

IIA ISSUES NOTE

INTERNATIONAL INVESTMENT AGREEMENTS



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THE GLOBAL MINIMUM TAX AND INVESTMENT TREATIES: EXPLORING POLICY OPTIONS

H I G H L I G H T S

- Nearly 140 jurisdictions have agreed to introduce a global minimum tax on the profits of the largest multinationals. The rules are designed in a way that the minimum tax will almost certainly be collected on undertaxed corporate income in some jurisdiction, requiring countries to act. At the same time, measures to implement the global minimum tax could potentially be scrutinised under international investment agreements (IIAs). Few IIAs comprehensively exclude taxation from their scope.
- Four IIA standards are most likely to cause tensions: the fair and equitable treatment (FET) provision, the umbrella clause, non-discrimination rules, and the expropriation provision. The first three could, depending on their interpretation and individual investor circumstances, discourage countries from collecting taxes. Especially the existence of negotiated and contractually stabilized tax incentives, for example, as part of the admission to a special economic zone, may prove sensitive under the FET standard and the umbrella clause. Frictions may similarly arise from the different treatment of the constituent entities of enterprises that are covered by the minimum tax and those that are not.
- Overall, it is unlikely that the introduction of the global minimum tax will cause a wave of investor–State dispute settlement (ISDS) cases under IIAs. Much depends on the particular circumstances of individual investors. To mitigate the impact of the global minimum tax, multinational enterprises (MNEs) may seek the replacement of corporate income tax incentives with other measures that provide economically comparable benefits. These could be, for example, reduced customs duties or renegotiated production sharing agreements. MNEs may attempt to use the threat of ISDS to induce governments to agree to the (partial) replacement of incentives. The GloBE Rules have been designed with the aim of enhancing the host State’s leverage in any such negotiations.
- These tensions and uncertainties highlight the importance of accelerating the reform of the IIA regime to ensure that it furthers and does not undermine the implementation of globally agreed policies in fields such as tax, climate action or health. In the interim, Governments may proceed to review and revise inefficient corporate income tax incentives. They can mitigate potential risks by adopting a coordinated approach on tax and investment, with particular attention to discretionary incentives and potential differences in treatment between foreign and local enterprises.

Introduction

International investment agreements (IIAs) form a regime consisting of over 2,500 treaties that are currently in force. Approximately 90 per cent of these are old-generation agreements were concluded in the 1980s, 1990s and 2000s. They generally contain unrefined treaty standards and grant broad access to investor–State dispute settlement (ISDS) in the form of binding international arbitration. Under almost all IIAs, an investor can initiate an ISDS case without requiring additional consent from the respondent. To date, investor claimants have brought 1,257 known treaty-based ISDS cases. About 15 per cent of the total cases involved tax measures (box 1).

The international tax regime is undergoing a large-scale modernization effort with discussions simultaneously taking place in different fora. The process was kickstarted with the Base Erosion and Profit Shifting (BEPS) Action Plan that launched the OECD/G20 BEPS Project in 2013. The Action Plan sought to introduce fundamental changes aimed at curbing tax avoidance and profit shifting (OECD, 2013). The project achieved a significant milestone with the adoption of a comprehensive package of reports in 2015. What has been dubbed BEPS 2.0 is now in full swing and seeks to resolve the unfinished aspects of the original BEPS Project relating to the tax challenges arising from the digital economy. One of the aspects that has drawn particular attention is the implementation of a global minimum tax. Now, approximately 140 jurisdictions participating in the OECD/G20 Inclusive Framework agree to tax the profits of large multinationals at a minimum effective rate of 15 per cent. To implement this agreement, the Global Anti-Base Erosion (GloBE) Rules (OECD, 2023a) have been developed.

The GloBE Rules are likely to exert some effect on all countries, even those deciding not to adopt the minimum tax or selected aspects thereof. Where a jurisdiction does not tax an MNE entity at the minimum rate, the tax jurisdictions of parent or sibling entities may enforce the minimum by imposing top-up taxes. Consequently, even non-participating countries may want to review and revise corporate income tax incentives they grant to investors. What lends the global minimum tax its force is not its acceptance by low-tax countries, but the willingness of higher-tax parent countries to compel its application (UNCTAD, 2022). Another way to think about the minimum tax is that it sets a floor for corporate income tax competition and provides countries with an opportunity to reconsider existing incentives. MNEs may not benefit from relocating investments in response to the removal of tax benefits as the minimum is enforced regardless of the location of the investment. Governments are thus somewhat protected from competition when withdrawing corporate income tax incentives that are inefficient in attracting real investment (OECD, 2022b). Other promotional measures such as investment incentives not linked to corporate income taxes as well as high-quality soft and hard infrastructure are instead likely to become more relevant for the location decisions of investors.

UNCTAD has previously pointed out that due to the risk of costly disputes arising from ISDS cases, policymakers would do well to consider potential areas of tension between the minimum tax and IIAs (UNCTAD, 2022a). This IIA Issues Note elaborates on the relationship between the GloBE Rules and IIAs. It presents those elements of the global minimum tax that are most likely to cause tensions from the perspective of investment protection disciplines and assesses the actual and perceived legal risks that IIAs pose to the implementation of the minimum tax. Four common IIA standards are analysed by reference to recent arbitral practice: (i) fair and equitable treatment (FET); (ii) umbrella clauses; (iii) non-discrimination rules and (iv) the expropriation provision.

Box 1. Tax-related measures and ISDS

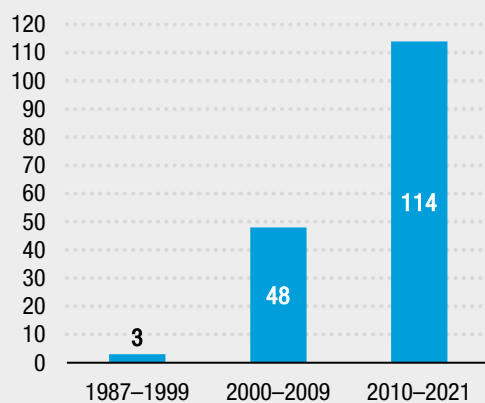
Most IIAs do not comprehensively exclude taxation from their scope, which means that a wide range of tax-related measures, whether of general or specific application, are covered by them (see box 2). UNCTAD data suggests that over 165 ISDS cases have challenged tax-related measures based on IIAs (box figure 1). The respondent States in these cases were countries at all stages of economic development (UNCTAD, 2022b).

The types of past tax-related ISDS claims were diverse (for example, withdrawal of incentives, increases in windfall profit taxes, and imposition of capital gains tax) and often intertwined with non-tax measures (for example, forced liquidation, interference with or termination of contracts, bankruptcy proceedings and money laundering investigations). Sometimes, the non-tax measures resulted from tax-related issues in the first place such as criminal proceedings as a consequence of tax offences. Tax-related ISDS cases can, but do not necessarily, overlap with the subject matter covered by double taxation treaties (DTTs) and the predominant mode of settling DTT disputes, the mutual agreement procedure (UNCTAD, 2021).

Box 1. Tax-related measures and ISDS

From 2000 to 2021, the absolute number of tax-related cases has grown at the same speed as the number of overall ISDS cases (box figure 2). Tax-related claims account for about 15 per cent of all publicly known ISDS cases that have been filed to date.

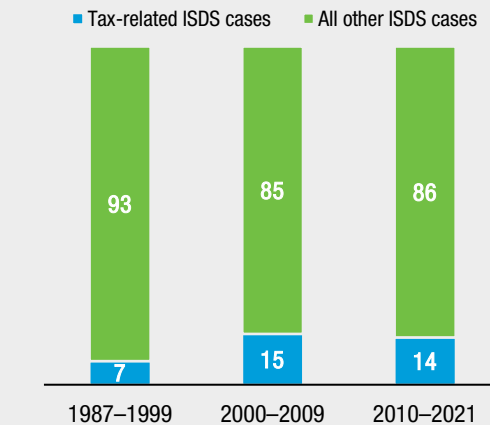
Box figure 1. Tax-related ISDS cases based on IIAs, 1987–2021 (Number of known cases)



Source: UNCTAD.

