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Pillar Two and tax treaties

The unresolved treaty challenges of the UTPR

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01 Introduction

The Global Anti-Base Erosion (GloBE) Model Rules agreed by the OECD/G20 Inclusive Framework in 2021 apply to multinational enterprise (MNE) groups whose consolidated revenues in at least two of the four preceding Fiscal Years equal or exceed EUR 750 million and are designed to ensure that such groups are subject to a minimum effective tax rate (ETR) of 15 per cent, through top-up taxes where the jurisdictional effective tax rate falls below that level.¹ The rules “are intended to be implemented as part of a common approach”,² yet they operate within and in tension with a network of more than 3,000 bilateral tax treaties allocating taxing rights between states.³

Whether the resulting top-up taxation is consistent with those treaties is among the most contested questions in contemporary international tax law. The Inclusive Framework maintains that the rules were designed to be compatible with treaties based on the OECD and UN

¹ OECD, Tax Challenges Arising from the Digitalisation of the Economy - Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS (OECD Publishing 2021) art 1.1.

² OECD, Tax Challenges Arising from the Digitalisation of the Economy - Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two) (OECD Publishing 2022), Introduction.

³ 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’ (Working Paper, 19 November 2021) <<https://ssrn.com/abstract=3967198>> accessed 27 September 2026, published as (2022) 14(1) World Tax Journal 3 (page references are to the working paper), analysing explicitly how the GloBE rules (IIR and UTPR) interact with tax treaties and identifying treaty obstacles and the risk of treaty override where Pillar Two is implemented in domestic law without treaty amendment.

Models;⁴ a substantial body of scholarship disagrees, at least as regards the Undertaxed Profits Rule (UTPR).⁵

This article argues that the question admits no single answer and compatibility must be assessed rule by rule.

02 The GloBE rules

The GloBE rules provide two interlocking charging mechanisms – the Income Inclusion Rule (IIR) and Undertaxed Profits Rule (UTPR). Under the IIR a parent entity is charged top-up tax on its allocable share of the low-taxed income of constituent entities, applied top-down through the ownership chain.⁶ The UTPR plays the backstop role: where low-taxed income is not fully captured by a qualified IIR, jurisdictions in which the group has constituent entities deny deductions or make an equivalent adjustment, with the residual top-up tax allocated by a two-factor formula of the number of employees and the net book value of tangible assets.⁷

There are two additional mechanisms in the overall Pillar Two framework: a Qualified Domestic Minimum Top-up Tax (QDMTT), levied by the low-tax jurisdiction under its own law (a domestic minimum top-up tax), reduces the jurisdictional top-up tax under the GloBE rule order, giving that jurisdiction first claim to the top-up.⁸ The Subject to Tax Rule (STTR), a treaty-based rule allowing source states to tax certain intra-group payments subject to an adjusted nominal tax rate below 9 per cent, is implemented through treaty amendment.⁹

⁴ OECD, Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), February 2023 (OECD Publishing 2023) Background.

⁵ cf Jefferson VanderWolk, 'The UTPR: Taxing Rights Gone Wild' (2022) 108 Tax Notes International 1369; Peter Hongler and others, 'UTPR – Potential Conflicts With International Law?' (2023) 111 Tax Notes International 141.

⁶ GloBE Model Rules (n 1) arts 2.1–2.3.

⁷ *ibid* arts 2.4–2.6.

⁸ *ibid* art 5.2.3.

⁹ OECD, Tax Challenges Arising from the Digitalisation of the Economy – Subject to Tax Rule (Pillar Two) (OECD Publishing 2023) model provision paras 1–4.

