Challenges at the intersection between investment provisions in regional trade agreements and implementation of the GloBE Rules under Pillar Two*

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Abstract

A number of regional trade agreements (RTAs) include investment protection provisions that may limit a country's ability to change tax measures. This limitation could raise concerns for States as regards the recently agreed global minimum tax under the Global Anti-Base Erosion (GloBE) Rules, as its implementation could amount to a breach of investment obligations. Therefore, this paper analyses how the GloBE Rules and their impact on investment incentives interact with investment provisions in RTAs, also considering the impact of the minimum tax on regional integration efforts and the potential for a regional approach to its implementation.

Keywords: GloBE, IIA, international taxation, Pillar Two, RTA, tax incentives

JEL classification codes: F13, F21, F23, H25, K34

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1. Introduction

From an economic standpoint, investment protection is argued to increase foreign direct investment (FDI) by providing certainty to investors and lessening the risks they face.[1] This argument served as a catalyst for the adoption of international investment agreements (IIAs) that provide rights and protections to investors.[2] Initially countries entered into bilateral agreements between two States, but it has now become the trend to incorporate investment protection rules within regional trade agreements (RTAs) (Lesher and Miroudot, 2007). This shift was largely influenced by the revolution in information and communication technology that transformed the nature of trade by making it "cheaper, easier and faster to coordinate activities from a distance" (Baldwin, 2011).

During this shift, new risks arose for investors, including technical, intellectual property and managerial risks, and it became apparent to policymakers that real economic integration could not be achieved without including investment provisions to alleviate these risks (UNCTAD, 2006). Trade laws at the time, developed for simpler trade concerns, were not sufficient, resulting in a governance gap that was filled by the signing of more in-depth RTAs that tackled complex issues that could not be addressed at a multilateral level, including investment protections. The large jurisdictional protection of investment, additional coverage of issues such as intellectual property, and instances of both pre-entry and post-entry investment protections, make RTAs unique.

Although investment protection provisions are important,[3] other big drivers of FDI are political stability, infrastructure, market and economic potentials, and natural resources (UNCTAD, 2022a). Though not the major factor in investment decisions, the availability of tax relief and other fiscal policies in a jurisdiction are seen as influencing investors, who are more likely to select a location that offer more beneficial incentives, other things being equal (Owens and Zhan, 2018). This has led countries to engage in tax competition to attract and retain investments, competition that is not only characterized by a reduction in corporate tax rates but has also produced a greater reliance on investment incentives (UNCTAD, 2022a).

[1] Laura Puccio, "Investment rules in trade agreements: Developments and issues in light of the TTIP debate", European Parliamentary Research Service, 22 September 2015, https://epthinktank.eu.

[2] IIAs are divided into two types: bilateral investment treaties and treaties with investment provisions. UNCTAD, "International Investment Agreements Navigator", Investment Policy Hub, https://investmentpolicy.unctad.org/international-investment-agreements/ (accessed 1 February 2023).

[3] Although the actual impact of IIAs on FDI has more recently been a subject of intense debate among policymakers, with studies varying in their conclusions, there is a general consensus that IIAs form part of a broader policy framework for investment that affects investment decisions (UNCTAD, 2009). For a review of the evidence of social benefits and costs of IIAs, see Pohl (2018).

However, tax incentives have had minimal impact on FDI flows and decisions on investment locations, rendering this tax competition detrimental to countries' economies as it prevents them from raising significant tax revenues (OECD, 1998). Thus, the international tax arena has long been trying to constrain States' (harmful) tax competition for investment.

In a recent attempt, the international community – through the OECD Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) – has agreed to a minimum effective tax rate (ETR) of 15 per cent on corporate profits. This is the Global Anti-Base Erosion (GloBE) Rules under the Pillar Two solution. Such minimum tax is expected to limit the use of tax incentives to attract investment by putting a floor on tax competition (Liotti et al., 2022; UNCTAD, 2022a). Nevertheless, investment obligations under RTAs may act as barriers to the implementation of the minimum tax as they could protect investors from changes in the domestic law of jurisdictions to adapt to the post-GloBE reality, especially if RTA signatories choose to revoke the tax incentives they offer to investors from other RTA members.

The aim of this paper is to analyse whether the implementation of the GloBE Rules or changes to domestic tax incentive regimes could amount to a breach of RTAs' investment protections. In addition, the paper considers the impact of the global minimum tax on regional integration efforts and the potential for a regional approach to its implementation. The analysis is limited to only five RTAs: the North American Free Trade Agreement (NAFTA), the Agreement between the United States, Mexico and Canada (USMCA), the Southern Common Market Agreement (MERCOSUR), the Association of Southeast Asian Nations Free Trade Area (ASEAN) and the Common Market for Eastern and Southern Africa (COMESA).[4]

Sections 2 and 3 describe the relevant investment provisions within RTAs and provide a summary of the GloBE Rules. Section 4 considers the relationship between investment provisions and measures to implement GloBE Rules, analysing whether the changes in domestic law required to adapt to them can breach RTAs' investment protections based on previous tribunal awards. Section 5 discusses the implications of these challenges for the future of regional integration efforts and proposes a regional approach to implementing the GloBE Rules.

[4] As these RTAs not only cover a large part of the world, but are used as a basis for other IIAs. However, other IIAs may similarly have provisions that limit a country's ability to implement GloBE. Thus, the paper intends to serve as a basis for further research into IIAs to determine whether a review of these agreements will be necessary.

2. Investment provisions in RTAs

2.1 Scope

The approach and depth of investment provisions varies across RTAs, driven by the policy objectives of each agreement.[5] For the purposes of this paper, four provisions are analysed: non-discrimination clauses, fair and equitable treatment (FET) requirements, expropriation clauses and investor–State dispute settlement (ISDS) clauses.

2.1.1 Non-discrimination clauses

Non-discrimination provisions prevent a host country from treating foreign investors less favourably than national investors (national treatment, or NT) or treating foreign investors from one State more favourably than foreign investors from another (most favoured nation treatment, or MFN) (Diebold, 2011). These obligations apply with regard to the post-entry, and in some instances the pre-entry, treatment of investors (UNCTAD, 1999a). They are intended to ensure the same competitive conditions in the host State for foreign and domestic investors (NT) and between two foreign investors (MFN). Consequently, member States are restricted from unduly favouring domestic investors under NT or specific foreign investors under MFN (UNCTAD, 1999a and 1999b). The obligations apply only to investors or investments in "similar" or "like" circumstances.[6] All RTAs under review provide for the application of and exceptions to NT and MFN obligations.[7]

2.1.2 Fair and equitable treatment

Broadly, the analysis of whether a particular State's action has violated the FET provision includes assessing whether the certainty, stability and predictability of the legal framework and the legitimate expectations of foreign investors have been breached (Ranjan, 2022). The FET clause has been criticised for its ambiguous wording, which has led to a broad interpretation by arbitral tribunals (UNCTAD, 2021). On one hand, FET is considered to provide protection similar to that afforded under customary international law; on the other, it is considered to set a higher standard than the international minimum (UNCTAD, 2006). This divergence in approaches has made it challenging to balance foreign investment protection and the sovereign right to regulate matters of public interest (UNCTAD, 2012).

