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Is the UTPR Extraterritorial or Discriminatory under Tax Treaties?

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IS THE UTPR EXTRATERRITORIAL UNDER TAX TREATIES?

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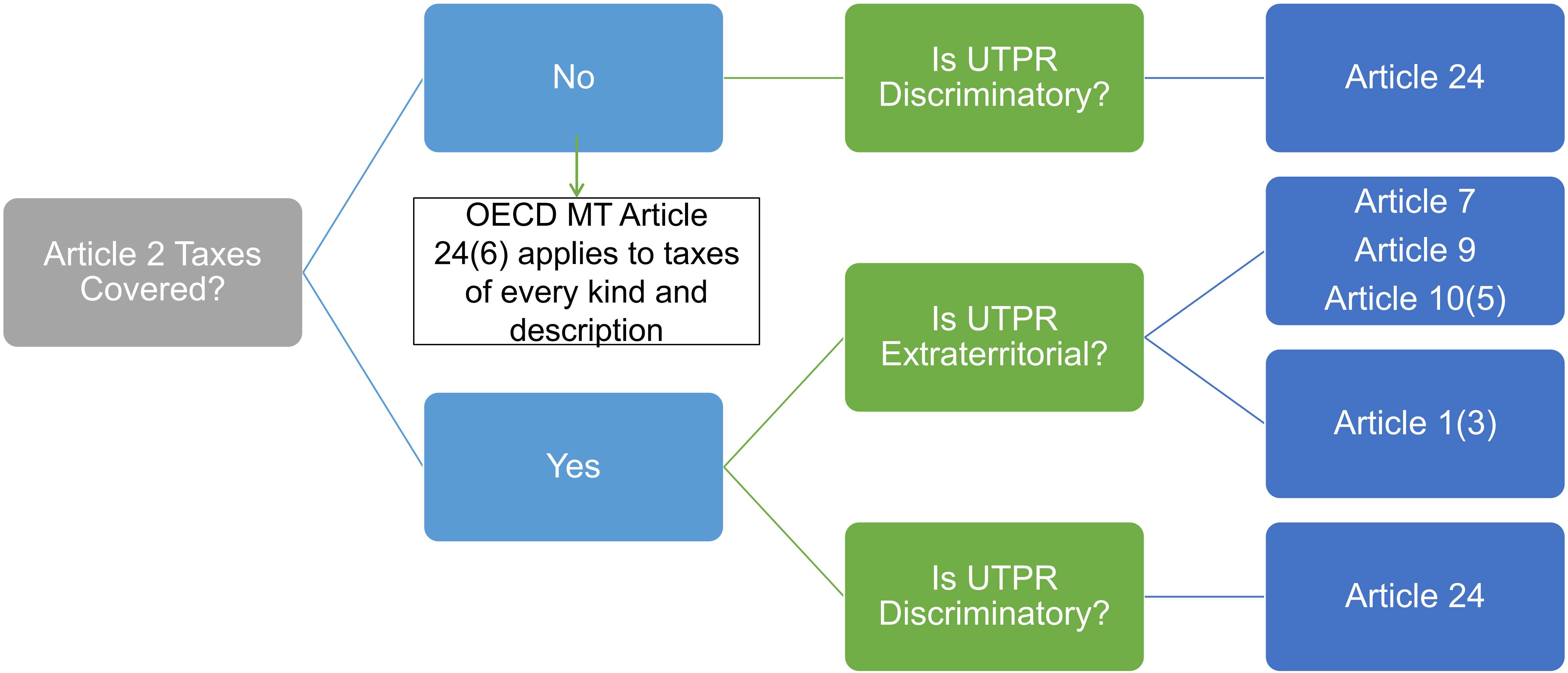


IS THE UTPR A COVERED TAX UNDER TAX TREATIES?

Question: Are top-up taxes considered to be taxes covered under Article 2 of the OECD Model?

