduardo Schoueri and Mateus Calicchio Barbosa, "A Persona e o Direito: entre a Realidade e a Ficção das Pessoas Jurídicas," *Revista Direito Tributário Atual*, no. 30 (2013): 251.
[190] Palm, "Juristische Person und Leistungsfähigkeitsprinzip," 301.
[191] Hey, "Verfassungsrechtliche Maβstäbe," 10.
[192] Hey, 10.
[193] Schön, "Die Funktion des Unternehmenssteuerrechts," 232.
[194] Desens, "Einführung zum KStG," K-32.
[195] Schön, "Die Funktion des Unternehmenssteuerrechts," 232.
[196] Desens, "Einführung zum KStG," K-32.
[197] Schön, "Die Funktion des Unternehmenssteuerrechts," 231–32.

usually has limited access to the company's assets and cannot use them to pay taxes[198]. The taxpayer cannot be required to "bring money from home" in order to pay a tax levied on income generated by an asset[199]. Without a CIT, the reinvested profits would remain untaxed for the time being. In such scenario, the gap would arise, bringing a significant advantage to legal forms over individuals. The postulate of a level playing field for companies therefore requires corporate profits to be taxed in the period they arise, regardless of whether these profits are distributed to shareholders or remain in the company's assets[200].

At the end of the day, this reasoning leads to the conclusion that also for CIT the general principles of income taxation are relevant[201]. If CIT only fills a gap found in the income tax system, it is clear that also the fulfilment of the gap shall be guided by the same principles of the system in which the gap was found. The general principles of income tax shall, in this case, also be applied to the taxation at the corporate level. Corporations are also considered to be subjects for the purposes of fundamental rights, and may also call upon constitutional freedoms and the equality clause, which leads to the conclusion that the ability-to-pay principle is also relevant at the level of the corporation[202]. The fact that corporations do not have ability-to-pay in the subjective sense does not contradict such conclusions. At the level of the corporation, its objective ability-to-pay will be considered in a first step[203]. In this respect, when considering the allocation of the tax burden, the focus must be on the corporation and not on the shareholders. In a second step, as soon as the profits are distributed to individuals, their subjective ability-to-pay can also be taken into consideration[204].

CIT therefore covers only a narrow section of the reality of the legal person, being only an "abbreviation" thereof[205]. Legal systems often view it this way, when they provide for relief on the distributed profits, considering the previous burden at the level of the corporation, and also when provision on the hidden profit distribution or on limitations to the compensations of losses in certain tax restructuring are considered. In other words, objective ability to pay cannot mean that the legal entity would be an end point of attribution under income tax law. Objective ability to pay is then only to be understood in the sense of technical solvency, which results from the legal capacity under private law. Because corporations and partnerships are abbreviations, they can only be technical points of contact for income taxes[206]. Material end-points of attribution of ability-to-pay are the "*personnes physiques*" in NEUMARK's sense.

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[198] Schön, 232.

[199] On the problems of the lack of realization, see Surrey, "Reflections on 'Integration' of Corporation and Individual Income Taxes," 336. Illustratively: *"It is not hard to imagine the arguments: Where does the money come from? Must I be forced to sell my stocks? And so on"*.

[200] Schön, "Die Funktion des Unternehmenssteuerrechts," 232.

[201] Röder, *Das System der Verlustverrechnung im deutschen Steuerrecht*, 171.

[202] Röder, 171.

[203] Acknowledging the objective ability-to-pay of legal persons, see BVerfG v. 21.06.2006 - 2 BvL 2/99, BVerfGE 116, p. 199. For a critical perspective on the decision, see Palm, "Juristische Person und Leistungsfähigkeitsprinzip," 297.

[204] Röder, *Das System der Verlustverrechnung im deutschen Steuerrecht*, 172–73.

[205] Palm, "Juristische Person und Leistungsfähigkeitsprinzip," 301.

[206] See Palm, 302. Examining the German system he concludes that the taxes paid by the corporation are constitutionally to be assessed as taxes of their shareholders. A double burden on the profits of the corporation as well as the partnership would be therefore unconstitutional.

A similar view prevails for other systems[207]. The most common defence of the CIT sees it as an indirect way to tax shareholders[208]. According to the (prevailing) contractarian theory, corporations are nothing more than a convenient connection point for a multitude of relations between shareholders, employees, customers and other stakeholders. Corporations "do not really exist"[209]. As a matter of fact, the tax burden is always ultimately carried by natural persons. Therefore, it is only meaningful to speak of vertical equity among natural persons. Corporations are able to pay taxes, but, "in a more fundamental sense", no corporation would have "ability-to-pay over and above that of the shareholders who would otherwise receive the profits taken by the government as taxes"[210].

CIT is therefore often justified in terms of a "withholding function"[211], working as a "backup for personal income tax"[212] – which is in essence the same argument made by SCHÖN with regard to the fulfilment of a gap. CIT would be nothing more than a convenient way of taxing the income of shareholders and prevent deferral. Absent a CIT, individuals could shelter their income by resorting to corporations, which would result in a deferral at least until a dividend distribution. Such deferral could economically amount to an exemption, if dividends are held long enough.

This system would also be better than an attribution system for the taxation of shareholders[213]. As large companies are commonly widely held, in most cases individual shareholders do not have control over profit distributions, in a sense that the company's profits will not necessarily impact the ability-to-pay of its shareholders. Simply attributing income to the shareholders due to the profits made by the company would thus be incompatible with fairness considerations[214]. The approach would also be problematic if one considers that a shareholder may hold the shares for only part of the taxing period – case in which the profits should be proportionally attributed to each shareholder – and large corporations also include other complexities, such as multiple classes of stock and information asymmetries[215].

2.4. Summary: substantial reasons and semantics

The justification of a tax refers to different types of substantial reasons, either goal reasons or rightness reasons, connecting it with values and evaluations. It is essentially a matter

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[207] See Richard Vann, "Taxing International Business Income: Hard-Boiled Wonderland and the End of the World," *World Tax Journal* 2, no. 3 (2010): 297. (maintaining that "*corporate tax is often regarded as necessary in a domestic context because of the problem of deferral of tax on retained earnings at the shareholder level under a realization-based income tax, though the general policy objective is to achieve at least approximate integration of corporate and shareholder tax*").
[208] Avi-Yonah, "Corporations, Society, and the State," 1201; Devereux et al., *Taxing Profit in a Global Economy*, 35.
[209] Avi-Yonah, "Corporations, Society, and the State," 1195.
[210] McLure Jr., "The Case for Integrating the Income Taxes," 257.
[211] Ting, *The Taxation of Corporate Groups*, 15.
[212] Devereux et al., *Taxing Profit in a Global Economy*, 59. Speaking of a function of "protecting the individual income tax system", see Kimberly A. Clausing, "Who Pays the Corporate Tax in a Global Economy?," *National Tax Journal* 66, no. 1 (2013): 153.
[213] Ting, *The Taxation of Corporate Groups*, 15. Discussing the issue of realization, see also Vann, "Taxing International Business Income: Hard-Boiled Wonderland and the End of the World," 295.
[214] Ting, *The Taxation of Corporate Groups*, 15.
[215] Devereux et al., *Taxing Profit in a Global Economy*, 64.

of moral reasoning, despite often being grounded on constitutional arguments among tax legal theories.

From this perspective, it cannot be rationally maintained that CIT is paid "in consideration of" any benefit that could eventually be provided by the state. There is simply no correlation between the payment of CIT and the availability of any specific resources or privileges granted by the state. The benefit theory does not bring any justification to the fundamental decision to separately tax corporate income.

With regard to the ability-to-pay argument, it is clear that CIT ultimately aims at burdening the shareholder, since, from an allocative perspective, it is meaningless to speak of burdening an entity. Only natural persons consume in the proper sense, and they are the only ones who are actually able to bear the burden of a tax. Hence, if the ability-to-pay discussion refers to an issue of tax justice, maintaining that the legal entity bears the burden is not useful for discussing the fairness of the allocation, since the burden will always be ultimately passed on to an individual.

CIT is therefore aimed at burdening the shareholder. Nonetheless, the reference to the "provisory nature" of the ability-to-pay of legal entities may be helpful for the purpose of building arguments to guide the taxation of legal entities. It also seems very helpful to portray the function of CIT as being that of filing a gap in the income tax system. In such cases, whether one acknowledges a provisory "ability-to-pay" to legal entities or not, is mostly a semantic issue. The material argument remains the same as denying the ability-to-pay of legal entities, as it is still sustained that the legal entities do not have their own, separate, ability-to-pay, but merely a "provisory" one.

The semantic issue can be defended as such: it seems useful to think of a provisory ability-to-pay of the legal entity in order to think of the structure of CIT. But a rational defence of it cannot go beyond the convenience, and must be followed by a further refinement on the relevant expressions[216] – which is outside the scope of this analysis. There is no single semantic convention on the meaning of such terms, and its usage will ultimately vary according to the legal tradition in each system, which may either enthrone it[217], or treat it as harmful, due to its excessive vagueness[218].

These are the conclusions concerning a traditional CIT. In order to understand how the GLOBE MODEL RULES interact with the ability-to-pay, it is necessary to gain further elements on the subject of the GLOBE MODEL RULES, which is the scope of chapter III. Section 4 of this chapter already brings some arguments on why the GLOBE MODEL RULES cannot be justified strictly on the grounds of the ability-to-pay, but the argument will only be completely built in chapter III.

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[216] On the concretization of the ability-to-pay principle in the German system, see Hey, 75–90. In the Swiss system, with specific reference to CIT, see Michael Bertschinger, *Die handelsrechtliche und steuerrechtliche Gewinnermittlung unter dem revidierten Rechnungslegungsrecht* (Bern: Stämpfi Verlag, 2020), 71–76.

[217] See, *e.g.,* Hey, 76. (defending the ability-to-pay as a fundamental "principle of fair taxation" and stating that the only alternative to the ability-to-pay principle would be the absence of a fundamental principle).

[218] See, *e.g.,* Gassner and Lang, "Die mangelnde Leistungsfähigkeit des Leistungsfähigkeitsprinzips," 643.

3. Real Incidence: the legal justification under economic scrutiny

Does the legal justification survive economic scrutiny? If the justification is grounded on substantial reasons, the actual effects of the tax should be considered, taking into consideration "the cardinal rule of incidence analysis that only individuals can bear the burden of taxation and that all tax burdens should be traced back to individuals"[219]. Does CIT in fact burden the shareholder? Or is the withholding theory merely grounded on false assumptions regarding its incidence? Is there a gap between the *mens legis* and the actual effects produced by the legislation?

Despite the systematic importance of the ability-to-pay principle, it is often acknowledged that the principle is not able to account for real incidence. As put by Harris, "the legislator cannot effectively prescribe who is to bear the burden of a tax"[220]. As a consequence, the very distinction between direct and indirect taxes is "artificial", as it "can only relate to a legislator's intention and not the actual fashion in which a tax is borne" [221]. According to Wernsmann, the characterization of a tax as an indirect or a direct tax is not related to the person who in fact bears the burden of the tax, but rather to whom should carry the burden, according to the purpose of the legislation[222].

The economic criticism to the withholding theory explores the distinction between nominal and real incidence: even though authors arguing for the theory seem to believe that real incidence is what matters (after all, they reject that the legal entity is being burdened), they do not go all the way through the argument. They argue that only individuals bear the real burden of a tax, and simply assume that the shareholder is the one bearing the incidence. The argument is neither empirically nor theoretically grounded.

In fact, there are several other candidates to bear the real burden of the CIT: employees, consumers and other stakeholders may be affected by it. Businesses will undoubtedly adjust their behavior to amendments of tax legislation. It is theoretically possible that shareholders are not the only ones being burdened by a CIT, or even that shareholders are not burdened at all by a CIT. Depending on the nature of the markets in which the business is carried out, the burden of the tax may be passed on to employees, by means of lower wages, to consumers, by means of higher prices, to suppliers, by means of lower payments for inputs, and so on[223]. If the business is inserted in a competitive market, earning just the minimum return rate, an increase of CIT would demand that they either raise prices or exit the market. The probable scenario after the tax raise would be a market with fewer competitors, fewer demand and higher prices, showing that the remaining consumers are the ones "worse off", carrying the burden of the tax increase[224].

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[219] Alan Auerbach, "Who Bears the Corporate Tax? A Review of What We Know," *Tax Policy and the Economy* 20 (2006): 2.

[220] Peter Harris, "The CCCTB GAAR: A Toothless Tiger or Russian Roulette?," in *CCCTB Selected Issues*, ed. Dennis Weber (Alphen aan den Rijn: Kluwer Law International, 2012), 278.

[221] Harris, 278.

[222] Rainer Wernsmann, *Verhaltenslenkung in einem rationalen Steuersystem* (Tübingen: Mohr Siebeck, 2005), 57.

[223] Devereux et al., *Taxing Profit in a Global Economy*, 35.

[224] Devereux et al., 35.

Ultimately, there is no credible available information allowing for a simplistic and direct attribution to either of these players[225]. One cannot aprioristically identify who actually bears the burden of the CIT[226]. Considering that market conditions may vary among different businesses, sectors, and countries, differences in real incidence are also expected[227]. Despite these limitations, there are important theoretical and empirical accounts of CIT real incidence, which are worth being taken into consideration, in order to properly understand the policy debates that influenced the enactment of the GLOBE MODEL RULES.

This section presents two extreme versions of a closed-economy and an open-economy-model. Such models are followed by a brief summary of the empirical accounts of the shifting of CIT burden. Finally, the section evidences how the reference to "economic rents" brought new hypotheses to the issue of economic incidence and significantly impacted recent debates on CIT.

3.1. The closed-economy model

The classic model of economic incidence of CIT has been developed by HARBERGER (1962), based on a closed economy with two sectors (corporate and non-corporate) in which only the former is taxed[228]. His conclusion was that capital owners (of all capital, and not just corporate capital[229]) would bear the entire burden of CIT, and labour none of it. The most important part of his work was to develop a general equilibrium analysis, according to which the burden of CIT would not be shifted from income to labour[230].

HARBERGER assumed that overall savings and investment were inelastic[231]. The model ignored the possibility that the total supply of a factor could change in response to taxation. Taxation of capital is assumed not to have an effect on savings rates, "just as a tax on labor income is assumed to exert no influence on hour or days of work"[232]. Both sectors, corporate and "non-corporate" (*e.g.*, real estate and agriculture), use capital and labour to produce income, but the corporate sector would be more able to substitute between capital and labour as inputs[233]. In this closed-economy model, CIT would lead to a "sectoral reallocation of capital", and the increase in tax revenues is exactly matched by a reduction in the net income of the recipients of capital income[234]. CIT would drive capital from the corporate to the non-corporate sector, leading to an increase of demand

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[225] Yariv Brauner, "The Non-Sense Tax: A Reply to New Corporate Income Tax Advocacy," *Michigan State Law Review* 591 (2008): 630.
[226] See Auerbach, "Who Bears the Corporate Tax?"; Brauner, "The Non-Sense Tax," 598.
[227] Devereux et al., *Taxing Profit in a Global Economy*, 35.
[228] Arnold Harberger, "The Incidence of the Corporate Income Tax," *Journal of Political Economy* 70 (1962): 215–40. For an account of subsequent developments of the closed-economy model, see Arnold Harberger, "The ABCs of Corporation Tax Incidence: Insights into the Open-Economy Case," in *Policy and Economic Growth* (Washington: American Council for Capital Formation, 1995), 51–53.
[229] Auerbach, "Who Bears the Corporate Tax?," 9.
[230] Daniel Shaviro, "Bittker's Pendulum and the Taxation of Multinationals," *Tax Notes Federal* 173 (2021): 628. On the importance of HARBERGER'S model, see also Clausing, "Who Pays the Corporate Tax in a Global Economy?," 151.
[231] Shaviro, "Bittker's Pendulum," 628; Charles McLure Jr. and Wayne Thirsk, "A Simplified Exposition of the Harberger Model I: Tax Incidence," *National Tax Journal* 28, no. 1 (1975): 3. For further discussion on the assumptions, see Auerbach, "Who Bears the Corporate Tax?," 9–10.
[232] McLure Jr. and Thirsk, "A Simplified Exposition," 3.
[233] Shaviro, "Bittker's Pendulum," 628.
[234] McLure Jr. and Thirsk, "A Simplified Exposition," 9.

for work in the corporate sector. As a consequence, wages would rise and CIT would be ultimately borne by business owners, which now must pay a higher salary[235].

HARBERGER's model led to the belief that CIT would be highly progressive. For a long time, it has been considered that for the purpose of distributional analysis of the tax system, it would be appropriate to assign the incidence of the corporate tax to capital, as a sort of "rule of thumb"[236]. Since the model assumes that overall savings and investment were inelastic, investors would bear the burden of CIT, which would also be a highly efficient tax, as it would not create inefficiencies to productivity or economic growth, other than those related to the transfer of capital shift to the non-corporate sector[237]. Interestingly, a CIT would burden "all owners of capital and not just owners of capital in the corporate sector"[238], which makes it less progressive than if only owners of corporate capital were burdened[239]. His model was highly influential and the methodology was extended to the examination of the incidence of a variety of other taxes[240].

3.2. The open-economy model

The subsequent decades showed the deficiencies of assuming a closed economy without cross-border capital flows. Trade barriers were progressively removed over time, and the rise of integrated global capital markets urged the development of models in which nations are treated as an open economy, from which capital is able to flow in and out.

Many open-economy models have been developed[241]. As a general trend, theories predicted that, in a small open economy, any source-based capital tax is inefficient, as capital becomes more mobile, and the price of capital is fixed with reference to a world return[242]. Also HARBERGER in subsequent modelling assumed that capital could go anywhere on the pursuit for the highest after-tax return available and that, at the margin, investors could expect a normal global rate of return[243]. In this context, all countries would be mere "price takers", without the ability to attract or retain capital, unless they provided the expected global after-tax return[244]. The essential assumption behind this model is that the world rate of return on capital lies beyond the influence of the country[245].

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[235] Shaviro, "Bittker's Pendulum," 628.

[236] Jane Gravelle, "Corporate Tax Incidence in an Open Economy," *Proceedings of the Annual Conference on Taxation Held under the Auspices of the National Tax Association-Tax Institute of America* 86 (1993): 173.

[237] Shaviro, "Bittker's Pendulum," 629. Even if less relevant than the inefficiencies under the open-economy model, their role cannot be underestimated. See, on the topic, Auerbach, "Who Bears the Corporate Tax?," 9.

[238]McLure Jr. and Thirsk, "A Simplified Exposition," 21.

[239] Discussing this issue with more detail, see Auerbach, "Who Bears the Corporate Tax?," 9.

[240] For further reference on the influence of HARBERGER, see Charles McLure Jr., "General Equilibrium Incidence Analysis," *Journal of Public Economics* 4, no. 2 (1975): 125–61.

[241] See e.g., Gravelle, "Corporate Tax Incidence in an Open Economy," 173. On the subsequent development of open-economy models, see Clausing, "Who Pays the Corporate Tax in a Global Economy?," 151.

[242] See Peter Diamond and James Mirrlees, "Optimal Taxation and Public Production," *American Economic Review* 61, no. 3 (1971): 261–78.

[243] Harberger, "The ABCs of Corporation Tax Incidence," 51.

[244] Shaviro, "Bittker's Pendulum," 629.

[245] Harberger, "The ABCs of Corporation Tax Incidence," 54.

A "strong version" of the model is described by SHAVIRO[246], which is of particular illustrative interest for the purposes of this exposition. In the example, each country offers its natural resources and the supply of workforce. The commercial development of these elements require the attraction of capital from global capital markets, by paying the expected global after-tax return (*e.g.*, 6%). As such suppliers of capital are only providing money, they can leave at any time, but they cannot demand more than 6%. From the perspective of the locals who need capital, they can raise as much capital as they like, but they cannot raise any capital if they pay less than 6% (and have no need to pay more). In this model, capital can always simply go "abroad"[247], which is a place where the 6% after-tax return is paid in virtually any application.

Therefore, all 6%-return investments are made and the surplus is kept by the locals. If the investor is taxed at a 25% rate, investors will demand an 8% return, while they will charge only the 6% if the income is exempted. In the scenario where income is taxed, investments that would generate between 6% and 8% are no longer made, while investors are just as well off, because they are able to shift their investments elsewhere. Also, the taxed investors who are demanding the 8% pre-tax return are not bearing the burden of the income tax, because they are deriving 6% either way. The incidence, in this case, is borne locally by resource owners (including workers whose wage is impacted).

If fully accepted, this model leads to the conclusion that capital bears none of the incidence of CIT. Investors are indifferent to CIT, while workers and other resource owners are affected by a demand reduction[248]. CIT is no longer progressive, and is likely to reduce national income and economic growth. It is thus generally regarded in the literature that an open economy that imposes a source-based tax on capital income will drive capital away until after-tax returns to capital equalize, which represents a distortionary cost to the national economy[249]. While the application of this logic to source-based CIT is more direct, a similar reasoning could be applied to the residence-based CIT taxation of MNEs foreign-source income[250].

This sort of model supports "the-end-of-history-view"[251] according to which CITs would be with their days counted[252]. Due to both distributional and efficiency concerns, there would be no justification to keep a system that burdens workers and consumers, while promoting inefficiencies that could be avoided. The later decades were marked by in-depth discussions of alternatives to CIT[253].

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[246] Shaviro, "Bittker's Pendulum," 629–30.
[247] Harberger, "The ABCs of Corporation Tax Incidence," 54.
[248] Shaviro, "Bittker's Pendulum," 630.
[249] Joseph Bankman, Mitchell Kane, and Alan Sykes, "Collecting the Rent: The Global Battle to Capture MNE Profits," *Tax Law Review* 72, no. 2 (2019): 202.
[250] Shaviro, "Bittker's Pendulum," 630.
[251] Shaviro, 630.
[252] See, however, arguing that such views have been "greatly exaggerated", Brian J. Arnold, "A Tax Policy Perspective on Corporate Residence," *Canadian Tax Journal* 51, no. 4 (2003): 1560.
[253] See, for a discussion contrasting the CIT with alternative approaches, Brauner, "The Non-Sense Tax." The author's premise is that "[i]nstead of trying to ameliorate the distortions of the corporate income tax, we should acknowledge its insensibility and work on improving alternative schemes" (fn. 18). For further discussion of proposals, see Joseph M. Dodge, "A Combined Mark-to-Market and Pass-through Corporate-Shareholder Integration Proposal," *Tax Law Review* 50, no. 3 (1995): 265–372; Michael S. Knoll, "An Accretion Corporate Income Tax," *Stanford Law Review* 49, no. 1 (November 1996): 1–43; Joseph Bankman, "The Engler-Knoll Consumption Tax Proposal: What Transition Rule Does Fairness (or Politics) Require," *SMU Law Review* 56 (2003): 83–98; Joseph Bankman and David A. Weisbach, "The Superiority

3.3. *The existing empirical studies*

From an empirical perspective, identifying the real incidence of a CIT is also a troublesome endeavour[254]. Besides the difficulties inherent to empirical research, one has to imagine what the "counterfactual" would be, *i.e.*, what would happen in the absence of the tax, or if the same revenue had been raised by other means. Since there may be disagreement on the counterfactual, disagreements on real incidence are a natural outcome, and the question remains largely "unresolved"[255]. Besides, changes in CIT have distinct effects on existing asset holders and on new investments. In the short run, an increase in CIT causes asset prices to fall, hurting the owners of the assets. Over time, the CIT modification changes the rate of return on investments, affecting the pattern of investment and wages[256]. Also this lag implies grave difficulties for empirical research[257].

Despite the challenges, there are relevant empirical accounts in the literature on the shifting of the CIT burden, both forward to consumers or backwards to labour, particularly in concentrated industries. If this is so, the tax will ultimately behave as "as a capricious form of sales or payroll tax that has no obvious justification"[258] – which means it would be more regressive, when compared to the original shareholder taxation proposition. As seen, the position according to which CIT is borne by shareholders assumes that the CIT does not change wages, interest rates or output prices, which is not confirmed by empirical evidence.

In fact, contemporary research has concluded that a significant part of the income tax is borne by labor. FUEST, PEICHL and SIEGLOCH (2018) after analysing a 20-year set of statistical data from German Municipalities, estimated that workers bear about 50% of the total burden of (local) corporate taxation[259]. Additionally, they concluded that "low-skilled, young and female employees bear a larger share of the tax burden", while wage

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of an Ideal Consumption Tax Over an Ideal Income Tax," *Stanford Law Review* 58, no. 6 (2006): 1413–56; Daniel Shaviro, "Beyond the Pro-Consumption Tax Consensus," *Stanford Law Review* 60, no. 3 (2007): 745–88; Joseph Bankman and David Weisbach, "Consumption Taxation Is Still Superior to Income Taxation," *Stanford Law Review* 60, no. 3 (2007): 789–802; David A Weisbach, "The Irreducible Complexity of Firm-Level Income Taxes: Theory and Doctrine in the Corporate Tax," *Tax Law Review* 60, no. 4 (2007): 215-262.; Ilan Benshalom, "How to Live with a Tax Code with Which You Disagree: Doctrine, Optimal Tax, Common Sense, and the Debt-Equity Distribution," *North Carolina Law Review* 88 (2010): 1217–74.

[254] Critically on recent approaches, see Clausing, "Who Pays the Corporate Tax in a Global Economy?," 153–56.

[255] Devereux et al., *Taxing Profit in a Global Economy*, 35.

[256] Auerbach, "Who Bears the Corporate Tax?," 1.

[257] Clausing, "Who Pays the Corporate Tax in a Global Economy?," 169. See also Auerbach, "Who Bears the Corporate Tax?," 9–10.

[258] McLure Jr., "The Case for Integrating the Income Taxes," 261.

[259] See Clemens Fuest, Andreas Peichl, and Sebastian Siegloch, "Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany," *American Economic Review* 108, no. 2 (2018): 393–418. The authors analyze the incidence of the "*Gewerbesteuer*", or local business tax, which is a tax of controversial justification in legal scholarship. The important issue for the economic analysis is that the tax base of the local business tax "is basically operating profits" and the authors assume that it is a tax "on business profits", similar to the *Körperschaftsteuer*, which is the German CIT. The authors acknowledge, however, that wage effects of local taxes may be larger when compared to national ones. For an in-depth discussion of the justification of the local business tax, which is irrelevant for the purpose of this chapter, see Rodi, *Die Rechtfertigung von Steuern als Verfassungsproblem*.

effects are negligible for large firms that operate in multiple jurisdictions[260]. SUÁREZ SERRATO and ZIDAR (2016) in an analysis which also took the impacts over landowners into consideration, estimated that firm owners would bear roughly 40% of the state corporate taxes in the US, while workers would bear 30-35% and landowners 25-30%[261]. LIU and ALTSHULER (2013) estimated the incidence of the CIT under imperfect competition, analysing data of effective marginal tax rates in the United States across different industries. The authors concluded that the elasticity of wages with respect to the corporate marginal effective tax rates increases with industry concentration and labour share of the CIT burden would be around 60-80% on average, but at least 42% in any case[262].

It is important to mention that the problem of a mismatch between intended and real incidence is not only observed in CIT, but also in other taxes. In VAT policy making and distributional analyses, it is often assumed that tax changes are fully and exactly passed through to consumer prices. This is no different in legal scholarship aiming at justifying the tax. There are, however, theoretical accounts of under and overshifting of the tax from firms to consumers, which may be explained, for instance, by competition aspects in certain markets[263], and have also been demonstrated empirically. BENZARTI and CARLONI (2019), examining data of a VAT cut for French sit-down restaurants in 2009, concluded that more than 55% of the incentive was pocketed by firm owners, while consumers received only 13.6% of the benefit[264]. Only a very small percentage of the tax cut was economically transferred to consumers[265], even though theoretically the VAT burdens the ability-to-pay of consumers, and one of the main goals of the reform was to decrease the price of meals in sit-down restaurants. Also in the case of personal income taxes the problem arises. SAEZ, SLEMROD and GIERTZ (2012) emphasize the need for attention to the extent to which behavioural responses to income tax changes reflect the shifting of the burden of the tax to other bases[266]. Literature refers, *e.g.*, to the theoretical possibility of an increase in CEO personal income taxation being shifted to the company. CEOs may have enough bargaining power to shift the burden to the corporation, by increasing their compensation, thus turning the alleged employee-borne tax into one that is employer-borne.

The issue could be further complicated. Standard theories of tax incidence ignore issues of tax enforcement, assuming that the obvious outcome would always be that the

[260] Clemens Fuest, Andreas Peichl, and Sebastian Siegloch, "Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany," *American Economic Review* 108, no. 2 (2018): 393.
[261] Juan Carlos Suárez Serrato and Owen Zidar, "Who Benefits from State Corporate Tax Cuts? A Local Labor Markets Approach with Heterogeneous Firms," *American Economic Review* 106, no. 9 (2016): 2582–2624.
[262] Li Liu and Rosanne Altshuler, "Measuring the Burden of the Corporate Income Tax Under Imperfect Competition," *National Tax Journal* 66, no. 1 (2013): 215–38.
[263] See Dora Benedek et al., "Estimating VAT Pass Through," *IMF Working Papers* 15, no. 214 (2015): 5.
[264] Youssef Benzarti and Dorian Carloni, "Who Really Benefits from Consumption Tax Cuts? Evidence from a Large VAT Reform in France," *American Economic Journal: Economic Policy* 11, no. 1 (2019): 38–63.
[265] The authors even acknowledge that their estimate of the benefits to customers might be biased upward, because the analyzed data does not consider smaller firms, which are even less likely to reduce prices. See Benzarti and Carloni, 40.
[266] Emmanuel Saez, Joel Slemrod, and Seth H Giertz, "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review," *Journal of Economic Literature*, 2012, 43.

successful evader is able to keep the evaded income entirely[267]. Recent literature on tax incidence has made efforts in fulfilling this gap, rejecting such assumption and affirming that standard incidence results may not hold when evasion opportunities are present[268]. ASATRYAN and GOMTSYAN (2020), analysing an enforcement episode in Armenia, which brought large retailers into the VAT system, concluded that consumers borne only up to a third of the tax burden through changes in price after the new measures of tax enforcement. The outcome suggests that the evasion rents were actually broadly shared with the consumers[269], which contradicts the traditional thinking that evaders are always able to entirely keep the amount evaded.

For the purposes of this chapter, it is enough to stress that empirical studies suggest that CIT would be a case where the mismatch between the nominal and actual incidence is particularly pronounced. The prevailing open-economy models, as well as the empirical accounts, allow one to conclude that a significant part of CIT would be a burden on labour, and not on capital, contrary to the traditional view grounded on closed-economy models.

3.4. The literature on economic rent

What is then the explanation for the contemporary focus on CIT? If CIT is such a distortionary and regressive tax, that burdens labour so intensely, why have policy makers and politicians focused so much effort on making CIT effective? Why was there no shift towards alternative taxes, potentially more efficient and with better distributive properties? There are certainly many possible reasons for this preference[270]. Nonetheless, there is also one explanation that is related to tax incidence, which is the focus of the present section.

3.4.1. A basic definition of economic rent

Despite the accounts of tax incidence described in the previous sections, a significant shift in the conclusions is observed if one considers a CIT that taxes strictly economic rents, instead of a traditional CIT, which also taxes normal returns. In contrast to traditional CIT, that comes with efficiency losses which go beyond the merely administrative costs of the tax, a CIT that only taxes economic rents is deemed to be a "painless tax"[271].

For now, definitional issues are left aside. There is some necessary disambiguation with regard to the differences between the use of the expression "economic rent" in economic scholarship *vis-à-vis* similar expressions, such as "residual profits" and "excess profits" in transfer pricing tradition. Such terms must also be contrasted with the defined term "Excess Profit" in the GLOBE MODEL RULES[272]. Even though there may be significant overlap between "economic rent" and the "residual profit" from transfer pricing (which

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[267] See, critically, James Alm and Keith Finlay, "Who Benefits from Tax Evasion?," *Economic Analysis & Policy* 43, no. 2 (2013): 139–54.
[268] Alm and Finlay; Zareh Asatryan and David Gomtsyan, "The Incidence of VAT Evasion," *ZEW Discussion Paper* 20–027 (2020): 1–68.
[269] Asatryan and Gomtsyan, "The Incidence of VAT Evasion," 46.
[270] Discussing feasibility issues of CIT reform, see Surrey, "Reflections on 'Integration' of Corporation and Individual Income Taxes," 336.
[271] See, critically, Shay, "The Deceptive Allure of Taxing Residual Profits," 1.
[272] Ch. IV, sec. 3, *infra,* is dedicated to this disambiguation.

are "broadly related"[273] and often used interchangeably), they are not identical[274]. Moreover, economic literature often disagrees on the proper mechanism to identify an excess over the normal return, conflating expressions such as "risk-free return", "normal return" and "routine return", as if they were one and the same[275]. The separation between true economic rents and routine returns is not straightforward, but the performance of a "painless tax" depends precisely on such distinction[276]. The differences to the GLOBE MODEL RULES defined term are more significant[277].

For the purposes of the present chapter, it is sufficient to say that economic rents, in the sense intended here, are above-average returns, as opposed to a normal return on investment. Firms are expected to survive only if over the course of time and in present value they provide at least a normal return on capital[278]. A contemporary definition of economic rent is, therefore, from a supply-side perspective, "those payments to a good that are in excess of the minimum payment necessary to have it supplied" or, from a demand-side "those benefits to an agent that are in excess of the minimum necessary for the agent to accept the transaction"[279].

3.4.2. Tax fairness and economic rent taxation

Economic theory in general treats the taxation of true economic rent as non-distortionary, as it would not change the behaviour in the economy[280]. It is well accepted that the taxation of economic rent does not produce distortions on investment[281], consumption or production[282], and does not discourage labour or supply[283]. A tax on business profits, as it is generally adopted by states, presents several inefficiencies, which are theoretically solved in the case of a tax on economic rents.

The first form of economic inefficiency is related to the investment decision. It arises when the tax prevents a business from undertaking a new investment project[284]. The investment project is undertaken when it is expected to generate economic rent, which is generally equivalent to being expected to earn at least a normal rate of return, commensurate with its risk[285]. If the investment is not expected to generate at least its

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[273] Michael Devereux et al., "Residual Allocation by Income" (Oxford University Centre for Business Taxation Working Paper No. 19/01, 2020), 22. In a similar sense, see Tarcísio Diniz Magalhães and Allison Christians, "Rethinking Tax for the Digital Economy After COVID-19," *Harvard Business Law Review*, no. 11 (2021): 12.
[274] Sebastian Beer et al., "Exploring Residual Profit Allocation" (IMF Working Paper, WP/20/49, 2020); Devereux et al., "Residual Allocation by Income," 22.
[275] See, critically, Shay, "The Deceptive Allure of Taxing Residual Profits," 2–4.
[276] Gregor Schwerhoff, Ottmar Edenhofer, and Marc Fleurbaey, "Taxation of Economic Rents," *Journal of Economic Surveys* 34, no. 2 (2020): 411.
[277] The relationship between such concepts is developed in chapter IV, sec. 3, *infra*.
[278]Beer et al., "Exploring Residual Profit Allocation," 18.
[279] Schwerhoff, Edenhofer, and Fleurbaey, "Taxation of Economic Rents," 400.
[280] Bankman, Kane, and Sykes, "Collecting the Rent," 202.
[281] Alan J. Auerbach, "Taxation, Corporate Financial Policy and the Cost of Capital," *Journal of Economic Literature* 21, no. 3 (1983): 35–36.
[282] Jack M. Mintz, "Taxes, Royalties and Cross-Border Resource Investments," in *International Taxation and the Extractive Industries*, ed. Philip Daniel et al. (London: Routledge, 2016), 308.
[283] Daniel Shaviro, "Mobile Intellectual Property and the Shift in International Tax Policy from Determining the Source of Income to Taxing Location-Specific Rents: Part Two," *Singapore Journal of Legal Studies* 2021, no. 1 (2021): 129.
[284] See Devereux et al., *Taxing Profit in a Global Economy*, 43.
[285] As addressed in sec. 3.2, *supra,* with regard to the open-economy model.

normal rate of return, commensurate with its risk, it shall not be undertaken. In this scenario, a traditional income tax represents an additional cost for the project, that is able to turn the economic rent from positive to negative – which is the same as making the rate of return falling from above the normal rate (investment will be undertaken) to below the normal rate (investment will not be undertaken). Hence, an investment that would be otherwise undertaken, is not undertaken due to tax considerations, which hinders tax neutrality. The same considerations also apply to the decision of whether to marginally increase the scale of the investment, thus also affecting the size of the business[286].

The second form of inefficiency is related to the financing of the business. Traditional income taxes are known to produce the so-called "debt-bias"[287]. Interest payments are generally deductible, whereas dividends payments are not, which creates an incentive for the business to be financed by debt and not equity. The economic cost arising from such inefficiency is less immediate and more controversial[288]. In a nutshell, it could be argued that a business that is financed by debt is more fragile and prone to default, which can also impair the financial health of other businesses[289].

Besides the efficiency gains, there would also be distributive gains, as the economic rent taxation would be borne predominantly by capital owners[290]. In a model featuring economic rents, shareholders would be the ones actually bearing the burden of corporate tax changes, which would make the tax highly progressive and non-distortionary[291].

Under this reasoning, the economic rent CIT "ticks both the optimal tax boxes of efficiency and equity"[292], making it very appealing to policy-makers and scholars in general. The empirical exam of any theory regarding the economic incidence of a tax on economic rent is, however, even more challenging than economic incidence analysis in general. Besides the general problems of empirical research on economic incidence, the concepts of routine return and economic rent have no direct counterpart in accounting and there is no information readily available on the topic in a consistent form[293].

Of course, the restriction of CIT to economic rents also brings tax collection concerns. The economic rent CIT raises the argument that such a tax would be invariably more beneficial to businesses, because the base would be smaller and a commensurate increase

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[286] See, on the relevant of CIT for the scale of investments, United Nations Conference on Trade and Development, *World Investment Report 2022: International Tax Reforms and Sustainable Investment*, United Nations Conference on Trade and Development (UNCTAD) World Investment Report (WIR) (United Nations, 2022), 104–5.

[287] As already acknowledged as a property of CIT more than half a century ago. See Franco Modigliani and Merton H. Miller, "Corporate Income Taxes and the Cost of Capital: A Correction," *The American Economic Review* 53, no. 3 (1963): 433–43.

[288] There are important writings and theories on the choices for either debt or credit financing. On the "trade-off theory", see Mark T. Leary and Michael R. Roberts, "Do Firms Rebalance Their Capital Structures?," *The Journal of Finance* 60, no. 6 (2005): 2575–2619. On the "pecking-order theory, see Stewart C. Myers, "The Capital Structure Puzzle," *The Journal of Finance* 39, no. 3 (1984): 574–92. On the "market-timing theory", see Malcolm Baker and Jeffrey Wurgler, "Market Timing and Capital Structure," *The Journal of Finance* 57, no. 1 (2002): 1–32. For an empirical account of the behavior of Brazilian companies, see Tatiana Albanez, "Impact of the Cost of Capital on the Financing Decisions of Brazilian Companies," *International Journal of Managerial Finance* 11, no. 3 (2015): 285–307.

[289] See Devereux et al., *Taxing Profit in a Global Economy*, 43.

[290] See Shay, "The Deceptive Allure of Taxing Residual Profits," 1.

[291] See Shaviro, "Beyond Consumption Tax Consensus," 632.

[292] See Shay, "The Deceptive Allure of Taxing Residual Profits," 1.

[293] Beer et al., "Exploring Residual Profit Allocation," 6.

in the tax rate would not be expected[294]. Depending on how much revenue a state wishes to collect from CIT, the adoption of such a tax base may face political resistance[295]. Unless policy-makers firmly believe that the taxation of economic rents will bring additional investment and increase the tax base, the adoption of such base with neutral impact on tax collection demands the increasing of CIT tax rate[296]. At the end of the day, if the state wishes to implement a revenue neutral reform, the choice must be made between a broader base with a lower rate (traditional CIT), or a narrower base with a higher rate (economic rent CIT).[297] The taxation of economic rent is contrary to the tax policy mantra "broaden the base, and lower the rates" [298], therefore bearing a significant potential to political aversion.

3.4.3. The contemporary relevance of economic rent taxation

The defence of a tax on economic rent is far from new, but it has gathered particular interest in the last decades. There are accounts of war taxes which were levied on "excess profits"[299], under which all earnings above an 8% return on invested capital were taxed at rates that could amount to 80%[300]. The 8% was intended to approximate the minimum return that investors could reasonably require, making the tax base resemble economic rents in the sense defined by David Ricardo[301]. Literature from the 1980s also conjectured on the economic incidence of economic rent taxation and referred to a "tax on economic rent" as a tax that "by definition cannot be shifted onto others and consequently produces no distortion or excess burden"[302]. Taxation of natural resources was also highly influenced by this theory[303].

With regard to business taxation, BOADWAY and BRUCE (1983) envisaged the enactment of a tax that would allow states to raise revenue in a non-distortive manner, taxing only

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[294] See Shay, "The Deceptive Allure of Taxing Residual Profits," 2.
[295] See, discussing the topic Johannes Becker and Clemens Fuest, "Does Germany Collect Revenue from Taxing the Normal Return to Capital?," *Fiscal Studies* 26, no. 4 (2005): 491–93.
[296] Making this argument with regard to the adoption of an ACE, see Schön, "Die Funktion des Unternehmenssteuerrechts," 245.
[297] MAGALHÃES and CHRISTIANS have also considered a separate economic rent CIT, in addition to traditional CIT, as "*a post-pandemic measure for the digital economy*". See Magalhães and Christians, "Rethinking Tax for the Digital Economy After COVID-19," 16.
[298] The mantra is essentially a concretization of Colbert's famous quote ("*The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest amount of hissing*"), being oriented by the need to circumvent taxpayer aversion. Discussing the mantra in the US context, with specific reference to economic rents, see Michael Keen and Joel Slemrod, *Rebellion, Rascals, and Revenue: Tax Follies and Wisdom through the Ages*, 1st ed. (Princeton: Princeton University Press, 2021), 240–43.
[299] Keen and Slemrod, 225. However, making the case that those "excess profits" would be different from the concept of "economic rent", see Lilian V. Faulhaber, "Lost in Translation: Excess Returns and the Search for Substantial Activities," *Florida Tax Review* 25, no. 2 (2022): 22–28.
[300] Keen and Slemrod, *Rebellion, Rascals, and Revenue*, 228.
[301] On the concept of Ricardian rent, see Robert Dorfman, "Thomas Robert Malthus and David Ricardo," *Journal of Economic Perspectives* 3, no. 3 (1989): 153–64.
[302] Albert M. Church, "Economic Rent, Economic Efficiency, and the Distribution of Natural Resource Tax Burdens: Copper and Coal," *Natural Resources Journal* 22, no. 3 (1982): 563.
[303] See Mintz, "Taxes, Royalties and Cross-Border Resource Investments," 306. See also Jack Calder, "Transfer Pricing – Special Extractive Industry Issues," in *International Taxation and the Extractive Industries*, ed. Philip Daniel et al. (London: Routledge, 2016), 98.

"pure profits", which would be those exceeding the opportunity cost of the investor[304]. Based on their work, DEVEREUX and FREEMAN (1991) proposed an Allowance for Corporate Equity ("**ACE**"), bringing significant practical insights that would allow for an immediate application of the measure[305]. Both proposals essentially aim at the taxation of economic rents, the "pure profits".

In the contemporary debate, the adoption of a CIT that is restricted to economic rent has gained momentum. Several authors have suggested, to a lesser or greater extent, that the design of the international tax system should take a tax on economic rent into consideration[306], including by means of a "Pillar Three"[307]. The adoption of ACE mechanisms around the globe is also a consequence of such influence – even though ACE mechanisms, as adopted in practice by states, often contain deviations, which are not derived from the economic model[308]. In the European Union, the Common Corporate Tax Base ("**CCTB**")[309], the Common Consolidated Corporate Tax Base ("**CCCTB**") [310] proposals, as well the BEFIT proposal[311], have all been influenced by such idea to a certain extent, since they all include mechanisms that approximate to the ACE to different levels[312]. Action 3 of the OECD/G20 BEPS Project, despite acknowledging that this was

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[304] The authors essentially proposed a notional deduction corresponding to the capital cost. See Robin Boadway and Neil Bruce, "A General Proposition on the Design of a Neutral Business Tax," *Journal of Public Economics* 24, no. 2 (1984): 231–39.

[305] Michael Devereux and Harold Freeman, "A General Neutral Profits Tax," *Fiscal Studies* 12, no. 3 (1991): 1–15. With further reference to the relevance of the contribution of BOADWAY and BRUCE, see Institute for Fiscal Studies, *Equity for Companies: A Corporation Tax for the 1990s* (London: Chameleon Press, 1991), 19, fn. 1.

[306] See, *e.g.,* Devereux et al., *Taxing Profit in a Global Economy*, 21–84; de Wilde, *Sharing the Pie*, 2015, 209–96.

[307] See Magalhães and Christians, "Rethinking Tax for the Digital Economy After COVID-19," 13; Allison Christians and Tarcísio Diniz Magalhães, "It's Time for Pillar 3: A Global Excess Profits Tax for Covid-19 and Beyond," *Tax Notes International*, no. 98 (2020): 507.

[308] See, on practical experiences regarding ACE mechanisms, Alexander Klemm, "Allowances for Corporate Equity in Practice" (IMF Working Paper WP/06/259, 2006); José Roberto Afonso and Melina Rocha Lukic, *Tributação da Renda das Pessoas Jurídicas no Brasil e os Juros sobre o Capital Próprio* (Curitiba: Juruá, 2016); Ernesto Zangari, "Addressing the Debt Bias: A Comparison between the Belgian and the Italian ACE Systems" (European Commission, Working Paper n. 44, 2014); Paolo Panteghini, Maria Laura Parisi, and Francesca Pighetti, "Italy's ACE Tax and Its Effect on a Firm's Leverage" (Kiel Institute for the World Economy, Economics Discussion Papers, No. 2012-31, 2012).

[309] European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final (25 Oct. 2016), Art. 11. The mechanism is labelled Allowance for Growth and Investment ("**AGI**").

[310] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final (25 Oct. 2016). (the explanatory memorandum states that "*[t]he distortions in the financing decisions of companies are reduced with an Allowance for Growth and Investment, which puts equity and debt financing on similar footing*").

[311] Action 4 of the BEFIT is to make a legislative proposal creating a Debt Equity Bias Reduction Allowance ("**DEBRA**"). See European Commission, Communication from the Commission to the European Parliament and the Council, Business Taxation for the 21st Century, COM(2021) 251 final (18 May 2021). A directive has been proposed on May 11th, 2022. See Commission Proposal for a Council Directive on Laying Down Rules on a Debt-Equity Bias Reduction Allowance and on Limiting the Deductibility of Interest for Corporate Income Tax Purposes (11 May 2022), 2022/0154(CNS). On the interplay between the DEBRA Directive and the GLOBE MODEL RULES, see Dieter Bettens, "The DEBRA Directive and Its Interplay With Pillar 2" 50, no. 12 (2022): 907–22.

[312] On the qualification of the AGI as an ACE, see Matthias Petutschnig and Silke Rünger, "The Effects of a Tax Allowance for Growth and Investment – Empirical Evidence from a Firm- Level Analysis" (International Taxation Research Paper Series, No. 2017-09, 2017). Describing the AGI as a "soft" ACE, see Maarten Floris de Wilde, "On the Future of Business Income Taxation in Europe," *World Tax Journal* 12, no. 1 (2019): 116.

"not a feature of any existing CFC rules", suggested that a possible approach to defining income would be an "excess profits analysis", by providing an exclusion to normal returns[313].

The "painless" nature of the taxation of economic rents has also been broadly evoked in the recent US CIT reforms – including *ex post*, in order to explain the inability of certain tax measures to incentivize investments. The Tax Cuts and Jobs Act of 2017 ("**TCJA**"), which lowered the CIT rate from 35% to 21%, was expected to trigger a flood of inbound investment, but no positive investment response could be attributed to the act itself[314]. An IMF paper attributed the failure to "stronger corporate market power" than that assumed by literature which predicted that investment would increase with such changes[315]. The Made in America Tax Plan later noted that the outcome could be explained by the fact that "much of the corporate tax falls on 'excess profits', not normal returns"[316], which is in essence a similar argument to the one provided by the IMF paper[317].

The Global Intangible Low-Taxed Income ("**GILTI**") – which in a certain sense inspired the GLOBE[318] – is often described as a form of global economic rent tax, applying a rate on a specified amount of excess profit[319]. Likewise, the advantages of economic rent taxation have also been evoked for the purpose of justifying the GLOBE MODEL RULES[320].

3.5. Summary: two narratives on real incidence

Public and corporate finance scholars remain sceptical about CIT in general, as it would be an inefficient and distortive tax in many aspects[321]. Besides the efficiency concerns, its burden would be significantly shifted to consumers, employees, and other stakeholders, meaning that it is not as progressive as the aggregate theory implies. In recent years, such conclusions have gained evidence from empirical studies, despite the challenges of this sort of economic modelling.

However, a CIT that is restricted to the taxation of economic rent has gained momentum among scholars, which has led to the support of measures that are intended to ensure the taxation of the economic rent of MNEs. Under such assumptions, CIT abandoned its

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[313] OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD, 2015), 49–50.
[314] See US Department of the Treasury, "The Made in America Tax Plan," April 2021, 4.
[315] See Emanuel Kopp et al., "U.S. Investment Since the Tax Cuts and Jobs Act of 2017" (IMF Working Paper WP/19/120, 2019), 17.
[316] See US Department of the Treasury, "The Made in America Tax Plan," 4.
[317] See Shaviro, "Bittker's Pendulum," 631.
[318] On potential comparisons between GILTI and GLOBE, *see* Mindy Herzfeld, "Can GILTI + BEAT = GLOBE?," *Intertax* 47, no. 5 (2019): 504–13; Daniel W. Blum, "The Proposal for a Global Minimum Tax: Comeback of Residence Taxation in the Digital Era?: Comment on Can GILTI + BEAT = GLOBE?," *Intertax* 47, no. 5 (2019): 514–22; John G. Rienstra, "Pillar Two from the US Perspective," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), 315–56; Frederik Schildgen, "GloBe – Lehren aus GILTI," *Internationale SteuerRundschau* 8, no. 11 (2019): 400–408. Treating the GLOBE MODEL RULES as a "direct extension" of GILTI, see Lilian V. Faulhaber, "Taxing Tech: The Future of Digital Taxation," *Virginia Tax Review* 39, no. 2 (2019): 175; Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 13.
[319] See G. Charles Beller, "GILTI: 'Made in America' for European Tax Unilateral Measures & Cooperative Surplus in the International Tax Competition Game," *Virginia Tax Review* 38 (2019): 282.
[320] This assertion is evidenced in detail in sec. 4.3, *infra*.
[321] See Rachel Griffith and Helen Miller, "Taxable Corporate Profits," *Fiscal Studies* 35, no. 4 (2014): 537.

position of being “a very bad tax instrument in a global economy” to become “one with great advantages”[322]. Hence, despite the existence of economic objections to the legal justification of the CIT, the issue becomes less controversial in the case of taxation of economic rents. The taxation of “pure profits” is deemed as both efficient and progressive, as it is expected to actually burden capital without significantly distorting economic decisions.

These are the conclusions concerning the economic debate on the CIT. In order to understand how the GLOBE MODEL RULES interact with the notion of economic rent, it is necessary to gain further elements on the object of the GLOBE MODEL RULES, which is the scope of chapter IV. Section 4 of this chapter demonstrates that the GLOBE MODEL RULES have been allegedly inspired by the notion of economic rent, and anticipates some of the criticism, but the argument will only be examined in detail with the assistance of further elements gained in chapter IV.

4. POTENTIAL JUSTIFICATIONS FOR A JURISDICTIONAL MINIMUM TAX

The GLOBE MODEL RULES are essentially a tool against tax competition between states[323]. They are aimed at preventing states from engaging in a race-to-the-bottom regarding tax rates, thus implying that CIT is a sound tax, whose base must be preserved. As a consequence, the RELEVANT MATERIAL take the desirability of CIT for granted. Despite mentioning the literature on tax incidence and the potential distortions of CIT, the GLOBE MODEL RULES are not intended to implement a general reform of domestic systems, turning them into taxes on economic rents. However, the GLOBE MODEL RULES are clearly influenced by the literature on economic rents, which is evoked in several parts of the RELEVANT MATERIAL.

The present section contextualizes the GLOBE MODEL RULES as a set of rules providing for a minimum tax, intended as a floor to tax competition. Within this purpose, it clarifies the interactions of Pillars One and Two, in order to delimitate the role of each Pillar, and evidence their complementary nature in relation to each other (sec. 4.1). It further draws on the theories on tax competition (sec. 4.2.1), as means to provide for a better understanding of the assumptions made by the OECD on the topic (sec. 4.2.3). The section also presents the arguments for the use of a minimum tax system, instead of resorting to broader harmonization measures (sec. 4.2.4).

Besides the discussion on tax competition, the GLOBE MODEL RULES have also been subject to broader debates on their impact on the allocation of resources. The OECD Secretariat is obviously aware of the distortive effects of traditional CIT. The present section demonstrates that the GLOBE MODEL RULES have been significantly influenced by the discussions on the non-distortionary nature of the taxation of economic rents. In the RELEVANT MATERIAL, it is suggested that the GLOBE MODEL RULES would inherently tax economic rents of MNEs (sec. 4.3.2.1) and also that it contains specific rules aimed at ensuring that routine returns are not taxed (sec. 4.3.2).

The section also considers the relevance of the single tax principle for justifying the GLOBE MODEL RULES. After briefly discussing the normative value of the principle (sec.

[322] See Shaviro, “Bittker’s Pendulum,” 632.
[323] See Pistone et al., “The OECD Public Consultation Document ‘Global Anti-Base Erosion (GloBE) Proposal – Pillar Two’: An Assessment,” 62. See also PUBLIC CONSULTATION DOCUMENT, p. 6.

4.4.1), the inability of the GLOBE MODEL RULES to implement the single tax principle is demonstrated (sec. 4.4.2). The justification of the GLOBE MODEL RULES grounded on anti-abuse reasoning is also rejected (sec. 4.5).

4.1. BEPS 2.0

It seems paradoxical that only a few years after the enactment of the BEPS Final Reports, the OECD would present proposals on the same issues addressed by the BEPS Project, questioning some of the foundations of international business taxation. Despite the alleged achievement of the goal of the BEPS Project[324], the OECD has engaged in reforms that significantly affect the ALS, which is partly overruled by Pillar One, and the sovereignty of states in determining their tax rates, partially denied by Pillar Two[325].

The question is, therefore, why the OECD has engaged in the reform of the ALS and has decided to challenge the still untouched sovereignty of states of determining their own tax rates. The answer to that question lies in mainly two elements: (i) the blatant unfairness of the allocation of taxing rights resulting from the application of the current regime to the digital economy, which led to the enactment of unilateral measures; and (ii) the perceived need to combat tax competition in the post-BEPS scenario.

4.1.1. Pillar One and the allocation of taxing rights

The BEPS Project cemented a certain view on the allocation of taxing rights based on "value creation", which is neither uncontroversial, inevitable nor apolitical[326]. The approach was supposed to ensure the taxation of income which by then managed to remain untaxed, while leaving behind issues of inter-state justice[327]. The BEPS Action Plan was clear in asserting that the actions were "not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income"[328]. Its goal was never to "disturb the basic allocations of current practices"[329].

With such a limited scope, while it obtained significant progress in certain areas, it was doomed to fail in relation to others. Problems arising from the digital economy could never be solved without some disturbance of the status quo[330]. The international regime

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[324] OECD/G20, Progress Report July 2018 – May 2019, Inclusive Framework on BEPS (OECD 2019).
[325] Ulrich Schreiber, "Remarks on the Future Prospects of the OECD/ G20 Programme of Work – Profit Allocation (Pillar One) and Minimum Taxation (Pillar Two)," *Bulletin for International Taxation* 74, no. 9 (2020): 338.
[326] See Luís Eduardo Schoueri, "Arm's Length: Beyond the Guidelines of the OECD," *Bulletin for International Taxation* 69, no. 12 (2015): 690–716. On the theoretical inconsistency of the approach, see Quentin, "Gently Down the Stream," 163.
[327] See Luís Eduardo Schoueri and Ricardo André Galendi Jr., "Justification and Implementation of the International Allocation of Taxing Rights: Can We Take One Thing at a Time?," in *Tax Sovereignty in the BEPS Era*, ed. Sergio André Rocha and Allison Christians (Alphen aan den Rijn: Kluwer Law International, 2017), 201.
[328] OECD, Action Plan on Base Erosion and Profit Shifting, Paris, OECD, 2013, p. 11.
[329] Hugh J. Ault, "Tax Competition and Tax Cooperation: A Survey and Reassessment," in *International Taxation in a Changing Landscape: Liber Amicorum in Honour of Bertil Wiman*, ed. Jérôme Monsenego and Jan Bjuvberg (Netherlands: Kluwer Law International, 2019), 10–11.
[330] Criticizing the "tweaking of rules", see Brauner, "What the BEPS?," 70; Báez Moreno and Brauner, "Taxing the Digital Economy Post BEPS... Seriously," 126.

needed an actual reform to bring an actual balance to the allocation of tax jurisdiction[331]. BEPS Action 1 failed to provide a satisfactory outcome to the digital economy, because the regime could not be merely amended to deal with the problems arising from the anachronism of physical presence[332]. Modification of one of its core elements was required, in order to preserve at least some level of inter-state justice. As a consequence, also an in-depth discussion on the fairness of the allocation of taxing rights was expected. This broader debate, however, was never in the BEPS Action Plan.

Therefore, the insufficiency of the outcome motivated unilateral action. Perhaps the main symptom of the shortfall of Action 1 was the immediate enactment of unilateral measures by states, not condoned by any of the BEPS Actions. Without a doubt, "it was the very failure of the BEPS 1.0 tax proposal that served as a catalyst for individual countries to begin imposing new digital taxes unilaterally"[333]. After the final reports of the BEPS project, the Digital Services Taxes ("**DSTs**") popped up in the international community.

DSTs – at least under their current form – are undesirable[334]. They are a consequence of the inability of the international community to reach consensus on the allocation of taxing rights. They are unilateral measures with pure revenue grabbing justification, and in practice behave as consumption taxes, being very unlikely that they burden the income of MNEs. The ones based on gross revenues operate like a special additional VAT[335]. They are not designed as taxes on corporate profits, but as taxes on total revenues associated with certain digital transactions. As such, they have the potential to be levied on loss-making firms and also lead to economic double taxation, being thus more distortive than profit-based taxes, potentially entailing higher prices, lower sales and less investment[336].

Several countries have announced or enacted either DSTs, or WHT on gross revenues from sales or offshore digital services, or equalization levies based on domestic sales or residents' use of digital services within their borders[337]. France, the UK and at least other 15 countries have DSTs in force[338]. The European Commission has unsuccesfully proposed a DST directive[339], while the UN is debating special provisions for income from

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[331] See Ricardo André Galendi Jr. and Guilherme Galdino, "Desafios da Economia Digital: do problema hermenêutico ao desequilíbrio na alocação de jurisdição," in *A tributação internacional na Era Pós-BEPS: soluções globais e peculiaridades de países em desenvolvimento*, vol. 3 (Rio de Janeiro: Lumen Juris, 2016), 285–317.

[332] See Hongler and Pistone, "Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy," 16.

[333] Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 6.

[334] For a defense of DSTs, see, however Young Ran Kim and Darien Shanske, "State Digital Services Taxes: A Good and Permissible Idea (Despite What You Might Have Heard)," *Notre Dame Law Review* 98, no. 2 (2022): 741–814; Wei Cui, "The Digital Services Tax on the Verge of Implementation," *Canadian Tax Journal* 67, no. 4 (2019): 1135–52; Daniel Shaviro, "Digital Service Taxes and the Broader Shift from Determining the Source of Income to Taxing Location-Specific Rents" (NYU Law and Economics Research Paper No. 19-36, 2019). For the negative effects of DSTs, see, instead of many, Wolfram F. Richter, "The Economics of the Digital Services Tax" (CESifo Working Paper No. 7863, 2019).

[335] Michael Graetz, "A Major Simplification of the OECD's Pillar 1 Proposal," *Tax Notes Federal* 101, no. 2 (2021): 215.

[336] ECONOMIC IMPACT ASSESSMENT, p. 144, para. 302.

[337] Graetz, "Major Simplification," 215.

[338] Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 5.

[339] European Commission, *Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence*, COM (2018) 147 final (Mar. 21, 2018).

automated digital services[340]. In summary, the fear of proliferation of DSTs, leading to economic inefficiencies and the distortion of global investment[341], is a justified concern.

Politically, the spreading of DSTs works as an incentive for states to engage in a negotiation of the allocation of taxing rights. GRAETZ considers that expecting the maintenance of the status quo as an alternative for reform is "unrealistic and futile"[342]. Also the OECD Secretariat has reputed that "it would be incorrect to assume that the counterfactual scenario looks like the status quo"[343], when examining the economic impacts of BEPS 2.0.

Therefore, the negotiation of Pillar One is in its core a diplomatic fight against unilateral measures: the best alternative to the negotiation is not the status quo, but a world full of distortive DSTs. The July 2021 Inclusive Framework Statement called for the elimination of DSTs as a condition for the adoption of the Pillar One solution[344]. However, countries that have already adopted a DST are reluctant to abandon the tax, at least until the US implement Pillar One, and there are clear signs that the issue could escalate to a trade war, leading to enactment of retaliatory measures by the US[345].

If concerted action is not taken, the growing frustration with the existing allocation of taxing rights and the increasing importance of the digital economy are expected to motivate the expansion and the mutation of unilateral measures, increasing their scope and reach[346]. This is the outcome to be avoided by Pillar One. The private sector has acknowledged that "a comprehensive and globally coordinated approach between jurisdictions" would be "the only way to obviate discriminatory unilateral action"[347]. Such a coordination should "include the binding abolition of any unilateral measures in place at the time of agreement and a commitment for a stable and sustainable international tax system" [348].

4.1.2. Pillar Two and tax competition

Another shortfall of the BEPS Project is that it was unable to combat tax competition to the extent deemed necessary by the OECD. Accordingly, "certain members of the Inclusive Framework" maintained that the BEPS measures would "not yet provide a comprehensive solution to the risks that continue to arise from structures that shift profit to entities subject to no or very low taxation"[349]. Hence, it calls for "global action" in

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[340] Commission of Experts on International Cooperation in Tax Matters, Twenty-Second Session, Item 3(i) of the Provisional Agenda, Tax Consequences of the Digitalized Economy–Issues of Relevance for Developing Countries, U.N. Doc. E/C.18/2021/CRP.1 (2021). On the topic, see Andrés Báez Moreno, "Because Not Always B Comes after A: Critical Reflections on the New Article 12B of the UN Model on Automated Digital Services," *World Tax Journal* 13, no. 4 (2021): 501–32.
[341] See ECONOMIC IMPACT ASSESSMENT, p. 144, para. 302.
[342] Graetz, "Major Simplification," 215.
[343] ECONOMIC IMPACT ASSESSMENT, Paris, p. 144, para. 300.
[344] OECD/G20, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy, 1 July 2021, p. 3. Discussing the conditionality and the relation with Pillar Two, see Noonan and Plekhanova, "Compliance Challenges of the BEPS Two-Pillar Solution," 530–34.
[345] Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 7.
[346] Graetz, "Major Simplification," 215.
[347] Federation of German Industries, "Position on the Reports on the Pillar One and Pillar Two Blueprints," December 2020, 5.
[348] Federation of German Industries, 5.
[349] PUBLIC CONSULTATION DOCUMENT, p. 24.

order to “stop a harmful race to the bottom, which otherwise risks shifting taxes to fund public goods onto less mobile bases including labour and consumption, effectively undermining the tax sovereignty of nations and their elected legislators”[350].

After BEPS, many states have announced or effectively implemented the reduction of CIT rates, which was perceived as a sign of increased tax competition. The alignment of the taxation of profits with value creation has not necessarily led to the increased taxation of profits in the (developed) economies, where assets were used, functions were performed and risks were assumed. It has also led to the effective movement of those assets, functions and risks to other states. In the post-BEPS scenario, states do not compete merely for international mobile book profits – as they used to according to the BEPS Project assumptions –, but for internationally mobile real investments[351].

The value creation standard brought by the BEPS Project is based on factors which are relatively mobile (functions, assets and risks), thus potentially creating economic distortions. Business are incentivized to shift their functions, assets and risks to low tax countries, in order to shift the allocation of profits. Investment decisions in such cases are significantly tax-driven[352]. This is a far more serious outcome than the shifting of book profits: states suffering with the shifting of real economic activity face decreasing investment and employment[353].

However, it must be clear that the GLOBE MODEL RULES do not merely aim at combating harmful tax competition, *i.e.* “free-riding” of governments and residents in relation to public goods produced and financed elsewhere[354]. It is not aimed at combating “tax havens” – in the common use of the jargon, referring to states that besides low taxation, aim at attracting paper rather than real activity, by offering a favourable regulatory environment precluding sharing of information[355]. It addresses tax competition in a much broader sense, as it will be further developed in section 4.2, *infra*.

4.1.3. Summary: the interaction between Pillars One and Two

It is clear that Pillar One and Pillar Two complement each other. A reform that is implemented with only one of the Pillars is incomplete and will motivate (the maintenance of) unilateral measures by the states. Even if far from ideal[356], there is some balance of interests in the adoption of both measures together, considering that Pillar One strengthens source-based taxation, while Pillar Two reinforces residence-based taxation.

However, there is a trend to privilege negotiations on Pillar Two over Pillar One. In the US, it has been maintained that the two Pillars would not be “linked by more than just

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[350] PUBLIC CONSULTATION DOCUMENT, p. 24.
[351] Schreiber, “Remarks on the Future Prospects of the OECD/ G20 Programme of Work – Profit Allocation (Pillar One) and Minimum Taxation (Pillar Two),” 338.
[352] Devereux et al., *Taxing Profit in a Global Economy*, 18.
[353] Schreiber, “Remarks on the Future Prospects of the OECD/ G20 Programme of Work – Profit Allocation (Pillar One) and Minimum Taxation (Pillar Two),” 338.
[354] OECD, *Harmful tax competition*, Paris: OECD, 1998, p. 16.
[355] Michael Keen and Kai Konrad, “The Theory of International Tax Competition and Coordination,” in *Handbook of Public Economics*, ed. Alan Auerbach, Raj Chetty, and Martin Feldstein, vol. 5, Handbooks in Economics (Amsterdam: Elsevier, 2013), 310.
[356] For criticism on the content of Pillar One, see Allison Christians and Tarcísio Diniz Magalhães, “A New Global Tax Deal for the Digital Age,” *Canadian Tax Journal* 67, no. 4 (2019): 1153–78.

politics"[357]. The case has already been made in the literature that Pillar One and Pillar Two should be separated, because it would be unwise to harm Pillar Two in order to salvage Pillar One[358]. Leaving aside a critical examination of the Pillar One proposal[359], the point is that even this limited version of market states' jurisdiction is far from granted[360].

In fact, adoption of Pillar One is also formally more complicated. While the GLOBE MODEL RULES could allegedly be implemented by domestic legislation alone – despite the potential incompatibility with DTCs[361] –, Pillar One is supposed to be implemented by means of a multilateral instrument. Even if consensus is politically reached – including over the complete elimination of DSTs – each state will still have to incorporate the measures domestically. Besides, the rhetoric on the difficulties of Pillar One is much stronger when compared to the approach on the implementation challenges of Pillar Two· In the ongoing rhetoric, while Pillar One is qualified as "not promising", Pillar Two is considered to be a "low-hanging fruit"[362].

By adhering to Pillar Two without any guarantees on the implementation of Pillar One, capital importing countries will be waiving the little bargaining power they have on the negotiation of taxing jurisdiction. Chances of adoption of Pillar One becomes much lower if capital exporting countries are already comfortable with the imposition of a floor to tax competition. In such context, the spread of unilateral measures will be an inevitable consequence, which is a failure of the cooperation efforts regarding the digital economy.

4.2. Pillar Two assumptions on tax competition

4.2.1. Theories on tax competition

Competition between companies incentivizes them to reduce prices and increase the quality of the products and services they provide. The benefits of competition to consumers is a fundamental dogma of liberal capitalism. However, globalization has affected not only the competition between enterprises, but also the competition between states[363]. While companies essentially compete for consumers, states compete for productive resources, intangible capital and tax revenue, resorting, among other tools, to

[357] U.S. Department of the Treasury, Presentation by the United States to the Steering Group of the Inclusive Framework Meeting (Apr. 8, 2021), p. 7.
[358] Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 46.
[359] See Xiaorong Li, "A Potential Legal Rationale for Taxing Rights of Market Jurisdictions," *World Tax Journal* 13, no. 1 (2021): 25–61; Yariv Brauner, "Developments on the Digital Economy Front: Progress or Regression?," *Intertax* 47, no. 5 (2019): 422–24; Wolfgang Schön, "One Answer to Why and How to Tax the Digitalized Economy," *Intertax* 47, no. 12 (2019): 1003–22.
[360] See Brauner, "Serenity Now!," sec. IV.
[361] On the relationship between Pillar Two and DTCs, see Schoueri, "Some Considerations on the Limitation of Substance-Based Carve-Out in the Income Inclusion Rule of Pillar Two"; Chand, Turina, and Romanovska, "Tax Treaty Obstacles in Implementing the Pillar Two Global Minimum Tax Rules and a Possible Solution for Eliminating the Various Challenges."
[362] Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 46.
[363] Luís Eduardo Schoueri, "Globalização, Investimentos e Tributação: Desafios Da Concorrência Internacional Ao Sistema Tributário Brasileiro," *Revista Brasileira de Comércio Exterior* 113 (2012): 6–13.

their own tax system[364]. Tax competition is a form of regulatory competition, whereby states seek to attract investments creating incentives through their tax systems[365].

The consensus regarding the beneficial nature of competition between enterprises is not observed in relation to tax competition. Public finance scholarship presents essentially two contrasting theories on the topic[366], rooted on the debates on federalism in the US[367].

Under the first view, competition for residents would make states more efficient and sensible to the needs and desires of their citizens[368]. There is a long-standing tradition in the public finance literature, maintaining that tax competition would not be a source of inefficiency[369]. In TIEBOUT's model, the competition between a sufficiently large number of countries, each of them offering a combination between taxation and public expenditure, along with the free movement of residents, would be able to ensure efficiency gains, and would be thus welfare enhancing. Likewise, STIGLER argued that the competition between communities would not present obstacles, but rather opportunities for each community to choose the type and scale of the functions of government they desire[370]. The position is also supported by authors that are particularly concerned with the leviathanic tendencies of the state[371]. It assumes that political process may distort the intrajurisdictional tax rate choice, detaching it from what a "benevolent planner"[372] would have chosen. For these authors, competition between jurisdictions would be a powerful formula to combat undesired expansionism of the public over the private sector. Competition would have the function of disciplining the public sector, which is always in an inexorable expansion[373].

Under the second view, the competition between jurisdictions would be a form of public choice distortion. Accordingly, in their effort to attract industries and create employment states would end up raising revenue below the ideal to finance public services[374]. The

[364] Eric Toder, "International Competitiveness: Who Competes Against Whom and for What?," *Tax Law Review* 65 (2012): 509.
[365] See Keen and Konrad, "The Theory of International Tax Competition and Coordination," 257; Julie Roin, "Competition and Evasion: Another Perspective on International Tax Competition," *The Georgetown Law Journal* 89 (2001): 545; Michael S. Knoll, "The Connection Between Competitiveness and International Taxation," *Tax Law Review* 65 (2012): 355.
[366] See Wallace E. Oates and Robert M. Schwab, "Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?," *Journal of Public Economics* 35 (1988): 333.
[367] See Advisory Comission on Intergovernamental Relations, "Regional Growth: Interstate Tax Competition" (Comission Report, March 1981). On the possibilities of applying such arguments and conclusions to "any set of horizontally related jurisdictions", see Keen and Konrad, "The Theory of International Tax Competition and Coordination," 261.
[368] The origins of this view is attributed to Charles M. Tiebout, "A Pure Theory of Local Expenditures," *Journal of Political Economy* 64, no. 5 (1956): 416–24.
[369] See, discussing the assumptions of such theory, Keen and Konrad, "The Theory of International Tax Competition and Coordination," 317–20.
[370] George J. Stigler, "The Tenable Range of Functions of Local Government," in *Federal Expenditure Policy for Economic Growth and Stability* (Washington: U.S. Government Printing Office, 1957), 216.
[371] Geofrey Brennan and James Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Indianapolis: Liberty Fund, 2000), 46.
[372] Discussing the "benevolent planner" as an assumption of economic studies on tax competition, see Keen and Konrad, "The Theory of International Tax Competition and Coordination," 317–20.
[373] See Oates and Schwab, "Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?," 333.
[374] See, for an overview, Oates and Schwab, 335.

description of the phenomenon as a "cut-throat competition" calls for the enactment of measures intended to save the states from themselves[375].

The defence of combative measures against international tax competition essentially mimics this second view. It is argued that tax competition would not bring significant efficiency gains, and that eventual efficiency gains would be outweighed by the social losses arising from the reduction of tax revenues[376]. A bold version of a harmonization measure was proposed by AVI-YONAH, by the time the BEPS Project was launched[377]. He considered that the G20 is composed of great capital exporters, which were residence to 90% of world's MNEs. It would be in these states' interest to tax their MNEs on their worldwide income at a rate between 20% and 30%, thus concomitantly producing capital import and capital export neutrality at an international level. The convenience of such measure is defended essentially on efficiency grounds[378]. Likewise, the arguments against international tax harmonization mimic the first view. Cooperation in the case of tax rates could be seen as a form of cartel among states, allowing for rent-seeking behaviour and wasteful government expending[379].

4.2.2. Competition for defining the distributive rules: a caveat

One relevant caveat is that this part of the literature does not deal with inter-state justice, which is often discarded as a political issue. AULT asserts that states also compete to define the distributive rules in a way that maximizes national tax revenue[380]. In this context, the perception that "high-tax developed countries generally share an interest in preserving an allocation system that disproportionately benefits them at the expense of developing countries"[381] comes into play. Regardless of the conclusions on the desirability of harmonization, it is important to consider that harmonization is negotiated and there are often hidden costs in such "consensual" harmonization measures[382]. The negotiation also has losers and winners.

Tax competition affects both residence and source taxation[383]. While harmonization allows some states to maintain their levels of social welfare, it also prevents other (developing) states from establishing levels of taxation that are congruent with the level

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[375] See e.g., Advisory Comission on Intergovernamental Relations, "Regional Growth: Interstate Tax Competition," 10.

[376] See *e.g.,* Yariv Brauner, "The Future of Tax Incentives for Developing Countries," in *Tax, Law and Development*, ed. Yariv Brauner and Miranda Stewart (Massachusetts: Edward Elgar Publishing, 2013), 25–56; Reuven Avi-Yonah, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," *Harvard Law Review* 113, no. 7 (2000): 1644–47; IMF, *Tax Policy Handbook* (Washington: IMF, 1995), 279–83.

[377] Reuven Avi-Yonah, "Is It Time to Coordinate Corporate Tax Rates? A Note on Horst" (Public Law and Legal Theory Research Paper Series, Paper No. 382, 2014), 2–3.

[378] For an account of capital import neutrality, capital export neutrality and capital ownership neutrality, see Schoueri and Galendi Jr., "Justification and Implementation," 201.

[379] See, *e.g.,* Daniel Shaviro, "Some Observations Concerning Multi-Jurisdictional Tax Competition" (New York University Law School, Public Law and Legal Theory Working Paper No. 13, 2000), 19–20; Tsilly Dagan, "The Costs of International Tax Cooperation" (Bar-Ilan University Faculty of Law, Working Paper No. 1-03, 2013), 25.

[380] Ault, "Tax Competition and Tax Cooperation: A Survey and Reassessment," 10–11.

[381] Ruth Mason, "The Transformation of International Tax," *American Journal of International Law* 114, no. 3 (2020): 393.

[382] Tsilly Dagan, *International Tax Policy: Between Cooperation and Harmonization* (Cambridge: Cambridge University Press, 2018), 137; Dagan, "The Costs of International Tax Cooperation," 23.

[383] Kane, "A Defense of Source," 321.

of development of their public sector. Besides, such form of harmonization also assumes that all tax systems share the tax burden in a similar way[384], and ignores the structure of the tax systems of developing countries, which, for several reasons, focus on consumption instead of income taxation[385]. The transition from tax competition to a multilaterally negotiated harmonization does nothing more than transfer powers to states with privileged positions in such negotiations, since the terms of the cooperation will not necessarily be in line with the interests and needs of the states with less bargaining power[386].

Pillar Two is a case where international law is used to impose some constraint on the ability of states to derive benefits from their unilateral action[387]. Tax competition is perceived as a source of global welfare losses, which can be combated through coordination[388]. However, even if in this case the pursuit of efficiency could be seen as theoretically possible – *e.g.,* the finding of an optimal tax base and an optimal tax rate –, a political decision must still be made with regard to the capture of the surplus from cooperation. The negotiation of the terms of the cooperation is ultimately a battler over the division of this surplus[389], which in the case of the GLOBE MODEL RULES orbits the definition of the state which has the right to impose the QDMTT, the IIR and the UTPR.

4.2.3. THE GLOBE MODEL RULES as a tool against tax competition

Pillar Two thus modifies a principle that has been upheld by the OECD for decades, namely that setting tax rates was a matter for sovereign states to decide, and not an issue that the OECD should deal with[390]. It represents a departure from the policy consensus agreed only a few years ago in the BEPS project, according to which "no or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it"[391]. The very existence of the Pillar Two debate makes clear that there is a policy preference to combat tax competition in its broadest sense. Countries promoting Pillar Two seem to believe that no or low taxation is indeed a cause of concern, even if real economic activities are taking place in the countries providing low tax rates[392]. Such preference is explicit in several parts of the RELEVANT MATERIAL.

Despite also acknowledging the potential benefits of tax competition[393], the ECONOMIC IMPACT ASSESSMENT argues that the strategic interactions between states produce

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[384] See Perry, "Pillar 2, Tax Competition, and Low Income," 116. (arguing that offering payroll tax reductions for MNE employers could be a measure adopted in conjunction with a QDMTT, as means to maintain tax competition after GLOBE).
[385] Vito Tanzi and Howell H. Zee, "Tax Policy for Emerging Markets: Developing Countries" (IMF Working Paper WP/00/35, 2000), 11.
[386] Dagan, *International Tax Policy: Between Cooperation and Harmonization*, 137; Dagan, "The Costs of International Tax Cooperation," 23.
[387] Bankman, Kane, and Sykes, "Collecting the Rent," 205.
[388] ECONOMIC IMPACT ASSESSMENT, p. 162, para. 358.
[389] Bankman, Kane, and Sykes, "Collecting the Rent," 205.
[390] See OECD/G20, Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, 13 February – 6 March 2019, p. 24, n. 90 (OECD 2010). See also Joachim Englisch and Johannes Becker, "International Effective Minimum Taxation – The GLOBE Proposal," *World Tax Journal* 11, no. 4 (2019): 483–529.
[391] OECD, Action Plan on Base Erosion and Profit Shifting, Paris, OECD, 2013, p. 10.
[392] Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal*, 4.
[393] ECONOMIC IMPACT ASSESSMENT, p. 162, para. 359.

negative fiscal externalities that could drive CIT rates below their optimal level, while leading to inefficiently high taxation of other less mobile bases, such as labour or consumption. In such scenario, uncoordinated policy design would be "likely to produce a globally inefficient outcome"[394].

The OECD Secretariat makes the case that the reduction of ETR differential across jurisdictions (i.e., reduction of the allowed level of tax competition) would improve the efficiency of the international allocation of capital[395]. Accordingly, firms would make investment decisions following post-tax returns. Decreasing the ETR differentials would reduce tax-induced behaviour and global output would increase as a consequence of more efficient capital allocation across jurisdictions. Essentially, it is expected that "[i]f enough large economies agree to implement Pillar Two, there will be no incentive for companies to put their businesses through low-tax jurisdictions"[396]. Therefore, the GLOBE MODEL RULES adopts the second view on tax competition, maintaining that a coordinated approach would be better than the current scenario of tax competition.

4.2.4. Minimum Taxes as a floor to tax competition

In order to effectively combat tax competition, the GLOBE MODEL RULES need to be adopted by all or most countries, guarantee sufficient harmonization of details, and bring forward a "strong form" of minimum tax[397].

States implementing the GLOBE MODEL RULES are in fact raising their taxes, therefore going against the trend to reduce tax rates to compete with each other. Even if such agreement is reached, it is necessary that it is implemented with sufficient harmonization of details, otherwise risking to impinge the ability of Pillar Two to obtain the stated objectives. The cooperation needed to introduce the GLOBE MODEL RULES "goes far beyond simply agreeing to introduce it"[398]. A "strong form" of the rules must be followed, with little or no space to states to decided which elements should be adhered to or not. Otherwise, tax competition will merely take place in the form of design of the elements of the minimum tax which have been weakly agreed to.

Economic literature has already suggested that "agreement on minimum tax rates at levels somewhat above the lowest in the observed outcome is likely to be a more fruitful path to coordinating away from inefficient outcomes than is agreeing on common rates"[399]. In this sense, Pillar Two sets "a lower bound to international tax competition"[400]. The minimum tax is intended to stop the race to the bottom of CIT rates and limit the ability of states to attract mobile invests via their CIT systems. As a consequence, the measure is also expected to make it easier for states to protect their national tax bases against tax planning efforts of MNEs[401]. By establishing a "minimum tax rate on all income", the GLOBE MODEL RULES are expected to reduce the incentive for taxpayers to engage in

[394] ECONOMIC IMPACT ASSESSMENT, p. 162, para. 358.
[395] ECONOMIC IMPACT ASSESSMENT, p. 152.
[396] Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 22.
[397] Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal*, 2–3.
[398] Devereux et al., 14.
[399] Keen and Konrad, "The Theory of International Tax Competition and Coordination," 320.
[400] Schreiber, "Remarks on the Future Prospects of the OECD/ G20 Programme of Work – Profit Allocation (Pillar One) and Minimum Taxation (Pillar Two)," 338.
[401] Schreiber, 340.

profit shifting and establish a "floor to tax competition among jurisdictions", having impacts on the behaviour of both taxpayers and states[402].

The identification of a minimum tax is challenging. The distinction between a minimum tax and a separate and supplemental tax is "a question of degree along a continuum"[403]. The tax base for a global minimum tax focuses on the foreign-sourced income earned by MNEs. The foreign taxes paid on the foreign-sourced income are compared to the one that would be paid under some version of a global minimum tax. If taxes paid are lower than the tax that would be paid under the minimum tax, the excess shall be paid to the jurisdictions which applies the minimum tax. The excess paid, however, does not trigger a refund from the state to the MNE[404]. If viewed strictly from the perspective of the local taxpayer, the global minimum tax behaves as taxation of the local entity on "an artificial base"[405].

In a "purposive sense", a minimum tax is characterized by its aim "to require – especially, or perhaps even exclusively, from 'high-income taxpayers" – the current year payment of at least some minimum percentage of economic income", which would not be due under the otherwise applicable CIT rules[406]. Premises of this reasoning are, therefore, that (i) economic income is normatively important to the distribution of current year tax burden, and (ii) such importance increases as economic income of the MNE rises[407]. This means that the minimum tax will often include a broader base than that of the regular system, in order to be closer to economic income. As a consequence, the minimum tax will operate as a floor on current year tax liability in relation to economic income[408]. In doing so, it may risk overtaxing the economic income, case in which its definition as a purposive minimum tax would not be precise[409]. In a "technical sense" a minimum tax is a tax that is due only if it exceeds the amount of regular tax that would be paid in the ordinary regime, but no refund is available to the amount paid in excess of the minimum tax. Under this definition, a 15% corporate minimum tax based on book income, payable only if and to the extent that it exceeds the amount due under regular CIT, would be a minimum tax. However, a 7% tax on large companies book income, which is payable in any event, without any reference to the taxpayer's liability under ordinary CIT, is not a minimum tax, but rather a new stand-alone tax instrument[410].

The GLOBE MODEL RULES provide for a minimum tax both in the purposive and in the technical sense. The GLOBE COMMENTARY refers to the GLOBE MODEL RULES as providing for "an international alternative minimum tax, that uses standardized base and tax calculation mechanics to identify pools of low-taxed income within an MNE

[402] PUBLIC CONSULTATION DOCUMENT, pp. 6-7.
[403] Daniel Shaviro, "What Are Minimum Taxes, and Why Might One Favor or Disfavor Them?," *Virginia Tax Review* 40, no. 2 (2021): 405.
[404] Shaviro, 400.
[405] Bankman, Kane, and Sykes, "Collecting the Rent," 213.
[406] Shaviro, "What Are Minimum Taxes, and Why Might One Favor or Disfavor Them?," 403.
[407] Shaviro, 403.
[408] Shaviro, 403.
[409] According to SHAVIRO, an example of such form of overtaxation of economic income could be found in the BEAT legislation; see Shaviro, 403. In a similar sense, arguing that the "BEAT manifests a stark departure from any defensible definition of income", see Bankman, Kane, and Sykes, "Collecting the Rent," 214.
[410] Shaviro, "What Are Minimum Taxes, and Why Might One Favor or Disfavor Them?," 403.

Group"[411]. The GLOBE MODEL RULES further impose "a co-ordinated tax charge that brings the Group's ETR on that income in each jurisdiction up to the Minimum Rate"[412].

4.3. The GLOBE MODEL RULES and the taxation of economic rents

Both Pillar One and Pillar Two refer to the distinction between a routine and a residual (Pillar One) or an excess (Pillar Two) profit. The question therefore arises whether such references are somehow related to the economic debate on economic rents, as addressed in sec. 3.4, *supra.* While, in the case of Pillar One, it is clear that the reference is not related to the benefits of a "painless tax", in the case of Pillar Two, the influence of the literature on economic rent is evident.

4.3.1. Economic rents in Pillar One

Pillar One resorts to the distinction between routine and residual profits, but such reference is related to a perceived failure of the ALS in allocating residual profits[413]. The distinction between routine and residual profits lies at the core of the Pillar One proposal, which embraces a hybrid methodology for treating routine and residual profits. Amount A is defined as "a share of residual profit allocated to market jurisdictions using a formulaic approach applied at an MNE Group (or business line) level"[414]. Using Pillar One terminology, it is a "new taxing right" that applies irrespective of the existence of physical presence, reflecting profits associated with the active and sustained participation of a business in the economy of a market jurisdiction. It is deemed as the "primary response" of the Unified Approach to the challenges of the digital economy.

Pillar One is not intended to provide for a "painless tax" in the sense described in sec. 3.4, *supra,* as both routine and residual profits are taxed somewhere under the proposal[415]. Pillar One intends to reallocate residual profits under a new nexus, creating a new taxing right. Nothing in the Pillar One proposal is oriented by the theories on the efficiency, neutrality and distributive benefits of a tax whose tax base is restricted to economic rents.

Restricting the reform to the allocation of the residual profit is a conciliatory proposal, which maintains the ALS applicable to the cases where it is considered to work properly, whereas migrating to a formulary solution in cases where the ALS is deemed to function poorly. The allocation of residual profits is precisely where the ALS fails to provide for satisfactory results. Hence, the distinct treatment to routine and residual profits is "difficult to justify analytically", even though it may be considered a "prudent political matter"[416]. The Pillar One Blueprint mentions that some members of the IF suggested that, beyond residual profit, also a portion of routine profit should be allocated to market jurisdictions in cases where remote marketing and distribution activities are facilitated by digitalization[417]. Such proposal has not been taken further.

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[411] GLOBE COMMENTARY, p. 8, para. 2.
[412] GLOBE COMMENTARY, p. 8, para. 2.
[413] See, on the challenges of allocation of residual profits, Quentin, "Gently Down the Stream," 163.
[414] OECD, "Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy," January 2020, 8.
[415] See Shay, "The Deceptive Allure of Taxing Residual Profits," 6.
[416] Graetz, "Major Simplification," 216.
[417] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project (OECD, 2020), 12.

4.3.2. Economic rents in Pillar Two

The GLOBE MODEL RULES, however, are at least allegedly, concerned with potential distortions on investment decisions that a minimum tax could bring[418]. It in fact carves out a part of the substance-based income on a jurisdictional base, justifying the carve-out in terms of neutrality and economic efficiency.

There is a clear trade-off between combating the shifting of profits to low-tax jurisdictions and supporting investment[419]. The adoption of a minimum tax raises aggregate revenues, but also raises the cost of capital, therefore tending to reduce investment.

The extent to which Pillar Two aims at economic rents can be examined from two perspectives. Under the first perspective, a significant part of the low-taxed MNEs' income would be inherently economic rents. Therefore, a global minimum tax would grasp profits which are essentially economic rents. Under the second perspective, the Substance-based Income Exclusion rules have been at least roughly designed to grant that the Top-Up Tax is predominantly levied over economic rents.

4.3.2.1. Pillar Two as a measure inherently aiming at economic rents

The first perspective on the incidence of the GLOBE MODEL RULES is that they would mostly burden the economic rents of MNEs, due to the very nature of the MNEs that fall within the scope of the BEPS 2.0 measures. According to this view, there would be something peculiar in the means by which large MNEs earn their profits, and it would be possible to set a rate without harming the underlying activity, only capturing a share of the economic rent earned by the MNE[420]. Such (digitalized) MNEs would operate in a market that is "structurally broken" [421], where competition is far from perfect. Economic rents are derived precisely from imperfect competition, where barriers to market entry (including intangibles) are present[422]. Following this reasoning, even a DST could be seen "as a tax on economic rents earned by digital platform companies from particular locations", which generates revenue "with minimal distortions to business decisions"[423].