[5] For an analysis of the structure and content of RTA investment provisions, see UNCTAD (2006).

[6] For an analysis of the approaches taken by tribunals in defining likeness, see UNCTAD (2005). The USMCA includes additional provisions that clarify what tribunals should consider when determining "likeness" (article 14.4(4)).

[7] For a deeper analysis of the exclusionary lists adopted in different agreements, see UNCTAD (2006).

Three of the RTAs – ASEAN (article 11), USMCA (article 14.6) and COMESA (articles 14–15) – provide clarifications that limit the FET requirement to the international minimum standards. NAFTA adopted an open-ended approach to FET, leading to several disputes in ISDS. Though NAFTA has been replaced by the USMCA, new NAFTA claims may be filed before 1 July 2023 in relation to disputes that arise out of investments made while NAFTA was in force and which existed on 1 July 2020.[8]

2.1.3 Expropriation

Generally, expropriation provisions prevent direct and indirect expropriation, the latter including "regulatory takings, creeping exportation and acts that are 'tantamount to' or 'equivalent to' expropriation" (UNCTAD, 2021, p. 30). By its very nature, taxation may be seen as a form of indirect expropriation. This must be determined case by case, ensuring that reasonable government action, such as new or modified tax regimes, can be achieved without claims for compensation because of adverse effects (UNCTAD, 2021, p. 37).

NAFTA (article 1110) provides for direct and indirect expropriation, or a measure tantamount to nationalization or expropriation. However, the USMCA offers more clarity on the factors to be considered when determining whether there has been indirect expropriation.[9] MERCOSUR only provides for direct expropriation where "investment is directly expropriated through the formal transfer of the title or the right of ownership" (article 6). COMESA provides for expropriation or measures tantamount to expropriation and also includes an exception for regulatory measures taken by countries to "protect or enhance legitimate public welfare objectives, such as public health, safety and the environment" (article 21). ASEAN (article 14) provides for direct expropriation or measures equivalent to expropriation.

2.1.4 Investor–State dispute settlement

ASEAN (section B), COMESA (article 28), NAFTA (section B, chapter 11) and USMCA (annex 14-D) all provide for ISDS. However, ISDS under the USMCA is available only between the United States and Mexico.

The future of ISDS remains a topic of debate as countries consider how best to balance the need for increased integration and the flexibility of countries to adopt domestic regulations that may be limited as a result of the lock-in effect of investment

[8] Debevoise & Plimpton LLP, "From NAFTA to USMCA: Main changes to the investor–State dispute settlement system", *Debevoise Update*, 7 May 2020.

[9] It considers several factors, including the economic impact of the government actions, the extent to which they interfere with distinct, reasonable investment-backed expectations and the character of the action (annex 14-B, chapter 14).

protections (UNCTAD, 2006). This has led recently to RTAs eliminating ISDS as a whole, though State–State disputes remain, or introducing new provisions to clarify the obligations in the agreement.[10]

2.2 Treatment of tax under RTA investment provisions

An important feature of taxation is that "it is based on the domestic legislative process, which is an expression of national sovereignty" (UNCTAD, 2000, p. 7). This heightens the sensitivity of the discipline and explains the limited inclusion of taxation matters into RTAs. Moreover, dialogue between the investment and tax communities has traditionally been limited.

Therefore, RTAs usually include a general tax carve-out excluding tax matters from the ambit of the agreement. There are also more specific exclusions of the preferential treatment afforded under double taxation treaties (DTTs) from the application of the MFN and NT obligations (UNCTAD, 2000). Moreover, an exclusion may also be provided if a tax measure is adopted to ensure an equitable or effective imposition or collection of taxes. Thus, in principle, the provisions of RTAs do not protect investors in the event of any change in the host State's tax system. However, in some cases, a claw-back in the carve-out is included to restore the application of certain protections in relation to tax measures.

The MERCOSUR Investment Protocol (article 5(6)) excludes preferential treatment afforded under DTTs from the application of non-discrimination provisions. It also states that nothing in the protocol shall be "construed in a manner that prevents the adoption or execution of any measure aimed at guaranteeing the *equitable or effective imposition or collection of taxes* in accordance with the provisions of the legislation of the state parties" (article 10 [emphasis added]). COMESA similarly excludes preferential treatment afforded under DTTs from the application of MFN (article 19), while also providing for a general exclusion of RTA protection for taxation matters, except in regard to the expropriation clause (article 23).

ASEAN (article 3(4)) has a carve-out for taxation matters, except for provisions on transfers and expropriation. DTTs are also given priority over the agreement (article 3(6)). Similar to MERCOSUR, a general exception is also provided to ensure that the agreement shall not prevent the adoption of measures "aimed at ensuring *equitable or effective imposition or collection of direct taxes* in respect of investment or investors of any member state" (article 17(1)(d) [emphasis added]). The disputing member State and the investor's State, also a member State, must determine whether a

[10] The MERCOSUR Investment Protocol does not provide for ISDS, and the USMCA seeks to clarify a number of provisions that have been disputed under NAFTA.

challenged measure is a taxation measure and, in the case of expropriation, whether a tax measure has an effect equivalent to expropriation (article 36(6–7)).

NAFTA excludes preferential treatment under DTTs (article 2103). However, MFN and NT are extended to "all taxation measures, *other than those on income, capital gains or on the taxable capital of corporations*, taxes on estates, inheritances, gifts and generation-skipping transfers" (article 2103(4)(b) [emphasis added]). Moreover, MFN and NT do not apply where the aim of the taxation measure was to ensure "*equitable and effective imposition or collection of taxes* and … does not arbitrarily discriminate between persons, goods or services of the parties, or arbitrarily nullify or impair benefits accorded under those Articles" (article 2103(4)(g) [emphasis added]). NAFTA also provides for a claw-back for the expropriation provision in relation to taxation, but an investor cannot institute a dispute under ISDS if the measure has been determined not to be expropriation by the appropriate competent authorities (article 2103(6), unless such decision is not given within six months.

