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**Research Report**

## How best to minimize conflicts between the Global Anti-Base Erosion tax rules and international investment agreements

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### **How best to minimize conflicts between the Global Anti-Base Erosion tax rules and international investment agreements**

by

Błażej Kuźniacki\*

The Global Anti-Base Erosion (GloBE) rules ([Pillar Two](#)) consist of [a set of domestic rules](#) applicable to MNEs with global consolidated revenue above EUR 750 million: the Qualified Domestic Minimum Top-up Tax, the Income-Inclusion rule and the Undertaxed-Profit rule. They function through interlocked mechanisms: if taxation up to 15% of an effective tax rate does not take place in one state, then the Top-up Tax will take place [somewhere](#) under the Income-Inclusion or the Undertaxed-Profit rules. This approach to taxation impacts the future of FDI attraction through tax incentives that lead to an effective tax rate below 15%: it may trigger conflicts with provisions in countries' international investment agreements (IIAs) by: (i) violating investors' legitimate expectations not to revoke prematurely tax incentives reducing their tax burden of an effective tax rate below 15%; (ii) indirectly expropriating [low-taxed constituent entities](#); and (iii) [treating foreign investors worse than domestic ones](#). This *Perspective* builds on [an earlier Perspective](#), to answer the question: how best to minimize conflicts between GloBE rules and IIAs?

This question is important for states, for both legal and economic reasons.

Legally, IIAs (international law) constitute *lex superior* toward GloBE rules (domestic law). Even if constitutional law allows for treaty overriding, customary international law precludes states from a violation of international obligations through their domestic law ([Articles 26-27 VCLT](#), [Article 3 ARISWA](#)).

Economically, tensions between the GloBE rules and IIAs may affect the investment climate of states, discourage investors and increase the price of contemplated projects.<sup>1</sup> The most vulnerable are low-income developing countries insofar as GloBE rules directly affect the rationale of [special economic zones](#) (most often found in these countries) that provide tax holidays (0% of effective tax rate) for foreign investors.<sup>2</sup>

The best way to avoid conflicts would be to implement GloBE rules through a multilateral treaty that would preserve the protection offered to FDI under IIAs.<sup>3</sup> However, such a solution is unrealistic in the foreseeable future.

Thus, there is a need for a solution that can be implemented today, as it lies within the power and ability of states in terms of:

- *Risk identification*—recognizing that there are IIA protection standards that can be invoked by foreign investors against domestic taxation under the GloBE rules.
- *Risk quantification*—determining the quantity of potential financial damages for investors.
- *Reassessment of tax incentives*—evaluating tax incentives to understand whether they are still effective or not and, if not, amending them to ensure their effectiveness without GloBE rules neutralizing them; otherwise [repealing them from the domestic tax system](#).
- *Risk mitigation*—deciding whether there is a justification for (i) transforming income-based tax incentives into [Qualified Refundable Tax Credits](#); (ii) a general replacement of tax incentives with non-tax incentives such as “[reduced customs duties, sales or excise taxes, or renegotiated royalty agreements in case of natural resource projects](#)”; or (iii) entering a dialogue with specific investors negatively affected by GloBE rules to provide them with non-tax incentives.

*Risk-mitigation* will not be effective without a consideration of the concept of collateral benefits. This concept precludes [states from providing benefits to MNEs that are connected to the taxation of their profits under GloBE rules](#). If that happens, however, other states can conclude that taxation through the Top-Up Tax did not take place. Thus, they may tax the untaxed income via the Income-Inclusion or the Undertaxed-Profit rules. Nevertheless, attempts of states to avoid conflicts with IIAs could be an important justification to provide non-tax benefits to investors at odds with the concept of collateral benefits. Indeed, the clear-cut legal obligation of states to act in good faith under international law (IIAs and VCLT) trumps a compliance with the concept of collateral benefits emerging from a vague guidance of the OECD to domestic law (GloBE rules).

The [OECD](#)-designed rules, once implemented by states, will [intentionally discourage MNEs from legally challenging the Top-up Tax](#) (and thus indirectly the GloBE interlocked mechanism) by making such challenges economically unviable, i.e., any legal challenge against the Top-up Tax in one state will mean that another state can immediately impose taxation under the Income-Inclusion rule or the Undertaxed-Profit rule. [This seems to create tensions with international law](#). Therefore, states need to carefully assess the OECD’s legislative recommendation before implementing it, having in mind their obligations under international law.

The four-step process outlined above charts a way forward since it:

- Relies on transparent communication between states and foreign investors, to explain that states intend to reconcile their interests with those of investors in accordance with the proportionality principle.
- Manifests good faith of states toward foreign investors affected by GloBE rules.

States can also provide general guidance to investors on the interplay between GloBE rules, IIAs and tax incentives on the websites of their relevant governmental agencies (e.g., ministries of finance,

economic development, investment promotion agencies). This is in line with a whole-of-government approach, [as championed by the UN](#), that increases legal certainty in the tax and investment domains, translating into greater respect for international law.

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<sup>1</sup> [Salacuse 2021](#), p. 161; [Fama 1970](#), pp. 383–417; [Echandi 2019](#), p. 60.

<sup>2</sup> [Dettoni & Myles 2023](#).

<sup>3</sup> [Kuźniacki 2023](#), p. 177; [Beyer 2024](#), p. 18.

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