Article 2(1) “taxes on income” (i.e. direct tax)? **or**

Article 2(2) “taxes on income” broadly defined? **or**

Article 2(3) “listed tax” (probably not) **or**

Article 2(4) “identical or substantially similar” to “taxes on income”?

An additional tax in the nature of an Excise Tax:*

Two Arguments: **(1)** UTPR amount is unconnected to (i) income of the entity liable for its payment, (ii) any income allocated or attributed to that entity from another entity and (iii) any existing income tax liability of another entity.

(2) The mechanism of reducing a deduction to increase the cash tax expense solely to satisfy the UTPR liability is in substance no different from paying an additional tax, a surtax, or any other separate levy.

* Allison Christians and Stephen E. Shay, “The Consistency of Pillar 2 UTPR With U.S. Bilateral Tax Treaties,” Tax Notes Int’l, Jan. 23, 2023

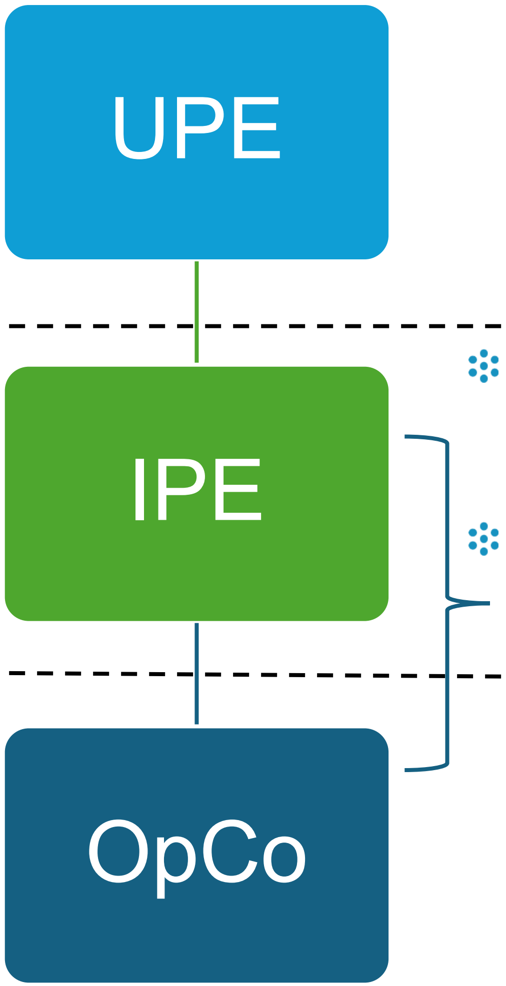
IS THE UTPR EXTRATERRITORIAL UNDER TAX TREATIES?