The USMCA (article 32.3) generally adopts a similar approach to DTTs as NAFTA did, while providing further guidance on treatment of inconsistencies between the agreement and the DTT (article 32.3(3)). It also includes similar provisions on the application of and exclusions to the NT and MFN clauses (article 32.3(6)(b)). Additional exclusion is provided where a taxation measure is aimed at ensuring the "equitable or effective imposition or collection of taxes, *including a taxation measure that differentiates between parties based on their place of residence for tax purposes*, provided that the taxation measure does not arbitrarily discriminate between persons, goods or services of the parties" (article 32.3(6)(h)[emphasis added]). Furthermore, the principle of exhaustion of location remedies is introduced, requiring an investor to have obtained a final decision from a court of last resort in the host State before submitting a claim to arbitration (article 14.4.5). However, this requirement is excluded for certain industries that fall under annex 14-E. Importantly, the ISDS process is limited to the United States and Mexico, where no ISDS claim can be brought by a United States or Mexican investor against Canada. Member States may also include a regime of tax incentives for investors (UNCTAD, 2000). Although none of the agreements reviewed have such regimes, it is important for policymakers to review their IIAs to identify such obligations, as they may have an impact on the implementation of the GloBE Rules.

Despite these robust exclusions, tax-related measures have been disputed under ISDS.[11] This is generally credited to broad language and lack of sufficient clarity in drafting (Uribe and Montes, 2019). Hence, RTAs' carve-outs have not prevented the institution of tax-related disputes.

[11] See annex 3 in UNCTAD (2022c).

3. International tax reform under BEPS 2.0

3.1 The GloBE Rules under Pillar Two

On 20 December 2021, the IF released the GloBE Model Rules (OECD, 2021) to ensure that large MNEs pay a minimum effective tax rate of 15 per cent on income arising in each of the jurisdictions in which they operate, through the application of a top-up tax. The global minimum tax is implemented through three domestic rules:

(i) the ***income inclusion rule*** (IIR), requiring that the ultimate parent entity (UPE) or an intermediate parent entity of an MNE group pay top-up tax on its share of the income of any low-taxed constituent entity (LTCE)

(ii) the ***undertaxed payments rule*** (UTPR), serving as a backstop to the IIR, providing a mechanism for making an adjustment of the top-up tax in relation to profits of a LTCE that is not in the scope of an applicable IIR

(iii) the ***qualified domestic minimum top-up tax*** (QDMTT),[12] allowing the low-tax jurisdiction to charge the top-up tax itself. Such a tax may reduce the top-up tax by the UPE jurisdiction to nil, as GloBE Rules give priority to the application of the QDMTT over the IIR (OECD, 2022a, article 5.2.3, para. 20)

The GloBE Rules are intended to apply to LTCEs of MNE groups that meet a €750 million threshold in the consolidated financial statements of the UPE in at least two of the four preceding fiscal years.[13] There are certain exclusions from the top-up tax application, which depend on the entities' activity and types of income.

For in-scope MNE groups, the top-up tax liability will have to be calculated for each jurisdiction where its constituent entities are located that has an ETR below 15 per cent. The jurisdiction's ETR is calculated through the following formula:

ETR = Adjusted Covered Taxes[14]/Net GloBE Income[15]

If the ETR is below 15 per cent, the jurisdiction is a "low-tax jurisdiction" and a top-up tax percentage has to be calculated, being the difference between the minimum rate and the ETR calculated for that jurisdiction (OECD, 2021, article 5.2.1.). The top-up tax will then be levied on the "excess profit", which corresponds to the

[12] The QDMTT is defined in article 10.1. GloBE Model Rules.
[13] Including excluded entities (OECD, 2022a, article 1.1, para. 12).
[14] Including, generally, income-based taxes (OECD, 2021, article 4.2)
[15] Articles 3.1–3.5 in OECD (2021).

amount of GloBE income for the jurisdiction remaining after applying a “substance-based income exclusion” (OECD, 2021, article 5.2.2), which is a formulaic carve-out that excludes a fixed return on payroll and tangible assets costs from the application of the Rules (OECD, 2022a, article 5.3, para. 25).

3.2 Implications of the GloBE Rules for investment tax incentives

The idea behind the GloBE Rules is that global action is needed both to stop a harmful race to the bottom on corporate taxes and to address the remaining risk of shifting profits to entities subject to low or no taxation. As such, the application of the top-up tax will limit the ability of countries to offer measures that reduce the corporate income tax (CIT) liability below 15 per cent.

The GloBE Rules do not explicitly prohibit countries from offering fiscal incentives or reduced CIT rates. Nevertheless, based on how the Rules are intended to operate, it is expected that the minimum tax will have a profound impact on the use of such incentives and rate reductions (OECD, 2022b; UNCTAD, 2022a). This is because the top-up tax will act in parallel to existing CIT systems to ensure that a group pays at least 15 per cent tax in every jurisdiction in which its constituent entities are located. As such, levying a top-up tax might lead to a situation in which the revenue forgone by one jurisdiction because of tax incentives is recaptured until a minimum 15 per cent tax is achieved.

An overall assessment of the impact of Pillar Two on the main categories of tax incentives adopted to attract FDI is provided by UNCTAD (2022a, table III.2) and Liotti et al. (2022).

4. Implications of investment provisions for the implementation of the GloBE Rules

The implementation of the GloBE Rules will require a number of domestic reforms that may affect an investment, including these three:

- Implementation of the IIR and UTPR: This will require a change in domestic law to introduce a top-up tax and provisions for adjustments.
- Introduction of the QDMTT: Countries may opt to introduce a QDMTT applicable only to in-scope companies or a QDMTT that applies to all taxpayers in the jurisdiction.
- Rationalization of tax incentives: Since the imposition of the top-up tax affects the actual benefit received from CIT incentives, countries may choose to eliminate certain incentives for in-scope companies.

It is therefore important to understand whether any of these changes could constitute a breach of investment protections identified within RTAs and what remedies, if any, are available for investors to challenge these changes.

4.1 Does GloBE amount to a breach of investment provisions under RTAs?

4.1.1 Fair and equitable treatment

Investors commonly rely on the FET provision (UNCTAD, 2005). Tribunals have found that the FET standard is breached where "it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective" (*S.D. Myers v. Canada*, 2020, para. 263). In the merits of claims, tribunals have considered whether the right to stability and predictability of the legal framework and the legitimate expectations of investors were violated (Ranjan, 2022).

In this context, investors could claim that the GloBE Rules and their impact on incentives amounts to a FET breach, arguing that the adoption of the minimum tax will violate the certainty, predictability and stability of the legal framework providing for the incentive. For example, investors could argue that the adverse effect of the GloBE Rules on tax incentives, or their direct revocation by the host State as a response to the Rules was unpredictable and not in line with their expectations of regulatory stability, on which the investor relied when making an investment in that jurisdiction. In certain circumstances, it could be argued that the State promised or assured investors that the incentives would be made available, giving rise to a legitimate and reasonable expectation.