03 Methodology: interpreting GloBE through tax treaties

Tax treaties limit, rather than create, domestic taxing powers, so conflict arises only where a treaty provision prohibits the taxation that GloBE legislation imposes. Domestic rules imposing taxation contrary to a treaty breach it at international law: under principles reflected in the Vienna Convention on the Law of Treaties (VCLT), a state must perform its treaties in good faith and cannot invoke internal law to justify non-performance, so such taxation constitutes an internationally wrongful act engaging state responsibility even where domestic constitutional rules permit it.¹⁰ Chand, Turina and Romanovska accordingly identify treaty override as a central risk of enacting the GloBE rules in domestic law without treaty amendment – a state may secure domestic effectiveness, but at the price of international responsibility, a risk that, on their analysis, can only be removed by treaty-based solutions.¹¹ Interpretation follows VCLT Articles 31-32; this matters because the Inclusive Framework's consensus documents may qualify as subsequent agreement or practice under Article 31(3), provided that the agreement of the parties to the particular treaty on its interpretation can be established.¹²

A threshold question is whether a top-up tax is a tax covered by Article 2 at all; this is least clear for the UTPR, which imposes liability on one entity by reference to low-taxed profits elsewhere.¹³

04 Arguments against compatibility

04.1 Article 7(1) of the OECD MC and UTPR

The most significant objection is aimed at the UTPR. According to Article 7(1) of the OECD MC, the business profits of a company in one

¹⁰ Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331, arts 26, 27, 31; ILC, Articles on Responsibility of States for Internationally Wrongful Acts (2001) arts 2, 3 and 32.

¹¹ Chand, Turina and Romanovska (n 3) 33-37.

¹² VCLT (n 10) arts 31-32.

¹³ On the classification of top-up taxes under Article 2 see Valentin Bendlinger, *The OECD's Global Minimum Tax and Its Implementation in the EU – A Legal Analysis of Pillar Two in the Light of Tax Treaty and EU Law* (Kluwer Law International 2023) 315-317 (top-up taxes as covered taxes); Allison Christians and Stephen E Shay, 'The Consistency of Pillar 2 UTPR With U.S. Bilateral Tax Treaties' (2023) 109 *Tax Notes International* 445 (UTPR likely not a covered tax until specifically referenced).

contracting state can only be taxed in another state if they are attributable to a permanent establishment in that state. However, the UTPR imposes a charge in jurisdiction A that is calculated by reference to the low-taxed profits of a group entity in jurisdiction B, even if the UTPR entity has no transactional connection with it.¹⁴ Valentin Bendlinger argues that this constitutes taxation of another enterprise's profits without any ownership interest, which the system of the OECD Model does not permit, and that the deduction-denial mechanism cannot mask the fact that foreign profits form the tax base.¹⁵ The UTPR allocation key (number of employees and net book value of tangible assets) has no connection to the location of the undertaxed income, which strengthens the argument that the UTPR ignores the economic-allegiance principles on which the treaty allocation of taxing rights is based.

04.2 Article 9(1) of the OECD MC and UTPR

According to Article 9(1) of the OECD MC, adjustments to profits between associated enterprises are permitted only to reflect arm's length conditions. A UTPR adjustment that effectively reallocates profits between associated enterprises otherwise than at arm's length may arguably conflict with Article 9's function of policing intra-group profit allocation.¹⁶ However, the 2025 Update to the Commentary clarifies that, once profits have been allocated in accordance with the arm's length principle, Article 9 does not generally determine whether expenses are deductible. Deductibility remains a matter for domestic law, subject in particular to Article 24(4).¹⁷

04.3 Article 24 of the OECD MC and UTPR

Article 24(4) of the OECD MC states that disbursements paid to residents of the other contracting state shall be deductible under the same conditions as payments to residents. The Inclusive Framework's position is that the UTPR does not contravene this

¹⁴ GloBE Model Rules (n 1) arts 2.4-2.6.

¹⁵ Bendlinger (n 13) 336-342, concluding that taxing another taxpayer's income in the absence of any ownership interest is impermissible under the system of the OECD Model and that the UTPR is therefore not compatible with tax treaties.

¹⁶ Chand, Turina and Romanovska (n 3) 27-28.