The ECONOMIC IMPACT ASSESSMENT brings a full page detailing the literature on economic incidence of the CIT[424] and another three detailing the studies on the tax sensitivity of MNE investment[425]. It gathers from the literature that "investment of entities in more profitable MNE groups is less sensitive to taxation, *a result that could also be driven by the existence of economic rents at the MNE group level*"[426]. It maintains that

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[418] Considering "reducing the importance of tax considerations in determining the location of investment" as one of the goals of Pillar Two, see United Nations Conference on Trade and Development, *World Investment Report 2022*, 107.
[419] Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal*, 45.
[420] See, on a tax on digitalized MNES, John Vella and Michael Devereux, "Implications of Digitalization for International Corporate Tax Reform," *Intertax* 46, no. Issue 6/7 (2018): 550–59.
[421] Magalhães and Christians, "Rethinking Tax for the Digital Economy After COVID-19," 14.
[422] See, on the relation between imperfect competition and economic rents, Isabel Verlinden, Vasistha Parmessar, and Stefaan De Baets, "Grappling with DEMPEs in the Trenches: Trying to Give It the Meaning It Deserves," *Intertax* 47, no. 12 (2019): 1049.
[423] Cui, "The Digital Services Tax on the Verge of Implementation," 1137.
[424] ECONOMIC IMPACT ASSESSMENT, p. 153.
[425] ECONOMIC IMPACT ASSESSMENT, pp. 154-156.
[426] ECONOMIC IMPACT ASSESSMENT, p. 153, para. 332.

entities that are within the scope of Pillars One and Two "may be less sensitive to taxes in their investment behaviour than entities in an average MNE" [427].

The OECD Secretariat makes reference to studies describing "superstar firms", which are highly productive and innovative, and often rely intensively on intangible assets. Such firms typically operate on a global scale and dominate certain product markets and are of particular importance "given the scope of the reform proposals"[428]. Particularly, "more profitable MNE groups" would be less sensitive to potential increases in taxation, because they would be less credit constrained. Additionally, their high profitability rates could be related to monopolistic or oligopolistic positions, "*in which case incidence tends to fall on monopoly rents rather than on normal returns to capital*", and induce smaller investment distortions[429]. Also, they would have greater opportunities and incentives to engage in tax planning, because these firms rely significantly on intangible assets, which they can strategically locate.

Despite not supporting a completely neutral outcome, the Secretariat's own analysis concludes that entities with a profitability rate above 15% would be significantly less sensitive to tax increases than entities with inferior profitability[430]. It also puts forth that the lower sensitivity could be related to the lower liquidity constraints faced by these MNEs[431]. In summary, the potential distortive effects of the BEPS 2.0 measures have been estimated in the ECONOMIC IMPACT ASSESSMENT. Accordingly, Pillar One and Pillar Two would ensue a "very small" native effect on global investment, because "the proposals would mostly affect highly profitable MNEs whose investment is less sensitive to taxes"[432]. The "economic rent" argument is therefore clearly present in the ECONOMIC IMPACT ASSESSMENT, but the limitations of the conclusions are fairly presented.

4.3.2.2. Pillar Two as a measure specifically aiming at economic rents

The GLOBE BLUEPRINT, despite referring to a more generic carve-out, also mentions that "the policy rationale" behind such rules "*is to exclude a fixed return for substantive activities within a jurisdiction*" from the scope of the GLOBE MODEL RULES. The GLOBE BLUEPRINT goes on to explain that "*[c]onceptually, excluding a fixed return from substantive activities focuses GloBE on 'excess income', such as intangible-related income, which is most susceptible to BEPS risks*"[433].

It is important to mention that the ECONOMIC IMPACT ASSESSMENT does not consider the whole Substance-based Income Exclusion, as it has been designed. For the purposes of the assessment, the carve-out on depreciation expenses was assumed to be 10% and approximated using the value and location of tangible assets, while the carve-out on payroll was not covered due to data limitations[434].

By the time of the preparation of the ECONOMIC IMPACT ASSESSMENT, there were still some design issues that had not been settled, such as the proper definition of the carve-

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[427] ECONOMIC IMPACT ASSESSMENT, p. 156, para. 343.
[428] ECONOMIC IMPACT ASSESSMENT, p. 154, para. 337.
[429] ECONOMIC IMPACT ASSESSMENT, p. 154, para. 338.
[430] ECONOMIC IMPACT ASSESSMENT, p. 155.
[431] ECONOMIC IMPACT ASSESSMENT, p. 156, para. 343.
[432] ECONOMIC IMPACT ASSESSMENT, p. 11.
[433] PILLAR TWO BLUEPRINT, p. 95, para. 332.
[434] ECONOMIC IMPACT ASSESSMENT, p. 150, para. 325.

out rules. With the enactment of the GLOBE MODEL RULES, the Substance-based Income Exclusion rules took form and further reference to the taxation of economic rents is found in the GLOBE COMMENTARY.

The rhetoric on economic rents got stronger in the GLOBE COMMENTARY, according to which "the IIR and UTPR provide a systematic solution to ensure all in scope MNE Groups pay *a minimum level of tax on their profits in excess of a routine return in the jurisdictions in which they operate*"[435]. This attribute is particularly granted by the Substance-based Income Exclusion rules, which ensure the incidence of the IIR and of the UTPR only to Excess Profits and, along with the computational rules of the Top-up Tax, "*avoids any tax induced distortions of investment decisions*"[436].

This statement is in stark contrast with the content of the earlier RELEVANT MATERIAL, and there is a clear change in the approach towards the topic. Indeed, any form of carve-out was previously perceived as not ideal. The PUBLIC CONSULTATION DOCUMENT affirmed that the adoption of a substance carve-out, including those providing for regimes compliant with the standards of BEPS Action 5 on harmful tax practices "would undermine the policy intent and effectiveness of the proposal"[437]. The phrasing was already present in the POW[438].

Another potential justification for a carve-out would be that it is designed to respect the "jurisdiction not to tax", as an expression of the sovereignty of the states. The carve-out would be "intended to preserve the possibility for countries to compete for real and productive investment"[439]. Under this view, if drafted according to the "substantive activity requirement" from Action 5, a carve-out would be a way to maintain some level of sovereignty of the states, while providing for an internationally agreed mechanism to further combat harmful tax practices[440].

However, the RELEVANT MATERIAL do not refer to any of those reasons[441]. The GLOBE MODEL RULES do not carve out regimes compliant with Action 5, but only provide for a formulaic substance carve-out that excludes an amount of income of 5% of the carrying value of tangible assets and payroll[442]. As they are designed, the GLOBE MODEL RULES have the potential to supersede regimes that are compliant with BEPS Action 5, therefore bringing a minimum taxes to cases where no harmful tax practices or real abuse can be identified[443]. The GLOBE MODEL RULES go way beyond the mere intention of combating

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[435] GLOBE COMMENTARY, p. 24, para. 2.
[436] GLOBE COMMENTARY, p. 120, para. 26.
[437] PUBLIC CONSULTATION DOCUMENT, p. 23.
[438] See POW, p. 29.
[439] United Nations Conference on Trade and Development, *World Investment Report 2022*, 121. Similarly, see Perry, "Pillar 2, Tax Competition, and Low Income," 107.
[440] Belisa Ferreira Liotti, "Limits of International Cooperation: The Concept of 'Jurisdiction Not to Tax' from the BEPS Project to GloBE," *Bulletin for International Taxation* 76, no. 2 (2022): 80. Also discussing the topic, see Hey, "The 2020 Pillar Two," 9; Pistone et al., "The OECD Public Consultation Document 'Global Anti-Base Erosion (GloBE) Proposal – Pillar Two': An Assessment," 74.
[441] Hey, "The 2020 Pillar Two," 9.
[442] See GLOBE MODEL RULES, Art. 5.3. For further reference on the carve-out, see ch. IV, sec. 3, *infra.* The argument is also made by Liotti, "Limits of International Cooperation: The Concept of 'Jurisdiction Not to Tax' from the BEPS Project to GloBE," 80.
[443] See also Schoueri, "Some Considerations on the Limitation of Substance-Based Carve-Out in the Income Inclusion Rule of Pillar Two," 543.

harmful tax practices and are an actual instrument against tax competition, in its broadest sense[444].

4.4. The GLOBE MODEL RULES and the single tax principle

It has already been argued in the literature that "Pillar Two would accomplish the single tax principle"[445], or that if Pillar Two succeeds "it might be fair to say that the single tax principle will finally be established as a cornerstone of the international tax system"[446].

There are at least two quick arguments against these assertions. The fist argument is that the GLOBE MODEL RULES apply to Entities and PEs that are part of an MNE Group with a consolidated group revenue that exceeds EUR 750 million in at least two of the preceding four consecutive fiscal years[447]. This norm alone already leaves an important part of the world economy outside of the GLOBE MODEL RULES' scope. The second argument is the very existence of a carve-out, which still allow for some level of non-taxation, and, therefore, also goes against the alleged principle.

After a brief discussion of the single tax principle, this subsection evidences that, also in a more fundamental sense, the GLOBE MODEL RULES are neither intended, nor able, to promote the principle.

4.4.1. The lack of normativity of the single tax principle

The "single tax principle" has originally been formulated in scholarship by AVI-YONAH[448]. It has further been adopted as actual normative basis in many subsequent academic writings on international tax law[449]. Besides the many supporters[450], the thesis has also gathered a significant number of opponents[451].

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444 Similarly, see Ana Paula Dourado, "The Global Anti-Base Erosion Proposal (GloBE) in Pillar II," *Intertax* 48, no. 2 (2020): 153–54.
445 Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," 4.Similarly, see Faulhaber, "Lost in Translation," 545.
446 Wolfgang Schön, "Is There Finally an International Tax System?," *World Tax Journal* 13, no. 3 (2021): 375.
447 GLOBE MODEL RULES, Art. 1.1.1.
448 See AVI-YONAH'S seminal article: Avi-Yonah, "International Taxation of Electronic Commerce.". The author subsequently wrote many articles on the principle, including a discussion on "who invented" it. See Reuven Avi-Yonah, "Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy," *New York Law School Law Review* 59 (2014): 305.
449 Considering the single tax principle as an element of "full taxation", *see* Mason, "The Transformation of International Tax." Presenting a "slight alteration" to the principle, see Sieb Kingma, *Inclusive Global Tax Governance in the Post-BEPS Era* (Amsterdam: IBFD, 2020), sec. 1.2.2.
450 See, *e.g.,* Diane M. Ring, "One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage," *Boston College Law Review* 44, no. 1 (2003): 79–175; Yariv Brauner, "An International Tax Regime in Crystallization," *Tax Law Review*, 259-328, 56, no. 2 (2003): 71. More recently, see Kingma, *Inclusive Global Tax Governance in the Post-BEPS Era*, sec. 1.2.2; Mason, "The Transformation of International Tax," 353–502.
451 See, *e.g.,* David Rosenbloom, "International Tax Arbitrage and the 'International Tax System,'" *Tax Law Review* 53, no. 2 (2000): 137–66; Michael J. Graetz, "Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies," *Brooklyn Journal of International Law* 26, no. 4 (2001): 1357–1448; Julie Roin, "Taxation without Coordination," *The Journal of Legal Studies* 31, no. 1 (2002): 61–94. More recently, see Luís Eduardo Schoueri and Guilherme Galdino, "Single Taxation as a Policy Goal: Controversial Meaning, Lack of Justification and Unfeasibility," in *Single Taxation?*, ed. Joanna Wheeler (Amsterdam: IBFD, 2018), 83–103; Elizabeth Gil García, "The Single Tax Principle:

As originally formulated, the principle was supposed to answer the question "*What is the appropriate level of taxation that should be levied on income from cross-border transactions?*"[452] The answer to this question would be that "*Income from cross-border transactions should be subject to tax once (that is, neither more nor less than once)*" [453].

The lack of normativity of the single tax principle has been sufficiently evidenced in the literature. This subsection is not intended to discuss at length the normative problems of the alleged principle. For the purposes of the chapter, it suffices to show that the GLOBE MODEL RULES are neither intended nor able to ensure the application of the "single tax principle". However, a couple of premises must be settled.

The thesis adopts the view according to which the "single tax principle" has no normative basis. It is not a written principle and it cannot be derived from any internationally accepted norms, either by deductive or inductive reasoning. It cannot be defended as the sole possible consequence of general clauses or general fairness considerations, such as equality or the ability-to-pay, and it is in no case supported by means of inductive reasoning, based on domestic legislations or the DTCs in force. It does not have the status of customary law, and is, at best, an inconsistent tax policy proposal[454].

The single tax principle is essentially derived from Capital Export Neutrality ("**CEN**")[455]. Claiming that the "international tax regime" is grounded on the single tax principle is the same as arguing that it is grounded on CEN, which is an arbitrary assertion. It implies either that all states pursue or wish to pursue CEN as a policy goal, which is a false assertion, or that all states should pursue CEN for their own welfare, which is also a very contentious issue[456]. Besides, it ignores Capital Import Neutrality ("**CIN**") as a possible (and more desirable) policy goal for some states, while also struggling with tax competition, which is detrimental to its enforcement[457]. The fact that it needs further

Fiction or Reality in a Non-Comprehensive International Tax Regime?," *World Tax Journal* 11, no. 3 (2019): 305–46.

[452] See Avi-Yonah, "International Taxation of Electronic Commerce," 517.

[453] See Avi-Yonah, 517.

[454] It is not within the scope of the chapter to criticize the single tax principle as a tax policy proposal. On the topic, see Schoueri and Galdino, "Single Taxation as a Policy Goal: Controversial Meaning, Lack of Justification and Unfeasibility," 83–84; García, "The Single Tax Principle: Fiction or Reality in a Non-Comprehensive International Tax Regime?"

[455] According to AVI-YONAH, CEN would be "widely accepted". See Avi-Yonah, "International Taxation of Electronic Commerce," 518. (maintaining that "*... the Single Tax Principle is justified as a goal of the international tax regime... from a theoretical perspective, if income derived from cross-border transactions is taxed more heavily than domestic income, the added tax burden creates an inefficient incentive to invest domestically*"). Equity considerations are also brought as a secondary argument "*From an equity perspective, undertaxation of cross-border income violates both horizontal and vertical equity when compared to higher tax rates imposed on domestic source income, and in particular on domestic labor income*". This is also, in essence, a CEN argument.

[456] For a discussion of these normative benchmarks, see Schoueri and Galendi Jr., "Justification and Implementation," 53–58.

[457] See, introducing the concept of Capital Ownership Neutrality ("**CON**"), Michael Devereux, *Capital Export Neutrality, Capital Import Neutrality, Capital Ownership Neutrality and All That* (London: Institute for Fiscal Studies, 1990). Further discussing the issue, see Mihir A. Desai and James R. Hines, "Old Rules and New Realities: Corporate Tax Policy in a Global Setting," *National Tax Journal* 57, no. 4 (2004): 937–60; Mihir A. Desai and James R. Hines, "Evaluating International Tax Reform," *National Tax Journal* 56, no. 3 (2003): 487–502.

cooperation in order to be properly enforced is already enough proof that it is not – and has never been – a valid principle of international law.

By inductive reasoning, the single tax principle can hardly be maintained. It is denied by several treaty provisions and policies adopted by the states. Tax sparing clauses are still an important part of the treaty policy of some countries[458]. Even if full implementation of BEPS measures is considered, at least two breaches of the single tax principle still survive[459]: cases where the taxpayer benefit from tax concessions deliberately made by one of the states, or cases where it benefits from unintended gaps in the tax system, without triggering the application of a PPT clause. In any case, there is no perfect implementation of the BEPS measures across states and one cannot derive a single tax principle when looking at the current state of art of international tax laws and treaties. At best, we witness a transitioning period, but it remains unclear whereto. As summarized by SCHÖN, "the substance matter of international tax law, in particular the allocation rules under tax treaties, has not reached a stable outcome in so far as traditional tax principles have been abandoned without new and solid principles taking their place"[460].

Besides the normativity problem, there are also doubts regarding the actual content of the principle. There are variations on how the alleged principle is phrased. Another possible phrasing used by MASON is that "all of a company's income should be taxed in places where it has real business activities"[461]. KINGMA presents a "slight alteration" to the principle, phrasing it as: "cross-border income should be subject to tax not more than once, but also not less than once at the rate determined by the state that may tax according to the benefits principle"[462].

This means that the content of the principle is also hard to grasp, and a rational discussion of its content demands some previous delimitation. The section does not engage in the discussion of the consistency of its use over time in the literature, or of what is the best or most precise phrasing of the principle. Instead, it simply takes the most recent use, by its original author, and in the specific context of Pillar Two: "*corporate profits should be subject to a minimum tax and (...) if the country with the primary right to tax such income (source or residence) does not impose tax at the minimum level, the other country involved should tax it*" [463].

The thesis acknowledges that the GLOBE MODEL RULES are a move in the direction of CEN[464], and that "the BEPS Action Plan adopted AVI-YONAH's analysis to a large extent"[465]. Those are policy considerations, and it is not the intention of the section to

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[458] On the adoption of tax sparing clauses, see Luís Eduardo Schoueri, "Tax Sparing: A Reconsideration of the Reconsideration," in *Tax, Law and Development*, ed. Yariv Brauner and Miranda Stewart (Massachusetts: Edward Elgar Publishing, 2013), 25–56.. On the importance of such clauses for the Brazilian tax treaty policy, see Luís Eduardo Schoueri, "Contribuição à História dos Acordos de Bitributação: a Experiência Brasileira," *Revista Direito Tributário Atual*, no. 22 (2008): 267–87.
[459] The examples are from Schön, "Is There Finally an International Tax System?," 374–75.
[460] Schön, 384.
[461] Considering the single tax principle as an element of "full taxation", *see* Mason, "The Transformation of International Tax."
[462] Kingma, *Inclusive Global Tax Governance in the Post-BEPS Era*, sec. 1.2.2.
[463] Avi-Yonah, Kim, and Sam, "A New Framework for Digital Taxation," n. 9.
[464] Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal*, 41.
[465] Schön, "Is There Finally an International Tax System?," 371.

debate them as such. It suffices to clarify that the single tax principle is by no means a principle of international tax law and that it does not guide the GLOBE MODEL RULES.

4.4.2. The GLOBE MODEL RULES as an inappropriate tool to ensure it

The GLOBE MODEL RULES are neither intended nor able to ensure the application of the "single tax principle". The GLOBE MODEL RULES do not prevent the existence of pockets of low-taxed profits in high-tax jurisdictions – whose existence has been acknowledged by the ECONOMIC IMPACT ASSESSMENT[466]. A key issue that had to be settled for the purpose of the GLOBE MODEL RULES was whether the ETR should be determined on the basis of an individual entity, a country, or for the entire foreign activities of an MNE[467]. The choice for one of these options involves a trade-off between the aims of the proposal and practicability concerns.

The argument against "world-wide blending" (aggregating profit and taxes paid on all foreign activities of the MNE) is that MNEs could still make use of zero-tax rate jurisdictions[468], and the approach would be thus "less effective in creating a floor for tax competition"[469]. For a minimum tax threshold of 15%, the MNE could, for instance, shift half of its profits from a country with a 30% rate to a country with a zero rate without triggering the incidence of the minimum tax. MNEs would still exploit differences in tax rates, and there would still be some incentive for states to engage in tax competition.

On the other hand, resorting to a jurisdictional blending, would have a "larger impact on profit shifting" as it would prevent MNEs from exploiting the differences in tax rates among states[470]. The acknowledged difficulty of this approach – which is adopted by the GLOBE MODEL RULES – is that it requires the creation of rules regarding the determination of the profits and ETR in each jurisdiction in which the MNE operates, thus resulting in greater administrative costs, complexity and uncertainty[471].

However, the possibility that an MNE exploits intra-jurisdictional differences in tax rates is not eliminated[472]. "Blending" is a term coined to describe "the ability of taxpayers to mix high-tax and low-tax income to arrive at a blended rate of tax on income that is above the [M]inimum [R]ate"[473]. Jurisdictional blending still allows for the non-taxation of income from an Entity, provided that there is another Entity being taxed at a sufficiently high level, as to avoid triggering the minimum tax. After all, under jurisdictional blending, the MNE's liability for additional tax is calculated with reference to the amounts necessary in each jurisdiction to bring the total amount of tax on the income in the jurisdiction up to the Minimum Rate.

It is possible, for instance, that a high-tax jurisdiction offers a privileged tax regime compliant with Action 5 to a certain "pocket" of profits, while submitting the rest of the

[466] ECONOMIC IMPACT ASSESSMENT, p. 83, para. 190.
[467] The issue is addressed by the OECD in the PUBLIC CONSULTATION DOCUMENT, p. 18.
[468] Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal*, 18.
[469] See PUBLIC CONSULTATION DOCUMENT, pp. 17-22. Discussing the topic, see Schwarz, *The OECD GloBE proposal*, 92–100.
[470] Devereux et al., *The OECD Global Anti-Base Erosion ("GloBE") Proposal*, 18.
[471] Devereux et al., 18.
[472] See Hey, "The 2020 Pillar Two," 8.
[473] PUBLIC CONSULTATION DOCUMENT, p. 32.

activities of the MNE to its ordinary (high rate). The system may, for instance, highly tax the airplane manufacturing activities of an entity, while submitting to very low taxation the profits of another entity exploiting an intangible related to artificial intelligence. In this case, due to the jurisdictional blending, the pocket of low-taxed profits would be neutralized by the other activities of the MNE, for the purpose of calculating the ETR. If this very same pocket of low-taxed profits was located in a jurisdiction where they could not be blended with other highly taxed activities of the MNE, then the application of the Top-up Tax would potentially be triggered, and the incentive eventually offered by the state would be neutralized.

SCHÖN affirms that, in order to comply with the single tax principle "an agreement to ensure substantial taxation of each item of profit made by a multinational firm somewhere in the world" would have to be reached[474]. This is not what the GLOBE MODEL RULES do. They do not ensure taxation of "each item of profit" made by an MNE, but ensure that a jurisdictionally blended profit is subject to a minimum tax.

Hence, even in a hypothetical world of uniform implementation and application of the GLOBE MODEL RULES by all jurisdictions, there is no "single tax principle" being enforced. Pockets of low-taxed income can still exist, provided that they are blended with other highly-taxed activities of the MNE in the same jurisdiction. This means that some states – where activities are already being performed – will still be able to attract investments by means of their tax systems, while other states – where no lucrative and substantive activities take place – will have their incentives neutralized by the GLOBE MODEL RULES. This scenario is only aggravated by the current design of the carve-out[475].

The issue of the pockets of low-taxed profits in high-tax jurisdictions cannot be treated as a merely collateral effect of the application of the GLOBE MODEL RULES. The ECONOMIC IMPACT ASSESSMENT asserts that "[t]hese pockets, while difficult to assess with the available data, may be substantial"[476]. There will still be non-taxed or low-taxed income, provided that they are attributed to an Entity in a state where there is sufficient highly-taxed income already being derived by other entities. No "single tax principle" is enforced by the GLOBE MODEL RULES.

Of course, the "principle" can be tweaked to adjust to the desired outcome – and this is perhaps one of the reasons of its academic popularity. It all comes down to how "corporate" and "profits" are defined. Jurisdictionally blended entities can be treated as a single entity, in order to claim that "corporate profits are subject to a minimum tax", thus leading to the conclusion that the single tax principle is being pursued. As it is phrased and debated, the single tax principle allows for this sort of semantic trickery. That is the reason why it is important to separately discuss which are the subjects of the GLOBE MODEL RULES, and clarify which are the policy choices underlying each of the approaches, properly separating semantics from substantial reasons. This is one of the tasks of chapter III, in which the decisions implicit to jurisdictional blending are further explored.

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[474] Schön, "Is There Finally an International Tax System?," 374.
[475] See, specifically on this topic, ch. IV, sec. 3.
[476] ECONOMIC IMPACT ASSESSMENT, p. 87, para. 202.

4.5. *The GLOBE MODEL RULES and the prevention of abusive behaviour*

It is also important to mention that the GLOBE MODEL RULES are not anti-abuse rules in the technical sense. They are by no means intended to combat abusive behaviour[477]. As rules designed to set a floor to tax competition, they do so without any reference to subjective or objective elements that could indicate abusive behaviour, or even aggressive tax planning, therefore also capturing "genuine profit shifting"[478]. They apply without reference to the intention of the MNE to diminish its tax burden, or to the artificiality of the implemented structure. The regime is also applicable to jurisdictions that present regimes in line with BEPS Action 5[479]. The rules apply even if the LTCE is engaging in a heavy industrial activity, with proper economic substance and multiple business purposes. Such elements are immaterial for the GLOBE MODEL RULES, whose trigger is merely the taxation of the jurisdictionally blended entities below the ETR. Conceptually, more could be made to align the payment of tax with the location of productive activities, without limiting tax competition for real investment[480].

The GLOBE MODEL RULES address the behaviour of states, by incentivizing them to raise the ETR. By doing so, only indirectly they affect the behaviour of taxpayers. They are rather a tool for states to protect themselves against each other (or some states from others) and prevent a race-to-the-bottom from happening. After most of the paper shifting has been addressed by BEPS 1.0, the shifting of actual economic activities was intensified, and it has been concluded that cooperation also with regard to a minimum level of taxation was the only way to effectively protect the tax base of states. This shift of economic activity is by no means abusive: as legal systems are largely still a national phenomenon, there is no (illegal) exploitation of the letter of legislation to the detriment of its spirit[481]. There is nothing abusive in the conduct of a taxpayer who decides to leave a country and migrate to another were the tax system is more favourable.

The question could still be made whether carving out substantial activities would not move the GLOBE MODEL RULES in the direction of a CFC regime[482] – thus turning them into anti-abuse rules. While there is some overlap between the GLOBE MODEL RULES and CFC regimes[483], their scopes are clearly different. CFC regimes, in general, deal with an

[477] In the same sense, see, Chand, Turina, and Romanovska, "Tax Treaty Obstacles in Implementing the Pillar Two Global Minimum Tax Rules and a Possible Solution for Eliminating the Various Challenges," 3; João Félix Pinto Nogueira and Alessandro Turina, "Pillar Two and EU Law," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), sec. 10.3.3.2. Also discussing the topic, see Liotti, "Limits of International Cooperation: The Concept of 'Jurisdiction Not to Tax' from the BEPS Project to GloBE," 80. Contrarily, see Heydon Wardell-Burrus, "Four Questions for UTPR Skeptics," *Tax Notes International* 108 (2022): 701.

[478] Vikram Chand and Benjamin Malek, "The Relevant Economic Activity Test and Its Impact on the International Corporate Tax Policy Framework," *British Tax Review* 3 (2019): 424.

[479] Discussing the topic, see Liotti, "Limits of International Cooperation: The Concept of 'Jurisdiction Not to Tax' from the BEPS Project to GloBE," 63.

[480] United Nations Conference on Trade and Development, *World Investment Report 2022*, 107.

[481] The design of anti-abuse rules requires the enunciation of a systematic goal, whose circumvention the anti-abuse rule is intended to address (legal gap). This kind of norm does not make an independent burden decision, but only serves to implement the burden decision made in the bypassed systematic norm. See, on the topic Johanna Hey, "Spezialgesetzliche Missbrauchsgesetzgebung aus steuersystematischer verfassungs- und europarechtlicher Sicht," *Steuer und Wirtschaft*, no. 2 (2008): 170; Ricardo André Galendi Jr., *A consideração econômica no Direito Tributário* (São Paulo: IBDT, 2020), 242–43.

[482] Hey, "The 2020 Pillar Two," 9.

[483] The overlap is dealt with in the GLOBE MODEL RULES. See, on the topic, ch. V, sec. 3.1.

undesired outcome of the separate-entity principle[484], being aimed at tackling artificial constructions and book profit shifting, by means of the artificial interposition of CFCs. They do not pursue any goal related to tax competition as such, and are not "directed against low taxation of foreign income in general"[485] (as is the case of the GLOBE MODEL RULES). The carve-out does not change this fact, as Excess Profits cannot be equated to passive income or to any of the items of income that would be usually covered by CFC rules. Besides that, any comparison with CFC rules would only take the IIR into account, and not the UTPR, which have no similarities with CFC rules[486].

Of course, the GLOBE MODEL RULES diminish the advantage that MNEs may derive from shifting activities to low-tax jurisdictions. With the 15% ETR floor, the advantage derived from the migration of activities is reduced, ultimately discouraging the behaviour to a certain extent[487]. Nevertheless, this fact alone is not sufficient to qualify the GLOBE MODEL RULES as anti-abuse rules. The GLOBE MODEL RULES may burden structures that are completely legitimate, while leaving behind schemes that could potentially be considered as artificial[488]. Instead of being aimed at closing a gap in an existing system (in the fashion of anti-abuse rules), the GLOBE MODEL RULES represent a fundamental overhaul of the tax sovereignty of states, by setting a floor to tax competition.

5. INTERIM CONCLUSIONS: *WHY DO THE GLOBE MODEL RULES BURDEN?*

The GLOBE MODEL RULES are ultimately a tool against tax competition[489]. The phenomenon which Pillar Two aims to combat is the effective shifting of economic activities from one state to another – which is, by all means, legitimate. Therefore, Pillar Two in general, and the GLOBE MODEL RULES in particular, are essentially a measure to protect the financing of the welfare state, by means of a certain allocation of the tax burden, allowing countries to maintain a policy of high CIT rates and CEN, while also preventing the shifting of real activities.

Additionally, one could bring forward the ability-to-pay argument. Understood from a legal perspective, one could argue that the non-taxation or the low taxation of certain items of income from legal entities would be in breach of the ability-to-pay principle and would ultimately mean that certain individuals would not be paying their fair share. The shareholder of an MNE that is able to engage in a tax planning that significantly reduces its tax burden would be better off when compared to the shareholder of a small or medium-sized company which is not able to engage in similar planning, due to its dimensions. From a legal perspective, the argument cannot be further explored without reference to the "subject" that is burdened by the GLOBE MODEL RULES. While the reference to the pockets of low-taxed income (sec. 4.4.2, *supra)* already makes clear that there are significant distortions to the idea of equality among legal entities or of MNE Groups, a more accurate exam of the reasoning can only be obtained after the clear specification of the subject of the GLOBE MODEL RULES in chapter III.

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[484] See also ch. III, sec. 3.5.2 and ch. V, sec. 3.1.1, *infra.*
[485] Hey, "The 2020 Pillar Two," 10. See also Hey, "Von Anti-Hybrids-Regeln," 257.
[486] Even in this case, one finds more differences than common features. See Kasper Dziurdź, "Income Inclusion Rule im Vergleich zur Hinzurechnungs- besteuerung – Funktionsweise, Zweck und Auswirkungen," *Steuer und Wirtschaft International* 11 (2021): 574.
[487] On this indirect impact, see Pistone and Turina, "The Way Ahead," sec. 14.2.1.
[488] Noting, *e.g.,* that "transfer mispricing remains unaffected by Pillar 2", see Perry, "Pillar 2, Tax Competition, and Low Income," 116.
[489] See Pistone and Turina, "The Way Ahead," sec. 14.2.1.

Examined from an economic perspective, the ability-to-pay argument, equated to the effective economic incidence of the tax, becomes more blurred. The economic incidence of CIT is contingent on several factors and the literature is cautious in making general assumptions on the topic. The last decades have witnessed contrasting theories, from the extreme progressivity to the blatant regressivity of CIT. Recent studies have argued, however, that in the case of taxation of economic rents, the shifting of the incidence and the impacts on the efficient allocation of capital would be less significant. The thesis does not intend to take a position on these economic assumptions. For the purposes of the present chapter, it suffices to show that the GLOBE MODEL RULES have been significantly influenced by the argument according to which the taxation of economic rents would be less distortive than the taxation of normal returns. Multiple references to "economic rents" are made throughout the ECONOMIC IMPACT ASSESSMENT, the GLOBE BLUEPRINT, and the GLOBE COMMENTARY, and these incidence theories have influenced the proposal to a great extent. While the reference to the justification based on economic rent (sec. 4.3.2, *supra)* already offers a general clue of some of the imprecisions of the approach, a more accurate exam of the reasoning can only be obtained after the clear specification of the object of the GLOBE MODEL RULES in chapter IV.

Meanwhile, the single tax principle remains without a legal ground, and the GLOBE MODEL RULES are certainly not aimed at enforcing it. Likewise, the structure of the rules does not allow one to maintain that they could be justified as anti-abuse rules.

CHAPTER II
THE GLOBE MODEL RULES' MECHANISM

1. INTRODUCTION: THE FIVE-STEP APPROACH

As concluded in chapter I, the GLOBE MODEL RULES essentially provide for a tool against tax competition. The present chapter aims at clarifying *how* tax competition is combated, by describing the mechanisms inherent to the minimum tax embedded in the GLOBE MODEL RULES. In essence, the GLOBE MODEL RULES provide for two interlocking domestic rules, which complement each other: the IIR, which imposes a Top-up Tax on a Parent Entity in respect of income below the ETR, and the UTPR, which is a supporting rule that denies tax deductions or requires an equivalent adjustment to the extent the low-tax income of a CE is not subject to tax under an IIR.

The chapter is mainly descriptive, being dedicated to clarifying the mechanisms within the GLOBE MODEL RULES. From the perspective of the thesis, it plays a fundamental structural role. It introduces the main defined terms, and contextualizes them in the general GLOBE MODEL RULES framework. It also allows further sections to simply assume the understanding of the relevant mechanisms of the GLOBE MODEL RULES, granting the fluidity of the more analytical work in the subsequent chapters.

Despite its descriptive nature, it aims at providing the best way to first approach the GLOBE MODEL RULES, which is a systematization effort, also of dogmatic importance. The chapter draws on the "five-step approach" provided in OECD "background material"[490], further including defined terms and a broader description of the relevant mechanisms within the approach. It also includes further clarification found in the GLOBE COMMENTARY and resorts to the GLOBE EXAMPLES where relevant. For a reader who is not completely updated with the GLOBE MODEL RULES and the RELEVANT MATERIAL, the chapter is essential for the full comprehension of the thesis. Even for a reader who is completely familiar with their content, however, the systematization effort and the description of the five-step approach could still be of interest.

The chapter is also important as means to introduce some of the defined terms. The GLOBE MODEL RULES do not (and could not) rely on domestic legislation, as they are intended to produce the same outcome for all relevant countries[491]. Instead, they resort to a "building-blocks technique"[492], with several definitional provisions, and multiple chains of references from one provision to another. In order to make sense of a rule, one has to gather multiple provisions which are spread throughout the document in a not particularly

[490] This five-step approach is generally presented in OECD "background material" on the topic, such as "Pillar Two Model Rules in a Nutshell" and "Fact Sheet", available at https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm, accessed on 15th March, 2022. For a different five-step approach (treating the calculation of the ETR as a single step and adding the "filling of the GLOBE information" as the last one), see Dietrich and Golden, "Consistency versus 'Gold Plating': The EU Approach to Implementing the OECD Pillar Two." For a four-step application of the rules, see United Nations Conference on Trade and Development, *World Investment Report 2022*, 107.

[491] Arnold, "An Investigation into the Interaction," 275.

[492] On the *Bausteintechnik,* see Thomas Möllers, *Juristische Methodenlehre* (München: Beck Verlag, 2017), 130.

intuitive order. Even though the use of references and chains of references is traditionally justified in terms of legislative efficiency[493], such technique often comes at the expense of the intelligibility of the legislative text[494].

Article 10.1 defines 158 terms and is not exhaustive. While it remits to most definitions included in other provisions of the GLOBE MODEL RULES[495], there are definitions along the document which are not mentioned in the list of Article 10.1[496]. The GLOBE COMMENTARY contains further definitional efforts. The term "value of the Entity"[497], for example, is not a defined term, being subject to a lengthy explanation in the GLOBE COMMENTARY[498]. Also the term "jurisdiction"[499], despite not being a defined term, "means a State as well as a non-State jurisdiction which has fiscal autonomy", according to the GLOBE COMMENTARY, following the definition of "Tax Jurisdiction" used in Country-by-Country Reporting ("**CbCR**") rules also for purposes of the GLOBE MODEL RULES[500]. "Low-Tax Jurisdiction", "UPE Jurisdiction" and "UTPR Jurisdiction", on the other hand, are all defined terms[501]. Furthermore, the usage of defined terms is not always consistent[502]. One may also find terms which are defined[503], further used as if they were a defined term[504], but not capitalized or included in the list of defined terms.

Whilst the significant definitional efforts, the application of the GLOBE MODEL RULES is not completely free from the dependence of amounts and relationships determined under domestic legislation[505]. In case of undefined terms, the problem of ambiguity will arise, as there is no rule setting forth a particular way to determine their content. For example, when defining "Entity", the GLOBE MODEL RULES makes reference to "any legal person", and "legal person" is not a defined term. The same happens with other terms, such as "arrangement", "ownership", "gain", "loss" and "equity interest", which, despite not being defined, are fundamental for the application of the GLOBE MODEL RULES. In any case, despite the inexistence of a rule on the interpretation of undefined terms, there should be no presumption that undefined terms should have their meaning under the

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[493] See Karl Larenz and Claus-Wilhelm Canaris, *Methodenlehre der Rechtswissenschaft*, 3rd ed., Springer-Lehrbuch (Berlin: Springer, 1995), 82; Ludwig Enneccerus and Hans Carl Nipperdey, *Allgemeine Teil des Bürgerlichen Rechts*, 15th ed., vol. I (Tübingen: Mohr Siebeck, 1959), 197–98.
[494] Möllers, *Juristische Methodenlehre*, 130.
[495] For example, "Constituent Entity" (Art. 1.3.), "Ultimate Parent Entity" (Art. 1.4.), "Excluded Entity" (Art. 1.5.)
[496] For example, Art. 10.2. defines "Flow-Through Entity", "Tax Transparent Entity", "Reverse Hybrid Entity", and "Hybrid Entity", but such definitions are not listed in Art. 10.1.1.
[497] GLOBE MODEL RULES, Art. 1.5.2(a). and Art. 1.5.2(b).
[498] GLOBE COMMENTARY, p. 22, para. 49-51.
[499] The term appears more than 300 times in the GLOBE MODEL RULES.
[500] GLOBE COMMENTARY, p. 221, para. 177.
[501] GLOBE MODEL RULES, Art. 10.1.1.
[502] See, *e.g.,* "Stateless Constituent Entity", which is a defined term, but Art. 10.3.2(b) simply refers to a "stateless Entity" (without the capitalization and without the word "Constituent" in-between). There is no reason to believe, however, that "Stateless Constituent Entity" and "stateless Entity" have different meanings.
[503] See GLOBE MODEL RULES, Art. 10.3.4., which includes the following definitional excerpt: "*a Constituent Entity is located in more than one jurisdiction (a dual-located Entity)*". Similarly, the definition of QDMTT in Art. 10.1.1: "*…Excess Profits of the Constituent Entities located in the jurisdiction (domestic Excess Profits)…*"
[504] See GLOBE MODEL RULES, Art. 10.3.5., referring to the "dual-located Entity"; Art. 10.1.1, referring to "domestic Excess Profits".
[505] Arnold, "An Investigation into the Interaction," 275.

domestic law of the country applying them. Considering the need for uniform application, undefined terms should have the meaning that is most appropriate for the GLOBE MODEL RULES, considering their ordinary meaning, as well as the context and purpose of the relevant provisions[506].

Another problem of intelligibility of the GLOBE MODEL RULES is that their drafting is not influenced by purely technical aspects and some reminiscences of negotiations and diplomatic language can be found. The most blatant example of such feature are the acronyms IIR and UTPR, which are misleading and do not adequately portray the content of the rules. Both acronyms are misnomers[507], due to reasons that could be called "historical"[508]. Following the PILLAR TWO BLUEPRINT, the IIR would require the inclusion of foreign-source income of the foreign entities of the MNE group as income of the parent entity[509] – therefore being called an "Income Inclusion Rule". In the GLOBE MODEL RULES, there is not properly an "income inclusion", but the name was kept. Likewise, the UTPR would originally apply to low-taxed deductible payments to other CEs, the "undertaxed payments", according to the PILLAR TWO BLUEPRINT[510]. Its maintenance in the GLOBE MODEL RULES is even more disturbing, because, in its current design, the rule does not apply to payments at all, but instead allows the denial of a deduction (or an equivalent measure) as means to charge a Top-up Tax[511].

In fact, the name "Undertaxed Payments Rule" has not been formally kept and does not appear in the GLOBE MODEL RULES or in the GLOBE COMMENTARY. "IIR" and "UTPR" are not included in the list of abbreviations and acronyms of the GLOBE MODEL RULES, despite their centrality to the functioning of such rules, which use them repeatedly, and even define the acronyms. IIR and UTPR (as acronyms) are defined terms (GLOBE MODEL RULES, Art. 10.1.1). The list of abbreviations and acronyms of the GLOBE COMMENTARY is more complete and includes the IIR, but not the UTPR. ARNOLD attributes this to "an oversight"[512], but there seems to be more to it. In fact, the term "Undertaxed Payments Rule" does not appear in the GLOBE MODEL RULES at all, and only the acronym UTPR is found in the GLOBE MODEL RULES and the GLOBE COMMENTARY. It has therefore already been claimed that the backstop rule would now be called UTPR, not as an acronym but rather as a standalone name[513]. It has also been suggested that the UTPR would now be known as the "Undertaxed *Profits* Rule"[514]. The

[506] Maintaining that "a provision dealing with the meaning of undefined terms should be included" and suggesting such content for the rule, see Arnold, 275.
[507] Arnold, "The Ordering of Residence and Source," 220.
[508] Treating the acronym "UTPR" as "historically conditioned", see Hans Zöchling, Kasper Dziurdź, and Christoph Marchgraber, "Globale Mindestbesteuerung: Welche Unternehmen sind betroffen?," *Steuer- und WirtschaftsKartei* 11 (2022): n. 4.
[509] PILLAR TWO BLUEPRINT, p. 112, para. 410.
[510] PILLAR TWO BLUEPRINT, p. 124, para. 457-458.
[511] See, specifically on the differences of the UTPR from the PILLAR TWO BLUEPRINT *vis-à-vis* the GLOBE MODEL RULES , ch. V, sec. 3.3.
[512] Arnold, "The Ordering of Residence and Source," n. 24.
[513] Jefferson VanderWolk, "The UTPR Is Inconsistent with the Nexus Requirement of Tax Treaties," Kluwer International Tax Blog, October 26, 2022.
[514] See, *e.g.,* Picciotto, "Formulary Approach: The Last Best Hope for MNEs," 437; Sol Picciotto, "UTPR Critics Miss the Point of Tax Treaty Principles," *Tax Notes International* 108 (2022): 153; Nathan Boidman, "No Rational Role for the UTPR," *Tax Notes International* 108 (2022): 287; Jefferson VanderWolk, "The UTPR Is Flawed: A Response to Prof. Picciotto," *Tax Notes International* 108 (2022): 285.

new name may already be found even in governmental documents[515], but it does not appear in any part of the RELEVANT MATERIAL[516].

The section is therefore justified both on the novelty of the GLOBE MODEL RULES, and on the complexity of these newly published documents. The understanding of GLOBE MODEL RULES' mechanisms and defined terms could not be merely assumed. At the same time, leaving the development of such rules to the sections dedicated to their in-depth discussion would harm the fluidity of the text.

The five-step approach for the application of the GLOBE MODEL RULES can be summarized as follows. The first step is identifying the in-scope Entities. The second step is calculating the GLOBE Income or Loss and the third step is determining the Adjusted Covered Taxes. Both the second and the third step are relevant for calculating the ETR for each jurisdiction, which is a ratio of the Adjusted Covered Taxes (numerator) over the GLOBE Income or Loss (denominator). In case the ETR for the jurisdiction is below the 15% Minimum Rate, a Top-up Tax is calculated in the fourth step. In the fifth step, the Top-up Tax shall be imposed and allocated under the IIR or the UTPR, in accordance with the agreed rule order. Schematically:

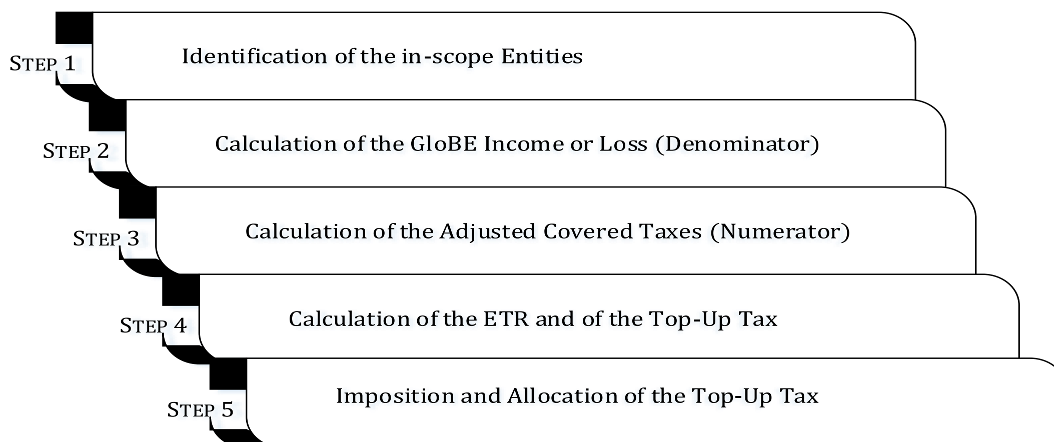

Figure 1: the five-step approach

Each of the five steps is very general and is further divided in twenty other steps for analytical purposes[517]. "Calculating the GLOBE Income or Loss" (second step, sec. 3, *infra*), for instance, is a very complex task, and merely asserting the need to calculate it is not very helpful for understanding the mechanics of the GLOBE MODEL RULES. Therefore, the steps are subdivided as follows:

[515] The name appears, *e.g.,* in the Irish consultation on the implementation of Pillar Two. See An Roinn Airgeadais, "Consultation on Pillar Two Minimum Tax Rate Implementation" (Tax Division, Department of Finance, May 2022), 9.

[516] Informing that "the need for a name change was discussed (without resolution) by Working Party 11 delegates at a meeting in April [2021]", see Casey Plunket, "What's in a Name? The Undertaxed Profits Rule," *Tax Notes International* 105 (2022): 1507.

[517] The subdivision is also inspired on the OECD "background material", which contains a similar subdivision to the one present in this chapter.

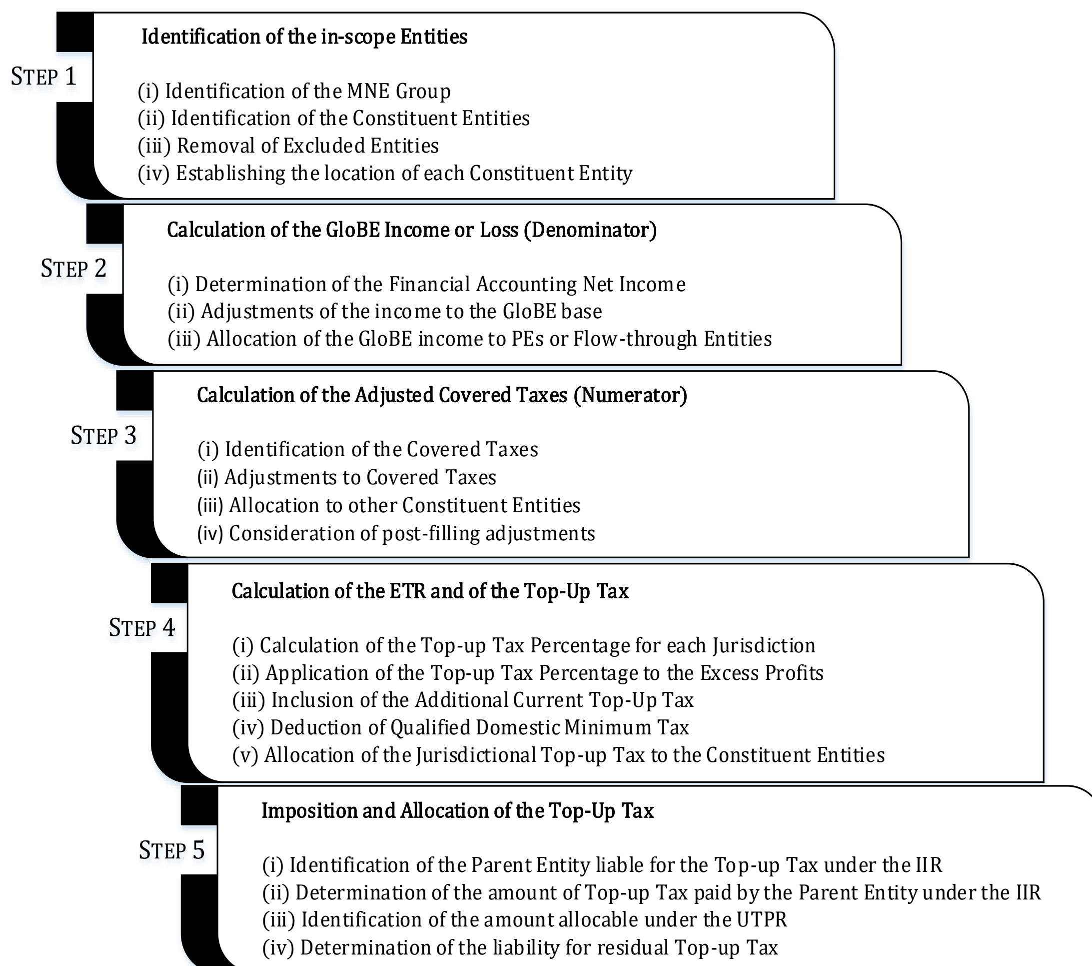

Figure 2: the five-step approach subdivision

Of course, further subdivisions could be conceived. One of the twenty steps, for instance, is the "Determination of the Financial Accounting Net Income" (sec. 3.1, *infra*), which is also very complex and brings further discussions for the purpose of examining the GLOBE MODEL RULES. However, such a refinement is not necessary for understanding the mechanics of the GLOBE MODEL RULES, as intended in the chapter. The GLOBE MODEL RULES and the GLOBE COMMENTARY present a multitude of more specific "steps" and "tests", which will be discussed either along the description of the steps or in subsequent chapters, as deemed necessary. The choice of which elements are presented in the chapter is guided by its structural role of introducing the main defined terms and ensuring the fluidity of the subsequent chapters.

2. STEP ONE: IDENTIFICATION OF IN-SCOPE ENTITIES

The first step for applying the GLOBE MODEL RULES is to identify the in-scope Entities. This step comprises: (i) identifying the MNE Groups within scope (sec. 2.1); (ii) identifying its CEs (sec. 2.2); (iii) removing any Excluded Entities (sec. 2.3); and (iv) identifying the location of each CE (sec. 2.4).

2.1. Identification of the MNE Group within scope

The GLOBE MODEL RULES apply to Entities and PEs that are part of an MNE Group with a consolidated group revenue that exceeds EUR 750 million in at least two of the preceding four consecutive fiscal years[518].

Decisive for this purpose are the Consolidated Financial Statements of the Ultimate Parent Entity ("**UPE**"), which is the Entity that owns directly or indirectly a Controlling Interest in any other Entity, and is not owned, with a Controlling Interest, directly or indirectly, by any other Entity[519]. Besides being used for the definition of Group, the UPE is also the starting point for identifying all the Entities that are part of the MNE Group, and in other provisions of the GLOBE MODEL RULES, such as the application of the IIR[520].

The "two-out-of-four-years test"[521] is intended to reduce the volatility in the application of the rules. The consolidated revenue for the current year (the tested Fiscal Year) is not considered for the test, ensuring that in the beginning of the tested Fiscal Year the MNE Group is able to know whether it will be subject to the GLOBE MODEL RULES in that year[522]. In case of mergers, the consolidated revenue threshold for a prior year is met if the sum of the revenues in the financial statements of each Entity is equal or greater than EUR 750 million[523]. For the purpose of the revenue threshold, it is irrelevant whether a portion of the interests in the Group Entity is owned (directly or indirectly) by minority interest holders. The revenues are not reduced by the amount attributable to minority shareholders. Also, because the threshold is based on consolidated revenue, and not on the aggregate revenues of each Group Entity, revenues from transactions with other Group Entities, which end up being eliminated in the consolidation process, are excluded from the revenue threshold test[524].

The definition of Group is subject to an "accounting consolidation test"[525]. A Group is defined as a collection of Entities that are related through ownership or control, being included in the Consolidated Financial Statements of the UPE, or excluded thereof solely on size or materiality grounds, or on the grounds that the Entity is held for sale[526]. There is also a deeming provision for those UPEs that do not prepare Consolidated Financial Statements. The "deemed consolidation test" requires the use of the financial statements that should have been prepared in accordance with an Authorised Financial Accounting Standard[527] that is either an Acceptable Financial Accounting Standard[528] or another

[518] GLOBE MODEL RULES, Art. 1.1.1.
[519] GLOBE MODEL RULES, Art. 1.4.1. In case of a Group formed by a Main Entity with multiple PEs, the UPE is the Main Entity (GLOBE MODEL RULES, Art. 1.2.3. and Art. 1.4.1.)
[520] GLOBE COMMENTARY, p. 19, para. 32.
[521] GLOBE COMMENTARY, p. 15, para. 6.
[522] GLOBE COMMENTARY, p. 15, para. 6.
[523] GLOBE MODEL RULES, Art. 6.1(b).
[524] GLOBE COMMENTARY, p. 15, para. 11.
[525] GLOBE COMMENTARY, P. 18, para. 21.
[526] GLOBE MODEL RULES, Art. 1.2.2.
[527] Meaning "a set of generally acceptable accounting principles permitted by an Authorised Accounting Body in the jurisdiction where that Entity is located". See GLOBE MODEL RULES, Art. 10.1.1.
[528] A list of jurisdictions whose accounting standards are Acceptable Financial Accounting Standard is provided in GLOBE MODEL RULES, Art. 10.1.1.

financial accounting standard that is adjusted to prevent any Material Competitive Distortions[529].

The GLOBE MODEL RULES applies only to MNE Groups, meaning that at least one Entity or PE must be located in a different jurisdiction than the UPE jurisdiction[530]. Due to concerns related to the fundamental freedoms[531], the EU Proposal presents a deviation in relation to this requisite and applies regardless of the international nature of the activities of the MNE, being thus applicable to a strictly domestic Group[532].

2.2. Identification of the Constituent Entities of the MNE Group

After identifying the relevant MNE Group, its CEs shall be identified. A CE is any Entity or PE of a Main Entity[533] included in an MNE Group subject to the GLOBE MODEL RULES[534], provided that it is not an Excluded Entity[535]. For the purposes of the GLOBE MODEL RULES, an Entity is any legal person (other than a natural person), or an arrangement that prepares separate financial accounts, such as a partnership or a trust[536].

The GLOBE MODEL RULES also provide for their own concept of PE, which include four possible meanings, contingent on the extent to which the concept of PE is covered under domestic legislation[537]. The distinction between such PEs is relevant for the purpose of application of other provisions of the GLOBE MODEL RULES, such as the rules on the location of the PEs[538] and the rules on the allocation of income or loss between a Main Entity and a PE[539].

In any case, it is essential for the comprehension of the GLOBE MODEL RULES that a PE which is a CE shall be treated as a separate CE from the Main Entity and any other PEs of the Main Entity[540]. This treatment is aimed at ensuring "parity in the treatment of foreign subsidiaries and PEs of the MNE Group"[541]. The income earned through PEs and the corresponding tax in one jurisdiction shall not be blended with the tax and the income of the Main Entity or other PEs in other jurisdictions[542].

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[529] GLOBE MODEL RULES, subparagraph (d) of the definition of Consolidated Financial Statements in Article 10.1. GLOBE COMMENTARY, para. 18(a).
[530] GLOBE MODEL RULES, Art. 1.2.1. GLOBE COMMENTARY, para. 20.
[531] Pinto Nogueira and Turina, "Pillar Two and EU Law," sec. 10.3.2; João Félix Pinto Nogueira, "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* 12, no. 3 (2020): sec. 4.3.4.
[532] See Art. 2, para. 1 and Art. 3, para. 5, of the proposed EU directive. See Ana Paula Dourado, "The EC Proposal of Directive on a Minimum Level of Taxation in Light of Pillar Two: Some Preliminary Comments," *Intertax* 50, no. 3 (2022): 203.
[533] Main Entity is defined as "the Entity that includes the Financial Accounting Net Income or Loss of the Permanent Establishment in its financial statements" (GLOBE MODEL RULES, Art. 10.1.).
[534] GLOBE MODEL RULES, Art. 1.3.1.
[535] GLOBE MODEL RULES, Art. 1.3.3.
[536] GLOBE MODEL RULES, Art. 10.1.
[537] GLOBE MODEL RULES, Art. 10.1. The definitions are discussed in ch. V, sec. 2.3.
[538] See ch. V, sec. 2.3.1, *infra.*
[539] See ch. V, sec. 2.3.2, *infra.*
[540] GLOBE MODEL RULES, Art. 1.3.2.
[541] GLOBE COMMENTARY, p. 18, para. 30.
[542] GLOBE COMMENTARY, p. 18, para. 30.

2.3. Removal of Excluded Entities

Not all Entities of the MNE Group are CEs. The GLOBE MODEL RULES also provide for a negative list of Excluded Entities, which are Entities that shall not be considered as CEs.

The qualification as an Excluded Entity has three practical effects. First, the IIR and the UTPR do not apply to Excluded Entities. Second, Excluded Entities do not have any administrative obligations under the GLOBE MODEL RULES. Third, the attributes of the Excluded Entities are removed from the various computations of the GLOBE MODEL RULES, with one important exception. The revenue of such Excluded Entities is still relevant for the application of the EUR 750 million revenue threshold[543].

Excluded Entities are a Governmental Entity, an International Organisation, a Non-Profit Organisation, a Pension Fund, an Investment Entity that is an UPE and a Real Estate Investment Vehicle that is an UPE[544]. Entities owned by these Excluded Entities can be considered to be Excluded Entities, if (a) they were set up by an Excluded Entity to hold its assets or invest its funds, or to carry out activities that are ancillary to the Excluded Entity's activities[545]; or if (b) such their financial accounting net income would otherwise be excluded from the GLOBE computations because it is composed of Excluded Dividends or Excluded Equity Gain or Loss[546].

2.4. Establishing the location of each Constituent Entity

After all CEs of the MNE Group are identified, along with the proper removal of Excluded Entities, it is then necessary to establish the location of each CE[547], according to Art. 10.3. As a general rule, an Entity is deemed to be located where it is a tax resident, whereas a PE is located where it is situated. Determining the location of the Entities is fundamental for jurisdictional blending and for determining where the Top-up Tax has to be paid. Art. 10.3 does not affect domestic and tax treaties provisions dealing with residence and source taxation[548].

3. STEP TWO: CALCULATION OF THE GLOBE INCOME OR LOSS

Step two and step three are dedicated to the ETR calculation. Once it has been established that the MNE Group falls within the scope of the GLOBE MODEL RULES, and its CEs have been properly identified and located, it shall be examined whether the ETR for each jurisdiction in which the Group operates is inferior to 15%. If this is the case, a Top-up Tax is calculated for that specific jurisdiction and allocated to the appropriate CEs, under the IIR and the UTPR. If, however, the ETR is equal or superior to 15%, no Top-up Tax arises in relation to that jurisdiction in the examined Fiscal Year.

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543 GLOBE COMMENTARY, para. 37.
544 GLOBE MODEL RULES, Art. 1.5.1.
545 GLOBE MODEL RULES, Art. 1.5.2(a).
546 GLOBE MODEL RULES, Art. 1.5.2(b).
547 The location of CEs is discussed in ch. V, sec. 2.1.
548 GLOBE COMMENTARY, p. 220, para. 170.

The ETR for a jurisdiction is a ratio of the sum of the Adjusted Covered Taxes (the numerator) and the GLOBE Income or Loss of the CEs located in the jurisdiction under examination (the denominator)[549].

$$ETR = \frac{Ajusted\ Covered\ Taxes}{GloBE\ Income\ or\ Loss}$$

In step two, the calculation of GLOBE Income or Loss embraces (i) determining the Financial Accounting Net Income (sec. 3.1); (ii) adjusting it to the GLOBE base (sec. 3.2); and (iii) allocating GLOBE Income or Loss to PEs or Flow-through Entities, where necessary (sec. 3.3).

3.1. Determination of the Financial Accounting Net Income

The starting point for calculating the GLOBE Income or Loss is the Financial Net Income or Loss of a CE. The net income (or loss) of the CE is determined by reference to the Consolidated Financial Statements of the UPE before any consolidation adjustment. The reference is, therefore, the stand-alone account, including the effects of intra-group transactions, as used in the preparation of the Consolidate Financial Statements of the UPE[550], i.e. "the bottom-line net income or loss of the Group Entity before making any consolidation adjustments that would eliminate income or expense attributable to intra-group transactions"[551].

The general rule is that the net income or loss of the CE has to be determined by using the same accounting standard that was used in the preparation of the Consolidated Financial Statements to determine the CE's income or loss[552]. The policy choice made by the GLOBE MODEL RULES with this regard is between the information used to prepare the Consolidated Financial Statements of the UPE and the local accounting standards for CEs in different jurisdictions. This approach is intended to avoid the risk of arbitrage from the use of different accounting standards and, at the same time, take into consideration compliance costs, by resorting to information that is already being prepared for reporting purposes[553].

GLOBE Income or Loss of the CE is not proportionally reduced for income or loss attributable to minority interests in the CE. Instead, the matter is dealt with at a different stage, upon the calculation and attribution of the Top-up Tax under the IIR[554].

The GLOBE MODEL RULES also provide for the possibility of using another Acceptable Financial Accounting Standard or an Authorised Financial Accounting Standard, instead of the standard followed by the UPE[555]. Three conditions must be met: (i) the financial accounts of the CE are maintained based on that accounting standard; (ii) the information contained therein is reliable, with appropriate mechanisms to ensure that the information is recorded accurately[556]; and (iii) the use of the other accounting standard does not result

[549] GLOBE MODEL RULES, Art. 5.1.
[550] GLOBE MODEL RULES, Art. 3.1.2.
[551] GLOBE COMMENTARY, p. 43, para. 3.
[552] GLOBE COMMENTARY, p. 44, para. 5.
[553] GLOBE COMMENTARY, p. 44, para. 7.
[554] GLOBE COMMENTARY, p. 44, para. 8.
[555] GLOBE MODEL RULES, Art. 3.1.3.
[556] For further clarification on the term "reliable", see GLOBE COMMENTARY, p. 46, para. 15.

in permanent differences in excess of EUR 1 million from the financial accounting standard of the UPE – or the relevant adjustments are made[557].

3.2. Adjustments of the income to the GLOBE base

The Financial Accounting Net Income is then subject to both *mandatory adjustments* and *optional adjustments*, which are intended to account for categories of income and expenses that IF members commonly treat differently for tax purposes[558]. These adjustments create, therefore, book-to-tax differences, which are considered "common" within IF jurisdictions[559], therefore building on the notion of a "typical CIT"[560] to construct a "common tax base"[561] for the GLOBE MODEL RULES.

Book-to-tax differences can be either permanent, if they are not reversed in a future period, or temporary (dealing with timing differences), if they are reversed in a future period. The adjustments made to the Financial Accounting Net Income at this stage are generally related to permanent differences, whereas the temporary differences are addressed in step three, upon the calculation of the Covered Taxes[562]. To the extent that an adjustment to the income excludes an amount of income from the GLOBE Income or Loss computation, Covered Taxes associated with such income shall also be excluded from the Adjusted Covered Taxes[563].

3.3. Allocation of the GloBE income to PEs or Flow-through Entities

Finally, the GLOBE Income or Loss must also be allocated to PEs[564] or to Flow-through Entities[565], where necessary. Such allocation rules are intended to ensure the appropriate allocation of Financial Net Income or Loss between these Entities and their owners[566].

A Flow-through Entity is generally defined as an Entity that is fiscally transparent in the jurisdiction where it was created[567], and it can be either a Tax Transparent Entity or a Reverse Hybrid Entity. A Tax Transparent Entity is a Flow-through Entity that is treated as fiscally transparent by the jurisdiction of its direct owners[568], whereas a Reverse Hybrid Entity is a Flow-through Entity that is treated as opaque or not fiscally transparent by the jurisdiction of its direct owners[569].

4. STEP THREE: CALCULATION OF THE ADJUSTED COVERED TAXES

In order to arrive at the Adjusted Covered Taxes, one must: (i) identify the Covered Taxes (sec. 4.1); (ii) adjust them for Additions and Reductions for Covered Taxes, including for

[557] For examples of adjustments, see GLOBE COMMENTARY, p. 46, para. 16.
[558] GLOBE COMMENTARY, p. 57, para. 76.
[559] GLOBE COMMENTARY, p. 46, para. 17.
[560] GLOBE COMMENTARY, p. 47, para. 20.
[561] GLOBE COMMENTARY, p. 47, para. 21.
[562] GLOBE COMMENTARY, p. 46, para. 17.
[563] GLOBE MODEL RULES, Art. 4.1.3(a).
[564] GLOBE MODEL RULES, Art. 3.4.
[565] GLOBE MODEL RULES, Art. 3.5.
[566] The allocation of income to such CEs is discussed in ch. V, sec. 2.3 and 2.4, *infra*.
[567] GLOBE MODEL RULES, Art. 10.2.1.
[568] GLOBE MODEL RULES, Art. 10.2.1(a).
[569] GLOBE MODEL RULES, Art. 10.2.1(b).

temporary differences and prior year losses (sec. 4.2); (iii) allocate them to other CEs as necessary (sec. 4.3); and (iv) take post-filling adjustments into account (sec. 4.4).

4.1. Identification of the Covered Taxes

The starting point to calculate the ETR numerator is the amount of Covered Taxes that is included in the financial net income calculation in the financial statements as an expense. The GLOBE MODEL RULES take the current tax expense accrued in the CE's Financial Accounting Net Income or Loss with respect to Covered Taxes and submits it to a series of adjustments.

The definition of Covered Taxes[570] embraces (a) Taxes recorded in the financial accounts of a CE with respect to its income or profits or its share of the income or profits of a CE in which it owns an Ownership Interest; (b) Taxes on distributed profits, deemed profit distributions, and non-business expenses imposed under an Eligible Distribution Tax System; (c) Taxes imposed in lieu of a generally applicable CIT; and (d) Taxes levied by reference to retained earnings and corporate equity, including a Tax on multiple components based on income and equity.

A Tax is defined as a compulsory unrequited payment to General Government[571], following the definition of Taxes used for statistical purposes[572]. They are "unrequited" in the sense that benefits eventually provided by the General Government to the taxpayer are not proportional to the amount paid – thus excluding fees and payments for privileges, services, property and other benefits from the definition of Tax. Fines, penalties and interests are also excluded from the definition of Tax[573].

For the purpose of identifying a Covered Tax, "the focus in on the underlying character of the Tax"[574]. Neither the name of the Tax, nor the mechanism used to collect it are determinative of its character. It is also immaterial whether the tax charge is levied under CIT rules or under a separate regime or statute. The timing is equally unimportant: in the case of a Tax on income distribution, it is irrelevant whether the distribution is attributable to current or previously accumulated earnings[575].

The GLOBE MODEL RULES expressly exclude Top-up Taxes from the definition of Covered Taxes[576], as the inclusion would result in a circular computation in the Fiscal Year that the Top-up Tax arise, undermining the agreed Minimum Rate[577].

A Disqualified Refundable Imputation Tax is also excluded. A Disqualified Refundable Imputation Tax is defined as an amount of Tax, other than a Qualified Imputation Tax, accrued or paid by a CE that is: (a) refundable to the beneficial owner of a dividend distributed by such CE in respect of that dividend or creditable by the beneficial owner against a tax liability other than a tax liability in respect of such dividend; or (b)

[570] GLOBE MODEL RULES, Art. 4.2.1.
[571] GLOBE MODEL RULES, Art. 10.1.
[572] See OECD, Revenue Statistics 1965-2017 Interpretative Guide, Annex A, Paris, OECD Publishing, 2018.
[573] GLOBE COMMENTARY, p. 91, para. 24.
[574] GLOBE COMMENTARY, p. 91, para. 23.
[575] GLOBE COMMENTARY, p. 91, para. 23.
[576] GLOBE MODEL RULES, Art. 4.2.2(a) to Art. 4.2.2(c).
[577] GLOBE COMMENTARY, p. 94, para. 38.

refundable to the distributing corporation upon distribution of a dividend[578]. It is excluded because it would be "similar to a deposit" and could not be properly taken into account upon the ETR computation[579].

Taxes paid by an insurance company in respect of returns to policyholders are also excluded[580], because amounts charged to policy holders for tax expense incurred by an insurance company in respect of returns to a policy holder are excluded from the computation of GLOBE Income or Loss[581].

Taxes that do not qualify as Covered Taxes, such as excise taxes and payroll taxes, are deductible in the computation of GLOBE Income or Loss[582], thus reducing the denominator for the ETR calculation[583]. The GLOBE COMMENTARY provides a negative list, with taxes that will generally not fall within the definition of Covered Taxes[584]. As one may see, the GLOBE MODEL RULES' definition of Covered Taxes has no direct interaction with the definition of the OECD-MC[585].

4.2. Adjustments to Covered Taxes

The Adjusted Covered Taxes for the Fiscal Year are defined as the current tax expense accrued in the CE's Financial Accounting Net Income or Loss with respect to Covered Taxes for the Fiscal Year, adjusted by Additions and Reductions (sec. 4.2.1), as well as by other adjustments intended to address temporary differences (sec. 4.2.2).

4.2.1. Additions and Reductions to Covered Taxes

Adjustments to the current tax expense amount are made for GLOBE purposes, which can be either Additions or Reductions to Covered Taxes[586].

An Addition may be required because the range of items identified as income taxes in financial statements may be narrower than the items that fall within the definition of Covered Taxes[587]. The Additions to Covered Taxes are the sum of[588]: (a) any amount of Covered Taxes accrued as an expense in the profit before taxation in the financial accounts; (b) any amount of GLOBE Loss Deferred Tax Asset carried forward[589]; (c) any amount of Covered Taxes that is paid in the Fiscal Year and that relates to an uncertain tax position where that amount has been treated for a previous Fiscal Year as a Reduction to Covered Taxes under Article 4.1.3(d); and (d) any amount of credit or refund in respect of a Qualified Refundable Tax Credit that is recorded as a reduction to the current tax expense.

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578 GLOBE MODEL RULES, Art. 10.1.
579 GLOBE COMMENTARY, p. 95, para. 40.
580 GLOBE MODEL RULES, Art. 4.2.2(e).
581 GLOBE MODEL RULES, Art. 3.2.9. See GLOBE COMMENTARY, p. 95, para. 40.
582 GLOBE COMMENTARY, p. 91, para. 22.
583 As calculated under step two. See sec. 3, *supra*.
584 GLOBE COMMENTARY, p. 94, para. 36.
585 GLOBE COMMENTARY, p. 91, para. 22.
586 GLOBE MODEL RULES, Art. 4.1.2. to Art. 4.1.5.
587 GLOBE COMMENTARY, p. 86, para 5.
588 GLOBE MODEL RULES, Art. 4.1.2.
589 On the GLOBE Loss Deferred Tax Asset and the conditions to its carry-forward, see ch. VI, sec. 4, *infra*.

A Reduction may be required in order to ensure that the ETR calculation of the CE reflects only taxes that arise in respect of GLOBE Income or Loss and that are expected to be paid within three years[590]. The Reductions to Covered Taxes is the sum of[591]: (a) the amount of current tax expense with respect to income excluded from the computation of GloBE Income or Loss under Chapter 3 of the GLOBE MODEL RULES; (b) any amount of credit or refund in respect of a Non-Qualified Refundable Tax Credit that is not recorded as a reduction to the current tax expense; (c) any amount of Covered Taxes refunded or credited, except for any Qualified Refundable Tax Credit, to a CE that was not treated as an adjustment to current tax expense in the financial accounts; (d) the amount of current tax expense which relates to an uncertain tax position; and (e) any amount of current tax expense that is not expected to be paid within three years of the last day of the Fiscal Year.

4.2.2. Adjustments to address temporary differences

After the Additions and Reductions, the Covered Taxes shall be adjusted for temporary differences and prior year losses[592]. These adjustments are intended to protect the integrity of the ETR calculation under the GLOBE MODEL RULES and include a limitation to the recognition of the deferred tax assets and liabilities to the Minimum Rate, as well as a recapture rule to ensure that amounts claimed as Covered Taxes are actually paid within an established period of time[593]. Instead of applying such rules, which are intended to provide an appropriate recognition of losses arising in no or low-tax jurisdictions, a simplified loss carry-forward equivalent may be elected[594]. Prior year losses are considered at the level of the calculation of the Adjusted Covered Taxes in subsequent Fiscal Years. These rules are analysed in greater detail in chapter VI.

4.3. Allocation to other Constituent Entities

As necessary, the Covered Taxes shall also be allocated to other CEs. The need for allocating Covered Taxes to other CEs arises in cases of application of CFC rules, distribution taxes (such as withholding taxes), and taxes in respect of a PE, a Tax Transparent Entity or a Hybrid Entity[595]. As such rules relate to the assignment of Covered Taxes to CEs, a more detailed exam is provided in chapter V.

4.4. Consideration of post-filling adjustments

In cases where there is an adjustment to a tax liability for a prior year, as a result e.g., of an audit or an amendment of the return to correct an error, special rules shall apply[596]. In general, such rules require the ETR to be recalculated for a prior year where there is a material reduction[597] in tax liability for that year. If additional Top-up Tax Liability results from the adjustment, such additional Top-up Tax is paid in the current Fiscal Year,

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[590] GLOBE COMMENTARY, p. 87, para 6.
[591] GLOBE MODEL RULES, Art. 4.1.3.
[592] GLOBE MODEL RULES, Art. 4.1.1(b) and Art. 4.1.2(b).
[593] GLOBE MODEL RULES, Art. 4.4.
[594] GLOBE MODEL RULES, Art. 4.5.
[595] GLOBE MODEL RULES, Art. 4.3. See ch. V, sec. 2.
[596] GLOBE MODEL RULES, Art. 4.6.
[597] An aggregate decrease of less than EUR 1 million in the Adjusted Covered Taxes determined for the jurisdiction for a Fiscal Year is considered an "immaterial decrease" (GLOBE MODEL RULES, Art. 4.6).

with no need to amend the return for the prior Fiscal Year. Likewise, increases in tax amounts for prior Fiscal Years are added to Covered Taxes in the current Fiscal Year.

5. STEP FOUR: CALCULATION OF ETR AND TOP-UP TAX

The fourth step is calculating the ETR and the Top-up tax. As seen, the ETR is a ratio between the Adjusted Covered Taxes with respect to a jurisdiction (numerator) and the GLOBE Income or Loss in such jurisdiction (denominator)[598].

$$ETR = \frac{Ajusted\ Covered\ Taxes}{GloBE\ Income\ or\ Loss}$$

The ETR is therefore calculated on a jurisdictional basis. Only if the ETR is below 15% the Top-up Tax in relation to the jurisdiction concerned will be triggered. The ETF is calculated based on a jurisdictional blending of Covered Taxes and GLOBE Income and Losses of all CEs in the jurisdiction[599].

If the ETR is above the Minimum Rate in a certain jurisdiction, the subsequent steps do not apply, and the CEs in the jurisdiction do not trigger the application of the Top-Up Tax. Only if the ETR is below the 15% minimum rate for the jurisdiction, the Top-up Tax Percentage of each Low-Taxed Constituent Entity ("**LTCE**") must be calculated. Hence, a CE is only treated as a LTCE if, after the jurisdictional blending, the ETR is below the Minimum Rate. An Entity can be taxed at a 0% rate, but still not trigger a Top-up Tax if, after the jurisdictional blending, the ETR for the jurisdiction is above the Minimum Rate.

The Top-up Tax of each LTCE is computed by: (i) calculating the Top-up Tax Percentage for each Low-tax Jurisdiction (sec. 5.1); (ii) applying the Top-up Tax Percentage to the Excess Profits of the Low-tax Jurisdiction (sec. 5.2); (iii) adding the Additional Current Top-Up Tax (sec. 5.3); (iv) deducting the amount of Top-up Tax imposed under a Qualified Domestic Minimum Top-up Tax (sec. 5.4); and (v) allocating the Jurisdictional Top-up Tax to the CEs in the Jurisdiction in proportion to their GloBE Income (sec. 5.5). The Jurisdictional Top-up Tax is defined by the following formula[600]:

$$\text{Jurisdictional Top-up Tax} =$$
$$(\text{Top-up Tax Percentage x Excess Profit}) + \text{Additional Current Top-up Tax} - \text{Domestic Top-up Tax}$$

5.1. Calculation of the Top-up Tax Percentage for each Low-tax Jurisdiction

The Top-up Tax percentage for the jurisdiction is obtained by subtracting the ETR from the Minimum Rate[601].

$$\text{Top-up Tax Percentage} = \text{Minimum Rate} - \text{ETR}$$

The Top-up Tax percentage is therefore the difference between the Minimum Rate and the ETR for each jurisdiction. An ETR of 10%, for example, leads to a Top-up Tax percentage of 5% for the jurisdiction.

[598] GLOBE MODEL RULES, Art. 5.1.
[599] Special rules for Minority-Owned CEs apply. See, on the topic, ch. III, sec. 4.1.2.1.2, *infra*.
[600] GLOBE MODEL RULES, Art. 5.2.3.
[601] GLOBE MODEL RULES, Art. 5.2.1.

5.2. Application of the Top-up Tax Percentage to the Excess Profits

Until the publication of the GLOBE MODEL RULES, it was not clear whether the Substance-Based Income Exclusion would also be deducted upon the determination of the denominator[602]. The rules made clear that the Substance-Based Income Exclusion is only applied when determining the Excess Profit[603]. The Top-up Tax percentage is then multiplied by the Excess Profit in the jurisdiction to determine the amount of Top-up Tax[604]. The Excess Profit for the jurisdiction for the Fiscal Year is defined as the Net GLOBE Income less the Substance-Based Income Exclusion[605].

Excess Profit = Net GloBE Income – Substance-Based Income Exclusion

The Net GLOBE Income of a jurisdiction for a Fiscal Year is the positive amount, if any, computed according to the following formula[606]:

Net GloBE Income = *GloBE Income of all CEs – GloBE Losses of all CEs*

GLOBE Income of all CEs and GLOBE Losses of all CEs are the sum of such amounts for the CEs located in the jurisdiction for the Fiscal Year[607].

The Substance-Based Income Exclusion amount for a jurisdiction is the sum of the payroll carve-out and the tangible assets carve-out for each CE (except for Investment Entities) in the jurisdiction[608]:

Substance-Based Income Exclusion = *payroll carve-out for all CEs + tangible assets carve-out for all CEs*

The payroll carve-out for a CE located in a jurisdiction is equal to 5% of its Eligible Payroll Costs of Eligible Employees that perform activities for the MNE Group in such jurisdiction, subject to some exceptions regarding Eligible Payroll costs[609]. A transitional relief is foreseen for the pay-roll carve-out. The value of 5% shall be replaced with the following values for each Fiscal Year beginning in each of the following calendar years[610]:

Fiscal Year Beginning In:	***Article 5.3.3 Rate***
2023	10%
2024	9,8%

[602] This choice would have significant impacts on the tax policy outcome. For a discussion, see Michael Devereux et al., "What Is the Substance-Based Carve-Out under Pillar 2? And How Will It Affect Tax Competition?" (European Network of Economic and Fiscal Policy Research,Policy Brief No. 39, November 2021), 5.

[603] Michael Devereux, John Vella, and Heydon Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition" (Oxford University Center for Business Taxation, Policy Brief, January 2022), 4.

[604] GLOBE MODEL RULES, Art. 5.2.2.

[605] GLOBE MODEL RULES, Art. 5.3.

[606] GLOBE MODEL RULES, Art. 5.1.2.

[607] GLOBE MODEL RULES, Art. 5.1.2(a) and Art. 5.1.2(b).

[608] GLOBE MODEL RULES, Art. 5.3.2.

[609] GLOBE MODEL RULES, Art. 5.3.3.

[610] GLOBE MODEL RULES, Art. 9.2.1.

2025	9,6%
2026	9,4%
2027	9,2%
2028	9,0%
2029	8,2%
2030	7,4%
2031	6,6%
2032	5,8%

The tangible asset carve-out for a CE located in a jurisdiction is equal to 5% of the carrying value of Eligible Tangible Assets located in such jurisdiction[611]. Eligible Tangible Assets means: (a) property, plant, and equipment located in that jurisdiction; (b) natural resources located in that jurisdiction; (c) a lessee's right of use of tangible assets located in that jurisdiction; and (d) a licence or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets[612]. A transitional relief is also foreseen for the pay-roll tangible asset carve-out. The value of 5% shall be replaced with the following values for each Fiscal Year beginning in each of the following calendar years[613]:

Fiscal Year Beginning In:	*Article 5.3.4 Rate*
2023	8,0%
2024	7,8%
2025	7,6%
2026	7,4%
2027	7,2%
2028	7,0%
2029	6,6%
2030	6,2%
2031	5,8%
2032	5,4%

5.3. Inclusion of the Additional Current Top-Up Tax

The GloBE Model Rules contain five provisions that require or permit a retroactive calculation of the ETR and Top-up Tax for a previous Fiscal Year or Fiscal Years taking into account an adjustment to the Adjusted Covered Taxes or the Net GloBE Income (or both) for the year[614]. Such provisions are called ETR Adjustment Articles, which is a defined term[615], and result in an inclusion to the jurisdictional Top-up Tax. The mechanism has been designed to avoid complexity and the administrative burden of correcting information previously provided[616].

5.4. Deduction of Qualified Domestic Minimum Tax

[611] GloBE Model Rules, Art. 5.3.4.
[612] GloBE Model Rules, Art. 5.3.4.
[613] GloBE Model Rules, Art. 9.2.2.
[614] GloBE Commentary, p. 127, para. 65.
[615] GloBE Model Rules, Art. 10.1.1. "ETR Adjustment Articles" means Article 3.2.6, Article 4.4.4, Article 4.6.1, Article 4.6.4, and Article 7.3.
[616] GloBE Commentary, p. 127, para. 66.

The Top-up Tax for the jurisdiction is further reduced by any applicable Qualified Domestic Minimum Top-up Tax ("**QDMTT**")[617]. The Domestic Top-up Tax is the amount payable under a QDMTT of the jurisdiction for the Fiscal Year[618].

In practice, the right of other jurisdictions to charge a Top-up Tax will in most cases not arise if the jurisdiction where the LTCE is located imposes a QDMTT. The jurisdiction where the LTCE is located is able to create, by means of its domestic legislation, a mechanism that imposes the Top-up Tax "before" another jurisdiction does it. A jurisdiction is not required to adopt a QDMTT under the common approach, but if it does, the QDMTT will in many cases reduce to nil the right of other jurisdictions to charge a Top-up Tax[619].

5.5. Determination of the Jurisdictional Top-up Tax to the Constituent Entities

Finally, the Jurisdictional Top-up Tax shall be determined to the CEs in the jurisdiction in proportion to their GLOBE Income[620]. This procedure is relevant to establish which CEs trigger a charge to Top-up Tax under the last step, and is performed in accordance with the following formula:

$$\text{Top-Up Tax of the CE} = \text{Jurisdictional Top-up Tax} \times \frac{\text{GloBE Income of the CE}}{\text{Aggregate GloBe Income of all CEs}}$$

Jurisdictional Top-up Tax[621] and GLOBE Income of the CE[622] for the jurisdiction for the Fiscal Year are both terms that have already been presented[623]. The Aggregate GLOBE Income of all CEs means the aggregate GLOBE Income of all CEs that have GLOBE Income for the Fiscal Year included in the computation of Net GLOBE Income[624] for the jurisdiction for the Fiscal Year.

If the Jurisdictional Top-up Tax is attributable to an Additional Current Top-up Tax[625] and the jurisdiction does not have Net GLOBE Income for the current Fiscal Year, Top-up Tax shall be determined using the same formula, but based on the GLOBE Income of the CEs in the Fiscal Years for which the recalculations corresponding to the Additional Current Top-Up Tax were performed[626]. The reasoning behind this rule is that, where a jurisdiction lacks Net GLOBE Income in the current year, it would be more appropriate to allocate Additional Current Top-up Tax based on the GloBE Income of the CEs in the relevant previous years, since all of the Top-up Tax has been calculated by reference to the Net GloBE Income of those years.

5.6. Exceptions on the triggering of the Top-Up Tax

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[617] GLOBE MODEL RULES, Art. 5.2.3.
[618] GLOBE MODEL RULES, Art. 5.2.3(d).
[619] GLOBE COMMENTARY, p. 118, para. 20.
[620] GLOBE MODEL RULES, Art. 5.2.4.
[621] GLOBE MODEL RULES, Art. 5.2.3.
[622] GLOBE MODEL RULES, Art. 3.2.
[623] See sec. 5.1, *supra*.
[624] In accordance with GLOBE MODEL RULES, Article 5.1.2.
[625] In accordance with GLOBE MODEL RULES, Article 5.4.1.
[626] GLOBE MODEL RULES, Art. 5.2.5.

The GLOBE MODEL RULES also provide for exceptions on the triggering of the Top-up Tax, which comprise a *de minimis* exclusion and the development of safe-harbours.

The *de minimis* exclusion is applicable for jurisdictions where the MNE has an Average GLOBE Revenue inferior to EUR 10 million and an Average GLOBE Income that is either a loss or inferior to EUR 1 million, being both computed on a three-year average basis[627]. It is an elective mechanism, whereby the Top-up Tax for the CEs located in a jurisdiction is deemed to be zero for a Fiscal Year if, for such Fiscal Year: (a) the Average GloBE Revenue of such jurisdiction is less than EUR 10 million; and (b) the Average GloBE Income or Loss of such jurisdiction is a loss or is less than EUR 1 million[628].

The GLOBE MODEL RULES make reference to the possibility of creation of safe-harbours, which shall be developed as part of the GLOBE Implementation Framework, aiming at limiting compliance and administration costs for MNE's operations which are deemed likely to be taxable at a rate higher than the Minimum Rate on a jurisdictional basis[629].

6. STEP FIVE: IMPOSITION AND ALLOCATION OF THE TOP-UP TAX

The fifth and last step is the imposition and allocation of the Top-up Tax, which is first imposed under the IIR on a Parent Entity with an Ownership Interest in the LTCE. Should any residual amount of Top-up Tax remain unallocated after the application of the IIR, the UTPR allocation mechanism results in a liability to Top-up Tax in the jurisdictions that introduced the UTPR.

The imposition and allocation of the Top-up Tax require: (i) identification of the Parent Entity liable for the Top-up Tax under the IIR (sec. 6.1); (ii) determination of the amount of Top-up Tax allocated to the Parent Entity under the IIR (sec. 6.2); (iii) identification of the remaining amount, if any, that is allocable under the UTPR (sec. 6.3); (iv) establishment of liability for residual Top-up Tax in the UTPR Jurisdictions through a UTPR adjustment (sec. 6.4).

6.1. Identification of the Parent Entity liable for the Top-up Tax under the IIR

The identification of the Parent Entity liable for the Top-up Tax under the IIR follows a top-down approach. The UPE of the MNE Group is primarily liable for the Top-up Tax of all LTCEs[630]. If the UPE is not required to apply an IIR, the Top-up Tax is imposed on the next Intermediate Parent Entity in the ownership chain that is subject to the IIR[631]. The top-down approach becomes clearer in the following scheme, provided by the GLOBE EXAMPLES[632]:

[627] GLOBE MODEL RULES, Art. 5.5.
[628] GLOBE MODEL RULES, Art. 5.5.1.
[629] GLOBE MODEL RULES, Art. 8.2.
[630] GLOBE MODEL RULES, Art. 2.1.1.
[631] GLOBE MODEL RULES, Art. 2.1.2. and Art. 2.1.3.
[632] GLOBE EXAMPLES, Example 2.1.3 – 2.

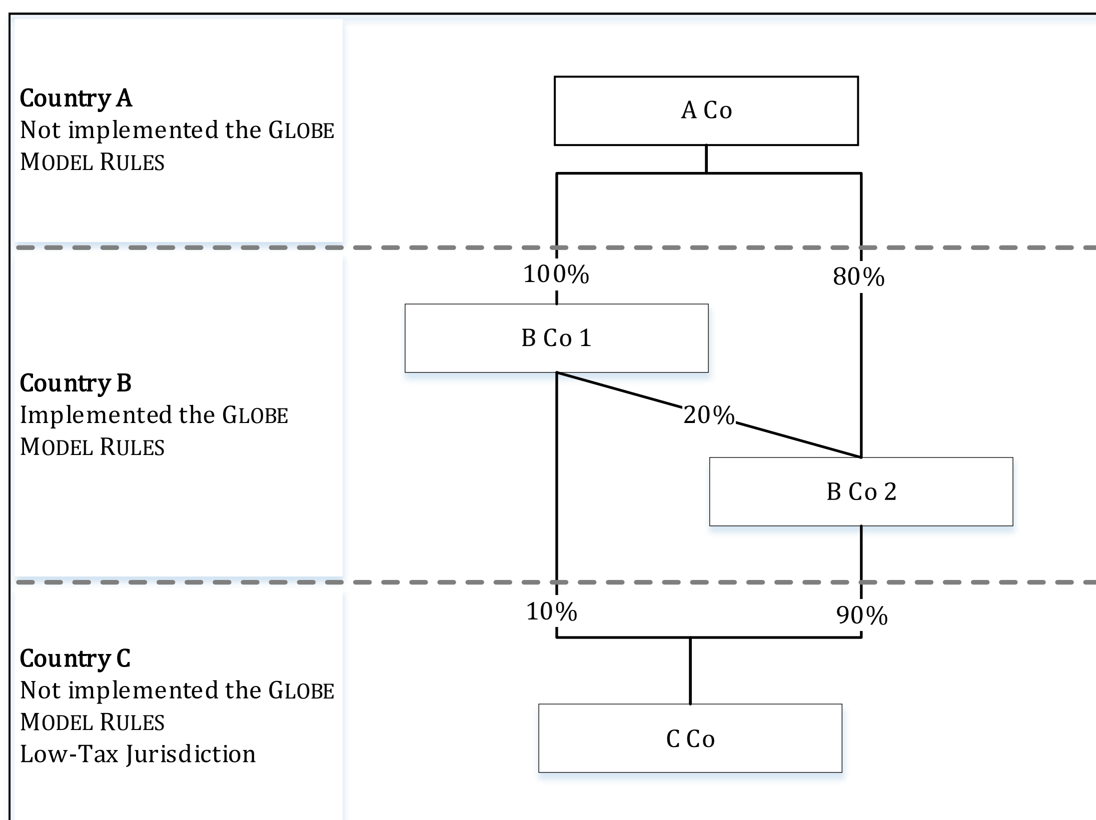

Figure 3 - GloBE Example 2.1.3 – 2.