Such an argument can be made both if the host country chooses to repeal tax incentives and if it elects to retain incentives and introduce the QDMTT for in-scope companies. In the latter case, the QDMTT would negate the benefits of the incentives, as a top-up tax would increase the financial burden on the investor, arguably leading to instability and uncertainty for investors and being against their legitimate expectations.

As discussed in section 2, the RTAs reviewed have carve-outs for taxation and no exceptions are provided for the FET requirement. This means that the FET obligation may not protect investors in the event of any change in the tax system of the invested jurisdiction. Thus, in principle, for the agreements under review, tax measures could not be challenged under FET (*Feldman v. Mexico*, 2002, para. 141). Nevertheless, as further discussed in section 4.1.4, the application of the tax carve-out is deemed contingent on the State's conduct being considered a bona fide taxation measure, whereby if investors can prove that the adoption of the minimum tax is a mala fide measure, they will be able to rely on the FET in ISDS irrespective of the carve-out.

In a previous tax-related claim based on a violation of the FET provision in NAFTA, the tribunal stated that a government's conduct towards an investment may be a violation of the customary FET obligation if it "amounts to gross misconduct, manifest injustice or […] bad faith or the wilful neglect of duty, whatever the particular context the actions taken in regard to the investment" (*Cargill v. Mexico*, 2009, para. 286). According to the tribunal, the action might fail to meet the FET requirement if

> …the complained of measures were grossly unfair, unjust or idiosyncratic; arbitrary beyond a merely inconsistent or questionable application of administrative or legal policy or procedure so as to constitute an unexpected and shocking repudiation of a policy's very purpose and goals, or to otherwise grossly subvert a domestic law or policy for an ulterior motive; or involve an utter lack of due process so as to offend judicial propriety (*Cargill v. Mexico*, 2009, para. 296).

In effect, the assessment of whether the State's conduct is "fair" and "equitable" broadly depends on the facts of the particular case. Such an obligation has to be enforced while examining the background and justifications for the change in the legal framework and its impact on the investment. That is, despite having an obligation to provide FET in RTAs, absent a stabilization clause or similar provision, States should still be free to change their regulatory regime and legal framework as an exercise of their sovereignty and in line with their policy objectives, without automatically incurring a breach of investors' legitimate expectations of stability and predictability of the system. In contrast, an actual violation of the FET may occur "where the investor has acquired rights, or where the state [sic] has acted in such a way so as to generate a legitimate expectation in the investor and that investor has relied on that expectation to make its investment" (*Micula v. Romania*, 2013, para. 667).

Based on this rationale, a claim challenging GloBE Rules under FET seems unlikely to succeed as not only might it be difficult for investors to prove that application of the Rules and/or withdrawal of an incentive is a mala fide taxation measure (so that the carve-out does not apply), but also that its effects (albeit unexpected) amount to gross misconduct and manifest injustice towards the investor affected.

4.1.2 Non-discrimination clauses

The GloBE Rules and their effects on incentives could be seen as discriminatory, since the top-up tax will in principle apply only to corporations that are members of MNE groups, thus affecting only "foreign investors". This could be seen as a discrimination (or a difference in treatment) based on nationality. If, for example, an incentive is granted generally to every company located in the territory of a State (thus, to both domestic and foreign investors) and owing to the GloBE Rules' operation, the incentive becomes ineffective only for foreign investors, or the host

State opts to withdraw the incentive only for in-scope companies, this could raise issues of violation of the NT provision in RTAs. In addition, a country may opt to introduce a QDMTT that applies only to in-scope companies while exempting domestic companies, where an argument could be made that the foreign investors are being treated less favourably than domestic companies in "like circumstances" and that therefore the country is breaching NT provisions.

For claims on NT, tribunals consider a number of factors, including (i) whether domestic investors are in "like circumstances" with the foreign investor making a claim, (ii) whether there has been discrimination, (ii) whether treatment is as a result of nationality and (iii) whether the foreign investor should receive the most favourable treatment given to domestic investors (*Feldman v. Mexico*, 2002, para. 166). A determination of "like circumstances" involves examining whether the foreign and domestic investors are in "the same sector, which [is] is interpreted widely to include the "economic sector" and "business sector" (*S.D. Myers v. Canada*, 2020, para. 250). This examination includes an analysis of the competitive relationship between the foreign and domestic investors (*ADM v. Mexico*, 2007, para. 199). As this is a high standard, satisfying the likeness test – that the MNE is in "like circumstances" with the domestic company – may prove challenging, though not completely impossible.

Moreover, the general tax carve-outs in RTAs may limit claims of an NT breach. As mentioned earlier, although the USMCA, NAFTA, and other RTAs were modelled after this approach and include a claw-back for NT and MFN provisions that restores their application, such claw-backs usually apply only to cases that do not relate to income and taxable capital of corporations. As such, investors may not be protected in relation to application of the GloBE Rules and withdrawal of tax incentives as they relate to taxation of income and profits of corporations.

Where the RTA does not include a claw-back but allows for the adoption or application of a measure aimed at ensuring the equitable and effective collection of taxes as provided for in the States' domestic legislation,[16] it also seems unlikely that a tribunal would find the application of GloBE Rules or the withdrawal of a tax incentive to be a breach of NT obligations.[17] This is especially because it could be argued that since the GloBE Rules aim to curb tax competition and ensure a minimum level of taxation on large MNE groups to reduce profit shifting, it may be a measure adopted to ensure an "equitable" and "effective" collection of taxes.

[16] Article 10(2), MERCOSUR Investment Protocol, and article 17(1)(d), ASEAN.

[17] It is important to mention that the USMCA as well, in article 32.3(6)(h), provides that nothing in the articles included in the claw-back apply to "the adoption or enforcement of a new taxation measure aimed at ensuring the equitable or effective imposition or collection of taxes, including a taxation measure that differentiates between persons based on their place of residence for tax purposes, provided that the taxation measure does not arbitrarily discriminate between persons, goods, or services of the Parties".

Therefore, the carve-outs available within RTAs may give sufficient protection to host countries for the actions they take and make it difficult for investors to succeed in claims of discrimination. Nevertheless, ensuring non-discriminatory treatment of cross-border investment is extremely important, especially in the context of those investments covered by IIAs. Thus, even if carve-outs are included, investors might still be able to challenge the rules' application based on a discriminatory treatment. This concern can be seen in the case of the European Union, where the directive proposed to implement the GloBE Rules states that it "should also apply to very large-scale, purely domestic groups. In this way, the legal framework would be designed to avoid any risk of discrimination between cross-border and domestic situations" (EU Commission, 2021, Recital 6). Such an approach arguably indicates the intention to avoid the discriminatory treatment that the rules may bring and that could restrict the functioning of the European Union internal market (De Broe and Massant, 2021; Pinto Nogueira, 2020).