¹⁷ OECD, The 2025 Update to the OECD Model Tax Convention (OECD 2025) Commentary on art 9, para 3.1 <https://www.oecd.org/content/dam/oecd/en/publications/reports/2025/11/the-2025-update-to-the-oecd-model-tax-convention_c7031e1b/5798080f-en.pdf> accessed 27 September 2026.

standard since the adjustment is based on a jurisdiction's classification as low-taxed rather than on the residence of the recipient. However, it could be argued that this constitutes disguised discrimination – while the criterion is formally residence-neutral, it is inextricably linked to residence because the UTPR may deny a deduction for a payment to a non-resident that would remain deductible if made to a comparable domestic recipient. The objection is weaker where the UTPR is imposed as a separate top-up tax or through the denial of an unrelated deduction.¹⁸

Article 24(5) prohibits the imposition of more onerous tax obligations on enterprises whose capital is owned or controlled by residents of the other state. As the UTPR, in practice, falls on local constituent entities of foreign-owned groups – a burden that domestically owned groups typically do not bear – an argument of ownership discrimination is possible. However, the argument succeeds only if a comparable domestically owned enterprise is treated more favourably because of foreign ownership rather than low-taxed income.¹⁹

04.4 OECD MC and IIR

Although it is less visible, the IIR is not entirely immune. Where a treaty follows the exemption method (Article 23A), taxing a resident parent on the exempt profits of a foreign permanent establishment through the IIR potentially recaptures income that the treaty requires the residence state to exempt. Treaties containing tax sparing clauses raise a parallel concern: top-up taxation claws back precisely the incentive relief that the treaty promised to preserve.²⁰ Finally, Article 10(5) prohibits a state from taxing a company's undistributed profits where the company is resident in the other state and derives profit from the first state. An objection therefore requires treating the IIR, although formally imposed on the resident parent, as in substance a tax on the foreign subsidiary's undistributed profits.²¹

¹⁸ OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint (OECD Publishing 2020) para 691; Chand, Turina and Romanovska (n 3) 28–31 (analysing the Blueprint design).

¹⁹ *ibid* 30–31.

²⁰ Chand, Turina and Romanovska (n 3) 14–18; Bendlinger (n 13) 331–336, concluding that the saving clause preserves the IIR under credit-method treaties but not under treaties applying the exemption method to permanent establishment income.

²¹ Chand, Turina and Romanovska (n 3) 4–7.

05 Arguments for compatibility

05.1 Controlled foreign company rules and IIR

The orthodox defence of the IIR rests on the treatment of controlled foreign company (CFC) rules. The OECD Commentary states that CFC-type taxation does not infringe Article 7(1) or Article 10(5), because the tax falls on the resident shareholder in respect of its own liability, not on the foreign company.²² The IIR is structurally analogous in the relevant respect: the parent jurisdiction taxes its own resident by reference to foreign income. On this view, treaties do not restrict a state's taxation of its own residents – a principle now codified in Article 1(3) of the 2017 OECD Model, which provides that the Convention “shall not affect” a state's taxation of its residents.²³ Where the saving clause is present, the IIR debate is substantially weakened, except as regards the provisions expressly carved out of Article 1(3) – notably Articles 23, 24 and 25 – so that the exemption-method objection survives.

05.2 UTPR as a tax on domestic entities

Some scholars characterise the UTPR not as a tax on foreign profits but as a domestic charge on domestic constituent entities, whose amount is merely calculated by reference to group-wide low-taxed income. On this view, Article 7 of the OECD MC restricts taxation of the profits of an enterprise of the other state; it says nothing about how a state computes the liability of its own enterprises. Article 9 of the OECD MC is not engaged, because the UTPR neither re-prices any transaction nor reallocates profits between associated enterprises. Under Article 24 of the OECD MC, the charge turns on the group's jurisdictional effective tax rate, not on the recipient's residence or on foreign ownership.²⁴ The practical stakes are in any event limited: the UTPR stands last in the rule order, behind the QDMTT and the IIR, and

²² OECD, Model Tax Convention on Income and on Capital: Condensed Version (OECD Publishing 2017) ('OECD MC') Commentary on art 1 para 81, art 7 para 14 and art 10 para 37; see also UN Model Double Taxation Convention between Developed and Developing Countries (2017) Commentary on art 1 para 40, art 7 para 8 and art 10 para 16.