In the example, if Country A had implemented the GLOBE MODEL RULES, A Co would be liable to the Top-up Tax related to the income of C Co, under the IIR, and no Entity located in Country B would be liable to a Top-up Tax[633]. A Co, as it is the UPE, would have to pay a tax in an amount equal to its Allocable Share of the Top-up Tax of the LTCE for the Fiscal Year[634].

However, as Country A has not implemented the GLOBE MODEL RULES, and the UPE is not required to apply the IIR[635], the Intermediate Parent Entity shall pay a tax in an amount equal to its Allocable Share of the Top-up Tax of the LTCE for the Fiscal Year. The Intermediate Parent Entity shall not be subject to the IIR, however, if another Intermediate Parent Entity that owns (directly or indirectly) a Controlling Interest in the Intermediate Parent Entity is required to apply a Qualified IIR for that Fiscal Year[636].

In the example, one of the Intermediate Parent Entities (B Co 1) that is required to apply the IIR holds some of the Ownership Interests of another Intermediate Parent Entity (B Co 2). However, the lower-tier Entity (B Co 2) is not prevented from applying the IIR because B Co 1 does not own a Controlling Interest in B Co 2. Hence, both B Co 1 and B Co 2 are required to apply the IIR.

Assuming that B Co 2's Allocable Share of C Co's Top-up Tax is 90% (based on its direct shareholding in C Co) and that B Co 1's Allocable Share of the Top-up Tax is 28% (10%

[633] GLOBE MODEL RULES, Art. 2.1.3(a).
[634] GLOBE MODEL RULES, Art. 2.1.1.
[635] GLOBE MODEL RULES, Art. 2.1.3(a).
[636] GLOBE MODEL RULES, Art. 2.1.3(b).

due to its direct ownership and 18% due to its indirect ownership), double taxation would arise. In order to avoid it, the GLOBE MODEL RULES require B Co 1 to reduce the Top-up Tax attributable to its indirect ownership in C Co by the amount that will be brought into charge by B Co 2, upon the determination of the amount of Top-up Tax paid by the Parent Entity under the IIR [637].

The GLOBE MODEL RULES except the top-down approach for a Partially-Owned Parent Entitie ("**POPE**"), which is defined as a CE (other than a UPE, a PE or an Investment Entity) that (a) owns (directly or indirectly) an Ownership Interest in another Constituent Entity of the same MNE Group and (b) has more than 20% of its Ownership Interests held by non-Group members. In the case of POPEs, the Top-up Tax is imposed on the POPEs that are subject to the IIR in priority to the top-down approach[638].

A POPE that owns (directly or indirectly) an Ownership Interest in a LTCE at any time during the Fiscal Year shall pay a tax in an amount equal to its Allocable Share of the Top-up Tax of that LTCE for the Fiscal Year[639], except if it is wholly-owned (directly or indirectly) by another POPE that is required to apply a Qualified IIR for that Fiscal Year[640]. The approach for POPEs becomes clearer with the following scheme, provided by the GLOBE EXAMPLES[641]:

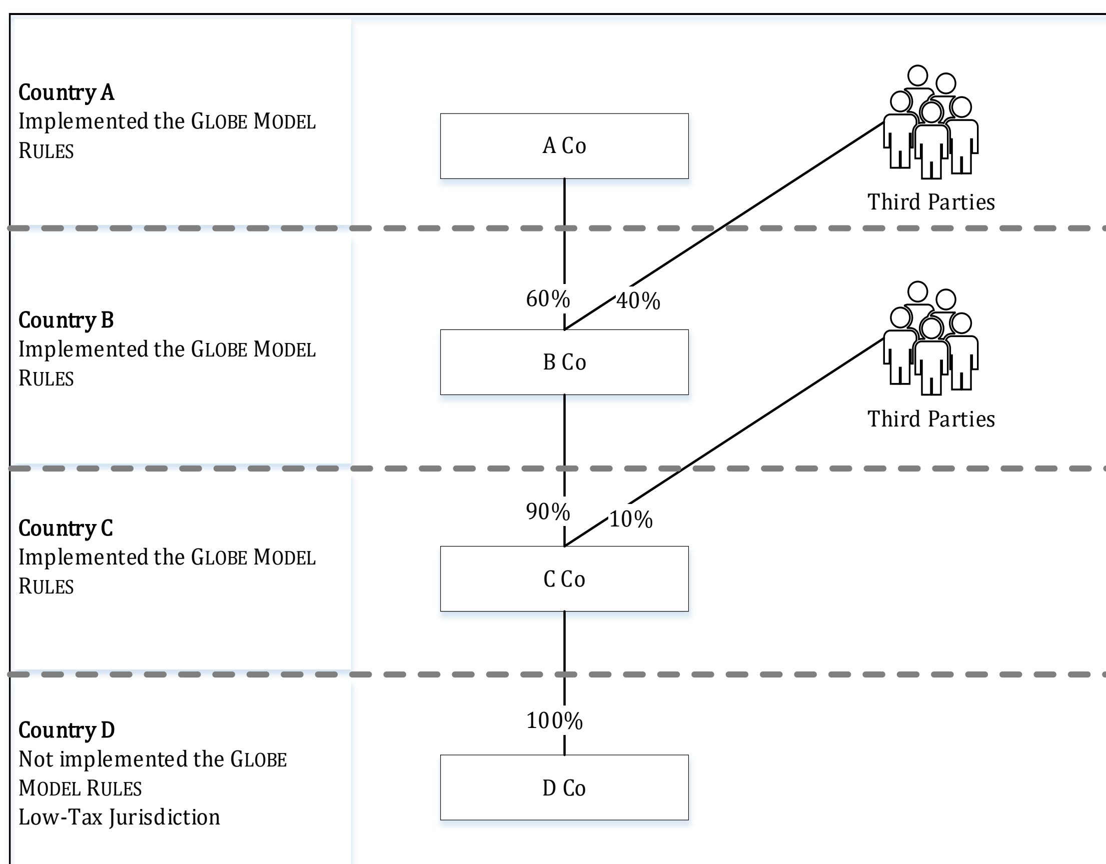

Figure 4 - GloBE Example 2.1.5 – 2.

[637] GLOBE MODEL RULES, Art. 2.3. See sec. 6.2.2, *infra.*
[638] GLOBE MODEL RULES, Art. 2.1.4. and Art. 2.1.5.
[639] GLOBE MODEL RULES, Art. 2.1.4.
[640] GLOBE MODEL RULES, Art. 2.1.5.
[641] GLOBE EXAMPLES, Example 2.1.5 – 2.

In the example, B Co and C Co are POPEs because more than 20% of their Ownership Interests are held by non-Group members. B Co has 40% of its Ownership Interests held directly by non-Group Members, while C Co has 46% of its Ownership Interests held directly (10%) or indirectly (40%*90% = 36%) by non-Group members.

C Co is not prevented from applying the IIR, because it is not wholly owned by another POPE[642]. Both B Co and C Co are required to apply the IIR, and any potential double taxation is eliminated by the application of the GLOBE MODEL RULES upon the determination of the amount of Top-up Tax paid by the Parent Entity under the IIR[643].

6.2. Determination of Top-up Tax allocated to the Parent Entity under the IIR

The determination of the amount of Top-up Tax allocated to the Parent Entity under the IIR is based on the Parent Entity's Inclusion Ratio. The Allocable Share of Top-up Tax is determined with reference to the share of the profits of the LTCE attributable to that Parent Entity on the basis of accounting standards[644]. In order to avoid double taxation, the GLOBE MODEL RULES also provide for an offsetting mechanism[645].

6.2.1. The Allocable Share of the Top-up Tax

A Parent Entity's Allocable Share of the Top-up Tax of a LTCE is an amount equal to the Top-up Tax of the LTCE (as calculated under step four) multiplied by the Parent Entity's Inclusion Ratio for the LTCE for the Fiscal Year[646]:

$$\textit{Parent Entity's Allocable Share of the Top-up Tax of a LTCE} = \\ \textit{Top-Up Tax of the CE} \times \textit{Parent Entity's Inclusion Ratio for the LTCE for the Fiscal Year}$$

A Parent Entity's Inclusion Ratio for a LTCE for a Fiscal Year is the ratio of (a) the GLOBE Income of the LTCE for the Fiscal Year, reduced by the amount of such income attributable to Ownership Interests held by other owners, to (b) the GLOBE Income of the LTCE for the Fiscal Year[647]:

$$\textit{Parent Entity's Inclusion Ratio for the LTCE for the Fiscal Year} = \\ \frac{\text{GloBE Income of the LTCE} - \text{amount of income attributable to Ownership Interests of other owners}}{\text{GloBE Income of the LTCE}}$$

The amount of GloBE Income attributable to Ownership Interests in a LTCE held by other owners is the amount that would have been treated as attributable to such owners under the principles of the Acceptable Financial Accounting Standard used in the UPE's Consolidated Financial Statements if the LTCE's net income were equal to its GLOBE Income and other listed assumptions were present[648].

[642] GLOBE MODEL RULES, Art. 2.1.5.
[643] GLOBE MODEL RULES, Art. 2.3. See sec. 6.2.2, *infra.*
[644] GLOBE MODEL RULES, Art. 2.2.
[645] GLOBE MODEL RULES, Art. 2.3
[646] GLOBE MODEL RULES, Art. 2.2.1.
[647] GLOBE MODEL RULES, Art. 2.2.2.
[648] GLOBE MODEL RULES, Art. 2.2.3.

In essence, it must be assumed that (a) the Parent Entity prepared Consolidated Financial Statements following the accounting standard (the "hypothetical Consolidated Financial Statements") – which is relevant in cases where the Parent Entity is not an UPE[649]; (b) the Parent Entity owned a Controlling Interest in the LTCE such that the income and expenses of the LTCE were consolidated on a line-by-line basis with those of the Parent Entity in the hypothetical Consolidated Financial Statements – which is intended to clarify that the LTCE is treated as if it were controlled by the Parent Entity preparing these hypothetical Consolidated Financial Statements, even if it is not[650]; (c) all of the LTCE's GloBE Income is attributable to transactions with persons that are not Group Entities – which is intended to clarify that the amount that should be allocated in the hypothetical allocation is the total GloBE Income of the LTCE, irrespective of whether some or all of that income was earned through transactions with Group Entities (being eliminated in preparing actual Consolidated Financial Statements)[651]; and (d) all other owners (including other CEs) are treated as not holding any Controlling Interests in the LTCE – which is aimed at ensuring that only the income attributable to direct and indirect Ownership Interests owned by the Parent Entity is included in the Parent Entity's Inclusion Ratio[652].

In practice, therefore, the determination of the amount of Top-up Tax to be paid by the Parent Entity starts with the amount of income attributable to Ownership Interests of other owners, in order to apply the other two formulas. In summary, the logical sequence would be contrary to the order of the paragraphs:

1) Calculate the amount of GLOBE Income attributable to Ownership Interests held by "other owners"[653];
2) Calculate the Parent Entity's Inclusion Ratio for the LTCE for the Fiscal Year[654];
3) Calculate the Allocable Share of the Top-up Tax[655].

The reference to one of the GLOBE EXAMPLES further elucidates the application of such rules. Consider the following diagram on the structure of an MNE[656]:

[649] GLOBE COMMENTARY, p. 30, para. 33.
[650] GLOBE COMMENTARY, p. 30, para. 34.
[651] GLOBE COMMENTARY, p. 30, para. 35.
[652] GLOBE COMMENTARY, p. 31, para. 36.
[653] GLOBE MODEL RULES, Art. 2.2.3.
[654] GLOBE MODEL RULES, Art. 2.2.2.
[655] GLOBE MODEL RULES, Art. 2.2.1.
[656] GLOBE EXAMPLES, Example 2.2.3 – 1.

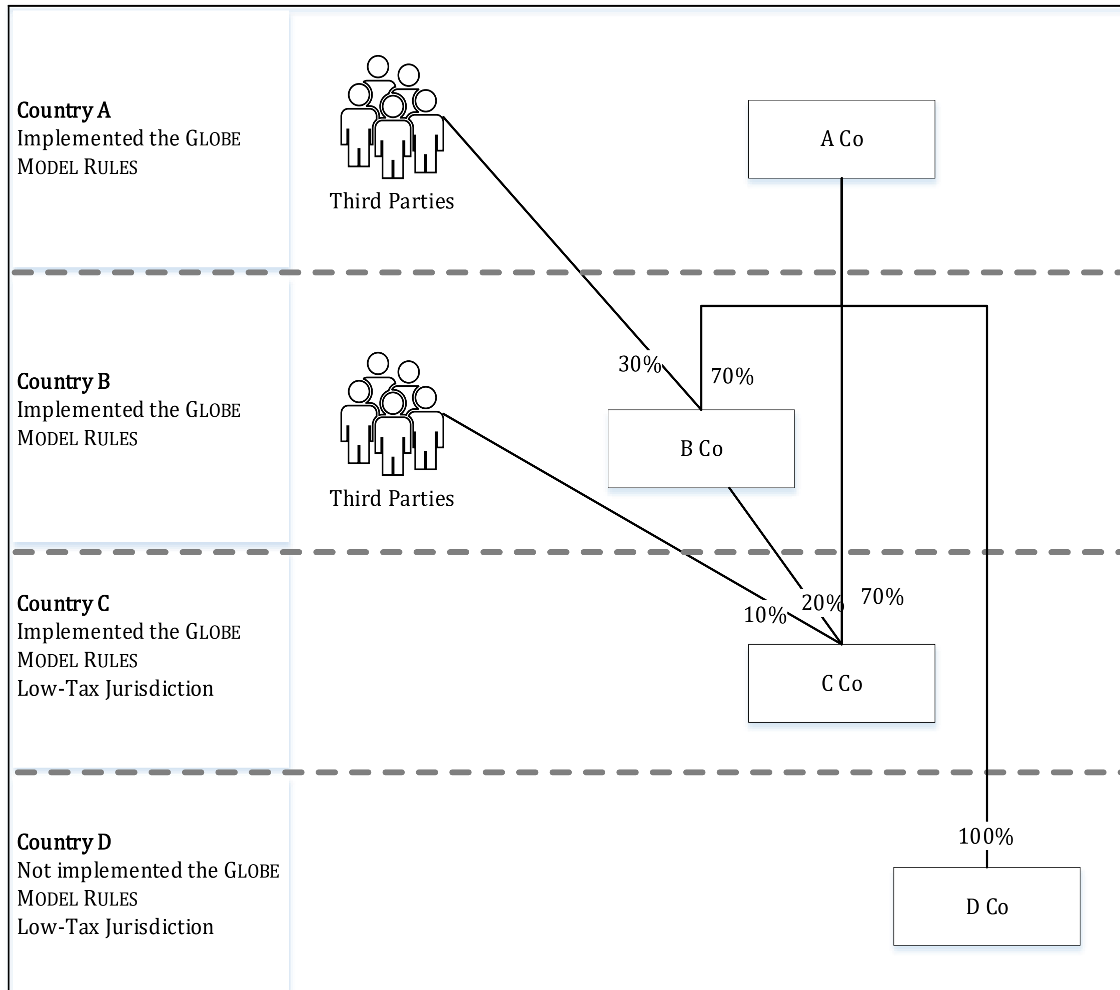

Figure 5: GloBE Example 2.2.3 – 1

For the example, the following calculations have been made regarding the LTCEs:

Entity	Consolidated Income	GloBE Income	Difference	Top-up Tax
C Co	18,000	20,000	2,000	1,000
D Co	0	35,000	35,000	500

With such information, it is possible to calculate (i) A Co's Allocable Share of the Top-up Tax of D Co; (ii) B Co's Allocable Share of the Top-up Tax of C Co; and (iii) A Co's Allocable Share of the Top-up Tax of C Co.

The simplest calculation regards A Co's Allocable Share of the Top-up Tax of D Co, which, following the logical sequence, can be determined as follows:

1) Calculate the amount of GLOBE Income attributable to Ownership Interests held by "other owners"[657]: D Co is wholly-owned by A Co and the amount is therefore zero.
2) Calculate the Parent Entity's Inclusion Ratio for the LTCE for the Fiscal Year[658]: applying the formula, the Parent Entity's Inclusion Ratio is 100% (= [35,000 GloBE Income – 0 other owners' interest] / 35,000 GloBE Income).
3) Calculate the Allocable Share of the Top-up Tax[659]: the Allocable Share of the Top-up Tax of D Co is 500 (= 500 Top-up Tax x 100% Inclusion Ratio).

The calculation of B Co's Allocable Share of the Top-up Tax of C Co presents further complications. If B Co actually prepared Consolidated Financial Statements pursuant to UPE's financial accounting standard, it would not consolidate the income and expenses of C Co, considering that B Co only owns a 20% Ownership Interest in C Co. However, due to the assumptions required by the "hypothetical Consolidated Financial Statements", B Co must assume that it owns a Controlling Interest in C Co such that it would be required to consolidate its income, expense, assets, liabilities and cash flows with C Co[660].

Taking this assumption into consideration, the application of the logical sequence would lead to the following result:

1) Calculate the amount of GLOBE Income attributable to Ownership Interests held by "other owners": further following the "hypothetical Consolidated Financial Statements", Ownership Interests held by A Co are treated as Ownership Interests held by non-Group Entities for purposes of applying the UPE's financial accounting standard[661]. In this case, 16,000 of the GloBE Income is attributed to Ownership Interests held by other owners (2,000 in relation to the 10% owned by a person that is not a Group Entity and 14,000 in relation to the 70% owned by A Co).
2) Calculate the Parent Entity's Inclusion Ratio for the LTCE for the Fiscal Year: B Co's Inclusion Ratio is 20% (= [20,000 GloBE Income – 16,000 other owners' interest] / 20,000 GloBE Income).
3) Calculate the Allocable Share of the Top-up Tax: B Co's Allocable Share of the Top-up Tax is 200 (= 1,000 Top-up Tax x 20% Inclusion Ratio).

The calculation of A Co's Allocable Share of the Top-up Tax of C Co presents further complications and would be incomplete without consideration of the offsetting mechanism. Applying the logical sequence:

1) Calculate the amount of GLOBE Income attributable to Ownership Interests held by "other owners": 3,200 of the GloBE Income is attributed to Ownership Interests held by other owners (2,000 in relation to the 10% Ownership Interests owned directly by non-Group Entities and 1,200 in relation to the 6% Ownership Interests indirectly owned by other non-Group Entities through B Co).

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657 GLOBE MODEL RULES, Art. 2.2.3.
658 GLOBE MODEL RULES, Art. 2.2.2.
659 GLOBE MODEL RULES, Art. 2.2.1.
660 GLOBE MODEL RULES, Art. 2.2.3(a).
661 GLOBE MODEL RULES, Art. 2.2.3(d).

2) Calculate the Parent Entity's Inclusion Ratio for the LTCE for the Fiscal Year: A Co's Inclusion Ratio is 84% (= [20,000 GloBE Income – 3,200 other owners' interest] / 20,000 GloBE Income).
3) Calculate the Allocable Share of the Top-up Tax: the (tentative) Allocable Share of the Top-up Tax is 840 (= 1,000 Top-up Tax x 84% Inclusion Ratio).

There is, in the example, a double taxation of the Top-Up Tax of C Co, which is allocated both to A Co and B Co. This double taxation is eliminated by the IIR offsetting mechanism, which sets forth the reduction of A Co's Allocable Share of the Top-Up Tax of C Co.

6.2.2. The IIR offsetting mechanism

As seen, strictly following the provisions of Article 2.2 could lead to double taxation. Therefore, the GLOBE MODEL RULES also provide for an IIR offsetting mechanism[662]. According to the offsetting mechanism, in case several Parent Entities are liable for the Top-up Tax under the IIR in respect of the same LTCE, the Parent Entity that is higher in the ownership chain shall reduce its Top-up Tax by the amount being paid by a lower-tier intermediate Parent Entity or POPE[663].

As a consequence, in the example, A Co must reduce its Allocable Share by an amount equal to the portion that is brought to charge under the IIR applicable to B Co, or 14% (= B Co 20% x 70%). As a result, A Co's Allocable Share of the Top-up Tax is 700 (= 840 tentative Allocable Share – 140 offset). Hence, each Parent Entity's Allocable Share of the Top-up Tax of each LTCE and the amount offset can be summarized as follows:

	A Co	B Co	Non-Group	Total
Allocable Share of C Co Top-up Tax	840	200	100	1,140
Article 2.3 Offset	(140)	-	-	(140)
Allocable Share of D Co Top-up Tax	500	-	-	500
Total Top-up Tax Allocated	1,200	200	100	1,500

6.3. Identification of the remaining amount allocable under the UTPR

Following a backstop mechanism, low-taxed income beneficially owned by an UPE that is not charged under an IIR shall be subject to the UTPR[664]. The application of the UTPR in fact broadens the scope of the rules, and also the income of the LTCE attributable to minority shareholders ends up being burdened by the UTPR[665]. The UTPR may also be applicable in relation to Top-up Tax arising in relation to the low-tax outcomes in the UPE Jurisdiction. The UTPR is not applicable to a CE that is an Investment Entity[666].

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[662] GLOBE MODEL RULES, Art. 2.3.
[663] GLOBE MODEL RULES, Art. 2.3.
[664] GLOBE MODEL RULES, Art. 2.5.
[665] See, on this effect, ch. V, sec. 3.3.3.4.
[666] GLOBE MODEL RULES, Art. 2.4.3.

According to the UTPR mechanism, CEs of an MNE Group located in a jurisdiction implementing the GLOBE MODEL RULES shall be denied a deduction (or required to make an equivalent adjustment under domestic law) in an amount resulting in those CEs having an additional cash tax expense equal to the UTPR Top-up Tax Amount for the Fiscal Year allocated to that jurisdiction[667].

The Total UTPR Top-up Tax Amount for a Fiscal Year is defined as the sum of the Top-up Tax calculated for each LTCE of an MNE Group for that Fiscal Year, subject to three adjustments[668]. First, the Top-up Tax calculated for a LTCE is reduced to zero if all of the UPE's Ownership Interests in such LTCE are held directly or indirectly by one or more Parent Entities that are required to apply a Qualified IIR in the jurisdiction where they are located with respect to that LTCE for the Fiscal Year[669]. Second, the Top-up Tax calculated for a LTCE shall be reduced by a Parent Entity's Allocable Share of the Top-up Tax of that LTCE that is brought into charge under a Qualified IIR[670]. Third, the application of the UTPR is also limited in cases where the MNE is in its initial phase of international expansion[671].

The reference to one of the GLOBE EXAMPLES further elucidates the UTPR mechanism. Consider the following diagram on the structure of an MNE[672]:

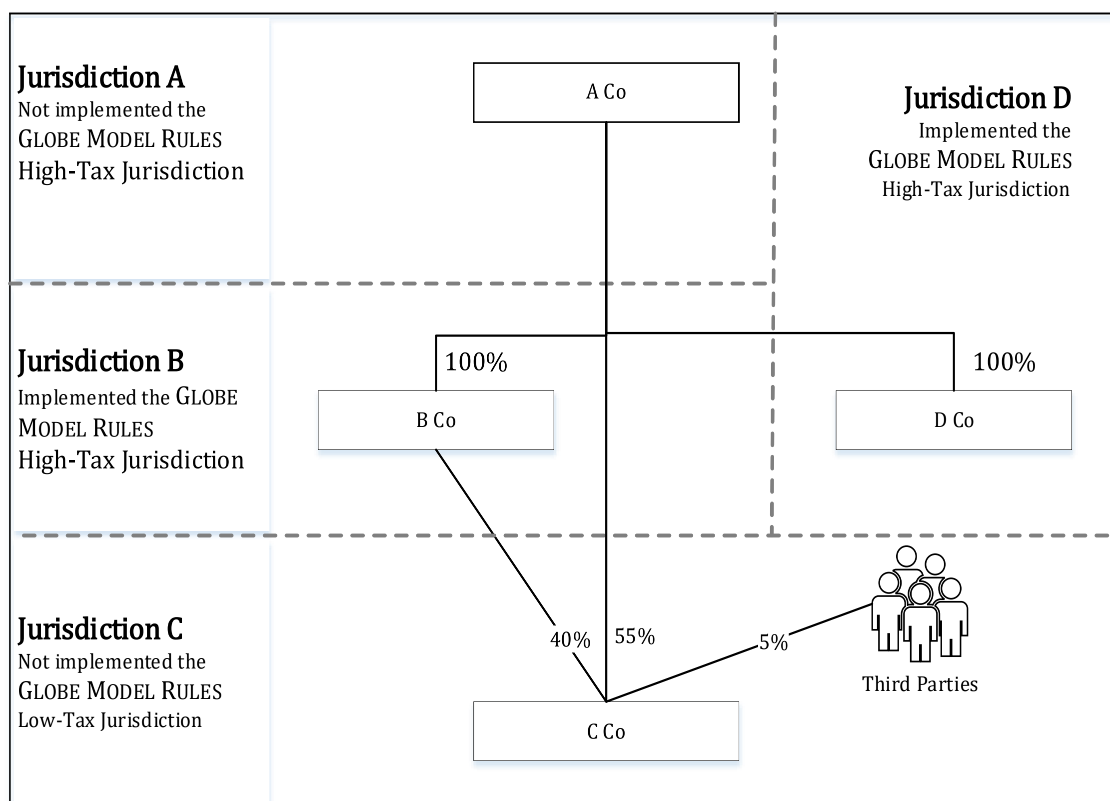

Figure 6: GloBE Example 2.5.3 – 1

[667] GLOBE MODEL RULES, Art. 2.4.1.
[668] GLOBE MODEL RULES, Art. 2.5.1. On the definition of Top-up Tax of a CE, see sec. 5.5, *supra*.
[669] GLOBE MODEL RULES, Art. 2.5.2.
[670] GLOBE MODEL RULES, Art. 2.5.3.
[671] GLOBE MODEL RULES, Art. 9.3.
[672] GLOBE EXAMPLES, Example 2.5.3 – 1.

In the example, it is further assumed that C Co is a LTCE and a Top-up Tax of 100 has been calculated to it.

B Co's Allocable Share of the Top-up Tax of C Co equals 40% and B Co is required to apply a Qualified IIR, being liable for a Top-up Tax of 40.

A Co is not required to apply a Qualified IIR. A Co holds 95% of C Co's Ownership Interest (40% indirectly via B Co and 55% directly). As a consequence, not all of A Co's Ownership Interest in C Co are held by a Parent Entity that is required to apply a Qualified IIR. Therefore, the UTPR Top-up Tax Amount must be calculated.

The Top-up Tax of 100 of C Co is reduced by the amount of B Co's Allocable Share of the Top-up Tax of C Co (40) to compute the UTPR Top-up Tax Amount that is allocated under the UTPR. The UTPR Top-up Tax Amount is 60 (= 100 – 40). The allocation of the UTPR Top-up Tax Amount among the UTPR Jurisdictions is performed under a formula that considers the Number of Employees and the total value of Tangible Assets held by the CEs in the UTPR Jurisdictions in the next step (sec. 6.4, *infra*). In the case at hand, the UTPR Top-up Tax Amount of 60 would be divided between B Co and D Co, according to their respective Number of Employees and the total value of Tangible Assets. Importantly, also the amount of Top-up Tax that would correspond to the 5% participation of the minority shareholders of the LTCE is burdened by the UTPR.

The GLOBE MODEL RULES also foresee a carry-forward mechanism for the UTPR Top-up Tax Amount. The UTPR shall apply to the extent possible with respect to the taxable year in which the Fiscal Year ends. In case the adjustment is insufficient to produce an additional cash tax expense for this taxable year equal to the UTPR Top-up Tax Amount allocated to the jurisdiction implementing the GLOBE MODEL RULES for the Fiscal Year, the difference shall be carried forward to the extent necessary to the succeeding Fiscal Years, being subject to the adjustment to the extent possible for each taxable year[673].

6.4. Setting the liability for residual Top-up Tax in the UTPR Jurisdictions

The right to impose the UTPR is allocated among the UTPR Jurisdictions by applying a two-factor allocation key based on (i) the total value of Tangible Assets ("**tvTA**") held and (ii) the Number of Employees ("**NE**") employed by all the CEs that are located in such UTPR Jurisdictions[674].

The UTPR Top-up Tax Amount allocated to the jurisdiction implementing the GLOBE MODEL RULES is determined by multiplying the Total UTPR Top-up Tax Amount by the jurisdiction's UTPR Percentage[675].

$$\text{UTPR Top-up Tax Amount of the jurisdiction} = \text{Total UTPR Top-up Tax Amount} \times \text{UTPR Percentage}$$

The UTPR Percentage of the jurisdiction implementing the GLOBE MODEL RULES is determined each Fiscal Year for each MNE Group according to the following equation[676]:

[673] GLOBE MODEL RULES, Art. 2.4.2.
[674] GLOBE MODEL RULES, Art. 2.6.
[675] GLOBE MODEL RULES, Art. 2.6.1.
[676] GLOBE MODEL RULES, Art. 2.6.1.

$$UTPR\ Percentage = 50\% \times \frac{NE\ in\ the\ jurisdiction}{NE\ in\ all\ UTPR\ jurisdictions} + 50\% \times \frac{tvTA\ in\ the\ jurisdiction}{tvTA\ Assets\ in\ all\ UTPR\ jurisdictions}$$

Where, for each Fiscal Year[677]:

(a) the NE in the jurisdiction is the total NE of all the CEs of the MNE Group located in the jurisdiction implementing the GLOBE MODEL RULES;
(b) the NE in all UTPR Jurisdictions is the total NE of all the CEs of the MNE Group located in a jurisdiction that has a Qualified UTPR in force for the Fiscal Year;
(c) the tvTA in the jurisdiction is the sum of the Net Book Values of Tangible Assets of all the CEs of the MNE Group located in the jurisdiction implementing the GLOBE MODEL RULES;
(d) the tvTA in all UTPR Jurisdictions is the sum of the Net Book Values of Tangible Assets of all the CEs of the MNE Group located in a jurisdiction that has a Qualified UTPR in Force for the Fiscal Year.

For the purpose of calculating the UTPR Percentage, NE and the Net Book Value of Tangible Assets held by an Investment Entity are excluded from the formula[678]. In case of a Flow-Through Entity, provided that they are not allocated to a PE, NE and the Net Book Value of Tangible Assets shall be allocated to the CEs (if any) in the jurisdiction where the Flow-Through Entity was created. If they are not allocated neither to a PE nor to a CE, they shall be excluded from the formula[679].

7. INTERIM CONCLUSIONS: *HOW DO THE GLOBE MODEL RULES BURDEN?*

The GLOBE MODEL RULES provide for a very complex mechanism to ensure a floor to tax competition. They essentially sets forth two interlocking domestic rules, which complement each other (the IIR and the UTPR), ultimately aiming at ensuring that no Top-up Tax remains unallocated, thus enforcing the taxation of GLOBE Income that would otherwise be taxed below the ETR.

In doing so, the GLOBE MODEL RULES deal with several concepts and realities, which are often incompatible from a theoretical point of view. The descriptive nature of the chapter does not allow for a critical approximation of such concepts and realities, but it gives a clear view of the challenges involved in the systematization of the GLOBE MODEL RULES.

The GLOBE MODEL RULES make reference to a multitude of subjects. While it starts with the notion of MNE Group, it further creates the notion of jurisdictional blending, triggering the Top-up Tax only if the blended Entities in a jurisdiction are subject to taxation below the ETR. After the Top-up Tax is triggered, the GLOBE MODEL RULES provide for the determination of the Top-up Tax to each of the CEs, thus abandoning the blending and the broader reference to the Group, to embrace the notion of separate entity.

The GLOBE MODEL RULES also build their own object. The starting point for calculating the GLOBE Income or Loss is the Financial Net Income or Loss of a CE, being

[677] GLOBE MODEL RULES, Art. 2.6.1.
[678] GLOBE MODEL RULES, Art. 2.6.2(a).
[679] GLOBE MODEL RULES, Art. 2.6.2(b).

determined, as a rule, by reference to the Consolidated Financial Statements of the UPE before any consolidation adjustment. The relevant provisions further provide for adjustments, which create book-to-tax differences, considered "common" within IF jurisdictions[680]. They build on the notion of a "typical CIT"[681] to construct a "common tax base"[682] for the GLOBE MODEL RULES. The determination of the Adjusted Covered Taxes is also very peculiar, being constructed with reference to the ultimate goal of the GLOBE MODEL RULES, which is to establish an enforceable floor to tax competition. The need to protect or maintain "the integrity" of the GLOBE MODEL RULES is repeated several times along the GLOBE COMMENTARY and is evoked in relation to specific rules.

The GLOBE MODEL RULES are also very detailed on spatial aspects. The rules related to the location of the CEs are fundamental to determine whether the ETR has been achieved in each jurisdiction – and thus to trigger the Top-up Tax. The identification of the location of the CEs deviates from the location of the CE which will charge the IIR and the UTPR. In order to enforce the floor to tax competition, the allocation of the Top-up Tax under the IIR and the UTPR ensures the taxation of income of the CE in a way that does not follow from the location of the LTCE. It creates a right to a jurisdiction to tax income arising in another jurisdiction. The IIR allocates Top-up Tax to a jurisdiction which is different from that of the LTCE, solely on the basis of Ownership Interests. The UTPR allocates Top-up Tax to a jurisdiction which is different from that of the LTCE, even though in the jurisdiction charging the UTPR there is no CE with Ownership Interests on the LTCE.

Finally, the GLOBE MODEL RULES also have a clear need to draw on temporal elements. Such rules aim not only at attributing revenues and expenses to a certain calendar-year and dealing with the complications of periodization, as all CITs are expected to do. The GLOBE MODEL RULES also present additional challenges, as they aim to prevent the taxation of jurisdictionally blended Entities at a level below the ETR in every Fiscal Year. Therefore, they also have to deal with situations where the Top-up Tax could not be charged in a Fiscal Year and must be carried forward, as well as to provide for mechanisms to deal with adjustments to a past Fiscal Year where necessary.

[680] GLOBE COMMENTARY, p. 46, para. 17.
[681] GLOBE COMMENTARY, p. 47, para. 20.
[682] GLOBE COMMENTARY, p. 47, para. 21.

CHAPTER III
THE SUBJECTS OF THE GLOBE MODEL RULES

1. INTRODUCTION: BETWEEN LEGAL PERSONS AND ENTERPRISES

Two main approaches on the definition of subjects have coexisted and shaped the debate on CIT[683]. On the one hand, the traditional consideration of separate entities, grounded on long-standing private law fictions and dependent on the ALS. On the other hand, an approach still in search for theoretical foundations, which aims at describing the enterprise as a unitary business and that, in its purest form, completely disregards the private law fictions and calls for a formulary allocation of taxing rights.

The separate entity doctrine has already been described as "the dominant principle in corporate tax law"[684]. Despite this dominance, the definition of corporate subjects varies greatly among states. Due to the existence of miscellaneous criteria, it would be "nearly impossible to identify a theoretical rationale for most domestic systems"[685]. The so-called "enterprise doctrine", on the other hand, despite having its roots in the beginning of the last century, has not yet obtained consensus on its exact contours and purpose. The nature of the "enterprise" has evolved significantly in the last decades – and so have the discussions on its description for CIT purposes.

The GLOBE MODEL RULES make several policy choices with regard to the definition of the relevant tax subjects. MNE Group, Entities, Constituent Entities, Permanent Establishment are all defined terms. In doing so, the GLOBE MODEL RULES are not immune to the very same theoretical problems that surround the separate-entity doctrine and the enterprise doctrine. Therefore, in order to properly discuss the justification and the design of the subjects in the GLOBE MODEL RULES, the present chapter is structured as follows.

Sec. 2 presents the main definitional challenges of the separate-entity doctrine. The main purpose of the section is to describe the multitude of criteria used by states to define the subjects of CIT. The section concludes by evidencing that one cannot find a general theory on the topic and that the experience of countries evidences that the domestic systems are, in some cases, not even internally consistent, thus explaining the preference for listing among countries.

Sec. 3 draws on the experience of domestic legislations and case law to evaluate the definitional challenges inherent to the enterprise doctrine. After examining the legal justifications for treating the unitary business as a single entity, the section discusses both the "economic" and the "legal" criteria to define a group for CIT purposes, evidencing the advantages and shortcomings of each policy choice.

[683] Yuri Biondi, "The Firm as an Enterprise Entity and the Tax Avoidance Conundrum: Perspectives from Accounting Theory and Policy," *Accounting, Economics, and Law: A Convivium* 7, no. 1 (May 24, 2017): sec. 1.
[684] Ting, *The Taxation of Corporate Groups*, 14.
[685] Daniel Gutmann, "General Report," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 4.

Sec. 4 discusses the subjects of the GLOBE MODEL RULES. It examines, in sec. 4.1., the definition of MNE Group, contrasting it with the discussion on the enterprise doctrine. The analysis allows for a critical consideration of the dogmatic choices embedded in the rules. In sec. 4.2., the definition of CE is discussed, benefiting from the conclusions regarding the separate-entity doctrine.

Finally, sec. 5 discusses the justification of the subjects in the GLOBE MODEL RULES. It evidences that the GLOBE MODEL RULES are not intended to provide for an equal treatment of MNE Groups or of CEs. By making a policy choice for jurisdictional blending, the GLOBE MODEL RULES in fact set the establishment of a floor to tax competition as a superior goal, which supersedes the equal treatment of any of the subjects described.

2. THE SEPARATE-ENTITY DOCTRINE

Despite the significant theorization on the justification of the CIT[686], and the fundamental importance of the separate-entity doctrine for CIT[687], there is very little convergence as to who is the corporate taxpayer[688]. The discussion of the justification of CIT is full of simplifications, and this becomes very clear when the CIT subjects are investigated in more detail[689]. Dogmatic approaches to the definition of CIT subjects vary significantly across states, and it does not seem possible to derive a general theory on the topic. In fact, most systems do not seem to be even internally consistent, and a multitude of criteria may apply for identifying the CIT subjects[690]. It is hard to find a country that consistently adhere to one general criterion[691].

There are indeed interesting proposals with this regard. L'HOTELLERIE-FALLOIS and BORREGO maintain that, if CIT has a withholding function[692], then it is necessary that income attributable at the level of the entity can be separated from the attribution of income to the members. This separation would only occur in the case of a corporation, since in the case of partnerships it is easier to attribute income directly to the partner. In the case of limited partnerships divided into shares, the application of this approach would determine partial transparency of the entity in connection to the part of income that is attributed to the general partner. Practical concerns would, on the other hand, justify full opacity of the entity[693]. The reality of the systems is, however, much more complex and deviates significantly from these general schemes. Not all systems rely on the distinction between corporations and partnerships, and a multitude of criteria may apply. General criteria may be identified, but they are not consistently applied throughout the systems,

[686] See ch. I, sec. 2 and 3, *supra.*
[687] Referring to the separaton as the "guiding principle" (*Leitprinzip*) of the taxation of corporate entities, see Frederik Schildgen, "Subject 1: Group approach and separate entity approach in domestic and international tax law," *Internationales Steuerrecht*, 2022, 554.
[688] Gutmann, "General Report," 1.
[689] A detailed analysis of a specific system is not the object of the section, which is merely intended to provide for a policy overview and allow for a more substantive analysis in sec. 4. For an in-depth comparison between the German, Dutch an US systems, see Ruben Martini, *Der persönliche Körperschaftsteuertatbestand* (Tübingen: Mohr Siebeck, 2016).
[690] Gutmann, 1-3.
[691] L'Hotellerie-Fallois and Borrego, "Legal Personality, Limited Liability and CIT Liability," 20.
[692] See ch. I, sec. 2.4, *supra.*
[693] See L'Hotellerie-Fallois and Borrego, "Legal Personality, Limited Liability and CIT Liability." (p. 34).

and important deviations may be found. Following the classification proposed by GUTMANN, legislations may resort to both "abstract" and/or "concrete" criteria.

2.1. Abstract criteria

The abstract criteria are those drawn from general legal principles or concepts, and seem to be prevalent amongst the legal systems[694]. While in several countries legal personality is presented as a condition for CIT liability, in other countries, limitation of liability is the definitive element[695]. It is also possible that tax legislation builds upon existing distinctions in company law, such as the difference between a partnership and a company[696].

2.1.1. Legal personality

From its very beginning, corporation law deemed each corporation as an independent legal entity with its own rights and duties, separate and distinct from its shareholders[697]. From a tax law perspective, legal personality has been taken as a criterion for taxing legal persons, under the so-called "legal personhood theory", according to which legal persons are understood as separate "beings" from the individuals which form them[698]. The lack of support to such theory is evidenced by the practical experience of countries[699]. In the EATLP comparative study on the topic, Russia was identified as the only country strictly adopting the legal personality criterion[700] and no other example of pure adherence to legal personality has been found among the nineteen jurisdictions that have been covered[701].

As a rule, despite resorting to legal personality as a criterion to define CIT liability, tax systems will often deviate from a strict adoption, either extending the subjective scope of the CIT to entities that are not legal persons (positive deviations), or setting forth that some entities, despite bearing legal personality, are transparent for tax purposes (negative deviations)[702]. In such systems, the definition of the CIT subject is "closely, but not exclusively, linked to the legal personality of the taxpayer"[703]. Even in systems where legal personality is the prevailing element for CIT liability, some entities that do not have its own legal personality are obliged to pay CIT[704].

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[694] Gutmann, "General Report," 2.
[695] See L'Hotellerie-Fallois and Borrego, "Legal Personality, Limited Liability and CIT Liability."
[696] See, *e.g.,* Theodore Fortsakis and Andreas Tsourouflis, "Greece," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 303–12.
[697] Phillip Blumberg, "The Transformation of Modern Corporation Law: The Law of Corporate Groups," *Connecticut Law Review* 37, no. 3 (2005): 606.
[698] L'Hotellerie-Fallois and Borrego, "Legal Personality, Limited Liability and CIT Liability," 20.
See L'Hotellerie-Fallois and Borrego, 22; Danil Vinnitskiy, "Russia," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 431–42.
[700] Vinnitskiy, "Russia," 431–42.
[701] L'Hotellerie-Fallois and Borrego, "Legal Personality, Limited Liability and CIT Liability," 22.
[702] L'Hotellerie-Fallois and Borrego, 22.
[703] See Johannes Heinrich and Claudia Slawitsch, "Austria," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 195. Similarly, see Marc Bourgeois, Bart Peeters, and Xavier Pace, "Belgium," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 208–10; Søren Friis Hansen and Jacob Graff Nielsen, "Denmark," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 231.
[704] See, *e.g.,* Hans Arts, "Netherlands," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 365–84.

2.1.1.1. Positive deviations

An important example of positive deviation is the inclusion of pools of assets as CIT subjects[705]. In Spain, pension funds, investment funds and other similar funds are taxed by CIT[706], whereas in Switzerland real estate investment funds are treated as CIT subjects[707]. Sweden also includes some investments funds as CIT subjects[708], despite the absence of legal personality of such entities. In Austria, societies, institutions, foundations and other special-purpose funds that do not have legal capacity are taxable subjects if no other taxable person is taxed on that income[709].

2.1.1.2. Negative deviations

An example of negative deviation is the exclusion of partnerships in some systems, even if they are treated as legal persons by private law. In Spain, civil law partnerships may have legal personality, but are even though not subject to CIT[710]. Similarly, in Sweden, partnerships and estates of deceased persons are excluded from CIT, despite having legal personality[711].

It is important to note that private law may also vary across countries on the attribution of legal personality to some entities. In such cases, the fact that some entities are not subject to CIT follows from private law. In the case of Poland, the exclusion of partnerships as CIT subjects is grounded on the fact that they lack legal personality in that system[712]. In Austria[713] and Germany[714], partnerships are not subject to CIT due to the lack of legal personality, despite having legal capacity to a certain extent[715]. In the German system, limited partnerships divided by shares ("*Kommanditgesellschaften auf Aktien*") have legal personality and the German CIT provides for partial transparency at the level of the general partner. A similar treatment is found in Italy, where partnerships other than limited partnerships divided by shares, do not have legal personality and are not liable to CIT[716].In Denmark, there is a historical reason why partnerships are not subject to CIT, closely linked to the civil law treatment of such entities. Even though case

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[705] See, *e.g.*, Francisco de Sousa da Câmara, Nuno de Oliveira Garcia, and José Almeida Fernandes, "Portugal," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 411–30; Stefan Olsson, "Sweden," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 467–86; Benn Folkvord, "Norway," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 385–98.
[706] See Álvaro de la Cueva González-Cotera and Adrián Arroyo Ataz, "Spain - Corporate Taxation," in *Country Tax Guides IBFD* (Amsterdam: IBFD, 2021), 447–48.
[707] Pierre-Marie Glauser, "Switzerland," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 494.
[708] See Olsson, "Sweden," 478.
[709] See Heinrich and Slawitsch, "Austria," 195.
[710] Domingo Jesús Jiménez-Valladolid de L'Hotellerie-Fallois and Félix Alberto Vega Borrego, "Spain," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 449–50.
[711] See Olsson, "Sweden," 478.
[712] See Hanna Litwińczuk and Karolina Tetłak, "Poland," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 402.
[713] See Heinrich and Slawitsch, "Austria," 191–95.
[714] See Ruben Martini, "Germany," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 287–92.
[715] See Martini, 287–92.
[716] See Luca Di Nunzio et al., "Italy," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 360.

law currently acknowledges that a partnership and a limited partnership are separate legal entities, when the first rules on CIT were introduced in 1903, a partnership was not considered to be a separate legal entity for civil law purposes[717].

2.1.2. *Limitation of Liability*

The second abstract criterion commonly seen in tax legislation is limitation of liability. Despite being one of the building blocks of the modern economy, it is a much more recent phenomenon than the legal personality[718]. In the early nineteenth century, with the perception that shareholders were increasingly not managers, but mere investors, came the political decision to limit their liability, and some countries make reference to the limitation of liability to determine whether an entity is subject to CIT[719].

L'HOTELLERIE-FALLOIS and BORREGO propose a classification with three possible approaches to the limited liability criterion[720]. Under the first approach, only if all members have limited liability is the entity subject to CIT. If even one of the members is subject to personal liability for debts of the entity, the entity is then treated as transparent[721]. Under the second approach, countries base the liability to CIT on the distinction between corporations and partnerships, and only entities whose structure corresponds to that of corporations are subject to CIT (being the limited partnerships divided into shares regarded as corporations for this purpose)[722]. Under the third approach, entities with both limited and unlimited partners are subject to partial transparency at the level of the general partner who will be taxed directly on the income attributed, while the entity is taxed as a CIT subject on the income attributable to limited partners[723]. The classification is full of caveats, as countries present significant deviations from the pure models. However, it remains useful to illustrate the multitude of possible approaches regarding the topic, as well as the challenges of theorization on the topic.

2.2. *Concrete criteria*

The concrete criteria, on the other hand, are those that rely on individual characteristics of entities, being an expression of a "more fact-sensitive approach"[724]. In Luxembourg, the leading criterion for CIT liability combines the entrepreneurial risk of the partner and a collegial running of the undertaking, and the actual features of the entity may impact its treatment for tax purposes[725]. Also the French legislation submits a civil partnership to

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[717] Hansen and Nielsen, "Denmark," 234.
[718] Blumberg, "The Transformation of Modern Corporation Law," 607.
[719] L'Hotellerie-Fallois and Borrego, "Legal Personality, Limited Liability and CIT Liability," 20.
[720] The classification is inspired in the one provided in L'Hotellerie-Fallois and Borrego, 22. (p. 24)
[721] This approach would be generally found in Nordic countries, despite significant deviations. For further detail on these regimes see Raimo Immonen and Jaakko Ossa, "Finland," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 247–48; Hansen and Nielsen, "Denmark," 225–30; Folkvord, "Norway," 388–91.
[722] This approach would be generally found in Luxembourg and Turkey, despite the important deviations. For further detail on these regimes, see Alain Steichen, "Luxembourg," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 355–57; Funda Başaran Yavaşlar, "Turkey," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 519–20.
[723] The only example of this approach (also with important deviations) would be the Netherlands. See Arts, "Netherlands," 374–75.
[724] Gutmann, "General Report," 2–3.
[725] See Steichen, "Luxembourg."

personal income tax as a rule, but to CIT if the partnership performs commercial activities[726]. Other systems seem to enthrone the carrying out of a business and therefore rely on the nature of the activities carried out[727].

2.3. Specific provisions for public (non-profit) entities

It is also frequent among countries to apply specific provisions to public (non-profit) purpose entities. There is, however, no common definition of public purpose among countries, and even within a system the issue may be controversial. In some countries a non-profit purpose is not sufficient and a public benefit must also be present[728]. Other systems go even further and make a distinction between public and charitable purposes[729]. These distinctions are ultimately contingent on the role played by initiatives from civil society in the welfare state, and may vary significantly in each legal tradition.

Besides the definition of public purpose, another problem is the extent to which the income of such entities is exempted from CIT[730]. Some entities also perform ancillary activities, which are distinct from the main activity, related to the public or charitable purpose. In such cases, tax systems diverge with respect to the treatment of the income from such ancillary activities. Three alternatives are generally possible with this regard: (i) taxing income from any for-profit business or economic activity; (ii) taxing activities exercised in competition with private (for-profit) purpose entities; and (iii) exempting also the income from ancillary activities, provided that some conditions are met.

In the first case, any "for-profit"[731], "lucrative"[732], "business"[733], "economic"[734], or "commercial"[735] activity, exercised by the entity will be subject to CIT[736], regardless of the subsequent application of the income to the public or charitable purpose. In the second case, only income from activities exercised in competition with private (for-profit) purpose entities is taxed[737]. This approach is based on the protection of competition and may be of particular importance within the EU[738]. Finally, there are also countries that exempt income from ancillary activities, provided that some conditions are met. Such conditions may include the prohibition of gain for the management of the entity, and/or an obligation to destine part or the total of the income earned in the ancillary activity to the public purpose activity. A maximum limit of exempted profits is also common. In

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[726] See Polina Kouraleva-Cazals, "France," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 255–79.
[727] Portugal and Hungary are mentioned as examples of this approach. See Éva Erdős, Petra Mihályi, and Máté Lakatos, "Hungary," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 317–19; Câmara, Garcia, and Fernandes, "Portugal," 415–21.
[728] See Kouraleva-Cazals, "France," 265–69.
[729] Polina Kouraleva-Cazals, "Atypical Entities and the Personal Scope of the Corporate Income Tax," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 77. Specifically on the Austrian rules, see Heinrich and Slawitsch, "Austria," 196.
[730] Kouraleva-Cazals, "Atypical Entities and the Personal Scope of the Corporate Income Tax," 78–81.
[731] See Vinnitskiy, "Russia," 434–39; Fortsakis and Tsourouflis, "Greece," 308.
[732] Bourgeois, Peeters, and Pace, "Belgium," 213.
[733] See Immonen and Ossa, "Finland," 249; Arts, "Netherlands," 368–79.
[734] Kouraleva-Cazals, "Atypical Entities and the Personal Scope of the Corporate Income Tax," 78.
[735] See Martini, "Germany," 293–94.
[736] Discussing the terminological differences, see Kouraleva-Cazals, "Atypical Entities and the Personal Scope of the Corporate Income Tax," 78–79.
[737] Kouraleva-Cazals, "France," 265–69; Hansen and Nielsen, "Denmark," 238.
[738] Kouraleva-Cazals, "Atypical Entities and the Personal Scope of the Corporate Income Tax," 79.

France, a "disinterested management" requirement applies, and the exemption of incidental for-profit activities is limited to EUR 60,000 per year. In the Netherlands, entities that are not authorized, by law, to distribute profits to their members or other parties are exempt from CIT if their profits do not exceed EUR 15,000 or EUR 75,000 per year[739]. In Portugal, for the exemption to apply, 50% of any taxable income must be applied in an activity furthering the statutory purpose and no gain for the entity's managers is allowed[740]. In Poland, the exemption is subject to the use of all income earned only for purposes of the statutory activity[741]. In the United States, more broadly, charitable organizations lose their exemption if any part of their earnings serves a private benefit[742]. In Sweden, charities are exempt from CIT on all of their investment income, as well as on any non-business income, and only charities specifically mentioned can be subject to CIT on real estate income[743]. In Austria, income derived by such entities from running a business is taxable, except when the business is necessary to reach the charitable goals of the corporation[744].

2.4. Summary: the preference for listing

One cannot find a consistent general theory, adopted by all states, on the definition of CIT subjects following the separate entity doctrine. Countries often present "an accurate and comprehensive list" of entities that are subject to CIT[745]. Listing is the easiest way to define the scope of CIT, which implies giving up on the ideal of a general theory on CIT liability. The preference for listing among countries, for the purpose of defining CIT liability, is therefore grounded on a perceived structural limitation to a general theory on the topic[746]. At the end of the day, the preference for listing is an acknowledgement of the inability of general criteria, either abstract or concrete, to provide for a comprehensive account of the tax subjects, thus turning the academic effort to construct a general theory into an "ex post rationalization"[747]. In practice, the general criteria mostly operate in the form of umbrella clauses within lists, and therefore work "as a tool to close potential tax gaps rather than as a principle statement intended to reflect the real nature of CIT subjects"[748].

3. THE ENTERPRISE DOCTRINE

As the world economy today is dominated by complex multi-tiered structures[749], the existence of corporate groups poses challenges to the separate-entity doctrine. The reference to corporate entities is in a certain sense reductionist and misses fundamental contents of the firm's economic nature[750]. A growing number of areas of legislation are now supplemented by the enterprise doctrine, focusing on the business enterprise as a

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[739] Kouraleva-Cazals, "France," 265–69.
[740] Câmara, Garcia, and Fernandes, "Portugal," 422–23.
[741] Litwińczuk and Tetłak, "Poland," 404–7.
[742] Henry Ordower, "United States," in *Corporate Income Tax Subjects*, vol. 12, EATLP International Tax Series (Amsterdam: IBFD, 2015), 572–73.
[743] Olsson, "Sweden," 479–80.
[744] See Heinrich and Slawitsch, "Austria," 196.
[745] Hansen and Nielsen, "Denmark," 229; Immonen and Ossa, "Finland," 246.
[746] Gutmann, "General Report," 6.
[747] Gutmann, 6.
[748] Gutmann, 6.
[749] Blumberg, "The Transformation of Modern Corporation Law," 608.
[750] Yuri Biondi, Arnaldo Canziani, and Thierry Kirat, "Coming Back to the Enterprise Entity," in *The Firm as an Entity*, ed. Yuri Biondi, Arnaldo Canziani, and Thierry Kirat (London: Routledge, 2007), 3.

whole, instead of on its component parts[751]. Also from a private law perspective, the reference to individual corporations as the basic legal unity has been described as "anachronistic and dysfunctional"[752]. The reference to the corporate entity is increasingly being substituted by doctrines which tend to focus on the business enterprise as a whole[753]. The adoption of the enterprise doctrine has served as a response of the legal system to deal with the problems of modern economy, where the traditional legal entity concept has proven to fail[754].

In CIT this trend is very clear. Legislations which treat the group as a taxable entity could already be found in the beginning of the last century, but they are now increasingly fashionable. Both the harmonization proposals within the EU[755] and the OECD Pillars contain definitions of a tax group for CIT purposes. In the international context, some authors go as far as claiming that "all serious reform efforts entail the adoption of unitary taxation"[756].

This section addresses the justification and the definitional challenges involved in treating the group as a taxable entity. After presenting a brief overview of economic theories on firm structures (sec. 3.1), the section presents the main legal justifications (sec. 3.2) for a group approach in CIT. The center of the section is the analysis of the definitional challenges in tax law (sec. 3.3), with particular reference to the so-called "economic" (sec. 3.4) and "legal" (sec. 3.5) criteria. As a summary of the section, the limitations of a strictly legal definition of group are discussed, while acknowledging its superior certainty features, when compared to economic criteria.

3.1. Enterprise and firm theory

The theoretical and analytical interest in the firm emerged at the beginning of the last century, as the nature and extent of the economic transformation under way were noticed[757]. Since then, the field has significantly evolved and there is a wide variety of concepts and theories about the firm, each focusing on certain aspects that are more significant for the approach. Already in the 1960s, MACHLUP identified 21 different theories of the firm[758]. Such theories make use of different theoretical lenses to address specific problems.

In each of these approaches, the definition of firm is essentially contingent on the problem with which the theorization aims at dealing[759]. For instance, neoclassical approaches were

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[751] Ting, *The Taxation of Corporate Groups*, 16.
[752] Blumberg, "The Transformation of Modern Corporation Law," 608. Referring to a "crisis" of legal persosn, see Fábio Konder Comparato and Calixto Salomão Filho, *O Poder de Controle na Sociedade Anônima*, 6th ed. (Rio de Janeiro: Forense, 2014), para. 99.
[753] Blumberg, "The Transformation of Modern Corporation Law," 605.
[754] Blumberg, 614.
[755] See, *e.g.* European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final (25 Oct. 2016), Art. 5(1). The "BEFIT" proposal will also include a group definition.
[756] Picciotto and Kadet, "The Transition to Unitary Taxation," 460.
[757] Biondi, Canziani, and Kirat, "Coming Back to the Enterprise Entity," 3.
[758] Fritz Machlup, "Theories of the Firm: Marginalist, Behavioral, Managerial," *The American Economic Review* 57, no. 1 (n.d.): 1–33.
[759] See, however, Romero Tavares, "Multinational Firm Theory and International Tax Law: Seeking Coherence," *World Tax Journal* 8, no. 2 (2016): 273. (considering that "*[a] unified knowledge-based*

mainly concerned with the determination of prices and quantities in markets, treating the firm as a production unit, equated to a "black box"[760]; contracting theories examine the choice of governance mechanism for exchanges[761]; resource theories tend to focus on the analysis of competitive advantage and the process of firm growth[762]. One can further speak of knowledge-based theories[763], strategic management theories[764], and so on[765]. Within these theories, a multitude of explanations for different firm structures may be found. Firm theories have presented several reasons for horizontal integration, vertical integration, as well as for simple diversification of activities within the firm[766].

A horizontally integrated group produces broadly the same line of goods in each geographic market where it operates. Horizontally integrated firms are common in domestic industries with fragmented local markets, and may also appear in a multinational context, by establishing subsidiaries in different countries to make the same or similar goods, intended for local selling. Classic examples in this case would be supermarket chains, bakeries and brewing companies. Contractual theories will in this case look for a governance or transaction-cost advantage to placing the subsidiaries under common administrative control. Horizontal integration will only exist if the controlled subsidiaries attain lower costs or higher revenue productivity than under separate managements. This advantage will often be explained by reference to a proprietary asset[767], which allows the firm to be more efficient than the competitors, thus contributing to its expansion.

A vertically integrated group produces outputs in some of its subsidiaries which serve as inputs to its other activities. A classic example of vertical integration is an aluminium smelter, which also controls the bauxite mine (raw ore) and the process of converting bauxite to alumina (output of the first processing stage)[768]. Contractual theories examine the costs and benefits of vertical integration, by comparing it to a scenario where the

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approach, which builds upon Knightian and Coasian theories of the firm and incorporates elements of the agency theory, seems to substantiate the 'state of the art' in the understanding of multinational firms").

[760] For an overview of the importance of the approach for microeconomics, see Manuel Becerra, *The Theory of the Firm for Strategic Management* (Cambridge: Cambridge University Press, 2009), 11–13.

[761] Ronald Coase, "The Nature of the Firm," *Economica* 4, no. 16 (1937): 486. Transaction-cost economics and other contractual perspectives are essentially theories of investment incentives, aimed at explaining firm ownership. See Becerra, *The Theory of the Firm for Strategic Management*, 253.

[762] See e.g., Valentina Corte et al., "The Role of Resource-Based Theory in Strategic Management Studies: Managerial Implications and Hints for Research," in *Handbook of Research on Competitive Strategy*, ed. Giovanni Battista Dagnino (Cheltenham: Edward Elgar Publishing, 2012), 109–46.

[763] Robert Grant, "Toward a Knowledge-Based Theory of the Firm," *Strategic Management Journal* 17, no. 10 (1996): 109–22.

[764] See e.g., Becerra, *The Theory of the Firm for Strategic Management*.

[765] See also Biondi, Canziani, and Kirat, "Coming Back to the Enterprise Entity," 6. (describing the firm as a dynamic system of interactions, interdependencies and complementarities, which is not fully explained by contracts and bargaining). Accordingly, the "economic theory of the firm as an entity" is aimed as comprehending the entity as "the actual economic coordination set up by the management system – especially through the implementation of a working organization", at the same time that it copes with the "ongoing economic process that accounting represents and helps to govern".

[766] Firms will often combine horizontal and vertical integration. A subsidiary may, for instance, organize a distribution system for a specific market, and have its line of goods consisting not only of its own products, but also of products bought from a parent or other entities of the group. On data related to the combination of vertical and horizontal integration, see Richard Caves, *Multinational Enterprise and Economic Analysis*, 3rd ed. (Cambridge: Cambridge University Press, 2007), 21–22.

[767] Such proprietary assets could be a brand or trademark, marketing and selling skills, patented process or design, know-how, among others. For an in-depth analysis of such assets, see Caves, 3–5.

[768] Caves, 15.

transactions are performed externally through the market[769]. Seeking efficiency in a scenario of opportunism and bounded rationality, firms are likely to internalize transactions that are more frequent, highly specific, complex, and uncertain. Economies of scale and other purely technological reasons may also contribute to the decision to internalize certain transactions. Knowledge-based explanations for vertical integration also include references to market power. Vertical integration is able to assure supply and/or demand for the firm, mitigate bargaining power and input cost distortions, elevate entry barriers, and enhance the ability to differentiate[770].

A third type of firm is found in cases of a diversified group, whose companies outputs are neither vertically nor horizontally related to one another[771]. Firms may expand and diversify, putting under the same control a multitude of business units, which present very low or no integration at all among themselves, commonly by means of holding structures. Firm theory also offers economic explanations for such structures that are less dependent on integration.

Firstly, also with a low level of integration, economies of scope may be explored. Even businesses which are clearly unrelated may benefit from some level of sharing of back-office activities, for example. Lower technology and administration costs may be obtained by merging related businesses, thus becoming a critical reason for diversification and aggregation within the group boundaries of different types of resources to conduct activities in several arenas. The knowledge-based view of the firm also brings further explanations for diversification[772]. Knowledge and innovation have been regarded as important reasons for engaging in multiple unrelated activities. By putting diverse resources and businesses under the same control, it may be possible to expand the potential to develop new knowledge. Hence, firms will often get into other areas in order to increase their stock of available skills and potentially achieve further growth. Besides, a firm's R&D activities often produce proprietary assets which are useful outside the initial industry of the firm, which might promote diversification and incentivize acquisitions[773].

At the lowest level of integration, lies simple diversification. Even diversification among unrelated businesses could result in lower cost of capital, better allocation and control of financial resources, as well as risk reduction[774]. Considering that a large firm is in general able to obtain funds under better conditions than a smaller firm, diversification may result in lower capital cost. The availability of information may also bring financial advantages with the ability to account for the benefits of diversification. The informational advantages of a corporate office over external capital markets may improve the capital allocation and the control of financial resources. A more stable cash flow can be obtained by shifting operations from one business to another, as a response to business cycles, thus reducing risks within the firm[775]. Additional reasons may be found in the case of MNEs.

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[769] Becerra, *The Theory of the Firm for Strategic Management*, 187–88.
[770] Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980).
[771] Caves, *Multinational Enterprise and Economic Analysis*, 22–27.
[772] See e.g., Grant, "Toward a Knowledge-Based Theory of the Firm," 109.
[773] Caves, *Multinational Enterprise and Economic Analysis*, 26.
[774] Jay Barney, *Gaining and Sustaining Competitive Advantage* (Harlow: Addison-Wesley, 1997).
[775] See Caves, *Multinational Enterprise and Economic Analysis*, 22–23.. Critically, however, see Becerra, *The Theory of the Firm for Strategic Management*, 180.(arguing that "[r]educing risk without any positive

The expansion of the activities to a multinational level brings diversification gains, arising from geographical diversification, which bears the potential of risk spreading[776].

It is important to mention that, within a firm, it is also possible that different levels of integration are combined. When seeking for the benefits of diversification, firms may do so through "selective intervention"[777]. Business units are left as virtually independent (replicating market mechanisms), in cases where there are few benefits for greater integration, while the benefits of integration are exploited where they may be present[778].

3.2. Enterprise and the ability-to-pay

The economic theories are descriptive, rather than normative. Empirical and descriptive assertions can also be relevant for the normativity, as legal rules are intended to regulate the economic reality, and this function can only be performed if an appropriate description of the economic facts is taken into account[779]. Therefore, if tax law intends to capture the enterprise as an economic reality, an appropriate description of the reality of economic groups is essential[780].

However, while approaching the economic theories, it is important to understand why they are relevant for tax law, i.e., which objectives the "deviation"[781] from the separate entity approach is intended to achieve. There is a wide range of legal scholarship dealing with the relationship between firm theory and the allocation of taxing rights[782], which is a different approach than the one intended in the present section. The treatment of the group as a taxable subject is based on two interconnected justifications: the ability-to-pay principle and the neutrality of forms[783].

As seen, for CIT purposes, the ability-to-pay of legal persons is generally recorded separately for each taxable entity, and the income of corporations is subject to separate taxation. The question is whether the separate entity approach should also be valid without special regulations for corporations that function as an economic unit. Group

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effect on operations or lower cost of capital does not add value and it does not make the firm more competitive or profitable").

776 Summarizing the statistical data on the financial benefits of multinationality, see Caves, *Multinational Enterprise and Economic Analysis*, 22–24. See also Peter Buckley and Mark Casson, *The Economic Theory of the Multinational Enterprise* (London: Macmillan, 1985), 11.

777 Oliver Williamson, *Markets and Hierarchies* (New York: Free Press, 1975). Discussing the topic, see Jacques Crémer, "Solving the 'Selective Intervention' Puzzle," *Revue d'économie Industrielle*, no. 129–130 (2010): 43–56.

778 See Comparato and Salomão Filho, *Poder de Controle*, para. 41. (treating the cummulative centralization of control and descentralization of administration as one of the benefits of a holding structure).

779 See Ulrich Palm, *Person im Ertragsteuerrecht* (Tübingen: Mohr Siebeck, 2013), 436.

780 Frederik Schildgen and Johanna Hey, "Das Sondersteuerrecht Verbundener Unternehmen," *IFST-Schrift* 554 (2022): 41.

781 Schildgen, "Group approach and separate entity approach," 554.

782 See, for example, Tavares, "Multinational Firm Theory and International Tax Law: Seeking Coherence," 243; Mitchell Kane, "Transfer Pricing, Integration and Synergy Intangibles: A Consensus Approach to the Arm's Length Standard," *World Tax Journal* 6 (2014): 282; Vann, "Taxing International Business Income: Hard-Boiled Wonderland and the End of the World," 291; Wolfgang Schön, "International Tax Coordination for a Second-Best World (Part III)," *World Tax Journal* 3, no. 2 (2010): 227.

783 A closely related argument is to treat the issue as a matter of equality. The argument has been made that the principle of equality would require nation states to subject a group of related companies, which jointly operate a business enterprise, to an overall tax burden that is equal to the burden to which a single company operating a business enterprise is subject. See de Wilde, *Sharing the Pie*, 2015, 159.

taxation systems break through the reality of legal entities and, to different degrees, generally allow for the computation of income at the group level. The problem is far from new: group taxation regimes are "as old as corporate income tax itself"[784].

In tax law, the dogmatic definitions of corporate group are inspired by the idea that such groups are an economic unit and should thus be treated as a single entity with regard to some features of its taxation[785]. The expression "group taxation regime" commonly refers to a set of rules that allows corporate taxpayers to compute the tax liability of related corporations on a consolidated or combined basis, including by means of transfer of particular tax attributes between the members of the group[786]. The fundamental role of a group taxation regime is to institutionally acknowledge the ability of a corporate group to share losses and ensure the roll-over of assets between its members[787]. Therefore, group taxation regimes generally allow for the offsetting of profits and losses of the members of the group. Another element is that group regimes generally allow for the deferral of the recognition of gains arising from asset transfers between members of the group. Some countries provide for even broader possibilities, resorting to approaches that resemble actual consolidations between the entities of the group[788]. In its purest version, the adoption of the unitary business enterprise within a system would also require that transfer pricing based on the ALS is abandoned. The MNE should be treated as a single taxable entity for corporate tax, and the classical approach according to which subsidiaries form separate taxable entities, and PEs are treated as independent enterprises for profit attribution, should be "let go"[789].

Hence, the idea of ability-to-pay of the group (*Gruppenleistunsfähigkeit*), which is based on the economic unit of economically related companies, can be used as justification for such an approach[790]. The attribution of profits as an expression of a breach of the separate entity approach follows from the relationship between the entities of the group. In this respect, one can speak of a shared responsibility for results in the economic sense, which would also justify loss absorption and offsetting among the entities[791]. According to BACHEM, if, in principle, everyone should pay taxes on what they have earned themselves, then the attribution of the profits and losses of a dependent company to the controlling company can be better justified if the majority shareholder shares responsibility for the results. This responsibility for results should be understood in an economic sense, not in a legal sense, so that the controlling company would be liable if there was no positive economic success[792]. Due to this relationship of dependency within the group, the entities would form an economic unity. Although they have not lost their legal independence, they have generally lost their economic independence. The identification of an economic

[784] Yoshihiro Masui, "General Report," in *Group Taxation*, Cahiers de Droit Fiscal International 89b (Deventer: Kluwer, 2004), 26. See also Johanna Hey and Arne Schnitger, "General Report," *Cahiers de Droit Fiscal International* 106A (2022): 30.
[785] Masui, "General Report," 23.
[786] The definition is also used in Masui, 25.
[787] See Ting, *The Taxation of Corporate Groups*, 38; Masui, "General Report," 26.
[788] See sec. 3.5.1.1, *infra,* on the regimes from Australia and New Zealand.
[789] de Wilde, *Sharing the Pie*, 2015, 159.
[790] IFST-Arbeitsgruppe, "Einführung einer modernen Gruppenbesteuerung: ein Reformvorschlag," *IFST-Schrift* 471 (2011): 45–46.
[791] IFST-Arbeitsgruppe, 45–46; Wilfried Bachem, "Neuregelung der Besteuerung im Konzern," *IFST-Schrift* 350 (1996): 54.
[792] Bachem, "Neuregelung der Besteuerung," 54.

unit would therefore be able to capture the ability-to-pay of the group, and group taxation rules would not represent any advantage for groups[793].

The treatment of corporate groups is also justified on the neutrality of forms. Treating the group as a taxable entity is a way to deal with the paradoxical case of the enterprise that has no legal form, considering that the scope of the enterprise and that of the company do not always coincide[794]. The consideration of the group as an economic unity would merely prevent a rather arbitrary segmentation of a uniform economic situation based on the legal form of the legal entity and the separate entity approach[795]. From an economic perspective, the tax law applicable to groups of companies should be neutral in relation to the organization form. The division of an economic activity between companies belonging to the group does not lead to an increased ability-to-pay, beyond the profit of the group[796]. Hence, the multiple burden to the entities of the group, which result solely from the legal independency of the entities, should be avoided whenever possible by the system[797]. Under this view, the legislature would be obliged to take into account the economic unity of the entities of the group, considering that the mere legal independency of the entities does not lead to an increased ability-to-pay[798].

3.3. The definitional challenge in tax law

The problem, however, is how to define this "economic unit", whose ability-to-pay tax law intends to capture. The experience of states present several criteria, which may vary according to legal traditions and the goal of the legislation at stake. The understanding of what should constitute an economic group also varies according to underlying economic theories[799], depending on the underlying theory of the firm[800], or on the underlying theory of organizational structures[801] that is adopted.

The enterprise doctrine focuses on the reality of the complex business enterprise, in which the activities are performed by multiple and intertwined legal entities[802]. It is tempting to simply make a vague assertion with respect to substance over form, meaning that the separate entity would be formalistic, whereas the enterprise doctrine would focus on substance. However, definitional challenges are inevitable in law. If it is one's intention to speak of enterprise, policy choices will inevitably arise. There is no such thing as a

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[793] See Johanna Hey, "Steuerpolitische Handlungsbedarf bei der Konzernbesteuerung," *FinanzRundschau* 21 (2012): 996; IFST-Arbeitsgruppe, "Einführung einer modernen Gruppenbesteuerung," 45–46..

[794] Frederik Schildgen and Johanna Hey, "Das Sondersteuerrecht Verbundener Unternehmen," *IFST-Schrift* 554 (2022): 6.

[795] See Schildgen and Hey, 21; Hey, "Steuerpolitische Handlungsbedarf," 996; IFST-Arbeitsgruppe, "Einführung einer modernen Gruppenbesteuerung," 45–46..

[796] See Hey, "Steuerpolitische Handlungsbedarf," 996.

[797] See Hey, 996.

[798] Despite asserting the obligation of the legislature, HEY acknowledges a large discretion for the legislature in performing such task in the German system. She maintains that there are several ways to take the ability-to-pay of the economic unity into account, and a single tax treatment to groups of companies could not be derived with millimetric precision ("*millimetergenau*") by means of constitutional reasoning. See Hey, 996.

[799] Bachem, "Neuregelung der Besteuerung," 50.

[800] Arguing based on theories of the firm, see Picciotto and Kadet, "The Transition to Unitary Taxation," 455–56; Schön, "International Tax Coordination for a Second-Best World (Part III)," 228–29.

[801] Arguing based on theories of organizational structures, see Bachem, "Neuregelung der Besteuerung," 47–48.

[802] Blumberg, "The Transformation of Modern Corporation Law," 609.

single economic reality, and in legal matters one is always substituting a legal form for another. Even authors who very strongly defend the broad application of formulary solutions acknowledge that one of the challenges of applying it for a group of companies is precisely defining a unitary business[803]. As stated by the US Supreme Court when examining the unitary business principle[804], "the unitary business concept (…) is not, so to speak unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principle motivating the approach"[805].

There are several ways to grasp an enterprise and, as a consequence, the definition of an economic group varies considerably among systems[806]. In 1933, on issues of railroads regulations, the Roosevelt administration abandoned the notion of "entity" as a legal concept, resorting to enterprise concepts, particularly the functional definition of "control"[807]. Such trend has been further followed on statutes and regulations of banking, insurance and financial services, not only in the US, but worldwide[808]. Also in other areas, legislation which deviates from the legal entity and take the enterprise as the relevant standard may refer to[809]: (i) a common public persona, with common trade name, logo and marketing; (ii) financial interdependence, characterized by the fact that some entities do not raise their capital independently from other entities of the group; (iii) administrative interdependence, consisting on the sharing of legal, auditing, public relations and other services by the entities of the group; (iv) group-wide benefits programs, in which the employees receive, *e.g.*, shares of the parent company in stock option plans, rather than entity-specific benefits.

In tax law, the descriptions of an enterprise are commonly based on two main factors: economic integration and control. Despite being both aimed at grasping the reality of the economic group, control and economic integration supposedly perform this task at different levels. For this reason, control is described as a purely legal criterion[810], whereas economic integration would reflect "an economic view" that "elevates substance over form"[811]. It is often maintained, therefore that, in theory, the definition of the economic group should follow from economic criteria, and, only because these criteria do not represent a sufficient level of legal certainty or are deemed impracticable, a minimum holding quota is chosen as a "workable solution"[812].

3.4. Integration: the "economic" criterion

The first dogmatic approach to defining an economic group is to look for economic integration. Under this criterion, the group is generally defined with reference to all

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[803] See Michael Kobetsky, "The Case for Unitary Taxation of International Enterprises," *Bulletin for International Taxation* 62, no. 5 (2008): 205.
[804] See, on the issue, sec. 3.4, *infra*.
[805] US: Container Corp. of Am. V. Franchise Tax Bd., 463 U.S. 159 (1983), at 167.
[806] Ting, *The Taxation of Corporate Groups*, 18.
[807] Blumberg, "The Transformation of Modern Corporation Law," 608.
[808] Blumberg, 609.
[809] Blumberg, 610.
[810] Walter Hellerstein and Charles E. McLure, Jr., "The European Commission's Report on Company Income Taxation: What the EU Can Learn from the Experience of the US States," *International Tax and Public Finance* 11, no. 2 (2004): 204. See also de Wilde, *Sharing the Pie*, 2015, n. 628.
[811] Joann Martens-Weiner, "Combined Reporting and the Unitary Business Principle: A Doctrine That Has Not (Yet) Made the Atlantic Crossing," *The State and Local Tax Lawyer* 2008 (2008): 188.
[812] Anne Schäffer and Christoph Spengel, "The Impact of ICT on Profit Allocation Within Multinational Groups: Arm's Length Pricing of Formula Apportionment?," *ZEW Discussion Paper* 03–53 (2003): 21.

commonly controlled entities that constitute a "single economically integrated business"[813]. There are several reasons that would account for the theoretical superiority of the economic integration criterion over the control criterion[814]. As seen, the formation of the group is inspired by the enterprise doctrine. Therefore, if two entities have no underlying economic ties with each other than common control, there is no reason why their incomes should be lumped together, or why the consolidation of these entities should have any relevance for the purpose of grasping the ability-to-pay. Under this theory, common control constitutes only one prerequisite of a unitary business, or an "economic unity" (*wirtschaftliche Einheit*). Other fundamental characteristics would include the existence of economies of scope or other economic interdependencies[815].

The case for the economic integration criterion is even stronger if the allocation of the income of the group is formula-based[816]. Formulary apportionment is premised on the idea that the determination of the source of income of cross-border activities on the basis of separate geographic accounting is impossible, due to the very nature of economic interrelationships. In the case of highly integrated companies, an allocation based on separate accounting does not provide a reliable result and is deemed to be practically impossible[817] - or at least this was the prevailing understanding[818] before the BEPS Project[819]. Considering that it is the immeasurable economic flows of value between the various components of the enterprise that justify the formulary apportionment, the delineation of the group should also be based on such relationships, and not on the "formalistic" notion of control[820].

The economic integration requirement is also able to prevent income shifting performed through the manipulation of the corporate form[821]. As it is focused on the economically intertwined elements of the business, it restricts the artificial shifting of profits among entities under common control – which would remain possible if the group is defined solely based on control.

However, the experience of the countries with economic integration criteria is troublesome[822]. The present subsection examines two cases of problematic application of criteria grounded on economic integration: the German fiscal unity regime (sec. 3.4.1) and the application of the unitary business principle in the US experience (sec. 3.4.2).

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[813] Hellerstein and McLure, Jr., "The European Commission's Report on Company Income Taxation," 203.
[814] Wolfgang Schön, "Group Taxation and the CCCTB," *Tax Notes International* 48, no. 11 (2007): 1074.
[815] Schäffer and Spengel, "The Impact of ICT on Profit Allocation Within Multinational Groups: Arm's Length Pricing of Formula Apportionment?," 21.
[816] See Martens-Weiner, "Combined Reporting and the Unitary Business Principle: A Doctrine That Has Not (Yet) Made the Atlantic Crossing," 186–87; Hellerstein and McLure, Jr., "The European Commission's Report on Company Income Taxation," 204.
[817] Schäffer and Spengel, "The Impact of ICT on Profit Allocation Within Multinational Groups: Arm's Length Pricing of Formula Apportionment?," 21.
[818] See, on the allocation of synergy rents under the ALS, Kane, "Synergy Intangibles," 282.
[819] For criticism on the developments related to the allocation of synergy rents, see Schoueri, "Beyond the Guidelines," 710–16.
[820] See Hellerstein and McLure, Jr., "The European Commission's Report on Company Income Taxation," 204–5.
[821] Martens-Weiner, "Combined Reporting and the Unitary Business Principle: A Doctrine That Has Not (Yet) Made the Atlantic Crossing," 188.
[822] Schön, "Group Taxation," 1074.

3.4.1. *The German fiscal unity regime (Organschaft)*

The German experience with its fiscal unity regime (*Organschaft*) "strongly attests to how an economically influenced model brings about unclear limitations"[823]. The institution of the fiscal unity regime in CIT was originally grounded on the idea that, in certain cases, the subsidiary would behave as a dependent operating division, completely integrated in the parent company, in its financial and economic functions. Such elements have been abolished over the years for CIT purposes, and the main requirements of the regime are now the holding of the majority of voting rights and the profit and loss absorption agreement.

In fact, the historical experience of Germany with criteria related to economic integration is negative to such an extent that it "makes it advisable for one to distance oneself from the examination of factual economic integration"[824]. The diffuse characteristics of organizational and economic integration are considered to be difficult to control and in practice bear the potential to be largely subject to manipulation.

Systematically, the German CIT does not set forth a uniform and comprehensive group taxation regime[825]. In particular, there are no regulations for the consolidation of interim results, debts and capital, and the legal consequences are based on an allocation of profits which is only partially modified by features of unit theory. Under this regime, the results of the controlled companies are determined separately and allocated to the controlling company, allowing for a consolidation of results. When determining the income subject to CIT, it is sometimes assumed that the tax group is one company. The main outcome of the regime is the intersubjective compensation of losses, grounded on the profit and loss absorption agreement, which makes the controlling company liable for the losses of the controlled company[826]. Essentially, the regime is an example of the trend observed in the sense of providing for partial deviations from the separate entity approach, instead of establishing the enterprise doctrine as "an overriding concept applied transcendentally throughout the entire legal spectrum"[827].

The objective of the subsection is not to provide an in-depth analysis of the fiscal unity regime, but merely to present the economic criteria developed to identify the "economic unity" (*wirtschaftliche Einheit*). For the thesis, what matters are the criteria developed to grasp the economic group as the subject of CIT, which are essentially based on the level of integration between the controlling and the controlled entity.

3.4.1.1. *The development of criteria by courts*

The *Organschaft* regime is "jurisprudence's child"[828]. The development of the fiscal unity regime[829] dates back to the case law of the Prussian Higher Administrative Court

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[823] Schön, 1074.
[824] Schön, 1074.
[825] IFST-Arbeitsgruppe, "Einführung einer modernen Gruppenbesteuerung," 19–20.
[826] IFST-Arbeitsgruppe, 19–20.
[827] Blumberg, "The Transformation of Modern Corporation Law," 611.
[828] Rainer Hüttemann, "Organschaft," in *Kernfragen des Unternehmenssteuerrechts*, ed. Wolfgang Schön and Christine Osterloh-Konrad (Heidelberg: Springer, 2013), 129.
[829] For historical accounts of the *Organschaft* regime, see Hüttemann, 129–31; IFST-Arbeitsgruppe, "Einführung einer modernen Gruppenbesteuerung," 11–13; Bachem, "Neuregelung der Besteuerung," 50–52.

(*preußische Oberverwaltungsgericht* – "**PrOVG**") in the 19th century, which would be further developed by the *Reichsfinanzhof* ("**RFH**") and the Federal Fiscal Court (*Bundesfinanzhof* – "**BFH**"), and finally codified by the legislature for CIT purposes in 1969[830]. The case law and legislature each pursued different objectives and were based on different theoretical approaches[831].

The PrOVG had decided on personal income tax and trade tax that a non-Prussian company maintained a business in Prussia if it used an intermediary (called "*Organ*" by the decision) active in Prussia who, like an employee in business matters, followed the instructions of the employer (parent company)[832]. From this "employee theory" (*Angestelltentheorie*), the PrOVG concluded that the income of the dependent body does not represent its own income, but income of the parent company. In this respect, the foreign company was subject to tax in Prussia as a way to prevent abusive arrangements.

In the 1920s, the RFH extended the application of the *Organtheorie* to sales tax and CIT[833]. From then on, a company was regarded as a dependent body if it was financially, economically and organizationally integrated into the controlling company in the manner of a mere business department. Such economic perspective should ensure taxation of the group based on its actual performance and avoid multiple taxation in the classic CIT system applicable at the time and in the gross sales tax system. For the recognition of a corporate tax group, the RFH required the conclusion of a profit and loss absorption agreement (*Gewinnabführungsvertrag*), whereby the controlled company remained subject to taxation according to the attribution theory (*Zurechnungstheorie*) and independently determined its income, which was then allocated to the controlling company[834]. The double taxation of the transferred profit was also prevented.

Later, the BFH applied the so-called accounting theory (*Bilanzierungstheorie*) to the fiscal unity, according to which the profit and loss transfer made under commercial law was to be adopted for CIT purposes on the basis of the profit and loss absorption agreement[835]. Any deviating tax result should be taxed by the controlled company itself. The BFH established the *Organschaft* as a tax theory of the economic unit of legally independent economic entities for the purposes of CIT[836].

The conclusion and actual implementation of a profit and loss absorption agreement is still a requisite of the *Organschaft* regime. The requisites of this contract are intended to

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[830] DE: Gesetz v. 15.8.1969, BGBl. I 1969, 1182; BStBl. I 1969, 471. For trade tax purposes, the *Organschaft* was already codified in 1936 (§ 2 Abs. 2 Nr. 2 S. 2 GewStG 1936), and for sales tax in 1934 (§ 2 Abs. 2 Nr. 2 UStG 1934).
[831] IFST-Arbeitsgruppe, "Einführung einer modernen Gruppenbesteuerung," 11–13.
[832] DE: PrOVG, Urteil v. 18.6.1896 – V 3/96, OVG in Staatssteuersachen Bd. 5, 163; PrOVG, Urteil v. 31.5.1902 – VI G 38/01, OVG in Staatssteuersachen Bd. 1 391.
[833] DE: RFH, Urteil v. 6.10.1920 – II A 141/20, RFHE Bd. 3, 283; RFH, Urteil v. 31.3.1922 – I A 10/22, RFHE Bd. 9, 167; RFH, Urteil v. 11.11.1927 – I A 75/27, RFHE Bd. 22, 183.
[834] DE: RFH, Urteil v. 18.2.1933 – I A 439/32, RStBl. 1933, 647; RFH, Urteil v. 31.10.1933, RStBl. 1934, 684; RFH, Urteil v. 28.11.1934, RStBl. 1935, 725; RFH, Urteil v. 22.1.1935 –I A 401/32, RStBl. 1935, 517.
[835] DE: BFH, Urteil v. 24.11.1953 – I 109/53 U, BStBl. III 1954, 21; BFH, Urteil v. 8.3.1955 – I 73/54 U, BStBl. III 1955, 187; BFH, Urteil v. 5.11.1957- I 163/56 U, BStBl. II 1957, 139.
[836] DE: BFH, Urteil v. 16.3.1965 – I 9/63 U, BStBl. III 1965, 386. IFST-Arbeitsgruppe, "Einführung Einer Modernen Gruppenbesteuerung: Ein Reformvorschlag," *IFST-Schrift* 471 (2011): 11–13. However, attributing more weight to the profit and loss absorption agreement as a private law condition, see Hüttemann, "Organschaft," 131.

ensure that there is an actual transfer of the financial and economic capacity between the entities[837]. The agreement was originally conceived as an instrument for the tax law qualification of the economic connection of independent subjects[838], which has historically played a decisive role in the justification of the regime[839]. Contemporarily, it is subject to significant criticism, as it has been acknowledged that the existence of an economic unit would be sufficient for consolidation[840]. For the purpose of the thesis, the agreement is not of particular interest. Instead, the section focuses on the financial, economic and organizational integration, as requisites aimed at identifying the group to which the fiscal unity regime was applicable, in order to understand their underlying logic and the reasons why some of them have been abandoned for CIT purposes.

3.4.1.1.1. Financial integration

The central requirement of the German fiscal unity regime is the existence of a subordination relationship between a controlling company and one or more controlled companies. This requirement is manifested in the financial integration requirement, which still applies for CIT purposes. The financial integration is the only criterion that is defined by legislation. Economic and organizational integration, despite mentioned in the legislation (and later abolished for CIT purposes), were not defined. The courts played a more decisive role in the case of such undefined criteria.

For the financial integration to be present, the controlling company must have the majority of voting rights in the controlled company (§ 14 Abs. 1 Nr. 1 S. 1 KStG), whereby direct and indirect holdings that convey majority voting rights are to be added together (§ 14 Abs. 1 Nr. 1 S. 2 KStG). The simple majority of voting rights is to be understood as the minimum requirement for the existence of a subordination relationship. The controlling entity must be able to ensure that the controlled entity carries out its will at least in the ordinary performance of business in shareholder meetings. The controlling entity does not need to be able to approve structural changes, such as modifications to the bylaws or of the share capital of the entity, which require a qualified majority under German law[841].

3.4.1.1.2. Economic integration

Economic integration, as developed by the courts, meant that the controlled company had to serve the operations of the controlling company, i.e. it had to be classified in its company as a form of dependent department of the controlling company[842].