4.1.3 Expropriation

As discussed in section 2, some RTAs contain a claw-back on the tax carve-out for expropriation, which means that investors may be protected against the application of the top-up tax and the withdrawal of tax incentives on the basis of the expropriation provision. That is, the GloBE Rules may be considered to be indirect expropriation as they involve charging additional tax on the investor, which may interfere with the value of the investment. As such, in principle, investors could seek to challenge the effects of the GloBE Rules before ISDS tribunals for unlawful expropriation.

In *Feldman v. Mexico* (2002), the tribunal noted that although there are many ways in which governmental authorities can force a company out of business, or significantly reduce its business's economic benefits, there are also valid government regulations, where "governments must be free to act in the broader public interest through [… e.g.,] the granting or withdrawal of subsidies" (para. 103). In this sense, a distinction must be made between indirect expropriation and the valid right of States to regulate.[18] An expropriation will take place

> when [the state] subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory .... *A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation …,*

[18] On the idea of this distinction under international investment law, see OECD (2004).

> *or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory* (*Feldman v. Mexico*, 2002, para. 105).[19]

On the basis of this distinction, the tribunal in the case concluded that there was no expropriation under NAFTA, as

> not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110. Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue (*Feldman v. Mexico*, 2002, para. 112).

Such changes do not always rise to the level of a violation of NAFTA.

Under such an interpretation, a tax measure might not constitute an indirect expropriation if it is bona fide general taxation. Although tribunals in later ISDS cases have applied this approach,[20] it does not necessarily make the analysis of whether a tax measure constitutes an indirect expropriation any clearer. The assessment depends on an examination of the facts and the States' conduct in the relevant case. A matter to consider will be the context of these changes, where the fact that the law has been made based on international agreement may make it difficult for investors to prove a state's action is mala fide.

This analysis applies to NAFTA, ASEAN and COMESA. Yet the USMCA, which also includes a claw-back in the carve-out for expropriation (article 14.8), excludes the possibility of investors submitting a claim to arbitration if the State has breached the provision with respect to indirect expropriation (article 14.D.3; annex 14-D). This means that under the USMCA, tax-related claims may not be submitted on the basis of an indirect expropriation by the host State.[21]

[19] Quoting American Law Institute (1987, section 712, comment g).

[20] Lisa Bohmer, "Looking back: In Feldman v Mexico, arbitrators unanimously rejected expropriating claim, but disregard on shifting the burden of providing discrimination", *Investment Arbitration Reporter*, 10 December 2018. www.iareporter.com.

[21] Notwithstanding this, claims with respect to a "legacy investment" (i.e. in relation to an investment established or acquired between 1 January 1994 and the termination date of NAFTA, and in existence on the date of entry into force of the USMCA) can still be submitted to arbitration in accordance with NAFTA, even after the entry into force of the USMCA. This possibility expires three years after the termination of NAFTA. Thus, while tax-related claims in relation to existing investments based on an indirect expropriation under NAFTA can still be submitted to arbitration, the three-year limit may not be sufficient for claims relating to the GloBE Rules.

4.1.4 Bona fide application of tax carve-outs

Beyond indirect expropriation, the bona fide general taxation standard has also been applied in claims relating to the application of the tax carve-out in RTAs. As highlighted in some cases, in order for the carve-out to apply, the State's conduct must be in line with its genuine exercise of taxation power, meaning that it is not intended to shield the State from egregious conduct. For instance, in a case concerning, among other issues, the revocation of tax incentives, the tribunal held that the carve-out "can apply only to bona fide taxation actions, i.e., actions that are motivated for the purpose of raising general revenue for the State" (*Yukos v. Russia*, 2014, para. 1431).

Thus, as long as the conduct of the State is perceived as a mala fide taxation measure, investors are protected by RTAs' obligations. As such, ISDS tribunals may have jurisdiction to examine a tax-related claim based on a violation of not only the indirect expropriation provision (except under the USMCA), but also of obligations such as FET, NT and MFN, even if not included in the claw-back in the RTAs' carve-out.

Against this background, claims regarding the negative impact of GloBE Rules on tax incentives and investments may not be automatically disregarded by arbitral tribunals if based on the argument that it is not a bona fide taxation measure. Yet it may be difficult for investors to prove that the State's action in implementing a minimum tax and (directly or indirectly) withdrawing incentives (as a response to the GloBE Rules) is a mala fide taxation measure and a violation of an RTA. This is because the Rules require a minimum level of taxation of 15 per cent, and that level has garnered international support. Thus, it may be difficult to prove that applying the Rules is a confiscatory and excessive State action that prevents the enjoyment of the investors' property in their territory. Moreover, the GloBE Rules aim to curb the harmful race to the bottom on CIT and address the risk of profit shifting to low- or no-tax locations. These facts may be relied on to argue that the GloBE Rules are an equitable and efficient imposition of corporate taxes, representing bona fide general taxation.

By contrast, the GloBE Rules have been perceived as unfair (not only to investors, but also to some States), as they go beyond their initial purpose and, in effect, may not bring about equitable and effective taxation for some jurisdictions (Dourado, 2022; Tandon, 2022). Furthermore, the Rules have the potential to undermine most tax incentives, even those granted e.g. to support environmental measures, or to help businesses cope with crises such as the COVID-19 pandemic, which can be assessed as being disproportionate in certain circumstances.

Nonetheless, as mentioned earlier, the analysis of the real impact of adopting the GloBE Rules on a particular investor must be made case by case. There can be specific cases where the State, by granting or assuring an incentive and

subsequently signing up to an international agreement, acted egregiously towards an investor that cannot operate in that jurisdiction under those circumstances, resulting in a breach of the RTA. Nevertheless, should investors begin to challenge the GloBE Rules and their effect on tax incentives based on a violation of RTAs, the arbitral tribunals' approach to this issue is not yet clear and may depend on case-by-case, fact-based investigations taking into account the context within which these measures have been taken. Yet, for the implementation of the IIR, QDMTT and UTPR, it seems that a claim would not likely succeed as they form part of the broader international agreement.

4.2 Remedies available to investors in RTAs

Because investors may seek to challenge a State's action under the GloBE Rules as being a violation of the relevant RTA, it is important to understand what remedies are available through RTAs' dispute resolution mechanisms. In the event of an investment dispute arising over the interpretation and application of an RTA, it is typically preferable under the RTA that the disputing parties initially seek to resolve the dispute by "amicable means", such as consultation and negotiation, the use of good offices, conciliation or mediation.[22] If the dispute is not settled satisfactorily through these means (usually within a certain period of time), then investors are allowed to submit to arbitration a claim that the State has breached a (qualifying) provision of the RTA, such as under international arbitration provided for under the ICSID Convention, among others.