Source: UNCTAD.

Box figure 2. Tax-related ISDS cases as share of total cases (Per cent)



Source: UNCTAD.

Overall, carefully designed measures to implement the global minimum tax do not create a significant risk of ISDS proceedings. However, the individual circumstances of specific countries and the tax-related special treatment they offer to investors can increase the potential for investor claims. In any case, multinational enterprises (MNE) subject to the global minimum tax are unlikely to initiate formal proceedings. Instead, they could utilize IIAs as a bargaining chip to bring governments to the negotiating table to partially replace corporate income tax incentives with economically similar benefits, while officially being taxed at the effective minimum rate. Strategies to minimize or eliminate this risk are proposed in the last part of this IIA Issues Note. Section 3 provides a checklist for investment and tax policymakers to help prevent back-rolling progress on the domestic implementation of the minimum tax. Crucially, the actual exposure to IIA-based claims heavily depends on the individual circumstances of each country. Mitigating any existing risks necessitates an individual assessment of affected entities by tax and investment policymakers.

1. What is the global minimum tax?

In 2020, participants of the OECD/G20 Inclusive Framework on BEPS reached an agreement on the adoption of a two-pillar approach to solve outstanding issues relating to the taxation of the digital economy. Pillar I aims to realign the taxation of MNE profits with the place of value creation, in particular by shifting taxing rights to market jurisdictions. Pillar II, among others, proposes a global minimum tax on the profits of MNEs at an effective rate of at least 15 per cent regardless of where profits arise. The rationale for the minimum tax is to combat profit shifting and to limit the harmful aspects of tax competition that arise from governments' efforts to attract and retain investment by offering favourable tax treatment relative to that available elsewhere (UNCTAD, 2022a). The OECD published the GloBE Model Rules for implementing the minimum tax in December 2021 (OECD, 2021b), along with technical commentary and concrete examples of how to apply them shortly thereafter (OECD, 2022). Further rules and instructions, most recently administrative guidance for the application of the model rules, have been published in 2023 (OECD, 2023b and OECD, 2023c).

As of June 2023, out of the 143 Members of the OECD/G20 Inclusive Framework on BEPS, almost 140 jurisdictions have joined the October 2021 *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*. This statement has the status of a 'common approach', which signifies that no jurisdiction is required to implement it, but participants accept implementation by others. If domestic rules are

adopted, they should be in line with OECD guidance (OECD, 2021a). The GloBE Rules are, thus, not legally binding themselves and only have the force of law when implemented in national legal frameworks. Moreover, States retain discretion as to how they implement the rules to ensure compatibility with their domestic tax systems.

In simplified terms, the proposed rules function as follows. First, tax jurisdictions are required to identify constituent entities of an MNE group that are within the scope of the rules,¹ meaning internationally operating MNEs with an annual revenue of at least 750 million euros. Second, the financial accounting net income of an MNE subsidiary is taken as the starting point to determine its net income or loss for the purposes of the application of the rules. Third, the amount of ‘adjusted covered taxes’ is then determined under the model rules. Most importantly, covered taxes are those imposed on income and profits. Once there is information on the covered entities (step 1), their income (step 2) and the amount of taxes they pay (step 3), the effective tax rate can be calculated. The entire net income and taxes of all constituent entities in a single jurisdiction are aggregated and the former is divided by the latter to determine the effective jurisdiction-wide tax rate. If this effective tax rate is below the minimum rate of 15 per cent, a top-up tax is triggered.

The top-up tax serves to broadly bring the effective tax rate up to the minimum rate. The amount of the top-up tax is calculated by first subtracting the so-called substance-based income exclusion from accounting profits to determine “excess profits”. The substance-based income exclusion (SBIE) is defined in the GloBE Rules as being equal to five per cent of eligible payroll expenses (“payroll carve-out”) and five per cent of the carrying value of tangible assets located in the jurisdiction in question (“tangible asset carve-out”). For a transitional period of ten years, ending in 2032, the percentages for the payroll carve-out and the tangible asset carve-out are higher. They are gradually reduced on a yearly basis from initially ten and eight per cent respectively. The rationale for allowing accounting profits to be reduced by the SBIE is that its constituent components are indicators of real activities in the jurisdiction. Because of the exclusion, incentives tied to substantive activities are less affected by the global minimum tax. “Excess profits”, the remainder after subtracting the SBIE, are then taxed at a rate equal to the differential between the effective jurisdiction-wide rate and the minimum rate of 15 per cent.

The model rules foresee that the jurisdiction where the income arises is first in line to impose this top-up tax in form of a Qualified Domestic Minimum Top-up Tax (QDMTT). If no QDMTT has been adopted, application of the income inclusion rule (IIR) is triggered. Primarily, the ultimate parent entity of the undertaxed constituent entity is liable to pay a top-up tax under the IIR. If the jurisdiction where that entity is located does not operate an IIR, the next lower intermediate parent entity pays the tax. In case there remains low taxed income not subject to any QDMTT or IIR, the Undertaxed Profits Rule (UTPR) serves as a backstop. Sibling entities of the undertaxed entity become liable to pay the outstanding tax. In essence, the QDMTT, the IIR and the UTPR impose an increased tax liability in different jurisdictions. Investment policymakers could think of the different top-up taxes in the following way: the QDMTT imposes a tax liability in the investor host State, the IIR does so in the investor home State, and the UTPR in a third jurisdiction where the investor has a subsidiary.²

Box 2. Tax carve-outs in IIAs

There is a wide range of approaches used in IIAs to deal with tax measures. On one end of the spectrum, a small number of treaties (1 per cent) contain no reference to tax whatsoever, making the treaty fully applicable to any tax measure. Next, the vast majority of IIAs includes partial carve-outs for domestic measures (83 per cent). The narrowest partial carve-out, and the most common approach, is a limited exclusion of the benefits arising from double taxation treaty (DTT) from the scope of the most-favoured nation (MFN) clause. In practice,

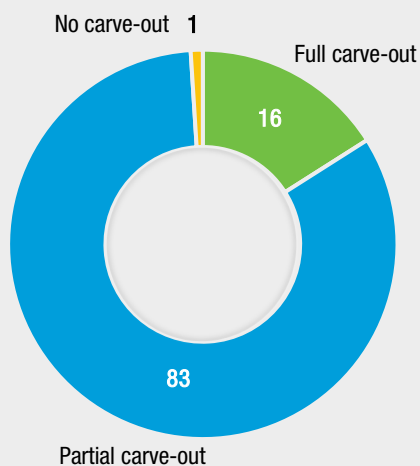
¹ Constituent entities are subsidiaries and permanent establishments of the MNE. There are differences between both concepts for tax purposes but from the perspective of IIAs, both can simply be thought of as investments.

² However, all three States are potentially investor host States from the point of view of IIAs. For QDMTTs, the jurisdiction of the undertaxed subsidiary is the host State. Any State of incorporation of entities that are higher up in the corporate chain are potential IIA home States. Similarly, for top-up taxes under the UTPR, the country where the tax is imposed is the host State and any place of incorporation of an entity higher up the corporate chain can serve as an investor home State. Under the IIR, even the jurisdiction of the ultimate parent entity could potentially be a host State for IIA purposes. Virtually all IIAs allow shareholders to bring reflective loss claims. Consequently, the jurisdiction where the ultimate parent entity is located is an IIA host State, for example, where the entity is (partially) owned by a private individual with a nationality that differs from that of the company. That the application of the top-up tax arises from the underpayment of taxes in a third country is irrelevant to the question whether an IIA is potentially applicable.

Box 2. Tax carve-outs in IIAs

this carve-out has been largely irrelevant. More importantly, other types of less widespread partial carve-outs exclude domestic tax measures from scrutiny under the NT, FET or expropriation provisions. On the other end of the spectrum, approximately one in six recently signed IIAs fully insulate all tax measures from being challenged. Generally, explicit clauses regulating the application of IIAs to tax measures are more widespread in recent treaties as compared to older ones. Box figure 3 displays data for 183 IIAs signed between 2015 and 2022.