The BFH defined economic integration as "economic purpose dependency" (*wirtschaftliche Zweckabhängigkeit*), meaning that the controlling company should pursue its own commercial purpose to which the controlled company could subordinate

[837] For an overview of the requisites and content of the agreement, see Jacob Hörnle, *Gesellschaftsrechtliche Maßgaben für eine Gruppenbesteuerung ohne Gewinnabführungsvertrag* (Baden-Baden: Nomos, 2019), 52–62.
[838] Hörnle, 65.
[839] See, on the relevance of the profit and loss absorption agreement, Hörnle, 66; Carl-Heinz Witt, *Die Konzernbesteuerung* (Köln: Otto Schmidt, 2006), 159.
[840] Hey, "Steuerpolitische Handlungsbedarf," 997.
[841] Hörnle, *Gesellschaftsrechtliche Maßgaben*, 50–51.
[842] Witt, *Die Konzernbesteuerung*, 183.

itself and which it could serve, promote or supplement[843]. Within this meaning, the controlled company should therefore appear in the manner of a dependent business division of the controlling company. The economic relevance of the companies for each other would be sufficient for this purpose[844].

It was sufficient for the BFH, if the controlling company's own commercial activity, exercised in addition to the management of the dependent company, was presented in an economic connection with the activity of the controlling company. It would suffice that both companies were represented as parts of an economic unit and the controlling company's own commercial activity was not of minor importance within the framework of the economic entity. The economic entity was created through uniform management, and, for this reason, it was necessary for the controlling company to exercise uniform management power over its own commercial activity and over that of the controlled company[845]. The requisite in this case was not that both companies should belong to the same line of business. The companies did not have to undertake the same line of business, and profit maximization and risk balancing were considered as permissible goals of the tax group[846]. They should be managed according to a uniform overall concept, and this could also be the case if the companies were combined for the purpose of maximizing overall profit or achieving a balance of risk[847].

From a business point of view, the requirement of economic integration was criticized for being in contradiction with modern forms of business organizations[848]. The BFH has also been criticized for confusing the possibility of economic integration with the requirement that the controlling company must operate a commercial company. In practice, the requisite of economic integration would in many cases make it impossible for a holding structure to qualify under the fiscal unity regime[849]. In a decision after the revocation of the economic integration criterion, the BFH acknowledged that economic integration would also be possible in case of a managerial holding company[850]. The meaning maintained in legal scholarship is, however, much broader. WITT maintains that economic integration would always be present if the controlled company serves the controlling company in any way within possible business objectives[851].

3.4.1.1.3. Organizational integration

The organizational integration existed if it was guaranteed that the will of the controlling company was actually carried out upon the management of the controlled company. This was the case in particular if the controlling company exercised uniform management power over its own commercial activity and the commercial activity of the controlled company. Another possibility to ensure the organizational integration was that parent and subsidiary were managed by the same person, which would be the clearest sign of a

[843] DE: BFH Urteil vom 8.4.1973 – I R 120/70, BStBl. II 1973, 740, 741.
[844] Bachem, "Neuregelung der Besteuerung," 79.
[845] DE: BFH Urteil vom 21.1.1976 – I R 21/74, BStBl. II 1976, 389, 390.
[846] Bachem, "Neuregelung der Besteuerung," 80–81.
[847] DE: BFH Urteil vom 21.1.1976 – I R 21/74, BStBl. II 1976, 389, 390.
[848] Bachem, "Neuregelung der Besteuerung," 80–81.
[849] Witt, *Die Konzernbesteuerung*, 14.
[850] DE: BFH Urt. vom 24.2.2005 – IV R 12/03, BFHE 209, 262.
[851] Witt, *Die Konzernbesteuerung*, 14.

common business policy to the outside world, despite its undesirability for business purposes in certain cases[852].

Organizational integration therefore required that a decision-making independent of the will of the controlling company could not be identified in the controlled company. The controlled company should always make decisions which were in line with the will of the controlled company, and a deviating will of the controlled company should be forbidden. The controlling company should be able to influence the decision-making of the controlled company at any time. The financial integration (majority of voting rights) was not sufficient to conclude for the existence of organizational integration, but in the case of a domination agreement, as defined under German law, there was an irrebuttable presumption of organizational integration[853]. Despite the prevalence of criticism towards the criterion, some authors contended that uniform management would be a secure indicator of economic responsibility for results[854].

3.4.1.2. The reforms and their motivation

A reform in 2000 brought about a fundamental innovation: the requisites for economic and organizational integration were abolished for CIT purposes[855]. A further simplification concerned the lifting of the ban on the aggregation of direct and indirect participations in connection with financial integration. The *Organschaft* also underwent further changes in 2001[856], and a harmonized set of requirements for CIT and trade tax was created. As of 2002, only financial integration is required for trade tax purposes as well, and the conclusion of a profit transfer agreement was also made a prerequisite for the trade tax group.

The reform is partially justified by a perceived failure in the economic and organizational integration requirements to capture the changing reality of economic groups. Scholarship mentions a change in the way groups were structured, away from the "functionally centralized group model", towards a "divisionally structured business unit" or "divisional group model"[857]. The *Organschaft* assumes a hierarchical enterprise structure, whereby the business is directed in a top-down approach ("*Stammhauskonzern*"), despite the existence of multiple other structures in the economic reality[858].

In the (traditional) functionally centralized group, the division of tasks is typically based on functional areas such as purchasing, production, sales and financing. In the divisional group, these functional areas are subordinate to the primary structure according to products, markets and regions. In such context, decisions concerning purchasing and sales are adapted to the product or the region. The management of the division at a sub-company holds its own responsibility for the results of the management therein, which enables faster reactions and facilitates the control of results. Each division is viewed as a separate "profit center", dedicated to a definable market. This division makes it easier to

[852] Bachem, "Neuregelung der Besteuerung," 71.
[853] Witt, *Die Konzernbesteuerung*, 183.
[854] See, discussing the topic, Otto H. Jacobs and Christoph Spengel, "Ertragsbesteuerung von Konzernen in Deutschland und Frankreich - Eine vergleichende Analyse unter besonderer Berücksichtigung der Behandlung konzerninterner Transaktionen," *Internationales Steuerrecht*, no. 3 (1994): 151.
[855] DE: Gesetz v. 23.10.2000, BGBl. I 2000, 3267; BStBl. I 2000, 1428.
[856] DE: Gesetz v. 20.12.2001, BGBl. I 2001, 3858; BStBl. I 2002, 35.
[857] Bachem, "Neuregelung der Besteuerung," 48.
[858] See, on the topic, Hörnle, *Gesellschaftsrechtliche Maßgaben*, 78–79.

control the group, and the decentralization of decision-making authority relieves the overall company management by shortening the information channels[859]. The financing needs have also changed, and large projects often became too expensive to be financed by one company alone. Therefore, as from the late 1980s in particular, minority shareholders have been included in the chains to a greater extent, subsequently leading to a trend whereby parent companies would only hold 51% of the shares[860].

In such context, the economic and organizational integration criteria would favour functionally and centrally structured groups, and the regime would not be neutral in comparison to the divisional group, in which the economic and organizational integration was more difficult to achieve. The criteria would therefore have become increasingly distortive and anti-competitive, as it inhibits optimal group structuring[861].

The regime could certainly be criticized under other organizational structures that also became common, mainly in the context of the digital economy. The exponential development of information and communication technologies and the growth of enterprise resource planning software have "allowed for the substantial 'integration' of management and operations within firms", enabling them to "grow beyond their formal legal-entity and jurisdictional boundaries"[862]. In any case, the reform of the regime was only partial, and many critiques to the current regime still remain, while reform proposals are discussed. The main object of the critiques is the profit and loss absorption agreement, which is commonly signed for purely tax reasons[863].

3.4.2. The unitary business principle in the US experience

The second experience worth narrating is found in the context of subnational taxation in the US, which is grounded on "the unitary business principle"[864]. At the federal level, an affiliated group is generally present if the entities are under common control[865], and

[859] Bachem, "Neuregelung der Besteuerung," 48.
[860] Bachem, 48.
[861] Bachem, 48.
[862] See, examining the relationship between firm theories and international tax law, Tavares, "Multinational Firm Theory and International Tax Law: Seeking Coherence," 258.
[863] Bachem, "Neuregelung der Besteuerung," 48. For criticism on the ability of the loss and absorption agreement to produce negative incentives on managers, see Hörnle, *Gesellschaftsrechtliche Maßgaben*, 78–79.
[864] See on the topic Rick Handel, "A Conceptual Analysis of Nexus in State and Local Taxation," *The Tax Lawyer* 67, no. 4 (2014): 623–714; Joann Martens-Weiner, "An Economist's View of Income Allocation Under the Arm's Length Standard and Under Formulary Apportionment," *The State and Local Tax Lawyer. Symposium Edition*, 2009, 25–56; Hollis Hyans and Gregory Roberts, "When Is Symmetry Between the Tax Base and Sourcing Rules Required?," *The State and Local Tax Lawyer. Symposium Edition*, 2009, 213–40; Tracy A Kaye and Michael K Mahoney, "Various Approaches to Sourcing Multijurisdictional Values: Sourcing Options Available to Tax Policy Makers," *The State and Local Tax Lawyer* 2009/10 (2010 2009): 57–70; Martens-Weiner, "Combined Reporting and the Unitary Business Principle: A Doctrine That Has Not (Yet) Made the Atlantic Crossing"; Benjamin F. Miller, "Principles for Sourcing of Multijurisdictional Income or 'Slicing a Shadow,'" *The State and Local Tax Lawyer* 2008 (2008): 51–81; Hellerstein and McLure, Jr., "The European Commission's Report on Company Income Taxation"; James A. Mirage, "A Solidification of the Unitary Business Principle: Allied-Signal, Inc. v. Director, Division of Taxation," *The Tax Lawyer* 46, no. 2 (1993): 541–54; Charles E. McLure, "An Economic Definition of a Unitary Business," *Proceedings of the Annual Conference on Taxation Held under the Auspices of the National Tax Association-Tax Institute of America* 76 (1983): 27–32.
[865] For federal tax purposes, an affiliated group is defined as one or more chains of includible corporations connected through stock ownership with a common parent, as long as the common parent owns, directly or

intercompany transactions shall be priced at arm's length[866]. Control is, however, not sufficient for the purposes of delineating the group for state tax purposes. A state is only entitled to tax income derived by an entity outside of its territory if the income is derived by a single unitary business conducted at least partially within its territory[867].

The criteria are also a "jurisprudence's child": the unitary business principle has been developed by means of constitutional argumentation[868], as a "constitutional method for determining tax jurisdiction"[869]. The Due Process Clause of the Fourteenth Amendment and the Commerce Clause of the US Constitution, as interpreted by the US Supreme Court, establish that a state may not, when imposing an income or franchise tax, "tax value earned outside its borders"[870]. Accordingly, there must be a "minimal connection between the interstate activities and the taxing State", as well as a "rational relation between the income attributed to the taxing state and the intrastate value of the corporate business"[871].

Such requirements are not violated, according to the US Supreme Court, in case the state taxes income that, despite being accounted to a different state by means of separate accounting, is related to intrastate and extra-state activities which forms part of a "single unitary business"[872] – and provided that at least some part of the unitary business is conducted in the state[873]. Taxation is allowed due to a perceived failure of separate accounting[874], considering that there is "some sharing or exchange of value" which is not "capable of precise identification or measurement"[875]. The apportionment shall also be "fair" and must also reflect a reasonable sense of how income is generated[876].

Therefore, one important difference in relation to the German *Organschaft* is that the unitary business principle plays a fundamental in the determination of taxing jurisdiction. It is not only a test related to the determination of the taxable subject, but also a nexus test[877].

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indirectly, at least 80% of the total stock of the subsidiary corporation, measured by vote or value (I.R.C. § 1504).

866 Martens-Weiner, "Combined Reporting and the Unitary Business Principle: A Doctrine That Has Not (Yet) Made the Atlantic Crossing," 187.

867 Rejecting alternative approaches, see US: MeadWestvaco Corp. v. 111. Dep't of Revenue, 553 U.S. (2008), at 30.

868 Hyans and Roberts, "When Is Symmetry Between the Tax Base and Sourcing Rules Required?," 212–13.

869 Phillip Popkin, "The Effect of the Internet Era and South Dakota v. Wayfair on the Unitary Business Rule Comments: Annual Survey of Federal En Banc and Other Significant Cases," *Boston College Law Review* 60 (2019): 98.

870 US: ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982), at 315.

871 US: Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768 (1992), at 772.

872 US: Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980), at 438.

873 US: Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983), at 166.

874 McLure, "An Economic Definition of a Unitary Business," 28.

875 US: Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983), at 166.

876 US: Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983), at 169. The criteria for the fairness of the allocation formula is not relevant for the present discussion. For a discussion on the topic, see Hyans and Roberts, "When Is Symmetry Between the Tax Base and Sourcing Rules Required?," 214–15.

877 For an approach focused on a nexus theory, see Popkin, "The Effect of the Internet Era and South Dakota v. Wayfair on the Unitary Business Rule Comments: Annual Survey of Federal En Banc and Other Significant Cases," 98.

3.4.2.1. The criteria developed by the Supreme Court

According to the US Supreme Court, a unitary business is one that presents "functional integration, centralization of management, and economies of scale"[878]. Economically, such elements are an expression of phenomena that can result in contribution and dependence, thus allowing one to conclude for the existence of an economic unity[879].

The problem of this formulation is that "neither a comprehensive list of potential unitary attributes nor a bright-line test of unity is possible"[880]. The examination of such factors is "necessarily fact-sensitive"[881]. Economic unity based, *e.g.*, on transfer of technological know-how, market sharing and reciprocal buying are not covered by the description of the Supreme Court, which only refers to functional integration, centralization of management, and economies of scale[882]. Despite the theoretical support for concluding that the three elements referred in the US Supreme Court case law are merely "indicia"[883] of the existence of a unitary business, legal scholarship has engaged in the systematization of such elements, based on the decisions of the Supreme Court.

3.4.2.1.1. Functional integration

Elements supporting the conclusion for the existence of a "functionally integrated enterprise" include[884]: (i) assistance to subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally; (ii) substantial role played in loaning funds to subsidiaries and guaranteeing loans provided by others; (iii) considerable interplay between the entities in the area of corporate expansion; (iv) substantial technical assistance provided by the parent to the subsidiaries; (v) supervisory role played in providing general guidance to the subsidiaries.

Explaining the functional integration criterion by reference to indicia does not clarify "how much" integration is necessary. A significant level of vagueness is present in the criterion, and the court may acknowledge the existence of some functional integration, but still reject the fulfilment of the requirement based on the comparison with a "'highly integrated business" from a former decision[885].

Functional integration is also deemed to be present if transactions between two entities are not performed at arm's length[886]. The reasoning is that if a company is willing to sacrifice revenue by selling below market price, then it would be safe to assume that this alliance would constitute a unitary business[887]. This understanding is, however, distanced from the economic rationale that underlies the unitary business principle. Mispricing of

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[878] US: Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768 (1992), at 776.
[879] McLure, "An Economic Definition of a Unitary Business," 28.
[880] McLure, 29.
[881] Mirage, "A Solidification of the Unitary Business Principle: Allied-Signal, Inc. v. Director, Division of Taxation," 545.
[882] McLure, "An Economic Definition of a Unitary Business," 29.
[883] See Mirage, "A Solidification of the Unitary Business Principle: Allied-Signal, Inc. v. Director, Division of Taxation," 545.
[884] US: Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983), at 179.
[885] See, *e.g.*, US: F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), at 364-65.
[886] US: Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768 (1992), at 776.
[887] Mirage, "A Solidification of the Unitary Business Principle: Allied-Signal, Inc. v. Director, Division of Taxation," 547.

transactions between parties under common control can be simply a way of reducing the tax burden, also performed between parties that are not functionally integrated.

Considering that case law "does not reveal a clear rationale underlying the component"[888], MIRAGE suggests that functional integration could be equated to economy of scope. Economies of scope are present if a firm can produce a given level of two or more products at a lower cost than separate firms producing the same level of output. They can be exploited not only when a tangible good such as a machine is left with underutilized, but also by means of sharing of intangible assets, such as manufacturing expertise and research activities[889].

3.4.2.1.2. Economies of scale

According to the US Supreme Court, the second element of the unitary business test is economies of scale. The court easily dismisses the existence of a unitary business in cases were the activities of the companies are unrelated to one another[890]. Resorting to comparisons with former case law, the court has maintained that a company was not using its subsidiaries to exploit economies of scale in a case where: (i) the parent company's operations were not inter-related with those of the subsidiaries so that the stable operation of one entity was important to the full utilization of capacity by the other; (ii) the parent did not provide "many essential corporate services" for the subsidiaries, and there was no centralized purchasing office with the purpose of increasing overall corporate profits through bulk purchases and efficient allocation of supplies among retailers; and (iii) sales were not facilitated through the use of a uniform credit card system, uniform packaging, brand names, and promotional displays, all run from the national headquarters[891].

Economies of scale can also be shown by the engagement in the same line of business, which is taken, however, as a mere indication, and not as a sufficient evidence of the pursuit of economies of scale. Accordingly, in cases where the corporation invests in a subsidiary engaged in the same "line of work" as itself, it would be much more likely that one of the functions of the investment is to make better use of the business-related resources through economies of scale[892]. Even though, one can also find cases where the economies of scale were not deemed to be present, despite the entities being engaged in the same line of business[893].

3.4.2.1.3. Centralization of management

The last component of the constitutional test is the centralization of management, which is deemed as "the most unclear and fact-specific factor in the test"[894]. Despite the controversies, the court has already emphasized that: (i) the actual exercise of managerial control is essential for the fulfilment of this component, and the potential to control through majority ownership does not suffice; and (ii) the mere existence of some

[888] Mirage, 547–48.
[889] Mirage, 547–48.
[890] See US: ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982).
[891] US: F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), at 370.
[892] US: Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983), at 718.
[893] See, *e.g.*, US: ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982).
[894] Mirage, "A Solidification of the Unitary Business Principle: Allied-Signal, Inc. v. Director, Division of Taxation," 550.

managerial links between the entities, in the form of occasional oversight, is not sufficient for the fulfilment of the requirement.

With regard to actual managerial control, the court considers that the centralization of management is not present if an entity has the potential to control the management of the subsidiaries, but does not exert this power[895]. The court held that no centralization of management was present in a case were the parent company elected all the directors of the subsidiary[896]. In such case, the court took into account that (i) each subsidiary operated as a distinct business enterprise with regard to full-time management; (ii) there were no rotations or exchanges of personnel between entities; (iii) there were no centralized training programs to transfer the parent's idea of merchandising, and each subsidiary developed its own managers, with its own philosophies[897]. For this reason, the test has already been criticized as "overly focused on managerial control"[898].

The court also made clear that occasional oversight with respect to *e.g.* capital structure, major debt, and dividends is not sufficient. For the court, it is decisive "whether the managerial role that the parent does play is grounded in its own operational expertise and its overall operational strategy"[899]. In this sense, centralization of management has been deemed not to be present in a case, despite the fact that the parent maintained several common directors with its subsidiaries, and the senior management of the parent frequently communicated with the senior management of the subsidiaries[900]. On the other hand, centralization of management was deemed to be present in a case where a central office was found to provide: (i) long-range planning for the company; (ii) maximization of overall company operations; (iii) development of financial policy and procedures; (iv) financing of corporate activities; (v) maintenance of the accounting system, legal advice, public relations, labour relations; (vi) purchase and sale of raw material, and coordination between the enterprise functions so as to obtain an optimum operating program[901].

3.4.2.2. Problems of their application

The application of the unitary business principle in practice shows how controversial its adoption can be. HELLERSTEIN and MCLURE JR. affirm that the unitary business principle "is more uniform in theory than in practice" [902], describing it as "a recipe for uncertainty and inconsistency in the determination of the consolidated group"[903]. PICCIOTTO and KADET also consider that there would be "a strong consensus that limiting unitary taxation to those parts of a firm's activities that can be considered a unitary business would be problematic and should be avoided"[904].

Like the economic and organizational integration in the German revoked legislation, the elements of the unitary business principle are a clear case of quantitative (or soritical)

[895] US: ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982), at 320-324.
[896] US: F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), at 362.
[897] US: F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), at 366-67.
[898] Popkin, "The Effect of the Internet Era and South Dakota v. Wayfair on the Unitary Business Rule Comments: Annual Survey of Federal En Banc and Other Significant Cases," 97.
[899] US: Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983), at 180.
[900] US: F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), at 369.
[901] US: Exxon Corp. v. Department of Revenue, 447 U.S. 207, 218, 224 (1980).
[902] Hellerstein and McLure, Jr., "The European Commission's Report on Company Income Taxation," 204.
[903] Hellerstein and McLure, Jr., 204.
[904] Picciotto and Kadet, "The Transition to Unitary Taxation," 455.

vagueness[905]: one has to answer "how much" integration is necessary for a unitary business to be present, and a clear dividing line between a unitary and a non-unitary business cannot be found. The type of reasoning in such cases shows that the court is always comparing different levels of integration, without ever tracing a bright-line. The unitary business principle is so fact sensitive that a unitary business could be described simply as "something that the Court knows when it sees it"[906].

The analytical efforts to further specify the elements of the unitary business (functional integration, economies of scale and centralization of management) are not able to draw a line either. As the reasoning of the court shows, one still has to answer "how much" of each of these elements is necessary for economic integration to be present, and the soritical vagueness remains. The analytical segregation also brings the additional question of whether the elements have different weights (*is centralization of management more important than economies of scale?*), and whether the absence of one can be compensated by an increased level of the other (*can a higher level of centralization of management compensate for an insufficient level of economies of scale?*). There is even some doubt on whether all the elements must be present in every case, being possible to maintain that the elements have been listed by the Supreme Court "in the disjunctive, rather than the conjunctive"[907]. In this sense, MCLURE maintains that centralization of management combined with functional integration, economies of scale, or some other form of economic interdependence would be sufficient for a finding of unity[908].

The unitary business principle has also been criticized as a nexus theory. In the context of digitalization, the test would have become obsolete, preventing states from receiving their fair share of interstate commerce[909]. Information technology has made strategic development and the implementation of business synergies more effective, and has also improved risk management and oversight, thus converting the unitary business into an "arbitrary standard"[910]. POPKIN maintains, therefore, that the test should be modified to consider the flow of value and the benefits given by the state.

3.4.3. The "held as capital asset" criterion: a motive test

DE WILDE proposes that the definition of entity for tax purposes would demand control and a "motive test", which is supposed to account for economic integration. Tax consolidation should only be allowed in scenarios where the parent company holds control for the purpose of employing it for the benefit of the underlying business enterprise on a continuing basis. This requisite would be present in cases where the property rights last for more than one production process. Considering that the unitary business approach requires that the shareholding interest reflects the integration into one

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[905] Discussing the forms of vagueness and meaning of soritical vagueness, see Geert Keil and Ralf Poscher, "Vagueness and Law: Philosophical and Legal Perspectives," in *Vagueness and Law: Philosophical and Legal Perspectives*, ed. Geert Keil and Ralf Poscher (Oxford: Oxford University Press, 2016), 2–4.
[906] Walter Hellerstein, "State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on ASARCO and Woolworth," *Michigan Law Review* 81, no. 1 (1982): 183–84.
[907] McLure, "An Economic Definition of a Unitary Business," 31.
[908] McLure, 31.
[909] Popkin, "The Effect of the Internet Era and South Dakota v. Wayfair on the Unitary Business Rule Comments: Annual Survey of Federal En Banc and Other Significant Cases," 96.
[910] Popkin, 100.

economic entity, operating a business enterprise, he maintains that the requirement would only be met in cases where the participation is held as capital asset[911].

The proposal, therefore, is to consider as part of the group only entities whose participation are held as a capital asset, following the distinction present *e.g.* in IFRS 5[912]. The reasoning is that, if the shares are held as capital asset, the property is available for the benefit of the business activities for more than one production process, approximating integration, whereas, if the shares are held as a current floating asset, no integration with the activities of the company whose shares are held is intended[913].

DE WILDE acknowledges that the adoption of a "motive test" is not common across jurisdictions. He attributes that to administrative inconvenience, as tax authorities would have to decide on the taxpayers' intention[914]. Besides the problem of uncertainty, the approach is not as comprehensive as the other integration criteria. Shares that are not held as capital asset certainly will not be part of the business unity. The merits of the thesis is to at least exclude such entities which are not held as capital asset, which are certainly not part of the economic group. However, it remains possible that multiple "business unities" are controlled by a holding company, without any form of integration, and with different sets of minority shareholders. Such economic unities would be treated as a single entity, in a sense that would not be allowed under a more restrictive interpretation of the other integration criteria described above.

3.5. Ownership thresholds: the "legal" criterion

With the exception of Denmark, contemporary group regimes apply bright-line ownership thresholds[915]. There are several alternatives to classify group regimes[916]. The consolidation policy is present where the system allows the consolidation of income and losses among entities belonging to the group[917]. From the enterprise doctrine, it follows that entities which are part of an enterprise should be treated as a single tax unit, with all the taxable income and losses consolidated[918]. The full consolidation policy can be implemented by means of a pooling system, an attribution system or an absorption system.

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[911] Maarten de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market* (Doctoral Thesis: Erasmus Universiteit Rotterdam, 2015), 178–79.
[912] de Wilde, 183.
[913] de Wilde, 177.
[914] de Wilde, 178.
[915] The Danish control concept is based on the financial reporting concept of control. See Hey and Schnitger, "General Report," 32.
[916] The classifications found in scholarship differ according to the needs of the exposition. The section is based on the classification presented by TING, which contrasts the regimes with the level of adoption of the enterprise doctrine, and is therefore in line with the purpose of the section. For different classifications of group regimes, see Hey and Schnitger, 32; Jankub Jankowski, "Tax Consolidation Regime in European Union: Towards One Unified Approach among All Member States?," *EC Tax Review* 30, no. 3 (2021): 120; OECD, *Corporate Loss Utilisation through Aggressive Tax Planning* (Paris: OECD, 2011), 31–32; Witt, *Die Konzernbesteuerung*, 85–108; Masui, "General Report," 29–31.
[917] The international experience also presents examples of group contribution and group relief systems, which are not considered for the purpose of the section, focused on the consolidation regimes. See on group contribution and group relief systems, Hey and Schnitger, "General Report," 32.
[918] Ting, *The Taxation of Corporate Groups*, 273.

In the pooling system, the parent company and its subsidiaries remain, to a large extent, being treated as separate entities for income tax purposes. The income or loss of each entity is computed on an individual basis. The results are further aggregated at a group level and adjusted for intra-group transactions, thus arriving at the consolidated taxable income or loss[919]. An example thereof is the Italian domestic consolidation regime. In this regime, the consolidating company determines the taxable base by adding all the (positive and negative) taxable bases of the companies that are part of the group. The consolidating company is obliged to make the final and periodic tax payments, and is entitled to carry-forward the net tax losses. Payments eventually made between the group members as consideration for the transfer of taxable base (*e.g.* transfer of losses) are neither taxable nor deductible[920]. The Spanish tax consolidation regime similarly defines the tax base of the tax group as the sum of the individual tax bases of the entities which are part of the group, subject to other specific provisions[921]. The greatest advantage of this system is simplicity. It takes into account the existing separate entity-oriented framework, making minor adjustments to arrive at the consolidated tax base. This system also interacts well with other income tax regimes[922]. This alternative, however, is the weakest application of the enterprise doctrine among the full consolidation alternatives.

In the attribution system, an example of which is the Dutch fiscal unity regime, assets liabilities and activities of consolidated subsidiaries are attributed to the parent company, in order to achieve the aggregation of taxable income and losses of the group[923]. Both the balance sheet and the profit and loss account of the entities are fiscally consolidated[924]. For other income tax purposes, the subsidiaries remain being treated as separate entities, as they remain formally subject to corporate income tax[925], which is particularly important for the application of tax treaties[926]. The attribution system represents a stronger application of the enterprise doctrine, when compared to the pooling system, but a weaker one, when compared to the absorption system[927].

In the absorption system, consolidated subsidiaries are deemed to have become divisions of the parent company, and cease to exist as individual companies, for income tax purposes. The parent company is deemed to hold directly all assets of the subsidiaries[928]. As a consequence, losses generated during consolidation are considered to be losses generated solely by the parent company[929]. In the Australian regime, the group submits a single consolidated income tax return, whereby the assets and liabilities of the subsidiary members are treated as assets and liabilities of the head company, and transactions undertaken by the subsidiary members of the group are treated as transactions of the head company. In summary, income of all members of a tax consolidated group is treated as being income of the head company of the group. All intra-group transactions are

[919] Ting, 272.
[920] See, on the domestic tax consolidation, Cesare Silvani, "Italy - Corporate Taxation," in *Country Tax Guides IBFD* (Amsterdam: IBFD, 2021), sec. 8.
[921] ES: *Ley del Impuesto sobre Sociedades*, Art. 62(1)(a).
[922] Ting, *The Taxation of Corporate Groups*, 272.
[923] Ting, 272.
[924] Hendrik-Jan van Duijn and Kim Sinnige, "Netherlands - Corporate Taxation," in *Country Tax Guides IBFD* (Amsterdam: IBFD, 2021), sec. 8.3.
[925] NE: Corporate Income Tax Law of 1969, Article 15(1).
[926] Ting, *The Taxation of Corporate Groups*, 272.
[927] Ting, 272.
[928] Ting, 272.
[929] Ting, 164.

ignored[930]. The system presents many advantages[931]. In the absorption system, intra-group asset transfers are completely ignored, and the transfers have no immediate tax implication. No tracing of asset movements is required, as there is no need to keep record of deferred gains or losses, or recapture of gains or losses when one of the entities leaves the group. Also, when an entity enters the group, there is no need to compute the "stand-alone" taxable income of the entity every year, because pre-consolidation losses are allowed to be set-off against the income of the group. The system also brings many complexities[932]. A major problem is the application of the tax cost setting rules, which requires one to reset the cost bases of assets of a subsidiary joining the group, and reconstitute such cost upon leaving the group[933]. Another problem of this system is the interaction with other parts of the income tax regime, which are designed to deal with a separate entity reality. Even though, the absorption system is the strongest application of the enterprise doctrine.

Therefore, an enterprise doctrine may be implemented at different levels, and several policy options are available for that. For the purpose of this chapter, however, what matters is how the group is defined. The scope of the section is to examine how the tax subject is defined in cases where the separate entity approach is partially abandoned. The extent to which the consolidation is adopted is not relevant for the purposes of the section.

3.5.1. Shareholding criterion

In tax group regimes, shareholding is the most common control factor seen in the definition of a group for tax purposes[934]. Defining the group by means of shareholding is simple to administer in practice, but might prove prone to abuse. Therefore, tax legislations often supplement shareholding with other elements, such as voting rights and rights to profits. There are two alternative ownership thresholds for group regimes in general, which could be described as "substantially 100%" and "substantially less than 100%"[935].

3.5.1.1. Substantially 100%

States that opt for a threshold substantially close to 100% in their group regimes include New Zealand, Australia and the Netherlands. In New Zealand, groups of resident companies that have 100% common ownership may elect to be subject to the consolidated group regime[936], with a caveat for small variations in shareholdings in compliance with company law requirements and up to 3% holdings of employees under approved share purchase schemes. The Australian group regime is available to "wholly owned subsidiaries", with a 1% caveat for shares issued under employee share schemes[937]. In the

[930] See, for further reference, Tom Toryanik, "Australia - Corporate Taxation," in *Country Tax Guides IBFD* (Amsterdam: IBFD, 2021), sec. 8.1.
[931] Ting, *The Taxation of Corporate Groups*, 272.
[932] Ting, 272.
[933] On cost-setting rules, see Toryanik, "Australia - Corporate Taxation," sec. 8.1.
[934] Ting, *The Taxation of Corporate Groups*, 276.
[935] Ting, 275.
[936] Besides the consolidated group regime, companies that are 66% or more commonly owned can offset losses by election as well as by subvention payment. See Kevin Holmes, "New Zealand - Corporate Taxation," in *Country Tax Guides IBFD* (Amsterdam: IBFD, 2021), sec. 8.1.
[937] See, for further reference, Toryanik, "Australia - Corporate Taxation," sec. 8.1. For further discussion on the Australian definition of control, see Ting, *The Taxation of Corporate Groups*, 124–25.

Dutch fiscal unity regime, the parent company must hold at least 95% of each class of shares and 95% of the voting rights in the subsidiary company, provided that the other shares do not entitle their holder to more than 5% of the company's distributed and retained profits[938].

The main justification for a high threshold is the proximity with the idea of economic unity, considering the absence of other applicable economic criteria[939]. Other explanations may include the state's concern with tax revenues. As access to a group regime may adversely impact tax revenues (due *e.g.* to loss offsets among the entities), restricting access to the regime by means of a high threshold may be a way to minimize such impact[940]. Besides that, practicability reasons may also be evoked. The US experience suggests that the existence of minority shareholders may add complexity to group regimes[941].

3.5.1.2. Substantially less than 100%

Among the regimes that opt for a lower threshold, one could mention Austria (more than 50%), Italy (more than 50%) Spain (70%-75%) and the US (80%). In Austria, a simple majority of more than 50%, both in terms of capital participation and voting rights, is required for the existence of a financial connection[942]. Italy also presents a very low threshold for accessing the group regime. For the purposes of the domestic tax consolidation, an eligible subsidiary is a resident company in which the parent (i) holds, directly or indirectly, the majority of the voting rights that can be exercised at the shareholders' meeting, (ii) holds, directly or indirectly, more than 50% of the subsidiary's stated capital and (iii) is entitled, directly or indirectly, to more than 50% of the profits of the subsidiary[943]. In Spain, the threshold has oscillated between 50 and 90% over the years[944]. Upon the introduction of the regime in 1977, there was a 50% threshold, which was increased to 90% in 1982 and reduced to 75% in 2002. Presently, the head company ("*entidad dominante*") shall hold, directly or indirectly, at least 75% (or 70% in case of listed companies) of the share capital and the majority of the voting rights of the other entities belonging to the group[945]. In the US, the threshold has been lowered over the years, from "substantially" all in 1917, to 80% since 1954[946].

Another example worth mentioning is the consolidation requirement of the CCCTB proposal[947]. The definition of qualifying subsidiary for the purpose of consolidation requires that the parent holds both a right to exercise more than 50% of the voting rights,

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[938] NE: Corporate Income Tax Law of 1969, Article 15(1) and (3). See also van Duijn and Sinnige, "Netherlands - Corporate Taxation," sec. 8.3.
[939] See Hüttemann, "Organschaft," 138.
[940] Ting, *The Taxation of Corporate Groups*, 276.
[941] Ting, 276.
[942] On the development of the Austrian regime, see Daniela Hohenwarter-Mayr, *Verlustverwertung im Konzern* (Wien: LexisNexis, 2009), 231–48.
[943] See Cesare Silvani, "Italy - Corporate Taxation," in *Country Tax Guides IBFD* (Amsterdam: IBFD, 2021), sec. 8.2.
[944] Ting, *The Taxation of Corporate Groups*, 276.
[945] ES: *Ley del Impuesto sobre Sociedades*, Art. 57(2)(b).
[946] Ting, *The Taxation of Corporate Groups*, 276.
[947] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final (25 Oct. 2016).

and an ownership right amounting to more than 75% of the subsidiary's capital or of the rights giving entitlement to profit[948].

A higher threshold than the mere control is considered to be a requirement for the group of companies to represent an economic unit[949]. Accordingly, the group parent must be able to determine the business policy of the group companies under company law, so that it is able to impose its will on the other group members, also by means of dismissing managers, if necessary.

HÜTTEMANN rejects the approximation between the idea of economic unit and the control trigger of substantially less than 100%[950]. He maintains that the idea of the "economic entity" would no longer be applicable in case of a participation requirement of 75%. The idea of the "economic unit" would only be "really convincing" in case of an approximation to 100% participation, if one wishes to focus solely on the amount of the financial participation and completely eliminate additional "economic" elements.

He proposes, however, that it would be possible to get rid of the idea of the economic unit and simply understand group taxation as a tax instrument aimed at achieving a certain tax "approximation" of holding structures and economic unit. Such an approach could be justified with the consideration that a parent company, which has a stake of 75% or more in a subsidiary, has such possibilities of influence under company law that it is able to act against the will of the minority shareholders and overcome the separation principle through corporate restructuring. Group taxation would spare companies from such restructuring for purely tax reasons and thus contribute to a certain equal treatment of economic unities and holding structures[951].

3.5.2. The broader control definitions in anti-abuse rules: a caveat

It is true that anti-abuse rules will often resort to much broader control definitions, as they are intended to play multiple roles within the system[952]. Thin-capitalization rules, CFC rules, and rules on the limitation of interests, for instance, will often apply by reference to the notions of economic control or de facto control. In such cases, it is possible that an entity is treated as a controlled entity, even if the 50% shareholding trigger is not met.

One may refer to "economic control" as a concept that focuses on rights to the profits, as well as capital and assets of a company in certain circumstances (dissolution or liquidation). This test acknowledges that an entity can be controlled through an entitlement to the underlying value of the company even without a majority of the shares. Likewise, the reference to "de facto control" describes a concept that looks at other factors, such as the persons who take the top-level decisions regarding the affairs of the entity, or who have the ability to direct or influence its day-to-day activities. "De facto control" may also be present in cases where there are particular contractual ties that permit one entity to exert a dominant influence over the other. The "de facto control" test generally operates as an anti-avoidance rule that apply in addition to other control tests,

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[948] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final (25 Oct. 2016), Art. 5(1).
[949] IFST-Arbeitsgruppe, "Einführung einer modernen Gruppenbesteuerung," 54.
[950] Hüttemann, "Organschaft," 138.
[951] Hüttemann, 139.
[952] See, on the topic, Schildgen and Hey, "Das Sondersteuerrecht," 23–34.

ensuring that they are not circumvented. As such, they require a significant factual analysis, being associated with complexity and uncertainty[953].

Such definitions are not designed to generally capture the enterprise as a single entity[954]. They operate in the context of rules which are partial deviations from the separate entity approach, and are designed essentially to deal with conducts perceived as abusive, which are only made possible in the context of the separate entity approach. Such rules are specific anti-avoidance rules ("**SAARs**"), which deal with the undesirable exploitation of certain features of a tax system based on the separate entity approach, such as the deferral of taxation by means of the interposition of a CFC, or the creation of excessive intra-group debt aiming at the reduction of the tax burden. They are designed to prevent an entity from avoiding taxation by means of its interaction with other entities – and, for this purpose, the ability to influence the other entities and derive benefits therefrom is decisive. Additionally, as SAARs, such rules commonly include other material requirements for their application, which are treated as indicative of abuse, such as the deriving of a certain amount of tainted income or the existence of a certain level of intra-group debt.

In summary, one cannot find a more ambitious theoretical foundation underlying such rules, in the sense of a definition of enterprise intended to describe a tax subject[955]. While group taxation relieves the taxpayer from the downsides of the separate entity-approach, anti-abuse rules are aimed at preventing the exploitation of the separate-entity doctrine within the economic group, but their application also takes place in broader cases, where some level of influence between entities is possible[956]. Their purpose is different from that of group regimes. They are designed as SAARs, and aim at specific conducts, following a "sniper approach" [957]. They are not intended to allow for the treatment of the enterprise as a single subject, but are rather creatures of the separate entity approach.

3.6. Summary

In the case of the definition of group for the purpose of group taxation regimes, the preference of resorting to control is very clear[958], and is also present in the CCCTB proposal as a requirement for consolidation. International experience has shown that economic integration is very difficult to apply in practice. Both the German fiscal unity regime and the US experience with state income tax account for the practical undesirability of the approach.

Even in case of comprehensive group regimes, the enterprise doctrine is hardly adopted in full. Disregarding intra-group transactions, for instance, is of the essence for the full adoption of a system based on the enterprise doctrine[959], but this is a rare feature of group taxation regimes. In general, group regimes are focused on allowing for the

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[953] See, *e.g.,* OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 24–25.
[954] Schildgen and Hey, "Das Sondersteuerrecht," 8.
[955] See, however, that the Danish control concept is based on the financial reporting concept of control. See Hey and Schnitger, "General Report," 32.
[956] See Schildgen and Hey, "Das Sondersteuerrecht," 23–34.
[957] Roy Rohatgi, *Basic International Taxation* (London: Kluwer Law International, 2002), 374. See, further discussing the relationship of the IIR with CFC rules, ch. V, sec. 3.1.3, *infra.*
[958] Ting, *The Taxation of Corporate Groups*, 19.
[959] de Wilde, *Sharing the Pie*, 2015, 166–67.

intersubjective compensation of losses and, in some cases, ensuring the roll-over of assets between its members – and they are often examined for their desirability under this perspective [960]. Even though some level of compensation of losses may be achieved by means of reorganization, a legislative framework is essential to grant legal certainty and a stable tax environment[961]. Approaches that provide for a satisfactory solution to this problem are deemed as a workable alternative. This feature might account for the absence of more ambitious implementations of the enterprise doctrine across tax systems.

When resorting to control upon the definition of the group, a more cautious approach is associated with a more ambitious adoption of the enterprise doctrine. It is not a coincidence that the regimes which most approximate a full adoption of the enterprise doctrine by means of consolidation, such as Australia and New Zealand, also include a shareholding requisite of substantially 100%. Lower thresholds, on the other hand, are commonly associated with the "competitiveness"[962] of the system, which, despite legitimate, is a non-fiscal purpose.

The taxation of the economic group as an entity is grounded on neutrality of forms and on the ability-to-pay of the group. Nevertheless, if two entities have no underlying economic ties with each other besides common control, there is no reason why their income should be lumped together at any level, or why the consolidation of these entities should have any relevance for the purpose of grasping the ability-to-pay. The control criteria, while much more workable than the integration criteria, may lead to situations where tax law treats as a unitary business a mere set of entities under common control, which present no economic connection among themselves. It is not only possible, but also frequent, that two separate entities are controlled by the same entity, but still represent two completely different businesses, independently managed by different persons, congregating two different groups of minority shareholders. Treating such diversification strategy as a unitary business can be grounded on the "competitiveness" of the system (assuming that the regime will be beneficial for the subjects involved, such as in the case of group regimes), but the relation with the ability-to-pay and the neutrality of forms becomes more blurred.

The identification of the group for tax purposes concerns the question of what influence tax law should have on corporate structuring, being the neutrality of forms a desirable feature of a tax system. Practical difficulties arise from the fact that economic integration has proven not to be suitable as a tax starting point for group taxation due to the lack of sufficient factual determination. A trigger of substantially less than 100% is seen as a "second-best" solution that ensures at least a certain approximation of the aimed reality, while maintaining the basic principles of tax law and a sufficient practicability for group tax regimes[963]. However, cases that cannot be explained by the "enterprise doctrine" will inevitably remain.

This problem has been well described by PICCIOTTO and KADET, but a dogmatic solution is still not available. Approaching the formulary apportionment under unitary taxation, they maintain that the unitary business principle would be too restrictive when firm theory is considered and that, provided that those businesses "remain under common

[960] See Ting, *The Taxation of Corporate Groups*, 38; Masui, "General Report," 26.
[961] Masui, "General Report," 26.
[962] Ting, *The Taxation of Corporate Groups*, 66.
[963] Hüttemann, "Organschaft," 142.

management and control, it must be assumed that the integration of even diverse business lines is a key element of their profitability" [964]. Such consideration would provide for a "principled rationale for the presumption that a corporate group under common ownership and central management and control should be treated as a unitary enterprise"[965]. The authors also maintain that such presumption should be "a rebuttable presumption with an antiabuse rule to prevent companies from gaming the apportionment factors" [966]. However, a control trigger, alone, is not able to implement the policy outcome intended by the authors, and the dogmatic challenge still remains: how to establish "central management" as a criterion, without incurring in the same problems of soritical vagueness inherent to the unitary business principle? How to design an antiabuse rule, which operates smoothly not only in the context of unitary taxation, but whenever the "enterprise" is taken as the relevant taxable subject? These questions remain unanswered.

In conclusion, the interest of tax law in the enterprise is functionally-oriented. Tax law can take the economic unit into consideration by several different forms, setting forth different conditions for the economic unity to be present, according to its need in a particular subsystem[967]. The enterprise doctrine is not "an overriding concept applied transcendentally throughout the entire legal spectrum"[968]. One does not find a linear and consistent application of the enterprise doctrine within a field of law, and not even within a specific part of income tax legislation, since "the application of the enterprise doctrine in practice is always subject to constraints and compromises"[969]. For the purpose of defining a taxable subject, the reference to control is a mere approximation of economic unit. As such, it may capture structures that do not represent a significant level of economic integration, and a higher participation threshold is common across jurisdictions, in order to avoid an excessively broad regime.

4. The definition of the subjects of the GloBE Model Rules

Having addressed the main features of the separate-entity and of the enterprise doctrine, it is now possible to properly examine the main definitions related to the subjects of the GloBE Model Rules. This section examines the definitions of MNE Group (sec. 4.1) and CE (sec. 4.2). The goal of the analysis is to provide for a dogmatic evaluation of the relevant concepts, as well as to offer the relevant elements for examine their justification (sec. 5).

4.1. The MNE Group

The GloBE Model Rules apply to CEs that are members of an MNE Group that has an annual revenue of EUR 750 Million or more in the Consolidated Financial Statements of the UPE[970]. A Group means a collection of Entities that are included in the Consolidated Financial Statements or are excluded merely on materiality grounds or on the grounds that the Entity is held for sale[971]. Even if the Entity is not consolidated on a line-by-line basis, it shall also be treated as part of the Group, as long as it remains sufficiently within

[964] Picciotto and Kadet, "The Transition to Unitary Taxation," 456.
[965] Picciotto and Kadet, 456.
[966] Picciotto and Kadet, 456.
[967] See Palm, *Person im Ertragsteuerrecht*, 437.
[968] Blumberg, "The Transformation of Modern Corporation Law," 611.
[969] Ting, *The Taxation of Corporate Groups*, 274.
[970] GloBE Model Rules, Art. 1.1.1.
[971] GloBE Model Rules, Art. 1.2.2.

the control of the UPE to fall within the general consolidation requirements of the relevant Acceptable Financial Accounting Standard[972].

The rule, therefore, strictly adheres to control as a criterion. Moreover, it expressly rejects any form of "motive test"[973] for the definition of Group. The fact that an Entity is excluded from the Consolidated Financial Statements of the UPE solely on size or materiality grounds, or on the grounds that the Entity is held for sale, is meaningless for the identification of the Group.

4.1.1. The IFRS definition of control

There is a significant level of discretion ("professional judgment") inherent to the definition of control under Acceptable Financial Accounting Standards, and the same facts and circumstances may be subject to diverse qualifications if submitted to different interpreters. As seen[974], the GLOBE MODEL RULES take the IFRS as the gold-standard for defining Consolidated Financial Statements. However, in countries where there is some form of group taxation, the group for tax purposes is not the same as the group for financial reporting[975]. For this reason, it is important to properly analyze the definition of control for the purposes of the Consolidated Financial Statements under the IFRS rules. Before examining the elements of the definition of control (sec. 4.1.1.2), the section provides a brief overview on its theoretical background (sec. 4.1.1.1), in order to evidence that the IFRS definition is not concerned with the integration of the consolidated entities, being aimed at the informational needs of the users of the statement.

4.1.1.1. The theoretical background

The theoretical background for the IFRS definition does not take the integration of the MNE as a relevant feature. The IASB expressly considered and rejected alternative proposals to the "controlling entity model", which ultimately prevailed upon the enactment of IFRS 10.

The concern upon the formulation of the standards related to consolidated financial statements was whether "consolidated financial statements meet the objective of financial reporting, by providing useful information to equity investors, lenders and other capital providers"[976]. The concept of reporting entity should be clearly linked to the objective of the financial statements[977]. In other words, the objective of financial reporting is the provision of financial information about the reporting entity. The information provided must be useful and assist potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. This is the objective that is taken into account when determining "when the boundary between two or more entities should be disregarded and the entities presented as a single unit"[978].

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[972] GLOBE COMMENTARY, p. 18, para. 24.
[973] See sec. 3.4.3, *supra.*
[974] For a more detailed analysis of the applicable financial statements, see ch. IV, sec. 2.2.1, *infra.*
[975] Christopher Nobes and Robert Parker, *Comparative International Accounting*, 14th edition (Harlow: Pearson, 2020), 38. See, however, sec. 3.5.2, *supra,* on the Danish regime.
[976] IASB, "Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity" (Discussion Paper, London, IASB, 2008), para. S9.
[977] IASB, para. 29.
[978] IASB, para. 24.

When examining which model should be used in order to comply with those informational needs, the IASB discarded two theoretical models and preferred the "controlling entity model", which was considered more appropriate to base IFRS 10.

4.1.1.1.1. The discarded models

In 2004, the IASB and the US FASB decided to carry out a joint project to develop a common conceptual framework, based on and built on both the existing IASB Framework and the FASB Conceptual Framework, which would be used as a basis for their respective accounting standards. The conceptual framework project was conducted in eight phases, and phase D related to the nature of the "reporting entity", the concept of control and the need for consolidated financial statements. The project was discontinued in 2012, but its development helps clarifying the rules of IFRS 10.

There is a very brief reference to a "synergistically managed assets approach" in one of IASB board discussions, which was not further pursued. In an IASB board meeting in 2007, the board discussed models for the composition of a group reporting entity for financial reporting purposes, which included: (i) the controlling entity model, (ii) the common control model, and the (iii) synergistically managed assets approach[979].

At that opportunity, the synergistically managed assets approach was discussed by the board for the first time[980]. According to this approach, the area of economic interest, "both for an individual entity and group entity", would be "circumscribed by the group of net assets that are managed synergistically together to generate returns to investors, creditors and others". The information available on the meeting merely states that the "synergistically managed assets approach was not pursued", while "there appeared to be a consensus that on a conceptual level the composition of the group reporting entity should be based on 'control' with the controlling entity model as 'main driver'"[981].

The "common control model" deserved more attention. Similarly to the synergistically managed assets approach, the common control model does not take control as a sufficient condition for consolidating. Under the common control model, the existence of a controlling entity would be a necessary, but not a sufficient factor in determining whether the commonly controlled entities would represent a circumscribed area of business activity of interest to equity investors, lenders and other capital providers[982]. Other circumstances would also need to be present[983]. Under one of the versions of this approach, only when the entities under the control of the same parent entity "are managed together as a single unit", the combined operations of the two entities are a circumscribed area of business activity of interest to existing and potential equity investors, lenders and other capital providers. The "degree of integration and interaction" between the subsidiaries is considered to mean that the returns to each subsidiary's capital providers are generated by the subsidiaries' combined business operations. Accordingly, information in the combined financial statements would help these capital providers

[979] See Deloitte, "Deloitte Meeting Notes" (IASB Board Meeting 15-18 May, 2007); IASB, "IASB Updated" (Board Decisions on International Fiscal Reporting Standards, May, 2007).
[980] See Deloitte, "Deloitte Meeting Notes."
[981] See Deloitte, "Deloitte Meeting Notes."
[982] IASB, "Preliminary Views," para. 94.
[983] See, on the circumstances in which such conditions would apply, IASB, paras. 82–91.

assess the amounts, timing and uncertainty of cash flows to them, such as dividends and interest[984].

4.1.1.1.2. *The controlling entity model*

In May 2008, in the discussion paper dedicated to the topic in phase D of the common conceptual framework, the board expressed its preliminary view that, overall, the controlling entity model would be more consistent with the objective of financial reporting than the common control model – or the synergistically managed assets approach, which is not even mentioned in the discussion paper. It was observed that when the investor has control over the investee, the investor has the ability to direct the investee's financing and operating policies, so as to access benefits flowing from it, as well as to increase, maintain or protect the amount of those benefits. Therefore, in such cases, disregarding the legal boundary between the parent and subsidiary, and presenting information about them as a single unit (understood as "a circumscribed area of business activity"), would provide "useful information"[985].

In December 2008, the exposure draft which was published in the context of the project that led to the enactment of IFRS 10, proposed that "the controlling entity model should be the only basis for consolidation" and did not discuss the application of the common control model[986]. The exposure draft implemented "at standards level" the wide understanding of a group formerly developed in the common conceptual framework[987], and therefore draws on the ideas developed therein. IFRS 10 was first published in 2011, being subject to further amendments in subsequent years.

The definition of control follows the controlling entity model and is therefore focused on the ability of the investor to direct the financial and operating policy of a company and derive benefits therefrom. The definition of control for the purpose of consolidated statements is concerned with the "strategic power" to determine the way the assets of the entity are used and benefit from the returns derived therefrom. No reference to integration or any form of synergy is found in the definition.

4.1.1.2. *The criteria under IFRS 10*

Under IFRS rules, a "parent" shall present consolidated financial statements. A parent is the investor that "controls" the investee, meaning the investor that "is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee" [988]. An investor controls an investee if and only if it cumulatively has: power over the investee; exposure, or rights, to variable returns from its involvement with the investee; and the ability to use its power over the investee to affect the amount of the investor's returns[989].

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[984] IASB, para. 90.
[985] IASB, para. 92.
[986] IASB, "ED 10 Consolidated Financial Statements" (Exposure Draft, London, IASB, 2008), para. BC34.
[987] IASB, para. BC29.
[988] IFRS 10, *Consolidated financial statements*, para. 6.
[989] IFRS 10, *Consolidated financial statements*, para. 7.

4.1.2. *Critical assessment of the GLOBE Group definition*

Considering the elements gained with the analysis of the enterprise doctrine[990], as well as the description of the GLOBE MODEL RULES[991], it is possible to critically examine the GLOBE Group definition. This section examines the material aspects of the definition (sec. 4.1.2.1), considering the purpose of the definition within the GLOBE MODEL RULES, as well as the formal aspects (sec. 4.1.2.2), focusing on the challenges it presents for legal certainty.

4.1.2.1. *Material aspects*

The policy choices made upon the definition of Group have significant impacts on the determination of which entities are relevant for the calculation of the ETR, of the Top-up Tax, and also of which entities are burdened by the charging rules. Among the material aspects, the section examines the consequences of the lack of an integration requirement (sec. 4.1.2.1.1) and also the special treatment set forth in relation to Minority-Owned CEs (sec. 4.1.2.1.2).

4.1.2.1.1. *The lack of an integration requirement*

The experience with the enterprise doctrine[992] shows that, despite the alleged theoretical superiority of integration criteria, they are not workable in practice and create too much uncertainty. Contemporary tax legislations across jurisdictions prefer the strict reference to shareholding and control, mainly grounded on practicability concerns.

Likewise, the GLOBE MODEL RULES have also chosen to define the MNE Group with exclusive reference to control, with no consideration to integration within the MNE Group. As seen, the historical development of the IFRS 10 criteria bears no relation with integration concerns. Accounting theories inspired on integration have been rejected at the early stages of development of the IFRS 10. In fact, the criteria for consolidation are oriented by informational purposes. It was never intended to account for the ability-to-pay of the group, but rather to provide useful information for investors and other stakeholders. The "synergistically managed assets approach" has been expressly rejected in the preparatory work that lead to the enactment of IFRS 10, and the theoretical foundations of the controlling entity model are not grounded on concerns related to the integration of the enterprise.

Besides that, the GLOBE MODEL RULES expressly reject any form of "motive test", by including in the Group definition Entities that are held for sale, even if such Entities are excluded from the Consolidated Financial Statements under the GAAP applied by the UPE. As seen, a "motive test" in the lines of IFRS 5 is maintained in the literature as a form of bringing the group definition closer to a unitary business approach[993]. Such approach is expressly rejected by the wording of Art. 1.2.2. of the GLOBE MODEL RULES.

In any case, the shortcomings of not adopting an integration requirement are less significant than it would be the case in the context of an ambitious consolidation regime.

[990] See sec. 3, *supra*.
[991] See sec. 4.1.1, *supra*.
[992] See sec. 3, *supra*.
[993] See sec. 3.4.3, *supra*.

The definition of the MNE Group is not intended to provide for a worldwide consolidation. The use of the criterion by the GLOBE MODEL RULES is more modest. The GLOBE MODEL RULES merely take the MNE Group as a starting point, and only allows for a pooling of the GLOBE Income of the CEs within a jurisdiction for the purpose of calculating the ETR. At the end of the day, the GLOBE MODEL RULES significantly rely on information of the individual CEs. This does not mean, however, that the policy choice is free from downsides. The broad definition of control presents shortcomings both from a taxpayers' and a tax authorities' perspective.

From a taxpayer's perspective, one problem that could be seen is that a Top-up Tax could be charged in relation to an Entity that is controlled, but not part of a unitary business. This feature could be seen as inconsistent with a stricter vision of the economic group, grounded on some form of enterprise doctrine. Considering the justification of the GLOBE MODEL RULES as a floor to tax competition, such feature could hardly be considered a major harm to the consistency of the rules. On the contrary, also this sort of investment would be expected to be covered under Pillar Two.

Another more significant shortcoming is that, in the case of a holding company that controls multiple separate businesses, it is possible that a CE belonging to one unitary business is charged by means of an IIR or an UTPR for a Top-up Tax related to a LTCE of another unitary business within the MNE Group[994]. Consider a holding company that controls a soy exporting business and a toy manufacturing business. Both business are controlled through separate CEs, which have their own management team, and control many other CEs spread around the world. The toy and the soy business are separately managed and present no synergy at all, being controlled by the holding company solely for the purpose of portfolio diversification. Each business presents a completely different set of minority shareholders. In the example, it is possible, *e.g.,* that a CE engaged in the soy business is charged by a UTPR to pay a Top-up Tax arising from an LTCE of the toy business. As a consequence, the minority shareholder of a toy CE will be burdened by a tax due on the activities of a LTCE in the soy business, with which the minority shareholder bears no relation at all[995].

From a tax authorities' perspective, the most obvious shortcoming would be the pooling of profits and losses of different businesses in a single jurisdiction, for the purpose of calculating the ETR, which is not consistent with a stricter view of the enterprise doctrine. Another potential problem that could be envisaged is that MNE Groups could find tax planning opportunities in acquiring control over entities or relocating CEs already under control that are not part of the unitary business as means to avoid a Top-up Tax. It is hard to speculate how feasible or relevant this would be in practice, but in theory a form of avoiding a Top-up Tax would be to acquire control over a (loss-making or highly taxed) entity in a certain jurisdiction in order to blend the income of another CE that would otherwise be qualified as an LTCE[996]. Relocation of CEs could also achieve a similar result. This could be performed even if the acquired entity is in no sense integrated in the activities of the MNE Group.

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994 See ch. V, sec. 3.3.3, *infra.*
995 This problem is further explored in ch. V, sec. 3.3.3, *infra.*
996 See, discussing potential tax planning strategies, Heydon Wardell-Burrus, "Tax Planning under the GloBE Rules," *British Tax Review*, no. 5 (2022): 623–58.

In summary, the GLOBE MODEL RULES resort to a multitude of approaches and theories, transitioning from separate-entity to enterprise approaches upon the construction of the relevant concepts and mechanisms. The inexistence of an integration requirement is in line with the eclecticism of the GLOBE MODEL RULES solution. While a more purist definition of MNE Group presents significant definitional challenges, which remain unresolved, defining a group with strict reference to control is justified on the practicability and legal certainty advantages of the approach.

4.1.2.1.2. The special treatment for Minority-Owned CEs

Another consequence of adopting the definition of control used for Consolidated Financial Statements' purposes is that the GLOBE MODEL RULES have to set forth special rules for computing the ETR and Top-up Tax of Minority-Owned CEs. As a consequence of the definition of control, it is possible that control is held with a relatively low participation. For such cases, the GLOBE MODEL RULES set forth a special treatment under Art. 5.6, which does not apply if the Minority-Owned Constituent Entity is an Investment Entity. In essence, under Art. 5.6, CEs that are controlled with a participation inferior to 30% are treated as a separate subgroup for the purpose of calculating the ETR and the Top-up Tax.

The GLOBE MODEL RULES define a Minority-Owned CE as a CE of the MNE Group where the UPE holds directly or indirectly 30% or less of its Ownership Interests, whereas a Minority-Owned Subgroup means a Minority-Owned Parent Entity and its Minority-Owned Subsidiaries[997].

In the case of a Minority-Owned CE or a Minority-Owned Subgroup, the rules for the computation of the ETR and Top-up Tax for a jurisdiction apply as if they were a separate MNE Group[998], or on an entity basis in case of a Minority-Owned Constituent Entity that is not a member of a Minority-Owned Subgroup[999]. The GLOBE Income or Loss of the Minority-Owned CE or of the Minority-Owned Subgroup, as well as their Adjusted Covered Taxes, are excluded from the determination of the remainder of the MNE Group's ETR for the jurisdiction.

In summary, in case of Minority-Owned CEs, there is a restriction to the jurisdictional blending. Instead of blending GLOBE Income and Losses and Adjusted Covered Taxes of all CEs in the jurisdiction, the provision requires that the ETR of Minority-Owned CEs and Minority-Owned Subgroups is calculated separately.

The justification for this treatment is found in the GLOBE COMMENTARY[1000]:

> *If the income and taxes of these different Constituent Entities were blended in the jurisdictional ETR computations,* ***low-tax outcomes in one Entity could result in a Top-***

[997] GLOBE MODEL RULES, Art. 10.1. Minority-Owned Parent Entity is further defined as "a Minority-Owned Constituent Entity that holds, directly or indirectly, the Controlling Interests of another Minority-Owned Constituent Entity, except where the Controlling Interests of the first-mentioned Entity are held, directly or indirectly, by another Minority-Owned Constituent Entity". Minority-Owned Subsidiary means "a Minority-Owned Constituent Entity whose Controlling Interests are held, directly or indirectly, by a Minority-Owned Parent Entity".
[998] GLOBE MODEL RULES, Art. 5.6.1.
[999] GLOBE MODEL RULES, Art. 5.6.2.
[1000] GLOBE COMMENTARY, p. 134, para. 97.

> ***up Tax for the jurisdiction, some of which would be borne by non-Group Entity owners of a different Constituent Entity****. While this can occur to some extent under the normal jurisdictional blending rules, the magnitude of the effect in the context of Minority-Owned Constituent Entities and the potential detrimental impact on these investment structures justifies a different rule.*

This is a problem that has already been presented in sec. 4.1.2.1.1, *supra*, with reference to the toy and soy businesses: a CE may be charged a Top-up Tax related to an LTCE with which it bears no connection other than common control. As the CEs may present multiple configurations of minority shareholders, charging a CE for a Top-up Tax related to an LTCE with which no relationship other than common control is present will not necessarily be fair with the minority shareholders. As the MNE Group is defined with reference to control and no further integration criterion applies, a CE does not necessarily benefit from being under the same control as the LTCE. Therefore, the minority shareholder risks being burdened by a Top-up Tax that presents no relationship with her ability-to-pay.

The solution from Art. 5.6 is therefore essentially a correction mechanism, which only becomes necessary because of the broad MNE Group definition. The problem dealt with under Art. 5.6 is not a problem that is exclusive to Minority-Owned CEs. As the GLOBE COMMENTARY acknowledges in the excerpt transcribed above, the problem is also present in case of the "normal jurisdictional blending rules". In case of Minority-Owned CEs, the problem only becomes more evident "and the potential detrimental impact on these investment structures justifies a different rule" [1001]. The GLOBE MODEL RULES are therefore conscious of the idiosyncrasies of the very broad definition of MNE Group that is chosen, and Art. 5.6 is aimed at mitigating some of the downsides of the policy option. The solution found makes clear the conciliatory nature of the MNE Group definition: while in the case of "normal jurisdictional blending rules", the definition creates a problem that is deemed as justified, "the magnitude of the effect" in case of Minority-Owned CEs demands a different solution.

While the solution of the GLOBE MODEL RULES seems generally consistent in case of application of the IIR, a significant distortion is found in the case of the application of the UTPR, which may lead to the non-Group owner of the CE still being burdened, despite the effort and added complexity of Article 5.6. One possible outcome of the application of Article 2.5.3 is that CEs of the MNE Group become liable to 100% of the Top-up Tax calculated for the Minority-Owned LTCE, despite holding less than 30% of its Ownership Interests. The issue will be presented in more detail upon the discussion of nexus rules in chapter V[1002].

For the present chapter, it is important to stress that the approach of Article 5.6 is only needed as a direct consequence of the broad definition of control. If a bright-line shareholding criterion of at least 50% were applicable, Minority-Owned CEs would not even exist, and the problem would be restricted to the cases of the "normal jurisdictional blending rules". If an integration criterion were applied, the problem would not arise even in the case of "normal jurisdictional blending rules". The burdening of the non-Group owner of the CE could be justified on the fact that the CE also benefits from pertaining to the MNE Group, considering the unitary business character of the CEs concerned.

[1001] GLOBE COMMENTARY, p. 134, para. 97.
[1002] See ch. V, sec. 3.3.3.

Therefore, also the non-Group owner of the CE would benefit from such relationship, thus justifying the burden. However, as the definition is strictly based on control, it is well possible that the non-Group owner of the CE is burdened merely due to a diversification strategy of the MNE Group. By holding participation on a CE, the non-Group owner of the CE does not necessarily derive a benefit from the fact that the CE is controlled by the same persons as the LTCE. Even though, the non-Group owner of the CE would still be burdened by a Top-up Tax, grounded on a very loose connection of the CE with the LTCE.

4.1.2.2. Formal aspects

Despite referring exclusively to control upon the definition of the Group, the GLOBE MODEL RULES have not resorted to the bright-line concept of control based on shareholding criteria, which is common to group regimes. Instead, the GLOBE MODEL RULES essentially require the interpreter to consider the IFRS 10 definition (or its equivalent under other Acceptable Financial Accounting Standard), which is a "principles-based" criterion. As seen, the definition of control for the purpose of IFRS 10 is not a "bright-line definition"[1003].

The definition presents additional legal certainty issues, which do not arise in case a bright-line shareholding trigger is used. The present section examines financial accounting literature on the definition of control, and the challenges of the vagueness inherent to the IFRS definition. In doing so, it refers to a distinction between "rules-based" and "principles-based" standards, which deviates from the legal meaning generally attributed to the terms. Accounting literature generally distinguishes between "rules-based standards", understood as accounting criteria that are very specific in their wording and very direct in their requirements of the account preparer, and "substance-over-form or principles-based standards", which are more general in their wording and guidance to users, and require some form of "professional judgment" to be applied[1004]. The section does not examine the distinction critically, despite its many problems. More important than examining the refinement of the distinction is to understand the meaning intended in the literature that uses it, in order to interpret the evidence and conclusions they provide.

4.1.2.2.1. The problem with "rules-based" definitions

Consolidated financial statements have been used in the US since the early 1900s, in the UK since the 1920s, and in continental Europe as from the 1980s[1005]. While some accounting systems have resorted to the power and benefits definition for decades, other systems would initially resort to bright-line rules as means to establish the definition of control[1006]. Control was then defined as the ownership of a majority voting interest (i.e.,

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[1003] Allison K. Beck et al., "Firm Equity Investment Decisions and U.S. GAAP and IFRS Consolidation Control Guidelines: An Empirical Analysis," *Journal of International Accounting Research* 16, no. 1 (2017): 37–57.

[1004] Jim Psaros and Ken T. Trotman, "The Impact of the Type of Accounting Standards on Preparers' Judgments," *Abacus* 40, no. 1 (February 2004): 76–93.

[1005] IASB, "Preliminary Views," para. 32.

[1006] Müller Victor, Cardos Ildiko Reka, and Ienciu Alin Ionel, "Consolidation Policy: Past, Present and Future Approaches to the Concept of Control," *The Journal of the Faculty of Economics, University of Oradea*, 2010, 541–47.

over 50% of the outstanding voting shares of another company)[1007]. In such cases, legal control was the only aspect analyzed for the purpose of concluding on the obligation to consolidate.

Many studies have suggested that this sort of rules-based standard would allow preparers to structure transactions strategically, in order to achieve a particular accounting treatment[1008]. The incentives for non-consolidation are explained by the "off-balance-sheet hypothesis". The non-consolidation of certain investees could result in not reporting entire assets, liabilities, revenues, and expenses in the consolidated statements. As a consequence of reporting such elements on an unconsolidated equity method accounting basis, conventional liquidity, solvency, and profitability ratios calculated from reported data will differ[1009]. Hence, the opportunity to keep an investee's debt off the consolidated balance sheet would present a strong motivation for firms to avoid consolidating investees[1010].

This approach would also open the door for creative accounting as it could be applied to shape the basis of consolidation, allowing, for instance, that companies got rid of debt from their consolidated statements by reducing their equity ownership in a subsidiary to levels below 50%. In case the subsidiary later becomes profitable, the investor would be able to acquire further shares and include it in the consolidated statements[1011]. Such outcome has led to an increased preference for principles-based standards when defining control. In the years following the Enron accounting scandal and other high-level fraud cases, the choir against rules-based standards gained momentum and bright-line rules where pointed as enablers of such schemes[1012]. Enron did not consolidate hundreds of off-balance-sheet entities and failed to recognize the associated liabilities[1013].

Empirical studies have also shown that the emphasis on fixed percentages for accounting for equity investments motivated companies to keep their ownership levels just below the thresholds to avoid equity method (20%) or consolidation accounting (50%)[1014]. PSAROS (2007) found that Australian companies would hold a substantial number of shares in other companies, but keep overall ownership level just below the 50% consolidation

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[1007] Examples thereof in the US were the definition of control from Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, which was issued in 1959, and FASB Statement no. 94, *Consolidation of All Majority-Owned Subsidiaries*, from 1987.

[1008] See Shehzad L. Mian and Clifford W. Smith, "Incentives for Unconsolidated Financial Reporting," *Journal of Accounting and Economics* 12, no. 1–3 (1990): 141.

[1009] Ronald M. Copeland and Sharon Mckinnon, "'Financial Distortion' and Consolidation of Captive Finance Subsidiaries In the General Merchandising Industry," *Journal of Business Finance & Accounting* 14, no. 1 (1987): 77–97.

[1010] Mian and Smith, "Incentives for Unconsolidated Financial Reporting," 141–71; Greg Whittred, "The Derived Demand for Consolidated Financial Reporting," *Journal of Accounting and Economics* 9, no. 3 (1987): 259–85.

[1011] Victor, Reka, and Ionel, "Consolidation Policy: Past, Present and Future Approaches to the Concept of Control," 546.

[1012] See, *e.g.,* Mark Nelson, "Behavioral Evidence on the Effects of Principles- and Rules-Based Standards," *Accounting Horizons* 17 (2003); George J. Benston and Al L. Hartgraves, "Enron: What Happened and What We Can Learn from It," *Journal of Accounting and Public Policy* 21, no. 2 (2002): 105–27.

[1013] Victor, Reka, and Ionel, "Consolidation Policy: Past, Present and Future Approaches to the Concept of Control," 546.

[1014] See Eugene E. Comiskey, Ruth Ann McEwen, and Charles W. Mulford, "A Test of Pro Forma Consolidation of Finance Subsidiaries," *Financial Management* 16, no. 3 (1987): 45–50; Psaros and Trotman, "The Impact of the Type of Accounting Standards on Preparers' Judgments," 76–93.

trigger[1015]. A similar pattern was observed in relation to the obligation to apply the equity method. COMISKEY and MULFORD (1986) concluded that fixed percentages US GAAP created incentives for companies to hold their investment stakes at levels just below 20%[1016]. The migration toward a principles-based standard arose as a reaction to a perceived failure of the former bright-line thresholds[1017].

4.1.2.2.2. The "principles-based" solution

In contrast with such emphasis on *quantitative criteria* (fixed percentages), accounting standards now require financial statement preparers and their auditors to apply *qualitative criteria* (such as exposure or rights to variable returns, and the ability to use power to affect returns) to assess the level of power over the investee. As seen, the IFRS adopts a more *de facto* definition of control, broader than legal ownership and detached from any clear-cut quantitative measure.

There is a significant stream of literature that examines the impact of principles-based standards on firms' financial reporting decisions[1018]. The question addressed by such studies is whether the migration to a principles-based standard is able to prevent the off-balance-sheet cases – and at what cost.

The costs of such approach are very clear. The lack of precision of the principles-based standards requires greater professional judgment and entails uncertainty[1019]. The need for greater professional judgment is due to the fact that analyzing the investor's level of economic influence over the investee is a much more complicated task than examining whether a certain numerical ownership threshold has been triggered. Indeterminate clauses are known to hinder legal certainty and the outcome is not different with regard to the application of financial accounting rules. The increased level of vagueness of the rules also increases the potential for litigation and principle-based standards have already been associated with increased litigation[1020]. Companies have also expressed concern on whether they would be able to gather all the necessary information to assess all relevant aspects of *de facto* control under IFRS 10[1021].

Despite the increased complexity and uncertainty, the conclusions regarding the effectiveness of principles-based standards are mixed. While some authors have argued that the increased involvement of specialists would not prevent "aggressive

[1015] Jim Psaros, "Do Principles-Based Accounting Standards Lead to Biased Financial Reporting? An Australian Experiment," *Accounting and Finance* 47 (2007): 527.
[1016] Eugene E. Comiskey and Charles W. Mulford, "Investment Decisions and the Equity Accounting Standard," *The Accounting Review* 61, no. 3 (1986): 519–25.
[1017] Beck et al., "Firm Equity Investment Decisions and U.S. GAAP and IFRS Consolidation Control Guidelines," 37–57.
[1018] See, *e.g.*, with further references, Mark E. Evans et al., "Reporting Regulatory Environments and Earnings Management: U.S. and Non-U.S. Firms Using U.S. GAAP or IFRS," *The Accounting Review* 90, no. 5 (2015): 1969–94; Christopher P. Agoglia, Timothy S. Doupnik, and George T. Tsakumis, "Principles-Based versus Rules-Based Accounting Standards: The Influence of Standard Precision and Audit Committee Strength on Financial Reporting Decisions," *The Accounting Review* 86, no. 3 (2011): 747–67.
[1019] George J. Benston, Michael Bromwich, and Alfred Wagenhofer, "Principles- versus Rules-Based Accounting Standards: The FASB's Standard Setting Strategy," *Abacus* 42, no. 2 (2006): 165–88.
[1020] Dain C. Donelson, John M. McInnis, and Richard D. Mergenthaler, "Rules-Based Accounting Standards and Litigation," *The Accounting Review* 87, no. 4 (2012): 1247–79.
[1021] Libor Vašek and Tereza Gluzová, "Can a New Concept of Control under IFRS Have an Impact on a CCCTB?," *European Financial and Accounting Journal* 9, no. 4 (2014): 117.

reporting"[1022], others have maintained that a principle-based definition of control would be more effective in stopping biased financial reporting than rules-based standards[1023]. BECK, BEHN, LIONZO, and ROSSIGNOLI (2017), using ownership data of US GAAP- and IFRS-compliant companies from 2004-2008, have concluded that despite a shift in the accounting standards to a more principles-based definition of control, companies continued to behave in a manner indicative of purposeful transaction structuring around the 50% threshold[1024]. They found an "unusually heavy concentration" of investment at or below 50%, which could mean that companies are continuing to anchor to bright-line guidance regarding consolidation accounting[1025]. In order to deal with the indetermination of the "principles-based standards", preparers seem to be following a trend to resort to cognitive "short-cuts", and adopt available answers in a black and white manner[1026]. Besides that, the "principle-based standards" do not seem to be very popular. MCENROE and SULLIVAN (2013) examined the perceptions of US public accountants and chief financial executives and, among other conclusions on principles-based standards, found that 71.4% of practitioners disagreed with the elimination of bright-line consolidation rules[1027].

4.1.2.2.3. Certainty issues in the control definition

Therefore, the "principles-based" approach of IFRS 10 brings with it a significant level of vagueness and discretion to the interpreter, but the benefits of the approach are not as straightforward. The discretion becomes even more troublesome when it is considered that the GLOBE MODEL RULES potentially submit the IFRS 10 (or other Acceptable Financial Accounting Standard) criteria to multiple interpreters. Besides the discretion inherent to the criteria, there are multiple authorities that could potentially apply them and disagree on the outcome. Besides the possible divergence between tax authorities and commercial authorities, a disagreement between tax authorities may also arise[1028]. It is possible that more than one state intends to apply an IIR and/or an UTPR, or that a QDMTT is applied at the same time as an IIR and/or an UTPR. For all these charging rules, a separate and independent conclusion, by each of the tax authorities, on which are the CEs of the MNE Group, is in principle possible.

The PILLAR TWO BLUEPRINT makes the case that the use of the definition from financial accounting standards would have a positive effect. It is argued that its application could reduce the incentive for the MNE Group to adopt structures "designed to artificially exclude or include subsidiaries from the group" [1029]. The off-balance-sheet hypothesis would be hindered by the GLOBE MODEL RULES, because it would create an incentive for

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[1022] Nelson, "Behavioral Evidence on the Effects of Principles- and Rules-Based Standards," 91–104.
[1023] Psaros and Trotman, "The Impact of the Type of Accounting Standards on Preparers' Judgments," 76.
[1024] Beck et al., "Firm Equity Investment Decisions and U.S. GAAP and IFRS Consolidation Control Guidelines," 38–39.
[1025] Beck et al., 39.
[1026] On the usage of such cognitive "short-cuts", see D. Jordan Lowe and Philip M. J. Reckers, "The Influence of Outcome Effects, Decision Aid Usage, and Intolerance of Ambiguity on Evaluations of Professional Audit Judgement: Evaluations of Professional Audit Judgment," *International Journal of Auditing* 1, no. 1 (1997): 43–58.
[1027] John E. McEnroe and Mark Sullivan, "An Examination of the Perceptions of Auditors and Chief Financial Officers Regarding Principles versus Rules Based Accounting Standards," *Research in Accounting Regulation* 25, no. 2 (2013): 196–207.
[1028] See sec. 4.1.2.2.3, *supra*.
[1029] PILLAR TWO BLUEPRINT, p. 24, para 44.

the Group to report loss-making entities, considering the benefits it could potentially have in reducing the Top-up Tax of a certain jurisdiction[1030].

Such conclusion is, however, far from evident. On the contrary, it seems that, besides importing problems, the GLOBE MODEL RULES could also cause some disturbance to financial reporting. The reference to consolidated financial statements will probably add new incentives for MNE Groups to engage in aggressive reporting in another direction, *i.e.* in order not to include some profitable entities in their consolidated statements. The incentives to work around the consolidation trigger will have an additional tax component. Avoiding the consolidation trigger will also become a way to avoid a potential Top-up Tax. This may reverse back to financial accounting in the form of poorer quality of financial information. It is, therefore, not possible to conclude for a straight-forward benefit, as envisaged by the PILLAR TWO BLUEPRINT.

The application of the "principles-based" consolidation criteria is full of uncertainties, which shall be solved by reference to the informational needs of the users of the financial information. While the "principles-based" solution may be a workable solution in the case of financial reporting, it is doubtful whether such elastic and fact-based criteria are fit for the more adversarial relationship between taxpayers and tax authorities. It is not absurd to think that taxpayers would exploit the indetermination of the criteria as far as possible, and tax authorities would use the indetermination to their favor.

4.1.3. Summary

From a tax law perspective, at first glance, it seems that the GLOBE MODEL RULES have combined the worst elements of both worlds upon the definition of MNE Group. On the one hand, the chosen concept is oriented towards the informational needs of investors and other stakeholders – and the theoretical benefits of the enterprise doctrine are not present. On the other hand, the chosen concept is not as precise and clear-cut as a shareholding criterion – and the practical benefits of the legal control criterion are not present.

Nevertheless, as discussed in sec. 3.4, *supra*, the experience of states with integration criteria allows one to conclude for their undesirability. The reference to "enterprise" in tax law scholarship is not as clear as it should be, and there is significant disagreement among scholars regarding the level of integration which would be necessary for the purpose of justifying a group approach. In any case, the policy choice presents significant impacts on the definition of the tax object and on the nexus rules, which will be examined in detail in chapters IV and V, respectively.

With regard to the control definition, the GLOBE MODEL RULES have resorted to a "principles-based" approach, which does not present the benefits of a clear-cut shareholding criterion, and demands the establishment of a solution to Minority-Owned CEs, adding more complexity to the regime. Despite the uncertainty issues, there is one important advantage to the approach. It allows the reference to the consolidated financial statements, which are essential for the application of the GLOBE MODEL RULES. The choice for the same criteria as those applicable to the consolidated statements is therefore

[1030] PILLAR TWO BLUEPRINT, p. 24, para 44.

justified in the PILLAR TWO BLUEPRINT in terms of practicability[1031], as a form of allowing for the use of financial reporting which is already available.

4.2. The Constituent Entities

The MNE Group is of fundamental importance for the application of the GLOBE MODEL RULES. Ultimately, however, the GLOBE MODEL RULES apply to CEs that are members of an MNE Group, and not to the MNE Group as a single economic unity[1032]. The identification of the MNE Group is just a starting point to identify the relevant CEs and subsequently make the necessary calculations for the purpose of determining whether a Top-up Tax will be charged.

4.2.1. The definition of Entity

A CE is any Entity or PE of a Main Entity[1033] included in an MNE Group subject to the GLOBE MODEL RULES[1034], provided that it is not an Excluded Entity[1035]. Entity is any legal person (other than a natural person), or an arrangement that prepares separate financial accounts, such as a partnership or a trust[1036].

The definition of Entity is therefore very broad and does not rely on abstract criteria, such as legal personality or limitation of liability[1037]. The definition of Entity makes reference to an "arrangement that prepares separate financial accounts", thus encompassing as subjects arrangements whose liability is not limited and that do not have their own legal personality. The definition does not resort to any of the concrete criteria, and does not require that the Entity carries on a business or any sort of economic activity.

4.2.2. The definition and justification of Excluded Entities

Excluded Entities are a Governmental Entity, an International Organization, a Non-Profit Organization, a Pension Fund, an Investment Entity that is an UPE and a Real Estate Investment Vehicle that is an UPE[1038]. The Excluded Entities are all defined terms. According to the GLOBE COMMENTARY, these Entities would generally not be consolidated on a line-by-line basis with a Group of operating Entities. The negative list is intended to ensure "completeness, consistency and to improve certainty of outcomes"[1039].

[1031] "Use of accounting consolidation rules for determining scope. While from a tax policy perspective there could have been reason to go beyond the consolidated group definition, to minimise cost and complexity the Pillar Two design stays with this definition and addresses particular risk areas through targeted rules only" (PILLAR TWO BLUEPRINT, p. 17, para. 24).
[1032] GLOBE MODEL RULES, Art. 1.1.1.
[1033] Main Entity is defined as "the Entity that includes the Financial Accounting Net Income or Loss of the Permanent Establishment in its financial statements" (GLOBE MODEL RULES, Art. 10.1.).
[1034] GLOBE MODEL RULES, Art. 1.3.1.
[1035] GLOBE MODEL RULES, Art. 1.3.3.
[1036] GLOBE MODEL RULES, Art. 10.1.
[1037] See, discussing such criteria from a general perspective, sec. 2.1, *supra*.
[1038] GLOBE MODEL RULES, Art. 1.5.1.
[1039] GLOBE COMMENTARY, para. 41.

4.2.2.1. Governmental Entities and International Organizations

Governmental Entities and International Organizations are both excluded on similar grounds: they are not typically subject to tax in their own jurisdiction and often benefit from exclusions from taxation under legislation and tax treaties[1040].

4.2.2.2. Non-Profit Organizations and Pension Funds

The exclusion of Non-Profit Organizations and Pension Funds is not clarified in the GLOBE COMMENTARY, but the grounds for the exclusion may be found in the purposive definition of such terms, nor in the PILLAR TWO BLUEPRINT. The definition of Non-Profit Organization requires that "substantially all of the Entity's income is tax-exempt for local tax purposes and that the Entity has no shareholders or members with a beneficial interest in its income or assets"[1041], leading to a reasoning that is similar to the exclusion of Governmental Entities and International Organizations. The Pension Fund is defined as an Entity that "is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary and incidental benefits to individuals"[1042]. These Entities are deemed to be typically portfolio investors, which would be "unlikely to have foreign operations and in most cases will not hold controlling interests in foreign subsidiaries"[1043]. Their exclusion would not be contrary to the GLOBE MODEL RULES policy rationale[1044].

The definition of Non-Profit Organization is, however, very restrictive. In order to be considered as a Non-Profit Organization, and therefore as an Excluded Entity, the Entity must be[1045]: (a) established and operated in its jurisdiction of residence: (i) exclusively for religious, charitable, scientific, artistic, cultural, athletic, educational, or other similar purposes; or (ii) as a professional organization, business league, chamber of commerce, labor organization, agricultural or horticultural organization, civic league or an organization operated exclusively for the promotion of social welfare. Furthermore, (b) substantially all of the income from the activities mentioned must be exempt from income tax in its jurisdiction of residence; and (c) no shareholders or members of the Entity may have a proprietary or beneficial interest in its income or assets. Additionally, (d) the income or assets of the Entity may not be distributed to, or applied for the benefit of, a private person or non-charitable Entity other than: (i) pursuant to the conduct of the Entity's charitable activities; (ii) as payment of reasonable compensation for services rendered or for the use of property or capital; or (iii) as payment representing the fair market value of property which the Entity has purchased. Finally, (e) upon termination, liquidation or dissolution of the Entity, all of its assets must be distributed or revert to a Non-profit Organization or to the government. The definition does not embrace "any Entity carrying on a trade or business that is not directly related to the purposes for which it was established".

Defined in such terms, a Non-Profit Organization could be included in the scope of the GLOBE MODEL RULES, even though, under the relevant domestic legislation, it is treated

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[1040] GLOBE COMMENTARY, pp. 198 and 200, para. 26 and 34.
[1041] GLOBE COMMENTARY, p. 205, para. 71.
[1042] GLOBE COMMENTARY, p. 208, para. 88.
[1043] PILLAR TWO BLUEPRINT, p. 30, para 73.
[1044] PILLAR TWO BLUEPRINT, p. 30, para 73.
[1045] GLOBE MODEL RULES, Art. 10.1.

as a non-profit entity and not taxed – or is partially exempted due to the nature of its activities. As seen, the definition cumulates many of the criteria adopted in different domestic legislations for defining non-profitable entities, and the GLOBE MODEL RULES risk, therefore, subjecting to a minimum tax an Entity that is considered as non-profitable under domestic definitions. One clear example is an entity that carries on a business and reverts all the profits to charitable purposes: even though such entities may be considered as non-profitable (and tax exempt) under some domestic systems[1046], it will not be an Excluded Entity for the purposes of the GLOBE MODEL RULES. Besides that, the GLOBE MODEL RULES also demand that substantially all of the income from the activities mentioned is exempted from income tax in its jurisdiction of residence. Hence, even though the concept is autonomous, it also takes elements from domestic legislation as a requisite. Therefore, the definition of Non-Profit Organization is still contingent on domestic legislation and a harmonized outcome cannot be derived from the GLOBE MODEL RULES.

4.2.2.3. Investment Funds and Real Estate Investment Vehicles

With regard to an Investment Fund and a Real Estate Investment Vehicle that are an UPE of an MNE Group, the justification of the exclusion lies on the protection of their status as tax neutral investment vehicles[1047]. If such Entities are not an UPE, they shall still be treated as CEs (provided that they meet the consolidation requirements), being treated as Investment Entities and subject to special rules for calculation of the ETR.

4.2.3. Entities owned by Excluded Entities

Entities owned by these Excluded Entities can be considered to be Excluded Entities, if (a) they were set up by an Excluded Entity to hold its assets or invest its funds, or to carry out activities that are ancillary to the Excluded Entity's activities[1048]; or if (b) their Financial Accounting Net Income would otherwise be excluded from the GLOBE computations because it is composed of Excluded Dividends or Excluded Equity Gain or Loss[1049]. The logic behind this exclusion is that such types of holding vehicles would not be expected to be subject to a Top-up Tax, since all of their income is excluded from the GLOBE Income[1050].

In the first case (a), the Entity must be subject to an ownership and an activities test. Under the ownership test, one or more Excluded Entities must own (directly or through a chain of Excluded Entities) at least 95% of the value of the Entity[1051]. The activities test is a facts and circumstances test, which requires all or almost all of the Entities' activities to be related to holding assets or investing funds[1052], or, alternatively, only carry out activities that are ancillary to the activities carried out by an Excluded Entity[1053].

[1046] See, discussing the multiple criteria under domestic systems, sec. 2.3, *supra*. See also Kouraleva-Cazals, "Atypical Entities and the Personal Scope of the Corporate Income Tax," 75.
[1047] GLOBE COMMENTARY, p. 20, para. 42.
[1048] GLOBE MODEL RULES, Art. 1.5.2(a).
[1049] GLOBE MODEL RULES, Art. 1.5.2(b).
[1050] GLOBE COMMENTARY, p. 23, para. 55.
[1051] Discussing the definition of "value of the Entity", see GLOBE COMMENTARY, p. 22, para. 49-51.
[1052] For examples, see GLOBE COMMENTARY, p. 22, para. 53.
[1053] On the meaning and extension of "ancillary activities", see GLOBE COMMENTARY, p. 22, para. 54.

In the second case (b), the Entity must be subject to an ownership and an income test. Under the ownership test, one or more Excluded Entities must own (directly or through a chain of Excluded Entities) at least 85% of the value of the Entity. As per the income test, "substantially all"[1054] of the Entity's income must be of Excluded Dividends or Excluded Equity Gain or Loss.

In the case of Entities owned by Excluded Entities, the GLOBE MODEL RULES also provide the Filling CE with the option not to treat such Entities as Excluded Entities, setting forth the need for a Five-Year Election on this matter[1055]. This election may be useful, for instance, in case an Investment Vehicle that is an UPE is willing to make its subsidiaries subject to the IIR, in order to avoid the application of the UTPR to multiple CEs[1056].

4.2.4. The special treatment for Investment Entities

As seen, Investment Entities that are an UPE are Excluded Entities. However, Investment Entities that are not an UPE are still treated as CEs. The GLOBE MODEL RULES include mandatory special rules for Investment Entities[1057] that are not Tax Transparent Entities (Art. 7.4)[1058], also allowing for elective regimes if some requirements are met (Art. 7.5 and Art. 7.6).