UTPR Residence-Based Tax Example

State A
IIR Free
ETR 17%

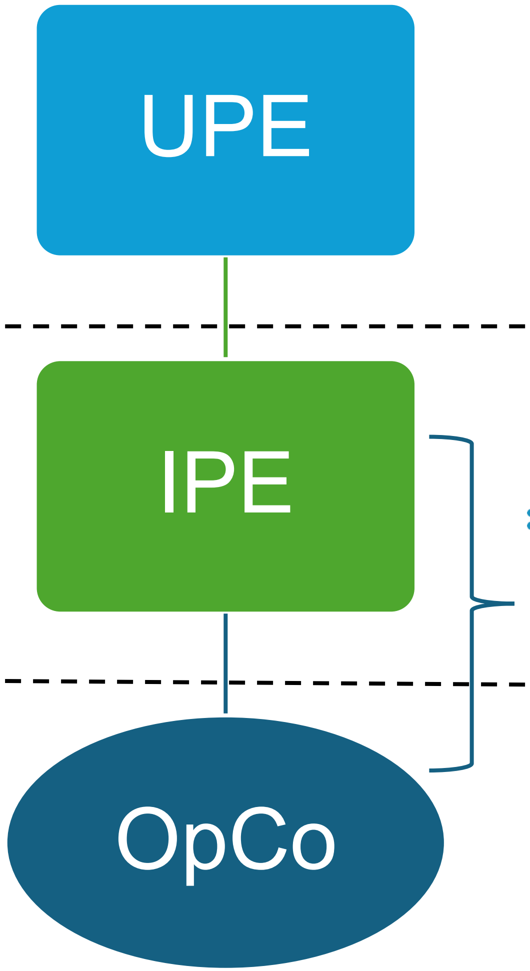
State B
IIR Free
ETR 10%
Top-up Tax 100

State C
ETR 17%
UTPR In force



- Article 9(1) of the B-C tax treaty? **or**
- Article 10(5) of the B-C tax treaty?

UTPR Source-Based Tax Example



- Article 7(2) of the B-C tax treaty?

TAX TREATIES AND EXTRATERRITORIALITY: OECD/UN MODEL

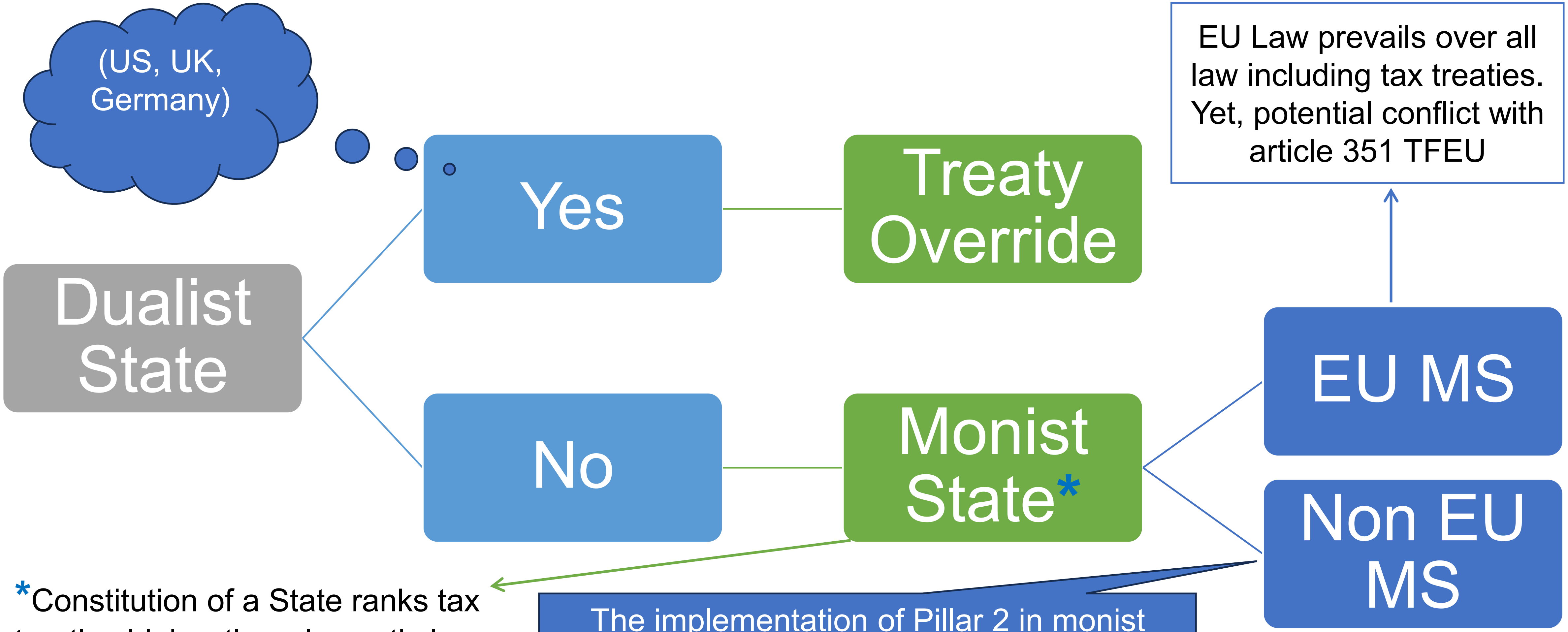
- **Many countries have adopted CFC rules** to counter the use of foreign base companies and protect their domestic tax base.
- **Concerns** were raised that CFC rules might conflict with **Article 7(1) and Article 10(5)** of tax treaties.
- **Article 1(3)** clarifies that taxing a country's own residents under **CFC rules does not breach treaty** provisions.
- **Even in the absence of Article 1(3),** OECD Commentary (Art. 7 para 14, Art. 10 para 37) supports the compatibility of CFC rules with tax treaties.
- Explicit treaty clarification is helpful but not necessary—**CFC rules** structured this way **are not** considered **treaty violations**.
- The **2021 UN Model** Commentary Article 1 para 65 **aligns** with this interpretation.