Figure 3. Tax carve-outs in recent IIAs signed in 2015–2022 (Per cent)



Source: UNCTAD.

Note: Based on an analysis of 183 IIAs for which texts are available (144 bilateral investment treaties and 39 other treaties with substantive investment protection provisions).

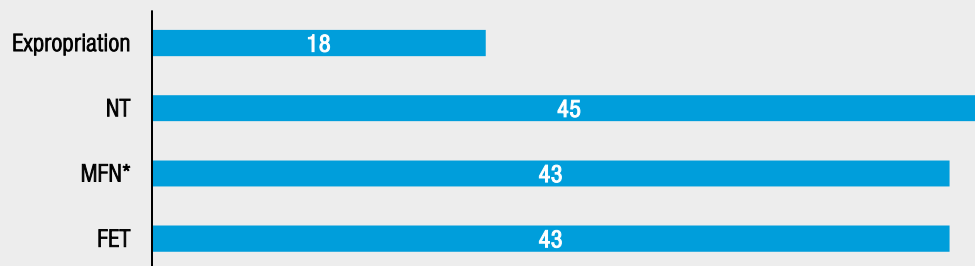
The vast majority of old-generation IIAs, which account for almost 90 per cent of all investment treaties that are currently in force, do not provide for any tax carve-outs that are relevant to the implementation of the global minimum tax. Very rare but of direct relevance to the Base Erosion and Profit Shifting Project, a small number of IIAs contain limited clarifications relating to internationally recognized tax policies and measures aimed at preventing the avoidance or evasion of taxation (e.g. Colombia–Republic of Korea FTA (2013), Article 21.3.6; EU–Singapore IPA (2018), Article 4.6.4).

Box figure 4 provides a more detailed breakdown of the applicability of IIA provisions to tax measures in recent IIAs, signed between 2015 and 2022. It focuses directly on the four provisions that are most relevant to the implementation of the global minimum tax by analysing the full and partial carve-outs in box figure 3 on the level of individual IIA provisions. Box figure 4 shows that the expropriation provisions of many recent IIAs – 82 per cent – apply to tax measures. Similarly, more than half of all MFN, NT and FET clauses in this sample of treaties are applicable to tax measures. They thus generally apply to the types of measures that are likely to be adopted to implement the global minimum tax, such as top-up taxes, the withdrawal of corporate income tax incentives or an increase of the headline corporate income tax rate. Thus, tax measures could be challenged by foreign investors even under the majority of recent IIAs.

Two broad types of partial carve-outs exist in practice. First, some IIAs directly specify that certain substantive protection standards (for example, the NT or FET provisions) do not apply to tax measures. Second, partial carve-outs sometimes take the appearance of full carve-outs but then go on to specify limitations and exemptions, effectively exposing domestic tax measures to scrutiny under a limited number of protection standards such as the expropriation provision. Comprehensive tax carve-outs are rare, even in recently concluded IIAs (see box figure 3). The most common partial carve-out continues to be the exclusion of DTT benefits from the MFN provision, which has a limited impact as most domestic tax measures, including those related to the implementation of the global minimum tax, are unrelated to DTT benefits. Almost 60 per cent of IIAs with partial carve-outs in box figure 3 are of this type and do not extend to any other tax measures. Consequently, despite the large number of recent IIAs with some type of carve-out (99 per cent) most tax measures can still be assessed under IIAs.

Box 2. Tax carve-outs in IIAs

Box figure 4. Tax carve-outs applicable to selected provisions in recent IIAs, 2015–2022 (Per cent)



Source: UNCTAD.

* Tax exclusions from the scope of the MFN provision exclusively relating to DTT benefits are not counted.

Source: UNCTAD.

Further guidance continues to be published, accompanied by scrutiny and debate of aspects of the minimum tax (see, for example, Hongler et al., 2023). At the same time, domestic implementation of the GloBE Rules is progressing in over 50 jurisdictions (OECD, 2023d). In late 2022, the European Union has adopted a Directive which requires implementation of the rules in its individual Member States by the end of 2023 (EU, 2022). Other tax jurisdictions where ultimate parent entities reside equally push ahead with the transposition of the rules into national legal frameworks. As more MNE headquarter jurisdictions begin to apply a top-up tax under the IIR, the pressure on other countries to follow suit increases. Countries which grant corporate income tax incentives that reduce the effective tax rate below the minimum will see their tax bases soaked up elsewhere under the IIR and UTPR. Preventing this requires them to adopt their own top-up taxes or otherwise adjust incentives to reach the minimum effective rate of 15 per cent. To support implementation, the African Tax Administration Forum (ATAF), for example, has published “Suggested Approaches to Drafting Domestic Minimum Top-Up Tax Legislation” (ATAF, 2023).

2. Investment protection standards and the global minimum tax

This section analyses four IIA protection standards that are most likely to create friction with the tax regime of host States. These substantive standards are: (i) fair and equitable treatment; (ii) umbrella clauses; (iii) non-discrimination rules; and (iv) expropriation.

From a procedural point of view, investment arbitration also interacts with the GloBE Rules. Under the rules, if taxpayers mount a judicial challenge of any amount of top-up tax, the top-up is not considered for purposes of calculating outstanding liabilities in other jurisdictions (OECD, 2023c). In practice, this means that any challenged amount should be collected again under the IIR or UTPR elsewhere. This seeks to prevent taxpayers from circumventing payment of the global minimum tax via legal challenges, including in ISDS proceedings. The peer review and ongoing monitoring process under the GloBE Rules would presumably be designed to ensure that States are not refunding the minimum tax (also by means of ISDS settlements). Increased transparency further arises from the reporting obligations of MNEs, which should capture cases where taxes have been refunded. It remains to be seen, however, whether these mechanisms are sufficient in practice to overcome practical problems arising from the opacity of the ISDS system. While steps towards transparency have been taken in recent years in the international investment regime, they are far from comprehensive. Consequently, it may not be clear to other jurisdictions when calculating outstanding liabilities whether a top-up tax in a host State has been challenged. A large share of arbitral proceedings continues to be sheltered from the public eye, going as far as a continued failure to publish final awards (Ortino, 2023). The very same problem that plagues the ISDS system more widely, here potentially impedes the functioning of the global minimum tax.

Procedural aspects aside, the following discussion focuses on the widespread unreformed formulation of the four aforementioned substantive IIA provision, their interpretation by ISDS tribunals, and potential interactions with measures to implement the global minimum tax.

a. Fair and equitable treatment

Old-generation IIAs typically include a fair and equitable treatment (FET) provision drafted in a minimalist, open-ended way. A breach of the FET provision is the most frequently invoked claim in ISDS cases overall. It is also the most likely standard to be invoked in tax-related ISDS cases. Owing to its open-ended and largely undefined nature, the FET standard, especially as it has been drafted in old-generation IIAs, has turned into an all-encompassing provision that investors have used to challenge any type of governmental conduct that they deem to hurt their interests (UNCTAD, 2018).

Many ISDS decisions have generally affirmed that the FET standard does not preclude States from exercising their regulatory powers in the public interest. However, arbitral tribunals have established boundaries to permissible regulatory action and at times have reached divergent conclusions on the acceptable level of State discretion under the provision. A number of components or elements that are not explicitly mentioned in the FET clause have transpired over time (UNCTAD, 2012): the protection of legitimate expectations, expectations of regulatory stability, freedom from coercion and harassment, the protection against conduct that is arbitrary, unreasonable, disproportionate and lacking in good faith, and the obligations of due process and transparency.

For tax administrations and tax policymakers working in an environment of evolving tax regulations, these various elements subsumed under a broad FET provision merit special attention when assessing the risks of tax-related ISDS claims. This includes procedural obligations for the adoption of laws and regulations imposed by the provision. The standards have been interpreted, for example, as requiring administrative due process such as sufficiently long timeframes for the phase-in of new rules, transparency in decision-making or, under certain circumstances, allowing for comments from affected stakeholders. In the past, investors have challenged retrospective amendments of tax legislation (*Cairn v. India*) and certain tax enforcement measures (such as the forcible collection of taxes, court proceedings and penalties) as arbitrary or disproportionate under FET.