The definition of Investment Entities comprises Investment Funds and Real Estate Investment Vehicles, as well as certain Entities owned by them, provided that the thresholds and conditions are met[1059]. Under these special rules, the ETR of Investment Entities shall be calculated separately from the ETR of the jurisdiction in which it is located[1060]. Accordingly, there are specific rules for calculating the Investment Entity's Adjusted Covered Taxes[1061], the MNE Group's Share of the Investment Entity's GLOBE Income[1062], of the Substance-based Income Exclusion for an Investment Entity[1063], as well as for the determination of the Top-up Tax[1064]. Such rules largely resemble the calculations generally made for other CEs, and are ultimately aimed at ensuring that there is no blending between Investment Entities and CEs that are not Investment Entities. In practice, there is a separate and independent calculation of the ETR for Investment Entities. The special rules only allow for jurisdictional blending of Investment Entities with other Investment Entities[1065].

[1054] Discussing the meaning of "substantially all", see GLOBE COMMENTARY, p. 23, para. 56.
[1055] GLOBE MODEL RULES, Art. 1.5.3.
[1056] See, for an example, GLOBE COMMENTARY, p. 23, para. 57.
[1057] The treatment is also extended to Insurance Investment Entities, which raise specific concerns and require further policy consideration. The topic will be addressed within the GLOBE Implementation Framework (see GLOBE COMMENTARY, p. 171, para. 77). The treatment of Insurance Investment Entities is left aside for the purpose of the thesis.
[1058] Article 3.5 remains applicable to the income of Investment Entities and Insurance Investment Entities that are Tax Transparent Entities (see GLOBE COMMENTARY, p. 171, para. 78).
[1059] GLOBE MODEL RULES, Art. 10.1.
[1060] GLOBE MODEL RULES, Art. 7.4.2.
[1061] GLOBE MODEL RULES, Art. 7.4.3.
[1062] GLOBE MODEL RULES, Art. 7.4.4.
[1063] GLOBE MODEL RULES, Art. 7.4.6.
[1064] GLOBE MODEL RULES, Art. 7.4.5.
[1065] GLOBE MODEL RULES, Art. 7.4.2.

The GLOBE MODEL RULES also allow for a Tax Transparency Election for Investment Entities (Art. 7.5), if the CE-owner is subject to a mark-to-market or similar regime at a tax rate that equals or exceeds the Minimum Rate[1066]. Investment Entities that are Tax Transparent Entities do not need to make this election[1067]. Under this election, the GLOBE Income and Covered Taxes of the Investment Entity flow through to the CE-owner and the calculation of a separate ETR is not needed[1068]. A CE-owner can also apply the Taxable Distribution Method (Art. 7.6) if it can be reasonably expected to be subject to tax on the distributions from the Investment Entity at least at the Minimum Rate[1069]. Under this election, the CE-owner includes distributions received from the Entity in the computation of its GloBE Income or Loss[1070].

The justification of a separate calculation of the ETR of Investment Entities is found in the GLOBE COMMENTARY, which states that the income of such Entities "is often subject to little or no tax at the entity level"[1071]. Therefore, the special treatment prevents an MNE Group from blending this low-taxed income with income of other CEs (Art. 7.4). At the same time, in cases where the income of Investment Entities is sufficiently taxed (at least at the Minimum), the need for a separate calculation may be prevented by the election mechanisms (Art. 7.5 and Art. 7.6).

Hence, the special treatment for Investment Entities is not justified by the separate entity doctrine, but is rather considered as a remedy against an undesirable outcome of jurisdictional blending. The GLOBE MODEL RULES assume that Investment Entities are often subject to little or no tax at the entity level and treat the blending of such Entities with other CEs as undesirable. A separate calculation of the ETR is foreseen (Art. 7.4), along with election mechanisms for the cases where the Investment Entities are taxed at least at the Minimum Rate (Art. 7.5 and Art 7.6)[1072].

4.2.5. The special treatment for fiscally transparent Entities

Considering the problems of resorting to the domestic definitions of a CIT taxpayer[1073], the GLOBE MODEL RULES provide for their own autonomous concepts in case of fiscally transparent Entities. The qualification of hybrid entities brings well-known challenges in cross-border transactions, and the GLOBE MODEL RULES provide for their own approach towards them, significantly reducing the impact of the domestic treatment and avoiding the problems that would arise from their adoption. Within this scope, the GLOBE MODEL RULES set forth four important concepts related to fiscally transparent Entities, understood as those Entities whose income, expenditure, profit or loss are treated, by a certain jurisdiction, as if they had been derived or incurred by the direct owner of the Entity in proportion to its interest[1074].

[1066] GLOBE MODEL RULES, Art. 7.5.
[1067] GLOBE COMMENTARY, p. 171, para. 75.
[1068] GLOBE COMMENTARY, p. 171, para. 75.
[1069] GLOBE MODEL RULES, Art. 7.6.
[1070] GLOBE COMMENTARY, p. 171, para. 76.
[1071] GLOBE COMMENTARY, p. 171, para. 74.
[1072] Considering the specific nature of the treatment of Investment Entities, these brief considerations suffice for the purpose of the thesis. The treatment of Investment Entities will are not specifically addressed in the other chapters.
[1073] See sec. 2, *supra*.
[1074] GLOBE MODEL RULES, Art. 10.2.2.

An Entity is a Flow-through Entity to the extent that it is fiscally transparent with respect to its income, expenditure, profit or loss in the jurisdiction where it was created (*e.g.,* a fiscally transparent partnership)[1075]. Based on the treatment of the direct owners under their domestic law, the Flow-through Entities are further divided into two categories: Tax Transparent Entities and Reverse Hybrid Entities[1076].

A Flow-through Entity is a Tax Transparent Entity to the extent that the domestic tax law of the owners also treat it as fiscally transparent, requiring the owner to recognize the income, expenditure, profit or loss of the Flow-through Entity as if it was income earned or expenditure borne by the owners[1077]. In a nutshell, a Tax Transparent Entity is treated as fiscally transparent both in the jurisdiction where it is located, and in the jurisdiction of the direct owners, being therefore subject to tax in the jurisdiction of the direct owners.

A Flow-through Entity is a Reverse Hybrid Entity if the domestic tax law of the jurisdiction of the owners do not treat it as fiscally transparent and, therefore, does not recognize the income, expenditure, profit or loss when earned or incurred by the Entity, but only upon distribution[1078]. The income of a Reverse Hybrid Entity is therefore not taxed, neither in the jurisdiction where the CE is located, nor in the jurisdiction of its direct owners.

Finally, a Hybrid Entity is an Entity that is treated as a separate taxable person for income tax purposes in the jurisdiction where it is located, to the extent that it is fiscally transparent in the jurisdiction in which its owner is located[1079]. In a nutshell, a Hybrid Entity is treated as opaque in the jurisdiction where it is located, but as fiscally transparent both in the jurisdiction of the direct owners, being therefore subject to tax both in the jurisdiction where it is located and in the jurisdiction of the direct owners.

The special treatment of Flow-through Entities and Hybrid Entities is aimed at dealing with potential distortions generated by the application of the rules to fiscally transparent Entities, and with the conflicts of qualification that may arise therefrom. The qualification of an Entity as a Flow-through Entity has impacts on the allocation of the GLOBE Income and Covered Taxes[1080]. An important outcome is that Reverse Hybrid Entities are treated as Stateless CEs, which basically means that they are subject to the calculation of the Top-up Tax on a standalone basis, without any room for jurisdictional blending[1081].

4.2.6. The parity between subsidiaries and PEs

The GLOBE MODEL RULES also provide for their own concept of PE. Under the GLOBE MODEL RULES, even if a jurisdiction does not provide for the concept of PE in its domestic legislation, or even for a CIT, a place of business (including a deemed place of business) through which operations are conducted outside the jurisdiction where the Main Entity is located shall be treated as a PE, provided that such jurisdiction exempts the income attributable to such operations.

[1075] GLOBE MODEL RULES, Art. 10.2.1.
[1076] GLOBE COMMENTARY, p. 218, para. 153.
[1077] GLOBE MODEL RULES, Art. 10.2.1(a); GLOBE COMMENTARY, p. 218, para. 154.
[1078] GLOBE MODEL RULES, Art. 10.2.1(b); GLOBE COMMENTARY, p. 218, para. 155.
[1079] GLOBE MODEL RULES, Art. 10.2.5.
[1080] See, ch. V, sec. 2, *infra*.
[1081] See, ch. V, sec. 2.5, *infra*.

For the purpose of the GLOBE MODEL RULES a PE is defined as[1082]: (a) a place of business (including a deemed place of business) situated in a jurisdiction and treated as a PE following an applicable DTC, provided that the income attributed to it is taxed in accordance with a provision similar to the Art. 7 of the OECD-MC ("**PEa**"); (b) if no DTC is applicable, a place of business (including a deemed place of business) which is taxed under domestic legislation on a net basis, similarly to tax residents ("**PEb**"); (c) if the jurisdiction has no CIT system, a place of business (including a deemed place of business) situated in that jurisdiction that would be treated as a PE under the OECD-MC, provided that the jurisdiction would have had the right to tax the income attributable to it under Art. 7 of the OECD-MC ("**PEc**"); or (d) a place of business (including a deemed place of business) not already described in items (a) to (c) through which operations are conducted outside the jurisdiction where the Entity is located provided that such jurisdiction exempts the income attributable to such operations ("**PEd**").

The determination of whether there is a PEa, PEb, PEc, or PEd is relevant to determine the location of the PE, and the corresponding allocation of GLOBE Income and Covered Taxes[1083]. In any case, it is essential for the comprehension of the GLOBE MODEL RULES that a PE which is a CE shall be treated as a separate CE from the Main Entity and any other PEs of the Main Entity[1084]. This treatment is aimed at ensuring "parity in the treatment of foreign subsidiaries and PEs of the MNE Group"[1085]. The income earned through PEs and the corresponding tax in one jurisdiction shall not be blended with the tax and the income of the Main Entity or other PEs in other jurisdictions[1086]. PEs are therefore treated as separate Entities and each PE is a CE on its own, without any blending with the Main Entity located in another jurisdiction.

4.2.7. Summary

The exam of the separate-entity doctrine showed that a consistent general theory, adopted by all states, on the definition of CIT subjects cannot be identified. Listing is the practical way to define the scope of CIT, which is a policy choice grounded on a perceived structural limitation to a general theory on the topic[1087]. Likewise the GLOBE MODEL RULES resort to multiple autonomous concepts, which are all tailored to the scope of the minimum tax: Excluded Entities, Investment Entities, Flow-Through Entities and PEs have all been defined taking specific goals and outcomes into consideration. The formulation of general justifications covering all categories is not possible. Specific reference to each autonomous concept is necessary to understand the reasons for the special treatment, as well as to situate them within the more general goals of the GLOBE MODEL RULES.

5. THE JUSTIFICATION OF THE SUBJECTS IN THE GLOBE MODEL RULES

The GLOBE MODEL RULES define, in summary, a plurality of subjects, which are relevant at different stages of the application of the rules. The question addressed in the present

[1082] GLOBE MODEL RULES, Art. 10.1.
[1083] See, ch. V, sec. 2.3, *infra*.
[1084] GLOBE MODEL RULES, Art. 1.3.2.
[1085] GLOBE COMMENTARY, p. 18, para. 30.
[1086] GLOBE COMMENTARY, p. 18, para. 30.
[1087] Gutmann, "General Report," 6.

chapter requires the identification of the subjects whose equal treatment is intended by the GLOBE MODEL RULES, and several candidates may be conceived.

5.1. The ability-to-pay of MNE Groups?

MNE Groups are not necessarily treated equally. In the GLOBE MODEL RULES, it is possible that an MNE Group is subject to an overall effective taxation that is very high, but also to a Top-up Tax, due to the configuration of a part of its business activities. An MNE Group may be subject to a 30% overall effective taxation, but still trigger a Top-up Tax in a certain jurisdiction, because of the existence of a LTCE therein. At the same time, another MNE Group may be subject to a 15% overall effective taxation, and still trigger no Top-up Tax, due to the distribution of the CEs across the jurisdictions. Theoretically, in a word of perfect and uniform application of the GLOBE MODEL RULES by all countries, all MNE Groups would be taxed at least at a 15% overall effective tax rate. However, some MNE Group would still trigger a Top-up Tax, despite not being subject to an overall taxation lower than 15%.

Besides that, the GLOBE MODEL RULES are not aimed at calculating the income of the MNE Group, and merely refers to the MNE Group in order to determine which CEs fall within their scope. This means that it is possible that the MNE Group incurs in an overall loss in a given Fiscal Year and is still subject to a Top-up Tax, due to the configuration of the CEs across the jurisdictions. In a situation that the CEs in a high-tax jurisdiction suffer substantive losses, but a LTCE in another jurisdiction presents low-taxed income, a Top-up Tax will still be charged.

Consequently, the GLOBE MODEL RULES cannot be justified as a measure intended to capture the ability-to-pay of the MNE Group. There is no guarantee that all MNE Groups will be treated equally: a loss-making MNE Group may trigger the charge of a Top-up Tax, a highly-taxed MNE Group may trigger a Top-up Tax, and many other unequal treatments between MNE Groups may be drawn from the GLOBE MODEL RULES. Even though a floor to the taxation of the MNE Groups could in principle be derived from the flawless application of the GLOBE MODEL RULES, there are many cases in which the charging of the Top-up Tax bears no relation to the overall taxation of the MNE Group. This pattern cannot be justified on the ability-to-pay alone.

5.2. The ability-to-pay of Constituent Entities?

CEs are not necessarily treated equally either. In the GLOBE MODEL RULES, it is possible that the same CE is subject to a Top-up Tax or not, depending on the characteristics of the other CEs located in the same jurisdiction. A CE that, considered in isolation, would trigger a Top-up Tax, may not trigger it depending on the characteristics of the other CEs located in the same jurisdiction. Differently from the case of MNE Groups, there is no minimum taxation of CEs. It is possible that, individually considered, a CE is subject to an ETR lower than 15%, but, due to the jurisdictional blending, is diluted by other CEs that are subject to a higher ETR, and no Top-up Tax is triggered. Due to the broad definition of MNE Group, the blending may occur also among CEs that are not economically integrated, and/or among CEs that present a completely different set of minority shareholders. This pattern cannot be justified on the ability-to-pay alone.

5.3. The ability-to-pay of blended Constituent Entities?

The only "subjects" that are treated equally under the GLOBE MODEL RULES are the jurisdictionally blended CEs. What matters for the purpose of triggering the Top-up Tax is whether the ETR on the Excess Profits of the jurisdictionally blended CEs is below the ETR. This pattern cannot be justified on the ability-to-pay alone. The ability-to-pay, understood as a measure for the sharing of the tax burden, is not able to justify the reason why "jurisdictionally blended CEs" are treated as the relevant subject that must be burdened at least at the ETR level. In order to justify this treatment, one has to resort to other goals which are unrelated to the ability-to-pay.

5.4. The floor to tax competition as the ultimate justification

The only justification for the GLOBE MODEL RULES that stands its grounds on all occasions is the establishment of a worldwide floor to tax competition. This justification supersedes the ability-to-pay in many circumstances and is the only one that is able to ground some of the measures embedded in the GLOBE MODEL RULES.

When it is affirmed that a certain purpose is sufficient to justify a restriction to equality, or the ability-to-pay, one is in fact acknowledging that the dimension of weight of the purpose is abstractly superior to the other right that is being restricted in the case[1088]. What the GLOBE MODEL RULES tells us is that, in some circumstances, the establishment of a worldwide floor to tax competition is more important than the equality between MNE Groups, CEs or any other potential subject that could be considered.

In the case of the GLOBE MODEL RULES, there is clearly some effort to take the ability-to-pay into account. However, when faced with the decision of whether it is more important to burden MNE Groups equally, or establish a floor to tax competition, the option for the latter goal has been made, at the expense of a consistent treatment grounded on the ability-to-pay – either of MNE Groups or CEs[1089]. This fact becomes clearer when one considers the arguments for rejecting global blending[1090]. If global blending was adopted, the case for an ability-to-pay of the MNE Group would be much stronger: one could in fact argue that the rules aimed at treating the MNE Groups equally and submit them to a minimum overall tax burden (even though the challenges of justifying the broad definition of MNE Group[1091] would remain).

What the GLOBE MODEL RULES in fact do is to treat the establishment of a floor to tax competition as a "superior" or "more important" purpose than treating subjects equally. The floor to tax competition comes at the expense of the equality among MNEs, CEs or any other potential subject that could be considered within the GLOBE MODEL RULES. The thesis does not go as far as to question the legitimacy of this objective, and the ability it has to justify a restriction to any possible meaning of the ability-to-pay principle and of

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[1088] See, on the topic, João Félix Pinto Nogueira, *Direito Fiscal Europeu - o Paradigma Da Proporcionalidade* (Coimbra: Wolters Kluwer, 2010), 239.

[1089] Discussing the possible levels of blending, see Schwarz, *The OECD GloBE proposal*, 92–100.

[1090] See PUBLIC CONSULTATION DOCUMENT, p. 17, para. 55. The policy choice was made even considering that worldwide blending would be a much simpler alternative. Accordingly, it has been stated that "*[w]hilst global blending may potentially result in lower overall compliance costs (depending on the final design of the rule) the difference in policy objectives will make this approach less effective in creating a floor for tax competition*" (PUBLIC CONSULTATION DOCUMENT, p. 18, para. 56.)

[1091] As discussed in sec. 4.1.2.3, *supra.*

the principle of equality. Voluntarism still reigns to a large extent in international tax law. The pros and cons of tax competition have already been presented[1092], and the IF clearly made a decision on the topic for one policy over the other.

One of the goals of the thesis is achieved, however, if it becomes clear that the GLoBE MODEL RULES cannot be primarily grounded on the ability-to-pay principle, the single tax principle, or any abuse theory. The GLoBE MODEL RULES have been drafted to combat tax competition: that is what justifies the jurisdictional blending, the way the ETR is calculated, and the charging of a Top-up Tax. There is a clear hierarchization of purposes. This conclusion is important because in legal reasoning one cannot simply attribute goals and justifications to a measure[1093], if they are counterfactual[1094]. It is not argumentatively rational to declare a certain purpose and enact measures that go on a different direction. This sort of expedient is very common in politics and diplomacy – and is therefore latent in many parts of the RELEVANT MATERIAL –, but it cannot be accepted within legal reasoning, for which truth as correspondence is an essential feature[1095].

6. INTERIM CONCLUSIONS: *WHOSE INCOME DO THE GLOBE MODEL RULES BURDEN?*

To a certain extent, the GLoBE MODEL RULES "have combined the incompatible objectives of adopting a unitary and formulaic approach with continued retention of the separate-entity and arm's-length principles"[1096]. From the perspective of the definition of the subjects, such policy choice for diametrically opposed doctrines appears in the form of rules inspired both by the separate-entity and the enterprise doctrines[1097].

The definition of MNE Group suffers from the problems that are already known to tax legal scholarship, related to the pros and cons of adopting either a legal or an economic criterion. However, considering the mechanisms of the IIR and, particularly, the UTPR, the broad definition that has been chosen is likely to trigger additional problems. The concepts guided by separate-entity doctrine take the form of autonomous concepts, tailored towards the goals of the legislation under consideration. Excluded Entities, Investment Entities, Flow-Through Entities and PEs have all been defined taking specific goals and outcomes into consideration, and a general explanation for the choices made cannot be formulated. Each one of the definitions requires specific examination and has its own justification.

Between the separate-entity and the enterprise doctrines, jurisdictional blending plays a central role. What matters for the purpose of triggering the Top-up Tax is whether the ETR on the Excess Profits of the jurisdictionally blended CEs is below the ETR. This pattern cannot be justified on the ability-to-pay alone. Such policy choice can only be explained by the centrality of the goal to establish a floor to tax competition.

[1092] See ch. I, sec. 4.2.1, *supra.*

[1093] On the argumentative requirements for evidencing goals and justifications, see Tércio Sampaio Ferraz Jr., *Introdução ao Estudo do Direito*, 10th ed. (São Paulo: Atlas, 2018), sec. 5.2.1.

[1094] On the problem of cherry-picking of arguments in teleological argumentation (illustratively, "picking out friends from the crowd at a cocktail party"), see William Eskridge Jr., "The New Textualism and Normative Canons," *Columbia Law Review*, no. 113 (2013): 547.

[1095] See, on the challenges of determination of purposes in tax law, Galendi Jr., *A consideração econômica no Direito Tributário*, 102–4.

[1096] Picciotto and Kadet, "The Transition to Unitary Taxation," 461.

[1097] See also Schildgen, "Group approach and separate entity approach," 559.

In summary, when making the relevant policy decisions, the IF has clearly taken some goals and justifications as more important than others. At the highest rank, one finds the establishment of a worldwide floor to tax competition, which serves as justification for restrictions to the ability-to-pay and the equal treatment of MNE Groups and CEs. The rhetoric against abusive behavior was an important part of the creation of the political momentum that allowed the commitments within the IF. Objectively viewed, however, the GLOBE MODEL RULES are not aimed at the behavior of MNE Groups, but rather at the behavior of states, and have been designed preliminary to force low-tax jurisdictions to raise their respective ETRs on Excess Profits of blended CEs.

A straight answer to the sub-question would be that the income being burdened is the income of the LTCE. Such income, however, is only burdened after taking into consideration elements related to the MNE Group and to the jurisdictionally blended CEs, which play an important role in the justification of the minimum tax.

CHAPTER IV
THE OBJECT OF THE GLOBE MODEL RULES

1. INTRODUCTION

In order to establish whether a Top-up Tax arises in a jurisdiction, the GLOBE MODEL RULES provide for the calculation of the ETR, which is a ratio between the Adjusted Covered Taxes with respect to a jurisdiction (numerator) and the GLOBE Income or Loss of the CEs (denominator) in such jurisdiction[1098]. Both the GLOBE Income or Loss and the Adjusted Covered Taxes are autonomous concepts of the GLOBE MODEL RULES. In other words, to set a floor to *corporate income tax*, the GLOBE MODEL RULES establish autonomous definitions for both *corporate income* (GLOBE Income or Loss) and *corporate income tax* (Adjusted Covered Taxes)[1099]. For the GLOBE MODEL RULES it is immaterial whether a jurisdiction provides for a tax rate in its domestic legislation that is superior to the Minimum Rate. What matters is whether taxation is above the ETR, following the autonomous concepts of the GLOBE MODEL RULES.

The general mechanism for calculating the Top-up Tax is presented in chapter II. The present chapter is dedicated to two specific elements of the calculation of the Top-up Tax, namely the GLOBE Income or Loss of the CE, and the Substance-Based Income Exclusion for the jurisdiction. The purpose of the chapter is to investigate the policy rationale behind such elements, as means to understand the justification of the object of the GLOBE MODEL RULES. While the calculation of the Top-up Tax includes mechanical rules that have been sufficiently addressed in chapter II, a deeper investigation of these two elements is essential to understand what is being burdened after all.

The provisions on the computation of the Adjusted Covered Taxes (Art. 4) contain the rules that determine the amount of taxes that shall be associated with the GLOBE Income or Loss for calculating the ETR, and they have been generally addressed in chapter II. The adjustments to Covered Taxes also operate as a mechanism to deal with temporal differences. As these rules relate to the temporal aspect of the GLOBE MODEL RULES, the analysis of these rules is the object of chapter VI.

The calculation of the GLOBE Income or Loss (Art. 3) requires the drafting of rules for the computation of a tax base, in the same fashion as a traditional CIT. However, there are also additional requirements in the context of the GLOBE MODEL RULES. Such rules are expected to be both acceptable from the perspective of IF jurisdictions, as well as easily operable, taking into consideration the complexities inherent to the common framework to a minimum tax. These issues are addressed in sec. 2.

The chapter also addresses the issue of economic rent taxation. The GLOBE MODEL RULES provide for a reduction to the Net GLOBE Income for the jurisdiction, consisting on the Substance-Based Income Exclusion[1100]. As asserted in chapter I, one of the

[1098] GLOBE MODEL RULES, Art. 5.1.
[1099] Similarly, see Diana Calderón Manrique, "The GloBE Tax Base: Road to the Jurisdictional Effective Tax Rate," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), sec. 2.1.
[1100] GLOBE MODEL RULES, Art. 5.3.1.

justifications raised for the GLOBE MODEL RULES in general, and for the Substance-Based Income Exclusion in specific, is that the outcome of their application would be ultimately a burden on economic rent, implying all the theoretical benefits of this form of taxation. Sec. 3, after referring to the existing theoretical framework on the taxation of economic rents, presents the shortcomings of the Substance-Based Income Exclusion.

2. THE GLOBE INCOME OR LOSS

The computation of GLOBE Income or Loss of a CE is one of the main elements to understand the content of the minimum tax. It offers the basis for the calculation of the numerator of the jurisdictional ETR. The computation is complex, and many specificities of the adjustments could be discussed at length. It reflects "a mix of technical necessity, policy considerations, and political compromises"[1101]. It is not within the scope of the chapter to provide for an in-depth analysis of the calculation basis of the Top-up Tax, which is expected to yield many interpretative controversies[1102]. Instead, it suffices to critically evaluate the general tax policy choices made with regard to its determination, and set its general structure, as means to understand the tax object of the GLOBE MODEL RULES. For this purpose, before presenting the rules on the computation of the GLOBE Income or Loss (sec. 2.2), the section discusses the policy choices underlying its definition (sec. 2.1).

2.1. Policy choices in the definition of GLOBE Income or Loss

With regard to the calculation of GLOBE Income or Loss, the main policy feature is the choice for resorting to IFRS and IFRS-equivalent financial statements as a "starting point" for determining it, with subsequent adjustments for GLOBE purposes. Therefore, the rules contain a choice for a partial dependence model (sec. 2.1.1), based on information-oriented accounting GAAPs (sec. 2.1.2), which imply important challenges to the definition of the tax base (sec. 2.1.3), giving rise to the need for adjustments (sec. 2.1.4).

2.1.1. The choice for a partial dependence model

Upon the determination of the tax base two basic models may be outlined. On the one hand, one may speak of dependence models[1103], whereby the determination of the tax base is dependent on financial accounting. On the other hand, one may find autonomous tax accounting models, or independence models, whereby tax legislation provides for a whole body of tax accounting rules, without resorting to financial accounting[1104]. In this case, financial statements are designed as performance indicators for investment decisions, and commercial rules operate separately from tax accounting rules[1105].

[1101] Mindy Herzfeld, "Do GILTI + BEAT + BMT = GloBE?," *Intertax* 50, no. 12 (2022): 891.
[1102] See, with a focus on the relationship between the tax base and accounting standards, Eva Eberhartinger and Georg Winkler, "Pillar Two and the Accounting Standards," *Intertax* 51, no. 2 (2023): 134.
[1103] Juan José Zornoza Pérez and Andrés Báez Moreno, "Modelos comparados de relación entre normas contables y normas fiscales en la imposición sobre el beneficio de las empresas," in *El Impuesto Sobre La Renta y Complementarios*, ed. Julio Roberto Piza Rodríguez, Pedro Sarmiento Pérez, and Roberto Insignares Gómez (Bogotá: Universidad Externado de Colombia, 2010), 432.
[1104] See Victor Borges Polizelli, "Balanço Comercial e Balanço Fiscal: Relações entre o Direito Contábil e o Direito Tributário e o Modelo Adotado pelo Brasil," *Revista Direito Tributário Atual*, no. 24 (2010): 591.
[1105] Nobes and Parker, *Comparative International Accounting*, 40.

The dichotomy[1106] is mostly schematic, and the reality of tax systems is normally situated somewhere in-between those schemes[1107]. Attempts at classifying countries into groups by the degree of connection between tax and financial reporting have been largely unsuccessful[1108]. The UK is commonly treated as an example of a jurisdiction adopting an independence model, but this was "never the case" and alignment between tax and financial accounting has been strengthened in the last decades[1109]. On the other extreme, Germany is commonly mentioned as a jurisdiction adopting a strong dependence model, but total conformity has never been present[1110], and the number of adjustments has been increasing since the late 1990s[1111]. Partial dependence, besides being the most common alternative in tax systems[1112], is also at the origin of the many interpretative problems that arise in such systems[1113].

The GLOBE MODEL RULES adopt a model that resembles a partial dependence system, taking the financial statements as a starting point, and submitting it to further adjustments for GLOBE purposes. Resembling the authoritative principle[1114], the taxable income is determined with reference to accounting rules and commercial accounting finds its way into the determination of the taxable profit. Only if the rules provide for deviations from accounting practice shall the financial reporting be adapted for GLOBE purposes. Therefore, the GLOBE MODEL RULES have opted for a partial dependence model, and the design of an autonomous tax accounting framework for GLOBE purposes has not been considered in the RELEVANT MATERIAL. While a common international tax base is generally deemed to be a more ambitious endeavor[1115], the design of a dependence model

[1106] German scholars commonly resort to a threefold classification, adding the partial dependence as a third category. See, *e.g.,* with further references, Lutz Schmidt, *Maßgeblichkeitsprinzip und Einheitsbilanz* (Heidelberg: Springer, 1994), 7–8. More refined classifications can also be found. See, generally, Polizelli, "Balanço Comercial e Balanço Fiscal."

[1107] See Andrés Báez Moreno, "True and Fair View and Tax Accounting," in *The Dynamics of Taxation : Essays in Honour of Judith Freedman*, ed. Glen Loutzenhiser and Rita de la Feria (Oxford: Hart Publishing, 2020), 349; Judith Freedman, "Financial and Tax Accounting: Transparency and 'Truth,'" in *Tax and Corporate Governance*, ed. Wolfgang Schön (Berlin: Springer, 2008), 78.

[1108] Discussing some of these studies, see Nobes and Parker, *Comparative International Accounting*, 40. Commenting on the changes observed in such linkage in the last decades, see Wolfgang Schön, "International Accounting Standards – A 'Starting Point' for a Common European Tax Base?," *European Taxation* 44, no. 10 (2004): 431.

[1109] Freedman, "Financial and Tax Accounting," 79. Other countries commonly mentioned are France, Belgium, and Japan. Nobes and Parker, *Comparative International Accounting*, 39.

[1110] Treating the German system already in the 1990s as a loose partial dependence system („*keine vollständige Bilanzeinheit, sondern eine eher lose Bilanzverknüpfung*"), see Schmidt, *Maßgeblichkeitsprinzip und Einheitsbilanz*, 9.

[1111] See Schön, "The Odd Couple," 116. Similarly, commenting on Sweden, see Freedman, "Financial and Tax Accounting," 79. Other countries commonly mentioned are the US, the Netherlands and Australia. Nobes and Parker, *Comparative International Accounting*, 39.

[1112] In a survey from 2012 considering 29 jurisdictions (27 EU jurisdictions, US and Switzerland), "no single country in the European Union where there is no relation between financial accounting and tax accounting" was found. See Christoph Spengel and York Zöllkau, eds., *Common Corporate Tax Base (CC(C)TB) and Determination of Taxable Income* (Berlin: Springer, 2012), 19.

[1113] Báez Moreno, "True and Fair View," 349; Freedman, "Financial and Tax Accounting," 89.

[1114] Besides "authoritative principle", the "*Maßgeblichkeitsprinzip*" has already been called "principle of dependence", "congruence principle" and "principle of decisiveness". See Eva Eberhartinger and Margret Klostermann, "What If IFRS Were a Tax Base? New Empirical Evidence from an Austrian Perspective," *Accounting in Europe* 4, no. 2 (2007): 143; Schön, "The Odd Couple," 115. "Fiscal determination" is also commonly used in this context. See Schön, "Group Taxation," 1075. For a historical overview, see Schmidt, *Maßgeblichkeitsprinzip und Einheitsbilanz*, 10–17.

[1115] Referring to the design of an autonomous tax base as "utopian", see Calderón Manrique, "The GloBE Tax Base: Road to the Jurisdictional Effective Tax Rate," sec. 2.5.

is also challenging, as it requires some level of agreement on a common GAAP. Considering the choice for a partial dependence model[1116], adherence to the IFRS and IFRS-equivalent GAAPs as a starting point is the only realistic and practical way of obtaining some level of uniformity for tax purposes[1117].

Partial dependence models are largely grounded on simplification[1118]. To the extent that financial accounting fulfils the requirements of tax law, a separate tax accounting becomes dispensable, making it possible to create cost savings for companies and diminish the need for details in tax legislation[1119]. Besides that, it is also argued that the use of a single method for both tax and financial reporting would create opposing pressures to increase reportable profits for the markets (financial) and to minimize them (tax), thus creating a "healthy equilibrium" and producing figures that are closer to the "true profit"[1120].

The arguments against the partial dependence are also substantial[1121]. They are essentially grounded on the fact that the purpose of financial accounting and tax rules are somehow divergent, and, as a consequence, accounting and tax law would be governed by different principles and rules. It will also occur in the experience of states that a reverse authoritativeness[1122] – i.e. the influence of tax accounting over financial accounting – takes place, as a "logical consequence" of the authoritative principle[1123]. The accounting treatment in the financial statements affects the tax position of the company, but is also affected by it: the tax adjustments are also relevant for commercial accounting. Tax incentives for investments, such as accelerated depreciation and tax-free reserves, for instance, sometimes have to be accounted for in financial accounting following national GAAPs. Tax rules also entail the recognition of deferred tax assets and deferred tax liabilities. Reverse authoritativeness is generally deemed to produce very conservative

[1116] An alternative would be the design of autonomous tax accounting rules. This path has been taken with regard to the CCCTB. Spengel and Zöllkau, *Common Corporate Tax Base (CC(C)TB) and Determination of Taxable Income*, 19–21. See also, in the context of the CCCTB, arguing for the superiority of developing a common tax base without any dependence on commercial accounting, Christopher Nobes, "A Conceptual Framework for the Taxable Income of Businesses, and How to Apply It under IFRS" (Certified Accountants Educational Trust, 2004), 21.
[1117] See, similarly, Schön, "Group Taxation," 1075; Schön, "International Accounting Standards," 440.
[1118] See, discussing the topic, Klaus von Sicherer, *Bilanzierung im Handels- und Steuerrecht* (Wiesbaden: Springer Fachmedien Wiesbaden, 2018), 129–36; Schön, "The Odd Couple," 116.
[1119] Freedman, "Financial and Tax Accounting," 74; Eberhartinger and Klostermann, "What If IFRS Were a Tax Base?," 145.
[1120] See, critically, Freedman, "Financial and Tax Accounting," 71.
[1121] See, discussing the topic, von Sicherer, *Bilanzierung im Handels- und Steuerrecht*, 129–36; Schön, "The Odd Couple," 116.
[1122] Besides "reverse authoritativeness", the "*umgekehrte Maßgeblichkeit*" has already been translated as "reverse conformity" and "reverse dependence". See Eberhartinger and Klostermann, "What If IFRS Were a Tax Base?," 143; Freedman, "Financial and Tax Accounting," 79; Schön, "The Odd Couple," 115.
[1123] Similarly, in the Swiss system, see Bertschinger, *Die handelsrechtliche und steuerrechtliche Gewinnermittlung unter dem revidierten Rechnungslegungsrecht*, 109–18. See, however, on the discussion on the reverse authoritativeness in the Spanish system, Andrés Báez Moreno, *Normas Contables e Impuesto sobre Sociedades* (Navarra: Thomson Aranzadi, 2005), 54.

profit figures for all purposes[1124]. However, reverse authoritativeness is also deemed to be a source of major distortion of the information value of financial accounts[1125].

The goal of establishing a common framework brings additional considerations against a dependence model. In the case of the GLOBE MODEL RULES, the main argument against a partial dependence model would be the challenge of identifying a single GAAP that would be used by all jurisdictions and that could be taken as a reference. The reference to the Consolidated Financial Statements of the UPE engenders significant interpretative problems[1126]. Furthermore, the choice of a GAAP has significant policy implications, which are decisive for the design of the rules. Establishing consensus with regard to such GAAP ultimately requires that a certain level of consensus with regard to the tax base is also present, which leads to the need of examining the different concerns among IF jurisdictions regarding the formal and material requirements of the computation of CIT[1127].

2.1.2. The choice of a GAAP: the contractual and valuation perspectives

Upon the design of a partial dependence system, the option is not simply between autonomous tax accounting and financial accounting, since accounting rules are not completely uniform. Many jurisdictions, besides providing for IFRS or IFRS-equivalent regulations, also set forth national accounting standards, oriented towards creditor protection, being correspondingly guided by a contractual, instead of a valuation/investor perspective[1128]. As put by SCHÖN, "book-tax conformity under financial accounts, which are governed by the aim of 'creditor protection,' means something quite different from book-tax conformity in the era of 'investor information'"[1129]. In fact, there are significant divergences between such approaches towards accounting[1130].

From the contractual perspective, accounting information contributes to the coordination of contractual relationships within a firm. Contracting-based accounting is associated

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[1124] See Schön, "The Odd Couple," 116; Freedman, "Financial and Tax Accounting," 79. See, on the history of reverse authoritativeness in German tax law, including its abolishment in 2009, Rolf Uwe Fülbier and Malte Klein, "Balancing Past and Present: The Impact of Accounting Internationalisation on German Accounting Regulations," *Accounting History* 20, no. 3 (2015): 361.

[1125] Schön, "The Odd Couple," 116. Arguing that the reliance on financial accounting by the GLOBE MODEL RULES could impair the quality of financial reporting, see Eberhartinger and Winkler, "Pillar Two and the Accounting Standards," 134.

[1126] See sec. 2.2.1, *infra.*

[1127] This feature is addressed to a certain extent in the GLOBE MODEL RULES by means of the adjustments. See sec. 2.2.2, *infra.*

[1128] Fülbier and Klein, "Balancing Past and Present: The Impact of Accounting Internationalisation on German Accounting Regulations," 346. For example, Germany allows the use of IFRS for individual company accounts but only for informational purposes, as national accounting standards continue to apply for tax law and profit distribution purposes. See Jürgen Ernstberger and Oliver Vogler, "Analyzing the German Accounting Triad — 'Accounting Premium' for IAS/IFRS and U.S. GAAP Vis-à-Vis German GAAP?," *The International Journal of Accounting* 43, no. 4 (2008): 347.

[1129] Schön, "The Odd Couple," 135.

[1130] Freedman, "Financial and Tax Accounting," 72. In Brazil, in the context of IFRS-convergence reforms, the expression "new accounting" (*nova contabilidade*) is commonly used. See, *e.g.,* Luís Eduardo Schoueri, "Juros sobre Capital Próprio: Natureza Jurídica e Forma de Apuração diante da 'Nova Contabilidade,'" in *Controvérsias Jurídico-Contábeis*, ed. Roberto Quiroga Mosquera and Alexsandro Broedel Lopes, vol. 3 (São Paulo: Dialética, 2012), 169–93.

with a "stewardship purpose"[1131], considering it provides for hard data, with which it is difficult to disagree. As a consequence of the goal of protecting the claims of creditors against the withdrawal of assets from the entities' funds, such accounting systems rely on verifiable, recurring and standardized information, emphasizing past transactions and breeding more historical information[1132]. Grounded on the "principle of prudence"[1133], profits will be shown as late as possible (realization principle) and losses as early as possible (imparity principle)[1134]. This approach tends to exaggerate the downside potential of the firm, while also underscoring the upside chances. In case of uncertainty, contracting-based accounting understates the profit, thus painting a conservative picture of the entity. Despite many reforms of national GAAPs aimed at their convergence towards valuation-based criteria[1135], the aim of creditor protection "is still at the heart of accounting law in many continental legal systems"[1136].

In the case of IFRS and IFRS-equivalent regulations, which adopt a valuation/investor perspective, the purpose is clearly informational. Investor-based accounting is expected to enable investors to forecast a firm's future cash flows, with a prospective focus[1137]. The objective of such financial statements is to provide a "true and fair view"[1138] on the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions[1139]. In doing so, they consciously make a choice to provide more timely information, even if at the cost of its objectivity, dealing with a trade-off between providing roughly right (but useful) information today, and precise (but potentially useless) information tomorrow[1140]. As a consequence, they present a more balanced picture of the firm, instead of a conservative one: uncertainties related to the upsides or downsides of its economic potential are shown symmetrically in the financial accounts[1141].

[1131] Fülbier and Klein, "Balancing Past and Present: The Impact of Accounting Internationalisation on German Accounting Regulations," 346.

[1132] For the relationship between accounting and creditor protection in Germany, see Holger Kahle, *Internationale Rechnungslegung und ihre Auswirkungen auf Handels- und Steuerbilanz* (Wiesbaden: Deutscher Universitätsverlag, 2002), 122–46.

[1133] See, on the principle of prudence, Báez Moreno, *Normas Contables*, 100–126; Schön, "International Accounting Standards," 431; Georg Thurmayr, *Vorsichtsprinzip und Pensionsrückstellungen* (Wiesbaden: Gabler Verlag, 1992), 17–21.

[1134] See, qualifying the realization and the imparity principles as subprinciples supported by the principle of prudence, Báez Moreno, *Normas Contables*, 103–16. See also Schön, "The Odd Couple," 134–35. Critically, see Bertschinger, *Die handelsrechtliche und steuerrechtliche Gewinnermittlung unter dem revidierten Rechnungslegungsrecht*, 175–98.

[1135] See Spengel and Zöllkau, *Common Corporate Tax Base (CC(C)TB) and Determination of Taxable Income*, 20. Specifically on the German reform from 2009 (*Bilanzrechtsmodernisierungsgesetz* – "**BILMOG**"), which touched "the core principles of contracting-based German accounting for the benefit of strengthening its valuation role", see Fülbier and Klein, "Balancing Past and Present: The Impact of Accounting Internationalisation on German Accounting Regulations," 359.

[1136] Schön, "The Odd Couple," 134.

[1137] Fülbier and Klein, "Balancing Past and Present: The Impact of Accounting Internationalisation on German Accounting Regulations," 347.

[1138] Broadly discussing the legal meaning of the term, see Báez Moreno, "True and Fair View," 89.

[1139] IAS 1, *Presentation of Financial Statements,* para. 9.

[1140] Eliseu Martins, "Prefácio," in *Imposto sobre a renda: uma proposta de diálogo com a contabilidade*, by Fernando Daniel de Moura Fonseca (Belo Horizonte: Fórum, 2018), 23.

[1141] Schön, "The Odd Couple," 136.

In summary, the divergence of objectives of the creditor and investor perspectives also leads to different recognition, measurement, and disclosure provisions[1142], as information for contracting purposes is not optimal for valuation and vice versa[1143]. The question is, thus, which of the recognition, measurement, and disclosure provisions better fit the needs of tax accounting.

The answer should be provided based on the purpose of tax law, and varies according to each jurisdiction, being also contingent on the tax theories adopted within each system[1144]. Tax accounting is intended to provide for a fair allocation of the tax burden[1145], and there is a strong need for legal certainty, as tax law is also tailored to protect taxpayers against disproportionate incursions in their fundamental rights[1146]. While a dependence model following contracting-based accounting has a long-standing tradition in some tax systems[1147], dependence models following a valuation-based accounting are a relatively new phenomenon[1148], which has been subject to intense debates in the last decades[1149].

In the case of contracting-based accounting, the divergent purposes[1150] are not necessarily competing purposes. Even though the calculation of legally distributable profit is a different purpose from the calculation of taxable profit, it is not necessarily a competing purpose, in the sense of requiring a different set of rules[1151]. After all, "both calculations benefit from precision in the rules and from the minimization of the use of judgement, which is not the case for the estimation of cash flows"[1152]. The scenario regarding information-based accounting, however, is more troublesome.

2.1.3. Challenges of a information-oriented GAAP for tax purposes

The GLOBE MODEL RULES have opted for IFRS and IFRS-equivalent accounting rules[1153], which are systems of investor-oriented accounting. This choice is grounded on

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[1142] Ernstberger and Vogler, "Analyzing the German Accounting Triad — 'Accounting Premium' for IAS/IFRS and U.S. GAAP Vis-à-Vis German GAAP?," 347.
[1143] Fülbier and Klein, "Balancing Past and Present: The Impact of Accounting Internationalisation on German Accounting Regulations," 346.
[1144] In the sense discussed in ch. I, sec. 2.1, *supra*
[1145] In the sense discussed in ch. I, sec. 2.4, *supra.* See Freedman, "Financial and Tax Accounting," 74–75.
[1146] See Roman Seer, in *Steuerrecht*, by Klaus Tipke and Joachim Lang, 23rd ed. (Köln: Otto Schmidt, 2018), 10; Schoueri, *Direito Tributário*, 74–75.
[1147] See Báez Moreno, *Normas Contables*, 82–83.
[1148] Schön, "The Odd Couple," 135.
[1149] See, *e.g.,* Andrés Báez Moreno and Thomas Kaiser, "'Fair Value' und die Korperschaftsteuer aus spanischer Sicht - Anmerkungen zur steuerlichen Geeignetheit der IFRS," *Steuer und Wirtschaft*, no. 2 (2007): 172–86; Alexsandro Broedel Lopes, "O Fair Value como Expressão da Essência sobre Forma: Considerações Contábeis," *Revista Direito Tributário Atual*, no. 51 (2022): 433.
[1150] See, for a critique of the thesis of the unitary purposes of commercial and tax accounting, Báez Moreno, *Normas Contables*, 87–100.
[1151] The application of the German GAAP, for instance, is closely tied to tax accounts and also serve as the basis for determining dividend restrictions. See Ernstberger and Vogler, "Analyzing the German Accounting Triad — 'Accounting Premium' for IAS/IFRS and U.S. GAAP Vis-à-Vis German GAAP?," 347.
[1152] Christopher Nobes, "Towards a General Model of the Reasons for International Differences in Financial Reporting," *Abacus* 34, no. 2 (1998): 171.
[1153] On the difference between "adoption of" and "convergence to" IFRS, see Nobes and Parker, *Comparative International Accounting*, 125.

on simplification concerns[1154]. The adequacy of a valuation-based GAAP for tax purposes is a more controversial topic[1155]. Traditionally, in countries where tax and financial reporting are closely linked, there is "an understandable reluctance" to adopt IFRS for unconsolidated statements[1156], given that the resulting profit involves more judgement[1157], and also presents valuation and liquidity concerns[1158].

As a matter of fact, from a strictly theoretical perspective, the superiority of value-based accounting for tax purposes could be maintained. Following the Schanz-Haig-Simons concept of income[1159], a full fair value accounting would correspond to the ideal measurement for the increase and decrease of economic power of a person[1160]. The economic argument is that an ideal income tax would tax the change in the value of investments each year, and would also measure gain and loss on an inflation adjusted basis[1161]. These idealistic demands face, however, real world concerns that could make full fair value accounting unfit for tax purposes[1162].

Differently from the case of contracting-based accounting, the difference in objectives and purposes also leads to several differences in the adequacy of criteria for measurement and recognition of assets and liabilities. Investor-oriented accounting poses many challenges to tax accounting, including, *e.g.,* with regard to capitalization of internal research expenses and some timing issues in relation to long-term contracts. Instead of aiming at providing for a full account of the problems related to a partial dependence model, the present section takes two problems of this approach as examples, in order to evidence how the GLOBE MODEL RULES deal with them.

2.1.3.1. Valuation

The first problem of resorting to valuation-based accounting refers to valuation itself[1163]. While, for investment purposes, a range of possible numbers suffices for the users of

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[1154] Accordingly, "[t]he simplest financial accounting standard for an MNE to use is one that it already used for other purposes" (PUBLIC CONSULTATION DOCUMENT, p. 10, para. 18).

[1155] See Schön, "The Odd Couple," 135. In Brazil, stating that value-based accounting would not be in line with the objectives of tax law, see, among many others, Martins, "Prefácio," 23; Fernando Daniel de Moura Fonseca, *Imposto sobre a renda: uma proposta de diálogo com a contabilidade* (Belo Horizonte: Fórum, 2018), 242–44; Pedro Augusto do Amaral Abujamra Asseis, "O Ajuste a Valor Justo (AVJ) Analisado sob o Conceito Jurídico de Renda," *Revista Direito Tributário Atual*, no. 32 (2014): 296; Ricardo Mariz de Oliveira, "Depurações do Lucro Contábil para Determinação do Lucro Tributável," in *Controvérsias Jurídico-Contábeis*, ed. Roberto Quiroga Mosquera and Alexsandro Broedel Lopes, vol. 5 (São Paulo: Dialética, 2014), 365. Contrarily, see Schoueri, "O mito do lucro real," 264.

[1156] However, in a survey from 2012, considering 29 countries, Bulgaria, Cyprus, Estonia, Malta and Portugal were already pointed out as countries that take IFRS accounting as basis for determination of taxable income, and other eight countries were identifying as countries were IFRS "may be relevant" for tax purposes. See Spengel and Zöllkau, *Common Corporate Tax Base (CC(C)TB) and Determination of Taxable Income*, 20.

[1157] Nobes and Parker, *Comparative International Accounting*, 354. See also Fülbier and Klein, "Balancing Past and Present: The Impact of Accounting Internationalisation on German Accounting Regulations," 359.

[1158] Bankman and Weisbach, "The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax," 1415.

[1159] On the topic, see Kevin Holmes, *The Concept of Income: A Multidisciplinary Analysis* (Amsterdam: IBFD, 2000), 80; Schoueri, "O mito do lucro real," 243.

[1160] Schön, "International Accounting Standards," 438.

[1161] Bankman and Weisbach, "The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax," 1415.

[1162] Schön, "International Accounting Standards," 439.

[1163] See, discussing the topic, Báez Moreno and Kaiser, "'Fair Value' und die Korperschaftsteuer," 180.

financial statements, tax accounting requires a single specific number, which defines the liability of the taxpayer[1164].

In contracting-based accounting, possible indeterminations concerning assets and liabilities are solved conservatively, for instance, by applying the "lower of market or cost" principle, or by the inclusion of provisions to the balance-sheet[1165]. The conservative approach is justified for tax purposes as, in case of doubt, the most beneficial treatment for the taxpayer is applied, which means that the state is only entitled to a portion of the profits when it is possible to be sure that the profit has arisen.

In valuation-based accounting the indetermination is settled by presenting it symmetrically. A clear example of this may be seen in the broad reliance of IFRS accounting on fair value. Defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date"[1166], the fair value reflects the volatility inherent to the market, and brings it to the financial accounts[1167]. The notion brings a substantial level of vagueness and discretion, often relying on "abstract projections"[1168]. As financial accounts are aimed at giving a range of relevant and reliable figures to a multitude of stakeholders, accounting standards will often give "guidance rather than detailed rules", making available a range of options to be applied at the discretion of company directors, under the auditors' advisory[1169]. While in case of existence of quoted market prices the fair value can be determined in a relatively straight-forward way, in other cases, the value of the asset will be subject to estimates and discretion. Without rigorous consideration and within a weak regulatory environment, adherence to fair value may produce inaccurate outcomes[1170]. In practice, it is also not easy to establish which assets are hard to value, and which are not. This also creates problems related to the need of a rather arbitrary line-drawing for the purposes of valuation-based accounting, which is also able to bring further distortions to taxation[1171].

2.1.3.2. Liquidity

Besides the valuation concerns, the adoption of value-based tax accounting may also lead to the taxation of unrealized profits, which is rejected in some systems[1172]. Under such legislations, the change in investment value is only taxed if it is realized in the form of a

[1164] Schön, "The Odd Couple," 136.
[1165] Schön, 136.
[1166] IFRS 13, *Fair Value Measurement,* para. 9.
[1167] Freedman, "Financial and Tax Accounting," 75.
[1168] See Lopes, "O Fair Value como Expressão da Essência sobre Forma," 445.
[1169] Freedman, "Financial and Tax Accounting," 75. See also Schön, "International Accounting Standards," 437.
[1170] See Lopes, "O Fair Value como Expressão da Essência sobre Forma," 445.
[1171] Schön, "The Odd Couple," 137.
[1172] See*,* discussing the issue, Kahle, *Internationale Rechnungslegung*, 222; Báez Moreno and Kaiser, "'Fair Value' und die Korperschaftsteuer," 177; Mariz de Oliveira, "Depurações do Lucro Contábil para Determinação do Lucro Tributável," 365.

sale or exchange[1173]. After all, there are complications in paying taxes without liquid assets, and the realization principle still lies at the center of most CIT systems[1174].

In contracting-based accounting, like the shareholders of the company, the state has to wait until a profit is realized and can be withdrawn without harming the company or its creditors[1175]. The historical cost method supports the objectivity of the tax assessment, and reduces the volatility of profits and losses that is otherwise reflected in the financial statements[1176]. The preference for the historical cost method is, after all, a manifestation of the realization principle[1177]. The state is therefore seen as a "dormant partner", being expected to share the risks and obligations of the company, not being entitled to any preferential treatment[1178].

In valuation-based accounting, considering the move towards fair-value accounting, the role of realization is minimized[1179]. Fair value accounting shows gains in the accounts which have not yet been realized on the market, so that the taxpayer has no corresponding liquidity available[1180]. This creates a problem to the extent that inefficiencies in capital markets make it difficult for the taxpayer to raise funds to pay the debt. As a consequence, investor-oriented accounting does not allow the taxpayer to rely on the market realization of profits as a way to satisfy tax liabilities[1181].

2.1.4. Tax adjustments in a valuation-based GAAP

The question is, therefore, whether it is possible to take a valuation-based GAAP as a starting point, and, by submitting it to adjustments for tax purposes, arrive at a profit figure that is satisfactory as a taxable base for the IF jurisdictions. As clarified upon the enunciation of the research question[1182], the thesis does not deal with "should-questions", and it is not within its scope to discuss what an ideal tax base for a minimum tax looks like. However, as the GLOBE MODEL RULES intend to offer a common approach towards a floor to tax competition, it is expected that they provide for a calculation mechanism that is acceptable for (most) IF jurisdictions.

With this regard, a reasonable middle-ground position seems to be that a valuation-based accounting will only provide for a workable tax base if fair value does not become the standard for the valuation of assets and liabilities[1183]. According to this position, there would be no fundamental difference between the income concepts of a workable tax accounting and IFRS accounting. Most features of recognition and valuation would be in

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[1173] Bankman and Weisbach, "The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax," 1415.
[1174] Freedman, "Financial and Tax Accounting," 75. For an overview of the Brazilian debate, see Victor Borges Polizelli, *O princípio da realização da renda: reconhecimento de receitas e despesas para fins do IRPJ* (São Paulo: Quartier Latin, 2012).
[1175] Schön, "The Odd Couple," 137.
[1176] Schön, "International Accounting Standards," 439.
[1177] Báez Moreno, *Normas Contables*, 105.
[1178] Schön, "The Odd Couple," 137.
[1179] Schön, 138; Kahle, *Internationale Rechnungslegung*, 222.
[1180] Schön, "International Accounting Standards," 439.
[1181] Schön, "The Odd Couple," 138.
[1182] See Introduction, sec. 3.
[1183] Similarly, in the context of CCCTB, see Schön, "International Accounting Standards," 439.

line with the goals of CIT, and fair value would be the only measurement of income that is deemed "too uncertain and volatile", also with liquidity concerns[1184].

Following this position, financial accounts could therefore be used as a starting point for determining taxable profits. However, there are important differences, which reflect government policy on taxable income and the conflicting scopes of a taxable base *vis-à-vis* the informational purposes of financial statements[1185]. The expression "starting point" implies that the rules are not used without adjustments to build a taxable base[1186] - and this is the approach that has been taken upon the drafting of the GLOBE MODEL RULES. There are substantive adjustments to be made before the GLOBE Income or Loss is achieved. The challenge, therefore, in designing a system, is to identify which are those differences and whether it is possible to approach them in a principled manner[1187].

2.2. The computation of GLOBE Income or Loss

The GLOBE Income or Loss of each CE is computed by taking the Financial Accounting Income or Loss of the CE (sec. 2.2.1) and submitting it to certain adjustments (sec. 2.2.2)[1188]. In approaching the Financial Accounting Income or Loss of the CE, reference is made to the GAAP of the UPE Jurisdiction. As such accounting standards are not completely uniform, the GLOBE MODEL RULES operate with a range of acceptable starting points. The Financial Accounting Income or Loss of the CE is further submitted to both mandatory and optional adjustments. The GLOBE Income or Loss presents itself as a manifestation of the pragmatic approach to reach a consensus among IF jurisdictions, working with a range of acceptable GAAPs, and keeping the adjustments to the lowest possible level (sec. 2.3).

2.2.1. The financial accounts as a starting point

Financial Accounting Net Income or Loss is defined as the net income or loss determined for a CE in preparing Consolidated Financial Statements of the UPE, before any consolidation adjustments eliminating intra-group transactions[1189]. The starting point, therefore, is the financial statements of the stand-alone CE, which is used for the purpose of preparing the Consolidated Financial Statements.

Consolidated Financial Statements is a defined term, which presents four alternative meanings (sec. 2.2.1.1 to sec. 2.2.1.4)[1190]. Even if the relevant financial statement taken as a starting point is the stand-alone financial statement before intra-group adjustments, the reference to the Consolidated Financial Statements is essential to establish which is the applicable GAAP. In all four meanings, there is a trend towards setting IFRS and IFRS-equivalent GAAPs as a gold-standard for the determination of the tax base. Nevertheless, in cases where "it is not reasonably practicable" to refer to the Consolidated

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[1184] Schön, 440.
[1185] Freedman, "Financial and Tax Accounting," 78. Similarly, see Kahle, *Internationale Rechnungslegung*, 221–22.
[1186] Similarly, in the context of CCCTB, see Schön, "International Accounting Standards," 436.
[1187] Freedman, "Financial and Tax Accounting," 78.
[1188] GLOBE MODEL RULES, Art. 3.1.1.
[1189] GLOBE MODEL RULES, Art. 3.1.2.
[1190] GLOBE MODEL RULES, Art. 10.1.1.

Financial Statements of the UPE, another GAAP may become applicable, provided that some conditions are met (sec. 2.2.1.5)[1191].

2.2.1.1. The Acceptable Financial Accounting Standard

According to Art. 10.1, Consolidated Financial Statements are:

> *(a) the financial statements prepared by an Entity in accordance with an Acceptable Financial Accounting Standard, in which the assets, liabilities, income, expenses and cash flows of that Entity and the Entities in which it has a Controlling Interest are presented as those of a single economic unit;*

Under this meaning, Consolidated Financial Statements are the consolidated financial statements prepared either according to the IFRS rules or the accounting standards of one of the listed jurisdictions that provide for Acceptable Accounting Standards[1192]. In such cases, the GAAP is applicable on its own terms, and there is no space to adjust it for Material Competitive Distortions.

2.2.1.2. The improper meaning for PEs

Under the defined term, Consolidated Financial Statements may also have an improper meaning, under the following terms:

> *(b) where an Entity meets the definition of a Group under Article 1.2.3, the financial statements of the Entity that are prepared in accordance with an Acceptable Financial Accounting Standard;*

Article 1.2.3 provides a "supplementary"[1193] definition of Group, treating as such an Entity that has one or more PEs in other jurisdictions. In such cases, there is only one legal person, and the Group has as UPE this legal person (the Main Entity) and its PEs are the CEs. Consequently, no consolidated financial statements in the proper sense is prepared. The financial statements of the Main Entity are treated as the "Consolidated Financial Statements". Under this definition, there is not properly a consolidated financial statement in the sense of IFRS 10, and the GLOBE MODEL RULES take the financial statements of the Main Entity as the Consolidated Financial Statements. After all, the PE is a tax law creature, which is already "consolidated" on a line-by-line basis in the financial statements of the Main Entity[1194]. The Main Entity already includes the Financial Accounting Net Income or Loss of the PE in its financial statements.

In this case, the definition of Consolidated Financial Statements is an autonomous concept of the GLOBE MODEL RULES, which, for its own purposes, treat as "consolidated" the financial statements of a single Entity. The financial statement of the Main Entity under this paragraph will only be treated as the Consolidated Financial Statements if it follows an Acceptable Accounting Standards (otherwise, para. (c) applies).

[1191] GLOBE MODEL RULES, Art. 3.1.3.
[1192] A list of jurisdictions whose accounting standards are Acceptable Financial Accounting Standard is provided in GLOBE MODEL RULES, Art. 10.1.1.
[1193] GLOBE COMMENTARY, p. 18, para. 25.
[1194] GLOBE COMMENTARY, p. 17, para. 22-23.

2.2.1.3. The adjustments for Material Competitive Distortions

Alternatively, in the case of jurisdictions that not provide for an Acceptable Financial Accounting Standard, and there is no Consolidated Financial Statements according to para. (a) and (b), para. (c) becomes applicable:

> *(c) where the Ultimate Parent Entity has financial statements described in paragraph (a) or (b) that are not prepared in accordance with an Acceptable Financial Accounting Standard, the financial statements are those that have been prepared subject to adjustments to prevent any Material Competitive Distortions; and*

Hence, in cases where there are no Consolidated Financial Statements – either in the proper sense (a) or in the improper one (b) – prepared according to an Acceptable Financial Accounting Standard, the financial statements that have been prepared shall be compared with a Consolidated Financial Statement that would be prepared following the IFRS principles and rules, in order to avoid Material Competitive Distortions.

Material Competitive Distortion is a defined term[1195] that provides for a mechanism to compare a GAAP that is not an Acceptable Financial Accounting Standard with the IFRS standard. It requires a comparison of the application of a specific principle or procedure under a GAAP with the corresponding IFRS principle or procedure. If the application results in an aggregate variation greater than EUR 75 million in a Fiscal Year, the accounting treatment of any item or transaction subject to that principle or procedure shall be adjusted to conform to the treatment required for the item or transaction under IFRS.

The mechanism is aimed at ensuring the role of the IFRS rules as a reference for financial statements for the purpose of the GLOBE MODEL RULES. The list of Acceptable Accounting Standards has been conceived as a form of positive-listing of countries that have IFRS-compliant systems[1196]. For countries that are not listed, the application of the local GAAP (Authorised Financial Accounting Standard, in the GLOBE vocabulary) shall be compared with the application of the IFRS principles and rules, in order to eliminate Material Competitive Distortion.

2.2.1.4. The deeming provision

The last definition deals with cases where the UPE does not present Consolidated Financial Statements in the sense of any of the three former paragraphs. In such cases, Consolidated Financial Statements are defined as follows:

> *(d) where the Ultimate Parent Entity does not prepare financial statements described in the paragraphs above, the Consolidated Financial Statements of the Ultimate Parent Entity are those that would have been prepared if such Entity were required to prepare such statements in accordance with an Authorised Financial Accounting Standard that is either an Acceptable Financial Accounting Standard or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions.*

Paragraph (d) is therefore a "deeming provision" for those UPEs that do not prepare Consolidated Financial Statements. The "deemed consolidation test" requires the use of the financial statements that should have been prepared in accordance with an Authorised

[1195] GLOBE MODEL RULES, Art. 10.1.1.

[1196] PILLAR TWO BLUEPRINT, p. 51.

Financial Accounting Standard[1197] that is either an Acceptable Financial Accounting Standard or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions. The provision will inevitably require an autonomous interpretation by tax authorities, since the Consolidated Financial Statements will be prepared for GLOBE purposes only. In the cases covered by the provision, the UPE would not otherwise be obliged to present such form of financial statements.

2.2.1.5. The application of another GAAP as an exception

Finally, if it is "not reasonably practicable" to determine the CE's Financial Accounting Net Income based on the UPE's GAAP, the Financial Accounting Net Income of the CE may be determined using another Acceptable Financial Accounting Standard or an Authorised Financial Accounting Standard if[1198]: (a) the financial accounts of the CE are maintained based on that accounting standard[1199]; (b) the information contained in the financial accounts is reliable[1200]; and (c) permanent differences in excess of EUR 1 million that differs from the financial standard of the UPE are conformed[1201].

The GLOBE COMMENTARY clarify that the rule is not expected to be applied in many cases, considering that the MNE Group will usually have a mechanism in place to convert the CE's financial statements into the accounting standard of the UPE, and, under such circumstances, the accurate calculation is deemed to be "reasonably practicable"[1202]. The exception would be intended to deal with cases such as a recent acquisition in which the acquired entities have traditionally applied another GAAP and the conversion into the GAAP of the UPE is not "reasonably practicable"[1203]. Therefore, the guidance of the GLOBE COMMENTARY is in the sense that only in limited circumstances a conversion of the financial statements should be deemed not to be "reasonably practicable".

2.2.1.6. Critical assessment: a range of acceptable starting points

Following the provisions of Article 3.1, the GLOBE Income or Loss is generally calculated taking the stand-alone financial statement of the CE, prepared according to the GAAP of the UPE as a starting point. If such GAAP is an Acceptable Financial Accounting Standard (generally IFRS or IFRS-compliant GAAPs) no adjustments to the GAAP are necessary. If, however, the GAAP is not an Acceptable Financial Accounting Standard, then it may be necessary to adjust it to avoid Material Competitive Distortions. In other words, the starting point is in most cases the stand-alone financial statements prepared according to the GAAP of the UPE, which is either an Acceptable Financial Accounting Standard or an Authorised Financial Accounting Standard (adjusted for Material Competitive Distortions). The only exception are the cases where it is not "reasonably practicable" to convert the financial statements of the CE, and another GAAP may be accepted.

[1197] Meaning "a set of generally acceptable accounting principles permitted by an Authorised Accounting Body in the jurisdiction where that Entity is located". See GLOBE MODEL RULES, Art. 10.1.1.
[1198] GLOBE MODEL RULES, Art. 3.1.3.
[1199] See GLOBE COMMENTARY, p. 46, para. 14.
[1200] See GLOBE COMMENTARY, p. 46, para. 15.
[1201] See GLOBE COMMENTARY, p. 46, para. 16.
[1202] GLOBE COMMENTARY, p. 45, para. 13.
[1203] GLOBE COMMENTARY, p. 45, para. 13.

The equivalence between the Acceptable Financial Accounting Standard and IFRS considers its informational purpose. These GAAPs provide for equivalent results in the sense that they fulfil the IFRS purpose of providing the stakeholders with a certain level of information[1204]. It should not be expected that the same facts, if submitted to different Acceptable Financial Accounting Standards, would lead to the exact same outcome, or to the exact same numbers to be taken as a starting point of a taxable base[1205]. Even though, one may expect them to be roughly similar, thus leading to the conclusion that the GLOBE MODEL RULES rather work with a range of acceptable starting points. The idea of a range is also implicit to the adjustments to avoid Material Competitive Distortions. Not all differences are eliminated, but only "material" differences, as defined. Hence, different MNE Groups, whose UPEs are located in different jurisdictions, may be subject to different starting points for calculating the GLOBE Income or Loss of their CEs. Even though, if the GLOBE MODEL RULES' assumption is correct, no "material" differences are expected.

Therefore, there is an important peculiarity in the partial dependence model that has been developed. The GLOBE MODEL RULES do not operate with an identity of starting points as means to calculate the GLOBE Income or Loss, but rather with a range of acceptable starting points – either that arising from the application of an Acceptable Financial Accounting Standard or of an Authorised Financial Accounting Standard (adjusted for Material Competitive Distortions if necessary). As described, one of the main challenges of establishing a partial dependence model within a common framework is the identification of an acceptable GAAP. The GLOBE MODEL RULES resort to a pragmatic solution, and accept GAAPs which are not expected to engender materially significant outcomes from each other (Acceptable Financial Accounting Standards), also providing for a correction mechanism where necessary (Authorised Financial Accounting Standards adjusted for Material Competitive Distortions).

This solution has the merits of identifying a single GAAP to be applied to all the CEs of the MNE Group. The calculation of the Top-up Tax will generally have the same starting point in all CEs of the same MNE Group, thus improving the effectiveness of the floor to tax competition, while preventing double incidence of the minimum tax. However, even though the applicable rules are uniform, there is no institutional mechanism to ensure their uniform interpretation. Such GAAPs require significant professional judgement upon their application[1206], and the solution will certainly bring several questions regarding the authority to interpret them. After all, jurisdictions applying an IIR, an UTPR or a QDMTT will be required to rely on the GAAP of the UPE Jurisdiction to apply the charging rule. The extent to which the tax authorities of other jurisdictions are expected to autonomously interpret the GAAP of the UPE Jurisdiction is still unclear and the topic will certainly be subject to much controversy.

A clear downside of the solution is that the starting point will not be uniform across MNE Groups, being contingent on the location of the UPE[1207]. The application of the GLOBE

[1204] Nobes and Parker, *Comparative International Accounting*, 245.
[1205] See, for instance, on the differences and convergences between IFRS and US GAAP, Nobes and Parker, 137–39.
[1206] See, specifically in relation to the GLOBE MODEL RULES, Eberhartinger and Winkler, "Pillar Two and the Accounting Standards," 134.
[1207] Similarly, discussing the downsides of the possibility of choosing between different GAAPs, see Schwarz, *The OECD GloBE proposal*, 96.

MODEL RULES, as they are drafted, is expected to submit financial accounting rules to additional stress[1208]. The pragmatic solution will only offer a viable framework if the application of the diverse Acceptable Financial Accounting Standards does not produce significantly different results from each other and if the mechanism to adjust Authorised Financial Accounting Standard for Material Competitive Distortions works properly. Otherwise, besides the obvious equality concerns, if the starting point proves to be manipulable for the purpose of calculating the Top-up Taxes, some level of regulatory competition among states will still be present[1209], and, as a consequence, the intended floor to tax competition may be harmed.

2.2.2. The adjustments to determine the GLOBE Income or Loss

The Financial Accounting Net Income or Loss of a CE shall be further adjusted for certain book-to-tax differences, considering differences between financial accounting results and taxable income results, which are deemed to be common in IF jurisdictions[1210]. Whereas some fiscal reservations are necessary, great deviations from the IFRS are avoided, as a strategy to obtain consensus. The adjustments need to be justified, and the more the rules distance themselves from the IFRS standard, the more difficult it becomes to find a common ground among the IF jurisdictions[1211].

The GLOBE COMMENTARY distinguish between permanent and temporary book-to-tax differences, contingent on whether they will reverse in a future period (timing differences) or not[1212]. While permanent differences are dealt with at the level of the GLOBE Income or Loss, being subject to Article 3.2, temporary differences are addressed by means of adjustments to the Covered Taxes, under the provisions of Article 4. Therefore, loss compensations, for instance, are not addressed by means of reduction of the GLOBE Income of a subsequent year, but rather by adjusting the Covered Tax for a subsequent year. Correspondingly, the present section deals only with the permanent differences, while the temporary differences are dealt with in chapter VI.

In order to deal with permanent differences, the GLOBE MODEL RULES provide for both mandatory (sec. 2.2.2.1) and optional (sec. 2.2.2.2) adjustments. These adjustments are complex and lengthy paragraphs of the GLOBE COMMENTARY are dedicated to explain them. For the thesis, it suffices to present an overview of their characteristics, as means to understand the general features of the tax object captured by the GLOBE MODEL RULES.

2.2.2.1. Mandatory Adjustments

In order to arrive at the CE's GloBE Income or Loss, the CE's Financial Accounting Net Income is mandatorily adjusted for: a) Net Taxes Expense; b) Excluded Dividends; c) Excluded Equity Gain or Loss; d) Included Revaluation Method Gain or Loss; e) Gain or Loss from disposition of assets and liabilities excluded under Article 6.3; f) Asymmetric Foreign Currency Gains or Losses; g) Policy Disallowed Expenses (generally illegal

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[1208] See, arguing that the rules may impair the quality of financial information, Eberhartinger and Winkler, "Pillar Two and the Accounting Standards," 134.
[1209] See, making the case that the GLOBE MODEL RULES incentivize regulatory (GAAP) competition between countries, Eberhartinger and Winkler, 134.
[1210] GLOBE COMMENTARY, p. 46, para 17.
[1211] See GLOBE COMMENTARY, p. 47, para 21. Similarly, regarding the CCCTB, see, Schön, "Group Taxation," 1076.
[1212] GLOBE COMMENTARY, p. 46, para 17.

payments and fines); h) Prior Period Errors and Changes in Accounting Principles; and i) Accrued Pension Expense[1213]. These terms are all defined in Article 10.1.1 of the GLOBE MODEL RULES[1214]. The mandatory adjustments also include industry-specific rules[1215] for insurance companies[1216] and International Shipping Income (which is excluded)[1217], as well as provisions regarding Intragroup Financing Arrangements[1218], treatment of Additional Tier One Capital[1219] and compliance with the ALS[1220]. For the purposes of computation of GLOBE Income or Loss, there is also a safeguard provision regarding Qualified Refundable Tax Credits (government incentives delivered via the tax system)[1221], which is aimed at preventing that they distort the ETR calculation[1222].

The mandatory adjustments present different functions in relation to the determination of the tax base. Some of the mandatory adjustments are intended to bring the CE's GLOBE Income or Loss more into alignment with the computation of taxable income under a typical CIT (*e.g.*, exclusion of equity method income or loss from a non-Controlling Interest in a corporation, exclusion of Policy Disallowed Expenses)[1223]. Other adjustments are intended to prevent double taxation of the MNE Group's income (*e.g.*, exclusion of dividends received from Constituent Entities) [1224]. There are also adjustments which are related to the nature of the minimum tax, and are designed to prevent the types of low-tax outcomes that the GLOBE MODEL RULES are intended to address (*e.g.,* arm's length requirement)[1225]. Finally, some adjustments are industry-specific, being intended to address specificities of certain business models (*e.g.,* international shipping income exclusion and exclusion of certain insurance company income)[1226].

2.2.2.2. *Optional Adjustments*

Among the optional adjustments, there are specific provisions dealing with stock-based compensation schemes[1227], consolidation of CEs that are located in the same jurisdiction[1228], and the offsetting of income and losses arising from the disposal of tangible assets (election to spread capital gains over five years)[1229]. These options are generally intended to eliminate potential unfair outcomes that could arise in certain contexts, and also make the application of the rules simpler where possible.

1213 GLOBE MODEL RULES, Art. 3.2.1.
1214 With the exception of "e) Gain or Loss from disposition of assets and liabilities excluded under Article 6.3.", which includes an express reference to another provision.
1215 As clarified in the Introduction, an in-depth analysis of these industry-specific rules is outside the scope of the thesis.
1216 GLOBE MODEL RULES, Art. 3.2.9.
1217 GLOBE MODEL RULES, Art. 3.3.
1218 GLOBE MODEL RULES, Art. 3.2.7.
1219 GLOBE MODEL RULES, Art. 3.2.10.
1220 GLOBE MODEL RULES, Art. 3.2.3.
1221 A more detailed analysis of the Qualified Refundable Tax Credits is outside the scope of the thesis. On the topic, see Perry, "Pillar 2, Tax Competition, and Low Income," 110–11.
1222 GLOBE MODEL RULES, Art. 3.2.4.
1223 GLOBE COMMENTARY, p. 47, para. 20.
1224 GLOBE COMMENTARY, p. 47, para. 20.
1225 GLOBE COMMENTARY, p. 47, para. 21.
1226 See GLOBE COMMENTARY, pp. 69-77.
1227 GLOBE MODEL RULES, Art. 3.2.2. Stock-based compensation deductions are "often one of the biggest causes of discrepancies between book and taxable income". See Herzfeld, "Do GILTI + BEAT + BMT = GloBE?," 890.
1228 GLOBE MODEL RULES, Art. 3.2.8.
1229 GLOBE MODEL RULES, Art. 3.2.6.

Furthermore, the Filling CE may also elect to determine gains and losses using the realization principle for purposes of computing GLOBE Income with respect to assets and liabilities that are subject to fair value or impairment accounting in the Consolidated Financial Statements[1230]. The provision demands a five-year election, and must be made with regard to all CEs within a jurisdiction. The provision also allows that the option is limited to tangible assets only.

This election to use realization in lieu of fair value accounting is not discussed in the PILLAR TWO BLUEPRINT and is an innovation of the GLOBE MODEL RULES. The GLOBE COMMENTARY does not refer to the valuation or the liquidity concerns addressed in sec. 2.1.3. Nevertheless, the optionality is justified on the grounds of "volatility"[1231], which is also a consequence of the valuation issue. The volatility problem is not presented as a fundamental issue, as it is discussed in the literature, but rather as a small inconvenience, which will demand an specific treatment in certain cases.

The optionality is another pragmatic solution to achieve consensus. It addresses the main concerns of the use of valuation-based accounting as a starting point for the tax base, while also maintaining it as an optionality. The reasons for treating it as an elective mechanism, instead of a mandatory adjustment, are not discussed in the RELEVANT MATERIAL. However, as pointed out, there is a general trend in the GLOBE MODEL RULES to limit the number of adjustments, given the simplification concerns. In any case, the elective mechanism covers the main theoretical criticism to the use of valuation-based accounting as a starting point for the tax base, even if the issue is not discussed as a fundamental problem in the GLOBE COMMENTARY.

From an ability-to-pay perspective, such optionality may raise constitutional concerns if a stricter view is adopted[1232]. Setting the realization principle as an optionality will potentially submit different MNE Groups to different regimes, privileging those MNE Groups which are prepared and willing to deal with more complexity, and operate within the intricacies of the elective system. Such elements should be irrelevant for the purpose of capturing the ability-to-pay of the relevant subjects and may ultimately lead to an unfair distribution of the tax burden.

2.3. Summary

The GLOBE Income or Loss of a CE is calculated by means of a partial dependence model, taking as a starting point the Financial Accounting Net Income or Loss of the stand-alone CE, as determined in preparing the Consolidated Financial Statements of the UPE, before consolidation adjustments. The starting point of the calculation is generally based on the GAAP of the UPE Jurisdiction, which may be either an Acceptable Accounting Standard or an Authorised Accounting Standard adjusted for Material Competitive Distortions. A peculiarity of the GLOBE MODEL RULES, therefore, is that there is a range of acceptable starting points. The financial accounts taken as starting point are prepared based on the GAAP of the UPE. As GAAPs are not completely uniform worldwide, the starting point will not be uniform across MNE Groups, being contingent on the location of the UPE.

[1230] GLOBE MODEL RULES, Art. 3.2.5.

[1231] GLOBE COMMENTARY, p. 65, para. 117.

[1232] See, on the constitutional issues of optionality in the German system, Dieter Birk, ""Besteuerung nach Wahl" als verfassungsrechtliches Problem," *Neue Juristische Wochenschrift* 37, no. 23 (1984): 1325.

Ultimately, different MNEs will calculate the GLOBE Income or Loss of CEs based on different rules for the determination of Financial Accounting Net Income or Loss.

The Financial Accounting Net Income is further adjusted to arrive at the GLOBE Income or Loss. The adjustments are generally intended to bring the CE's GLOBE Income or Loss into alignment with the computation of taxable income under a typical CIT, prevent double taxation of the MNE Group's income, as well as prevent the types of low-tax outcomes that the GLOBE MODEL RULES are intended to address. The main concerns arising from the use of valuation-based accounting for the purpose of calculation of the tax base are addressed by means of an elective system, which allows the determination of gains and losses using the realization principle for the purpose of calculating the GLOBE Income or Loss.

Ultimately, even in a world of uniform adoption of the GLOBE MODEL RULES, MNE Groups whose UPEs are located in different jurisdictions will not be subject to the same rules for the calculation of the Top-up Tax, as the GAAPs of the UPEs may vary. The floor to tax competition is therefore not established with milimetrical precision, but by means of the rough approximations that the convergence of GAAPs is able to provide. Setting the realization principle as an optionality also raises equality concerns, as it makes the tax burden contingent on the ability of the taxpayer to operate within the complexities of the system, with potentially unfair results.

3. THE EXCESS PROFITS AND THE TAXATION OF ECONOMIC RENTS

Despite the importance of the computation of the GLOBE Income or Loss of the CE, which is an element of the calculation of the Top-up Tax Percentage[1233], the Jurisdictional Top-up Tax is levied on the Excess Profit. The GLOBE Income or Loss of the CEs for the jurisdiction are blended, to arrive at the Net GLOBE Income for the jurisdiction. The Excess Profit for the jurisdiction is obtained by subtracting the Substance-Based Income Exclusion from the Net GLOBE Income for the jurisdiction. As seen, the justification of the Substance-Based Income Exclusion is strongly grounded on the idea of taxation of economic rents[1234].

The present section is aimed at examining whether the content of some of the GLOBE MODEL RULES provisions is in line with the alleged goal of providing for a tax on economic rent. In order to implement such analysis, the section presents a framework for the taxation of economic rents (sec. 3.1), followed by the analysis of the Substance-Based Income Exclusion (sec. 3.2)

3.1. A framework for the taxation of economic rents

Economic rents were already described as "an attractive but notoriously elusive tax target", and its isolation without affecting resource allocation would be "a difficult policy task"[1235]. Profits include a combination of the normal rate of return, a risk premium, economic rents and the return to managerial or entrepreneurial inputs[1236]. However, there

[1233] See ch. II, sec. 5.5, *supra*.
[1234] See ch. I, sec. 4.3, *supra*.
[1235] Church, "Economic Rent, Economic Efficiency, and the Distribution of Natural Resource Tax Burdens," 563.
[1236] Griffith and Miller, "Taxable Corporate Profits," 536.

is some controversy on the relative importance of each of those elements[1237]. The average corporate profit rate is substantially higher than the long-term risk-free rate, proxied by the return on government bonds. Part of this difference is explained as a risk premium which corporate investors require, thus suggesting that other factors also play a role[1238]. Another part may reflect the return to complementary effort by individuals with an equity stake, being potentially attributable to entrepreneurial and managerial efforts[1239]. A further part of the profits is deemed to be economic rents, which is a return earned over and above the normal return. Economic rents can arise due to a multitude of elements, mainly the exploitation of market power or of a scarce resource[1240]. Economic rents can be broadly defined as "returns in excess of the return required to keep capital employed in its current use"[1241]. Another similar formulation is to define economic rents as "a payment for a commodity or factor of production in excess of the amount required to secure use of that scarce resource from its owner"[1242].

How does a tax system capture the economic rent? There are basically two ways to exempt normal returns from taxation[1243]: one can either conceive a system of up-front expensing[1244] or allow an annual deduction for the normal return. The structure of the carve-out makes the investigation of the second system relevant for the purpose of examining the tax object of the GLOBE MODEL RULES.

There is a significant line of scholarly research dedicated to design a tax system that is at the same time easily operable and non-distortive, by means of an ACE[1245]. In this system, the tax base is the current earnings of the firm (i.e. profits gross of depreciation and interest), net of two deductions. The first deduction is intended to represent the cost of economic depreciation and does not need to account for true economic depreciation. In this case, the "economic rent" is defined as the "returns that exceed the opportunity cost of capital"[1246]. What is decisive for this deduction is that a "balancing charge" is levied (or a rebate paid) if assets are sold or scrapped for a price that is different from their tax-written-down value[1247].

The second deduction represents the opportunity cost of finance, and is defined as "the nominal interest rate on default-free bonds multiplied by the tax-written-down value of the firm's depreciable assets"[1248]. Under the ACE, companies are therefore given an

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[1237] Griffith and Miller, 536.
[1238] Griffith and Miller, 541.
[1239] Griffith and Miller, 542.
[1240] For a more comprehensive typology of economic rents, see Schwerhoff, Edenhofer, and Fleurbaey, "Taxation of Economic Rents," 398.
[1241] Griffith and Miller, "Taxable Corporate Profits," 540.
[1242] Church, "Economic Rent, Economic Efficiency, and the Distribution of Natural Resource Tax Burdens," 563.
[1243] Rachel Griffith, James Hines, and Peter Birch Sørensen, "International Capital Taxation," in *Dimensions of Tax Design: The Mirrlees Review*, ed. Institute for Fiscal Studies (Oxford ; New York: Oxford University Press, 2010), 976.
[1244] This system operates by allowing an immediate deduction for business investments and is also known as a "cash flow tax". See Griffith, Hines, and Sørensen, 975–76.
[1245] As discussed in ch. I, sec. 3.4, *supra.*
[1246] Devereux and Freeman, "A General Neutral Profits Tax," 2.
[1247] Stephen Bond and Michael Devereux, "On the Design of a Neutral Business Tax under Uncertainty," *Journal of Public Economics* 58 (1995): 58.
[1248] Bond and Devereux, 58.

allowance reflecting the opportunity cost of equity finance[1249]. The approach therefore requires the determination of an appropriate rate of return and of the eligible equity, in order to obtain the normal return:

normal return = (rate of return) × (eligible equity)

The allowance is reached by adding up the historical value of the funds put into the company by the shareholders, and further multiplying such amount by an appropriate nominal interest rate. The shareholders' funds would therefore comprise the "current value of all funds put into the company by its shareholders, either in the form of new equity or retained earnings"[1250].

The ACE already implies some simplification, as it does not measure true economic depreciation or the actual rate of return required by investors in the firm[1251]. Also, some assumptions and terminological elements are worth highlighting. The model does not account for the risk premium demanded by the investor to compensate for the variability of possible outcomes. A risk-averse investor would require a risk premium to invest in the firm, instead of the risk-free return, proxied by government bonds. DEVEREUX and FREEMAN argue that the implementation of a symmetric ACE would reduce the risk premium that shareholders require, making the government a sleeping partner in the risky project. In such case, the reduction of the risk borne by the shareholder is also followed by a reduction in their expected return and "the two effects would exactly cancel out", making the system entirely neutral[1252]. Understood in this sense, the term "normal return" indicates the minimum rate of return required by an investor, considering the risk of the investment, thus including the risk premium required to compensate the investor for risk[1253]. This concept of normal return is therefore also a synonym for opportunity cost of the investment or "cost of capital". It reflects the return an investor must expect from an investment, so that it will be worth undertaking, considering the risk profile. The rate of return in this case will consider, therefore, the minimum required by an investor to compensate both for the time value of money and the risk involved[1254].

There are however, divergent positions on whether a risk-free or a risk-inclusive rate of return should be adopted, and other authors will argue for the setting of a higher return than that set with reference to government bonds[1255]. Leaving aside the theoretical discussion on the topic, it suffices to mention that the OECD/G20 suggestion for a CFC on excess profits did not follow the risk-free approach, and suggested that, in order to calculate the normal return, a "risk-inclusive rate of return" should be adopted[1256]. It was also maintained that normal investors would not accept a risk-free rate of return on an investment with an uncertain income stream, and a "premium reflecting the risk

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[1249] Devereux and Freeman, "A General Neutral Profits Tax," 4.
[1250] Devereux and Freeman, 11.
[1251] Bond and Devereux, "On the Design of a Neutral Business Tax under Uncertainty," 70.
[1252] Devereux and Freeman, "A General Neutral Profits Tax," 8. For a similar approach, supposing that, "in general, the capital market is in equilibrium, which means that the ex-post return to capital is equal to the short-term risk-free bond yield", see Becker and Fuest, "Does Germany Collect Revenue from Taxing the Normal Return to Capital?," 507.
[1253] Devereux et al., *Taxing Profit in a Global Economy*, 24.
[1254] Devereux et al., 24.
[1255] See, on the topic, Miranda Stewart, *Tax and Government in the 21st Century* (Cambridge: Cambridge University Press, 2022), 201; Griffith, Hines, and Sørensen, "International Capital Taxation," 926.
[1256] OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 49.

associated with an equity investment" should be added[1257]. The issue is, however, not discussed in the RELEVANT MATERIAL.

3.2. The Substance-Based Income Exclusion

As seen, the GLOBE COMMENTARY affirm that the Substance-Based Income Exclusion would ensure that the Top-up Tax would be calculated only in relation to Excess Profits, thus avoiding "*any tax induced distortions of investment decisions*"[1258]. The reasoning clearly implies that the carve-out would make the Top-up Tax a tax on pure economic rents, which cannot be confirmed when examining the content of the relevant rules.

The Substance-Based Income Exclusion amount for a jurisdiction is the sum of the payroll carve-out and the tangible assets carve-out for each CE (except for Investment Entities) in the jurisdiction[1259]. The payroll carve-out for a CE located in a jurisdiction is equal to 5% of its Eligible Payroll Costs of Eligible Employees that perform activities for the MNE Group in such jurisdiction, subject to some exceptions regarding Eligible Payroll costs[1260]. A transitional relief is foreseen for the pay-roll carve-out[1261]. The tangible asset carve-out for a CE located in a jurisdiction is equal to 5% of the carrying value of Eligible Tangible Assets located in such jurisdiction[1262]. A transitional relief is also foreseen for the payroll tangible asset carve-out[1263].

The Substance-Based Income Exclusion presents shortcomings both upon the definition of the eligible equity (sec. 3.2.1) and of the rate of return (sec. 3.2.3). The carve-out as a whole also presents challenges that are not related to its design as such, but rather to the very broad definition of MNE Group (sec. 3.2.2).

3.2.1. Shortcomings of not referring to the firm's depreciable assets

As may be seen from the wording of Article 5.3, instead of referring to the tax-written-down value of the firm's depreciable assets, the GLOBE MODEL RULES make reference to Eligible Payroll Costs of Eligible Employees that perform activities for the MNE Group in the jurisdiction and to the carrying value of Eligible Tangible Assets located in the jurisdiction. Such amount may be, in some cases, broader and, in other cases, narrower than the tax-written-down value of the firm's depreciable assets. There is no identity between the tax-written-down value of the firm's depreciable assets and the sum of the amounts of Eligible Payroll Costs of Eligible Employees that perform activities for the MNE Group in the jurisdiction and the carrying value of Eligible Tangible Assets located in the jurisdiction.

This approach is significantly different from that of Action 3, regarding the proposal of a CFC on excess profits. In such proposal, the OECD/G20 defined eligible equity as "equity invested in assets used in the active conduct of a trade or business, including IP assets"[1264], and suggested two options for calculation: (i) to use the book value of eligible assets less

[1257] OECD, 49.
[1258] GLOBE COMMENTARY, para. 26, p. 120.
[1259] GLOBE MODEL RULES, Art. 5.3.2.
[1260] GLOBE MODEL RULES, Art. 5.3.3.
[1261] GLOBE MODEL RULES, Art. 9.2.1.
[1262] GLOBE MODEL RULES, Art. 5.3.4.
[1263] GLOBE MODEL RULES, Art. 9.2.2.
[1264] OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 50.

the liabilities apportioned to the eligible equity (ii) to use tax basis or tax acquisition cost for the valuation, as determined under the law of the parent jurisdiction[1265]. This approach is much closer to the theoretical model – and the reasons for abandoning the approach are not entirely clear.