In such investor–State disputes, "[t]he foreign investor will challenge *acts and measures* (or the lack of appropriate action) *taken by the sovereign State* or a sub-entity thereof in its sovereign capacity" (UNCTAD, 2010, p. 11) that effectively hinder or have the potential to hinder their investments and are allegedly violations of the obligations under RTAs. In this sense, before delving into the question of whether there is an actual breach of the RTA, for the purposes of the GloBE Rules it is relevant to clarify a preceding point, namely, which State should be regarded as taking an action detrimental to investment in relation to the application of the minimum tax?

As discussed in section 2, the RTAs under review allow for ISDS, with the exception of MERCOSUR. Investors may only be able to institute ISDS proceedings that relate to an action of a member State that is the host State, i.e. where the investment is located. This means that if the damage is caused by a jurisdiction that is not a party in the RTA, or by another party of the RTA that is not the host State,

[22] Article 1118, section B, chapter 11, NAFTA; article 14.D.2, annex 14-D (Mexico-United States Investment Disputes) USMCA; article 26, COMESA; and section B, ASEAN.

it may not be possible to submit claims to ISDS. Such a conclusion is relevant in relation to the GloBE Rules, since the detrimental effect on an investment may arise in three different scenarios, depending on both the rule applicable and the jurisdiction applying it. In addition, for the purposes of ISDS, claims can be brought forward only if the “covered investment” and “investor” requirements are satisfied under the relevant RTA, both of which may also vary in relation to the GloBE Rules, depending on the charging mechanism and the affected entity.

The GloBE Rules provide an order that establishes the order of priority in the application of its charging provisions.[23] Accordingly, if a top-up tax is to be levied in a jurisdiction, such a low-tax jurisdiction has priority to levy the tax under the QDMTT. If the jurisdiction does not charge the QDMTT, then the UPE jurisdiction can apply the IIR and charge the top-up tax. If neither the QDMTT nor the IIR is available, the UTPR can be applied by another jurisdiction where a constituent entity of the MNE group is located. In this context, the detrimental effect of the GloBE Rules on an investment can be caused by (i) the jurisdiction itself through the QDMTT, (ii) the UPE jurisdiction (or an intermediate parent entity) through the IIR or (iii) another jurisdiction where the MNE group has a constituent entity through the UTPR.

The first scenario, i.e. QDMTT application, might be covered by the ISDS provisions. That is, the State in whose territory the investor has made an investment (the host State) that has breached an RTA obligation by imposing the QDMTT, a situation in which it is usually allowed to submit a claim to arbitration under these agreements. In this case, the “investment” is the participation, ownership or control in the constituent entity that has an ETR below 15 per cent, and the “investor” is the owner or shareholder (such as the UPE). Thus, investors could seek to challenge the QDMTT charge on the basis of a violation of a protection granted under RTAs. A similar claim could also be raised by an investor if the State chooses to directly revoke incentives that the investor has relied on to make an investment therein (e.g. breaking their legitimate expectation of a regulatory stability) as a result of adopting the GloBE Rules. In these claims, it could be argued that the States’ conduct is not a bona fide taxation measure and amounts to an unlawful (indirect) expropriation, and/or a breach of the FET, NT or MFN requirements, as discussed in section 4.1.

The second (IIR) and third (UTPR) scenarios might also be covered under ISDS. However, in these claims the host State that causes the damage, the investor and the covered investment will change. Moreover, the case will not relate to the impact of the GloBE Rules on the incentives granted in the low-tax jurisdiction (the host State in the first scenario), but on the additional tax imposed by either the UPE or the UTPR jurisdiction.

[23] See on the matter, Devereux et al. (2022).

Under the second scenario, where no QDMTT is applied and the IIR is levied by the UPE jurisdiction, the relevant investor will be the UPE's owner (e.g. a shareholder), the covered investment will be the UPE itself and the host State causing a damage to the investment will be the UPE jurisdiction. As such, investors may challenge the UPE jurisdiction's top-up tax charge on their investment under RTAs, since, even though the top-up tax is charged because the LTCE is located in another territory, under the IIR it is the UPE that pays the top-up tax. Thus, the action of the host State (the UPE jurisdiction) in applying the IIR could be seen as detrimental to the investor's investment (the UPE).

The third scenario concerns charging the UTPR, the host State being the State applying the UTPR. The investment is the participation, ownership or control in the affected constituent entity and the investor is the owner of the constituent entity affected by the UTPR (e.g. the UPE). Thus, the action of the host State (the UTPR jurisdiction) in applying the UTPR could be seen as detrimental to the investor's investment (the constituent entity located in the UTPR jurisdiction), and thus be chal lenged in ISDS.

Where an IIA relies on a broader definition of investment, both indirect and direct investment in the constituent entity may be considered a "covered investment" (UNCTAD, 2021). Thus, under a broader definition, even if the UPE does not directly own or control the constituent entity, where an intermediate company is interposed, the participation may be considered a covered investment.

As mentioned in section 2, some RTAs such as MERCOSUR have removed the ISDS provisions, a trend that may be adopted in other agreements. It increasingly seems that investors may find themselves limited from instituting ISDS claims. Nevertheless, investors may still be able to bring claims directly before domestic courts, depending on the circumstances of the case. Moreover, a claim can be advanced by the investor's home State using the State-to-State dispute settlement mechanism, explained in section 5.

4.3 Lessons from past experience

Investors have previously used ISDS to challenge proposed international reforms. For example, Phillip Morris brought ISDS claims against both Uruguay and Australia, challenging measures taken to implement the World Health Organization Framework Convention on Tobacco Control 2013 (*Philip Morris Asia v. Australia*, 2015; *Philip Morris v. Uruguay*, 2016). Yet, in neither case was Phillip Morris successful. Of note, in the Uruguay case the tribunal held that, in consideration of the breach of the FET obligation, Uruguay's actions were a response to scientific consensus that tobacco had harmful effects and could not therefore be considered "arbitrary, grossly unfair, unjust, discriminatory or disproportionate" (*Philip Morris v. Uruguay*, 2016, para. 410). The tribunal's decision may be indicative of an

acceptance that where there is a global consensus, it would be difficult to prove an infringement of the FET obligation.

Investors have also challenged countries' climate change policies (UNCTAD, 2022b). Unlike the tobacco control regulation where the tribunals have seemingly reaffirmed the global agreement on the harmful impact of tobacco, claims against climate-related measures have had more polarizing results. For instance, of the environmental cases that have been concluded, 40 per cent were decided in favour of the country and 38 per cent decided in favour of the investor (UNCTAD, 2022b). A similar trend is noted in cases raised in regard to renewable energy. Although half of the cases are pending, 53 per cent of the concluded cases have been decided in favour of the investor (UNCTAD, 2022b). Therefore, in this context, ISDS challenges may limit the ability of countries to adapt their renewable energy regulatory framework (UNCTAD, 2022b). Nonetheless, although investors are entitled to certainty, the host State should still be free to change its regulatory regime and legal framework in line with its policy objectives, without automatically breaching its investment obligations.