With respect to the implementation of measures related to the global minimum tax, two components are of particular importance: the protection of legitimate expectations as well as the requirement of regulatory stability. Their relevance arises from the fact that low effective corporate income tax rates are often the result of special tax incentives. On average, statutory headline rates applicable to MNEs subject to the global minimum tax are 6 per cent higher than effective rates (UNCTAD, 2022a). Part of this divergence can be explained by the existence of regulations that are put in place specifically to induce (foreign) investments. Expectations, including of regulatory stability, arise from such government regulations.

Even if not a binding legal requirement, the global minimum tax may in practice lead governments to withdraw corporate income tax incentives or effectively undermine them by imposing top-up taxes. The compatibility of such measures with the FET clause markedly depends on the specific situation of the foreign investor. Relevant criteria include the extent of specific commitments made by governments (for example, assurances of long-term stability in domestic laws or investment contracts as well as the existence of other specific representations towards individual investors) and the manner in which changes are implemented. Benefits that result from discretionary decision-making by government officials and are “frozen” in time under special stabilization clauses often give rise to investor expectations that could potentially be enforced under the FET provision.

(i) Legitimate expectations

Albeit not grounded in state practice or *opinio juris*, the protection of legitimate expectations has repeatedly been identified by tribunals as a key element of the FET provision (UNCTAD, 2012). Under the standard, tribunals argue that where a State’s conduct creates reasonable and justifiable expectations on the part of an investor, they are required to act in accordance with these expectations. The main debate nowadays relates to the question of what actions on the part of the State give rise to legitimate expectations. Broadly, lines can be drawn between two types of arbitral awards: those that only consider unequivocal, specific, and explicit promises – specific assurances – to result in legitimate expectations; and those that adopt an expansive approach whereby general legislation can, under certain circumstances, equally do so.

If the investor has been granted specific rights as the result of formal and individual encounters with authorised representatives of the State, a high level of expectation arises. Where tax concessions are the result of negotiations or granted based on procedures that allow for the discretion of State representatives, the standard is more likely to be engaged. This could be the case in specific contracts or governmental decrees relating to one particular investor

and their tax treatment. Stabilization clauses in individual investor-State contracts will further support the claim that the withdrawal or undermining of tax incentives violates the FET clause. Similar considerations can apply to situations where tax free status results from the admission to special economic zones (SEZs) (UNCTAD, 2019). Where such admission requires more than pure formalities or the physical establishment within the zone but involves, for example, meeting certain requirements and a vetting process whose criteria are not known to the investor, simply abrogating tax-based incentives may run counter to the investor's expectations.

Whether provisions of general law, such as a tax code, can give rise to legitimate expectations is more controversial in arbitral practice. Recently, a number of arbitral tribunals dealing with the withdrawal of solar incentives in Spain and Italy have accepted that investors can generally form legitimate expectations on the basis of general legislation. The question of the existence of legitimate expectations that prevent States from altering the tax treatment of foreign investors is, thus, rarely an either/or question but tends to be assessed on a sliding scale. Overall, the jurisprudence is still in search of a clear line. However, the possibility that individual tribunals side with investors exists. Where low corporate income tax rates are granted for circumscribed time frames to small groups of foreign investors such as those in a specific sector, tribunals are far more likely to find that this gives rise to legitimate expectations as opposed to a low headline rate that applies across the board. Stabilization clauses under general domestic legislation such as a country's investment code or sector specific rules, including, for example, mining codes, can further strengthen the investor's claim to legitimate expectations.

(ii) Regulatory stability

The second element of particular interest with respect to the adoption of measures to ensure compliance with the global minimum tax is the requirement of regulatory stability. ISDS tribunals commonly recognise that there is no requirement of absolute stability; what is important is the stability of the essential characteristics of the regulatory framework. Especially States in a process of economic development are known to regularly adapt their regulatory frameworks (e.g. *Paushok v. Mongolia*). As with legitimate expectations, an assessment under "regulatory stability" is highly context dependent. ISDS tribunals found several criteria to be relevant.

First, the magnitude of the change can weigh in favour of finding of a breach of the FET provision. Generally, the imposition of a 15 per cent effective corporate income tax can be regarded as more or less drastic depending on the prior tax burden. For this assessment, it is less relevant whether the increase results from the withdrawal of incentives, the imposition of a QDMTT or the raising of the statutory headline rate. It could be argued that an increase from a very low or zero tax rate modifies the "essential characteristics" of the previous framework. This argument is more difficult to make for a tax rate increase from 12 to 15 per cent. Assurances of stability, not giving rise to legitimate expectations discussed above, such as general statements by high-level State representatives can be relevant in this context.

Second and somewhat related to the magnitude of the change is the economic impact of the measure on the investor. The stronger the economic impact, the more likely it is that tensions arise with commitments under IIAs. As a general observation, a 15 per cent effective income tax rate is unlikely to result in an economic impact on individual investors that, in the absence of other relevant factors, can breach the requirement of regulatory stability. Moreover, investors might be able to benefit from the substance-based income exclusion, lowering the share of their profits subject to any top-up tax. Additionally, the GloBE Rules foresee so-called *de minimis* exceptions and (transitional) safe harbours which lower the administrative burden on foreign investors. Thus, the economic impact is likely to remain within bounds.

Moreover, the fact that the minimum tax is the outcome of a prolonged discussion at the international level supports arguments as to the foreseeability and legitimacy of regulatory changes to foreign investors' tax treatment. At least as of late 2021, prudent investors would have foreseen the possibility of adverse changes to the global tax framework (e.g. *Isolux v. Spain*). The widespread nature of the minimum tax, approximately two thirds of all tax jurisdictions have signed the statement on a two-pillar solution, underlines its *bona fide* character. This means the GloBE Rules should benefit from a strong presumption of compliance with IIA disciplines (see similarly, for example, *Philip Morris v. Uruguay*). A related justification for regulatory changes in this area can be that they are a result of external circumstances, at least with respect to domestic minimum taxes. If a State fails to raise its effective tax rate, another jurisdiction will soak up their tax base by imposing top-ups. This means that the profits of the MNE will be subject to the minimum tax either way. In this light, it would be difficult for affected entities to plead that the measures came as a surprise. Nevertheless, appropriate phase-in periods, including the transitional safe harbour proposed under

the GloBE Rules (OECD, 2022c), can help to further lower the risk of tensions with IIAs, especially when States adopt measures other than top-up taxes under the GloBE Rules, such as the unilateral withdrawal of tax incentives.

In conclusion, the FET provision is the IIA standard most likely to create tensions with measures adopted in pursuit of the global minimum tax. Virtually no old-generation IIA excludes tax measures from the FET provision and even those recent IIAs that contain safeguards for tax measures often still cover relevant domestic measures under the provision (box 2). An assessment relating to the protection of legitimate expectations and regulatory stability often turns on the specific circumstances in which investors were granted income-tax based incentives. Where they are the result of general legislation, such as a low headline rate in the country in question, or can be obtained as a consequence of compliance with pure formalities, challenges are unlikely to succeed. However, where low effective rates of specific MNE subsidiaries resulted from formal and individual encounters with authorised representatives of the State, especially where such treatment is stabilized for specific periods under investor-State contracts or in domestic rules, current jurisprudence could favour the finding of a violation of the FET provision. Here, arbitral tribunals do not tend to draw distinctions between different organs of the State. Treatment can be promised by one State organ such as an investment promotion agency and later this promise is not upheld by another organ such as the revenue service. For the purposes of public international law, the State is generally a monolithic entity.