As a consequence of the restrictive definition of the calculation basis for the carve-out, there is no guarantee that the benefits of a tax on economic rents will be present: the allocative, financing and distributional distortions will still remain. The approach can be considered, at best, as resembling a "soft ACE", which addresses the flaws of traditional CIT only to a very limited extent. As put by DE WILDE, this sort of approach "can rarely be taken seriously as a means of remedying the flaws of the conventional corporate tax base"[1266].

3.2.1.1. The intangible assets

One clear shortcoming of the Substance-based Income Exclusion rule in relation to the theoretical model is that no deduction is provided for intangible assets. According to the PILLAR TWO BLUEPRINT, the exclusive use of payroll and tangible assets as indicators of "substantive activities" would be justified because such factors would be "generally expected to be less mobile and less likely to lead to tax induced distortions". Furthermore, excluding a fixed return from substantive activities would focus the rules on "excess income", "such as intangible-related income, which is most susceptible to BEPS risks"[1267].

It is not conceptually precise to equate "intangible-related income" and "excess income". It has been already hypothesized that the increasing of excess returns derived by MNEs could be partially explained by the fact that intangible assets play a more relevant role than they used to[1268]. The composition of profits has changed over time, following the evolution of firms' activities. Productive activities are increasingly reliant on the use of intangible assets, as the investment in intangible assets has overtaken the investment in tangible assets in some economies in the last decades. This increase may have increased risk premium and contributed to the creation of economic rents[1269]. In some cases, they can provide temporary monopoly power, and create excess returns. In fact, industries that hold intangible assets seem to earn higher than average excess returns[1270].

However, the policy choice of not allowing any form of deduction related to intangible assets is not explainable by reference to the corporate finance theory on economic rents. The choice seems to be much more oriented towards the consideration that MNEs could use intangible assets to engage in BEPS opportunities. However, it is "far from obvious that low taxed IP income can be equated with tax avoidance or aggressive tax

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[1265] OECD, 54.
[1266] The author makes this point when referring to the AGI in the CCCTB. See de Wilde, "On the Future of Business Income Taxation in Europe," 116.
[1267] PILLAR TWO BLUEPRINT, p. 95; GLOBE COMMENTARY, p. 120, para. 25. For a similar reasoning, see ECONOMIC IMPACT ASSESSMENT, pp. 165-167.
[1268] Laura Power and Austin Frerick, "Have Excess Returns to Corporations Been Increasing over Time?," *National Tax Journal* 69, no. 4 (December 1, 2016): 835.
[1269] Griffith and Miller, "Taxable Corporate Profits," 543.
[1270] Power and Frerick, "Have Excess Returns to Corporations Been Increasing over Time?," 837.

planning"[1271]. Even if the concern may be justified to a certain extent, the complete exclusion of intangible assets from the carve-out is an excessive measure.

Even though many other examples could be conceived, one clear case suffices to demonstrate the point. It is common that MNEs grow inorganically and expand to other countries by means of acquisitions. In such acquisitions, a goodwill will often be paid, being accounted as an intangible asset. The Substance-based Income Exclusion rule provides no deduction in relation to such asset – and there is no clear anti-abuse reasoning behind this choice, as the concern regarding BEPS susceptibility in such case would be much more restricted, if any. Besides that, as the amount is clearly an investment made by the shareholders, granting the deduction in relation to such asset is essential to ensure the neutrality of the system, in the terms described in sec. 3.1, *supra.*

By not allowing for a deduction corresponding to such goodwill, it is evident that the systems risks charging a Top-up Tax on elements which should be treated as normal returns, thus bringing about the very same distortions inherent to traditional CITs. Curiously enough, the OECD/G20 suggestion for a CFC on excess profits considered that the "eligible equity" for the purpose of calculation of the excess profit would be "equity invested in assets used in the active conduct of a trade or business, *including IP assets*, should be treated as eligible equity"[1272]. The rejection of a carve-out on intangibles for the purpose of defining excess profits therefore a feature that only appeared in the context of Pillar Two.

3.2.1.2. The Eligible Payroll Costs and Eligible Tangible Assets

The GLOBE COMMENTARY clarifies that the "policy rationale" behind the substance-based carve-out based on payroll and tangible assets is to "exclude a fixed return for substantive activities within a jurisdiction" [1273]. The choice of these factors is deemed to be justified because they are "generally expected to be less mobile and less likely to lead to tax-induced distortions", and, conceptually, an allowance based on them would make the GLOBE MODEL RULES more focused on "excess profits"[1274].

The RELEVANT MATERIAL, therefore, apparently conflate the exclusion of a fixed return for substantive activities, on the one hand, and the focus on "excess profits", on the other hand. Theoretically, as in the ACE proposal only a deduction on the tax-written-down value of the firm's depreciable assets should be allowed, there would be no space for a deduction related to payroll in the model. Therefore, while the carve-out does not allow for a deduction related to intangible assets, it also includes a deduction on payroll, which is not conceived in the theoretical model. Nevertheless, mainly in the case of large MNEs which are highly dependent on intangible assets, the deduction based on the substance carve-out would be much lower than the one foreseen in the ACE model.

The apparent conflation, however, is not further explored at a theoretical level, and the ECONOMIC IMPACT ASSESSMENT estimates the impact of the carve-out without trying to justify the choice of factors with reference to the taxation of economic rent. The

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[1271] Hey, "The 2020 Pillar Two," 9.
[1272] OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 50.
[1273] GLOBE COMMENTARY, p. 120, para. 25.
[1274] PILLAR TWO BLUEPRINT, p. 95; GLOBE COMMENTARY, p. 120, para. 25. For a similar reasoning, see ECONOMIC IMPACT ASSESSMENT, pp. 165-167.

ECONOMIC IMPACT ASSESSMENT finds that the share of carved-out profit in a jurisdiction is "relatively well correlated with the aggregate profitability ratio at the jurisdiction level"[1275] and conclude that the effect of a formulaic substance-based carve-out on Pillar Two revenue gains is relatively small[1276]. No assertion is made, however, in relation to the approximation of normal returns.

The GLOBE MODEL RULES, therefore, come up with a solution that tries to focus on economic rents, while not allowing for a deduction based on intangible assets, due to BEPS concerns. A carve-out based on tangible assets and payroll is a halfway solution that, despite offering some relief, does not guarantee that a reasonable approximation of the normal returns is excluded.

The carve-out could also be interpreted as "intended to preserve the possibility for countries to compete for real and productive investment"[1277]. Even though some leeway is preserved, the carve-out only provides for a presumed returned on some factors of production, and also the competition for "real and productive investments" is harmed by the rules.

3.2.2. Shortcomings of the combination of the carve-out and jurisdictional blending

Another evident outcome of the Substance-Based Income Exclusion, mainly when combined with jurisdictional blending, is that, while some countries will continue to be able to use their tax systems to attract intangible-related income, other countries will lose such ability[1278]. As seen, the carve-out benefits jurisdictions with a significant level of tangible assets and personnel, to the detriment of countries where such elements are scarcer. Considering the way it is drafted, this approximation between the carve-out and elements which are an indication of substance bears no relation with any possible meaning of the so-called "value creation principle"[1279]. This is because the MNE Group is allowed a carve-out on assets and payroll that are completely unrelated to the activities of the CE benefiting from the tax incentive.

Given the very broad definition of MNE Group, it is possible that a conglomerate has tangible assets and personnel from a business segment in a jurisdiction, which also benefits another business segment with a less significant amount of assets and personnel. Consider, for instance, a conglomerate that controls both a mining business and a fast-food chain in a certain jurisdiction, both taxed at a 30% ETR. The conglomerate also controls a software business, benefiting from significant tax incentives offered by the very same jurisdiction, being taxed at a 0% rate on the intangible-related income of such business. This conglomerate will likely trigger no Top-up Tax in such jurisdiction, both because of jurisdictional blending (which is able to keep the ETR above 15%), and because of the carve-out, which will take the mining and fast-food assets and personnel

[1275] ECONOMIC IMPACT ASSESSMENT, p. 93, para. 214.
[1276] ECONOMIC IMPACT ASSESSMENT, p. 94, para. 220.
[1277] United Nations Conference on Trade and Development, *World Investment Report 2022*, 121. Discussing the topic, see also Hey, "The 2020 Pillar Two," 9; Pasquale Pistone, "Smart Tax Competition and the Geographical Boundaries of Taxing Jurisdictions: Countering Selective Advantages Amidst Disparities," *Intertax* 40, no. 2 (2012): 74; Liotti, "Limits of International Cooperation: The Concept of 'Jurisdiction Not to Tax' from the BEPS Project to GloBE," 80.
[1278] Similarly, see Pistone and Turina, "The Way Ahead," sec. 14.3.2.1.
[1279] For multiple discussions on its meaning, see the references presented in the Introduction, sec. 1.

into account, and allow that such elements carve out the untaxed profits of the software business. In such case, the jurisdiction will be successful in offering tax incentives, allowing for the existence of untaxed income within its borders. The GLOBE MODEL RULES will not prevent such outcome.

However, a country that hosts no mining and fast-food activities from the MNE Group will not be able to offer the same tax incentives to the software business. If the software business is the sole business of the MNE Group in a jurisdiction, there will be no jurisdictional blending or carve-out with tangible assets and personnel from the other CEs. In such case, if the CE is taxed at a 0% rate, the charging of a Top-up Tax will arise. This outcome cannot be explained by the ability-to-pay, the single tax principle, or even the value creation principle. It is merely an arbitrary outcome that allows some countries to keep a large leeway on offering tax incentives, while preventing other countries from behaving the same way.

The example is far from being merely theoretical. Low tax rates regarding digital investments are not a peculiarity of low-tax jurisdictions. According to a survey from 2018, 19 out of 33 major economies taxed digital investments at an ETR below 10%, and 25 taxed below 15% (and some countries even tax them at a negative rate). Only 8 countries provided for an effective average tax rate above 15%[1280]. The Secretariat estimates that 8% of the total profit in high-tax jurisdictions is taxed below a 12.5% rate[1281]. Due to the interaction of the carve-out with jurisdictional blending, it is possible that some of these countries will still able to maintain this beneficial treatment, while other countries will not be able to do so. The effect is also acknowledged in the ECONOMIC IMPACT ASSESSMENT. When examining the potential effect of the carve-out on pockets of low-taxed profit, it concludes that the profit in these pockets "is likely to benefit more from a formulaic substance-based carve-out than profits in jurisdictions with low average ETRs, where less economic activity may generally be located"[1282].

3.2.3. Shortcomings of adopting a fixed rate

Another problem can be identified in the use of a fixed rate. Both the payroll carve-out and the tangible asset carve-out for a CE located in a jurisdiction are determined by multiplication by a 5% fixed rate. A "transitional relief" is foreseen in both cases (Art. 9.2). The 5% fixed rate is the one treated as normatively relevant for the purpose of discussing the justification of the carve-out. The other rates are "transitional", which means that they are intended to be abandoned, and treated as a "relief", which means that they set the tax base at a level that is below the one considered as ideal for the purposes of the GLOBE MODEL RULES.

One cannot find in the RELEVANT MATERIAL any clear indication of how such 5% rate has been calculated, and most of the modelling included in the ECONOMIC IMPACT ASSESSMENT takes a 10% rate into account[1283]. The identification of a normal rate of

[1280] ZEW and PWC, "Digital Tax Index: Locational Tax Attractiveness for Digital Business Models" (PWC, 2018), 8.
[1281] ECONOMIC IMPACT ASSESSMENT, p. 89.
[1282] ECONOMIC IMPACT ASSESSMENT, p. 94, para. 220.
[1283] See, *e.g.*, ECONOMIC IMPACT ASSESSMENT, p. 88, para. 205, and p. 93, para. 217.

return is traditionally very problematic[1284]. The Action 3 rate of return proposal was a risk-inclusive rate of return, which would be of "approximately 8% to 10%, although this varies by industry, leverage, and jurisdiction"[1285], considering a risk premium between 3% and 7%, also varying across industries, jurisdictions and depending on the leverage of the company[1286]. There is no discussion related to why such assumptions have been abandoned for the purposes of Pillar Two.

The only reference that may be found are the general statements with regard to the taxation of excess profits, and the non-distortionary nature of this sort of taxation. What is clear from the adoption of a fixed rate is that there is a methodological choice, also embedded in the ECONOMIC IMPACT ASSESSMENT, to focus on the impacts on investment carried out in the country of the UPE, rather than in any of the foreign locations where the MNE has operations[1287]. As pointed out by the UNCTAD, this methodological choice prioritizes the investment impact for the MNE Group, rather than a project-perspective, or a perspective dedicated to the analysis of foreign direct investment ("**FDI**")[1288]. Furthermore, this perspective is not in line with the general structure of the GLOBE MODEL RULES, which sets the minimum taxation by reference to a jurisdictional, country-by-country, perspective.

3.2.3.1. The relevance of the jurisdictional approach

As seen, the Top-up Tax is triggered by reference to jurisdictional blending. The GLOBE MODEL RULES calculate the minimum tax by reference to profits and losses arising in each jurisdiction. There is no "global blending": high taxes paid in one jurisdiction do not compensate for low taxes in other jurisdictions, and profits derived in a country cannot be used to compensate losses derived in another country. For this reason, it is not consistent to try to define the "global economic rent" derived by the MNE by reference to a fixed rate generally applicable, without consideration to the country in which the activities are performed. There is no global profit being calculated, but only "jurisdictional profits". In order to be consistent with the general structure of the GLOBE MODEL RULES, the economic rents that could be approximated, if any, would be the ones derived by the jurisdictionally blended entities, which is the subject taken as a reference for the purpose of triggering the right to charge a Top-up Tax.

What the GLOBE MODEL RULES in fact achieve is to demand that countries establish a minimum tax on the jurisdictionally blended GLOBE Income (net of the Substance-Based Income Exclusion rule, called "Excess Profits" as a defined term) derived in their jurisdiction. The preference for taxing such profits is of the state of the CEs, which can always raise their own tax rates (preventing the minimum tax from being triggered), or implement a QDMTT, preventing other states from charging the Top-up Tax under the IIR or the UTPR[1289]. The structure of the GLOBE MODEL RULES does not resemble that

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[1284] Illustratively, in the context of the Canadian tax reform in the 1960s, the Carter Commission Report stated: "We simply do not know the extent to which the expected before-tax rates of return in different countries reflect the "true" return from capital. We are forced to fall back on pragmatic considerations." See Royal Commission on Taxation, *Report of the Royal Commission on Taxation*, vol. 4 (Ottawa: Roger Duhamel, 1966), 506.
[1285] OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 49.
[1286] OECD, 54.
[1287] United Nations Conference on Trade and Development, *World Investment Report 2022*, 101.
[1288] United Nations Conference on Trade and Development, 101.
[1289] These relations will be further explored in ch. V.

of CFC rules, and they should not be thought of as the taxation of foreign activities of the controlling parent. The GLOBE MODEL RULES do not address the abusive behaviour related to the interposition of CFCs[1290].

On the CFC rules on excess profits proposal, with a clear CEN inspiration, the Action 3 Final Report, while acknowledging that "it may at first appear sensible to use the risk-free rate of return in the CFC jurisdiction", concluded that "the principle underlying CFC rules is that the parent company has the influence to determine where the CFC is located (and whether income is shifted to it)"[1291]. The parent company would therefore be likely to make investment decisions based on the rate of return in the parent jurisdiction, and the rate of return should be calculated on based on that of the parent jurisdiction. A similar reasoning also oriented the GILTI rules[1292].

The GLOBE MODEL RULES are not intended to address abusive behaviour concerning the interposition of CFCs and do not adopt a worldwide blending such as the one inherent to the GILTI rules[1293]. The comprehensive definition of MNE Group does not allow one to merely argue on the basis of decisions of the Parent Entity, as the scope is broad enough to capture conglomerates that do not behave as unitary businesses. Besides that, unlike the CFC rules, the GLOBE MODEL RULES are not designed to deal with the erosion of a domestic base: there is not a logic of retrieving to a parent entity an income that should originally "belong" to it. The charging rules are merely aimed at ensuring that the Excess Profits of the LTCE are taxed somewhere and, in doing so, they allow for multiple patterns of burden. The Top-up Tax will not always be charged in the UPE Jurisdiction: the POPE treatment and the cases where an UTPR is triggered completely deviate from the apparent CEN logic. There is no guarantee that the UPE will be the burdened CE, and there are many instances where the burdened CE is lower in the chain, and where even minority shareholders end up being economically burdened[1294].

In the case of a jurisdictional floor to tax competition, the focus should not be on the decision of the Parent Entity to invest domestically or abroad, but rather on whether the minimum tax is non-distortive from the perspective of the host countries. Otherwise, while the tax will operate in a relatively neutral way to certain jurisdictions, it will harm investments in other jurisdictions due to the differences in the rate of return that is expected therein, for an investment to be made. Unlike CFC rules and the GILTI rules, the GLOBE MODEL RULES are expected to create a worldwide standard, that should be reasonable from the perspective of all countries, and not only from a unilateral perspective oriented by CEN of a single country. Therefore, a shift in the analytical focus from the foreign affiliate's country of operations (host country) to the underlying, value-creating FDI project itself, becomes necessary[1295].

1290 See also ch. V, sec. 3.1, infra.
1291 OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 54.
1292 See Faulhaber, "Lost in Translation," 19.
1293 Referring to the difference of "technique", of the GLOBE vis-à-vis the GILTI, see Hey, "The 2020 Pillar Two," 9.
1294 See, for more detail on the impact of the charging rules, ch. V, sec. 3.3.3, *infra*.
1295 See United Nations Conference on Trade and Development, *World Investment Report 2022*, 116.

3.2.3.2. *Entity and group level investment in the* ECONOMIC IMPACT ASSESSMENT

Despite the clear jurisdictional orientation of the GLOBE MODEL RULES, the ECONOMIC IMPACT ASSESSMENT makes an analysis that considers both the impacts on "entity level investment" and the "group level investment". The first refers to investment by subsidiaries that are part of the MNE Group, which are not necessarily located in the country of the UPE. Such investment decisions tend to consider the ETR of the relevant jurisdiction. The second refers to the combined investments of the MNE Group, reflecting the organizational structure of the MNE group as well as the relevant tax rules in the respective jurisdictions[1296].

With regard to the entity level investment, the conclusion is that CEs that would otherwise have realized ETRs below the Minimum Rate could face an increase in investment costs, and affected MNEs would potentially respond by reducing or relocating some of their investments[1297]. In line with the "superstar firms" argument[1298], it is further maintained that CEs in more profitable MNE Groups could be less sensitive to tax increases and relocation could be lower[1299].

With regard to group level investment, the report concludes that it "would remain at a similar level and global output would remain the same"[1300]. The methodological approach of the Secretariat has limitations that are worth being mentioned. Only the impact of IIR is considered (and not of the UTPR), and the model accounts for "a formulaic substance-based carve-out on depreciation expenses", while the carve-out on payroll is left aside due to data limitations[1301]. It is further assumed that the UPE "conducts operations through its subsidiaries located in other jurisdictions" and that the final consumer good is sold to a global consumer base. Such assumptions may not be present in case of MNE Groups that follow a diversification strategy, or MNE Groups that are not managed in an integrated manner, with the UPE behaving as a holding company[1302]. Finally, it is also assumed that the MNE is in a profit position and that investment is financed by retained earnings, thus disregarding the treatment of loss-making firms[1303].

Even if one considers that the assumptions of the ECONOMIC IMPACT ASSESSMENT are a fair approximation of the content of the rules, there is no reason to believe that all states should or will treat group level investment as the ideal framework when national interests are considered. As the ECONOMIC IMPACT ASSESSMENT acknowledges, entity level investment responds negatively to an increase in the effective marginal tax rate[1304]. Therefore, the implementation of the GLOBE MODEL RULES is expected to lead to a relocation of investments at an entity level, while the MNE group level investment "would remain at a similar level and global output would remain the same"[1305]. The group-level perspective is clearly enthroned by the ECONOMIC IMPACT ASSESSMENT, as

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[1296] ECONOMIC IMPACT ASSESSMENT, p. 149, para. 319.
[1297] ECONOMIC IMPACT ASSESSMENT, p. 176, para. 387.
[1298] See ch. I, sec. 4.3.1, *supra*. ECONOMIC IMPACT ASSESSMENT, p. 154, para. 337.
[1299] ECONOMIC IMPACT ASSESSMENT, p. 176, para. 387.
[1300] ECONOMIC IMPACT ASSESSMENT, p. 149, para. 320.
[1301] ECONOMIC IMPACT ASSESSMENT, p. 150, para. 322.
[1302] See, on the topic, ch. III, sec. 3.1.
[1303] ECONOMIC IMPACT ASSESSMENT, p. 150, para. 323.
[1304] ECONOMIC IMPACT ASSESSMENT, p. 149, para. 320.
[1305] ECONOMIC IMPACT ASSESSMENT, p. 149, para. 320.

pointed out by the UNCTAD. Accordingly, the impact of a minimum taxation on group-level taxation is lower than at the FDI level, since MNEs have the opportunity to optimize investment decisions by choosing the best location within their geographic network[1306].

From the perspective of individual countries, entity level investment should not be relegated to the background. After all, the GLOBE MODEL RULES is a game of winners and losers[1307]. The ECONOMIC IMPACT ASSESSMENT is not able to account for all the specificities of the GLOBE MODEL RULES, as they have later been approved by the IF. It is credible, however, that the losers in this case are not only tax havens, but also countries that could partially lose their ability to use their tax systems to attract investments – mainly when one considers the nature of the carve-out as well as the potential impacts of jurisdictional blending[1308]. This limitation could have different impacts across countries, benefiting countries with a strong presence of the MNE Group, mainly by means of tangible assets and personnel, while harming those in which the MNE Group is not highly invested and such features are not present. As seen[1309], offering a beneficial treatment to certain forms of (digitalized) businesses is not only a feature of low-taxing jurisdictions, but also of some of the major European economies[1310]. In the end, some states will be able to offer certain types of tax incentives, which will be neutralized by a Top-up Tax if offered by other states.

3.2.3.3. The need for a jurisdictional approach towards the rate

As seen, the risk-free rate of return varies by country, and it can generally be calculated by reference to an average of the government bond rate over several years[1311]. If the carve-out is really intended to approximate economic rents, then a more refined approach would be necessary, taking into account the different features of each economy. Each country presents a different risk profile and, therefore, the normal return expected from the investment varies according to each jurisdiction. As the calculation of the minimum tax follows a jurisdictional approach, the application of a fixed rate for each and every country becomes inconsistent with the goal of taxing economic rents. If the intention is to capture economic rents on a jurisdictional basis (considering that world-wide blending has been rejected), then the rate should follow from the specific characteristics of the market in which the jurisdictionally blended entities are located. Following the literature discussed in section 3.1, *supra*, the design of a tax on economic rents requires reference to the information routinely used in existing CIT and "the nominal interest rate on default-free bonds, which in most countries can be well approximated by the nominal interest rate on government securities"[1312]. Hence, different rates should be applied for each year and for each jurisdiction, in order to ensure a more appropriate approximation of the taxation of economic rents.

[1306] United Nations Conference on Trade and Development, *World Investment Report 2022*, 124.

[1307] In the sense addressed in ch. I, sec. 4.2.2. See, addressing the argument with reference to cooperation in general, Mason, "The Transformation of International Tax," 393; Ault, "Tax Competition and Tax Cooperation: A Survey and Reassessment," 10–11; Dagan, *International Tax Policy: Between Cooperation and Harmonization*, 137; Dagan, "The Costs of International Tax Cooperation," 23. Addressing the issue with specific reference to Pillar Two, see Bankman, Kane, and Sykes, "Collecting the Rent," 205.

[1308] See sec. 3.2.2, *supra.*

[1309] See sec. 3.2.3, *supra.*

[1310] ZEW and PWC, "Digital Tax Index: Locational Tax Attractiveness for Digital Business Models."

[1311] See sec. 3.1, *supra.* Converging, OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 54.

[1312] Bond and Devereux, "On the Design of a Neutral Business Tax under Uncertainty," 70.

The structure of the GLOBE MODEL RULES leads one to conclude that the minimum tax should be examined from the perspective of the country where the jurisdictionally-blended CEs are located, and not of its controlling parent, or of the MNE Group. If the scope of the Substance-Based Income Exclusion rule is to ensure the taxation of economic rent, then further refinement of the rate is necessary. While the 5% fixed rate can be a good approximation for some economies during certain periods, it will also prove to be a very poor estimation in cases of other economies, or during other periods. The GLOBE MODEL RULES may therefore impact investment in different economies adversely. While the fixed rate may be sufficient, in some cases, to ensure that the Top-up Tax is only charged on economic rent (disregarding, here, the other shortcomings), in other cases, the approximation will be clearly off, and the tax will in the end also burden normal returns.

The approximation is particularly problematic if one considers the reality of developing countries, which are used to two-digit interest rates, which affect the cost of capital and the expected normal return for an investment to be made in the jurisdiction. In such cases, on the top of all other shortcomings of the Substance-Base Income Exclusion, the 5% fixed rate will be clearly insufficient, leading to the conclusion that the Top-up Tax will also be charged on normal returns – with all the distortive effects arising therefrom. A possible amendment to the GLOBE MODEL RULES, in this sense, would be to substitute the 5% fixed rate by a graduation of rates, taking into consideration the nominal interest rate on government bonds in the relevant jurisdiction (or other measures of a risk-free rate of return in the jurisdiction). The transitional period, during which the transitional relief from Art. 9.2 applies could be used by states to review the fixed-rate approach.

The UNCTAD has alerted that, in a world where developing economies are limited in their ability to offer tax incentives, they could find themselves in a disadvantage regarding FDI attraction, since they would be less able to afford financial commitments associated with infrastructure provisions or subsidies[1313]. After all, if taxation is harmonized, "competition shifts from tax levers to alternative investment determinants, and from fiscal incentives to financial incentives"[1314].

Orienting the carve-out towards nominal interest rates on default-free bonds (or other measures of a risk-free rate of return in the jurisdiction), besides better aligning the GLOBE MODEL RULES with the taxation of economic rent, would be a way of diminishing the disadvantages faced by countries with structural deficiencies. Of course, investing in a country with sufferable infrastructure, unskilled personnel, an unstable institutional setting and a weak currency demands an expected return that is compatible with such risks and shortcomings – otherwise the investment is not made. MNEs expect a higher normal return to invest in such countries, when compared to the investment in more stable economies. Not accidentally, countries with a comparatively high nominal interest rate on default-free bonds are precisely the countries which are not able to offer an attractive investment environment. The differences of interest rates accounts for such discrepancies, at least to a certain extent – and that is precisely the reason they are referred to in the ACE model as a "proxy". The GLOBE MODEL RULES could well proceed in a similar manner and differentiate across jurisdictions.

[1313] United Nations Conference on Trade and Development, *World Investment Report 2022*, 154.
[1314] United Nations Conference on Trade and Development, 154.

3.3. Summary: the carve-out and the taxation of economic rents

As clarified in the introduction[1315], it is not the object of the thesis to argue whether the GLOBE MODEL RULES should provide for the taxation of economic rents or not. The thesis does not provide for a normative framework on how the minimum tax should be. Instead, the thesis contrasts the alleged purposes, which are attributed to the GLOBE MODEL RULES in the RELEVANT MATERIAL, with the actual content of the rules.

The intentions regarding the drafting of a carve-out have evolved over time[1316]. The content of the RELEVANT MATERIAL is, to a certain extent, ambiguous in relation to the actual intentions behind the drafting of the Substance-Based Income Exclusion rule. While the POW[1317] and the PUBLIC CONSULTATION DOCUMENT[1318] contain clear statements against the adoption of any carve-out whatsoever, the PILLAR TWO BLUEPRINT[1319] and the GLOBE COMMENTARY[1320] include assertions aimed at embellishing the outcomes of applying a carve-out. Such differences in the statements are ultimately an expression of differing views on the purpose of the rules[1321].

3.3.1. The carve-out as it is

Upon the definition of the carve-out, the GLOBE MODEL RULES adopted a halfway solution, by means of a mechanism that could be labeled as a "soft ACE". While the BEPS concerns regarding a carve-out on intangible assets are to a certain extent understandable, the Substance-Based Income Exclusion, as it is written, is excessively restrictive. Not every intangible asset allows for the sort of profit-shifting with which the prohibition is concerned, and there would certainly be other means to address the issue in a more proportionate way. The addition of a carve-out based on personnel, besides the absence of a clear theoretical justification, does not eliminate the risk that the GLOBE MODEL RULES also ends up capturing normal returns. The adoption of a fixed rate is likely to impact investments in some jurisdictions adversely, with a particularly higher impact on countries that are considered risky and do not offer a stable environment for investments.

The lack of clarity of purposes regarding the carve-out is evident[1322]. The POW and the PUBLIC CONSULTATION DOCUMENT include statements that are openly against the adoption of a carve-out[1323]. The position seems to have evolved. Both the ECONOMIC IMPACT ASSESSMENT and the PILLAR TWO BLUEPRINT argue that the carve-out would make the rules more focused on economic rents, while partially acknowledging the limitations of the approach.

[1315] See Introduction, sec. 4.
[1316] On the absence of a clear purpose for the carve-out, see also Perry, "Pillar 2, Tax Competition, and Low Income," 107.
[1317] POW, p. 29.
[1318] PUBLIC CONSULTATION DOCUMENT, p. 23.
[1319] GLOBE BLUEPRINT, p. 95, para. 332.
[1320] GLOBE COMMENTARY, p. 120, para. 26.
[1321] See, discussing differing views, United Nations Conference on Trade and Development, *World Investment Report 2022*, 107.
[1322] See, criticizing the absence of clear purposes with regard to other elements of Pillar Two, Hey, "Von Anti-Hybrids-Regeln," 261–62.
[1323] Likwise, treating the carve-out as undesirable, see Pistone and Turina, "The Way Ahead," sec. 14.3.2.2.

The wording of the GLOBE COMMENTARY, on the other hand, is overly optimistic regarding the effects of the carve-out, and it lacks theoretical support. There is no reason to believe that the carve-out, as designed, "avoids any tax induced distortions of investment decisions"[1324]. The ECONOMIC IMPACT ASSESSMENT keeps its scientific tone and offers no support to such statement. Besides, considering that the GLOBE COMMENTARY is intended to assist on the interpretation of the GLOBE MODEL RULES, the phrasing does not need to be in the GLOBE COMMENTARY. Paragraphs 25 and 26 of the GLOBE COMMENTARY to Article 5.3 should be reviewed, considering the conceptual inconsistencies that may be found in both excerpts and the lack of theoretical ground for the assertions made.

An alternative rationale to the carve-out, as it is drafted, is hard to grasp. Without a clear indication in the RELEVANT MATERIAL, one can only speculate on alternative goals of the carve-out[1325]. Furthermore, as put by PISTONE and TURINA, without due attention to the discriminatory effects of the carve-out, the floor to tax competition could "in fact surreptitiously introduce a bias in favour of a capital export neutrality policy option"[1326].

3.3.2. Improving the carve-out

Considering that profits are calculated on a jurisdictional basis, a capital exporting perspective is not inconsistent with the content of the rules. In order to approximate the GLOBE MODEL RULES and the taxation of pure economic rents, it would be necessary to (i) take the tax-written-down value of the firm's depreciable assets as the calculation basis of the carve-out; and (ii) provide for a rate for the carve-out that varies according to the interest rates in the relevant jurisdiction, thus abandoning the fixed rate approach. A more restrictive carve-out, considering BEPS risks, is a deviation from the theoretical model, which may lead to distortions similar to those observed in traditional CITs[1327].

The question would still remain, however, of whether there is a way of solving the distortions arising from jurisdictional blending. This problem is not properly related to the definitions surrounding the carve-out, but rather to the definition of MNE Group. As addressed in chapter III, former experiences in comparative tax law have shown that the adoption of economic criteria to define the taxable entity is not desirable from a legislative technique perspective. The adoption of participation criteria appears as a second-best solution, which, despite the theoretical shortcomings, is more workable in practice.

As a consequence of this policy choice, jurisdictional blending remains subject to the same sort of criticism that can be made in relation to the definition of MNE Group[1328], namely that it provides for the blending of CEs that bear no relation to which other, other than common control – which is an outcome that cannot be justified by the traditional argumentation regarding the neutrality of forms and the ability-to-pay of the group. Likewise, if the CEs are not managed as a unitary business, but rather serve a portfolio diversification strategy of the UPE, potentially with different sets of minority

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[1324] GLOBE COMMENTARY, p. 120, para. 26.
[1325] See, for alternative explanations for the carve-out, Perry, "Pillar 2, Tax Competition, and Low Income," 107; Faulhaber, "Lost in Translation," 545; Pistone and Turina, "The Way Ahead," sec. 14.3.2.2; Liotti, "Limits of International Cooperation: The Concept of 'Jurisdiction Not to Tax' from the BEPS Project to GloBE," 63.
[1326] Pistone and Turina, "The Way Ahead," sec. 14.3.2.2.
[1327] See ch. I, sec. 3, *supra.*
[1328] See ch. III, sec. 4.1.2, *supra.*

shareholders, there is no reason to believe that lumping their profits and losses together would contribute to identify the economic rents of the MNE Group. In such case, also the application of the carve-out of one CE to reduce profits of the other will be hard to justify on a theoretical basis – and reference to practicability and tax policy design issues becomes necessary. The plausibility of such lumping of profits and losses of the MNE Group becomes even more problematic when the jurisdictional approach is considered, since an additional random segmentation of the CEs, oriented by national borders, is obtained, as a result of the location of each CE.

4. INTERIM CONCLUSIONS: *WHAT DO THE GLOBE MODEL RULES BURDEN?*

The GLOBE MODEL RULES burdens by means of computation of a Jurisdictional Top-up Tax, which is levied on the Excess Profit. The GLOBE Income or Loss of the CEs for the jurisdiction are blended, to arrive at the Net GLOBE Income for the jurisdiction. The Excess Profit for the jurisdiction is obtained by subtracting the Substance-Based Income Exclusion from the Net GLOBE Income for the jurisdiction.

The GLOBE Income or Loss of a CE is calculated by means of a partial dependence model, taking as a starting point the Financial Accounting Net Income or Loss of the stand-alone CE, as determined in preparing the Consolidated Financial Statements of the UPE, before consolidation adjustments. The Financial Accounting Net Income is further adjusted to arrive at the GLOBE Income or Loss. The adjustments are generally intended to bring the CE's GLOBE Income or Loss into alignment with the computation of taxable income under a typical CIT, prevent double taxation of the MNE Group's income, as well as prevent the types of low-tax outcomes that the GLOBE MODEL RULES are intended to address. The main concerns arising from the use of valuation-based accounting for the purpose of calculation of the tax base are addressed by means of an elective system, which allows the determination of gains and losses using the realization principle for the purpose of calculating the GLOBE Income or Loss. Considering the decisive role of the GAAP of the UPE, regulatory competition may still take place, and the floor to tax competition is largely dependent on the level of convergence of the GAAPs.

The jurisdictional Top-up Tax is levied on the Excess Profit, which is obtained by subtracting the Substance-Based Income Exclusion from the Net GLOBE Income for the Jurisdiction. The justification of the Substance-Based Income Exclusion is strongly grounded on the idea of taxation of economic rents[1329], but it cannot be upheld as such. Even if some relief to normal returns is provided, there is no reason to believe that the GLOBE MODEL RULES exclusively burden economic rents. Upon the definition of the carve-out, the GLOBE MODEL RULES adopted a halfway solution, by means of a mechanism that could be labelled as a "soft ACE", with additional complications arising from the fact that the MNE operates in multiple jurisdictions. As a consequence, the carve-out is likely to impact investments in some jurisdictions adversely, with a particularly higher impact on countries that are considered risky and do not offer a stable environment for investments. There is no theoretical or empirical ground to maintain that the carve-out "avoids any tax induced distortions of investment decisions"[1330].

[1329] See ch. I, sec. 4.3, *supra*.
[1330] GLOBE COMMENTARY, p. 120, para. 26.

CHAPTER V
SPATIAL ELEMENTS OF THE GLOBE MODEL RULES

1. INTRODUCTION: THE DIFFERENCE BETWEEN ASSIGNMENT AND CHARGING RULES

Source and residence have traditionally oriented the allocation of taxing rights, thus creating the need for residency and source rules[1331], whose efficacy is subject to increasing criticism[1332]. As there are no clear economic or equitable principles to orient the division of income among states[1333], the design of such rules has already been described as a "significantly arbitrary exercise"[1334]. While the residence concept is clearly in a precarious situation[1335], mainly considering the possibilities of manipulation[1336], criticism regarding source rules is particularly intense, and they have been reputed as "meaningless", "largely artificial" and "devoid of any conceptual foundation"[1337].

On a preliminary note, it is important to assert that the discussion on the allocation of income is essentially a legal debate, which makes very little sense from an economic perspective[1338]. In the Schanz-Haig-Simons concept of income[1339], income does not "come from some place" and is not susceptible to characterization as to its source. Income does not refer to production, but rather to consumption and wealth accumulation. Therefore, its location is "presumably the place of residence of the person doing the consuming and accumulating" [1340] – in economic terms, an individual, and not a legal entity[1341]. CEN, CIN and CON do not provide for a complete account either[1342]. Leaving aside the conceptual challenges related to the debate on residency and source rules[1343], it suffices for the present thesis to refer to source rules as functionally oriented constructs, designed to establish the "geographical location of income", within the intent of coordinating claims by various jurisdictions on the tax base (distributional function)[1344].

[1331] Shay, Fleming Jr., and Peroni, "What's Source Got," 83; Michael J. McIntyre, "The Use of Combined Reporting by Nation States," *Tax Notes International* 35 (2004): 925.
[1332] See Kane, "A Defense of Source," 314.
[1333] Showing that neither the ability-to-pay principle nor the benefit principle provides a guiding light for the allocation of taxing rights, see Schön, "International Tax Coordination for a Second-Best World (Part I)," 67.
[1334] Shay, Fleming Jr., and Peroni, "What's Source Got," 84.
[1335] Schön, "International Tax Coordination for a Second-Best World (Part I)," 69.
[1336] Arnold, "A Tax Policy Perspective on Corporate Residence," 1564.
[1337] Edward Kleinbard, "Stateless Income," *Florida Tax Review* 11, no. 9 (2011): 751–53.
[1338] Hugh J. Ault and David F. Bradford, "Taxing International Income: An Analysis of the US System and Its Economic Premises," in *Taxation in the Global Economy* (Chicago: University of Chicago Press, 1990), 31. See, however, examining geographic source of income as an efficiency concept, Kane, "A Defense of Source," 353.
[1339] See, on the Schanz-Haig-Simons concept of income, Bankman and Weisbach, "The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax," 1417; de Wilde, *Sharing the Pie*, 2015, 213.
[1340] Ault and Bradford, "Taxing International Income," 31.
[1341] See ch. I, sec. 2.3.3.
[1342] Schön, "International Tax Coordination for a Second-Best World (Part I)," 78.
[1343] See, for the theoretical discussion, Kane, "A Defense of Source," 322; Kleinbard, "Stateless Income," 750; Ault and Bradford, "Taxing International Income," 30.
[1344] Kane, "A Defense of Source," 331. See also, critically on the "true geographic source of income", Walter Hellerstein, "International Income Allocation in the Twenty-First Century: The Case for Formulary Apportionment," *International Transfer Pricing Journal* 12, no. 3 (2005): 104.

Considering the challenges inherent to the justification of CIT[1345], such as the fact that corporations do not "consume", residency rules perform a similar function with regard to legal entities, and also coordinate claims by jurisdictions on the tax base[1346].

On the one hand, residency rules generally establish links between the taxpayer and the taxing jurisdiction, based on factors such as the place of incorporation[1347] and the place of effective management[1348] of legal entities[1349]. Their justification is the existence of some level of political[1350] or personal[1351] connection between the taxpayer and the state. The argument for residence taxation also takes into account that the residence jurisdiction holds the necessary information to burden the taxpayer according to the ability-to-pay[1352].

Source rules, on the other hand, aiming at establishing the "spatial location of income"[1353], resort to the location of various income-generating events, the location of the taxpayer's property, or even the source of payment in some cases[1354]. Its justification is commonly grounded on some version of the benefit principle (including its "market access" version[1355]), considering the benefits provided by the source state that made possible the generation of income[1356].

The presentation of the dichotomy residence/source can also vary in scholarship. KLEINBARD uses the term "source country" to refer to any country other than that of the domicile of the MNE's "ultimate parent company", in which the group derives business or investment income[1357]. In the case of the GLOBE MODEL RULES, some authors use the expression "source country" to refer to the jurisdiction where the profit is declared for

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[1345] See ch. I, sec. 2.3.3. Proposing a shareholder-based definition of corporate residence, which deviates from the common understanding of corporate residence rules, see J Clifton Fleming, Robert J Peroni, and Stephen Shay, "Defending Worldwide Taxation With A Shareholder-Based Definition Of Corporate Residence," *Brigham Young University Law Review*, 2016, 1681.

[1346] Residency rules are also legal constructs and residence conflicts are likewise a long-lasting problem in the international experience, also when DTCs are considered. See Kees van Raad, "Dual Residence," *European Taxation* 28 (1988): 261; Robert Couzin, *Corporate Residence and International Taxation* (Amsterdam: IBFD, 2002), sec. 5.1.2.

[1347] See Luc De Broe, "Corporate Tax Residence in Civil Law Jurisdictions," in *Residence of Companies under Tax Treaties and EC Law* (Amsterdam: IBFD, 2009), sec. 4.3.

[1348] See Guglielmo Maisto et al., *Dual Residence of Companies under Tax Treaties*, International Tax Studies 1 (Amsterdam: IBFD, 2018), 4; De Broe, "Corporate Tax Residence in Civil Law Jurisdictions," sec. 4.5.

[1349] McIntyre, "The Use of Combined Reporting by Nation States," 925.

[1350] Kane, "A Defense of Source," 314.

[1351] Ault and Bradford, "Taxing International Income," 12.

[1352] Kane, "A Defense of Source," 313. (stating that "*[a]bility to pay should be assessed based on a taxpayer's comprehensive income, not on portions of a taxpayer's income that have been subdivided into different pots based on source*").

[1353] Kane, 311.

[1354] Luís Eduardo Schoueri, "Brazil," in *BRICS and the Emergence of International Tax Coordination*, ed. Yariv Brauner and Pasquale Pistone (Amsterdam: IBFD, 2015), 41–80.

[1355] Shay, Fleming Jr., and Peroni, "What's Source Got," 92. Also treating the "market access" theory as a benefits-based theory, see Kane, "A Defense of Source," n. 10.

[1356] Kane, "A Defense of Source," 315.

[1357] According to his definition: "*The domicile of a multinational enterprise's ultimate parent company is referred to in the literature as the 'residence' country. A country other than the residence country in which a multinational group derives business or investment income is referred to as the 'source' country*". Kleinbard, "Stateless Income," 702.

both tax and accounting purposes – the jurisdiction of the CE[1358]. Perhaps, there is already some criticism and a different perspective on the topic, embedded in this very terminological choice[1359]. From a functional perspective, however, such country is not necessarily the "source country", as it is not necessarily the country where the income is earned. A LTCE may, for instance, receive passive income from abroad, case in which the jurisdiction of the LTCE is not the source jurisdiction in relation to this item of income. Under the GLOBE MODEL RULES' terminology, income is attributed to the CE (subsidiary or PE) located in a jurisdiction, which is not necessarily the source jurisdiction of the relevant item of income. Even though simply referring to the jurisdiction of the CE as "source country" may be justified in other contexts[1360], its usage in the present thesis would be misleading[1361].

Another feature that is relevant to determine the "spatial location of income" is the reference to the ALS[1362]. In a system that applies the separate-entity doctrine, the ALS plays an important role in apportioning income to each of the entities involved in a controlled transaction. The ALS also plays a role as a nexus rule: the state of the entity to which the income is allocated has the right to tax it. Formulary Apportionment ("**FA**") is the main alternative method for the allocation of income across jurisdictions[1363]. Under

[1358] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 2. See also Arnold, "The Ordering of Residence and Source," 222. In the case of CFC rules, designating the CFC state as the "source country", see Reuven Avi-Yonah, "The Deemed Dividend Problem," *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association* 97 (2004): 252. See, however, making the distinction between "base country" and "source country", OECD, "Double Taxation Conventions and the Use of Base Companies R(5)" (adopted by the OECD Council on 27 November, 1986), para. 8. BEPS Action 3 Final Report also distinguishes between the jurisdiction which is the source of income and the CFC jurisdiction. See OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 46.

[1359] In an earlier text completely unrelated to the GLOBE discussion, ARNOLD asserts the following: "*I suspect that in the early days of the income tax, the treatment of domestic corporations as separate taxable entities was extended to foreign corporations without much thought (just as the treatment of limited liability companies and the check-the-box rules in the United States were developed in the domestic context and extended to foreign entities without much thought)*". Even though, he conceives that "*it is difficult for me to understand how a system in which foreign corporations are treated as transparent would operate in practice*". See Arnold, "A Tax Policy Perspective on Corporate Residence," 1560.

[1360] DEVEREUX et. al. indeed acknowledge their choice for a "rather loose terminology", which would be in line with a "broader understanding" of the expression. Considering the differences in the scope of the present thesis, the terminology is not sufficient and the refinement presented in this section becomes necessary. See Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," n. 4.

[1361] Another possible dichotomy in the context of the GLOBE MODEL RULES is home/host country. See Picciotto et al., "For a Better GLOBE," 864.

[1362] On the topic, see, generally, Schoueri, "Beyond the Guidelines," 690; Luis Eduardo Schoueri and Ricardo André Galendi Jr., "The Arm's Length Standard: Justification, Content, and Alternative Proposals," in *Research Handbook on International Taxation*, ed. Yariv Brauner (Edward Elgar Publishing, 2020), 153.

[1363] See Richard Krever and Peter Mellor, "History and Theory of Formulary Apportionment," in *The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option*, ed. Richard Krever and François Vaillancourt, Series on International Taxation, volume 76 (Alphen aan den Rijn: Wolters Kluwer, 2020), 9–39; Reuven Avi-Yonah and Zachée Pouga Tinhaga, "Formulary Apportionment and International Tax Rules," in *Taxing Multinational Enterprises as Unitary Firms* (Brighton: Institute of Development Studies, 2017), 67–74; J. Clifton Fleming, Robert Peroni, and Stephen Shay, "Formulary Apportionment in the U.S. International Income Tax System: Putting Lipstick on a Pig?," *Michigan Journal of International Law* 36, no. 1 (2015): 1–57; Reuven Avi-Yonah and Ilan Benshalom, "Formulary Apportionment: Myths and Prospects," *World Tax Journal*, no. 3 (2011): 371–98; Hellerstein, "International Income Allocation," 103. Critically, see Alistair Pepper, Jessie Coleman, and Thomas D

this approach, the taxpayer (the "enterprise"), instead of following the separate-entity approach, is required to distribute its total income across jurisdictions based on a formula that is intended to measure its business activities in each location[1364]. The GLOBE MODEL RULES, despite including some formulary elements[1365], generally calculate a Top-up Tax based on a separate-entity approach, with some leeway for jurisdictional blending. They require obedience to the ALS[1366], as a way of properly apportioning GLOBE Income to the CEs.

The GLOBE MODEL RULES are special, however, in the sense that they first assign the GLOBE Income and Covered Taxes to the CEs, in order to calculate a Top-up Tax, and, in a subsequent step, they allocate a taxing right to another jurisdiction, based on a charging rule, applied on another CE. Ultimately, a jurisdiction will have the right to tax income that is allocated, under the GLOBE MODEL RULES, to a CE located in another jurisdiction[1367]. From a systematic perspective, the person earning the income (the LTCE) is not the tax debtor of the resulting tax claim, which extends to another person[1368] – a Parent Entity in the case of the IIR, or another CE in case of the UTPR.

This mechanism generally deviates from the traditional residence/source dichotomy – and, to a certain extent, it cannot be explained even by the reference to the common understanding of CFCs as anti-abuse rules[1369]. In order to approach this feature in a structured way, the present chapter first examines the rules on the assignment of income and taxes (sec. 2), to the extent that they are relevant for the purpose of allocation of GLOBE Income and Covered Taxes, and subsequently discusses the charging rules (sec. 3), which are ultimately responsible for establishing a nexus between the Excess Profit of the LTCE and the jurisdiction charging a Top-up Tax under the IIR and the UTPR.

2. THE RULES ON ASSIGNMENT OF INCOME AND TAXES

In the structure of the GLOBE MODEL RULES, the allocation of GLOBE Income and Covered Taxes to a jurisdiction generally follows the location of the CE. The rules on the location of CEs are found in Art. 10.3, and are decisive for the purpose of jurisdictional blending, as well as for the calculation and allocation of the Top-up Tax. Determining the ETR requires the allocation of GLOBE Income and Covered Taxes to the CE pursuant to its location, following the separate financial accounting information and the special provisions found in the GLOBE MODEL RULES.

The GloBE Income or Loss of a CE is computed by reference to the Financial Accounting Net Income used for preparing Consolidated Financial Statements of the UPE, before any

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Bettge, "Why It's Still Not Time for Global Formulary Apportionment," *Tax Notes International* 107 (2022): 911.

[1364] Martens-Weiner, "An Economist's View of Income Allocation Under the Arm's Length Standard and Under Formulary Apportionment," 48.

[1365] The proper delineation of such elements is explored in sec. 3.3.2.2, *infra.*

[1366] GLOBE MODEL RULES, Art. 3.2.3.

[1367] See also Herzfeld, "Do GILTI + BEAT + BMT = GloBE?," 891.

[1368] See, for a systematic analysis of this phenomenon in German tax law, Jörn Grosch, *Die Trennung von Einkünfteerzielung und Steuerschuldnerschaft* (Wiesbaden: Springer Fachmedien Wiesbaden, 2018). In the Brazilian tax law, on the difference between "taxpayer" (*contribuinte*) and "liable person" (*responsável*), see Schoueri, *Direito Tributário*, 620.

[1369] See sec. 3.1.1, *infra.*

consolidation adjustments eliminating intra-group transactions[1370]. Special rules apply to the allocation of income to a PE (Art. 3.4) and to a Flow-through Entity (Art. 3.5). Considering the whole of the separate-entity principle in the allocation of income, the GLOBE MODEL RULES also provide for adjustments in case the "Arm's Length Principle"[1371] is not respected[1372]. As a rule, the Arm's Length Principle only leads to an adjustment for the purpose of the GLOBE MODEL RULES if the CEs under consideration are located in different jurisdictions. Any transactions between CEs located in different jurisdiction shall follow the Arm's Length Principle[1373]. However, a loss from a sale or other transfer of an asset between two CEs located in the same jurisdiction shall also be computed based on the Arm's Length Principle if that loss is included in the computation of GloBE Income or Loss[1374].

Likewise, the Adjusted Covered Taxes of a CE are determined with reference to the current tax expense accrued in the Financial Accounting Net Income or Loss with respect to Covered Taxes of the CE. Special Rules to PEs, Tax Transparent Entities and Hybrid Entities, as well as for the allocation of CFC taxes and taxes on distributions from one CE to another thus become necessary. In such cases, there are specific rules that ensure the allocation of Covered Taxes from one CE to another CE (Art. 4.3).

Despite the many references to DTCs and domestic legislation, the provisions on the location of Entities do not affect the domestic and treaty provisions dealing with residence and source taxation[1375]. The rules addressed in this section are, therefore, rules on the allocation of GLOBE Income and Covered Taxes to CEs, for the purposes of the GLOBE MODEL RULES, or rules on the "assignment of income and taxes"[1376]. The location of the CE is also relevant to establish the right to charge a Top-up Tax[1377], but the focus of the section is to identify the allocation of GLOBE Income and Covered Taxes for the purpose of calculating the ETR and determining whether a Top-up Tax shall be charged. For this purpose, the section is structured as follows. After examining the general rule on the location of CEs (sec. 2.1), the section analyses the treatment of dual-located Entities (sec. 2.2), PEs (sec. 2.3), Flow-through Entities (sec. 2.4), as well as the special rules applicable to Stateless CEs (sec. 2.5) and CFC taxes (sec. 2.6).

2.1. The general rule on the location of Constituent Entities

[1370] See GLOBE MODEL RULES, Art. 3.1.

[1371] "Arm's Length Principle" is a defined term, broadly meaning "the principle under which transactions between Constituent Entities must be recorded by reference to the conditions that would have been obtained between independent enterprises in comparable transactions and under comparable circumstances (GLOBE MODEL RULES, Art. 10.1.1.)

[1372] For a more detailed exam of the potential interactions between Pillar Two and transfer pricing, see Vikram Chand, "The interaction between the Arm's Length Principle and Pillar II Global Minimum Tax Rules: A technical and policy-oriented analysis," *IFF Forum für Steuerrecht*, 2022, 367–87; Johan Hagelin and Jean-Edouard Duvauchelle, "Pillar Two and Transfer Pricing," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), 263–82.

[1373] GLOBE MODEL RULES, Art. 3.2.3.

[1374] GLOBE MODEL RULES, Art. 3.2.3.

[1375] GLOBE COMMENTARY, p. 220, para. 170.

[1376] PILLAR TWO BLUEPRINT, p. 77.

[1377] The charging rules are examined in sec. 3, *infra.*

The principle underlying the location rules is to follow the treatment under local domestic law, giving priority to tax residence, whenever possible[1378]. If an Entity is a tax resident in a jurisdiction based on its place of management, place of creation or similar criteria, it is located in that jurisdiction. In all other cases, it is located in the jurisdiction where it was created[1379]. The general rule is broadly designed to encompass criteria generally used in domestic legislation to designate tax residency, and do not require the Entity to be a legal person, being also potentially applicable to partnerships[1380]. The phrasing is not intended to cover, however, elective regimes that allow an entity organized outside a jurisdiction to claim tax residency in the jurisdiction[1381]. In case of changes of location during the Fiscal Year, the location of the CE shall be that of the beginning of the Fiscal Year[1382].

2.2. The treatment of dual-located Entities

The GLOBE MODEL RULES also provide for tiebreaker rules for the event that a CE is considered to be located in more than one jurisdiction[1383]. The GLOBE tiebreaker follows the result of a tiebreaker of an applicable DTC. In case no DTC is applicable, or its application does not solve the issue of dual-residency[1384], then the Entity is deemed to be located in the place with higher Covered Taxes[1385] or higher Substance-based Income Exclusion[1386], in that order. If both the Covered Taxes and the Substance-based Income Exclusion is the same or zero, than the Entity is considered a Stateless CE, unless it is the UPE of the MNE Group, case in which it is located where it was created (place of incorporation or place of organization)[1387]. The characterization of an Entity as a dual-located Entity also may impact the application of the IIR[1388].

While adhering to the outcome of the application of DTCs is an understandable solution, the reference to Covered Taxes and Substance-based Income Exclusion would demand further justification. Even though the GLOBE COMMENTARY is silent on the topic, both the amount of Covered Taxes and Substance-based Income Exclusion can be taken as signs of economic allegiance, and as a reasonable measure to decide on the location of the CEs for the purpose of the GLOBE MODEL RULES. Because the goal of the GLOBE MODEL RULES is to set a floor to tax competition, the reference to Covered Taxes, in particular, is in line with the intended goal, at least as a subsidiary measure, for cases in which no DTC applies, or the application of the DTC does not produce a solution to the residence conflict.

2.3. The treatment of PEs

Since a PE is a tax rather than an accounting concept, separate financial accounting information for PEs cannot be taken for granted. The allocation of GLOBE Income to PEs

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[1378] GLOBE COMMENTARY, p. 221, para. 172.
[1379] GLOBE MODEL RULES, Article 10.3.1.
[1380] GLOBE COMMENTARY, p. 222, para. 180.
[1381] GLOBE COMMENTARY, p. 222, para. 183.
[1382] GLOBE MODEL RULES, Article 10.3.6.
[1383] GLOBE MODEL RULES, Art. 10.3.4. to Article 10.3.6.
[1384] GLOBE MODEL RULES, Art. 10.3.4(a)(ii) and Article 10.3.4(a)(iii).
[1385] GLOBE MODEL RULES, Art. 10.3.4(b)(i).
[1386] GLOBE MODEL RULES, Art. 10.3.4(b)(ii).
[1387] GLOBE MODEL RULES, Art. 10.3.4(b)(iii).
[1388] GLOBE MODEL RULES, Article 10.3.5.

is intended to follow the accounting treatment as far as possible, but also takes the applicable DTCs and domestic rules into consideration[1389]. Therefore, besides the location of PEs (sec. 2.3.1), it is also necessary to set forth specific rules on the allocation of income to PEs (sec. 2.3.2).

2.3.1. The location of PEs

The location of PEs is determined as follows[1390]: PEa is located in the jurisdiction where it is taxed as a PE under the DTC; PEb is located in the jurisdiction where it is subject to net basis taxation based on its business presence; PEc is located in the jurisdiction where it is situated. Finally, PEd is considered to be a stateless PE.

2.3.2. The allocation of GLOBE Income and Covered Taxes to PEs

In the case of PEa, PEb and PEc, Financial Accounting Net Income or Loss of the PE is the net income or loss reflected in its financial accounts (if they exist) or the amount that would have been reflected in its separate financial accounts (if they existed) - both being prepared in accordance with an Acceptable Financial Accounting Standard or an Authorised Financial Accounting Standard subject to adjustments to prevent Material Competitive Distortions[1391]. The Financial Accounting Net Income or Loss of the PE, in such cases, shall be adjusted, if necessary, to reflect the amount and items of income and expenses that can be attributed to the PE following an applicable DTC (PEa) or domestic legislation (PEb)[1392], or the amount and items that would have been attributed to it in accordance with Article 7 of the OECD-MC (PEc)[1393]. In the case of PEd, the PE's income is the income that the Main Entity jurisdiction exempts from tax and that is attributable to activities occurring outside the jurisdiction, while the PE's expenses are any expenses that are not taken into account in the jurisdiction of the Main Entity because they are attributable to activities occurring outside the jurisdiction[1394]. Correspondingly, the amount of any Covered Taxes included in the financial accounts of a CE with respect to GLOBE Income or Loss of a PE is allocated to the PE[1395].

Considering the need to prevent the double deduction of losses for the computation of income, special rules apply for the allocation of PEs' GLOBE Losses that are treated as an expense of the Main Entity and are not set off against an item of income that is subject to tax under the law of both the Main Entity's and the PE's jurisdiction[1396]. A corresponding treatment is also provided for the computation of Covered Taxes[1397].

2.4. The treatment of Flow-through Entities

The GLOBE MODEL RULES also provide a special treatment for the allocation of GLOBE Income and Covered Taxes to Flow-Through Entities. These rules are necessary because such Entities may have their separate financial accounts showing their Financial

[1389] GLOBE COMMENTARY, p. 77, para. 186-187.
[1390] GLOBE MODEL RULES, Art. 10.3.3.
[1391] GLOBE MODEL RULES, Art. 3.4.1. See GLOBE COMMENTARY, p. 77, para. 188-189.
[1392] GLOBE MODEL RULES, Art. 3.4.2(a).
[1393] GLOBE MODEL RULES, Art. 3.4.2(b).
[1394] GLOBE MODEL RULES, Art. 3.4.3.
[1395] GLOBE MODEL RULES, Art. 4.3.2(a).
[1396] GLOBE MODEL RULES, Art. 3.4.5.
[1397] GLOBE MODEL RULES, Art. 4.3.4.

Accounting Net Income or Loss regardless of the fact that they have no taxable net income or loss, considering the allocation to the Entity owners under the tax rules[1398]. Given that the GLOBE MODEL RULES rely on accounting information, a specific treatment to the allocation of GLOBE Income and Covered Taxes of fiscally transparent Entities is necessary.

2.4.1. The location of Flow-through Entities

The rules on the location of Flow-through Entities deviate from the general rule[1399]. If the Flow-Through Entity is an UPE or is required to apply an IIR, then it is located where it was created (place of incorporation or place of organization)[1400]. In the other cases, the Flow-Through Entity is treated as a Stateless CE[1401].

2.4.2. The allocation of GLOBE Income and Covered Taxes to Flow-through Entities

The general mechanism of the allocation of GLOBE Income or Loss from a Flow-through Entity is to first reduce it by the amount attributable to owners that are not members of the MNE Group[1402], ensuring that the jurisdictional ETR of the members of the MNE Group is not influenced by taxes paid by non-members of the Group[1403]. Second, in case the Financial Accounting Net Income of a PE is included in the Financial Accounting Net Income of the Flow-through Entity, then it has to be subtracted[1404] (and allocated to the PE[1405]), in order to ensure that the Financial Accounting Net Income of the PE is not computed twice for the purpose of calculating the ETR[1406]. Third, the remaining amount of the Financial Accounting Net Income or Loss of the Flow-through Entity is allocated as follows: (i) in case of a Tax Transparent Entity that is not an UPE, to the CE's owners[1407]; (ii) in case of a Tax Transparent Entity that is an UPE, to the UPE[1408] (iii) in case of a Reverse Hybrid Entity, to the Stateless CE[1409].

Special rules also apply for the allocation of Covered Taxes. The amount of any Covered Taxes included in the financial accounts of the CE with respect to GLOBE Income or Loss of a PE is allocated to the PE[1410]. In the case of a Tax Transparent Entity, the amount of Covered Taxes with respect to the GLOBE Income or Loss allocated to a CE-owner is also allocated to the CE-owner[1411]. Conversely, in relation to a Hybrid Entity, the amount of Covered Taxes in the financial accounts of the CE-owner on income of the Hybrid Entity is allocated to the Hybrid Entity[1412].

1398 GLOBE COMMENTARY, pp. 79-80, para 204.
1399 GLOBE MODEL RULES, Art. 10.3.2.
1400 GLOBE MODEL RULES, Art. 10.3.2(a).
1401 GLOBE MODEL RULES, Art. 10.3.2(b). See, on the treatment of Stateless CEs, sec. 2.5, *infra*.
1402 GLOBE MODEL RULES, Art. 3.5.3; GLOBE COMMENTARY, p. 80, para. 206.
1403 GLOBE COMMENTARY, p. 80, para. 206.
1404 GLOBE MODEL RULES, Art. 3.5.1(a).
1405 Following the framework described in sec. 2.3.2, *supra.* GLOBE MODEL RULES, Art. 3.5.4.
1406 GLOBE COMMENTARY, p. 80, para. 207.
1407 GLOBE MODEL RULES, Art. 3.5.1(b).
1408 GLOBE MODEL RULES, Art. 3.5.1(c). In such case, Art. 7.1 applies. A detailed analysis of this provision is out of the scope of the thesis.
1409 GLOBE MODEL RULES, Art. 3.5.1(c).
1410 GLOBE MODEL RULES, Art. 4.3.2(a).
1411 GLOBE MODEL RULES, Art. 4.3.2(b).
1412 GLOBE MODEL RULES, Art. 4.3.2(d).

The rationale of the GLOBE MODEL RULES, therefore, is to provide for corrections on the allocation of GLOBE Income and Covered Taxes, in cases where the allocation pursuant to financial accounts does not suffice. Because fiscally transparent Entities are commonly subject to an autonomous tax treatment, the need for such adjustments arise, considering the goal of establishing a floor to tax competition. In case the income of the Flow-Through Entity is taxed in the hands of the CE-owners (Tax Transparent Entity), the GLOBE MODEL RULES allocate both the GLOBE Income and the corresponding Covered Taxes to such CE-owners. In case the income is not taxed, neither in the jurisdiction in which the CE is located, nor in the jurisdiction of the CE-owners (Reverse Hybrid), the GLOBE Income is allocated to the CE, which is treated as a Stateless CE, being thus subject to the calculation of the Top-up Tax on a standalone basis.

2.5. The treatment of Stateless Constituent Entities

KLEINBARD coined the term "stateless income" to refer to income that is subject to tax in a jurisdiction which is not the domicile of a group's ultimate parent company, the jurisdiction where a company's customers are located, or the jurisdiction where factors of production are located[1413]. The term essentially deals with the phenomenon of income that faces low or zero taxation, in cases where the tax base is stripped from source countries and the income is not included in the tax base of the residence country (of the ultimate parent company, in KLEINBARD's terminology)[1414]. The ability to generate stateless income is inherent to MNEs and such possibility is not available to wholly domestic firms[1415].

The GLOBE MODEL RULES do not mention *stateless income*, but rather *Stateless CEs*. The essence of KLEINBARD's concept, however, is maintained, and the defined term is aimed at dealing with the non-taxation of income derived by certain CEs. The justification for treating the GLOBE Income allocated to a Stateless CE on a standalone basis is that such income will generally be "stateless income", not considered under the laws of any jurisdiction as income of a resident taxpayer or PE[1416].

According to the GLOBE COMMENTARY, there are two cases where a CE is treated as a Stateless CE. The first is the case of a Reverse Hybrid Entity where neither the jurisdiction of the Entity nor the jurisdiction of its owners recognizes the income as the income of a resident taxpayer[1417]. The second is the case of PEd, whose income is exempted in the jurisdiction of the Main Entity and not taxed in any other jurisdiction[1418]. In both cases, therefore, like in KLEINBARD's concept, the relevant CE (or its income) escapes taxation in all of the jurisdictions potentially involved.

The income allocated to a Stateless CE is considered for GLOBE purposes on a standalone basis, and a separate Top-up Tax is calculated for it, without any consideration for jurisdictional blending. CEs considered as Stateless CEs cannot be blended with each

[1413] Kleinbard, "Stateless Income," 701. The first appearance of the term took place in an earlier article. See Edward Kleinbard, "Throw Territorial Taxation From the Train," *Tax Notes* 114 (2007): 549.
[1414] See, commenting on the term, Kane, "A Defense of Source," 318.
[1415] Kleinbard, "Stateless Income," 702.
[1416] GLOBE COMMENTARY, p. 221, para. 175.
[1417] GLOBE MODEL RULES, Art. 10.3.2(b); GLOBE COMMENTARY, p. 221, para. 176.
[1418] GLOBE MODEL RULES, Art. 10.3.3(d); GLOBE COMMENTARY, p. 221, para. 176.

other. As, by definition, Stateless CEs are those whose income is not subject to taxation in any jurisdiction, they are always subject to a 0% ETR, thus triggering the charge of a Top-up Tax in case they have Excess Profits.

There is, however, a third case, not considered for the justification of the GLOBE COMMENTARY: a dual-located Entity to which no Tax Treaty applies, or whose application does not solve the issue of dual-residency, in case both the Covered Taxes and the Substance-based Income Exclusion in each jurisdiction is the same or zero[1419]. Also this CE shall be treated as a Stateless CE, but the justification of the GLOBE COMMENTARY ignores the occurrence. In such case, it is theoretically possible that the CE is subject to taxation above the ETR, but still treated as a Stateless CE. In fact, treating a CE as a Stateless CE only because the designed tiebreaker rules are not able to solve the residence conflict is neither principled nor pragmatically reasonable. Besides that, the GLOBE MODEL RULES do not provide specific treatment for the Covered Taxes of such Stateless CE. The other forms of Stateless CEs (Reverse Hybrid Entity and PEd) do not demand rules on the allocation of Covered Taxes, as, per definition, they are not subject to taxation. The dual-located Stateless CE, however, may have been subject to taxation, even above the ETR. Even though the occurrence of such form of Stateless CE may be rare in practice, the calculation of its ETR would be a troublesome endeavour from the perspective of the application of the rules.

2.6. Controlled Foreign Companies Tax Regimes and the allocation of Covered Taxes

The calculation of the Top-up Tax depends on the calculation of the jurisdiction's ETR, which, in turn, depends on the Adjusted Covered Taxes and the GLOBE Income or Loss of the LTCE. It is possible, however, that some or all of the income earned by a CFC located in one jurisdiction is also subject to tax in the jurisdiction of a parent CE. Before the GLOBE MODEL RULES came out, there was a concern that some level of integration between the minimum taxation rules and CFC regimes would be necessary[1420].

CFC rules provide for the taxation of income of one entity at the level of a parent entity, not modifying the financial accounting treatment of the income of the CFC. As the calculation of the ETR is based on individual financial statements, absent a special treatment for CFC rules, the taxes charged on CFC income would be treated as Covered Taxes of the parent CE's residence jurisdiction, even though the CFC's GLOBE Income would not be included in the parent CE's profits for accounting purposes. Such mismatch could be dealt with either at the level of the GLOBE Income (i.e., "pushing up" the income of the CFC to the parent CE) or at the level of the Covered Taxes (i.e., "pushing down" the taxes of the parent CE to the CFC). The GLOBE MODEL RULES opted for the latter policy alternative.

Accordingly, taxes paid by the parent CE on the income of the CFC due to a Controlled Foreign Companies Tax Regime are allocated to the CE that earns the income for accounting purposes[1421]. This is the same "general process" applicable to PEs[1422]. The

[1419] GLOBE MODEL RULES, Art. 10.3.4(b)(iii).
[1420] Hey, "The 2020 Pillar Two," 12; Brian J. Arnold, "The Evolution of Controlled Foreign Corporation Rules and Beyond," *Bulletin for International Taxation* 73, no. 12 (2019): 645.
[1421] GLOBE MODEL RULES, Art. 4.3.2(c).
[1422] GLOBE COMMENTARY, p. 98, para. 58.

GLOBE MODEL RULES provide for a broad definition[1423] of "Controlled Foreign Companies Tax Regime", meaning "a set of tax rules (other than an IIR) under which a direct or indirect shareholder of a foreign entity (the controlled foreign company or CFC) is subject to current taxation on its share of part or all of the income earned by the CFC, irrespective of whether that income is distributed currently to the shareholder"[1424].

ARNOLD maintains that the provision would have the "effect of aligning the entity that earns the income and the country in which the income is earned and the taxes on that income, irrespective of the residence of the parent entity that pays the taxes"[1425].

The GLOBE MODEL RULES distinguish, however, between two categories of CFC taxes[1426]: CFC taxes on Passive Income[1427], and CFC taxes on income other than Passive Income. CFC taxes on income other than Passive Income are fully allocated to the CFC[1428]. CFC taxes on Passive Income, on the other hand, are subject to a limitation consisting on the lesser of two factors: (i) the amount of CFC taxes attributable to the CFC's Passive Income, and (ii) the Top-up Tax Percentage of the jurisdiction in which the CFC is resident multiplied by the Passive Income attributed to the parent CE and subject to tax under a CFC Tax Regime[1429].

Ultimately, CFC taxes on Passive Income are allocated to the CFC at a maximum of 15% of the Passive Income. CFC taxes in excess of such amount remain as Covered Taxes of the parent CE that pays the tax, thus increasing the ETR in the jurisdiction of the parent CE, and not of the jurisdiction of the CFC. In practice, the amount of CFC tax pushed down to the jurisdiction in which the CFC is located is reduced from 15% by the percentage difference between its ETR and its rate of tax on Passive Income[1430]. The "practical effect" of the limitation is to cap the amount of CFC taxes treated as Covered Taxes on the Passive Income of the CFC to the Minimum Rate[1431].

The rationale for this limitation is to prevent the parent CE in a high-tax jurisdiction with CFC rules from diverting the Passive Income to a CFC in a low-tax jurisdiction, as a form of sheltering other income of the LTCE from a Top-up Tax[1432]. The logic is simple: given the CFC rules, the Passive Income will be generally subject to the same tax burden if it is derived by the CFC or by the parent CE. In this context, the parent CE could still be

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[1423] Discussing other regimes that could be included, see Arnold, "An Investigation into the Interaction," 276.

[1424] GLOBE MODEL RULES, Art. 10.1.

[1425] Arnold, "An Investigation into the Interaction," 274.

[1426] The expression "CFC taxes" is used in the GLOBE MODEL RULES (Art. 4.3.1), but is not a defined term. Following ARNOLD, the expression is hereby used for convenience, meaning "*taxes paid by a parent entity pursuant to the CFC rules of the country in which the parent entity is resident*". See Arnold, 274.

[1427] Passive Income is a defined term, whose meaning is generally in line with the tax jargon, with adaptations for the purpose of the minimum tax: "*Passive Income means income included in GloBE Income that is: (a) a dividend or dividend equivalents; (b) interest or interest equivalent; (c) rent; (d) royalty; (e) annuity; or (f) net gains from property of a type that produces income described in paragraphs (a) to (e), but only to the extent a Constituent Entity-owner is subject to tax on such income under a Controlled Foreign Company Tax Regime or as a result of an Ownership Interest in a Hybrid Entity*" (GLOBE MODEL RULES, Art. 10.1). Commenting the definition, and arguing that it should be more comprehensive, see Arnold, 277–78.

[1428] GLOBE MODEL RULES, Art. 4.3.2(c).

[1429] GLOBE MODEL RULES, Art. 4.3.3.

[1430] See also, for an illustrative example, Arnold, "An Investigation into the Interaction," 280.

[1431] GLOBE COMMENTARY, p. 99, para. 63.

[1432] Arnold, "An Investigation into the Interaction," 280.

willing to transfer the rights to Passive Income to an LTCE, as a way of sheltering the LTCE from a Top-up Tax. With the limitation, the application of the CFC rules will shelter the Passive Income of the LTCE against a Top-up Tax, but no further income of the LTCE will be sheltered. Therefore, the application of the limitation only to Passive Income is justified by the fact that this sort of income is easily movable, as opposed to other forms of income, which would demand the transfer of substantial activities[1433]. The shifting of substantial activities to a CFC is not prevented by the mechanism, which only applies to Passive Income. A similar reasoning justifies the application of the limitation to a Hybrid Entity[1434]. The limitation of Art. 4.3.3 is therefore intended to "maintain the integrity of the jurisdictional blending rules in relation to mobile income"[1435].

In summary, the allocation of CFC taxes is designed to deal with a mismatch between the location of the GLOBE Income and the corresponding Covered Taxes. As CFC rules are tax rules that do not follow the income allocation from financial accounting, a specific treatment is necessary. The push-down mechanism generally increases the ETR in the jurisdiction of the CFC and reduces the ETR of the parent CE subject to the CFC rules. The GLOBE MODEL RULES also contain a cap aimed at ensuring the integrity of the minimum taxation rationale, considering that, otherwise, CEs could be incentivized to shift Passive Income to CFCs, as a way to prevent a Top-up Tax from arising.

2.7. Summary

The GLOBE MODEL RULES are designed to establish a floor to tax competition. In order to do so, they have to assign GLOBE Income and Covered Taxes to the CEs, as means to compute the ETR for each jurisdiction. The attribution of GLOBE Income and Covered Taxes generally follows from the location of the CEs whose financial accounting statements are used for the purpose of preparing the Consolidated Financial Statements of the UPE. The general rule is to follow the residence principle for the allocation of GLOBE Income and Covered Taxes. The rules are, therefore, based on the separate-entity doctrine: despite the reference to the Consolidated Financial Statements of the UPE, the GLOBE MODEL RULES assign income and taxes to each CE.

Considering the general reliance of the GLOBE MODEL RULES on individual financial accounting statements to determine the GLOBE Income and the Covered Taxes, special rules are necessary in case of PEs, Flow-Through Entities and Hybrid Entities, to the extent that such CEs are subject to a specific tax treatment under domestic legislation. The treatment of Stateless CEs and the allocation of CFC taxes are particularly designed to ensure the integrity of the rules, within the scope of setting an effective floor to tax competition. The special rules only confirm the allocation under the separate-entity doctrine, as they are designed to ensure the proper allocation of income and taxes to CEs individually considered.

Despite the allocation of income and taxes described in this section, the right to charge a Top-up Tax is commonly allocated to another jurisdiction, under the GLOBE MODEL RULES. The rules acknowledge that the income arises in a certain jurisdiction, but allocate a right to tax it to another jurisdiction, under the charging rules.

[1433] Discussing the limitations of this explanation, see Arnold, 280.
[1434] GLOBE MODEL RULES, Art. 4.3.2(d).
[1435] GLOBE COMMENTARY, p. 99, para. 62.

3. THE CHARGING RULES AS NEXUS RULES

The computation of the Top-up Tax for each CE is undertaken prior to, an independent of, the charging rules[1436]. This means that the ETR computation and the mechanism for collecting the Top-up Tax are separate design features of the rules[1437]. After calculating the Top-up Tax in relation to a LTCE, liability for the amount of Top-up Tax is further allocated either to a parent Entity (IIR) or to another CE (UTPR)[1438]. The application of the IIR or the UTPR may be hindered by the existence of a QDMTT.

The overall structure of the charging rules has already been described as an "interconnected series of on/off switches"[1439], or "fiscal fail-safes"[1440] which support each other in implementing the agreed ETR. The Top-up Tax is calculated with reference to the ETR of jurisdictionally-blended CEs' income, and the respective taxing right is further allocated to a jurisdiction by means of a QDMTT, an IR or an UTPR. Following the design of the GLOBE MODEL RULES, applied according to the five-step approach, the main switch is the IIR, which can be "switched off" by a QDMTT. The UTPR is only "switched on" if neither a QDMTT nor an IIR applies. The switches are designed to implement the commitment of states to set a floor to tax competition and there is a clear co-dependence in their functioning.

Without the inherent logic of the charging rules, the logic of tax competition would prevent states from establishing the floor to tax competition. Under the GLOBE MODEL RULES' logic, a low-tax jurisdiction is incentivized to adopt a QDMTT, because, otherwise, the income of the LTCE will be taxed by means of an IIR or an UTPR. Home countries, on the other hand, are incentivized to adopt an IIR, because, otherwise, the income of the LTCE will be taxed by means of the UTPR. At the same time, the UTPR protects states adopting the IIR against tax inversions. The main practical argument against CEN and the taxation of worldwide income – of which the IIR is, to a certain extent, an expression – is that such policy would simply lead to the shifting of residence, to a state that does not adopt worldwide income taxation[1441]. Likewise, the adoption of an IIR by a state would simply lead to the shifting of residence to a state that does not apply an IIR (the so-called "tax inversion")[1442]. In practice, states would have no incentives to adopt a CEN policy, due to tax competition, which the GLOBE MODEL RULES significantly limit. The logic of the UTPR is to do away with the incentive to escape an IIR, by ensuring that the same Top-up Tax is also charged in case the relevant CE moves its residence elsewhere.

[1436] PILLAR TWO BLUEPRINT, p. 112, para. 413.
[1437] PILLAR TWO BLUEPRINT, p. 113, para. 414.
[1438] PILLAR TWO BLUEPRINT, p. 113, para. 415.
[1439] Allison Christians and Tarcísio Diniz Magalhães, "Undertaxed Profits and the Use-It-or-Lose-It Principle," Tax Notes International, November 4, 2022.
[1440] Ruth Mason, "A Wrench in GLOBE's Diabolical Machinery," Tax Notes International, September 16, 2022; Mason, "The Transformation of International Tax," 376–80.
[1441] This conclusion is at the base of the defense of CON. See Desai and Hines, "Old Rules and New Realities," 956; Desai and Hines, "Evaluating International Tax Reform," 494.
[1442] Plunket, "What's in a Name? The Undertaxed Profits Rule," 1507.

Following such logic, the present section is structured as follows. Sec. 3.1 provides for a preliminary discussion on the expansion of tax jurisdiction embedded in the GLOBE MODEL RULES, within the intent of limiting the scope of the analysis. Sec. 3.2 debates the justification of the IIR, which is the main charging rule in the GLOBE MODEL RULES. Sec. 3.3 is dedicated to the UTPR, which is the backstop mechanism. Finally, sec. 3.4 discusses the QDMTT, which, despite playing a decisive role in the allocation of jurisdiction is technically not a charging rule, and has been conceived at a later stage of the works under Pillar Two.

3.1. Preliminarily: the expansion of tax jurisdiction

In income taxes in general, both the country in which the taxpayer is resident[1443] and the country where the taxpayer earns income have jurisdiction to tax such income[1444]. Under DTCs and domestic legislations, the residence country generally offers relief for double taxation, either by exempting foreign-sourced income from income tax, or by allowing credit for the tax imposed on the relevant income by the source country[1445]. Both the OECD-MC and the UN-MC typically confirm the general principle, according to which the source country tax has priority over the residence country tax[1446].

3.1.1. CFC rules as SAARs

Against this background, the enactment of CFC rules is an important development in international tax law[1447]. They provide for the taxation of foreign-sourced income of an entity that is not resident in the taxing jurisdiction – thus allowing, at least at first glance, for taxation despite the inexistence of a residency or a source nexus. By the time of their initial adoption, they "represented a major expansion of US residence taxing jurisdiction"[1448]. In the 1930s, the initial debates on CFC rules in the US raised the concern that taxing a foreign national on her foreign sourced income was in breach of international law, which led to the enactment of a deemed dividend rule[1449]. Without regard to the fact that, economically, the taxation of a deemed dividend is equivalent to the taxation of a foreign source income, the rule has been upheld by US Courts[1450]. In the

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[1443] AVI-YONAH affirms that the jurisdiction to tax under the residence principle – defined as "mere physical presence in the country for a minimum number of days" – would be part of customary international tax law. According to him, taxation by the state of residence would be "so widely followed and incorporated into so many treaties" that it could be considered "part of customary international law, even though it seems contrary to widely shared understandings of nationality". See Reuven S Avi-Yonah, "International Tax as International Law," *Tax Law Review* 57, no. 4 (2004): 485–484.

[1444] See Arnold, "The Ordering of Residence and Source," 219; McIntyre, "The Use of Combined Reporting by Nation States," 925; Shay, Fleming Jr., and Peroni, "What's Source Got," 83.

[1445] See OECD-MC and UN-MC, Art. 23-A (exemption method) and Art. 23-B (credit method)

[1446] One may find, however, exceptions to this general principle, such as on the taxation of royalties in the OECD-MC, or on the requisites for the existence of a PE in order to allow the taxation of business profits. Broader preferences to the source state are found, if the UN-MC is considered. For a comparative overview, see Pasquale Pistone, "General Report," in *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties*, ed. Michael Lang et al. (Cambridge: Cambridge University Press, 2012), 1–36. Considering the UN proposal towards digital services, see Báez Moreno, "Because Not Always B Comes after A," 501–32.

[1447] See, for a historical perspective, Ludovica Ostorero, "Historical Background to CFC-Rules and Policy Considerations," in *Concept and Implementation of CFC Legislation*, ed. Nathalie Bravo and Alexandra Miladinovic (Viena: Linde, 2021), 3–34.

[1448] Avi-Yonah, "The Deemed Dividend Problem," 251.

[1449] Avi-Yonah, 251.

[1450] Avi-Yonah, 251.

1960s, the deemed dividend treatment was further extended to investments held by corporations[1451]. The development of CFC rules represented a significant expansion of the residence principle, which occurred silently, without much appreciation from an international law perspective. There was no objection from the international community, grounded on public international law concerns. Instead, the US inaugurated a trend, and several other developed states adopted CFC legislation in the following decades[1452], even abandoning the deemed dividend approach and adopting a pass-through one. CFC rules are now widespread[1453], and they are an important feature of any modern income tax system[1454].

Originally, CFC rules have been conceived as a measure directed "at deferment of tax on certain forms of income accruing in tax-haven jurisdictions"[1455]. Designed as SAARs, these provisions resort to a "sniper approach"[1456] to deal with an undesired consequence of the separate-entity principle, namely the deferment of taxes by means of the interposition of base companies[1457]. Some form of disregarding of the interposed CFC is implicit to the original intent of CFC rules: instead of carrying out a direct investment, there is the interposition of an entity for strictly tax reasons[1458], and CFC rules essentially provide for a correction to this behaviour. In the 1980s, the OECD also referred to CFC legislation as rules aimed at dealing with the phenomenon of base companies, which aim at the sheltering of income from taxation in the residence country "by the mere fact that the base company is an entity of its own and is recognized as such in the base country"[1459]. The function of CFC rules has remained since then largely the same[1460].

The development of ECJ case law on the "wholly artificial arrangements" has stressed the nature of CFC rules as SAARs, and significantly shaped the development of CFC rules in the EU – and, one could say, worldwide as well[1461]. In 2006, the ECJ, recalling

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[1451] Avi-Yonah, 252.

[1452] See Arnold, "The Evolution of CFCs," 631–48; Ostorero, "Historical Background to CFC-Rules and Policy Considerations," 6–16.

[1453] 30 of the countries participating in the OECD/G20 BEPS Project had CFC rules. See OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 9. In an OECD survey from 2020, 49 jurisdictions with CFC rules have been identified. See OECD, *Corporate Tax Statistics*, 2nd ed. (OECD: Paris, 2020), 2.

[1454] Perhaps the main evidence of such statement is the existence of an Action in the BEPS Project, dedicated exclusively to their development. See OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*.

[1455] See Royal Commission on Taxation, *Report of the Royal Commission on Taxation*, 4:514.

[1456] Rohatgi, *Basic International Taxation*, 374.

[1457] The first use of the expression "base company" is attributed to William J. Gibbons, "Tax Effects of Basing International Business Abroad," *Harvard Law Review* 69, no. 7 (1956): 1207. See also William J. Gibbons, "Tax Factors in Basing International Business Abroad," *The International Executive* 3, no. 2 (1961): 9–10. For an in-depth analysis on the topic, see Luc De Broe, *International Tax Planning & Prevention of Abuse under Domestic Tax Law, Tax Treaties & EC-Law: A Study of Conduit & Base Companies* (Doctoral Thesis: Katholieke Universiteit Leuven, 2007), 27.

[1458] De Broe, *International Tax Planning & Prevention of Abuse under Domestic Tax Law, Tax Treaties & EC-Law: A Study of Conduit & Base Companies*, 28.

[1459] OECD, "Double Taxation Conventions and the Use of Base Companies R(5)," para. 9.

[1460] See, *e.g.*, Arnold, "A Tax Policy Perspective on Corporate Residence," 1562. , In the German system, speaking of a rationale of combating the shielding effect of corporations, ("*Die Ratio, die Abschirmwirkung von Körperschaften zu beseitigen...*"), see Grosch, *Die Trennung von Einkünfteerzielung und Steuerschuldnerschaft*, 118.

[1461] BEPS Action 3 Final Report takes *Cadbury Schweppes* and subsequent cases into consideration and sets out recommendations which should be applicable to all jurisdictions, making specific references to EU

its case law, affirmed that the mere fact that a resident company establishes a subsidiary in another Member State could not give rise to "a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedoms"[1462]. However, it also considered that a measure restricting the freedom of establishment could be justified where it "specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned"[1463]. In order to justify a restrictive measure on the freedom of establishment, the rule shall be specifically tailored "to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory"[1464]. The wholly artificial arrangement will be present if, in addition to a subjective element, consisting in the intention to obtain a tax advantage[1465], an objective requirement is also fulfilled: the CFC shall be regarded as "a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State"[1466]. Correspondingly, besides many features, the CFC rules of the Anti-Tax Avoidance Directive ("**ATAD**") do not apply to CFCs engaged in substantive economic activity supported by staff, equipment, assets and premises[1467].

The BEPS Project also cemented the perception of CFC rules as SAARs. The very first paragraph of the BEPS Action 3 Final Report states that "groups can create non-resident affiliates to which they shift income and that these affiliates may be established wholly or partly for tax reasons rather than for non-tax business reasons"[1468]. CFC rules would therefore "combat this by enabling jurisdictions to tax income earned by foreign subsidiaries where certain conditions are met"[1469]. The Final Report further provides an analysis of the items of income that are generally covered by CFC rules, as well as of the elements that should be considered for a "substance analysis"[1470]. More than that, the Action 3 Final Report speaks of a "deterrent effect" of CFC rules, meaning that they "are not primarily designed to raise tax on the income of the CFC", but rather "to protect revenue by ensuring profits remain within the tax base of the parent"[1471]. As put by ARNOLD, "they are intended to be prophylactic, not to raise revenue"[1472].

In summary, CFC rules are anti-abuse rules, which paradoxically deviate from the separate-entity principle, with the precise goal of enforcing it. In doing so, they commonly have a basic operational structure. In cases where the CFC is subject to the regime, a portion of its attributable income (commonly referred as "tainted income") is included in the income of its shareholder, being subject to tax in the country of residence of the shareholder. The fact that the CFC is established in a low-tax jurisdiction, in general, does

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Law, where applicable. See OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 17.

[1462] EU: ECJ, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Comissioners of Inland Review,* decided on September 12th, 2006, para 50.

[1463] EU: ECJ, Case C-196/04, *Cadbury Schweppes plc,* para 51.

[1464] EU: ECJ, Case C-196/04, *Cadbury Schweppes plc,* para 55.

[1465] EU: ECJ, Case C-196/04, *Cadbury Schweppes plc,* para 64.

[1466] EU: ECJ, Case C-196/04, *Cadbury Schweppes plc,* para 68.

[1467] Art. 7(2) Anti-Tax Avoidance Directive (2016/1164).

[1468] OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, 11.

[1469] OECD, 11.

[1470] OECD, 44–49.

[1471] OECD, 13.

[1472] Arnold, "The Evolution of CFCs," 633. Similarly, see Arnold, "An Investigation into the Interaction," 275.

not suffice to trigger the application of the regime. In effect, considering the anti-abuse concerns, "the status of the CFC as a separate legal and taxable entity is ignored" and the shareholders are taxed on their share of its tainted income "as if they had earned that income directly"[1473].