OECD POSITION ON UTPR

- Report on **Pillar Two Blueprint** (paragraphs 689 et seq.): **UTPR does not infringe on profit attribution rules in articles 9(1) and 7(2) of the OECD model Convention** because it only affects how a jurisdiction taxes its own residents akin to domestic rules on non-deductible expenses:
  - It is generally recognised, however, that **once the profits have been allocated** in accordance with the **arm's length principle**, **how they are taxed** is a matter determined by the **domestic law** of each country.

- Therefore, the UTPR and IIR does not require tax treaty changes but rather could be implemented through domestic law only

TAX TREATIES OVERRIDE



*Constitution of a State ranks tax treaties higher than domestic law (e.g. Belgium, Cyprus, France, Netherlands, Switzerland)

The implementation of Pillar 2 in monist States where domestic law cannot override a tax treaty will be a challenging task

IN THE ABSENCE OF A TAX TREATY: CUSTOMARY INTERNATIONAL LAW

- **Principle of Sovereign Equality of States (Principle of Territoriality)**

- **Principle of Non-Interference in internal affairs**: the obligation of other states to respect **Fiscal Sovereignty**

- **Customary international law** is created when:
  - **State practise** (i.e. this involves the consistent and widespread actions of states in their interactions with each other); and
  - **Opinion Juris** (i.e. the belief that these practices are legally obligatory, not just a matter of policy or courtesy).

- This potential conflict could be addressed if Pillar 2, particularly the UTPR, were to attain the status of customary international law and be recognised as an accepted limitation on the tax sovereignty of other states.

EXAMPLE OF EXTRATERRITORIALITY: CFC LEGISLATION

- In the US, CFC legislation (adopted in 1962) was considered unconditional and a violation of customary international law to tax a foreign source of income of a foreign corporation.
- The number of countries with CFC legislation has doubled from 32 countries in 2001 to 64 in 2020
- Arguably, CFC legislation is extraterritorial but cannot be considered as a violation of customary international law.

- Is CFC Legislation similar to UTPR? Put differently, is the UTPR a reverse CFC rule? Two arguments:
  - **Parent Controls the CFC** and therefore can make it pay a dividend; and
  - CFC rules reflect the **economic ownership** of the CFC by the patent.