The uncertainties arising from the old-generation FET clause increasingly lead countries to adopt refined provisions in recent IIAs or entirely omit the provision. An emerging practice is to replace the FET standard with a closed or exhaustive list of State obligations, while imposing a high threshold for a finding of liability only attained by serious instances of host State misconduct (for example, a “flagrant”, “manifest” or “fundamental” breach of due process) (UNCTAD, 2020). Legitimate expectations are generally not incorporated as part of this closed list in new IIAs. Instead, if included at all, legitimate expectations are to be “taken into account” in assessing a breach of one of the elements of the FET provision without giving rise to a self-standing claim.

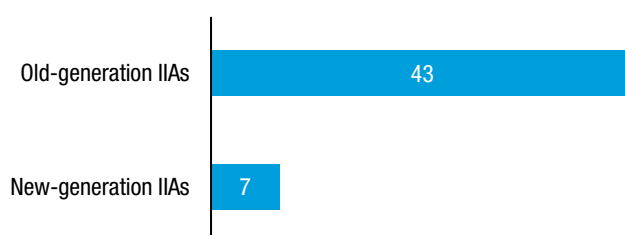
b. Umbrella clauses

An “umbrella” clause requires a host State to respect any obligation assumed by it with regard to a specific investment (for example, in a contract between an investor and the State or in an investment authorization or licence). The clause brings contractual and other individual obligations under the “umbrella” of the IIA, making them potentially enforceable through ISDS. By subjecting contractual violations to IIA arbitration, an umbrella clause makes it even more important for countries to have the technical capacity to carefully craft the respective contractual arrangements (for example, when they enter into investment or concession contracts).

The main difficulties with “umbrella” clauses are that they (1) effectively expand the scope of the IIA by incorporating non-treaty obligations of the host State into the treaty, which may increase the risk of being faced with costly legal proceedings, and (2) have given rise to conflicting interpretations by investor–State tribunals resulting in a high degree of unpredictability.

Many old-generation IIAs contain a broadly worded umbrella clause (figure 1). Given the unpredictability arising from expansive interpretations by arbitral tribunals, umbrella clauses have largely fallen out of favour and are included in only a minority of new-generation IIAs. However, even where no umbrella clause exists in an applicable IIA, ISDS tribunals have allowed umbrella clauses to be “imported” via the MFN provision from the respondent States’ third-country IIAs (e.g. *EDF and others v. Argentina*). This means that MNEs and their subsidiaries could claim umbrella clause protections in ISDS proceedings based on IIAs that do not feature this clause.

Figure 1. Prevalence of umbrella clauses in old- and new-generation IIAs (Per cent)



Source: UNCTAD, IIA Navigator.

Note: For the prevalence of umbrella clauses in new-generation IIAs, 84 treaties signed between 2016 and 2020 have been analysed.

With respect to measures relating to the global minimum tax, the umbrella clause could be utilized to incorporate so-called stabilization commitments contained in State contracts. Historically, such clauses were often formulated as “freezing clauses” that fix the tax treatment of foreign investors for specific periods or the entire duration of the investment. Such clauses continue to exist but more recent contracts generally provide for economic equilibrium clauses instead (Mansour and Nakhle, 2016). These allow host States to adapt their regulatory frameworks but require them to adequately compensate investors in case of negative effects and reinstate the previous “economic equilibrium”.

In theory, only traditional (tax) freezing clauses would prevent host States from imposing top-up taxes, withdrawing incentives or raising headline rates. Under these clauses States are not free to adapt the tax treatment of (foreign) investors. In practice, however, they are likely to raise similar issues as “economic equilibrium” clauses when it comes to the implementation of the global minimum tax. As long as MNE subsidiaries do not reach the effective tax rate of 15 per cent, their parent or sibling entities may be liable to pay top-up taxes. Little is thus gained by investors who insist on the immutability of the tax environment in the host State. Consequently, investors are likely inclined under both types of stabilization clauses to renegotiate incentives, discussed in Section 3 below. Freezing clauses as well as economic equilibrium clauses and their enforceability under the umbrella provision of IIAs allow investors to request governments to replace income-tax based investment incentives with, for example, reduced customs duties, sales or excise taxes or renegotiated royalty agreements in case of natural resource projects.³

Commonly, umbrella clauses cover *contractual* commitments between States and investors. Going beyond this, a limited number of tribunals have found that umbrella clauses can extend to obligations which have been unilaterally assumed by States. Such unilaterally assumed obligations may, for example, arise from legislative and regulatory instruments. There is a risk that expansive arbitral interpretations stretch the applicability of umbrella clauses to changes to or withdrawals of tax incentives and tax holidays originally provided under a domestic law such as an investment code or industry-specific regulatory frameworks.

The wording of the umbrella clause may matter in this respect. One can distinguish between two types of clauses. On the one hand, some provisions require that commitments have been “assumed” by the State, for example where governmental decrees are directed at specific investors or investments (e.g. *LG&E v. Argentina*). On the other hand, there are IIAs whose umbrella clause requires that the obligation has been “entered into”. The latter wording is generally seen to imply a contractual or quasi-contractual relationship. However, recent arbitral jurisprudence argued that unilateral commitments directed at a small and well-defined class of investors and/or investments can also be said to have been “entered into” (e.g. *ESPF and others v. Italy*).

When adopting changes, it is important to bear in mind that many ISDS tribunals see the State as a singular entity. According to this interpretation, tensions can arise where one organ of the State undermines the benefits granted by another organ. For example, investment promotion agencies, which are often involved in the provision of tax-based incentives (UNCTAD, 2022a), could contractually guarantee the stability of the tax environment to the foreign investor. When this contractual stipulation is undermined through regulatory action taken by tax authorities, who may not be parties to the investor-State contract, ISDS tribunals may still regard it as falling within the scope of the umbrella clause.

As the above explanation reveals, elements that arise under umbrella clauses can overlap with considerations under FET provisions. The analysis of whether specific assurances were made to investors is largely determinative in both cases. For umbrella clauses, such specific assurances would generally need to exist in the form of contractual stabilization clauses or, depending on the wording of the clause and the tribunal’s interpretation, unilaterally assumed legislative or regulatory commitments of tax stability. The FET clause is generally somewhat wider in this regard, taking assurances beyond contractual arrangements into account.

c. Non-discrimination provisions

Non-discrimination provisions protect foreign investors and investments against discrimination vis-à-vis domestic investors and vis-à-vis other foreign investors. The national treatment (NT) and most-favoured-nation treatment (MFN) provisions originally aimed to ensure competitive equality between investors with regard to concrete host

³ Importantly, when doing so, States have to ensure that they do not provide so-called collateral benefits under the GloBE Rules (OECD, 2022), see the discussion below in Section 3.

State conduct and treatment under domestic laws and regulations (UNCTAD, 2021).⁴ They require that the host State does not discriminate – *de jure* or *de facto* – on grounds of nationality.

The GloBE Rules impose top-up taxes, by design, exclusively on the profits of constituent entities of in-scope MNEs. A potential tension arises under the non-discrimination provisions from the difference in treatment accorded to entities of in-scope and out-of-scope MNEs. Generally, non-discrimination provisions do not prevent host States from imposing different treatment on investors that are not in “like circumstances”. For example, it is possible to distinguish between investors when they operate in different economic sectors or because of their diverging enterprise sizes. The main difficulty relates to the determination whether constituent entities of in-scope and out-of-scope entities are, in fact, in “like circumstances” with respect to measures related to the global minimum tax.

In the absence of explicit guidance in IIAs on the factors to be considered in the determination of “like circumstances”, arbitral tribunals have wide discretion to determine the scope of the NT and MFN obligations in each specific case (box 3). This has led to surprising outcomes in the past. For example, foreign investors in widely different sectors were seen to be in like circumstances allowing for a comparison of the tax treatment of exporters of flowers, seafood and oil (e.g. *Occidental v. Ecuador*).