A large number of the cases linked to climate change relate to old-generation IIAs, creating significant pressure for States to undertake the necessary reform of IIAs to reduce the risk of disputes and provide sufficient room for policy reform (UNCTAD, 2022b). Other steps could be taken to prevent these risks, including signing interpretive statements that clarify the relationship between investment provisions and these reforms (Shadikhodjaev, 2016, p. 343).

5. Implications and future for regional integration efforts

5.1 Interaction between IF and non-IF member States that are signatories to RTAs

The GloBE Rules have been agreed to as part of BEPS 2.0 by all but four members of the IF.[24] The IF was established in June 2016 to engage interested non-OECD jurisdictions, including developing economies, in the implementation of the BEPS 1.0 package, ensuring that all those joining would participate in the activities on an equal footing. The role of the IF was extended to BEPS 2.0, for which it worked intensively to provide a consensus-based solution, culminating in the agreement on the two-pillar approach. As a result, as of 16 December 2022, 138 jurisdictions joined the IF agreement under the OECD/G20 BEPS Project (2021), which encompasses the GloBE Rules.[25]

[24] Holdouts are Kenya, Nigeria, Pakistan and Sri Lanka.

[25] The list of members is available at www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-october-2021.pdf.

Although the IF is a significant global tax body with the important objective of bringing together OECD and non-OECD member jurisdictions at the negotiation table, no legal obligations arise from its commitments. As the OECD acknowledges, BEPS outputs are merely "soft law legal instruments", not legally binding on the parties, where "there is an expectation that they will be implemented accordingly by countries that are part of the consensus" (OECD/G20 BEPS, 2015, p. 5), since the decisions taken within the IF are "morally binding to all parties in the process" (OECD, 2017, p. 10).

Thus, whereas there is an expectation that the IF agreement on the GloBE Rules will be implemented by the countries that are part of the consensus, in principle, the agreement itself does not create any legal obligation. The minimum tax will come into effect only if and when implemented in the domestic law of the IF members that have joined the agreement, where once effectively adopted, it will represent hard, legally binding law.

Moreover, the GloBE Rules are meant to be implemented as part of a "common approach" (OECD, 2022a, Introduction, para. 1). This means that IF members that join the agreement are not required to adopt the rules themselves but accept their application by other IF members (OECD/G20 BEPS Project, 2021, p. 3). Furthermore, if a jurisdiction decides to adopt the GloBE Rules, "it agrees to implement and administer them in a way that is consistent with the outcome provided under the GloBE Rules and the commentary" (OECD, 2022a, Introduction, para. 14). Such a common approach represents "an agreement in principle regarding a tax policy direction" (Schoueri and Galdino, 2020, p. 5), where there is the (mere) expectation that countries will reach a level playing field in the future.

Against this background, it might seem that the GloBE Rules will apply to and affect only investments of jurisdictions that have agreed to them under the IF agreement. Nevertheless, it has already been stated that no country can afford not to adapt to this new reality, as those countries that do not adhere to the minimum tax may still be affected. As UNCTAD points out, "Residence countries will apply the top-up tax under the IIR to countries that have not accepted the agreement in exactly the same way as they will to countries that have. The key point is that topping up to the minimum can be achieved unilaterally by the residence country" (UNCTAD, 2022a, p. 143). This global reach may have a significant impact on RTAs and regional integration efforts, especially since IF and non-IF members can coexist within the RTA framework.

Though the GloBE Rules have been agreed on by most members of the IF, a significant number of countries – especially developing countries – are not members of the IF and were not part of the agreement.[26] This lack of a real "global" consensus may raise

[26] The IF has 127 countries as members (excluding the 17 that are jurisdictions rather than countries), and the United Nations has 193 Member States and 2 permanent observers. This means that only two-thirds of countries recognized by the United Nations are at the table in the IF and took part in the discussions. For a list of United Nations Member States, see www.un.org/en/about-us/member-states.

some questions for regional integration, as there are cases in which signatories to the GloBE Rules are members of the same RTA as States that are not signatories. This is the case, for example, with Kenya (IF member) and Burundi, Comoros, Djibouti, Eritrea, Eswatini, Ethiopia, Libya, Madagascar, Malawi, Rwanda, Sudan, Uganda and Zimbabwe (none of them IF members), which (so far) have not signed the global agreement but are members of the COMESA Agreement together with the Democratic Republic of the Congo, Egypt, Mauritius, Seychelles and Zambia, which have joined the international agreement.

In this context, does the lack of a real global consensus have implications at a regional level and within the RTA context? Can jurisdictions that have not joined the agreement and those that have done so be parties to the same RTA? In principle, the answers to these questions seem to depend on whether countries that have adhered to the IF agreement apply the minimum tax only in relation to those countries that have also signed on to it, or whether they go beyond and apply it equally to those that have not.

To achieve the overarching objectives of Pillar Two, the minimum tax must be applied to in-scope MNEs located in most or all jurisdictions around the world in a coherent and coordinated manner. If this does not happen, tax competition will not be reduced as intended, but rather shifted to those jurisdictions that are not part of the IF agreement. Thus, as UNCTAD (2022) has correctly pointed out, it seems unlikely that countries that have not signed the agreement will be able to avoid the top-up tax effects.

At the regional level, the uneven application of the GloBE Rules could lead to distortions in the location of investment, which is not beneficial for regions. Foreign investors could divert their investments from one jurisdiction to another in the same region to avoid the application of the minimum tax in the former, creating (or increasing) tax competition in the region.

States sign RTAs seeking to establish and intensify economic cooperation, investment liberalization and protection among members, with the objective of promoting and ensuring dynamic development of the region. It would be counterproductive for RTA jurisdictions to adopt different approaches towards the GloBE Rules, creating or increasing the competition among them, rather than assisting each other and the region to achieve a better level of development.

If they choose to do so, and investors from RTA jurisdictions that have not joined the agreement are taxed under the GloBE Rules by another RTA jurisdiction that has implemented them, the former may wish to challenge the action of the latter in a State-to-State dispute, arguing that the result of the application of the top-up tax is not in line with the objectives of the RTA.