²³ OECD MC (n 22) art 1(3).

²⁴ Christians and Shay (n 13); Allison Christians and Tarcísio Diniz Magalhães, 'Undertaxed Profits and the Use-It-or-Lose-It Principle' (2022) 108 Tax Notes International 705.

is designed as a deterrent backstop which, if Pillar Two works as intended, should rarely raise revenue.²⁵

05.3 QDMTT and STTR

The QDMTT is generally the least controversial mechanism under tax treaties, as the low-tax jurisdiction taxes entities located there on their own income, although its treatment may still depend on the relevant treaty.

Conversely, the STTR permits source taxation that existing treaty provisions may otherwise preclude; it is therefore being implemented through a dedicated multilateral instrument, making it compatible by construction.²⁶ This acknowledges that part of the minimum tax package alters treaty outcomes. However, it also demonstrates a deliberate choice to route treaty-modifying rules through treaty amendment, while keeping the IIR and UTPR within the domestic-law space that the Commentary already accommodates.

06 Interim assessment

The rules thus occupy a range of positions: the QDMTT is the least treaty-sensitive; the IIR is defensible, particularly where the saving clause applies; the STTR is compatible by design; and the UTPR is the subject of significant debate, with a legal challenge to Belgium's UTPR currently pending before the Court of Justice of the European Union. That reference tests the UTPR against EU primary law, including the Charter, the fundamental freedoms and the principle of fiscal territoriality, rather than against tax treaties.²⁷ Consistency must be assessed not for "the global minimum tax" as a whole, but for each rule under each treaty - which is precisely why additional measures to ensure consistency matter.

²⁵ Michael P Devereux, 'International Tax Competition and Coordination with a Global Minimum Tax' (2023) 76(1) National Tax Journal 145, 154, 157, 162.

²⁶ Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule (adopted 15 September 2023, opened for signature 2 October 2023) <<https://oe.cd/sttr-mlt>> accessed 27 September 2026 ('STTR MLI'); in force for Albania and San Marino from 1 January 2027 following the deposit of the second instrument of ratification (Albania, 15 September 2026); entry into force of the Convention is distinct from its entry into effect for a particular Covered Tax Agreement under art 12.

²⁷ Belgian Constitutional Court, judgment no 104/2025 of 17 July 2025, ECLI:BE:GHCC:2025:ARR.104; Case C-519/25 American Free Enterprise Chamber of Commerce v Ministerraad, request for a preliminary ruling lodged 31 July 2025 [2025] OJ C/2025/5575 (pending).

07 Ensuring consistency and reducing disputes

07.1 Domestic measures

States can minimise conflict at the implementation stage.

Implementing the Model Rules essentially verbatim, and treating the Commentary and Administrative Guidance as interpretive sources – as the EU Directive in substance secures among Member States – preserves the shared interpretive framework on which qualified status depends, although it cannot by itself cure a conflict with a treaty concluded with a third state.²⁸

Adopting a QDMTT moves top-up taxation onto the least controversial domestic ground and, where the QDMTT also meets the QDMTT safe harbour standards, largely pre-empts exposure to the IIR and UTPR.²⁹

Legislatures can also clarify the relationship between GloBE charges and treaty obligations. However, deliberate treaty override remains an option for dualist states, despite the fact that it breaches the treaty – a breach that domestic law cannot excuse under VCLT Articles 26 and 27.³⁰

07.2 Bilateral measures

Treaty partners can insert the Article 1(3) saving clause into older treaties to remove most doubts regarding the IIR; they can also renegotiate or switch off tax sparing and exemption-method provisions that conflict with top-up taxation, or adopt purpose-built ‘safeguard clauses’ that expressly authorise the application of qualified GloBE rules notwithstanding other treaty provisions – a solution proposed by Chand, Turina and Romanovska.³¹ However,

²⁸ Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union [2022] OJ L328/1, recital 24 (directing Member States to use the OECD Model Rules and accompanying guidance as a source of illustration or interpretation).