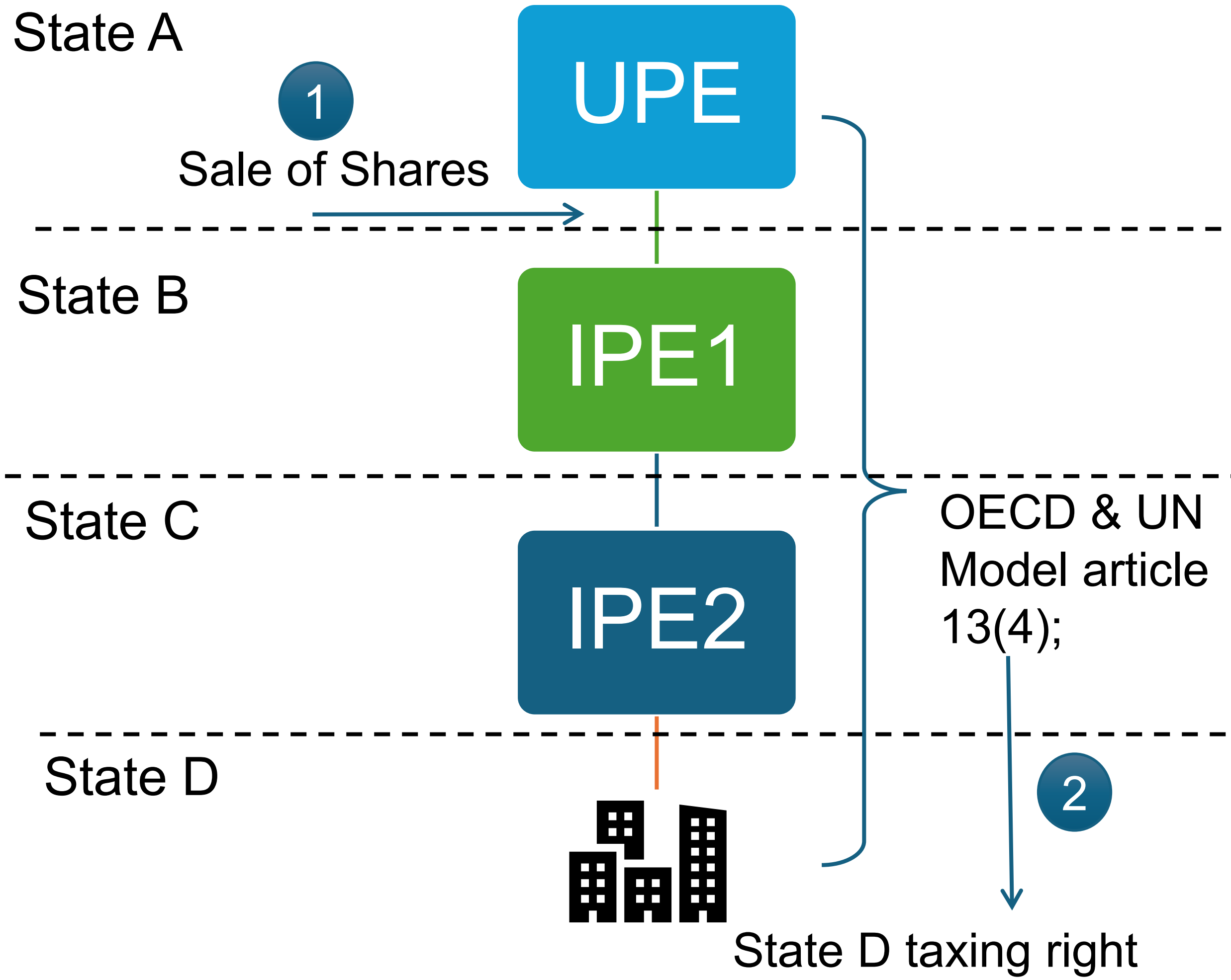
- According to Professor Reuven S. Avi-Yonah both arguments fail (see "*Is the UTPR Extraterritorial or Discriminatory?"* Tax Notes Int'l, March 17, 2025)