The GloBE Rules are far from arbitrary and pursue the dual goal of capturing MNEs with the highest base erosion and profit shifting risk while seeking to avoid the imposition of an undue compliance burden. They apply to so-called in-scope enterprises, internationally operating companies with an annual turnover above 750 million euros. The minimum turnover needs to be achieved in at least 2 out of the past 4 years to avoid triggering obligations in unwarranted circumstances. Moreover, *de minimis* exceptions for small constituent entities and (transitional) safe harbour provisions apply. Furthermore, 750 million euros is the same threshold above which country-by-country reporting obligations are triggered for large enterprises (OECD, 2022).

In arbitral jurisprudence, it has been acknowledged that the size of an enterprise can make a difference when it comes to determining whether companies are in like circumstances (UNCTAD, 2021). Governments may, for example, treat artisanal miners and large mining corporations differently (e.g. *Infinito Gold v. Costa Rica*). Tribunals also found that the size of an investment project can mean that they are not proper comparators (e.g. *Pawlawski AG v. Czechia*). Equally, it has been acknowledged that objective thresholds are legitimate when they distinguish between companies based on their capacity, size, and economic dimensions (e.g. *Belenergia v. Italy*).

Box 3. Defining “like circumstances” in new-generation IIAs

Old-generation IIAs commonly include broad non-discrimination clauses without restrictions or qualifications. Many non-discrimination provisions in these outdated treaties do not include a requirement that foreign investors and investment are in “like circumstances”. Arbitral tribunals have, however, largely understood most-favoured-nation and national treatment clauses to implicitly contain this criterion. What factors are to be considered in the determination of likeness is, nevertheless, entirely left to the discretion of the arbitrators when interpreting unqualified provisions.

New-generation IIAs generally clarify that a finding of “like circumstances” depends on the totality of circumstances, including whether the relevant treatment distinguishes between investors or investments based on legitimate public welfare or regulatory objectives (UNCTAD, 2020). Moreover, some treaties clarify that tribunals should take specific factors into account such as the business sector in which the investment operates, the goods or services produced and consumed, the actual or potential impact of the investment on third persons, including the local/regional/national population and environment, the public/private nature of the investment, as well as the aim and purpose of the measure at issue (UNCTAD, 2020).

⁴ MFN provisions have rarely been invoked to challenge the actual level of material treatment given to foreign investors in specific circumstances, for example arising out of the more favourable application of tax measures to investors from third States (UNCTAD, 2010). More frequently, investors rely on MFN clauses to import more investor-friendly provisions from the host State’s IIAs with third States. For example, claimants could attempt to circumvent tax exceptions in the base treaty (where another IIA signed by the host country does not contain them) or try to import an umbrella clause.

Box 3. Defining “like circumstances” in new-generation IIAs

Particularly important with respect to tax measures are distinctions based on the residence of the taxpayer as differences in treatment under tax rules generally flow from residence rather than nationality. Generally, such residence-based distinctions can be read into the “like circumstances” criterion. Some new-generation IIAs now explicitly specify that differences in tax treatment are justified where they arise from differences in taxpayer residence. While this clarification is not needed as such, it may help to prevent some of the overly far-reaching interpretations that occur to this day. Generally, tackling tax avoidance by MNEs and drawing residence-based distinctions between taxpayers constitute legitimate policy purposes that justify differences in treatment.

Source: UNCTAD.

Two potential concerns with respect to the non-discrimination rules in IIAs exist. Both can be mitigated if the implementing jurisdiction makes particular choices when adopting the global minimum tax. Under arbitral jurisprudence, the difference in size that justifies a difference in treatment generally relates to the size of the investment in the host State. The 750-million-euro threshold under the GloBE Rules, however, operates in a different manner. It is the turnover of the entire MNE group to which this threshold applies. This is regardless of where or by which entity this turnover is generated.⁵ Under the GloBE Rules, a QDMTT could be imposed on one entity, part of an in-scope MNE group, but not on an entirely identical equally low-taxed entity that is part of an overall smaller MNE group. To the extent that a state perceives this risk as significant under its IIAs, it could choose to adopt a QDMTT with a lower threshold than 750 million euros (or without a threshold). A phasing in of the obligation for smaller MNEs over time could be justified by reference to the compliance burden which might be proportionately higher for smaller MNEs.

A second potential non-discrimination issue arises by virtue of exempting purely domestic enterprises under the GloBE Rules as currently published. Low-taxed large enterprises that exclusively operate in one jurisdiction, even when exceeding the threshold of 750 million euros, are excluded from the model rules. However, each implementing jurisdiction can decide whether or not to extend the application of the GloBE Rules to wholly domestic companies as has been done, for example, by the EU. If a jurisdiction chooses not to do so, there may be a potential non-discrimination concern where identical entities are treated differently solely by virtue of differences in ownership: one being owned by a multinational enterprise, the other being part of a purely domestic group. States can avoid this risk by extending the operation of the global minimum tax to wholly domestic entities.

Two main criteria form the basis to distinguish between entities under the model rules: first, being part of an enterprise that operates in more than one jurisdiction; and, second, the size of the overall group, exceeding the cumulative threshold of 750 million euros. The subsidiaries of different enterprises could otherwise be perfectly identical, but one is subject to top-up taxes and the other is not. It can be argued that belonging to an MNE group results in circumstances that justify the different treatment. MNE subsidiaries, for example, may have better access to cheaper financing for their operations or can rely on intra-group synergies. They are, hence, not in “like circumstances” as similarly sized domestic companies that do not form part of a larger group. The objective threshold of 750 million euros might then be justified. For large domestic enterprises that have a turnover above the threshold, however, under current arbitral jurisprudence it becomes increasingly difficult to sustain an argument that the difference in treatment is justified.

ISDS award at times recognise that differences in treatment are justified where they arise as a consequence of a globally coordinated approach (see similarly, for example, *Philip Morris v. Uruguay*). The weight that a tribunal gives to such arguments, however, is difficult to predict. Pillar II, with almost 140 participating jurisdictions, constitutes a widespread agreement. The thresholds operated under the GloBE Rules are a consequence of the legitimate aim of fighting base erosion and profit shifting while keeping the administrative burden within bounds. Nevertheless, an assessment of measures related to the global minimum tax under the non-discrimination provisions of IIAs is not straightforward. Pillar II is a non-binding ‘common approach’ (see above, Section 1) and even binding international

⁵ The GloBE Rules provide for a *de minimis* exception, stating that in jurisdictions where the revenue of the MNE group is below 10 million euros and the income does not exceed 1 million euros, no top-up tax is imposed. This primarily reduces compliance costs on part of the MNE.

treaties, while generally being considered as articulating legitimate aims that can justify otherwise discriminatory treatment, have not consistently been recognised by tribunals as shielding governments from challenges.

In the interim of IIA reform, States could adopt several short-term solutions to abate the tensions arising from the non-discrimination provisions in IIAs. Imposing top-up taxes also on large domestic enterprises may help to alleviate the most pressing concerns. The EU is adopting this best-practice approach in a Directive requiring the implementation of the GloBE Rules in EU Member States (EU, 2022). The Directive explicitly does so to “avoid any risk of discrimination”. Additionally, lowering the threshold for enterprises to be in-scope over time or raising effective income tax rates across the board may equally mitigate potential problems. Both of these approaches are acceptable under the OECD’s guidance. Lastly, when adopting GloBE-related measures, a broader review of corporate income tax incentives is preferable over targeting specific in-scope enterprises to avoid the appearance of discrimination. The long-term strategy of governments should, however, be the reform of IIAs to ensure that investment protection rules do not impede the good faith domestic implementation of internationally agreed upon policies and best practices, including the global minimum tax.

d. Expropriation

The expropriation provision is meant to protect foreign investors in case of dispossession of their investments by the host country. Generally, IIAs allow States to expropriate investments as long as the taking is effected for a public purpose, in a non-discriminatory manner, under due process of law and against the payment of compensation (UNCTAD, 2011).

While the relationship between taxation and expropriation is undefined in most IIAs, it is generally held that “confiscatory” taxation amounts to expropriation. Confiscatory taxation is understood to occur in cases where the tax measure has the effect of substantially depriving investors of the value of their investments and where this is not otherwise justified. The threshold for a finding of a “substantial deprivation” is subject to a case-by-case determination by arbitral tribunals.