²⁹ OECD, Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023 (OECD Publishing 2023) ch 5 (QDMTT Safe Harbour) <<https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf>> accessed 27 September 2026.

³⁰ Chand, Turina and Romanovska (n 3) 33–37.

³¹ Chand, Turina and Romanovska (n 3) 43–45.

bilateral renegotiation is slow and piecemeal, given the thousands of treaties involved.

07.3 Multilateral measures

The efficient path is multilateral. The STTR MLI offers a template for a broader Pillar Two instrument inserting saving and safeguard clauses across the treaty network in one step, as the BEPS MLI did for treaty abuse.³² Short of amendment, Inclusive Framework instruments – the Commentary, Administrative Guidance and peer-review outcomes – may, subject to conditions noted above, operate as subsequent agreement or practice under VCLT Article 31(3), guiding interpretation toward accommodation. The qualification architecture likewise reduces disputes: centralised determination that a jurisdiction’s rules are “qualified” forestalls unilateral second-guessing – though it concentrates interpretive power in the Inclusive Framework and does not bind courts on treaty compatibility; since September 2026, qualified status is also subject to full legislative review.³³ Limits remain: GloBE top-up taxes may not be “taxes covered” under Article 2 of every treaty, casting doubt on the success of a claim under the mutual agreement procedure, and no GloBE-specific arbitration yet exists.³⁴ Finally, the January 2026 Side-by-Side Package accommodating the United States illustrates both the system’s capacity for pragmatic conflict-avoidance and its fragility: some of the most significant disputes are being managed politically, outside the treaty framework altogether.³⁵

³² STTR MLI (n 26); Chand, Turina and Romanovska (n 3) 47 (proposing a dedicated Pillar Two multilateral instrument).

³³ OECD/G20 Inclusive Framework on BEPS, Central Record of Legislation with Transitional Qualified Status (OECD 2025) <<https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-globe-rules-pillar-two-central-record-legislation-transitional-qualified-status.pdf>> accessed 27 September 2026; OECD/G20 Inclusive Framework on BEPS, Terms of Reference and Methodology for the Full Legislative Review (OECD, 11 September 2026) <<https://www.oecd.org/en/topics/sub-issues/global-minimum-tax/global-anti-base-erosion-model-rules-pillar-two.html>> accessed 27 September 2026.

³⁴ Chris Noonan and Victoria Plekhanova, 'Mandatory Binding Dispute Resolution in the Base Erosion and Profit Shifting (BEPS) Two Pillar Solution' (2023) 72 International and Comparative Law Quarterly 437, 455–457; on whether GloBE top-up taxes constitute covered taxes under Article 2 see Bendlinger (n 13) 315–317.

³⁵ OECD/G20 Inclusive Framework on BEPS, Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), Side-by-Side Package (OECD 2026) <<https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/side-by-side-package.pdf>> accessed 27 September 2026.

08 Conclusion

The global minimum tax is neither consistent nor inconsistent with tax treaties as a whole; consistency is a property of each rule under each treaty. The QDMTT is the least treaty-sensitive mechanism, the IIR is defensible, and more clearly so where the saving clause applies, the STTR is compatible by construction once in effect for the relevant treaty, and the UTPR remains genuinely contested. A significant judicial examination of the UTPR – albeit under EU primary law rather than tax treaties – will come from the Court of Justice of the European Union in Case C-519/25, pending as at 27 September 2026. Until that ruling is issued, the most effective safeguards are those examined above: faithful domestic implementation, adoption of the QDMTT, bilateral saving and safeguard clauses, and ultimately a multilateral instrument based on the STTR model. The United States’ Side-by-Side approach shows that the most serious conflicts can be resolved politically, but long-term consistency requires the GloBE rules to be embedded in treaty law itself.

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