IS THE UTPR IN LINE WITH THE CUSTOMARY INTERNATIONAL LAW

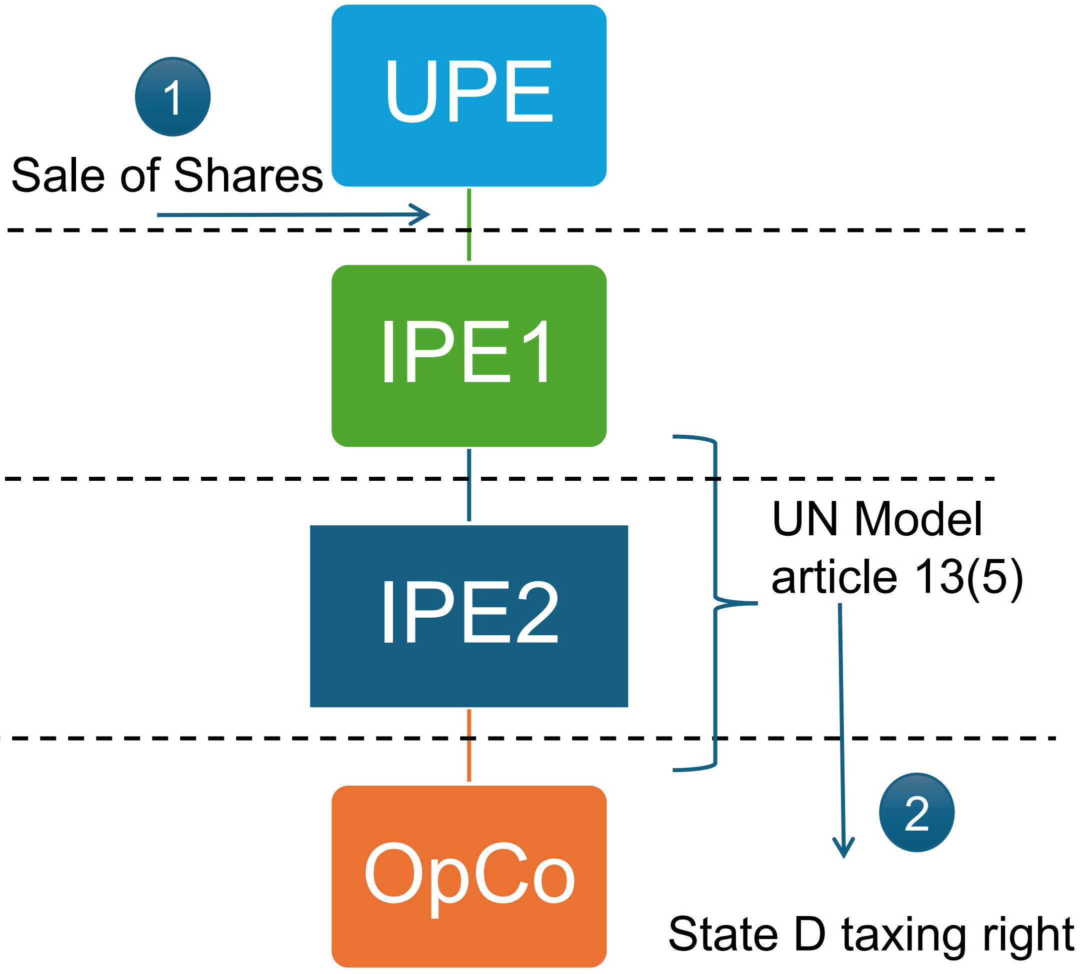
- The Inclusive Framework involves more than **140 countries** and jurisdictions that in principle approved the Pillar 2 rules (**soft law**)
- **UTPR**: **32 States** adopted or are in progress (including 5 EU MS that deferred the UTPR to 2030 under the EU Minimum Taxation Directive)
- **IIR: 46 States** adopted or are in progress (including 5 EU MS that deferred the IIR to 2030 under the EU Minimum Taxation Directive)
- **(Q)DMTT: 57 States** adopted or are in progress
- Total:
  - 55 territories with laws in force
  - 12 in progress
- Does Pillar 2 and in particular UTPR meet the customary law requirements of **opinio juris** and **state practice** and because it has been implemented by a sufficient number of jurisdictions?

OTHER EXAMPLES OF EXTRATERRITORIALITY: INDIRECT TRANSFERS

Indirect transfer of immovable property



Indirect transfer of substantial shareholdings



IS THE UTPR DISCRIMINATORY UNDER TAX TREATIES?

TWO MAIN CATEGORIES OF DISCRIMINATION IN INCOME TAXES

1. Personal characteristics:

Who are you? Discrimination based on identity: nationality, residence, ownership, family, legal status etc.