Previous tribunals have found, for example, that a 20 per cent sales tax on certain beverages was not expropriatory. (see, for example, *ADM v. Mexico*). Similarly, awards have determined that a 99 per cent tax on windfall profits for sales above a certain reference price did not substantially deprive the investor of the value of the investment (see, for example, *Burlington v. Ecuador*). Likewise, taxes that make certain activities less profitable or even uneconomic to continue do not per se amount to an expropriation as governments frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations (*Feldman v. Mexico*).

Generally, the expropriation provision is unlikely to cause problems with respect to the global minimum tax. Measures to implement the global minimum tax need to increase the effective tax rate applicable to “excess profits” to 15 per cent. This level of taxation is hardly sufficient for the measures to attain the character of a “fundamental deprivation”. Moreover, top-up taxes under the GloBE Rules, an increase in headline tax rates or the withdrawal of tax benefits would all be adopted in pursuit of a globally agreed approach. Investors subject to changing rules could hardly plead that they were surprised by the domestic implementation of the GloBE Rules. The coordinated nature in which the global minimum tax is introduced on the international plane evidences its *bona fide* character, meaning the measures benefit from a strong presumption of compliance with IIA disciplines (see similarly, for example, *Phillip Morris v. Uruguay*).

A potential issue that arises under the expropriation clause is the approach adopted by a minority of tribunals of “slicing” an investment into its constituent parts, which are said to constitute investments on their own. The inquiry whether an expropriation has occurred then focuses on, for example, the direct expropriation of a tax-free licence as opposed to the economic impact on the entirety of the investment, i.e. the subsidiary or permanent establishment of the MNE. To illustrate, the tribunal in *Ampal-American and others v. Egypt* found that a licence to operate tax free until a specified moment in time is a vested right that can be expropriated separately. Other tribunals have strongly disagreed with this approach, instead contending that an investment must be viewed as a whole to determine whether it has been subject to expropriation (see, for example, *Electrabel v. Hungary*). It is questionable that future tribunals rely on this controversial approach of dividing investments up and finding that the tax treatment of an investment constitutes a separate investment on its own that can directly be expropriated by means of regulatory action.

3. Mediating the relationship between IIA disciplines and the global minimum tax

The preceding discussion reveals that measures to implement the global minimum tax could, subject to the specific circumstances of individual investors, create tensions with international investment commitments. It is, however, unlikely that the introduction of the global minimum tax will cause a wave of investor–State arbitrations under IIAs. This is the case for a number of interrelated reasons, discussed below.

a. The (partial) replacement of income-tax incentives: the role of ISDS and rules on “collateral benefits”

There is considerable uncertainty as to the way in which relevant IIA clauses will be interpreted and much depends on the particular circumstances of individual investors. Given the structure of the GloBE Rules, low-taxed profits of MNEs are subject to top-up taxes somewhere. This can be in the State where they arise, under a QDMTT, in a State higher up the corporate chain, under the IIR, or in a third jurisdiction, under the UTPR. Thus, even escaping minimum taxation in one country has potentially a limited or no effect on lowering the overall income tax burden of the MNE group. Consequently, MNEs have little incentive to preserve corporate income tax incentives in jurisdictions where their overall burden is below the agreed minimum. For investors it arguably matters little where top-up taxes are levied. For governments, this locational question is far more relevant.

Given the fact that low-taxed income will be subject to tax somewhere, there is a risk that MNEs request that corporate income tax incentives be replaced with economically comparable benefits that are only indirectly captured by the global minimum tax. Such incentives affect the cost structure and profitability of an entity rather than directly the effective tax rate. A straightforward example would be the granting of a cash benefit instead of a reduced corporate income tax rate. The GloBE Rules foresee this possibility and limit the ability of governments to provide so-called “collateral benefits”, which circumvent the global minimum tax. Where a jurisdiction collects a QDMTT to nominally comply with the minimum tax but then provides a related benefit, the QDMTT is considered not to have been levied in the first place. This triggers a top-up tax elsewhere, negating the economic advantage obtained by the investor. The commentary to the model rules explaining this provision is intentionally drafted in a broad manner. The previously mentioned cash grant, or, for example, a tax refund linked to the QDMTT, is captured by the GloBE Rules. There are, however, other benefits that an outside observer might not be able to link to a QDMTT. Refunds of customs duties, export taxes and sales taxes could be designed in a targeted manner but would, on paper, be benefits that accrue to all taxpayers and are not directly linked to any top-up taxes. Similarly, renegotiated production sharing or royalty agreements could increase the investor’s profits to neutralize the economic impact of a QDMTT. The same holds for public spending on infrastructure, which can be targeted. The anticipated peer review and ongoing monitoring process for the global minimum tax would seek to prevent the artificial refunding of any QDMTT in this manner. However, it remains to be seen whether it will be able to achieve this objective in practice. While effectively dealing with harmful income tax competition, the GloBE Rules may mean that the race to the bottom (or the top of incentives) partially shifts to different arenas (UNCTAD, 2022a).

Given the design of the global minimum tax, investors are likely eager to obtain incentives that raise income instead of lowering the effective tax rate, while simultaneously avoiding the receipt of a collateral benefit. Why would governments agree to do so? The answer to this question is heavily country dependent and, in many ways, relates to the reasons why low corporate income taxes were granted in the first place. In the short- and medium term after the introduction of the global minimum tax, IIAs may constitute an additional factor that induces governments to agree to the (partial) replacement of incentives, even in situations where normally they would not want to do so.

Tax jurisdictions have a choice to increase the effective tax rate of low-taxed entities or, alternatively, not to do so. For a jurisdiction not to raise the tax rate means that investors have no basis on which to bring any ISDS dispute. However, this also implies that another jurisdiction, likely a developed country, soaks up the entirety of the tax incentive under the IIR or UTPR. Tax jurisdictions may not be particularly amenable to these prospects. A solution would be to return such tax revenue, for example, in the form of development aid. Alternatively, tax jurisdictions may decide not to forego the additional tax income and impose a QDMTT or otherwise raise the effective tax rate for low-taxed MNE affiliates. When doing so, they may, depending on the individual circumstances of an investor, face the risk of an ISDS claim.

Normally, such claims should be discouraged by the design of the GloBE Rules. However, as discussed above, the secrecy of ISDS proceedings may mean that challenging a top-up tax goes unnoticed. In this case, a QDMTT would still count as such in contravention of what the GloBE Rules prescribe. Moreover, it is unclear how tax

administrations would deal with damages awarded in ISDS proceedings or an agreed settlement. The value of an arbitral award is generally treated as income for tax purposes. If damages were awarded to the host State entity, usually done net of taxes, they would constitute a cash payment directly related to a top-up tax and, thus, constitute a collateral benefit. The investor does not derive a net economic benefit from such an award. In past cases where affiliated host and home State entities jointly brought proceedings, tribunals have at times ordered payment of the entire award directly to the foreign investor to avoid taxation of the award in the investor host State (for example, *PSEG v. Turkey*, and *Corn Products v. Mexico*). The monetary damages would count as income in the investor home State and be subject to taxation there. The question arises if this income could in some way be treated as a collateral benefit. Under the current rules, any related benefit is considered to constitute a collateral benefit. However, in the case of an international arbitral award this is difficult as the award is part of the (taxable) income of another entity in a different jurisdiction, that of the investor home State. The link becomes even more tenuous where an award is sold on the secondary market. Damages under the assigned award are then collected by an entity unrelated to the original investor. In this scenario, investors gain a net benefit from a finding that the modified tax treatment in the host State constitutes an IIA violation.