3.1.2. Worldwide taxation regimes: a (semantic) caveat

Brazil is often pointed out as an example of a jurisdiction with deviant "CFC rules"[1474]. Brazil approximates a CEN policy, and taxes undistributed dividends, not following a piercing the veil or a deemed dividend approach: the taxed profits are those of the foreign entity[1475]. The Brazilian regime is not specifically tailored to tackle tax deferral, and, unlike typical CFC rules, has a very broad scope. It captures not only the profits of CFCs, but also the profits of associated companies under certain circumstances, irrespective of distribution. All profits of controlled corporations are taxed on a yearly-basis, regardless of their distribution to the parent company[1476]. For the taxation of controlled companies, the application of the rules is not contingent on where the foreign entity is located or on the nature of its income. There is no exam of whether there is an arrangement merely for tax purposes or the performance of genuine activities. The rules are clearly not designed as SAARs, but provide, instead, for a general regime[1477].

Whether the Brazilian rules should be called "CFC rules" is a semantic issue to a large extent[1478]. The qualification depends on what is meant by "CFC rules". If one takes the GLOBE MODEL RULES' defined term "Controlled Foreign Companies Tax Regime"[1479], which is phrased in very broad terms, then the Brazilian rules are CFC rules. For the purposes of the interpretation of the GLOBE MODEL RULES, the Brazilian rules shall undoubtedly be qualified as a "Controlled Foreign Companies Tax Regime". However, if one takes the traditional understanding of CFC rules as SAARs, as they are discussed in BEPS Action 3 Final Report and in the ECJ case law, then the Brazilian rules are not CFC rules, but rather rules that provide for worldwide taxation. For this reason SCHOUERI and GALDINO refer to the Brazilian rules as "worldwide income taxation legislation"[1480].

[1473] Arnold, "The Evolution of CFCs," 634.

[1474] Refering to the Brazilian regime as CFC rules, see, e.g., Hey, "The 2020 Pillar Two," 10; Arnold, "The Evolution of CFCs," 634. The use of the expression is also common in Brazilian literature. See, *e.g.,* Paulo Rosenblatt and Rodrigo Torres Pimenta Cabral, "Regime de transparência fiscal na tributação dos lucros auferidos no exterior (CFC Rules): lacunas e conflitos no direito brasileiro," *Revista de Direito Internacional* 14, no. 2 (2017): 450–63.

[1475] Luís Eduardo Schoueri and Guilherme Galdino, "Controlled Foreign Company Legislation in Brazil," in *Controlled Foreign Company Legislation*, ed. Georg Kofler et al. (Amsterdam: IBFD, 2020), sec. 7.1.2.3.

[1476] BR: Law No. 12,973/14, Art. 77.

[1477] Comparisons between the Brazilian regime and the "traditional" CFC rules are common in the Brazilian literature considering both the 2001 and the 2014 regimes. See, *e.g.,* Roberto Codorniz Leite Pereira, "O Novo Regime de Tributação em Bases Universais das Pessoas Jurídicas Previsto na Lei nº 12.973/2014: as Velhas Questões foram Resolvidas?," *Revista Direito Tributário Atual*, no. 33 (2015): 413–42; Vanessa Grazziotin Dexheimer, "Tributação dos Lucros não Distribuídos Auferidos por Controladas e Coligadas no Exterior," *Revista Direito Tributário Atual*, no. 28 (2012): 367–84.

[1478] Schoueri and Galdino, "Controlled Foreign Company Legislation in Brazil," sec. 7.1.

[1479] Meaning "*a set of tax rules (other than an IIR) under which a direct or indirect shareholder of a foreign entity (the controlled foreign company or CFC) is subject to current taxation on its share of part or all of the income earned by the CFC, irrespective of whether that income is distributed currently to the shareholder*". (GLOBE MODEL RULES, Art. 10.1)

[1480] Schoueri and Galdino, "Controlled Foreign Company Legislation in Brazil," sec. 7.1.

Regardless of the terminological preference, what must be clear is that Brazil does not tax CFCs grounded on anti-abuse concerns, but rather on a broader policy choice for worldwide taxation of income derived by CFCs of a Brazilian entity. The Brazilian rules have no "prophylactic" or "deterrent effect", but are indeed aimed at raising revenue[1481]. Considering the difference of scope, the discussion of the compatibility with DTCs acquires different contours[1482]. This sort of worldwide taxation is commonly referred in US scholarship as a desirable policy[1483], and the compatibility of such an approach with public international law has not been subject to particular academic scrutiny, being commonly taken for granted[1484]. Even though it is acknowledged that CFC rules are usually restricted to the tainted income in low-tax countries, authors commonly maintain that there would be no "inherent limitation" on their scope[1485].

3.1.3. The GLOBE MODEL RULES and the expansion of tax jurisdiction

AVI-YONAH affirms that during the 1930s-1960s period, there was "a clear rule of customary international law that prohibited taxing foreign corporations on foreign source income", which was "observed universally and was considered binding"[1486]. Those statements are supported by the anecdotal reference to the US experience. He goes on to affirm that, since the development of CFC legislations, this rule has been changed by a lot of countries, and the US no longer considers it binding[1487], with no particular attention to international law concerns. Likewise, one should add, the subsequent expansion of taxing jurisdiction carried out by the Brazilian rules, which tax CFCs as a worldwide taxation policy, and not as an anti-abuse measure, faced no particular opposition in the international scenario. In an environment of tax competition, it is not surprising that the uncompetitive Brazilian rules did not cause any trouble in the international community[1488].

The GLOBE MODEL RULES certainly represent a further expansion of taxing jurisdiction, since, within the aim of ensuring a floor to tax competition, they allow for the taxation of income of controlled CEs, even if no anti-abuse reason is present (IIR)[1489]. While "the scope of CFC rules has not been extended beyond passive income and limited types of

[1481] Litigation on the rules may ammout to billions of dollars. See, *e.g.,* BR: STJ, REsp 1.325.709/RJ, Reporting Justice Napoleão Nunes Maia Filho, published on May 20th, 2014.
[1482] Luís Eduardo Schoueri and Ricardo André Galendi Jr., "Taxation of Controlled Foreign Companies in Brazil - Still a Case for Article 7," in *Tax Treaty Case Law Arounde the Globe 2017*, ed. Michael Lang et. al. (Wien: Linde, 2018), 171–84; Luís Eduardo Schoueri and Mateus Calicchio Barbosa, "CFC Rules and Tax Treaties in Brazil: A Case for Article 7," in *Tax Treaty Case Law Arounde the Globe 2015*, ed. Michael Lang et. al. (Wien: Linde, 2016), 69–85.
[1483] See, *e.g.,* with further references, Fleming, Peroni, and Shay, "Putting Lipstick on a Pig?," 19. (claiming that "worldwide, non-deferred taxation is the least distortive in regard to the question of where to locate business investment and activity").
[1484] The non-deferred taxation is generally deemed to be justified due to the ownership by US residents. Further discussing the topic, see Fleming, Peroni, and Shay, 21.
[1485] Arnold, "The Evolution of CFCs," 634.
[1486] He also makes the case that "the CFC concept arguably has become part of customary international law" (Avi-Yonah, "International Tax as International Law," 488.)
[1487] Avi-Yonah, 490.
[1488] See, on the trade-off between competitiveness and tax collection, Arnold, "The Evolution of CFCs," 635.
[1489] Similarly, see Hey, "Von Anti-Hybrids-Regeln," 257. For the similarity to GILTI rules with this respect, see Herzfeld, "Can GILTI + BEAT = GLOBE?," 507. For the "narrower scope" of CFC rules, vis-à-vis the GLOBE, see Calderón Manrique, "The GloBE Tax Base: Road to the Jurisdictional Effective Tax Rate," sec. 2.2.2.

business income"[1490], the GLOBE MODEL RULES effectively aim to implement a minimum tax on the Excess Profits. This approach is very different from the Brazilian policy, which presents a different underlying scope. One thing is to affirm the right of a state to provide for worldwide taxation. Another thing is to affirm the right of a state to discriminate income from legitimate businesses performed abroad, solely on the ground of the level of ETR. Unlike the Brazilian policy, the IIR is not designed as a general regime, but as a measure against certain states, implying some sort of discrimination among jurisdictions. Besides that, the GLOBE MODEL RULES also provide for the UTPR, which allows for the taxation of CEs in the state of another CE of the MNE Group, even if the CE holds no direct or indirect participation in the other. From a nexus rule's perspective, this is a completely "unusual"[1491] approach, which finds no precedent in the international experience.

While the content of the IIR and of the UTPR will be critically examined against the potential justifications of the GLOBE MODEL RULES, the thesis does not provided for a framework of public international law, against which such expansion of taxing jurisdiction could be analysed. It is not within the scope of the thesis to examine whether the GLOBE MODEL RULES violate any possible nexus requirement that could be derived from (customary) public international law – or even to discuss the existence of such framework[1492]. It is also not within the scope of the thesis to evaluate the GLOBE MODEL RULES against any form of "international tax regime"[1493] that could be conceived, or even to discuss its compatibility with DTCs[1494]. Instead, the section aims at identifying the structure of the rules, and examine whether such structure is in line with the possible justifications of the GLOBE MODEL RULES.

3.2. The Income Inclusion Rule (IIR)

The IIR is the main charging rule in the GLOBE MODEL RULES, which allocates a taxing right to a jurisdiction of a Parent Entity to charge a Top-up Tax on the income of the LTCE. The section initially clarifies that the IIR is in fact a misnomer (sec. 3.2.1), which does not provide for an "income inclusion" in the fashion of CFC rules. Instead, within the aim of allocating the right to charge a Top-up Tax on the Excess Profits of the LTCE, the IIR applies a top-down approach as a rule (sec. 3.2.2), and provides for a separate treatment of POPEs as a special case (sec. 3.2.3). Against this background, the justification of the IIR is further investigated (sec. 3.2.4).

3.2.1. The IIR as a misnomer

[1490] Arnold, "The Evolution of CFCs," 642.
[1491] Arnold, "The Ordering of Residence and Source," 222.
[1492] See, *e.g.,* VanderWolk, "The UTPR Is Flawed: A Response to Prof. Picciotto," 285. (stating, as a matter of principle of general international law, that "*the principle of comity extends to income taxation, such that a sovereign state may tax a resident on all of its income from any and all sources but may not properly tax that resident on the basis of income arising elsewhere that does not belong to the taxpayer in either form or substance, but rather belongs to a resident of another country*").
[1493] See, for an account of Pillar Two *vis-à-vis* "full taxation, Mason, "The Transformation of International Tax," 387.
[1494] Discussing the compatibility of the IIR with DTCs, see Ana Paula Dourado, "The Pillar Two Top-Up Taxes: Interplay, Characterization, and Tax Treaties," *Intertax* 50, no. 5 (2022): 388; Navarro, "Jurisdiction Not to Tax," 14; Chand, Turina, and Romanovska, "Tax Treaty Obstacles in Implementing the Pillar Two Global Minimum Tax Rules and a Possible Solution for Eliminating the Various Challenges," 3.

The PUBLIC CONSULTATION DOCUMENT envisioned the IIR as a rule "requiring a shareholder in a corporation to bring into account a proportionate share of the income of that corporation"[1495] if the Minimum Rate was not met. The rule would be intended to "supplement a jurisdiction's CFC rules" [1496]. According to the PILLAR TWO BLUEPRINT, the IIR would operate "in a way that is similar to a CFC rule", subjecting a domestic taxpayer to tax on its share of the foreign income of any controlled subsidiary[1497]. The IIR would require the inclusion of income of the controlled Entities as income of the parent Entity – therefore being called an "Income Inclusion Rule". The IIR would effectively operate by requiring a Parent Entity (in most cases, the UPE) "to bring into account its share of the income of each Constituent Entity located in a low-tax jurisdiction", taxing the income up to the Minimum Rate[1498]. The PILLAR TWO BLUEPRINT therefore suggested that the IIR would be structured either as a deemed distribution provision, or as a piercing the veil provision, directly attributing income to the parent entity[1499].

The charging provision finally approved by the IF in the GLOBE MODEL RULES is at odds with the CFC similarity intended by the PILLAR TWO BLUEPRINT, and with its very denomination as an "income inclusion" rule[1500]. The wording of the relevant provision makes it very clear that the "income" being taxed is that of the LTCE, and that no "inclusion" in the Parent Entity's tax base is provided. As put by ARNOLD, the IIR is, in fact, a "misnomer"[1501], as there is no "income inclusion" in the mechanism of the rule.

According to Article 2.1.1, the UPE "shall pay a tax in an amount equal to its Allocable Share of the Top-up Tax of that Low-Taxed Constituent Entity [LTCE] for the Fiscal Year"[1502]. As seen, the Top-up Tax is calculated by reference to the income of the LTCE, and the charging rules allocate the taxing right to another jurisdiction. The reference to an Allocable Share is merely intended to acknowledge that the liability at UPE level should be proportional to the Ownership Interests held in the LTCE. The rule in no sense suggests that "income" is as such attributable to the UPE. While the PILLAR TWO BLUEPRINT made reference to the application of the IIR to the "proportionate share of the income" of the CE, the wording of the GLOBE MODEL RULES refer to the "Allocable Share of the Top-up Tax".

In fact, the IIR operates in a way that is different from a CFC rule. As it is not designed to deal with the abuse of a domestic tax system, the answer regarding the country to which the taxing right should be allocated is not immediate. Unlike the CFC rules, the IIR does not operate to restitute the income that has been artificially shifted from an entity, but aims at setting forth a floor to tax competition. Considering this goal, there are many

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1495 PUBLIC CONSULTATION DOCUMENT, p. 29, para. 10.
1496 PUBLIC CONSULTATION DOCUMENT, p. 29, para. 10.
1497 PILLAR TWO BLUEPRINT, p. 112, para. 411.
1498 PILLAR TWO BLUEPRINT, p. 112, para. 410.
1499 For a discussion of the IIR as designed in the PILLAR TWO BLUEPRINT, see Vasiliki Agianni, René Offermanns, and Marnix Schellekens, "The Income Inclusion Rule," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), 55–98.
1500 See Pedro Guilherme Lindenberg Schoueri and Ricardo André Galendi Jr., "Who Is the 'Taxpayer' for the IIR and Why It Does Matter," Kluwer International Tax Blog, August 16, 2022.
1501 Arnold, "The Ordering of Residence and Source," 220.
1502 A similar phrasing is also found in relation to an Intermediate Parent Entity (Art. 2.1.2) and to a POPE (Art. 2.1.4), which also "shall pay a tax in an amount equal to its Allocable Share of the Top-up Tax".

candidates to which the right to charge a Top-up Tax could be allocated (the UPE[1503], an Intermediate Parent Entity[1504] and a POPE[1505]). That is the reason why, following the wording of the GLOBE MODEL RULES, there is not an "income inclusion" (which would require limiting the choice of allocation of taxing rights *ab initio*), but rather the calculation of a Top-up Tax on the Excess Profits of the LTCE (which can be allocated to different CEs). For this purpose, the top-down approach and the treatment of POPEs have been designed.

3.2.2. The top-down approach

Under the top-down approach[1506], the UPE is required to pay a tax in an amount equal to its Allocable Share of the Top-up Tax of the LTCE for the Fiscal Year[1507]. If the UPE is located in a jurisdiction where it is not required to apply a Qualified IIR for the Fiscal Year, then the next Intermediate Parent Entity down the ownership chain is required to apply the IIR to its Allocable Share of the Top-up Tax for an LTCE[1508].

The PILLAR TWO BLUEPRINT brings three reasons for the choice for the top-down approach[1509]. The first two reasons are of a practical nature, being aimed at the reduction of complexity of the rules, while the third reason is of a conceptual nature.

The first reason is that applying the IIR to the UPE would reduce compliance burdens and coordination issues. By reducing the number of jurisdictions in which the IIR could potentially apply, the complexity arising from the application of the rule by multiple jurisdictions would also be reduced. In fact, the top-down approach reduces the number of jurisdictions potentially applying the IIR, mainly if it is considered that countries which are the headquarters of the UPEs are more likely to adopt the GLOBE MODEL RULES.

The second reason is that the priority of the UPE would make the use of a single accounting standard more feasible. The top-down approach would be in line with the policy decision of using the accounting standards of the UPE. By allocating the taxing right to the jurisdiction of the UPE, the top-down approach would reduce the instances where the IIR is applied by a CE other than the one that has prepared the Consolidated Financial Statements. In fact, as has already been mentioned[1510], one of the problems of application of the GLOBE MODEL RULES is its interpretation by multiple jurisdictions, mainly when there is the potential that the tax administration of one jurisdiction has to interpret the accounting rules of the other jurisdiction. The priority of the UPE Jurisdiction is in fact able to reduce the complexity of the IIR, when compared to other potential allocations of taxing rights.

The only conceptual reason given by the PILLAR TWO BLUEPRINT is that the top-down approach would be consistent with jurisdictional blending. As the jurisdictional blending and the definition of MNE Group are determined by reference to common control by the UPE, it would be more appropriate to give priority to the UPE Jurisdiction upon the

[1503] GLOBE MODEL RULES, Art. 2.1.1.
[1504] GLOBE MODEL RULES, Art. 2.1.2.
[1505] GLOBE MODEL RULES, Art. 2.1.4.
[1506] The top-down approach is described with examples in ch. II, sec. 6.2, *supra.*
[1507] GLOBE MODEL RULES, Art. 2.1.1.
[1508] GLOBE MODEL RULES, Art. 2.1.2. and Art. 2.1.3.
[1509] PILLAR TWO BLUEPRINT, p. 115, para. 423.
[1510] See ch. III, sec. 4.1.2.2, *supra.*

allocation of the taxing right. In fact, the MNE Group will, in many cases, include CEs that are not owned or controlled by lower-tiered CE that might apply the IIR. However, the allocation of the taxing right to the UPE Jurisdiction is not a necessary outcome, and the argument is not convincing. It would still be possible to allocate the taxing right only to CEs that hold participation on the LTCE. This approach would be more complex, but the point is that the jurisdiction blending does not offer a separate explanation for the top-down approach. If anything, the argument could be reduced to another reason of practical nature. After all, the taxing right could also be allocated from a bottom-up perspective, and there is no reason why the jurisdictional blending would demand the allocation of the taxing right to the UPE Jurisdiction. Other reasonable policy choices could have been made, and there is no relation between the jurisdictional blending and the need to allocate the taxing right to the UPE Jurisdiction.

In summary, as far as the RELEVANT MATERIAL is concerned, the top-down approach is justified by practicability reasons. Allocating the taxing right primarily to the UPE Jurisdiction is a way to reduce the complexity of the GLOBE MODEL RULES, to the extent that it is expected that only one jurisdiction will have to calculate the IIR, applying its own rules on the Consolidated Financial Statements. However, a convincing conceptual reason for the approach cannot be found. The RELEVANT MATERIAL does not discuss the fairness of the allocation of the taxing right, and the argument grounded on the jurisdictional blending is not convincing, as it would be possible to find other policy choices that are just as compatible with jurisdictional blending.

3.2.3. The treatment of POPEs

The top-down approach does not apply in case there is a POPE in the ownership chain[1511]. In such case, the right to charge a Top-up Tax is allocated to the jurisdiction of the POPE[1512]. In case the POPE is wholly-owned (directly or indirectly) by another POPE that is required to apply a Qualified IIR, the right of the jurisdiction of the POPE that is higher in the ownership chain prevails[1513].

The treatment of POPEs is explained as an "exception"[1514] to the top-down approach, aimed at addressing "a potential leakage"[1515] in the rules. As the PILLAR TWO BLUEPRINT points out, in cases of "split-ownership", where not all the income of the MNE Group is beneficially owned by the UPE, because Ownership Interests in the profits of some of the CEs are held by third parties, the application of a top-down approach would still be possible. One could simply limit the application of the IIR to the share of income beneficially owned by the UPE. However, such adoption of the top-down approach would be problematic for two reasons.

The first problem is that the approach could lead to economic distortions[1516]. Essentially, it would privilege structures where the CEs are POPEs, because the participation of minority shareholders in the LTCE would not be burdened. The economic distortion would be that the minority interest in an Intermediate Entity would be more valuable,

[1511] The treatment of POPEs is described with examples in ch. II, sec. 6.2, *supra*.
[1512] GLOBE MODEL RULES, Art. 2.1.4.
[1513] GLOBE MODEL RULES, Art. 2.1.5.
[1514] PILLAR TWO BLUEPRINT, p. 119, para. 439; GLOBE COMMENTARY, p. 25, para. 9.
[1515] GLOBE COMMENTARY, p. 25, para. 8.
[1516] PILLAR TWO BLUEPRINT, p. 118, para. 436.

after tax, than an equivalent equity interest in the UPE. This difference of treatment could ultimately lead to avoidance structures, whereby, instead of holding participation only on the UPE, individuals would also hold direct participation in other CEs, in order to avoid a Top-up Tax. The economic distortion could also influence the way acquisitions are performed. The second problem is that, if the top-down approach was applied also in case of existence of a POPE in the chain, then the non-adoption of the IIR by the IIR Jurisdiction could lead to a reduction of the Top-up Tax, while also burdening the minority shareholder[1517].

Hence, in the case of a LTCE owned[1518] by a POPE, i.e., a CE that has more than 20%[1519] of the Ownership Interests in its profits held by persons that are not CEs, the top-down approach does not apply. Instead, the POPE treatment ensures that the IIR applies more comprehensively to the income of the LTCE, even if a part of the income is not beneficially owned by the UPE. By pushing down the tax obligation to the POPE, also the income of the LTCE beneficially owned by the minority shareholders ends up being taxed – which does not happen in case of application of the top-down approach, where only the Allocable Share of the Top-up Tax of the UPE on the LTCE will be burdened.

Therefore, there are two consequences of the adoption of the POPE exception. The first one relates to the allocation of the taxing right, which is shifted from the UPE Jurisdiction to the jurisdiction of the POPE. The second one relates to the income that is being burdened. In case of application of the top-down approach, only the Allocable Share of the Top-up Tax of the UPE on the LTCE will be burdened. However, in case of application of the POPE exception, also the income attributable to Ownership Interests held by other owners will be burdened.

As for the allocation of the taxing right, the matter is not discussed as such in the RELEVANT MATERIAL. Instead, it is treated as a natural outcome of a measure intended to prevent economic distortions. The POPE treatment is an exceptional treatment in relation to the general top-down approach, being aimed at preventing a "leakage" in the rules, and justified by the economic distortions that would otherwise arise if the top-down approach was kept in case of split-ownership.

When the allocation of tax burden is considered, not only MNE Groups are impacted by the GLOBE MODEL RULES, but also the minority shareholders of the POPEs end up being indirectly burdened by a Top-up Tax. In case of application of the IIR to a POPE, not only the Ownership Interests attributable to the UPE will be burdened, but also the ones attributable to minority shareholders. This means that the POPE mechanism actually broadens the scope of the GLOBE MODEL RULES, burdening not only the income of the LTCE beneficially owned by the UPE (as is the case of the top-down approach), but also the income of the LTCE attributable to minority shareholders.

In fact, there are multiple random impacts to minority shareholders. As the POPE treatment only applies in cases where the CE has more than 20% of the Ownership Interest in its profits held by persons that are not CEs, then a minority shareholder will not be burdened if the participation of persons other than CEs is below 20%. Hence, the

[1517] This problem is better understood by visualizing Example 6.3.2B (PILLAR TWO BLUEPRINT, 208).
[1518] The POPE is not required to control the LTCE. See GLOBE COMMENTARY, p. 75, para. 16.
[1519] The exact percentage was still undetermined in the PILLAR TWO BLUEPRINT, and a 10% trigger was also considered as a possible policy option. See PILLAR TWO BLUEPRINT, pp. 113-114, para. 418.

treatment to minority shareholders is contingent on the level of minority participation in a CE. The 20% is aimed at ensuring that the additional complexity of the POPE exception only applies in situations where an important percentage of profits would otherwise remain undertaxed[1520]. The 20% trigger is referred to as a "significant" participation in the GLOBE COMMENTARY[1521].

Another curious outcome is that the split-ownership rules apply to situations where there is a POPE that has equity interests in the LTCE, but does not apply in case of direct participation of the minority shareholders in the LTCE[1522]. Hence, minority shareholders which have a direct participation on the LTCE are not burdened by a Top-up Tax, even in cases where the participation is above 20%.

3.2.4. The justification of the IIR

Unlike CFC rules, the IIR is not grounded on the abusive behavior of the relevant entities. The IIR applies irrespective of the artificiality of the activities of the LTCE and is able to burden legitimate businesses' income, with sole reference to the ETR to which the Excess Profit is subject. The IIR does not provide for a worldwide taxation regime either. Instead, there is a discrimination of LTCEs, based on the jurisdiction in which it is located (Minimum Rate), on the attributes of the other CEs with which their income is blended (jurisdictional blending), and on the substance (assets and employees) of the MNE Group in the jurisdiction (Substance-Base Income Exclusion). Such discrimination is not built on the need to combat abusive behaviour, but rather on the goal to provide for a floor to tax competition[1523]. Correspondingly, there is no attribution of income to a Parent Entity ("income inclusion"), but the creation of a right of one jurisdiction to tax the income derived by another CE, located in another jurisdiction.

Unlike CFC rules, the IIR is not designed to restitute an income that should be attributed to a certain entity. As CFC rules are generally designed to prevent abuse of a domestic system, the reference system against which the abuse is examined is the domestic system of the parent entity, and both the objective scope (which income is taxed) and the subjective scope (which CFCs are covered) are determined with reference to this goal. In case of application of the IIR, the undesired outcome is the low taxation by the jurisdiction of the LTCE. The behaviour being combated is that of a state, and not of a taxpayer. In such case, a broader discussion on the nexus rules for the allocation of the right to tax such income would be expected. Instead of resorting to an argumentation based on the fairness of the allocation of taxing rights, the RELEVANT MATERIAL take the path of practicability. The rule/exception scheme (top-down/POPE) is designed to ensure an application that is easier to administrate (top-down), while also preventing "economic distortions" that would arise in exceptional cases (POPE treatment). Hence, whether the taxing right is allocated to the UPE Jurisdiction, to the jurisdiction of the Intermediate Parent Entity, or to the jurisdiction of the POPE, is justified in the GLOBE MODEL RULES on practical concerns.

The application of the IIR also affects the amount of Top-up Tax being charged. Whether the rule or the exception applies also has a significant impact on the scope of the IIR.

[1520] PILLAR TWO BLUEPRINT, p. 119, para. 442.
[1521] GLOBE COMMENTARY, p. 25, para. 7.
[1522] PILLAR TWO BLUEPRINT, p. 119, para. 438.
[1523] The relations between both goals are addressed in general terms in ch. I, sec. 4.5, *supra*.

Under the top-down approach, only the Allocable Share of the Top-up Tax of the UPE on the LTCE is burdened, whereas the POPE treatment also burdens the POPE's minority shareholders. As a consequence, minority shareholders are adversely impacted in case they are direct shareholders of the LTCE, shareholders of the POPE, or in case they are minority shareholders in a structure subject to the top-down approach. Also this difference of treatment is grounded on practical concerns. At the end of the day, however, the pragmatic solution leads to random patterns of burden to the minority shareholders of the CEs, which end up being burdened or not, depending on patterns that are out of their control and that are immaterial for their ability-to-pay: a direct shareholder of the LTCE is not burdened by a Top-up Tax, but a shareholder of a POPE is; a minority shareholder with a 10% participation may or may not be burdened under the POPE treatment, depending on whether the CE has other shareholders, amounting to a minority participation superior to 20%; and so on.

In summary, the IIR is not justified as an anti-abuse rule, but rather as a rule aimed at setting a floor to tax competition. As such goal was formerly unknown in the international experience (at least as a common approach to be implemented by a great number of jurisdictions), the allocative answer to the right to tax is not immediate. The RELEVANT MATERIAL avoids making arguments on the fairness of the allocation, resorting, instead, to a reasoning based on practicality. The outcome is that the right to tax may be allocated to the UPE Jurisdiction, to the jurisdiction of an Intermediate Parent Entity or to the jurisdiction of the POPE, contingent on the adoption of the IIR by the relevant jurisdictions, as well as on the participation structure of the CEs. The IIR also impacts minority shareholders adversely, and they may or may not be burdened by the IIR, following elements which are unrelated to their ability-to-pay. Such difference of treatment, despite not being minor, is grounded on the practical concerns of the IIR, being treated as a collateral damage of the design of operable rules.

3.3. The Undertaxed Payments/Profits Rule (UTPR)

The UTPR has been designed as a backstop of the IIR from the start, but it has been subject to significant changes in its underlying policy justification. The PUBLIC CONSULTATION DOCUMENT envisioned the UTPR as "a tax on base eroding payments that complements the income inclusion rule by allowing a source jurisdiction to protect itself from the risk of base eroding payments"[1524]. The undertaxed payments rule was expected to deny a deduction or impose source-based taxation for a payment to a related party if that payment was not subject to tax at a minimum rate[1525]. It was essentially a source-country measure, and the possibility of a WHT was not excluded. The UTPR of the GLOBE MODEL RULES is very different from this initial idea. While the PILLAR TWO BLUEPRINT maintained some resemblance with the original idea from the PUBLIC CONSULTATION DOCUMENT, the rule has been drastically changed in the GLOBE MODEL RULES. There is a significant change in the content of the UTPR, when the PILLAR TWO BLUEPRINT and the GLOBE MODEL RULES are compared, to an extent that even the name of the mechanism has been harmed[1526].

[1524] PUBLIC CONSULTATION DOCUMENT, p. 33, para 25.

[1525] For discussions of the UTPR as designed in the PILLAR TWO BLUEPRINT, see Schwarz, *The OECD GloBE proposal*, 177–89; Teresa Morales and Oana Popa, "The Undertaxed Payments Rule," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), 133–66.

[1526] See, on the terminological issue, ch. II, sec. 1, *supra*.

The present section separately exams the UTPR from the PILLAR TWO BLUEPRINT (sec. 3.3.1) and the UTPR finally approved in the GLOBE MODEL RULES (sec. 3.3.2), further providing for a discussion of the justification of the mechanism in the broader context of the GLOBE MODEL RULES (sec. 3.3.3).

3.3.1. The UTPR in the Pillar Two Blueprint

According to the PILLAR TWO BLUEPRINT, the UTPR would have the same general purpose as the IIR. Specifically, its policy rationale would be to "protect jurisdictions against base erosion through intra-group payments" to LTCEs, while ensuring that, in aggregate, the rules would not burden CEs that are taxed above the Minimum Rate. The UTPR would not only function as a backstop to the IIR, but also reduce the incentives for tax driven inversions, by charging the Top-up Tax that is not charged under an IIR[1527]. The IIR already had priority over the UTPR, and the latter would only apply to profits of a LTCE that had not been subject to a Top-up Tax under the former[1528].

Like in the GLOBE MODEL RULES, the UTPR from the PILLAR TWO BLUEPRINT used the same calculation mechanic as the IIR to determine the amount of Top-up Tax allocable in relation to the profits in scope of the rule[1529]. The main difference between both UTPRs is the mechanism for the allocation of the right to charge such Top-up Tax.

In the PILLAR TWO BLUEPRINT's mechanism, the Top-up Tax was allocated to a UTPR Taxpayer[1530] as follows[1531]: (i) first, if the UTPR Taxpayer made any deductible payments to the LTCE during the relevant period, the Top-up Tax that would apply to the income of such CE is allocated in proportion to the total of deductible payments made directly to the LTCE by all UTPR Taxpayers ("first allocation key"); (ii) second if the UTPR Taxpayer had net intra-group expenditure, the remaining Top-up Tax, if any, was allocated in proportion to the total amount of net intra-group expenditure incurred by all UTPR Taxpayers ("second allocation key").

Another feature of the mechanism was that, depending on the nature of the intra-group payments of a given CE, no Top-up Tax could be charged. A CE would not trigger a Top-up Tax under the UTPR when (i) it had not made any intra-group payments to CEs located in jurisdictions where the MNE's jurisdictional ETR is below the Minimum Rate and (ii) it had net related party income (and not net related party expenses) for the purpose of applying the rule[1532]. In such cases, a Top-up Tax under the UTPR would only be charged in the jurisdiction of other CEs.

[1527] PILLAR TWO BLUEPRINT, p. 124, para. 457.

[1528] PILLAR TWO BLUEPRINT, p. 125, para. 460. See also Giulia Gallo and Andreas Perdelwitz, "Coordination and Rule Order," in *Global Minimum Taxation? An Analysis of the Global Anti-Base Erosion Initiative*, ed. Andreas Perdelwitz and Alessandro Turina, IBFD Tax Research Series 4 (Amsterdam: IBFD, 2021), sec. 7.3.3.2.

[1529] PILLAR TWO BLUEPRINT, p. 127, para. 470.

[1530] "UTPR Taxpayer" is a capitalized term in the PILLAR TWO BLUEPRINT, but the term has been abandoned, and is not a defined term in the GLOBE MODEL RULES. It is defined in the PILLAR TWO BLUEPRINT (p. 123) as "any Constituent Entity that is located in a jurisdiction that has implemented the UTPR in accordance with the GloBE rules (a UTPR Jurisdiction)".

[1531] PILLAR TWO BLUEPRINT, p. 127-128, para. 473.

[1532] PILLAR TWO BLUEPRINT, p. 139, para. 534.

3.3.1.1. The first allocation key: the direct payments

The first allocation key took into consideration the payments made directly by a UTPR Taxpayer to a LTCE. Each UTPR Taxpayer would be allocated a portion of the Top-up Tax that was computed in relation to the income of each LTCE on an entity-by-entity basis, according to the following formula[1533]:

$$\frac{\text{Direct intragroup payments from UTPR Taxpayer A to LTCE Z}}{\text{All direct intragroup payments from all UTPR Taxpayers to LTCE Z}}$$

The first allocation key would therefore allocate the Top-up Tax to CEs that made direct payments to a LTCE. Such mechanism was intended to ensure that the UTPR allocated Top-up Tax in priority to those jurisdictions where there was a "readily identifiable and direct connection between the payment and shifting of intra-group profit" [1534]. The rule was designed to capture "the most obvious and straight-forward intra-group profit stripping arrangements". Direct payments to a LTCE were considered as the "easiest to identify", thus limiting the need for adjustments and reducing the compliance costs[1535]. Assuming that the simplest way of profit shifting was to make intra-group deductible payments, the first allocation key addressed such behaviour by allocating a Top-up Tax in proportion to deductible payments made by UTPR Taxpayers to LTCEs[1536]. The first allocation key also included two caps[1537], and it was possible that, even in cases where the LTCE received direct payments from UTPR Taxpayers, some of the Top-up Tax still remained unallocated (being therefore subject to the second allocation key)

One notices, therefore, that there was an attempt to justify the UTPR as a mechanism against "profit stripping arrangements". The payments made to a LTCE were taken as indicia of such sort of arrangement, and used as a justification for the allocation of a taxing right, as if it were a correction of an abuse committed by the relevant CEs. This justification is essentially a separate entity-based one, as it implies some assumptions with regard to the artificiality of the payments made from one CE to the other. The considerations made are transactional, thus working with the reality of payments made from a CE to another, instead of disregarding such transactions, even if they are within the same MNE Group.

3.3.1.2. The second allocation key: the net intra-group expenditure

In some circumstances, the application of the first allocation could not be enough to allocate the totality of the Top-up Tax, either because it was possible that a LTCE did not receive any direct payments, or because the first allocation key could be limited by the operation of the caps, thus leaving some Top-up Tax unallocated[1538]. For such cases, the second allocation key would apply and allocate any remaining Top-up Tax to UTPR

[1533] PILLAR TWO BLUEPRINT, p. 129, para. 481.
[1534] PILLAR TWO BLUEPRINT, p. 129, para. 480.
[1535] PILLAR TWO BLUEPRINT, p. 129, para. 480.
[1536] PILLAR TWO BLUEPRINT, p. 128, para. 475.
[1537] PILLAR TWO BLUEPRINT, p. 132, para. 498.
[1538] PILLAR TWO BLUEPRINT, p. 129, para. 483.

Taxpayers in proportion to their net intra-group expenditures. UTPR Taxpayers that had net related-party income would therefore be excluded from such allocation key[1539].

The second allocation key considered all payments and receipts to and from other CEs (both domestic and foreign), in order to determine a UTPR Taxpayer's net intra-group expenditure. Each UTPR Taxpayer would be allocated a portion of the total remaining Top-up Tax that was not allocated under the first allocation key, as per the following formula[1540]:

$$\frac{\text{Net intragroup expenditure of UTPR Taxpayer A}}{\text{Sum of all net related party expenditure of UTPR Taxpayers}}$$

The effort of the PILLAR TWO BLUEPRINT in justifying the second allocation key is also based on the separate-entity doctrine. The second allocation key would prevent MNE Groups from circumventing the application of the first allocation key, by routing payments through entities that are not subject to the UTPR. The reference to net intra-group expenditure would provide a simple way to address such "conduit structures", allocating the Top-up Tax without the need to trace the destination of all payments made within the MNE Group[1541]. The rule would not only be a backstop to the IIR, but also an "anti-conduit rule" that resorts to a "fungibility of money approach" and disregards the specificity of payment flows. The second allocation key would provide for a "proxy" that assumes that the profit shifting risks would be greater among CEs that have a net intra-group expenditure[1542].

Again, one notices an attempt to justify the UTPR as a mechanism against "profit stripping arrangements" or, more specifically, against "conduit structures". While the first allocation rule took as a premise that direct payments made to an LTCE would be indicative of abuse, which would justify the allocation of a Top-up Tax to the UTPR Taxpayer, the second allocation rule took a step further. Considering the complexities surrounding the many payment flows, it assumed that net intra-group expenditure could be taken as a proxy for the allocation of a Top-up Tax to the UTPR Taxpayer. The same logic of the first allocation key is present, with a clear separate-entity orientation: the charging of a Top-up Tax would be a way of restituting a taxing right that should belong to the UTPR Jurisdiction, but has disappeared due to a diversion strategy of the MNE Group, carried out by means of intra-group expenditures made by the UTPR Taxpayer.

3.3.1.3. Reasons for the abandonment of the allocation keys

The UTPR in the PILLAR TWO BLUEPRINT was very complex and such complexity was not derived from a principled approach. The PILLAR TWO BLUEPRINT built a narrative of profit shifting performed by means of intra-group payments and tried to fix this problem by means of the UTPR design. Both the narrative and the solution are questionable. The outcome was a set of complex rules whose justification is not convincing, as it demands significant generalizations and a very rough account of the nature of intra-group payments.

[1539] PILLAR TWO BLUEPRINT, p. 129, para. 484.
[1540] PILLAR TWO BLUEPRINT, p. 130, para. 485.
[1541] PILLAR TWO BLUEPRINT, p. 128, para. 477.
[1542] PILLAR TWO BLUEPRINT, p. 128, para. 478.

The PILLAR TWO BLUEPRINT acknowledged the complexity of the UTPR. It stated that the UTPR would be "a more complex rule to apply", requiring "a greater amount of co-ordination between jurisdictions than the IIR"[1543]. The complexity was attributed to the fact that the outcomes under the UTPR would vary depending on the amount of intra-group payments made by each CE[1544]. The reference to payments for the purpose of allocating taxing rights brought the challenge of identifying intra-group payments and making further adjustments[1545]. Both the first and the second allocation keys would be determined with reference to information available in financial books and records of the CEs (adjusted for items that are not generally deductible under the laws of the payer jurisdiction). In the case of the first allocation key, reference is made to the financial books and records of the CEs located in the jurisdictions where the MNE's jurisdictional ETR is below the Minimum Rate. In the case of the second allocation key, reference is made to the financial books and records of the UTPR Taxpayers. Such features would demand an extensive framework for compliance and administration of the UTPR. The PILLAR TWO BLUEPRINT discusses a standardized self-assessment return that would be prepared by the MNE only for the purposes of the UTPR, with certifications that should be provided to each tax administration[1546]. It is clear, therefore, that the complexity of the rule might have contributed to its abandonment.

Besides that, such complexity did not derive from a principled approach. The justification of the allocation keys includes a significant argumentative stretch. It cannot simply be assumed that any and every direct payment made to a LTCE is abusive, nor that any and every CE with intra-group net expenditure is engaged in some form of abusive behaviour. The approach is particularly problematic if one considers the broad definition of MNE Group[1547], and the fact that the rules do not provide for a carve-out that exclude tax incentives compatible, for instance, with Action 5 Final Report – being therefore not tailored to capture abusive structures[1548]. Hence, the logic according to which the UTPR would merely restitute a taxable income to the "UTPR Taxpayer" is not appealing.

In any case, it is important to note that the UTPR from the PILLAR TWO BLUEPRINT is grounded on an effort to reconcile the rule with the separate-entity approach. All the reasoning is based on the idea that there was an "original" attribution of income, which was manipulated by the CEs by means of intra-group payments. The UTPR was built to capture such manipulation and somehow restitute the "original" attribution of income. In doing so, however, it resorts to generalizations that hardly resemble reality and could lead to distorted outcomes. This approach was completely abandoned in the GLOBE MODEL RULES, and the UTPR does not include any attempt of reconciliation with the separate-entity doctrine, resorting instead to an eclectic approach that combines elements of separate-entity and enterprise doctrines.

3.3.2. The UTPR in the GloBE Model Rules

Under the GLOBE MODEL RULES' UTPR, there is no reference to any intra-group payments, and the intention of reconciling the rule with the separate-entity approach has

[1543] PILLAR TWO BLUEPRINT, p. 124, para. 458.
[1544] PILLAR TWO BLUEPRINT, p. 124, para. 458.
[1545] PILLAR TWO BLUEPRINT, pp. 131-132, para. 495-496.
[1546] PILLAR TWO BLUEPRINT, pp. 139-140.
[1547] See ch. III, sec. 4.1.2, *supra.*
[1548] See ch. I, sec. 4.5, *supra.*

been completely abandoned. The sort of anti-abuse reasoning used to justify the UTPR as a measure against "profit stripping arrangements" is not found in the GLOBE MODEL RULES. Because the current design of the UTPR first appeared in the GLOBE MODEL RULES, their actual content is only discussed in the GLOBE COMMENTARY, and one cannot find a more policy-oriented explanation of its content in the RELEVANT MATERIAL. The modifications to the UTPR were so substantial that the discussions found in the PUBLIC CONSULTATION DOCUMENT and the PILLAR TWO BLUEPRINT are not helpful to understand most of the policy choices made upon the drafting of the UTPR.

3.3.2.1. The determination of the UTPR Top-up Tax Amount

In case the case of the IIR, as discussed[1549], the top-down approach is applied as a rule, and the POPE treatment, as an exception. While the top-down approach takes into consideration only the Allocable Share of the Top-up Tax of the UPE on the LTCE, the POPE treatment embraces the Allocable Share of the Top-up Tax of the POPE on the LTCE, which means that the scope of the charging rule is broadened. The top-down approach only captures income of the LTCE beneficially owned by the UPE, while the POPE treatment also submits to the Top-up Tax the portion of income that is beneficially owned by minority shareholders of the POPE.

Similarly, the UTPR also works with a dual mechanism. The exemption mechanism (Art. 2.5.2.) is primarily applied, and ensures that only the income of the LTCE beneficially owned by the UPE is burdened. In case the exemption mechanism is not applicable, then the deduction mechanism (Art. 2.5.3.) becomes applicable, thus broadening the scope of the charging rules, also capturing the portion of income that is beneficially owned by minority shareholders of the LTCE.

3.3.2.1.1. The exemption mechanism (Art. 2.5.2.)

The exemption mechanism applies when the Parent Entity or Entities that apply the IIR collectively hold all of the UPE's Ownership Interests in the LTCE[1550]. The exemption mechanism ensures that no Top-up Tax is charged under the UTPR if all of the UPE's Ownership Interest in the LTCE are held directly or indirectly by one or more Parent Entities that are required to apply an IIR in relation to the LTCE[1551]. In summary, because the UTPR is a backstop to the IIR, in case the IIR plays its role and submits all the relevant income to a Top-up Tax, no Top-up Tax will be allocated under the UTPR.

In case the exemption mechanism does not apply, then the scope of the rules is significantly broadened. Under the deduction mechanism, a Top-up Tax is calculated for the LTCE, without any regard to the participation of the UPE in such profits. The CEs of the MNE Group become liable to a tax on all of the income that is beneficially-owned by minority shareholders, i.e. on the total amount of Top-up Tax of an LTCE. As seen[1552], in case of application of the IIR to a POPE, the scope of the GLOBE MODEL RULES is widened, ultimately covering not only the income of the LTCE beneficially owned by the UPE, but also the income of the LTCE beneficially owned by minority shareholders. As the UTPR is a backstop to the IIR, it would be expected that the UTPR was also impacted

[1549] See sec. 3.2.2, *supra.*
[1550] GLOBE COMMENTARY, p. 37, para. 72.
[1551] GLOBE MODEL RULES, Art. 2.5.1.
[1552] See sec. 3.2.3, *supra.*

by this broadening of scope. However, the scope in case of application of the UTPR is much broader – and this is so not only in the case of POPEs. In fact, the qualification of POPEs is not taken into account for the purpose of the UTPR. The UTPR always burdens the low-taxed income that is beneficially owned by minority shareholders. This happens not only in the case of POPEs, but in all cases in which the Top-up Tax is not reduced to zero under the exemption mechanism.

3.3.2.1.2. The deduction mechanism (Art. 2.5.3.)

The deduction mechanism applies in case the Parent Entity or Entities that apply the IIR do not hold all of the UPE's Ownership Interests in the LTCE[1553]. Article 2.5.3 reduces the Total UTPR Top-up Tax Amount by the amount of Top-up Tax subject to the IIR (instead of reducing it to zero)[1554]. As a consequence, low-taxed income that is beneficially owned by minority shareholders is kept within the scope of the charging rule. Thus, instead of merely working as a backstop to the IIR, the Top-up Tax broadens the scope of the charge, in case there are minority shareholders in the structure. Unlike in the exclusion mechanism, in the deduction mechanism, the allocation of the Top-up Tax is not restricted to the amount attributable to the participation of the UPE. It is not necessary to examine whether a POPE would have been subject to the IIR (case in which the minority shareholders would also be burdened under the IIR). Instead, the mechanism provides for the deduction of the tax due under an IIR from the amount of Top-up Tax that is computed on the total amount of income of the LTCE, without taking into consideration the UPE's Allocable Share of the Top-up Tax.

This treatment is completely spelled out in the GLOBE COMMENTARY and is undoubtedly meant by the wording of the provision. The GLOBE COMMENTARY literally states that the mechanism "allows for a greater tax expense than the Top-up Tax that would have been collected under the IIR if it had applied at the UPE level, because it is not limited to the UPE's Allocable Share of the Top-up Tax due in respect of LTCE"[1555]. The choice for broadening the scope of the rule is not discussed in further detail in the GLOBE COMMENTARY, which merely states that the application to the total amount of Top-up Tax of an LTCE "simplifies its application" [1556].

It is important to note that, in case of application of the deduction mechanism, the scope is even broader than in the case of the POPE treatment by the IIR. While the POPE treatment by the IIR burdens the income beneficially-owned by the minority shareholders of the POPE, the UTPR deduction mechanism burdens the income beneficially owned by the minority shareholders of the LTCE (which, as discussed, are never captured by the IIR).

The outcome of the deduction mechanism also engenders distributional concerns. One could think of a POPE that is not subject to the IIR, thus triggering the application of the UTPR charged on another POPE, which is completely unrelated to the LTCE. In such case, the minority shareholders of the POPE subject to the UTPR will be burdened by a tax based on income beneficially-owned by the minority shareholders of the POPE that holds participation in the LTCE.

[1553] GLOBE COMMENTARY, p. 37, para. 72.
[1554] GLOBE COMMENTARY, p. 38, para. 78.
[1555] GLOBE COMMENTARY, p. 38, para. 78.
[1556] GLOBE COMMENTARY, p. 38, para. 78.

3.3.2.2. The formula for allocating the Top-up Tax

The GLOBE MODEL RULES abandoned the reference to intra-group payments in determining the allocation of the UTPR Top-up Tax, substituting it for "a substance-based allocation key"[1557]. This is a significant change of course in relation to the approach intend in the PILLAR TWO BLUEPRINT. Instead of the former allocation keys based on intra-group payments, the UTPR Top-up Tax Amount is determined by multiplying the Total UTPR Tax Amount for the LTCEs in a jurisdiction by the UTPR Percentage. The UTPR Percentage of the jurisdiction implementing the GLOBE MODEL RULES is determined according to the following equation[1558]:

$$UTPR\ Percentage =$$

$$50\% \times \frac{NE\ in\ the\ jurisdiction}{NE\ in\ all\ UTPR\ jurisdictions} + 50\% \times \frac{tvTA\ in\ the\ jurisdiction}{tvTA\ Assets\ in\ all\ UTPR\ jurisdictions}$$

The formula considers, therefore, the Number of Employees ("**NE**") and the total value of Tangible Assets ("**tvTA**") in each jurisdiction that has a Qualified UTPR in force for the Fiscal Year. The formula is supposed to reflect "the relative substance of the MNE Group in each UTPR Jurisdiction", thus providing for a "simple and transparent allocation key", able to facilitate coordination among jurisdictions[1559]. The GLOBE COMMENTARY further argues that the jurisdictions where the MNE Group has more substance would be more able to absorb the adjustments under the UTPR.

Besides providing for a special treatment to the NE and Tangible Assets of Flow-through Entities[1560], the rules also exclude from the formula the NE and Tangible Assets of Investment Entities[1561]. Following the logic that Investment Entities are often subject to reduced taxation[1562], the NE and Tangible Assets of Investment Entities are not considered in the formula, because such Entities are also excluded from the application of the UTPR. It is maintained that "allocating some of the UTPR Top-up Tax Amount to a jurisdiction that has only Investment Entities would reduce the effectiveness of the UTPR"[1563].

The choice of the elements of the formula is generally grounded on practicability concerns. The elements of the formula are based on numbers required in the MNE Group's CbCR and are, therefore, "bright-line measures based on existing compliance mechanisms[1564]. The definitions of NE and Tangible Assets are similar to those of BEPS Action 13 for the purposes of CbCR. Reference is also made to the stability of the elements of the formula. They are not expected to be significantly different from one Fiscal Year to another, unless the MNE Group undertakes a significant restructuring[1565].

[1557] GLOBE COMMENTARY, p. 39, para. 79.
[1558] GLOBE MODEL RULES, Art. 2.6.1.
[1559] GLOBE COMMENTARY, p. 39, para. 81.
[1560] GLOBE MODEL RULES, Art. 2.6.2(b).
[1561] GLOBE MODEL RULES, Art. 2.6.2(a).
[1562] See ch. III, sec. 4.2.4, *supra,* discussing such statement in relation to Investment Entities.
[1563] GLOBE COMMENTARY, p. 40, para. 89.
[1564] GLOBE COMMENTARY, p. 39, para. 82.
[1565] GLOBE COMMENTARY, p. 39, para. 87.

The only substantial justification of the formula that one may find in the GLOBE COMMENTARY is that it is intended to acknowledge that substance may take many forms, depending on industry and business model of the MNE Group[1566]. The discussion on the elements of the formula is a sensible topic, as it is broadly related to inter-nations equity. The laconism of the GLOBE MODEL RULES on the topic is, therefore, not surprising.

For the purposes of the thesis, it is important to highlight that the GLOBE COMMENTARY intends to ground the choice of elements of the allocation formula on practicability concerns, leaving the issues of inter-nations equity to the background. The thesis does not build a normative framework to evaluate which allocation formula would be preferable. While the issue is of fundamental importance, due to a methodological limitation, the formula is not further discussed as a matter of inter-nations equity. In line with the scope of the thesis, it suffices to state that the GLOBE MODEL RULES are designed to set a floor to tax competition, and any allocation of the right to charge the UTPR that ensures its effectiveness is able to achieve this goal.

3.3.2.3. The collection of the UTPR

In fact, the flexibility of the collection mechanism of the UTPR evidences that GLOBE MODEL RULES are not particularly concerned with allocating the UTPR according to the formula. The rules are rather focused on the effectiveness of the collection, even if such effectiveness comes at the expense of the allocation formula. Finding a justification for the allocation of the formula is not a particular concern of the GLOBE MODEL RULES, considering that there are instances where the UTPR will be charged in a way that is completely unrelated to the allocation formula.

With respect to the charging of the UTPR, the GLOBE MODEL RULES set forth that the CE shall be denied a deduction for otherwise deductible expenses (or be subject to an equivalent adjustment under domestic law) in an amount resulting in a cash expense equal to the Top-up Tax allocated to the jurisdiction[1567] (sec. 3.3.2.3.1). The rules also provide for a mechanism that ensures that the UTPR is charged as soon as possible, allowing for the charging by other UTPR Jurisdictions in cases where the CE does not present the "tax capacity" to be charged an UTPR (sec. 3.3.2.3.2).

3.3.2.3.1. Denial of deductions as a collection mechanism

The GLOBE COMMENTARY offers important guidance on the collection mechanism of the UTPR. The transaction in relation to which the deduction is denied does not to need to be a transaction with another CE, and several examples of deductions that could be denied are conceived[1568]. However, a denial of deduction recorded against non-taxable income, which, therefore, does not result in an additional amount of cash tax expense payable by the CE, does not constitute a valid denial of a deduction for the purposes of a UTPR adjustment[1569].

The expression "equivalent adjustment under domestic law" is very comprehensive. The GLOBE COMMENTARY illustrates that the adjustment could even take the form of an

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[1566] GLOBE COMMENTARY, p. 39, para. 83.
[1567] GLOBE MODEL RULES, Art. 2.4.1.
[1568] GLOBE COMMENTARY, p. 32, para. 45.
[1569] GLOBE COMMENTARY, p. 32, para. 45.

"additional Tax levied directly on a resident taxpayer in an amount equal to the allocated UTPR Top-up Tax Amount"[1570]. What matters is that the adjustment should result in an additional cash tax expense, either in the current year, or in a future year (under a carry-forward mechanism). The UTPR adjustment shall be imposed as soon as possible and a carry-forward mechanism to address the situation where the UTPR adjustment does not produce a cash tax expense for the Fiscal Year is also provided[1571].

Therefore, the denial of a deduction is simply a collection mechanism. It is completely unrelated to the logic of the UTPR from the PILLAR TWO BLUEPRINT. The transaction in relation to which the deduction is denied does not to need to be a transaction with another CE, and the "profit-stripping" argument does not apply in relation to such payments. In fact, the jurisdiction implementing the UTPR may choose not to use the mechanism at all and simply levy an additional tax in an amount equal to the UTPR Top-up Tax Amount.

The GLOBE COMMENTARY does not discuss the preference for this collection mechanism. One important issue is to understand why it has been conceived, instead of simply allowing for the levy of a tax (as it may, in any case, be chosen by the implementing jurisdiction). Two explanations may be found for such choice.

The GLOBE COMMENTARY states that the mechanism reduces "the risk of allocating Top-up Tax to a jurisdiction that does not have enough capacity to impose the UTPR adjustment" [1572]. In this context, "capacity" is generally related to the existence of deductions that can be denied and lead to a cash tax expense. The first explanation is, therefore, that the UTPR collection mechanism is aimed at ensuring that the tax is collected as soon as possible and, being confirmed by the deeming provision of Art. 2.6.3[1573].

The second possible explanation is that the drafters wished to maintain some flexibility on the collection of the tax in relation to CEs that are in a loss position[1574]. As the CE is ultimately charged a Top-up Tax calculated on the income of the LTCE, and they bear no direct connection with each other, it is possible that the Top-up Tax ends up being charged on a CE that itself has no income – and is not expected to ever benefit from the income of the LTCE. The denial of deductions ensures that the cash tax expense only arises in cases in which the CE is profitable (therefore the need for a carry-forward mechanism). Understood as such, the denial of deduction is another manifestation of the separate-entity principle, as it prevents a loss-making CE from being charged a Top-up Tax (at least until it becomes profitable again). However, adopting it is ultimately an option of the implementing jurisdiction, and the GLOBE MODEL RULES also conceive the possibility of simply levying a tax on the CE.

Because the CE being charged a Top-up Tax under the UTPR may also have minority shareholders, further ability-to-pay concerns could be raised in case a loss-making CE is charged a Top-up Tax. The minority shareholder, despite only holding participation in a

[1570] GLOBE COMMENTARY, p. 33, para. 47.
[1571] GLOBE MODEL RULES, Art. 2.4.2.
[1572] See, however, GLOBE COMMENTARY, p. 39, para. 81
[1573] See sec. 3.3.2.3.2, *infra*.
[1574] The loss-making CE is mentioned as an example of a case where it would be possible that an UTPR is not collected in a given Fiscal Year, by means of the denial of the deduction. See GLOBE COMMENTARY, p. 34, para. 58.

loss-making CE, will burdened by a tax calculated on the income of the LTCE, from which the minority shareholder is never expected to benefit.

3.3.2.3.2. The "as-soon-as-possible" mechanism (Art. 2.6.3)

In fact, the collection mechanism of the UTPR is only completely understood in connection with the deeming provision of Art. 2.6.3. The GLOBE MODEL RULES provide for a special case in which the UTPR Percentage of a jurisdiction is deemed to be zero. Essentially, the mechanism ensures that the UTPR is charged as soon as possible and ultimately indicates that the GLOBE MODEL RULES are very flexible in relation to the allocation of taxing rights to the UTPR Jurisdiction[1575].

The UTPR Percentage of the jurisdiction for an MNE Group is deemed to be zero for a Fiscal Year as long as the Top-up Tax Amount allocated to the jurisdiction in a prior Fiscal Year has not resulted an additional cash tax expense to the CEs equal, in total, to the UTPR Top-up Tax Amount for that prior Fiscal Year allocated to the jurisdiction[1576]. The NE and the Tangible Assets of the CEs of this MNE Group located in a jurisdiction with a UTPR Percentage of zero for a Fiscal Year shall be excluded from the formula for allocating the Total UTPR Top-up Tax Amount for that Fiscal Year. This rule does not apply for a Fiscal Year if all jurisdictions with a Qualified UTPR in force for the Fiscal Year have a UTPR Percentage of zero for the MNE Group for that Fiscal Year[1577].

The special mechanism is intended to ensure that "no more Top-up Tax is allocated to such a jurisdiction until it has been able to impose the requisite amount of tax"[1578]. In practice, it ensures that the UTPR Top-up Tax is charged as soon as possible, considering all the CEs in the UTPR Jurisdictions. The special case can be better understood with the assistance of one of the GLOBE EXAMPLES, whose facts are summarized in the following diagram[1579]:

[1575] Discussing the practical effect of Art. 2.6.3 on the compatibility of the UTPR with DTCs, see Wardell-Burrus, "Four Questions for UTPR Skeptics," 702.
[1576] GLOBE MODEL RULES, Art. 2.6.3.
[1577] GLOBE MODEL RULES, Art. 2.6.4.
[1578] GLOBE COMMENTARY, p. 41, para. 92.
[1579] GLOBE EXAMPLES, Example 2.6.4 – 1.

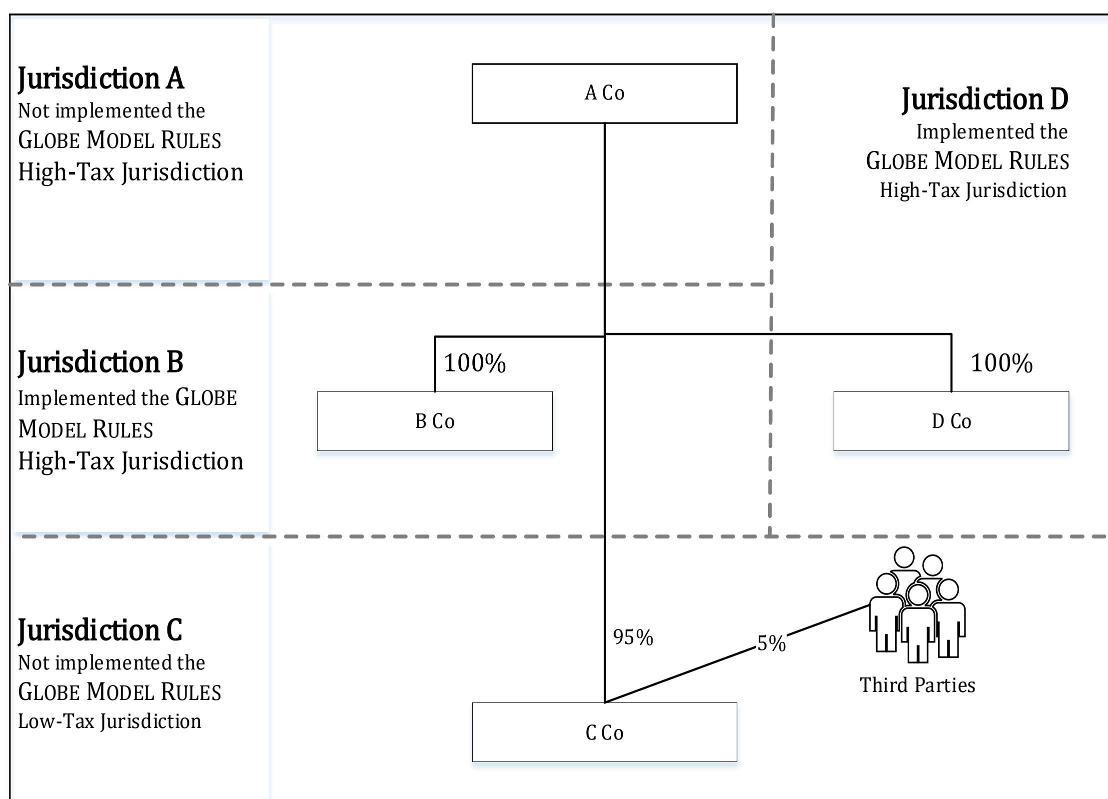

Figure 7: GLOBE EXAMPLE 2.6.4 - 1

In the diagram, B Co does not own any Ownership Interest in C Co and A Co holds its Ownership Interest in C Co directly. As a consequence, no CE is required to apply a Qualified IIR, because none of the jurisdictions that implemented the GLOBE MODEL RULES hold an Ownership Interest in C Co. Assuming a Top-up Tax of 100 in respect of C Co, all of it would be allocated to other jurisdictions under the UTPR, and none of it would be subject to an IIR.

For the example, the UTPR for jurisdictions B and D have been calculated considering the NE and Tangible Assets, resulting in an UTPR Percentage of 50% for each jurisdiction, for each of the Fiscal Years 1 to 4.

In Fiscal Year 1, Jurisdiction B and D are each allocated an amount of Top-up Tax of 50. In the example, Jurisdiction B is not able to collect the whole amount of 50 for the taxable year in which Fiscal Year 1 ends – because it is not able to create an additional cash expense. Therefore, under the special case rule, Jurisdiction B's UTPR Percentage is deemed to be zero for Year 2 (and following Years) as long as the UTPR Top-Up Tax Amount of 50 allocated to Jurisdiction B in Year 1 has not resulted in B Co having an equivalent additional cash tax expense. In other words, no more UTPR Top-up Tax Amount shall be allocated to Jurisdiction B until it is able to impose the 50 UTPR.

In Fiscal Year 2, as a consequence of its inability to charge the UTPR for Fiscal Year 1, Jurisdiction B has a UTPR percentage of zero (its NE and Tangible Assets are excluded from the formula), and the whole UTPR Top-up Tax calculated for Fiscal Year 2 (100) is allocated to Jurisdiction D. For the example, assume that Jurisdiction B is again not able to collect the whole amount of UTPR Top-up Tax related to Fiscal Year 1 (50). Besides, for Fiscal Year 2, also Jurisdiction D is not able to collect the whole amount of 100 (allocated in respect of Fiscal Year 2) for the taxable year in which Fiscal Year 2 ends. In

principle, both Jurisdictions B and D would have a UTPR Percentage of zero for Fiscal Year 3[1580], but the rule does not apply in cases where the UTPR Percentage of all jurisdictions would be reduced to zero[1581].

In Fiscal Year 3, therefore, the Total UTPR Top-up Tax Amount of 100 is allocated to Jurisdictions B and D in respect of their original UTPR Percentage based on the formula (50%/50%) without the application of the special case rule. An amount of 50 of Top-up Tax is added to the other UTPR Top-up Tax Amounts that are still to be collected by each Jurisdiction. For the example, it is further assumed that all remaining UTPR Top-up Tax Amounts are collected in both jurisdictions for the taxable year in which Fiscal Year 3 ends.

In Fiscal Year 4, considering that all of the previous UTPR amount have already been collected in both jurisdictions, the UTPR Top-up Tax Amount of 100 is allocated to Jurisdictions B and D based on their respective UTPR Percentages determined using the Formula. The following table summarizes the outcomes for each Fiscal Year:

Fiscal Year	UTPR Top-up Tax Amount	Allocation to Jurisdiction B	Allocation to Jurisdiction D
1	100	50 (UTPR Percentage of 50%)	50 (UTPR Percentage of 50%)
2	100	0 (UTPR Percentage of 0%)	100 (UTPR Percentage of 100%)
3	100	50 (UTPR Percentage of 50%)	50 (UTPR Percentage of 50%)
4	100	50 (UTPR Percentage of 50%)	50 (UTPR Percentage of 50%)

In practice, the deeming provision may completely jeopardize the outcome of applying the formula. For an extreme example, consider that the only profitable CE in an UTPR Jurisdiction is also the one with the lower NE and amount of Tangible Assets. If the other CEs do not become profitable, the UTPR will be allocated in a way that is completely indifferent to the content of the formula, being based exclusively on the "tax capacity" of the CE. The deeming provision, at the end of the day, puts the "tax capacity" of the CE in front of any possible nexus justification that could be derived from the elements of the formula.

3.3.3. The justification of the UTPR

The UTPR supplements the IIR and is applied only to the extent that the Top-up Tax has not been charged under a QDMTT or an IIR. A Top-up Tax charged under the UTPR is, however, an "unusual tax", and both scholars and practitioners struggle with finding a proper justification for it[1582]. While the IIR can find some resemblance in the logic of CFC rules, the UTPR burdens affiliates that are under common control, but have no direct participation on each other and potentially no other connections[1583]. The UTPR would be

[1580] GLOBE MODEL RULES, Art. 2.6.3.
[1581] GLOBE MODEL RULES, Art. 2.6.4.
[1582] See, *e.g.,* Arnold, "The Ordering of Residence and Source," 222.
[1583] VanderWolk, "The UTPR Is Flawed: A Response to Prof. Picciotto," 285.

"flawed insofar as it allows taxation of income where there is no economic nexus to the taxing jurisdiction"[1584].

3.3.3.1. The UTPR and the separate-entity doctrine

The difficulty in understanding the UTPR is that the country charging the Top-up Tax will be neither the residence nor the source state of the relevant income[1585]. As seen, under the UTPR, the Top-up Tax is allocated among the members of the MNE Group based on each CE's proportionate share of the net book value of tangible assets and the number of employees of the MNE Group[1586]. The allocation can be further modified by the application of the deeming provision from Art. 2.6.3. The allocation of taxing rights is not guided by the traditional residence/source dichotomy, but rather by indicia of substantive business activities (the net book value of tangible assets and the number of employees) of the MNE Group, or simply by the "tax capacity" of the CE. The Top-up Tax charged based on the UTPR cannot be characterized as a source tax, because it is related to income earned in another country. It cannot be characterized as a residence tax either, as it will not be paid by the CEs that earned the income being subject to taxation[1587].

The anti-abuse justification from the PILLAR TWO BLUEPRINT has been completely abandoned in the GLOBE MODEL RULES. Nothing in the UTPR resembles the former "profit stripping" justification, as the allocation of taxing rights is carried out by means of a formula, or by reference to the "tax capacity" of the CE. Therefore, one does not find any form of disregarding of legal entities in the approach. There is no attempt to impute the income of the LTCE to the CE being charged by the UTPR.

Despite this clear content of the UTPR, CHRISTIANS and MAGALHÃES maintain that "the UTPR can be understood as calling for tax veil piercing by pushing down income that, under the agreed framework, should have been taxed in the hands of the upstream company"[1588]. Likewise, PICCIOTTO maintains that the UTPR "would allow a state under its domestic legislation to adjust the accounts of a constituent entity within its jurisdiction to recover the top-up tax attributable to it under the UTPR rules", which would not entail "taxing the profits of a nonresident"[1589]. While this could be true in the PILLAR TWO BLUEPRINT version (provided that one accepted all the questionable assumptions regarding intra-group payments), the GLOBE MODEL RULES have completely deviated from this logic. This sort of reasoning is not even implicit to the UTPR anymore.

As seen, there is no inspiration on the anti-abuse reasoning in the design of the UTPR of the GLOBE MODEL RULES. There is no reference to intra-group payments, or to the net intra-group expenditure, and the Top-up Tax is simply allocated through a formula or by reference to the "tax capacity" of the CE. It is possible that the UTPR charges a Top-up Tax on a CE that had no relations with the LTCE for which the tax was calculated – and was never expected to have any relations with such LTCE.

[1584] VanderWolk, "The UTPR Is Inconsistent with the Nexus Requirement of Tax Treaties."
[1585] Arnold, "The Ordering of Residence and Source," 223.
[1586] Arnold, 223.
[1587] Arnold, 223.
[1588] Christians and Magalhães, "Undertaxed Profits and the Use-It-or-Lose-It Principle."
[1589] Picciotto, "Formulary Approach: The Last Best Hope for MNEs," 437. Similarly, see Christians and Magalhães, "Undertaxed Profits and the Use-It-or-Lose-It Principle."

Another important evidence of the abandonment of the anti-abuse reasoning is that the term "UTPR Taxpayer" has been left behind[1590]. The term was defined in the PILLAR TWO BLUEPRINT as any CE "located in a jurisdiction that has implemented the UTPR in accordance with the GloBE rules (a UTPR Jurisdiction)"[1591]. Considering the "profit stripping" justification, which underlies the reference to intra-group payments, the UTPR would burden the actual UTPR Taxpayer, *i.e.*, it would burden the CE on its own income, which was "restituted" to it by means of the UTPR mechanism, following the intended anti-abuse approach. In the GLOBE MODEL RULES' structure, however, the income being taxed is clearly the income of the LTCE, and the UTPR merely allocates a taxing right over the income, based on a formula that considers substantial activities, also allowing for deviations from the formula in order to make the tax effective (Art. 2.6.3.). There is no effort to maintain that the income should have actually been allocated to the CE on which the UTPR is charged.

Besides that, even if one is still able to see some "profit stripping" justification in the current design, the burdening of minority shareholders remains without an explanation. In case of application of the deduction mechanism, also the income beneficially-owned by minority shareholders of the LTCE is burdened. Hence, if the justification of the rule is a supposed "profit stripping", there is no reason why the minority shareholder should also be burdened. Any justification, in this case, would have to deal with the reasons why the MNE Group would strip profits to the benefit of minority shareholders as well. While some anti-abuse reasoning could be conceived in the case of a close connection between the MNE Group and the minority shareholders, there is no evidence that the rules have been tailored to deal with such structures.

Hence, the GLOBE MODEL RULES take the backstop function of the UTPR to a next level, and do not try to reconcile it with the traditional residence/source dichotomy which has always been associated to the separate-entity approach. Speaking in the separate-entity approach vocabulary, one has to acknowledge the right of the UTPR Jurisdiction to tax the income of a LTCE located in another jurisdiction. In such case, the UTPR Jurisdiction is neither the source nor the residence jurisdiction of the LTCE. Therefore, a justification grounded on the traditional nexus rules cannot be found for the UTPR.

The UTPR and the enterprise doctrine

Besides the "recovery" argument (clearly a separate-entity argument), PICCIOTTO also rejects the argumentation based on the separate-entity doctrine, maintaining that it would be "remote from the reality of affiliates within an integrated corporate group under common management and control"[1592]. Accordingly, it would be "totally irrational to treat a subsidiary that is part of a multinational corporate group under common management and control as if it were an independent legal person"[1593]. Instead, he maintains that affiliates would be like "the various parts of a vehicle, all essential in their own way to the functioning of the whole, but under the control of the firm's top

[1590] The expression "taxpayer" is not used neither in the context of the IIR nor in the context of the UTPR. The only two occurrences of the term are found in GLOBE MODEL RULES, Art. 4.4.3. and Art. 9.1.1. It is not clear to whom the term refers in the context of such provisions.
[1591] PILLAR TWO BLUEPRINT, p. 123.
[1592] Picciotto, "Formulary Approach: The Last Best Hope for MNEs," 437.
[1593] Picciotto, "UTPR Critics Miss the Point of Tax Treaty Principles," 153.

managers"[1594], and claims that the GLOBE "adopts a unitary approach to the taxation of MNEs"[1595]. His justification for the UTPR is therefore clearly grounded on some version of the enterprise doctrine. Likewise, CHRISTIANS and MAGALHÃES, besides their "tax veil piercing" argument (equally a separate-entity argument), also refer to "the single economic unit that the entities form by virtue of being under the common control" and maintain that "economically, all the entities' respective tax attributes pertain to and affect the entire group"[1596]. The two main problems of this line of reasoning have both been addressed by the thesis at this point.

The first one refers to the excessively broad definition of MNE Group, which captures more than the reality of "integrated" MNE Groups under "common management" (PICCIOTTO), behaving as a "single economic unit" (CHRISTIANS and MAGALHÃES). As the MNE Group is defined by reference to control, there is no guarantee that the CEs under consideration behave as a unitary business or as a single enterprise[1597]. They can possibly be part of a portfolio diversification strategy of an UPE that functions as a holding company. It is possible that the business of the LTCE and that of the CE to which the UTPR applies are related through nothing but control, and one is unable to identify any sort of integration or even a common management between both CEs. It is also possible that the LTCE and the CE of the UTPR Jurisdiction have a different set of minority shareholders, which adds further problems to the fairness of such allocation of the tax burden – as is clear in the application of the deduction mechanism.

The second problem is that the argument ignores the actual design of the GLOBE MODEL RULES. It is simply not true that the rules adopt "a unitary approach to the taxation of MNEs"[1598]. The application of the GLOBE MODEL RULES is largely based on the separate-entity approach[1599]. As seen, the rules provide for the identification of the relevant CEs, the determination of their geographical location, as well as the attribution of income to such CEs, which are expected to deal with each other observing the ALS. This is not different with the UTPR. The income that is calculated is that of CEs, with some space for jurisdictional blending, and not the income of the MNE Group. Profits of one jurisdiction cannot be blended with losses from another jurisdiction. It is not possible to simply ignore such features and argue that the UTPR would be somehow grounded on an enterprise approach. After all, the UTPR clearly charges a Top-up Tax that is calculated based on income of the LTCE, and not on any form of unitary taxation.

In fact, despite resorting to a formula, the UTPR does not provide for FA in the sense it is commonly addressed in the tax legal scholarship. In a unitary system, in general, the assignment of income is accomplished by means of an apportionment formula[1600]. The

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[1594] Picciotto, "Formulary Approach: The Last Best Hope for MNEs," 437.
[1595] Sol Picciotto, "Justifying the UTPR: Nexus and Economic Connection," *Tax Notes International* 108 (2022): 667.
[1596] Christians and Magalhães, "Undertaxed Profits and the Use-It-or-Lose-It Principle."
[1597] See ch. III, sec. 4.1, *supra.*
[1598] Picciotto, "Justifying the UTPR: Nexus and Economic Connection," 667.
[1599] Curiously enough, such feature is acknowledged in an earlier article co-authored by PICCIOTTO. See Picciotto and Kadet, "The Transition to Unitary Taxation," 461. In the article, referring to BEPS 2.0 in general, the authors state that "*policy statements and detailed proposals have combined the incompatible objectives of adopting a unitary and formulaic approach with continued retention of the separate-entity and arm's-length principles. Yet the perspective of unitary taxation is diametrically opposed to the separate-entity principle*."
[1600] McIntyre, "The Use of Combined Reporting by Nation States," 926.

rules inherent to the formula are, therefore, the source rules of the system[1601] – at least if source rules are understood as the rules that assign income to particular geographical areas[1602]. The UTPR, however, does not allocate *income* based on the formula, but rather the *taxing right* to charge a Top-up Tax. The income that is being taxed is still the income of the LTCE, which is allocated to a jurisdiction that is not the jurisdiction charging the Top-up Tax under the UTPR. The deeming provision of Art. 2.6.3 adds complexity to the allocation, and also distances the mechanism from FA. A justification grounded on the enterprise doctrine cannot be maintained.

3.3.3.3. The UTPR and a hybrid justification

Even if the enterprise justification does not hold, one could think of a hybrid explanation, taking into account the eclecticism of the GLOBE MODEL RULES. It could be argued that the GLOBE MODEL RULES shield the normal returns of the CEs by means of the carve-out and only subject the economic rents to a Top-up Tax charged under the UTPR. As economic rents cannot be economically attributed to separate entities, being rather attributable to features of the enterprise as a whole[1603], the right to tax economic rents could be allocated to any CE of the MNE Group, at least as a subsidiary measure. The UTPR would be, under this reasoning, a hybrid form of allocation of taxing rights over economic rents of the MNE.

Of course, the justification would still be harmed by the problem of the broad MNE Group definition[1604]. Still, one would also find a third problem, which refers to the shortcomings of the Substance-Based Income Exclusion, as the thesis has already addressed. The carve-out is not able to capture normal returns[1605]. If the UTPR were grounded on a hybrid approach between separate-entity and enterprise doctrines, at least the normal return would be expected to be shielded before one could speak of any form of economic rents attributable to the MNE Group as a whole, being thus allocated to another CE by means of a formula. Besides, the rules are not designed to capture economic rents of the MNE Group, drawing, instead, on the reality of jurisdictionally-blended CEs. The analysis of the Substance-Based Income Exclusion showed that there is no reason to believe that it provides for a minimally accurate estimation of normal returns, and, in many circumstances, normal returns may also be burdened under the denomination of Excess Profits. Hence, it is not possible to justify the UTPR as a hybrid form of allocation of taxing rights over economic rents of the MNE.

3.3.3.4. The UTPR as a measure of last resort

While a principled justification is not possible, reference to a pragmatic one becomes necessary. The UTPR can only be justified as a measure of last resort, aimed at ensuring a floor to tax competition, which is expected to play only a limited role. ARNOLD calls it "a necessary enforcement mechanism or an anti-avoidance rule to reinforce the effectiveness of the Pillar Two minimum tax" [1606]. It only applies to the extent that the

[1601] McIntyre, 926.
[1602] As it has been established as a premise in sec. 1, *supra.*
[1603] For an analytical classification of economic rents, see Schwerhoff, Edenhofer, and Fleurbaey, "Taxation of Economic Rents," 398.
[1604] See ch. III, sec. 4.1.2, *supra*
[1605] See ch. IV, sec. 3.3, *supra.*
[1606] Arnold, "The Ordering of Residence and Source," 223. Similarly, see Hey, "Von Anti-Hybrids-Regeln," 257.

relevant Top-up Tax is not charged under an IIR or a QDMTT. It has an important function of incentivizing states to adopt the IIR, and also preventing UPEs from shifting their residences to states that have not implemented an IIR[1607]. Without the UTPR, the IIR could be rendered ineffective[1608], as there is no guarantee or even an agreement in the sense that all IF countries will adopt an IIR. Without a backstop, countries would not be willing to enact an IIR, fearing inversions of UPEs to jurisdictions without an IIR[1609]. Ultimately, the UTPR ensures that the floor to tax competition is established even without the application of the IIR by all IF countries. It also gives UPE Jurisdictions a tool to protect themselves against tax inversions.

A more principled justification of the UTPR, which reconciles its content with traditional nexus rules, does not seem possible. It is a pragmatic solution, following the failed attempt of the PILLAR TWO BLUEPRINT to design a principled and operable rule (the PILLAR TWO BLUEPRINT's UTPR has neither of these attributes). From a separate-entity perspective, the UTPR is troublesome because it allocates taxing rights to a state that is neither the residency nor the source state of the income. From an enterprise doctrine perspective, considering the broad definition of MNE Group, as well as the shortcomings of the Substance-based Income Exclusion rule, there is no guarantee that the income being taxed is anyhow related to the jurisdiction charging the Top-up Tax under the UTPR or to the CE located therein. A hybrid explanation, combining elements of the separate-entity and enterprise doctrine is not possible either.

Finally, arguments potentially dealing with the ability-to-pay of MNEs do not provide for a full account of the UTPR. As described, the UTPR's deduction mechanism also covers the income beneficially-owned by minority shareholders. More than that, the UTPR potentially charges a Top-up Tax on a CE with minority shareholders that are completely unrelated to the LTCE over which the Top-up Tax was calculated.

Whether the Top-up Tax will be charged by means of the IIR or the UTPR is not contingent on the behaviour of the MNE Group, but rather on the adoption of the IIR by the states. The relevant CEs will be subject only to the IIR, if the Parent Entity or Entities that apply the IIR collectively hold all of the UPE's Ownership Interests in the LTCE (exemption mechanism)[1610]. If one of the referred Parent Entities is not subject to the IIR, then the UTPR comes into play, and the scope of the GLOBE MODEL RULES is broadened (deduction mechanism). In case of application of the UTPR, the total amount of the Top-up Tax calculated for a LTCE will also burden the income that is beneficially-owned by minority shareholders of the LTCE. The top-down/POPE scheme is left behind, and the UTPR ensures the charging of a Top-up Tax calculated on the total amount calculated for the LTCE.

This difference of scope is generally explained in the GLOBE COMMENTARY as a simplification measure[1611]. In practice, however, there will be a narrower scope if all the Parent Entities that apply the IIR collectively hold all of the UPE's Ownership Interests in the LTCE, and a wider scope if the UTPR is applied under the deduction mechanism. This means that the burden on the MNE Group is lower when the referred Parent Entities

[1607] Arnold, "The Ordering of Residence and Source," 223.
[1608] Arnold, 223. Similarly, see Wardell-Burrus, "Four Questions for UTPR Skeptics," 699.
[1609] Plunket, "What's in a Name? The Undertaxed Profits Rule," 1507.
[1610] GLOBE COMMENTARY, p. 37, para. 72.
[1611] GLOBE COMMENTARY, p. 38, para. 78.

are subject to the IIR, and potentially higher when the UTPR comes into play. In effect, being subject to the IIR is preferable to being subject to the UTPR. This could work as an incentive for the jurisdictions to adopt an IIR, or for MNE Groups to be structured in a way that Parent Entities are located in jurisdictions applying the IIR. If minority shareholders (directly or indirectly) hold participation in the LTCE, the burden under the application of the UTPR is higher than in the case of application of the exemption mechanism. The GLOBE COMMENTARY does not discuss the potential outcomes of this difference, but there is a clear incentive for the adoption of the IIR, as the application of the UTPR is broader – further enforcing the nature of the UTPR as a subsidiary measure.

In summary, the UTPR is in line with the policy objective of establishing a floor to tax competition, which is the general purpose of the GLOBE MODEL RULES. Its content, however, is very unusual, as a consequence of the eclecticism inherent to Pillar Two. It can be justified as a subsidiary measure to ensure the floor to tax competition, but, as far as nexus rules are concerned, the pragmatic solution does not meet a principled reasoning. The differences in scope between the IIR and the UTPR, despite being explained as a simplification measure, are hard to understand from an allocative perspective. Whether such a policy design is in line with general principles of international law or with the content of DTCs currently in force is beyond the scope of the present thesis[1612], and will surely be a point of attention in the forthcoming years, in case the UTPR is implemented by jurisdictions[1613].

3.4. The Qualified Domestic Minimum Top-up Tax (QDMTT)

Despite not being systematically qualified as a charging rule under the GLOBE MODEL RULES, the QDMTT plays an important role in the chain of incentives that is intended to set a global floor to tax competition. The jurisdiction of the LTCE is able to prevent a Top-up Tax from being charged under an IIR or an UTPR, by enacting a QDMTT, which reduces the amount of Top-up Tax for the jurisdiction[1614].

QDMTT means a tax that applies to Excess Profits of the domestic CEs and operates to increase domestic tax liability with respect to those profits to the Minimum Rate[1615]. As a defined term, QDMTT is a minimum tax that is included in the domestic law of a jurisdiction and that[1616]: (a) determines the domestic Excess Profits in a manner that is equivalent to the GLOBE MODEL RULES; (b) operates to increase domestic tax liability with respect to domestic Excess Profits to the Minimum Rate for the jurisdiction and CEs; and (c) is implemented and administered in a way that is consistent with the outcomes provided for under the GLOBE MODEL RULES and the GLOBE COMMENTARY.

The preference of taxing rights given to UPE countries was perceived as a "major flaw"[1617] of the PILLAR TWO BLUEPRINT. The ordering would grant superior taxing rights

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[1612] See, briefly discussing the topic, Picciotto, "Justifying the UTPR: Nexus and Economic Connection," 667; Jefferson VanderWolk, "The UTPR Disregards the Need for Nexus," *Tax Notes International* 108 (2022): 545–46; VanderWolk, "The UTPR Is Inconsistent with the Nexus Requirement of Tax Treaties"; Wardell-Burrus, "Four Questions for UTPR Skeptics," 699–700.
[1613] Rejecting any possible comparison between the UTPR and the BEAT, Herzfeld, "Do GILTI + BEAT + BMT = GloBE?," 895.
[1614] GLOBE MODEL RULES, Art. 5.2.3.
[1615] GLOBE COMMENTARY, p. 212, para. 116.
[1616] GLOBE MODEL RULES, Art. 10.1.
[1617] Picciotto et al., "For a Better GLOBE," 864.

to MNE's home countries, being particularly disadvantageous to low-income countries, which are, as a rule, only host to MNEs[1618]. In a sense, the QDMTT "changes the politically sensitive rule order" [1619] of Pillar Two. The GLOBE MODEL RULES' mechanism sets forth a Top-up Tax, which can be charged under a QDMTT, an IIR and an UTPR, *in that order.* The addition of the QDMTT to the GLOBE MODEL RULES significantly changes the allocation of taxing rights under Pillar Two and contributes to addressing concerns over the fairness on the allocation of taxing rights embedded in the preliminary discussions on its design [1620]. The QDMTT mitigates the concerns according to which Pillar Two would operate to generate revenue gains for the countries where MNEs are headquartered[1621]. Its priority over the IIR and the UTPR is therefore "not surprising"[1622], as the same outcome could be produced by the jurisdiction of the CE by means of reform of its tax legislation.

If the QDMTT is equal to the Top-up Tax Rate multiplied by the Excess Profits, then it cancels any right of other jurisdictions to charge a Top-up Tax under an IIR or an UTPR[1623], provided that there is a uniform implementation and application of the GLOBE MODEL RULES. The mechanism allows a jurisdiction to collect the revenue that would otherwise have been collected by a foreign jurisdiction over income derived by a CE within the CE's jurisdiction territory[1624]. Under this mechanism, assuming that there will be IIRs and UTPRs in force over the world, states would be strongly incentivized to enact a QDMTT, knowing that such enactment would not harm its competitive position[1625]. In a scenario of uniform implementation and application of the GLOBE MODEL RULES, the enactment of a QDMTT does not increase the total tax that would be paid by an MNE, but merely changes the jurisdiction to which the tax shall be paid. If the Top-up Tax would be charger either way under an IIR or an UTPR, the enactment of a QDMTT merely allow the state of the CE to charge the tax, instead of waiving revenue to another jurisdiction[1626]. From this perspective, it could be argued that the GLOBE MODEL RULES establish a floor to tax competition by incentivizing countries to enact a QDMTT[1627]. After all, it should be expected that most countries adopt a QDMTT to avoid waiving tax revenues to other states, as the same income may trigger the charge of a Top-up Tax under an IIR or an UTPR[1628].

Another important feature is that the outcome of introducing a QDMTT cannot be easily replicated by simply raising tax rates[1629]. In fact, it could be argued that, even without the QDMTT, the initial right to impose a tax would belong to the jurisdiction in which the CE is located, since, by raising taxes, they are able to completely eliminate any charging

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[1618] Picciotto et al., 864.
[1619] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 4.
[1620] Devereux, Vella, and Wardell-Burrus, 4. See also Arnold, "The Ordering of Residence and Source," 224.
[1621] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 4.
[1622] Arnold, "The Ordering of Residence and Source," 225.
[1623] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 4.
[1624] See Arnold, "The Ordering of Residence and Source," 224.
[1625] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 4. Similarly, see Perry, "Pillar 2, Tax Competition, and Low Income," 107.
[1626] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 5.
[1627] Devereux, Vella, and Wardell-Burrus, 3.
[1628] Arnold, "The Ordering of Residence and Source," 227.
[1629] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 8. See also Arnold, "The Ordering of Residence and Source," 225; Arnold, "An Investigation into the Interaction," 282.

under an IIR or an UTPR[1630]. However, the QDMTT allows states to specifically design this tax increase to the minimum necessary to comply with the GLOBE MODEL RULES[1631]. If a country presents a CIT rate below 15% and simply raises the rate, Top-up Taxes may still be due, considering the differences in the tax base. As seen, the definition of Excess Profits is very peculiar, and it is highly unlikely that any country adopts a tax base identical to the one derived from the application of the GLOBE MODEL RULES. Hence, by simply increasing tax rates, states may end up increasing taxation over a base that is different from the one taken as reference by the GLOBE MODEL RULES, becoming less competitive, while not necessarily eliminating the risk that another state charges an IIR or an UTPR[1632]. The natural difficulties of a general reform of a domestic system, which would have to deal with existing tax incentives and the politics surrounding them, make the adoption of a QDMTT a much more viable solution, which is justified as "a practical mechanism"[1633]. DEVEREUX et. al. also conjecture that some low-tax countries could be incentivized to substitute their own CIT for a QDMTT, at least for MNEs that would fall within the scope of the GLOBE MODEL RULES[1634].

Hence, from a strictly distributional perspective, it is true that, if the jurisdiction of the CE chooses not to impose the minimum tax, it can "hardly complain"[1635], if another jurisdiction exercises its right under another charging rule, either the IIR or the UTPR[1636]. The preference to charge a Top-up Tax belongs to the CE's jurisdiction, which, assuming a uniform implementation and application of the GLOBE MODEL RULES, is able to charge a Top-up Tax under the QDMTT, thus inhibiting the appearance of any taxing right under an IIR or an UTPR. This argument naturally assumes that the jurisdictions have agreed that the relevant income should be subject to the minimum tax. After all, the minimum tax is a limitation to tax competition[1637], and an expansion of the tax jurisdiction of states to tax income derived abroad by non-resident entities is implicit to the GLOBE MODEL RULES[1638] - and, from this perspective, some states could still "complain".