The inverse may also be problematic. If jurisdictions choose to apply the GloBE Rules only in relation to others that have signed the agreement, this can cause a difference in treatment of investors from different RTA jurisdictions. That is, the top-

up tax would be levied on investors from States that have joined the IF agreement, but not on investors from others that have not, whereas under the RTA, the jurisdictions should ensure similar treatment among their investors or with investors from other jurisdictions. For instance, if an RTA jurisdiction levies the QDMTT on an investor from another RTA jurisdiction that has signed the agreement, but not on an investor from another jurisdiction that has not signed it, then it could be argued that that State applying the GloBE Rules has not accorded the same treatment to foreign investors as it does to its own investors or to investors from third countries, breaching an obligation under the RTA. Although it could be said that the home state of the affected investor "allowed" this difference in treatment to arise by joining the agreement,[27] the investor could try to argue that under the RTA this implies a breach of the NT or the MFN provisions.

Although nothing prevents the coexistence of IF and non-IF members within the RTA framework, for purposes of regional integration and development, it is not desirable for signatories to an RTA to adopt different approaches to the GloBE Rules, as demonstrated above. Rather, RTA signatories should adopt a coordinated approach to the application and operation of GloBE Rules, not only to avoid State-to-State disputes and eventual termination of these agreements, but also to ensure the development of the region as a whole and intensify economic integration as initially intended under the RTA.

5.2 State-to-State disputes

While the paper focuses on investor–State dispute, it is relevant to note that the agreements under review also provide for State-to-State dispute (UNCTAD, 2003), which may be instituted to challenge the application and effects of the GloBE Rules.

If RTA signatories choose to adopt different approaches to implementing the GloBE Rules, or if IF and non-IF members coexist within the RTA framework, State-to-State dispute could be instituted to analyse whether the action of the State applying the minimum tax is consistent with the objectives and purpose of the RTA.[28] For the five RTAs under review, State-to-State disputes may be possible only between member states of the same RTA. In State-to-State dispute settlement, therefore, it is relevant to identify whether the jurisdiction applying the charging provision is a party to the same RTA as the investor's home State.

[27] Though, as mentioned earlier, the IF agreement is not legally binding on the States signing it, and if that State does not charge the QDMTT, another State may apply the IIR or UTPR anyway.

[28] This could be possible as "[a] given dispute, matter or question may relate to the 'interpretation' or 'application' of an IIA. […] 'Application' relates to the extent to which the actions or measures taken or proposed by the contracting parties comply with the terms of an agreement, its object and purpose" (UNCTAD, 2003, p. 14).

Although possible, State-to-State dispute settlement has almost never been resorted to (UNCTAD, 2003). However, the mechanism is gaining attention, especially as a result of growing limitations on the scope of ISDS. Thus, while the use of State-to-State dispute settlement is contentious (Bernasconi-Osterwalder, 2014) and might seem unlikely, it is not completely ruled out in the case of the GloBE Rules, especially because a real global consensus is lacking, resulting in the coexistence within the same RTA framework of signatories and non-signatories to the IF agreement.

5.3 A regional approach to the implementation of Pillar Two

Though difficult to achieve, global tax harmonization has been promoted as a solution to the negative side effects of tax competition (Konrad and Schjelderup, 1999). This is why the agreement on Pillar Two is of particular importance (Casella and Souillard, 2022). However, despite this positive aspect, the minimum tax may intensify competition for out-of-scope corporations, high-net-worth individuals, tax incentives outside of the CIT system and non-tax incentives. Therefore, the implementation of the GloBE Rules introduces new opportunities for tax coordination within regional blocs, to implement taxation in line with regional investment objectives and prevent "new" or adapted forms of tax competition (UNCTAD, 2022a).

Noting the importance of having coherent and consistent implementation of Pillar Two, the European Union formally adopted the Directive on the minimum tax.[29] The Directive reflects the agreement at the IF, with adjustments to ensure conformity with European Union law (EU Commission, 2021). The African Tax Administration Forum (ATAF) has also published a suggested approach to drafting the domestic minimum tax top-up tax legislation that has been customized to meet the specific challenges that African countries face (ATAF, 2023). Such joint approaches provide certainty for all stakeholders, especially where levels of regional integration are high. They may also include a shared accounting standard, strengthening information exchange and building capacity through technical support in the region.

Most importantly, by adopting a coordinated regional response to the GloBE Rules, a region could benefit from sharing resources to reduce the administrative costs and burdens that may arise from implementation of the Rules. Moreover, jurisdictions could join their strengths to make investors more attracted to the region, despite the adoption of the minimum tax.[30]

[29] European Union, "Fair taxation: Commission welcomes agreement on minimum taxation of multinationals", press release, 13 December 2022, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_7674.

[30] For example, Titus (2022) called on African countries to adopt a regional response to the implementation of a QDMTT and to adapt their tax incentives to become non-tax equivalents.

In addition, countries may consider the signing of a multilateral treaty instrument that clarifies the position of the RTAs and the GloBE Rules to mitigate risks that implementing the rules could be considered a breach of commitments (UNCTAD, 2022a). Such a treaty may be more easily signed or developed within a more integrated regional bloc.

The adoption of a regional approach to implementing and interpreting measures such as the QDMTT and the adoption of a common understanding of this new environment also have the potential to prevent uncertainty for investors. This regional approach could then be relied on in the domestic courts to ensure consistency and certainty in the treatment of investment within the regional bloc.

6. Conclusions and policy considerations

A growing number of RTAs include substantive investment provisions that may limit a country's ability to change tax measures. This paper analyses how the GloBE Rules and their impact on investment incentives interact with RTAs' investment protection provisions.

Although the GloBE adoption and its effects may be challenged under the ISDS mechanism of RTAs, the likelihood of success is unlikely. Not only because of tax carve-outs under RTAs that may limit the possibility of submitting tax-related cases to arbitration, but also because countries may successfully claim that the measures were aimed at "effective or equitable" imposition of direct taxes and are excluded from the investment protection afforded in the agreement. Moreover, MNEs have faced significant public pressure and scrutiny over perceived unfair tax practices (Speitmann, 2021). Consequently, there is a likelihood that MNEs that choose to challenge the GloBE Rules would face reputational risk, since they could be seen as challenging a political consensus that the tax system reform is needed to curb tax competition, eliminate tax havens and minimize profit shifting.

Nonetheless, in order to avoid both distortions in the location of investment and the creation of new (or increased) tax competition, regional blocs should consider adopting a regional approach to the implementation of the GloBE Rules. This will ensure consistency in the implementation and provide certainty of treatment to investors. In addition, countries may need to consider whether similar rules are required outside of CIT, including tax incentives provided for capital taxes and value added taxes.

By adopting a coordinated regional response to the GloBE Rules, signatories of RTAs may not only avoid State-to-State disputes among the Member States, but could also benefit from sharing resources to reduce administrative costs and burdens that may arise and from joining their strengths to make the region more

attractive to investors. Such a regional approach to addressing the recent changes in the international tax arena has the potential to ensure the development of a region as a whole and intensify economic integration. This paper can be seen as a basis for ongoing dialogue on these issues.

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