2. Activity: production/product:

Discrimination based on your tax base e.g. production, income, product, deductions, restructuring, groups, rates etc.

NON DISCRIMINATION AND UTPR

UTPR Pillar 2	Domestic tax law

State A
UPE

State B
IPE

State C
OpCo

UTPR applicable

VS

UPE
IPE
OpCo

Domestic Group

Questions!

Thank you for your attention!

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THANK YOU!

Christiana HJI Panayi is a Professor in Tax Law at Queen Mary University of London. She teaches on the EU Tax Law, International Tax Law and Transfer Pricing courses of the LLM Programme. Christiana is also a researcher at the Institute for Fiscal Studies and a visiting professor at the Vienna University of Economics and Business and the University of Notre Dame. In the past, Christiana was also an Adjunct Professor of European Union Tax Law at New York University, a Visiting Professor at Sorbonne University (Ecole de droit de la Sorbonne, Université Paris 1), at the University of Luxembourg and at the University of Lausanne. Christiana has published extensively in the area of EU and International Tax Law and is considered a leading expert in her field.

Christiana speaks regularly at tax conferences and teaches abroad. She has lectured at New York University, the University of Cambridge, Boston College, the University of Lausanne, the Chartered Institute of Taxation, the European Commission, the Academy of European Law, the Vienna University of Economics and Business Administration, the University of Luxembourg, the University of Amsterdam and various other universities. She has also designed and conducted workshops on International and EU tax law for Her Majesty's Revenue and Customs, the UK Treasury and various south European organizations and accounting firms. In October 2024, Christiana testified as an expert at the FISC Committee of the European Parliament.

Christiana has been appointed twice as an expert member at the European Commission's Joint Transfer Pricing Forum (JTPF) and the Platform for Tax Good Governance. She is also a member of the CFE's ECJ Taskforce, a member of the BEPS Monitoring Group, a member of the European Association of Tax Law Professors and a member of the CIOT's Examination Sub-Committee for the ADIT.

Christiana studied at Oxford University for her BA in Jurisprudence and for the BCL. She also has a PhD from the London School of Economics. Before joining Queen Mary, Christiana worked for Allen and Overy LLP. She is a non-practising solicitor of England and Wales.

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Demis specialises in corporate income tax law, transfer pricing and international tax (treaty) law. He has a strong track record with clients in advising on transfer pricing issues and in complex corporate tax law issues. His extensive interest on comparative income tax law (US, UK, Canada and Australia) offers him a unique advantage in solving complex tax issues in Cyprus.

Demis received his Master of Laws (MSc) in Tax Law from Oxford University. He was trained from a Big4 company and holds a first-class Bachelor's degree in Accounting and Finance from the UK, as well as being a qualified Chartered Accountant in England & Wales. He also holds an LLB from Frederick University Cyprus.

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Christos Theophilou is a distinguished tax expert, providing advisory services to both private and corporate clients on intricate international tax and transfer pricing issues. His expertise encompasses cross-border investments, private equity structuring, structured finance, intellectual property structuring, and international trade.

Christos holds an MSc in Tax Law from Oxford University, a Bachelor's degree in Economics, and an LLB Law degree from Frederick University. He is a Chartered Accountant in England & Wales and has obtained the Advanced Diploma in International Taxation (ADIT) from the UK Chartered Institute of Taxation.

Christos is a prolific contributor to various esteemed international tax publications, including IBFD, Tax Notes International, Bloomberg Tax, International Tax Review, Edward Elgar, and IFA. Furthermore, Christos is currently a member of the Tax Policy and Strategy committee of ICPAC.

Christos also serves as a freelance lecturer for Tolley's (LexisNexis) and IBFD, where he lectures on ADIT Paper 1 Principles of International Tax, Transfer Pricing, and Pillar 2. He is a frequent speaker at international tax conferences, sharing his extensive knowledge and insights with the global tax community.

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