Most host States likely prefer to raise tax revenue themselves, as opposed to letting other jurisdictions soak up their tax base. However, they do not gain additional revenue from the imposition of top-up taxes in cases where this violates IIA obligations (ISDS as a threat). At the same time, investors have to speculate on the uncertain outcome of ISDS proceedings and the unclear treatment of a resulting damages award (ISDS as uncertainty). The partial replacement of incentives, depending on each parties' bargaining power, becomes a possible middle-path scenario. The revenue foregone by tax administrations in the case of the non-imposition of top-up taxes does not create a net benefit to investors as the low-taxed income is subject to the minimum elsewhere. This brings MNEs to the negotiating table. IIAs, *depending on the factual circumstances*, enhance the investor's leverage. Any direct or indirect withdrawal of incentives could potentially be challenged, preventing the host State from gaining additional tax revenue. Meeting in the middle, while partially undermining the minimum tax, could be in the interest of both parties. The sophisticated design of the GloBE Rules here enhances the host State's leverage in the renegotiation of corporate income tax incentives.

Expert knowledge of international legal obligations across different fields of specialization is necessary for governments to assess whether and how to engage in the renegotiation of incentives. A detailed understanding of investment disciplines allows for an assessment of the validity of investor claims, which are heavily dependent on their individual situation. The existence of circumstances that can give rise to valid claims constitutes a key factor in determining whether countries might want to restructure corporate income tax incentives or may safely omit doing so. Tax rules, in turn, are relevant to avoid the provision of so-called "collateral benefits" that may disqualify already collected top-up taxes (OECD, 2022a).

b. Moving forward: policy options in the short- to long-term

The above discussion should not be understood as implying that tax jurisdictions should refrain from the introduction of top-up taxes or the review and withdrawal of inefficient corporate income tax incentives. Instead, it seeks to highlight problems with the existing international investment regime, which is in dire need of reform. It also underlines the necessity for coordinated action with respect to tax and investment policymaking on the international plane. UNCTAD previously proposed a multilateral instrument that clarifies the relationship between the global minimum tax and IIAs to create legal certainty and ensure that the latter does not impede the implementation of the former (UNCTAD, 2022). This instrument could be adopted in a self-standing manner or as part of a larger package of treaty-based measures for the implementation of Pillars I and II. Table 1 further sets out some of the relevant short-term considerations to avoid any potential friction between the minimum tax and IIAs.

In the mid- to long-term, continuous action should be taken in two areas. First, old-generation IIAs should be reformed. The adoption of the global minimum tax is but one of the many issues that underline the urgency of IIA reform. This reform process should, among others, ensure that IIAs do not impede the implementation of internationally agreed policies in areas such as tax, climate change and health. Recent IIAs generally fare better in safeguarding policy space while protecting investors. Commonly, recent IIAs have more refined clauses that explicitly guide the interpretation by arbitral tribunals. UNCTAD's IIA Reform Accelerator (UNCTAD, 2020) provides reform options for most of the treaty clauses discussed above, including those relevant to tax measures. States can directly rely on the proposed model language in the IIA Reform Accelerator or adapt it to their specific developmental objectives. With respect to tax measures specifically, recent IIAs provide for a variety of approaches such as full or

partial carve-outs and joint veto procedures. Especially the latter directly allow States (often in the form of their tax authorities) to participate in the assessment of the IIA compatibility of tax measures.

Second, a coordinated approach on tax and investment is necessary. On the international plane, further discussion and research on how to integrate both areas of policymaking is needed (see, for example, UNCTAD, 2018). UNCTAD has previously called for a synergistic approach with respect to the tax-investment policy link and pointed out that national or international action to tackle tax avoidance should consider interdependencies with IIAs (UNCTAD, 2015). On the national level, inter-ministerial task forces that allow different government stakeholders to exchange experiences and work in an integrated manner can help to ensure a consistent approach to tax-based incentives for investment. Most tax administrations could develop technical expertise with respect to IIA disciplines through closer interaction with government departments in charge of the negotiation of IIAs and the defence of ISDS cases and vice versa. To support this engagement, various recent UNCTAD publications directly deal with the interaction of tax and investment policymaking (UNCTAD, 2022a). For example, UNCTAD has published a guide on [International Investment Agreements and Their Implications for Tax Measures: What Tax Policymakers Need to Know](#) (UNCTAD, 2021). A twin guide on DTTs for investment policymakers is forthcoming. Other organizations equally seek to support governments in implementing the global minimum tax (for example, IISD, 2023; ATAF, 2023). UNCTAD will continue its work to bring the tax and investment communities closer together.

Table 1. Short-term considerations relating to IIAs and the implementation of the global minimum tax

Issue	Explanation
Are there any MNE entities in the jurisdiction that are subject to GloBE Rules and that could invoke the protective standards of an IIA?	Even the existence of a single in-force treaty could prove to be relevant. Governments should bear in mind that arbitral tribunals allow investors to (re)structure investments to rely on IIAs. There are very few jurisdictions where no constituent entities of in-scope enterprises operate or that have no or very few IIAs.
Does the national IIA network consistently exclude tax measures from the scope of the relevant provisions (FET, MFN, NT, umbrella and expropriation clauses)?	Where tax measures are consistently and fully excluded from IIAs, the risk of investor claims is significantly lowered. However, tax carve-outs in existing IIAs are often partial. Moreover, MNEs could potentially rely on investor-State contracts or domestic investment laws which grant treatment that is substantively and procedurally similar to IIA standards.
Are certain classes of investors granted special tax treatment as the result of discretionary decision-making procedures, for example in negotiated investor-State contracts or arising as a consequence of the admission to special economic zones?	Discretionary decision-making, including specifically negotiated outcomes, may support an investor's claim to legitimate expectations or with respect to regulatory stability under FET clauses. UNCTAD's research reveals that the majority of tax incentives is granted as a result of such procedures (UNCTAD, 2022a), requiring governments to be particularly careful in reviewing these incentives. The tax-related treatment in investor-State contracts can further be relevant with respect to umbrella clauses in IIAs.
Is there a practice of including stabilization clauses in investor-State contracts or in domestic legislation such as general investment codes or sector-specific rules?	Stabilization clauses such as tax freezing or economic rebalancing clauses are sometimes included in State contracts or legislation and can be a relevant factor when assessing the investor's expectations of receiving the promised treatment. They are also relevant in assessing potential breaches of umbrella provisions in IIAs.
Are there large domestic enterprises to which top-up taxes do not apply or which are otherwise exempted from measures seeking to ensure compliance with the global minimum tax?	Different treatment of purely domestic companies can create problems under the NT provisions of IIAs. ISDS tribunals may find that national investors are in "like circumstances" as foreign investors who are affected by the implementation of the global minimum tax. Tax authorities avoid a risk of adverse findings by treating large foreign and domestic investors similarly when in like circumstances.
Does the review of income tax incentives exclusively target in-scope companies?	MFN and NT provisions can be relevant where tax authorities engage in a more comprehensive review of incentives granted to attract investment. To lower the risk of adverse findings, the revision of incentives should be wider in scope and not selectively and exclusively target companies that are likely to be affected by the GloBE Rules.
Is the application of the proposed implementing measures prospective in nature and does it follow requirements of transparency and due process?	IIAs are not only relevant with respect to the substantive treatment of foreign investors. They also impose process-related obligations. The implementation of any tax measures in relation to the global minimum tax should ensure adherence to standards of good governance to avoid litigation risk.

Source: UNCTAD.

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Reform Package for the International Investment Regime (2018)

https://investmentpolicy.unctad.org/uploaded-files/document/UNCTAD_Reform_Package_2018.pdf

Reforming Investment Dispute Settlement: A Stocktaking (IIA Issues Note, No. 1, March 2019)

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International Investment Agreements Reform Accelerator (2020)

https://unctad.org/system/files/official-document/diaepcbinf2020d8_en.pdf

IIA Toolbox for Promoting Sustainable Energy Investment (2023)

https://unctad.org/system/files/official-document/wir2023_en.pdf

UNCTAD Investment Policy Online Databases

International Investment Agreements Navigator

<https://investmentpolicy.unctad.org/international-investment-agreements>

IIA Mapping Project

<https://investmentpolicy.unctad.org/international-investment-agreements/iaa-mapping>

Investment Dispute Settlement Navigator

<https://investmentpolicy.unctad.org/investment-dispute-settlement>

Investment Laws Navigator

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