As most concepts and provisions of the GLOBE MODEL RULES, the QDMTT raises significant interpretative issues[1639], and the design is not free from flaws. The GLOBE COMMENTARY acknowledges that the amount of a QDMTT may differ from that determined under the GLOBE MODEL RULES as a result of different applicable accounting standards[1640]. This is because the minimum tax may be computed based on a local Authorised Financial Accounting Standard that is different from the standard used in the Consolidated Financial Statements and still be considered as a QDMTT[1641]. The difference may result in an amount of QDMTT in excess of the amount of Top-up Tax that would otherwise be computed as a Jurisdictional Top-up Tax[1642]. The GLOBE COMMENTARY further clarifies that the excess is not intended to reduce the Top-up Tax

[1630] Similarly, see Arnold, "The Ordering of Residence and Source," 222.
[1631] See Arnold, 224.
[1632] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 8.
[1633] See Arnold, "The Ordering of Residence and Source," 225.
[1634] Devereux, Vella, and Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," 10.
[1635] Arnold, "The Ordering of Residence and Source," 222.
[1636] Arnold, 222.
[1637] See ch. I, sec. 4.2.4, *supra.*
[1638] See sec. 3.1.3, *supra.*
[1639] See, addressing potential problems, Arnold, "An Investigation into the Interaction," 282–88.
[1640] As calculated under GLOBE MODEL RULES, Art. 5.2.3. See ch. IV, sec. 2.2.1, *supra.*
[1641] GLOBE COMMENTARY, p. 212, para. 117.
[1642] As calculated under GLOBE MODEL RULES, Art. 5.2.3. See ch. II, sec. 5.5, *supra.*

under the GLOBE MODEL RULES below zero or result in a refund of, or credit against future, Top-up Tax under the GLOBE MODEL RULES[1643]. Such discrepancies are certainly a problem, due to the risk of double taxation they entail. In any case, the GLOBE Implementation Framework is expected to further assist tax administrations in determining whether a minimum tax is considered as a QDMTT[1644].

3.5. Summary: taxing rights under the GLOBE MODEL RULES

The GLOBE MODEL RULES certainly represent an expansion of taxing jurisdiction. Within the aim of ensuring a floor to tax competition, they allow for the taxation of income of controlled CEs, even if no anti-abuse reason is present (IIR), or the allocation of taxing rights to the jurisdiction of another CE of the MNE Group, even if the CE holds no direct or indirect participation in the LTCE (UTPR).

The IIR is not justified as an anti-abuse rule, but rather as a rule aimed at setting a floor to tax competition. The right to tax may be allocated to the UPE Jurisdiction, to the jurisdiction of an Intermediate Parent Entity or to the jurisdiction of the POPE, contingent on the adoption of the IIR by the relevant jurisdictions, as well as on the participation structure of the CEs. The IIR also impacts minority shareholders adversely, which may or may not be burdened by the IIR, following elements which are unrelated to their ability-to-pay. The UTPR is, likewise, in line with the policy objective of establishing a floor to tax competition. Its content, however, is very unusual, as a consequence of the eclecticism inherent to Pillar Two. It can be justified as a backstop measure, but, as far as nexus rules are concerned, the pragmatic solution does not meet a principled reasoning. The QDMTT, despite not being technically a charging rule, also plays a fundamental role in the structure of the GLOBE MODEL RULES, and offers an important tool for jurisdictions to adjust their system and avoid waving revenue from a Top-up Tax that is expected to be charged in another jurisdiction either way.

4. INTERIM CONCLUSIONS: *WHERE DO THE GLOBE MODEL RULES BURDEN?*

The GLOBE MODEL RULES first assign the GLOBE Income and Covered Taxes to the CEs, in order to calculate a Top-up Tax, and, in a subsequent step, allocate a taxing right to another jurisdiction, based on a charging rule, applied on another CE. They attribute a taxing right to a jurisdiction with regard to income that is allocated, under the GLOBE MODEL RULES, to a CE located in another jurisdiction. Systematically, the person earning the income (the LTCE) is not the tax debtor of the resulting tax claim, which extends to another person.

In order to set the floor to tax competition, the GLOBE MODEL RULES assign GLOBE Income and Covered Taxes to the CEs, as means to compute the ETR for each jurisdiction. The assignment follows from the location of the CEs, adopting the residence principle for the allocation of GLOBE Income and Covered Taxes. The rules are, therefore, based on the separate-entity doctrine. Special rules are necessary in case of PEs, Flow-Through Entities and Hybrid Entities, to the extent that such CEs are subject to a specific tax treatment under domestic legislation. The treatment of Stateless CEs and the allocation of CFC taxes are particularly designed to ensure the integrity of the rules, within the scope of setting an effective floor to tax competition. The special rules confirm

[1643] As calculated under GLOBE MODEL RULES, Art. 5.2.3. See ch. II, sec. 5, *supra*.
[1644] GLOBE COMMENTARY, p. 212, para. 118.

the preference for the separate-entity doctrine, being designed to ensure the proper allocation of income and taxes do CEs individually considered.

However, the right to charge a Top-up Tax is commonly allocated to another jurisdiction, under the GLOBE MODEL RULES. The rules acknowledge that the income arises in a certain jurisdiction, but allocate a right to tax it to another jurisdiction, under the charging rules. Once again, one notices the eclecticism of the GLOBE MODEL RULES: it provides for the allocation of income to CEs, following the separate-entity approach, but then, as a backstop, allocates taxing rights to members of the MNE Group based on participation or on a formula, thus mimicking elements of a formulary approach.

As a system intended to establish a floor to tax competition, they privilege the right of the host jurisdiction to tax the income, either by means of reforming the system or by the enactment of a QDMTT. The IIR and the UTPR are not grounded on a principled approach, and the allocation of taxing rights they provide is justified on practicability arguments. Under the IIR, the right to tax may be allocated to the UPE Jurisdiction, to the jurisdiction of an Intermediate Parent Entity or to the jurisdiction of the POPE, contingent on the adoption of the IIR by the relevant jurisdictions, as well as on the participation structure of the CEs. The UTPR has undergone significant changes throughout the project. While the PILLAR TWO BLUEPRINT alternative made a significant (but still unconvincing) effort to align the mechanism with the traditional approach towards nexus rules, the GLOBE MODEL RULES version of the UTPR resorted to a formula and the tax capacity of the CE. Despite being simpler, as it does not demand the accurate exam of intra-group payments, the formula is likely to face more criticism from an academic perspective, and its outcome could be considered much harder to reconcile with the DTCs currently in force.

CHAPTER VI
TEMPORAL ELEMENTS OF THE GLOBE MODEL RULES

1. INTRODUCTION

One of the central problems of income computation is how to strike a balance between, on the one hand, the objectives of period-dependent income taxes, in order to ensure the proper financing of state activities, and, on the other hand, the economic and legal objectives of theoretical income taxes, which should ideally not be restricted to any sort of periodization[1645]. Such feature might become particularly problematic in cases where a temporal mismatch leads to a "negative income"[1646]. For tax purposes, a loss may be defined as a negative difference between revenues and expenses, connected with a given economic activity within a certain period of time[1647]. Given that the concept of loss and the rules concerning its compensation are normative constructs, the structure of each tax system will determine in which cases losses are deemed to exist for tax purposes, and in which cases they may be compensated[1648]. From a legal perspective, such analysis should consider the proper distribution of the tax burden, which may be increased or decreased if losses are disregarded or taken into account by the tax system[1649].

The GLOBE MODEL RULES deal with such problem under the term "temporary difference", meaning the differences in the timing of the recognition of income and expenses under financial and tax accounting rules[1650]. The issue is dealt with at the level of Adjusted Covered Taxes. Besides the relevant Additions and Reductions, the Covered Taxes shall be adjusted for temporary differences and prior year losses, either by means of the Total Deferred Tax Adjustment Amount (calculated under Art. 4.4)[1651], or by means of the GLOBE Loss Deferred Tax Asset (calculated under Art. 4.5)[1652].

The chapter aims at clarifying what is the relevant period of the income that shall be subject to the minimum tax. For this purpose, it is structured as follows. Sec. 2 discusses the temporal aspects of CIT in general, presenting the challenges for the GLOBE MODEL RULES. Sec. 3 provides for a caveat, clarifying the role of the Additional Current Top-up Tax. Sec. 4 is dedicated to the mechanism to address temporary differences, while sec. 5 examines the GLOBE Loss Deferred Tax Asset. Sec. 6 critically examines the systematic features of the intertemporal mechanism of the GLOBE MODEL RULES.

[1645] See Christian Thiemann, *Verluste im Steuerrecht* (Tübingen: Mohr Siebeck, 2020), 34.
[1646] See Hey, 332.
[1647] See Thiemann, *Vertluste im Steuerrecht*, 1. For a discussion of the definition of income as "period-dependent", see Thomas Birtel, *Die Zeit im Einkommensteuerrecht* (Berlin: Duncker & Humblot, 1985), 147–49.
[1648] Thiemann, *Vertluste im Steuerrecht*, 1.
[1649] Thiemann, 1.
[1650] PILLAR TWO BLUEPRINT, p. 84, para. 288.
[1651] GLOBE MODEL RULES, Art. 4.1.1(b).
[1652] GLOBE MODEL RULES, Art. 4.1.2(b).

2. Temporal Aspects of Income Taxation

In order to address the temporal aspects of CIT which are relevant for the analysis of the GloBE Model Rules, the section examines the relationship between the lifetime principle (sec. 2.1) and periodization (sec. 2.2).

2.1. The lifetime principle

Tax legal scholarship has since long acknowledged that, as an extension of the ability-to-pay, no taxpayer should bear a heavier or a lighter burden merely because of the timing of the realization of certain items of income[1653]. Persons with equal lifetime economic resources should bear equal lifetime burdens[1654]. Taxation of income should ideally leave the total burden of tax unaffected by shifts of income between the various years. The tax burden should not depend on whether the inflow of income is steady or fluctuating. A much closer approach to equality in the burden of taxpayers would be obtained if crude periodization was left behind[1655]. There is a "virtual unanimity among tax policy analysts on the theoretical superiority of the lifetime perspective"[1656].

Translated to CIT terms, the lifetime principle requires a consideration of the total profit of the enterprise during its lifetime, meaning the profit derived from the beginning to the end of its activities[1657]. In its pure form, this principle does not depend on the corporate structure, on whether the business is conducted domestically or across borders, on the application of profit allocation methods, or on the sequence of profits and losses throughout the years[1658].

2.2. Periodization as a technical feature

As it happens, however, the state cannot wait for the end of the activities of the enterprise to collect taxes[1659]. From a tax policy perspective, it is correspondingly accepted that periodization is artificial[1660], being merely a technical feature of tax systems[1661]. Periodization is necessary as means to fulfil the financial needs of the state[1662].

Periodization of income taxes implies that it is possible that equally high lifetime incomes are burdened differently. By disregarding the effects of negative income, periodization leads to a problem of congruence[1663], and also harms the effectiveness of progressive

[1653] William Vickrey, "Averaging of Income for Income-Tax Purposes," *Journal of Political Economy* 47, no. 3 (1939): 381.
[1654] See, on the development of the argument from a tax policy perspective, Lawrence Zelenak, "Tax Policy and Personal Identity over Time," *Tax Law Review* 62 (2009): 333.
[1655] Vickrey, "Averaging of Income," 381.
[1656] Zelenak, "Tax Policy and Personal Identity over Time," 335.
[1657] See Klaus-Dieter Drüen, *Periodengewinn und Totalgewinn: Zum Einfluß des Totalgewinngedankens auf die steuerrechtliche Gewinnermittlung* (Berlin: Duncker & Humblot, 1999), 86.
[1658] Jürgen Lüdicke et al., "Cross-Border Loss Utilization," *Bulletin for International Taxation* 68, no. 6/7 (2014): 377.
[1659] Schoueri, "O mito do lucro real," 259.
[1660] See Caroline Schrepp, *Steuerliche Verlustnutzung im Rückwirkungszeitraum: § 2 Abs. 4 UmwStG: Legitime Missbrauchsbekämpfung oder verfassungswidriges Umstrukturierungshindernis?* (Baden-Baden: Nomos, 2021), 39; Schoueri, "O mito do lucro real," 259.
[1661] With further references, see Drüen, *Periodengewinn und Totalgewinn*, 85.
[1662] Schoueri, "O mito do lucro real," 259.
[1663] See Birtel, *Die Zeit im Einkommensteuerrecht*, 156–59.

rates[1664]. If the lifetime and not the period is the relevant time frame to determine the ability-to-pay of a subject, then one faces controversies that in some systems may amount to a constitutional problem[1665]. The basic substantive tax law question is whether and to what extent time is to be considered continuous or divided into annual periods, thus approaching or departing from the lifetime income for the assessment of the ability-to-pay[1666].

Some scholars have questioned the feasibility of the lifetime perspective, but a more conceptual defence of the superiority of periodization cannot be found. GRAETZ, for example, argues that a Congress cannot bind a later Congress, which would make it impossible for a group of legislators to make a political agreement on a fair taxation oriented towards the lifetime principle[1667]. The arguments for periodization often take the form of criticism of the practicability of adopting a more ambitious system, oriented towards the lifetime principle[1668]. While a feasible system oriented towards the lifetime principle is not designed, the need for periodization remains as an inevitable feature of modern income tax systems.

2.3. The reality of the systems and the challenges for GLOBE purposes

Considering the need to balance the abstract fairness of lifetime taxation and the financial needs of the state, the principle of lifetime income is only partially implemented in tax laws[1669], in the form of deviations from periodization[1670]. Taxation on an annual basis is therefore the rule, with some leeway to the carry-over of losses or of start-up expenses.

The question to be examined under the GLOBE MODEL RULES is, therefore, what is the relevant period of the income that shall be subject to the minimum tax. In other words, what must be settled is the period in relation to which taxation must be above the ETR, in order not to trigger a Top-up Tax. The GLOBE MODEL RULES adopts the Fiscal Year as the relevant period, but also included mechanisms to deal with temporary differences, by means of adjustments to the Covered Taxes. The PILLAR TWO BLUEPRINT acknowledged that temporary differences could be the sole reason for a low ETR. The temporary differences would "have an effect on the periodic measurement of the ETR but do not affect the average ETR over the life of the entity"[1671]. Such an outcome is deemed

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[1664] See Birtel, 159–63; Schoueri, *Direito Tributário*, 434–35.

[1665] See, *e.g.,* for the German system, Hey, 332–38. For the Brazilian system, see Luís Eduardo Schoueri and Mateus Calicchio Barbosa, "Imposto de renda e capacidade contributiva: a periodicidade anual e mensal no IRPJ," *Revista Direito Tributário Atual*, no. 47 (2021): 569–613.

[1666] Roland Ismer, "Prinzipien der Einkünfteermittlung - Periodizitätsprinzip," in *Einkünfteermittlung*, ed. Johanna Hey, vol. 34, DStJG (Köln: Otto Schmidt, 2011), 99.

[1667] Michael J. Graetz, "Paint-by-Numbers Tax Lawmaking," *Columbia Law Review* 95, no. 3 (1995): 655. The argument, however, is not related to the fairness of the burden, but rather to the political desirability of the adoption of a lifetime perspective.

[1668] BUCHANAN argues that the horizontal equity improvements would not justify the added complexity of VICKREY's proposal for lifetime averaging. See Neil Buchanan, "The Case Against Income Averaging," *Virginia Tax Review* 25 (2006): 1185.

[1669] Lüdicke et al., "Cross-Border Loss Utilization," 377. For a comprehensive historical overview in the German system, see Birtel, *Die Zeit im Einkommensteuerrecht*, 171–88.

[1670] In the US, it has been noted that the lifetime approach has had little influence on the design of the income tax, and only a limited number of exceptions to annual periodization may be found. See Zelenak, "Tax Policy and Personal Identity over Time," 334. Even though, the author makes reference to significant provisions, allowing, for instance, the carry-back of two years and carry-forward of 20 years for net operating losses, and permitting net capital losses of individuals to be carried forward indefinitely.

[1671] PILLAR TWO BLUEPRINT, p. 84, para. 289.

as undesirable, as temporary differences were not expected to lead to a tax liability under the rules[1672]. For this reason, the mechanism to address temporary differences (Art. 4.4) and the GLOBE Loss Election (Art. 4.5) have been designed[1673].

3. THE ADDITIONAL CURRENT TOP-UP TAX

Before addressing the mechanisms that deal with temporary differences, it is important to segregate them from a correction mechanism provided by the GLOBE MODEL RULES. Another intertemporal mechanism of the GLOBE MODEL RULES is the Additional Current Top-up Tax. As already described[1674], upon the calculation of the jurisdictional Top-up Tax, an Additional Current Top-up Tax is added in the formula, as follows:

Jurisdictional Top-up Tax = *(Top-up Tax Percentage x Excess Profit) + Additional Current Top-up Tax – Domestic Top-up Tax*

Different from the Adjustments to Covered Taxes, which are aimed at dealing with temporary differences, the Additional Current Top-up Tax arises in cases where there is a recalculation related to a previous year, as a consequence of correcting information previously provided.

The GLOBE MODEL RULES contain five provisions that require or permit a retroactive calculation of the ETR and Top-up Tax for a previous Fiscal Year or Fiscal Years taking into account an adjustment to the Adjusted Covered Taxes or the Net GloBE Income (or both) for the year[1675]. Such provisions are called ETR Adjustment Articles, which is a defined term[1676]. In general terms, the five ETR Adjustment Articles relate to (i) a recapture of a deferred tax liability[1677], (ii) an adjustment related to an Aggregate Asset Gain (which may be used to adjust GLOBE Income or Losses from previous Fiscal Years)[1678], (iii) an adjustment that leads to a material reduction in Covered Taxes for a previous Fiscal Year[1679], (iv) an adjustment related to an unpaid Covered Tax for a previous Fiscal Year[1680], and (v) an adjustment in the context of an Eligible Distribution Tax System[1681].

The ETR Adjustment Articles do not refer to temporary differences, but to actual corrections related to previous periods. When the ETR Adjustment Articles result in adjustments to the Adjusted Covered Taxes, the change will affect the ETR for one or more of the prior Fiscal Years. The rules for performing the necessary re-calculations for a prior year are found in Articles 5.4.1 and 5.4.2. Besides those rules, Article 5.4.3 sets out a special rule for allocating Top-up Taxes that arise under Article 4.1.5.

1672 PILLAR TWO BLUEPRINT, p. 84, para. 289.
1673 The GLOBE MODEL RULES present other specific provisions aimed at flattening the ETR over time, such as Art. 3.2.6, which allows a Filling CE to make an election to spread gains on the alienation of certain assets over many Fiscal Years. The analysis of such specific provisions is outside of the scope of the thesis.
1674 See ch. II, sec. 5.5, *supra*.
1675 GLOBE COMMENTARY, p. 127, para. 65.
1676 GLOBE MODEL RULES, Art. 10.1.1. "ETR Adjustment Articles" means Article 3.2.6, Article 4.4.4, Article 4.6.1, Article 4.6.4, and Article 7.3.
1677 GLOBE MODEL RULES, Art. 4.4.4.
1678 GLOBE MODEL RULES, Art. 3.2.6..
1679 GLOBE MODEL RULES, Art. 4.6.1.
1680 GLOBE MODEL RULES, Art. 4.6.4.
1681 GLOBE MODEL RULES, Art. 7.3.

The Additional Current Top-up Tax is the amount determined, or treated as Additional Current Top-up Tax, under Art. 4.1.5 or Art. 5.4.1 for the jurisdiction for the Fiscal Year[1682]. This is the amount to be included under the formula.

Art. 5.4.1 provides the mechanism for performing the re-calculations for the prior year if the ETR of a jurisdiction is subject to an ETR Adjustment. Any additional Top-up Tax computed in respect of those prior Fiscal Years is treated as Additional Current Top-up Tax, which is allocated to CEs in the jurisdiction under Article 5.4.2.

Article 4.1.5 contains a special rule that applies when there is no Net GLOBE Income in a jurisdiction for the Fiscal Year and the CE has a deferred tax asset that has arisen due to a permanent difference, such as a loss attributable to an amount that is not deductible for GLOBE purposes, in the same Fiscal Year[1683]. This is expected to happen if, for instance, the local tax rules in the CE's jurisdiction grant a deduction from income that is in excess of the amount that would be allowed for financial accounting purposes and such difference will not reverse over time (*e.g.,* notional interest deductions or a super deduction). Article 4.1.5 sets forth the taxation at the Minimum Rate of the excess benefit resulting from the permanent difference in the year it is created. The reasoning behind this rule is that allowing the CE to use its local tax loss as the starting point for determining its Total Deferred Tax Adjustment Amount would undermine the integrity of the GLOBE MODEL RULES, since it would allow the CE to substitute "the (more generous) local tax rules for those agreed under the GLOBE"[1684].

The mechanism of Additional Current Top-up Tax aims to avoid complexity and the administrative burden of correcting information previously provided[1685]. Neither is there amendment to previous GLOBE Information Return nor additional separate payment of Top-up Tax. The Additional Top-Up Tax is instead charged to the Fiscal Year in which the recalculation was performed. The Additional Top-Up Tax is not intended to be used for the correction of ordinary mistakes, which should follow from the relevant administrative procedures for correction, eventually giving raise to the assessment of interest and penalties[1686]. The Additional Top-up Tax mechanism is used in the cases described in the ETR Adjustment Articles.

4. THE MECHANISM TO ADDRESS TEMPORARY DIFFERENCES (ART. 4.4)

The mechanism to address temporary differences is aimed at dealing with cases where income or loss is recognized in a different year for financial accounting and tax purposes[1687]. The wording of the GLOBE MODEL RULES with regard to the mechanism to address temporary differences is laconic, and the mechanism can only be properly understood after reference to the GLOBE COMMENTARIES and the GLOBE EXAMPLES.

The mechanism builds on deferred tax accounting and include key adjustments which are intended to "protect the integrity" of the GLOBE MODEL RULES[1688]. It uses existing

1682 GLOBE MODEL RULES, Art. 5.2.3(c).
1683 GLOBE COMMENTARY, p. 90, para. 19.
1684 GLOBE COMMENTARY, p. 90, para. 20.
1685 GLOBE COMMENTARY, p. 127, para. 66.
1686 GLOBE COMMENTARY, p. 127, para. 67.
1687 GLOBE COMMENTARY, p. 100, para. 67.
1688 GLOBE COMMENTARY, p. 100, para. 67.

deferred tax accounts maintained by the MNE Groups to simplify compliance, but also requires adjustments which are only explained by the rationality of the GLOBE MODEL RULES[1689]. The rules intended to "protect the integrity" of the GLOBE MODEL RULES include: (i) using the lower of the Minimum Rate or the applicable tax rate to calculate deferred tax assets and liabilities[1690], which prevents deferred tax amounts from sheltering unrelated GLOBE Income; and (ii) recapturing certain amounts claimed as deferred tax liabilities that are not paid within five Fiscal Years.

The section clarifies how the accounting rules are taken as a starting point for determining the Total Deferred Tax Adjustment Amount (sec. 4.1), briefly presents the adjustments to and exclusions from the Total Deferred Tax Adjustment Amount (sec. 4.2), and further enunciates the specific recasting rules for deferred tax assets (sec. 4.3), as well as the recapture rules for deferred tax liabilities (sec. 4.4).

4.1. Accounting rules and the Total Deferred Tax Adjustment Amount

In order to better approach the mechanism to address temporary differences and its relationship with tax accounting rules, two simplified examples are examined, one referring to a deferred tax liability (sec. 4.1.1) and another considering a deferred tax asset (sec. 4.1.2).

4.1.1. The deferred tax liability

The GLOBE COMMENTARY provides an example on the functioning of the mechanism to address temporary differences[1691], which is helpful to approach the mechanism with regard to a deferred tax liability. In the example, Company A is a CE located in Country Z, which imposes a 15% CIT. Company A purchases Asset M for 100. Asset M benefits from immediate expensing under the tax legislation of Country Z. For financial accounting purposes, Asset M is amortized over five years. In the case, income is recognized in a different year for financial accounting and tax purposes.

In Fiscal Year 1, Company A earns 100 of operating income and, for domestic legislation, has no taxable income, due to the immediate expensing of Asset M. For financial accounting purposes and for the GLOBE MODEL RULES, Company A has 80 of income (100 of operating income – 20 of amortization of Asset M).

Without the mechanism to address temporary differences, a Top-up Tax of 12 would be calculated for Fiscal Year 1, because the ETR would be zero (no Covered Tax paid in Fiscal Year 1). The 80 of income (equated to the Excess Profit, for the example) would be subject to a 15% Top-up Tax Percentage, leading to 12 of Top-up Tax.

The mechanism to address temporary differences is intended to adjust for this timing difference, by permitting the deferred tax assets and liabilities of the CE to be taken into account. In the example, there is a temporary difference due to the existence of an amount of income that is GLOBE Income in Fiscal Year 1 and will reverse as the asset is amortized for financial accounting purposes over the following four Fiscal Years. The amount of such temporary difference is 80.

[1689] GLOBE COMMENTARY, p. 100, para. 68.
[1690] GLOBE MODEL RULES, Art. 4.4.1.
[1691] GLOBE COMMENTARY, p. 100, para. 67.

Following standard tax accounting principles, the mechanism shelters the amount of 80 by allowing a deferred tax liability of 12 to be recognized for Fiscal Year 1. In Fiscal Year 1, the amount of 12 is added to the Adjusted Covered Taxes of the CE, as "Total Deferred Tax Adjustment Amount"[1692], thus leading, in the example, to an ETR of 15% (12 of Adjusted Covered Taxes / 80 of GLOBE Income).

Neither the GLOBE MODEL RULES nor the GLOBE COMMENTARY spell out the financial accounting treatment of the reversal of deferred tax assets and deferred tax liabilities. They take the understanding of the financial accounting treatment for granted and the example ends here. For the purpose of the first approach of the mechanism, however, it is important to fully develop the financial accounting and the GLOBE treatment. Consider that Company A kept earning 100 of operating income over the subsequent four Fiscal Years. The relevant financial information could be summarized as follows:

Fiscal Year	Book Expensing of Asset M	Tax Expensing of Asset M	Excess Tax over Book	GLOBE Income	Taxable Income (local tax law)
1	20	100	80	80	0
2	20	0	(20)	80	100
3	20	0	(20)	80	100
4	20	0	(20)	80	100
5	20	0	(20)	80	100

Considering the CIT of 15%, financial accounting would recognize an income tax expense of 12 for each of the five Fiscal Years. The income tax payable would be zero in Fiscal Year 1, and 15 in each of the following four Fiscal Years. The deferred tax liability of 12, would be reversed in the subsequent four Fiscal Years, in which a negative deferred tax expense of 3 would be recognized for each Fiscal Year. In summary:

Fiscal Year	Income Tax Expense	Income Tax Payable	Deferred Tax Liability
1	12	0	12
2	12	15	(3)
3	12	15	(3)
4	12	15	(3)
5	12	15	(3)

The deferred tax liability impacts the Adjusted Covered Taxes in Fiscal Year 1, in which it is added in the form of Total Deferred Tax Adjustment Amount. When established, the deferred tax liabilities are recorded as tax expenses. As seen, the mechanism prevents a Top-up Tax from arising in Fiscal Year 1.

The reversal of the deferred tax liability (negative deferred tax expense) also influences the Adjusted Covered Taxes in their corresponding Fiscal Years. The deferred tax expense for the Fiscal Year is comprised of the net movement in deferred tax assets and liabilities between the beginning and the end of the Fiscal Year[1693]. What matters, therefore, for the purpose of calculating the Total Deferred Tax Adjustment Amount is the "net movement" in deferred tax liabilities, and not the total amount of deferred tax liabilities.

[1692] GLOBE MODEL RULES, Art. 4.4.1.
[1693] GLOBE COMMENTARY, p. 101, para. 70.

The deferred tax liability, for financial accounting purposes, is reduced from 12 (Fiscal Year 1), to 9 (Fiscal Year 2), 6 (Fiscal Year 3), 3 (Fiscal Year 4), and zero (Fiscal Year 5). A net movement of (3) is observed in each subsequent Fiscal Year. For the purpose of calculating the Total Deferred Tax Adjustment Amount, it is not the amount deferred tax liability that is taken into account, but the "net movement" of (3) in each Fiscal Year. As a consequence, for each of the subsequent Fiscal Years, the Total Deferred Tax Adjustment Amount of (3) is computed, which reduces the Adjusted Covered Taxes.

In Fiscal Years 2 to 5, the amount of 3 is subtracted from the Covered Taxes of the CE, as "Total Deferred Tax Adjustment Amount"[1694], thus leading, in the example, to an ETR of 15% (12 of Adjusted Covered Taxes / 80 of GLOBE Income). In summary, the ETR keeps constant in the five Fiscal Years. The Adjusted Covered Tax is 12 (0 of Covered Taxes + 12 of Total Deferred Tax Adjustment Amount) in Fiscal Year 1 and 12 (15 of Covered Taxes – 3 of Total Deferred Tax Adjustment Amount) in Fiscal Years 2 to 5. The mechanism adjusts for a temporary difference and flattens the ETR, thus preventing the charging of a Top-up Tax in Fiscal Year 1, while also reducing the Adjusted Covered Taxes for the subsequent Fiscal Years.

The GLOBE MODEL RULES also provide for rules which are not explained by financial accounting, such as a recapture mechanism in case the deferred tax liability is not reversed within the subsequent five Fiscal Years[1695]. The recapture mechanism does not apply, however, in relation to deferred tax liabilities associated with policy allowed tax expenses[1696].

4.1.2. The deferred tax asset

Tax losses that can be further compensated with income from subsequent periods are recognized as a deferred tax asset for financial accounting purposes. In order to clarify the functioning of the mechanism to address temporary differences with regard to a deferred tax asset, consider the following example. Company A is a CE of an MNE Group, being the only CE located in Country A, where it is subject to a 15% CIT. The carry-forward of tax losses is available under domestic legislation of Country A, which also provides that the loss compensation for each year cannot reduce the taxable profit in more than 25% in each tax year.

In Fiscal Year 1, Company A has a loss which is identical under domestic legislation and the GLOBE MODEL RULES, resulting in a total GLOBE Loss of (100) for the Fiscal Year. The tax loss gives rise to a deferred tax asset for financial accounting purposes equal to the tax loss multiplied by the CIT rate (100 x 15% = 15). The generation of this deferred tax asset is incorporated into Company A's Total Deferred Tax Adjustment Amount[1697] and treated as a reduction to Company A's Adjusted Covered Taxes[1698].

Consider that Company A was able to reverse the loss situation and earned 100 of operating income in each of the subsequent four Fiscal Years. When the loss carry-

[1694] GLOBE MODEL RULES, Art. 4.4.1.
[1695] GLOBE MODEL RULES, Art. 4.4.4. See sec. 4.4.1, *infra*
[1696] GLOBE MODEL RULES, Art. 4.4.5. See sec. 4.4.2, *infra*
[1697] GLOBE MODEL RULES, Art. 4.4.1.
[1698] GLOBE MODEL RULES, Art. 4.1.1.

forward is used in a subsequent year in Country A, the deferred tax asset is treated as an addition to Company A's Adjusted Covered Taxes, thus preventing a Top-up Tax from arising in Fiscal Years 2 to 5. The relevant financial information could be summarized as follows:

Fiscal Year	Difference Tax over Book	GLOBE Income	Taxable Income (local tax law)
1	(100)	(100)	0
2	25	100	75
3	25	100	75
4	25	100	75
5	25	100	75

Considering the CIT of 15%, financial accounting would recognize an income tax expense of (15) for Fiscal Year 1 and an income tax expense of 15 for each of the subsequent four Fiscal Years. The income tax payable would be zero in Fiscal Year 1, and 11.25 in each of the following four Fiscal Years. The deferred tax asset of 15, would be reversed in the subsequent four Fiscal Years, in which a deferred tax expense of 3.75 would be recognized for each Fiscal Year. In summary:

Fiscal Year	Income Tax Expense	Income Tax Payable	Deferred Tax Asset
1	(15)	0	15
2	15	11.25	(3.75)
3	15	11.25	(3.75)
4	15	11.25	(3.75)
5	15	11.25	(3.75)

The deferred tax asset impacts the Adjusted Covered Taxes in Fiscal Year 1, in which it is added in the form of Total Deferred Tax Adjustment Amount. When established, the deferred tax assets are recorded as negative tax expenses (i.e., income tax benefit).

The reversal of the deferred tax asset (deferred tax expense) also influences the Adjusted Covered Taxes in their corresponding Fiscal Years. As seen, the deferred tax expense for the Fiscal Year is comprised of the net movement in deferred tax assets and liabilities between the beginning and the end of the Fiscal Year[1699]. Like in the case of differed tax liabilities, what matters for the purpose of calculating the Total Deferred Tax Adjustment Amount is the "net movement" in deferred tax assets, and not the total amount of deferred tax assets.

The deferred tax asset, for financial accounting purposes, is reduced from 15 (Fiscal Year 1), to 11.25 (Fiscal Year 2), 7.5 (Fiscal Year 3), 3.75. (Fiscal Year 4), and zero (Fiscal Year 5). A net movement of (3.75) is observed in each subsequent Fiscal Year. For the purpose of calculating the Total Deferred Tax Adjustment Amount, it is not the amount of deferred tax asset that is taken into account, but the "net movement" of 3.75 in each Fiscal Year. As a consequence, for each of the subsequent Fiscal Years, the Total Deferred Tax Adjustment Amount of 3.75 is computed, which increases the Adjusted Covered Taxes.

[1699] GLOBE COMMENTARY, p. 101, para. 70.

Without the mechanism to address temporary differences, a Top-up Tax of 3.75 would be calculated for Fiscal Years 2 to 5, because the ETR would be 11.25% for each of these Fiscal Years (11.25 of Adjusted Covered Taxes / 100 of GLOBE Income). The 100 of GLOBE Income (identical to the Excess Profit, for the example) would be subject to a 3.75% Top-up Tax Percentage, leading to 3.75 of Top-up Tax.

As seen, the mechanism to address temporary differences is intended to adjust for this timing difference, by permitting the deferred tax assets and liabilities of the CE to be taken into account. In the example, there is a temporary difference due to the existence of a loss in Fiscal Year 1 that reverses as the loss is compensated for tax purposes over the following four Fiscal Years. The amount of such temporary difference is 100.

Following standard tax accounting principles, the mechanism shelters the amount of 100 by allowing a deferred tax asset of 15 to be recognized over Fiscal Years 2 to 5. In Fiscal Year 1, the amount of 15 is reduced from the Adjusted Covered Taxes of the CE, as "Total Deferred Tax Adjustment Amount"[1700]. In the example, the adjustment to the Covered Taxes is irrelevant, because there is a GLOBE Loss in the Fiscal Year and no Top-up Tax arises. In Fiscal Years 2 to 5, the amount of 3.75 is added to the Covered Taxes of the CE, as "Total Deferred Tax Adjustment Amount"[1701], thus leading to an ETR of 15% (15 of Adjusted Covered Taxes / 100 of GLOBE Income). In these Fiscal Years, the mechanism prevents a Top-up Tax of 3.75 from arising in each Fiscal Year.

In summary, the mechanism adjusts for a temporary difference and flattens the ETR, thus preventing the charging of a Top-up Tax in Fiscal Years 2 to 5, while also reducing the Adjusted Covered Taxes for Fiscal Year 1 – in the example, without impact on the charging of a Top-up Tax.

The GLOBE MODEL RULES also provide for rules regarding the tax rate at which the deferred tax asset shall be recast[1702]. For financial accounting purposes, a deferred tax asset will typically be recast at the domestic tax rate, in order to adjust for timing differences between financial accounting recognition and domestic tax recognition. For GLOBE purposes, however, the deferred tax asset is recast with reference to the Minimum Rate in case they have been recorded at a rate in excess of the Minimum Rate[1703]. In the case of deferred tax assets, it is possible to recast them at the Minimum Rate if the taxpayer can demonstrate that the deferred tax asset is attributable to a GLOBE Loss, even in cases where it was recorded at a rate which is below the Minimum Rate[1704].

4.2. Exclusions from and Adjustments to the Total Deferred Tax Adjustment Amount

The amount that is added to the Adjusted Covered Taxes of a CE for a Fiscal Year under the mechanism to address temporary differences is called Total Deferred Tax Adjustment Amount. The calculation of the Total Deferred Tax Adjustment Amount starts with the amount of deferred tax expense accrued in the financial accounts of a CE if the applicable tax rate is below the Minimum Rate. If the deferred tax expense accrues in the financial accounts at a rate above the Minimum Rate, it is recast at the Minimum Rate for GLOBE

[1700] GLOBE MODEL RULES, Art. 4.4.1.
[1701] GLOBE MODEL RULES, Art. 4.4.1.
[1702] GLOBE MODEL RULES, Art. 4.4.1 and Art. 4.4.3. See sec. 4.3, *infra*
[1703] GLOBE MODEL RULES, Art. 4.4.1.
[1704] GLOBE MODEL RULES, Art. 4.4.3. See sec. 4.3, *infra.*

purposes. The reference of a "deferred tax expense accrued" for the Fiscal Year conveys the idea of "net movement", as clarified in the GLOBE COMMENTARY[1705].

For GLOBE purposes, the financial accounting is only a "starting point"[1706]. The deferred tax expense accrued is subject to exclusions[1707] and adjustments[1708].

4.2.1. Items excluded from the computation of GLOBE Income or Loss

The first element that is excluded from the Total Deferred Tax Adjustment Amount is the amount of deferred tax expense with respect to any items that are excluded from the computation of GLOBE Income or Loss[1709]. The exclusion is intended to prevent taxes associated with items not considered for the calculation of GLOBE Income or Loss from being used to increase the amount of Adjusted Covered Taxes. Their inclusion would result in "an overstatement of the jurisdictional ETR"[1710].

4.2.2. Unpaid Disallowed Accruals and Unclaimed Accruals

The amount of deferred tax expense that relates to Disallowed Accruals and Unclaimed Accruals is also excluded from the Total Deferred Tax Adjustment Amount[1711]. These accruals only increase the Total Deferred Tax Adjustment Amount in the Fiscal Year in which they are actually paid[1712].

The first accrual that is excluded is the Disallowed Accrual, which means[1713]: (a) any movement in deferred tax expense accrued in the financial accounts of a CE which relates to an uncertain tax position; and (b) any movement in deferred tax expense accrued in the financial accounts of a CE which relates to distributions from a CE.

In relation to uncertain tax positions (a), there is a high level of uncertainty as to whether such amounts will be paid in the future, and the amount may not be treated as Covered Taxes unless and until it is actually paid[1714]. The GLOBE MODEL RULES do not define "uncertain tax position". The GLOBE COMMENTARY is not assertive with regard to its definition, and affirms that "the precise criteria may differ under Acceptable Financial Accounting Standards"[1715]. However, it acknowledges two characteristics that are "generally" present: (i) it arises from a filing position that is not more likely than not to be sustained upon examination; and (ii) a reserve is established for the position[1716].

The lack of an autonomous definition of uncertain tax position in the GLOBE MODEL RULES is detrimental to legal certainty and to the uniform application of the rules. The GLOBE MODEL RULES leave the concept contingent on the applicable GAAP.

[1705] GLOBE COMMENTARY, p. 101, para. 70.
[1706] GLOBE COMMENTARY, p. 101, para. 70.
[1707] GLOBE MODEL RULES, Art. 4.4.1
[1708] GLOBE MODEL RULES, Art. 4.4.2.
[1709] GLOBE MODEL RULES, Art. 4.4.1(a).
[1710] GLOBE COMMENTARY, p. 102, para. 72.
[1711] GLOBE MODEL RULES, Art. 4.4.1(b).
[1712] GLOBE MODEL RULES, Art. 4.4.2(a).
[1713] GLOBE MODEL RULES, Art. 4.4.6.
[1714] GLOBE COMMENTARY, p. 109, para. 110.
[1715] GLOBE COMMENTARY, p. 109, para. 110.
[1716] GLOBE COMMENTARY, p. 109, para. 110.

Considering the scope of the GLOBE MODEL RULES, it would be advisable to use the two criteria and set uncertain tax position as a defined term in the GLOBE MODEL RULES.

In relation to taxes levied upon distributions (b), the GLOBE COMMENTARY affirms that they are excluded until actual payment, because the MNE Group generally has control over the timing of the distributions between CEs and it would be "inappropriate" to an increase to Adjusted Covered Taxes for deferred tax amounts related to distribution taxes[1717].

The second accrual that is excluded is the Unclaimed Accrual, which means any increase in a deferred tax liability recorded in the financial accounts of a CE for a Fiscal Year that: (a) is not expected to be paid within the five subsequent Fiscal Years after the recording of the deferred tax liability; and (b) is not included in Total Deferred Tax Adjustment Amount for such Fiscal Year by the Filing CE in the Annual Election[1718]. Therefore, the Unclaimed Accrual is also excluded due to its uncertain nature.

In summary, Disallowed Accruals and Unclaimed Accruals are excluded until paid, due to the "speculative nature" as to *whether* they will be paid (Disallowed Accrual) or as to *when* they will be paid (Unclaimed Accrual)[1719]. Once such amounts are actually paid, they are taken into account for GLOBE purposes, by means of an inclusion to the Total Deferred Tax Adjustment Amount.[1720]

4.2.3. Impact of a valuation adjustment or accounting recognition adjustment

In order to prevent distortions[1721], valuation adjustments or accounting recognition adjustments are also excluded[1722]. The exclusion is intended to ensure that the deferred tax asset is recorded in the same year as the economic loss that gave rise to the asset. The need for this exclusion arises because, under financial accounting rules, the deferred tax asset is adjusted if it is not forecast to be used in the future[1723]. Also, in case a loss deferred tax asset is not recognised, because it did not meet the recognition criteria, the amount will still be accounted for in the GLOBE MODEL RULES. For GLOBE purposes, the impact of the recognition criteria is ignored, and the deferred tax asset is computed even if the future use of the attribute is not probable[1724]. The exclusion is therefore also intended to flatten the ETR and prevent a Top-up Tax from arising when it should not[1725].

4.2.4. Re-measurement with respect to a change in the applicable domestic rate

The amount of deferred tax expense that results from a change in the applicable domestic rate is also excluded[1726]. The exclusion is justified by the fact that such amounts are considered as changes to amounts already accrued and should not be accounted as

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[1717] GLOBE COMMENTARY, p. 109, para. 111.
[1718] GLOBE MODEL RULES, Art. 4.4.7.
[1719] GLOBE COMMENTARY, p. 102, para. 75.
[1720] GLOBE MODEL RULES, Art. 4.4.2(a). See GLOBE COMMENTARY, p. 103, para. 83.
[1721] GLOBE COMMENTARY, p. 102, para. 76.
[1722] GLOBE MODEL RULES, Art. 4.4.1(c).
[1723] GLOBE COMMENTARY, p. 102, para. 76.
[1724] GLOBE COMMENTARY, p. 102, para. 77.
[1725] For a practical example of the functioning of the provision, see GLOBE COMMENTARY, p. 102, para. 78.
[1726] GLOBE MODEL RULES, Art. 4.4.1(d).

additional Covered Taxes for the Fiscal Year[1727]. The impact of the change in the applicable domestic rate is dealt with by means of the Additional Top-up Tax[1728], being therefore treated as a correction, and not as a temporary difference.

4.2.5. Generation and use of tax credits

The last exclusion relates to the amount of deferred tax expense with respect to the generation and use of tax credits[1729], which are defined as "an amount that taxpayers can subtract directly from taxes owed to a government"[1730] (unlike deductions, which reduce the amount of taxable income). Such tax credits are also excluded as means to prevent distortions[1731]: the generation of tax credits should not give rise to a Top-up Tax[1732]. There is one example on the application of the mechanism to address temporary differences in the GLOBE EXAMPLES, aimed at demonstrating why the amount of deferred tax expense with respect to the generation and use of tax credits is excluded from the Total Deferred Tax Adjustment Amount for a CE for the Fiscal Year[1733].

In the example, A Co is a CE of an MNE Group, being the only CE located in Country A. It is subject to a CIT of 25%, and the tax base of such CIT is the same as the GLOBE tax base. Country A also has a minimum tax regime in place, which provides that at least 17% of CIT must be paid in a taxable year.

In Fiscal Year 1, the CE earns 100 of GLOBE Income in Country A. The tax liability would in principle be 25, but Country A also provides an incentive tax credit of 15 to the CE, which, because of the 17% minimum tax, is reduced to 8 for Fiscal Year 1. The remaining 7 are available for a carry-forward to a future tax year, pursuant to domestic legislation. In conclusion, the CE pays 18 of CIT in Country A and carries forward an excess credit of 7.

In Fiscal Year 2, the CE once again earns 100 of GLOBE Income in Country A and has an initial tax liability of 25. For Fiscal Year 2, there is, however, no incentive tax credit. The CE resorts to its carry-forward of 7, and pays 18 of CIT.

Article 4.4.1(e) excludes the amount of deferred tax expense with respect to the generation and use of tax credits from the Total Deferred Tax Adjustment Amount for a CE for the Fiscal Year. Therefore, the carry-forward of 7 generated in Year 1 does not give rise to a deferred tax asset for GLOBE purposes, thus not reducing the Adjusted Covered Taxes for Country A in Fiscal Year 1. Correspondingly, the use of the carry-forward in Fiscal Year 2 does not increase the Adjusted Covered Taxes for Country A in Fiscal Year 2 either. As a consequence, the ETR is 17% in Fiscal Year 1 and 18% in Year 2 for Country A. Illustratively:

[1727] GLOBE COMMENTARY, p. 103, para. 79.
[1728] The rules that govern how domestic tax rate changes are taken into account for GloBE purposes are Art. 4.6.2 and 4.6.3. See GLOBE COMMENTARY, p. 103, para. 79.
[1729] GLOBE MODEL RULES, Art. 4.4.1(e).
[1730] GLOBE COMMENTARY, p. 103, para. 80. "Tax credits" are not a defined term, being another example of an expression that is defined in the GLOBE COMMENTARY. On the topic, see ch. II, sec. 1, *supra.*
[1731] GLOBE COMMENTARY, p. 103, para. 80.
[1732] GLOBE COMMENTARY, p. 103, para. 82.
[1733] GLOBE EXAMPLES, Example 4.4.1 – 1.

	Fiscal Year 1	Fiscal Year 2
GLOBE Income/Loss	100	100
Country A CIT (25%)	(25)	(25)
Incentive tax credit	15	0
Application of the carry-forward	0	7
Minimum tax adjustment	(7)	0
Final Country A tax	(17)	(18)
Country A ETR	17%	18%
Country A Top-up Tax	0	0
Excess tax credit carry-forward	7	0

The GLOBE EXAMPLES conclude that if the tax credit were not excluded, "the Country A results would have been distorted by the generation of excess tax credits in Year 1, as the credit carry-forward would give rise to a deferred tax asset that would otherwise reduce Adjusted Covered Taxes below the Minimum Rate"[1734].

4.3. The recasting at the Minimum Rate for deferred tax assets

In the case of deferred tax assets, the GLOBE MODEL RULES allow a recast at the Minimum Rate, even if the deferred tax asset has been recorded at a rate lower than the Minimum Rate, when the asset is attributable to a GLOBE Loss[1735]. The rule is intended to preserve "the basic tenet that a GloBE Loss of EUR 1 should offset GloBE Income of EUR 1"[1736]. If a loss deferred tax asset is recorded at a 5% rate, a GLOBE Loss of 100 results in a deferred tax asset of 5. If 100 of GLOBE Income is later earned, the reversion of the deferred tax asset could still lead to the calculation of a Top-up Tax of 10. The recast at the Minimum Rate ensures that a GLOBE Loss of 100 shelters GLOBE Income of 100[1737]. This recast must be performed in the Fiscal Year in which the loss becomes a GLOBE Loss. The Total Deferred Tax Adjustment Amount is thereby decreased by the amount of incremental deferred tax asset generated[1738].

4.4. The recapture rules for deferred tax liabilities

In the case of deferred tax liabilities, the GLOBE MODEL RULES provide for a recapture scheme (sec. 4.4.1), which does not apply, however, in case of specific policy allowed categories (sec. 4.4.2).

4.4.1. The Recaptured Deferred Tax

The mechanism to address temporary differences includes recapture rules for deferred tax liabilities that do not reverse within five Fiscal Years[1739]. As a rule, if they do not reverse within five Fiscal Years, deferred tax liabilities must be recaptured in the Fiscal Year in which the increase in the Recaptured Deferred Tax Liability was originally included in the Total Deferred Tax Adjustment Amount[1740]. For this purpose, each item of deferred tax expense for a CE must be tested in each Fiscal Year for recapture. An anti-abuse justification may be inferred for such treatment from the GLOBE COMMENTARY, even if

[1734] GLOBE EXAMPLES, Example 4.4.1 – 1, para. 5.
[1735] GLOBE MODEL RULES, Art. 4.4.3.
[1736] GLOBE COMMENTARY, p. 104, para. 87.
[1737] GLOBE COMMENTARY, p. 104, para. 87.
[1738] GLOBE COMMENTARY, p. 105, para. 88.
[1739] GLOBE MODEL RULES, Art. 4.4.4.
[1740] GLOBE COMMENTARY, p. 105, para. 89.

no explicit mention may be found. The GLOBE COMMENTARY merely states that goal of the rule is to ensure that such deferred tax liabilities "are actually settled within the required period of time"[1741], but one may consider as a justification that deferred tax liabilities typically unrelated to substantive activities are prone to manipulation by the taxpayer[1742].

4.4.2. The Recapture Exception Accrual

Not every deferred tax liability, however, is subject to recapture. An exceptional treatment is provided by the Recapture Exception Accrual rule[1743]. The rule provides for categories of deferred tax liabilities in relation to which the monitoring for recapture is not necessary. The exceptional treatment finds a threefold justification in the GLOBE COMMENTARY. The provision lists tax expenses accrued attributable to changes in associated deferred tax liabilities, which leads to temporary differences that: (i) are common in IF jurisdictions; (ii) are material to MNE Groups; and (iii) are typically related to substantive activities in a jurisdiction, or not prone to manipulation by the taxpayer[1744].

The Recapture Exception Accrual comprises[1745]: (a) cost recovery allowances on tangible assets (b) the cost of a licence or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets; (c) research and development expenses; (d) de-commissioning and remediation expenses; (e) fair value accounting on unrealised net gains; (f) Foreign currency exchange net gains; (g) Insurance reserves and insurance policy deferred acquisition costs; (h) Gains from the sale of tangible property located in the same jurisdiction as the Constituent Entity that are reinvested in tangible property in the same jurisdiction; and (i) the respective additional amounts accrued as a result of accounting principle changes regarding the listed categories[1746].

In summary, in case of such policy allowed exceptions, no control for recapture is necessary, and the five Fiscal Years limit does not apply.

4.5. Summary

The mechanism to address temporary differences take accounting rules as a starting point for determining the Total Deferred Tax Adjustment Amount, further submitting them to adjustments and exclusions. The mechanism also includes specific recasting rules for deferred tax assets and recapture rules for deferred tax liabilities. The complex mechanism aims at preventing a Top-up Tax from being triggered in cases where the average ETR over the life of the entity is above the Minimum Rate[1747], preventing the ETR from falling below the Minimum Rate due to temporary differences that are expected to reverse in the future.

[1741] GLOBE COMMENTARY, p. 105, para. 89.
[1742] This justification may be derived *a contrario sensu* from the justification of the exception, as commented below. See GLOBE COMMENTARY, p. 105, para. 91.
[1743] GLOBE MODEL RULES, Art. 4.4.5.
[1744] GLOBE COMMENTARY, p. 105, para. 91.
[1745] GLOBE MODEL RULES, Art. 4.4.5.
[1746] The categories are individually discussed in the GLOBE COMMENTARY, pp. 105-109.
[1747] PILLAR TWO BLUEPRINT, p. 84, para. 289.

5. THE GLOBE LOSS ELECTION AS A SIMPLIFIED REGIME (ART. 4.5)

The GLOBE Loss Election (Art. 4.5) is an elective mechanism that applies in lieu of the mechanism to address temporary differences (Art. 4.4). It allows for the effective carry-forward of GLOBE Losses with a deemed deferred tax asset, the GLOBE Loss Deferred Tax Asset. Instead of applying the complex mechanism of Art. 4.4, a simplified loss carry-forward equivalent may be elected in relation to a jurisdiction[1748]. Following the simplified mechanism, which is designed to provide an appropriate recognition of losses arising in no or low-tax jurisdictions, prior year losses are considered at the level of the calculation of the Adjusted Covered Taxes in subsequent Fiscal Years.

Despite the possibility of being elected in relation to any jurisdiction, the GLOBE Loss Election is expected to be particularly useful in relation to jurisdictions that do not impose a CIT or impose it at a very low rate. When the GLOBE Loss Election is applied, the mechanism to address temporary differences no longer applies, and temporary differences are more likely to result in a Top-up Tax[1749].

5.1. The GLOBE Loss Deferred Tax Asset

The GLOBE Loss Deferred Tax Asset is equal to the Net GLOBE Loss in a Fiscal Year for the jurisdiction multiplied by the Minimum Rate[1750].

GLOBE Loss Deferred Tax Asset = Net GLOBE Loss x Minimum Rate

The GloBE Loss Deferred Tax Asset is "a jurisdictional attribute of the MNE Group"[1751]. The GLOBE Loss Deferred Tax Asset does not transfer with a CE in the event it leaves the MNE Group[1752]. In the event of transfer of a CE, the GloBE Loss Deferred Tax Asset remains with the transferor MNE Group even if it no longer has any CE in the jurisdiction.

Consider, for example[1753], that MNE Group 1 has made a GLOBE Loss Election in relation to Country A, where it controls CE Z, which is sold to MNE Group 2. The acquirer (MNE Group 2) does not receive any GloBE Loss Deferred Tax Asset of CE Z. MNE Group 2 is not impacted by the GLOBE Loss Election made by MNE Group 1. MNE Group 2 may still elect the GLOBE Loss Election for Country A, provided that the GLOBE Information Return is the first GLOBE Information Return that includes Country A[1754].

This leads to a curious outcome, in which an MNE Group may sell all participation in CEs in a certain jurisdiction, and remain with a balance of GLOBE Loss Deferred Tax Asset for the jurisdiction. In such case, however, it will not be possible to use the balance to compensate GLOBE Income in the jurisdiction, as the MNE Group has no CEs therein. The amount will only be compensated if the MNE Group acquires other entities in the jurisdiction, and to the extent that there is GLOBE Income allocated to CEs in the

[1748] GLOBE MODEL RULES, Art. 4.5.
[1749] GLOBE COMMENTARY, p. 109, para. 113.
[1750] GLOBE MODEL RULES, Art. 4.5.1.
[1751] GLOBE COMMENTARY, p. 110, para. 117.
[1752] GLOBE MODEL RULES, Article 6.2.1(f).
[1753] For the example, see GLOBE COMMENTARY, p. 110, para. 117.
[1754] See sec. 5.3, *infra.*

jurisdiction. Such aspect stresses the nature of the GLOBE MODEL RULES as setting a floor to the tax competition, even if to the detriment of ability-to-pay of the MNE Group.

5.2. The carry-forward of the GLOBE Loss Deferred Tax Asset

In the elective regime, the MNE Group will basically maintain a balance of GLOBE Loss Deferred Tax Asset for the elected jurisdiction. The balance of the GLOBE Loss Deferred Tax Asset is carried forward to subsequent Fiscal Years, being reduced, in each Fiscal Year, by the amount used[1755]. Like the mechanism to address temporary differences, the elective regime also works by means of an Adjustment to Covered Taxes. In a Fiscal Year in which it is used, the amount of GLOBE Loss Deferred Tax Asset is added to Covered Taxes under Article 4.1.2[1756].

The balance must be used in any subsequent Fiscal Year in which there is Net GLOBE Income in an amount equal to the lower of the Net GLOBE Income multiplied by the Minimum Rate or the amount of available GLOBE Deferred Tax Asset[1757]. The complexities of the mechanism to address temporary differences, which are intended to flatten the ETR throughout the years, are not present in case of the elective mechanism.

For this reason, the elective regime is only expected to be useful (from the perspective of the taxpayer) in jurisdictions with no CIT or with very low CIT rates. While the mechanism to address temporary differences is designed to shelter a certain amount of income against a Top-up Tax, the elective regime is less refined, and will only be advantageous to the taxpayer in case the jurisdiction consistently provides for a CIT with very low rates. The elective mechanism allows for a much simpler form of carry-forward of the GLOBE Loss, without sheltering an amount of income against a Top-up Tax to the same extent as the mechanism to address temporary differences.

5.3. The moment of the election for the regime

The GLOBE Loss Election is made by the MNE Group in relation to each jurisdiction where it has a CE. The election cannot be made with regard to a jurisdiction with an Eligible Distribution Tax System[1758], and special rules apply for a Flow-through Entity that is an UPE[1759]. The election must be filed with the GLOBE Information Return of the MNE Group filed for the first Fiscal Year in which the MNE Group has a CE located in the jurisdiction for which the election is made[1760]. As clarified by the GLOBE COMMENTARY, “the GloBE Loss Election is an election that may only be made once”[1761].

The “once-in-life-time” nature of the GLOBE Loss Election is justified by the GLOBE COMMENTARY on anti-abuse grounds. Accordingly, while the GLOBE Loss Election is intended to provide “a relief mechanism or simplification for jurisdictions”, it should not “allow for manipulation or distortions by shifting into and out of the election over time”[1762]. There are several reasons to consider the approach as disproportionate. The rule

[1755] GLOBE MODEL RULES, Art. 4.5.2.
[1756] See also GLOBE COMMENTARY, p. 110, para. 114.
[1757] GLOBE MODEL RULES, Art. 4.5.3.
[1758] GLOBE MODEL RULES, Art. 4.5.4.
[1759] GLOBE MODEL RULES, Art. 4.5.6.
[1760] GLOBE MODEL RULES, Art. 4.5.5.
[1761] GLOBE COMMENTARY, p. 110, para. 116.
[1762] GLOBE COMMENTARY, p. 110, para. 116.

fails to consider the multitude of legitimate reasons why the MNE Group could change its choice in relation to GLOBE Loss Election for a jurisdiction.

If an Entity enters the MNE Group, and the MNE Group already holds a CE in the jurisdiction and has not made the GLOBE Loss Election in relation to that jurisdiction, it will not be possible to reconsider the choice. Even though the characteristics of the new CE may be significantly different from that of the CE initially held, the MNE Group will not be able to make the GLOBE Loss Election. Also, if one or multiple CEs in a jurisdiction leave the MNE Group, modifying the extent and nature of the activities of the Group in the jurisdiction, it will not be possible to adhere to the GLOBE Loss Election mechanism if such decision has not been already made before.

The MNE Group can also acquire control over an Entity of another MNE Group, which had made the GLOBE Loss Election for the relevant jurisdiction. In this case, the CE will not carry its GLOBE Loss Election attributes. If the acquiring MNE Group has not opted for the GLOBE Loss Election in relation to that jurisdiction, the mechanism will not be applicable to the acquired CE, even if the former MNE Group applied the mechanism in relation to the Entity. According to the GLOBE COMMENTARY, when a CE "has been acquired from another MNE Group, whether such MNE Group has or has not made a GloBE Loss Election will not be relevant or taken into account for purposes of the acquiring MNE Group"[1763].

Even if there is no modification in the number of CEs in the jurisdiction, the activities of the MNE Group in the jurisdiction may go through significant changes – and several legitimate business reasons can be conceived for that. For a variety of reasons, the Group may decide to either increase of decrease the investment in a jurisdiction, which could change the decision to choose for the GLOBE Loss Election mechanism. The business environment can also change and significantly impact the profitability of the relevant CEs, which would affect the elements to be considered upon the GLOBE Loss Election.

The rule also prevents the MNE Group from reacting to modifications of the legislation in the jurisdiction. The jurisdiction may change its legislation, either increasing or reducing the ETR, which could affect the decision of the MNE Group to make the GLOBE Loss Election for that jurisdiction or not.

Another element to be considered is that the GLOBE MODEL RULES is an unprecedented experience, to which MNE Groups are expected to quickly adapt. Also from this perspective the "once-in-life-time" nature of the GLOBE Loss Election seems disproportionate. While the concern with manipulation or distortions by shifting into and out of the election over time is understandable, other approaches could be considered that would equally prevent manipulation and distortions, while granting some healthy flexibility in the envisage transition to a world of a global minimum tax.

MNE Groups should be allowed to choose for the GLOBE Loss Election mechanism in cases where relevant changes in the number of CEs in the jurisdiction, in the activities they perform, or in the tax legislation of the jurisdictions, have been observed. As it is phrased, the "once-in-life-time" nature of the GLOBE Loss Election does not take into

[1763] GLOBE COMMENTARY, p. 110, para. 117.

account the dynamic nature of business activities and of the tax systems of the jurisdictions.

5.4. Revocation of the election of the regime

The Filling CE can subsequently revoke the GLOBE Loss Election for a jurisdiction, case in which the GLOBE Loss Deferred Asset for the jurisdiction will be reduced to zero[1764]. The GLOBE COMMENTARY clarify that the reduction to zero is necessary because the transition to the mechanism to address temporary differences (Art. 4.4) allows the CEs to compute the historic deferred tax assets and liability as if they had been calculated under Art. 4.4 for the prior Fiscal Years, also considering the rules applicable to a Transition Year[1765]. For this reason, allowing the carry-forward of the GLOBE Loss Deferred Asset could potentially lead to a "double benefit for losses and other distorted outcomes"[1766].

5.5. Summary

The GLOBE Loss Election is a simplification alternative in relation to the mechanism to address temporary differences. It provides for a simpler way to carry forward losses, in relation to jurisdictions where a Top-up Tax is always expected to arise if the CEs present GLOBE Income. The mechanism does not work properly in relation to jurisdictions where the tax rates are higher, and a Top-up Tax may or may not arise, depending on the attributes of the CE located therein. Unlike the mechanism to address temporary differences, the GLOBE Loss Election is not able to prevent a Top-up Tax from arising in a jurisdiction with a higher CIT, being instead a rough approximation of the issue.

The decision regarding whether to make a GLOBE Loss Election is therefore generally contingent on the features of the jurisdiction. MNE Groups are expected to make the election in relation to jurisdictions with no or a very low CIT. This perception seems to lead to the conclusion that MNE Groups will be able to make an upfront choice in relation to each jurisdiction. As only the tax attributes of the jurisdiction are important for the decision to make a GLOBE Loss Election, the "once-in-a-lifetime" nature of the GLOBE Loss Election would be justified. However, a change in the nature and extent of the activities performed in the jurisdiction, as well as changes in the tax legislation of the jurisdiction, might present justified reasons for the MNE Group to make a GLOBE Loss Election, and there is no antiabuse reason to forbid the election in such cases. Under the current wording of the GLOBE MODEL RULES, however, an election in such cases will not be possible.

6. SYSTEMATIC FEATURES OF THE INTERTEMPORAL MECHANISMS

Having presented the main features of the mechanism to address temporary differences and of the GLOBE Loss Election, it is possible to critically evaluate the impacts of limiting the loss compensation to the Minimum Rate (sec. 6.1) and not allowing for a carry-forward of the Substance-Based Income Exclusion (sec. 6.2).

6.1. Limiting the loss compensation to the Minimum Rate

1764 GLOBE MODEL RULES, Art. 4.5.4.
1765 GLOBE MODEL RULES, Art. 9.1.
1766 GLOBE COMMENTARY, p. 110, para. 115.

Both the mechanism to address temporary differences and the GLOBE Loss Election limit the loss compensation with reference to the Minimum Rate.

One important feature of the mechanism to address temporary differences is that there is no reference to jurisdictional blending. The provisions make reference to the Total Deferred Tax Adjustment Amount for a CE, and to the GLOBE Income or Loss of the CE. As a consequence, "the basic tenet that a GloBE Loss of EUR 1 should offset GloBE Income of EUR 1"[1767] is somehow disconnected from the elements that trigger a jurisdictional Top-up Tax, which depend on the existence of Net GLOBE Income (which is the concept that ultimately implements jurisdictional blending). While there is some level of intraperiodical loss compensation between the CEs in order to calculate the ETR, the relevant entity for the purpose of the mechanism to address temporary differences is the separate entity, the CE. As a consequence of the deferred tax asset mechanism, together with the 15% limitation, the carry-forward only protects GLOBE Income of the CE, and ensures that the income of the CE (and not of the blended CEs) is taxed at least at 15% also if a longer period is taken into consideration. For the purposes of the mechanism to address temporary differences, there is no consideration to the GLOBE Income or Loss of the other CEs in the jurisdiction.

For GLOBE purposes, the deferred tax asset is recast with reference to the Minimum Rate in case they have been recorded at a rate in excess of the Minimum Rate[1768]. This ultimately means that a GLOBE Loss of a CE may be carried forward to compensate a GLOBE Income of the CE, but may not be carried forward to compensate GLOBE Income of another CE in the same jurisdiction. In other words, what matters for triggering the Top-up Tax in a single Fiscal Year is the income of blended CEs, but this logic does not extend to a longer period. The mechanism is limited to the reality of a single CE, and the reference to blended CEs is not kept consistent across periods.

The GLOBE Loss Election, on the other hand, takes a jurisdictional approach on the carry-forward of losses. However, it only allows for a carry-forward in case there is a Net GLOBE Loss. Only if the blended CEs present a loss, will it be possible to carry forward such net amount. In case only one of the CEs presents a GLOBE Loss, no carry-forward will be possible. The approach is a simplification mechanism, which ensures that the blended CEs are always subject to the Minimum Rate, while granting some leeway for interperiodical compensation. In case of a jurisdiction where a Top-up Tax may or may not arise, the approach will not be satisfactory for MNE Groups, which are likely not to make a GLOBE Loss Election for the jurisdiction. Besides the treatment of losses, there are other temporary differences which are not dealt with by the simplified mechanism. Therefore, the application of the GLOBE Loss Election is likely to trigger a Top-up Tax in situations which would otherwise be prevented by the mechanism to address temporary differences.

6.2. The interaction with the substance carve-out

As a consequence of the functioning of the mechanism based on deferred tax assets, as well as the mechanics of the GLOBE Loss Election, the carve-out cannot be carried

[1767] GLOBE COMMENTARY, p. 104, para. 87.
[1768] GLOBE MODEL RULES, Art. 4.4.1.

forward[1769]. If the deduction of the Substance-based Income Exclusion from the Net GLOBE Income leads to a "loss" instead of an Excess Profit, such loss is not carried forward. The absence of a mechanism able to ensure the carry-forward of such loss drives the GLOBE MODEL RULES further away from the goal of taxing economic rents[1770].

One important feature of the taxation of economic rents is that it is hard to distinguish them from delayed return from past investments[1771]. If a firm invests in a new technology, which is expected to earn a normal return, but with delay, such returns may look like economic rents when they arise, since they may be higher than the opportunity cost of resources in the relevant period. A way of preventing that the system ends up taxing routine returns due to timing issues is to allow for the carry-forward of the amount treated as the opportunity cost of capital, in case it is not deducted against taxable profits in a certain period.

Such feature is not available under the GLOBE MODEL RULES, which do not allow for the carry-forward of the amount calculated under the Substance-Based Income Exclusion rule, if its deduction leads to a "loss" in a certain period. The mechanism to address temporary differences only deals with amounts registered as a deferred tax asset, which do not embrace the amount calculated under the Substance-Based Income Exclusion rule. As a consequence, no mechanism to carry forward this deduction is provided.

This outcome is not accidental, nor unintended. The PILLAR TWO BLUEPRINT states clearly that "[i]f the carve-out amount exceeds the GloBE income in the relevant period, the excess amount cannot be carried-forward to reduce future GloBE income"[1772]. The assertion is not further discussed in the PILLAR TWO BLUEPRINT or in the GLOBE COMMENTARY. It makes clear, however, that, from the beginning, the mechanism to address temporary differences was designed not to allow for this carry-forward. In any case, it is clear that this feature drives the GLOBE MODEL RULES further away from the intent of providing for a tax on economic rent. With their current design, it is possible that the rules end up taxing routine returns, due to mere timing issues, which should be irrelevant for the purposes of the taxation of economic rents.

Another feature that is inherent to a model of taxation on economic rents is to allow losses to be carried forward with an interest mark-up, in order to ensure a mitigation[1773] of the neutrality problem arising from the absence of symmetry for the treatment of profits and losses[1774]. The GLOBE MODEL RULES present no mechanism that approximates such allowance.

[1769] See also Kasper Dziurdź and Christoph Marchgraber, "GloBE: Why a Nominal Tax Rate of More Than 15% Might Not Be Enough," *Bulletin for International Taxation* 76, no. 11 (2022): sec. 4.2.

[1770] See, discussing the relation between the Substance-Based Income Exclusion and the taxation of economic rents, ch. IV, sec. 3, *supra*.

[1771] Griffith and Miller, "Taxable Corporate Profits," 541.

[1772] PILLAR TWO BLUEPRINT, p. 93.

[1773] The solution alleviates the problem of not giving immediate refund, but does not perfectly replicate it, because the business can go insolvent, and the net cash injection of a refund will not be present, which may be significant for a financially distressed business. Discussing such problems, see Devereux et al., *Taxing Profit in a Global Economy*, 323.

[1774] Devereux and Freeman, "A General Neutral Profits Tax," 7. Defending such an approach for the EU, see de Wilde, "On the Future of Business Income Taxation in Europe," 116.

7. INTERIM CONCLUSIONS: *WHEN DO THE GLOBE MODEL RULES BURDEN?*

The GLOBE MODEL RULES work under the assumption that Excess Profits shall be taxed at least at the Minimum Rate in all Fiscal Years. Some leeway against temporary differences is provided, among other provisions, by the mechanism to address temporary differences (Art. 4.4) and, alternatively, by the GLOBE Loss Election (Art. 4.5).

The mechanism to address temporary differences works with reference to deferred tax assets and liabilities of the CE. No reference to the blended CEs is found. A GLOBE Loss of a CE may be carried forward to compensate a GLOBE Income of the CE, but may not be carried forward to compensate GLOBE Income of another CE in the same jurisdiction. While, within a Fiscal Year, the income of blended CEs is the decisive element for triggering the Top-up Tax, this logic does not extend to a longer period. The mechanism is limited to the reality of a single CE, and the reference to blended CEs is not kept consistent across periods.

The GLOBE Loss Election, on the other hand, takes a jurisdictional approach on the carry-forward of losses, and only allows for a carry-forward in case there is a Net GLOBE Loss. As a simplification mechanism, it ensures some leeway for interperiodical loss compensation, but ignores other temporal differences, which might be acceptable for MNE Groups in case of CEs located in jurisdictions with no or very low CITs.

The temporal mechanisms completely ignore the Substance-Based Income Exclusion, which cannot be carried forward. As a consequence, the provisions drive the GLOBE MODEL RULES further away from the justification grounded on the taxation of economic rents. Besides the shortcomings of the Substance-Based Income Exclusion[1775], normal returns may also be captured by the GLOBE MODEL RULES as a consequence of mere temporal mismatches between income and expenses.

[1775] See ch. IV, sec. 3.2.

CONCLUSIONS

The main goal of the dissertation is to answer what are the justifications of the GLOBE MODEL RULES and how are they expressed in the structure of the rules. In light of the preceding chapters, the research question can be answered by the following thesis:

1. *The GLOBE MODEL RULES are primarily aimed at setting a floor to tax competition. This goal supersedes any other possible justification for their adoption, and ultimately guides the design of the model provisions. The floor to tax competition is established by means of a set of complex rules, which resort to opposing theoretical assumptions, thus limiting the possibility of a systematic and principled approach towards their content. Despite being generally in line with the goal of establishing a floor to tax competition, the rules are hard to reconcile with traditional nexus rules and tax policy principles. Their structure evidence an eclectic and pragmatic approach, which is extremely dependent on uniform adoption to be successful. The crystallization of a "strong form" requires that the rules are approached doctrinally as a closed system. Their adoption by IF states will add another layer of complexity to international taxation, but the most troublesome distortions will arise if divergent approaches are undertaken by states. Even minor deviations from their content upon domestic adoption are likely to either render the minimum tax less effective or give rise to double or over (minimum) taxation.*

This main thesis has been reached with the assistance of six sub-questions. Answering each of these sub-questions also allowed for the formulation of the following specific theses, which grounded the main thesis and are also a fundamental part of the dissertation.

WHY DO THE GLOBE MODEL RULES BURDEN?

2. *The GLOBE MODEL RULES are intended to set a floor to tax competition, being therefore primarily a tool against tax competition* (ch. I). Setting a floor to tax competition is the ultimate justification for the enactment of the rules, which supersedes any other possible reason for adopting them. Many of the design features of the GLOBE MODEL RULES – including the fundamental choice for jurisdictional blending – can only be explained by the intention of setting a floor to tax competition.

3. *The GLOBE MODEL RULES have not been designed to enthrone the ability-to-pay principle (broadly understood as the tax concretization of the equal treatment among subjects), despite containing several elements that can be explained as a deference to it* (ch. I, ch. III, and ch. IV). The choice for jurisdictional blending contradicts any possible reference to the ability-to-pay of the MNE Group, of the CEs, or any other possible subject to which the rules apply (ch. III). Besides, practical aspects related to the definition of the tax object have oriented the determination of the GLOBE Income and of Covered Taxes, to an extent that a uniform tax base is not obtained. The definition of the tax base ultimately varies according to the location of the UPE, and may vary also according to choices made by the taxpayer, considering the need to reduce complexity (ch. IV). At a more fundamental level, however, ability-to-pay is not restrained by geographical or political borders. Nor is it contingent on the will of the taxpayer. The goal of taxing subjects according to the ability-to-pay is therefore superseded in the GLOBE MODEL RULES by the goal of establishing a floor to tax competition, and many of the

policy choices lack a theoretical justification, being merely grounded on practicability – while the outcome is still a very complex set of rules.

4. *The GLOBE MODEL RULES do not provide for a tax on economic rents* (ch. I, ch. III, ch. IV, ch. VI). The RELEVANT MATERIAL present ambiguous and contradictory wording on the goal of setting a tax on economic rent. The wording of the GLOBE COMMENTARY is overly optimistic regarding the effects of the carve-out, and it lacks theoretical support. There is no reason to believe that the carve-out, as designed, "avoids any tax induced distortions of investment decisions". The ECONOMIC IMPACT ASSESSMENT keeps its scientific tone and offers no support to such statement. A closer exam of the Substance-Based Income Exclusion evidences that it is not able to turn the Top-up Tax into a tax on economic rents (ch. IV). Even if some relief to normal returns is provided, there is no reason to believe that the GLOBE MODEL RULES exclusively burden economic rents.

5. *The GLOBE MODEL RULES have not been designed as anti-abuse rules* (ch. I, ch. IV, and ch. V). The calculation of the Top-up Tax does not take any subjective or objective element of artificiality into account, being strictly based on the ETR to which the jurisdictionally-blended CEs are subject. Therefore, it is possible that a Top-up Tax is charged on to the performance of legitimate business by a CE, simply due to the fact that it is taxed below the Minimum Rate. This is a measure against tax competition (behaviour of states) and not against abusive schemes (behaviour of the taxpayer). Of course, by limiting tax competition, the benefits that an MNE Group may obtain by exploring differences of tax burden across jurisdiction is also restricted. The relationship between the GLOBE MODEL RULES and tax abuse is, however, merely indirect, and the rules are not specifically designed to target abusive schemes. The GLOBE MODEL RULES may burden structures that are completely legitimate, while leaving behind schemes that could potentially be considered as artificial.

6. *The GLOBE MODEL RULES are neither intended nor able to ensure the application of the "single tax principle"* (ch. I, ch. III, ch. IV, ch. VI). The GLOBE MODEL RULES do not prevent the existence of pockets of low-taxed profits in high-tax jurisdictions. It is possible, for instance, that a high-tax jurisdiction offers a privileged tax regime compliant with BEPS Action 5 to a certain "pocket" of profits, while submitting the rest of the activities of the MNE to its ordinary (high) rate. The GLOBE MODEL RULES do not ensure the taxation of each item of profit made by an MNE, but rather that a jurisdictionally blended profit is subject to a minimum tax. Even in a hypothetical world of uniform implementation and application of the GLOBE MODEL RULES by all jurisdictions, there is no "single tax principle" being enforced. Pockets of low-taxed income can still exist, provided that they are blended with other highly-taxed activities of the MNE in the same jurisdiction. The application of the Substance-Based Income Exclusion further aggravates this scenario.

HOW DO THE GLOBE MODEL RULES BURDEN?

7. *The GLOBE MODEL RULES provide for a very complex mechanism to ensure a floor to tax competition, dealing with a series of autonomous concepts, which evidence the eclectic and pragmatic nature of the rules and hinder a more principled approximation* (ch. II). The mechanism provides for two interlocking domestic rules, which complement each other (the IIR and the UTPR), ultimately aiming at ensuring that no Top-up Tax

remains unallocated, and enforcing the taxation of GLOBE Income that would otherwise be taxed below the ETR. In doing so, the GLOBE MODEL RULES deal with several concepts and realities, which are often incompatible with each other from a theoretical point of view, thus inhibiting a more systematic and principled approach towards their content.

WHOSE INCOME DO THE GLOBE MODEL RULES BURDEN?

8. *The GLOBE MODEL RULES define a plurality of subjects, which are relevant at different stages of the application of the rules* (ch. II and ch. III). The definition of the subjects is in line with the goal of setting a floor to tax competition. The Top-up Tax is calculated by reference to the jurisdictionally-blended CEs, ultimately aiming at ensuring that the ETR in each jurisdiction is kept at least at the Minimum Rate. The income being burdened is the income of the LTCE. Such income, however, is only burdened after taking into consideration elements related to the MNE Group and to the jurisdictionally blended CEs, which play an important role in the justification of the minimum tax.

9. *The GLOBE MODEL RULES are not aimed at burdening the overall income of the MNE Group (enterprise doctrine), and merely refer to the MNE Group in order to determine which CEs fall within their scope. MNE Groups are not necessarily treated equally, and the GLOBE MODEL RULES cannot be justified as a measure intended to capture the ability-to-pay of the MNE Group* (ch. III). In the GLOBE MODEL RULES, it is possible that an MNE Group is subject to an overall effective taxation that is very high, but also to a Top-up Tax, due to the configuration of a part of its business activities. An MNE Group may be subject to a 30% overall effective taxation, but still trigger a Top-up Tax in a certain jurisdiction, because of the existence of a LTCE therein. At the same time, another MNE Group may be subject to a 15% overall effective taxation, and still trigger no Top-up Tax, due to the distribution of the CEs across the jurisdictions. It is also possible that the MNE Group incurs in an overall loss in a given Fiscal Year and is still subject to a Top-up Tax, due to the configuration of the CEs across the jurisdictions. There is no guarantee that all MNE Groups will be treated equally: a loss-making MNE Group may trigger the charge of a Top-up Tax, a highly-taxed MNE Group may trigger a Top-up Tax, and many other unequal treatments between MNE Groups may be drawn from the GLOBE MODEL RULES

10. *The definition of MNE Group is very broad, and take only control into consideration, leaving behind any form of integration requirement. An MNE Group is not necessarily a synergistically managed enterprise, and may comprise several CEs which bear no relation with each other, besides common control, and which present different sets of minority shareholders* (ch. III). This policy choice engenders significant effects on the definition of the tax object and on the charging rules, allowing for the blending of CEs which present no integration with each other, as well as for the charging of a Top-up Tax on a CE which is completely unrelated to the LTCE that is taxed below the ETR. The definition of MNE Group is a decisive structural element of the GLOBE MODEL RULES, and its broad formulation is the root of many of their theoretical shortcomings.

11. *For the purposes of triggering a Top-up Tax, the GLOBE MODEL RULES do not take into account the income of CEs individually considered (separate-entity doctrine), and there is no equal treatment between CEs* (ch. III). In the GLOBE MODEL RULES, it is possible that the same CE is subject to a Top-up Tax or not, depending on the

characteristics of the other CEs located in the same jurisdiction. A CE that, considered in isolation, would trigger a Top-up Tax, may not trigger it depending on the characteristics of the other CEs located in the same jurisdiction. It is possible that, individually considered, a CE is subject to an ETR lower than 15%, but, due to the jurisdictional blending, is diluted by other CEs that are subject to a higher ETR, and no Top-up Tax is triggered. Due to the broad definition of MNE Group, the blending may occur also among CEs that are not economically integrated, and/or among CEs that present a completely different set of minority shareholders.

12. *The only "subjects" that are, as a rule, treated equally under the GLOBE MODEL RULES are the jurisdictionally blended CEs* (ch. III). What matters for the purpose of triggering the Top-up Tax is whether the ETR on the Excess Profits of the jurisdictionally blended CEs is below the ETR. This pattern cannot be justified on the ability-to-pay alone. The ability-to-pay, understood as a measure for the sharing of the tax burden among subjects, is not able to justify the reason why "jurisdictionally blended CEs" are treated as the relevant subject that must be burdened at least at the ETR level. In order to justify this treatment, one has to resort to the goal of setting a floor to tax competition, which is unrelated to the ability-to-pay. This finding confirms the assertion that the goal of setting a floor to tax competition supersedes any other possible justification for the design of the GLOBE MODEL RULES.

WHAT DO THE GLOBE MODEL RULES BURDEN?

13. *The GLOBE MODEL RULES burden by means of the computation of a Jurisdictional Top-up Tax, which is levied on the Excess Profit* (ch. II and ch. IV). The GLOBE Income or Loss of the CEs for the jurisdiction are blended, to arrive at the Net GLOBE Income for the jurisdiction. The Excess Profit for the jurisdiction is obtained by subtracting the Substance-Based Income Exclusion from the Net GLOBE Income for the jurisdiction. The GloBE Income or Loss of a CE is calculated by means of a partial dependence model, subject to adjustments that are generally intended to bring the CE's GLOBE Income or Loss into alignment with the computation of taxable income under a typical CIT, prevent double taxation of the MNE Group's income, as well as prevent the types of low-tax outcomes that the GLOBE MODEL RULES are intended to address.

14. *The GLOBE MODEL RULES do not ensure a uniform set of rules to calculate the Top-up Tax for a LTCE, as the determination of the ETR and of the Excess Profits is, as a rule, contingent on the GAAP of the UPE* (ch. IV). Ultimately, even in a world of uniform adoption of the GLOBE MODEL RULES, MNE Groups whose UPEs are located in different jurisdictions will not be subject to the same rules for the calculation of the Top-up Tax, as the GAAPs of the UPEs may vary. The floor to tax competition is therefore not established with milimetrical precision, but by means of the rough approximations that the convergence of GAAPs is able to provide. Setting the realization principle as an optionality also raises equality concerns, as it makes the tax burden contingent on the ability of the taxpayer to operate within the complexities of the system, with potentially unfair results.

15. *The Substance-Based Income Exclusion does not make the Top-up Tax a tax on economic rents* (ch. I and ch. IV). Upon the definition of the carve-out, the GLOBE MODEL RULES conceived a mechanism that could be labelled as a "soft ACE". While the BEPS concerns regarding a carve-out on intangible assets are to a certain extent understandable,

the Substance-Based Income Exclusion, as it is written, is excessively restrictive. Not every intangible asset allows for the sort of profit-shifting with which the prohibition is concerned, and there would certainly be other means to address the issue in a more proportionate way. The addition of a carve-out based on personnel, besides the absence of a clear theoretical justification, does not eliminate the risk that the GLOBE MODEL RULES also ends up capturing normal returns. The adoption of a fixed rate is likely to impact investments in some jurisdictions adversely, with a particularly higher impact on countries that are considered risky and do not offer a stable environment for investments.

16. *One evident outcome of the Substance-Based Income Exclusion, mainly when combined with jurisdictional blending, is that, while some countries will continue to be able to use their tax systems to attract intangible-related income, other countries will lose such ability* (ch. IV). The carve-out benefits jurisdictions with a significant level of tangible assets and personnel, to the detriment of countries where such elements are scarcer. Considering the way it is drafted, this approximation between the carve-out and elements which are an indication of substance bears no relation with any possible meaning of the so-called "value creation principle". This is because the MNE Group is allowed a carve-out on assets and payroll that are completely unrelated to the activities of the CE benefiting from the tax incentive, provided that they are under common control.

WHERE DO THE GLOBE MODEL RULES BURDEN?

17. *The GLOBE MODEL RULES first assign the GLOBE Income and Covered Taxes to the CEs, in order to calculate a Top-up Tax, and, in a subsequent step, allocate a taxing right to another jurisdiction, based on a charging rule, applied on another CE* (ch. II and ch. V). They attribute a taxing right to a jurisdiction with regard to income that is allocated, under the GLOBE MODEL RULES, to a CE located in another jurisdiction. Systematically, the person earning the income (the LTCE) is not the tax debtor of the resulting tax claim, which extends to another person.

18. *The assignment of GLOBE Income and Covered Taxes follows from the location of the CEs (residence principle), and these rules are based on the separate-entity doctrine* (ch II and ch. V). Special rules are necessary in case of PEs, Flow-Through Entities and Hybrid Entities, to the extent that such CEs are subject to a specific tax treatment under domestic legislation. The treatment of Stateless CEs and the allocation of CFC taxes are particularly designed to ensure the integrity of the rules, within the scope of setting an effective floor to tax competition. The special rules confirm the preference for the separate-entity doctrine, being designed to ensure the proper allocation of income and taxes do CEs individually considered.

19. *The right to charge a Top-up Tax is commonly allocated to another jurisdiction, under the IIR and the UTPR, while still privileging the right of the host jurisdiction to tax the income, either by means of reforming the system or by the enactment of a QDMTT* (ch. II and ch. V). The rules acknowledge that the income arises in a certain jurisdiction, but allocate a right to tax it to another jurisdiction, under the charging rules. Once again, one notices the eclecticism of the GLOBE MODEL RULES: it provides for the allocation of income to CEs, following the separate-entity approach, but then, as a backstop, allocates taxing rights to members of the MNE Group based on participation or on a formula, thus mimicking elements of a formulary approach.

20. *The IIR and the UTPR are not grounded on a principled approach, and the allocation of taxing rights they provide is justified in the RELEVANT MATERIAL on practicability arguments* (ch. II and ch. V).

21. *Unlike CFC rules, the IIR is not justified as an anti-abuse rule, but rather as a rule aimed at setting a floor to tax competition* (ch. I and ch. V). As a consequence, there is no immediate answer with respect to the jurisdiction that should be entitled to tax such income. The RELEVANT MATERIAL avoids making arguments on the fairness of the allocation of taxing rights arising from the IIR, resorting, instead, to a reasoning based on practicability. The outcome is that the right to tax may be allocated to the UPE Jurisdiction, to the jurisdiction of an Intermediate Parent Entity or to the jurisdiction of the POPE, contingent on the adoption of the IIR by the relevant jurisdictions, as well as on the participation structure of the CEs. The IIR also impacts minority shareholders adversely, and they may or may not be burdened by the IIR, following elements which are unrelated to their ability-to-pay. Such difference of treatment, despite not being minor, is grounded on the practical concerns of the IIR, being treated as a collateral damage of the design of operable rules.

22. *The UTPR can only be justified as a measure of last resort, aimed at ensuring a floor to tax competition, which is expected to play only a limited role. Neither a separate-entity nor an enterprise approach is able to explain the nexus element underlying the UTPR* (ch. V). Its content is very unusual, as a consequence of the eclecticism inherent to Pillar Two. As far as nexus rules are concerned, the pragmatic solution does not meet a principled reasoning. The differences in scope between the IIR and the UTPR, despite being explained in the RELEVANT MATERIAL as simplification measures, cannot be justified from an allocative perspective.

WHEN DO THE GLOBE MODEL RULES BURDEN?

23. *The GLOBE MODEL RULES work under the assumption that Excess Profits shall be taxed at least at the Minimum Rate in all Fiscal Years, also providing for some leeway against temporary differences* (ch. VI). The main provisions addressing temporary differences are the mechanism to address temporary differences (Art. 4.4) and the GLOBE Loss Election (Art. 4.5).

24. *The mechanism to address temporary differences (Art. 4.4) is limited to the reality of a single CE, and the reference to jurisdictionally blended CEs is not kept consistent across periods* (ch. VI). The mechanism works with reference to deferred tax assets and liabilities of the CE. No reference to the blended CEs is found. A GLOBE Loss of a CE may be carried forward to compensate a GLOBE Income of the CE, but may not be carried forward to compensate GLOBE Income of another CE in the same jurisdiction. While, within a Fiscal Year, the income of blended CEs is the decisive element for triggering the Top-up Tax, this logic does not extend to a longer period.

25. *The GLOBE Loss Election (Art. 4.5) takes a jurisdictional approach on the carry-forward of losses, and only allows for a carry-forward in case there is a Net GLOBE Loss, which is defined jurisdictionally* (ch. VI). As a simplification mechanism, which applies optionally, it ensures some leeway for interperiodical loss compensation, but ignores other temporal differences. The simplification mechanism may be an acceptable

alternative for MNE Groups in case of CEs located in jurisdictions with no or very low CITs.

26. *The temporal mechanisms completely ignore the Substance-Based Income Exclusion, which cannot be carried forward, driving the GLOBE MODEL RULES further away from the justification grounded on the taxation of economic rents* (ch. I, ch. IV and ch. VI). Besides the shortcomings of the Substance-Based Income Exclusion, normal returns may also be captured by the GLOBE MODEL RULES as a consequence of mere temporal mismatches between income and expenses. This feature is also a deviation from the theoretical model on the taxation of economic rents.

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