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Does Pillar 2 Qualify Transparent Entities and PEs as Residents Under Tax Treaties?

by Valentin Bendlinger

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In this article, Bendlinger explains how the relationship between pillar 2 and tax treaties remains unresolved, using the example of transparent entities and permanent establishments, raising multiple open questions.

Introduction

Tax treaties apply to resident persons, and article 4 of the OECD and U.S. model conventions define who qualifies as a resident person. Both require a person to be liable to tax under domestic law of either contracting state; however, both models also explicitly state that a resident person "does not include any person who is liable to tax in that State in respect only of income from sources in that State." In simple terms this means that to qualify as a resident, a person needs to be liable to tax on worldwide income. Under these conditions, transparent entities and permanent establishments as a rule do not qualify as resident persons.

But within the framework of the global minimum tax, transparent entities and PEs are qualified as distinct taxpayers — constituent entities (CEs) — under certain circumstances. In principle, if qualified, they are liable to tax on the worldwide profits of the multinational enterprise group of which they are a part. This raises the question of whether pillar 2 transforms transparent entities and PEs into resident persons under tax treaties. This article examines that question.

PEs, Transparent Entities, and Pillar 2 Treaty Compatibility

Pillar 2 subjects MNE groups' CEs to a top-up tax if the MNE group hits the threshold of €750 million annual revenue and is subject to an effective tax rate of less than 15 percent in any jurisdiction it owns such a CE.[1] The top-up tax is calculated on the MNE group's profits, separately for every jurisdiction in which it owns CEs, multiplied by the difference between the ETR achieved in that specific jurisdiction and the minimum tax rate of 15 percent.[2] Put differently, the top-up tax equals the amount of tax that is to be levied to assure that the minimum tax level of 15 percent is achieved within the tested jurisdiction. If a top-up tax liability arises within a specific jurisdiction (in this case pillar 2 assumes the jurisdiction to be a low-tax jurisdiction), the top-up tax can be collected using three different tax mechanisms:

- First, the low-tax jurisdiction itself takes precedence in the collection of the top-up tax, and it may collect the tax assigned to its

[1] *See* article 1.1.1, OECD/G20 Inclusive Framework on BEPS, "Tax Challenges Arising From Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)" (Dec. 20, 2021).

[2] *See id.* at article 5.2.

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territory by means of a qualified domestic top-up tax (QDMTT).[3]

- Second, if the low-tax jurisdiction fails to do so, the income inclusion rule kicks in. According to this rule, the ultimate parent entity (UPE) in the ownership chain is obliged to collect the respective top-up tax instead. If the UPE is in a non-pillar-2 compliant jurisdiction, the IIR may be applied by any parent entity of the low-taxed CEs in the ownership chain. Specific rules then determine which CE is a parent entity of the low-taxed CE and will be obliged to collect the revenue. This ensures that the IIR is only collected once within the same ownership chain.[4]
- Third, if there is neither a QDMTT nor a parent entity obliged to collect the top-up tax via the IIR, the undertaxed profits rule assigns the remaining top-up tax to any CE within the group according to a formula based on amounts of payroll and carrying values of local tangible assets.[5] The UTPR allocates the remaining top-up tax revenues to all jurisdictions that implemented the global anti-base-erosion (GLOBE) rules and in which the MNE group either has a controlled entity or a PE according to certain criteria.[6]

The question whether QDMTT, IIR, and UTPR are in line with tax treaties has been the subject of intensive debate in the literature, in particular the treaty compatibility[7] of the UTPR.[8] Any analysis of treaty compatibility of pillar 2 taxes starts with the question of which CE within the group can rely on which tax treaty.[9]

Some argue that pillar 2 subjects the whole MNE group to tax, meaning that the MNE group itself is to be considered as the resident person under articles 1 and 3(1)(a) of the OECD model convention.[10] However, the QDMTT, IIR, and UTPR are levied on individual CEs, so either at the level of separate entities — whether transparent or opaque — or at the level of these entities' PEs.[11] The prevailing opinion in the literature acknowledges that the treaty compatibility of pillar 2 taxes is to be tested on the level of every single CE. Because the QDMTT, IIR, and UTPR are regularly levied on legal persons or

[3] *Id.* at article 5.2.3, (a QDMTT may reduce the jurisdictional top-up tax to zero).

[4] *Id.* at article 2.1.

[5] *Id.* at articles 2.4 to 2.6.

[6] *See* formula at *id.* at article 2.6.1.

[7] Among the so-called UTPR supporters, who argue that UTPR is in line with treaties, *see* 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, p. 445; Jeffery Kadet, "Defending the UTPR: Creative Corporate Structuring Can't Hide Real Connections," *Tax Notes Int'l*, Nov. 28, 2022, p. 1071; Tarcísio Diniz Magalhaes, "Give Us the Law: Responses and Challenges to UTPR Resisters," *Tax Notes Int'l*, Dec. 5, 2022, p. 1257; Sol Picciotto, "Rebutting the Logic of UTPR Skeptics," *Tax Notes Int'l*, Dec. 12, 2022, p. 1371; Magalhães, "UTPR Opposition: A Game of Whack-a-Mole," *Tax Notes Int'l*, Dec. 19, 2022, p. 1531; Christians and Magalhaes, "Undertaxed Profits and the Use-It-or-Lose-It Principle," *Tax Notes Int'l*, Nov. 7, 2022, p. 705; Picciotto, "Justifying the UTPR: Nexus and Economic Connection," *Tax Notes Int'l*, Nov. 7, 2022, p. 667; Picciotto, "UTPR Critics Miss the Point of Tax Treaty Principles," *Tax Notes Int'l*, Oct. 10, 2022, p. 153.

[8] Identifying themselves as so-called UTPR sceptics, *see* M.F. De Wilde, "Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification," Kluwer International Tax Blog (Jan. 12, 2022); Jefferson VanderWolk, "The UTPR is Inconsistent with the Nexus Requirement of Tax Treaties," Kluwer International Tax Blog (Oct. 26, 2022); VanderWolk, "The UTPR Disregards the Need for Nexus," *Tax Notes Int'l*, Oct. 31, 2022, p. 545; Robert Goulder, "Pillar 2 and Tax Treaties: MLI, Where Art Thou?" *Tax Notes Int'l*, Nov. 7, 2022, p. 775; VanderWolk, "Much Ado About Pillar 2," *Tax Notes Int'l*, Nov. 14, 2022, p. 821; Goulder, "Confessions of a UTPR Skeptic," *Tax Notes Int'l*, Nov. 14, 2022, p. 907; VanderWolk, "The UTPR Is Far From Becoming Part of Customary International Tax Law," *Tax Notes Int'l*, Nov. 28, 2022, p. 1069; VanderWolk, "The UTPR: Taxing Rights Gone Wild," *Tax Notes Int'l*, Dec. 12, 2022, p. 1369; VanderWolk, "The UTPR Is Flawed: A Response to Prof. Picciotto," *Tax Notes Int'l*, Oct. 17, 2022, p. 285; VanderWolk, "Tax Treaties Pose Problems for the UTPR," *Tax Notes Int'l*, Oct. 3, 2022, p. 29; Nathan Boidman, "UTPR's Effect on Outside Shareholders: Another Reason to Oppose?" *Tax Notes Int'l*, Jan. 9, 2023, p. 189; VanderWolk, "The UTPR, Treaties, and CFC Rules: A Reply to Avi-Yonah and Schler," *Tax Notes Int'l*, Jan. 9, 2023, p. 187; Angelo Nikolakakis and Jinyan Li, "UTPR: Unprecedented (and Unprincipled?) Tax Policy Response," *Tax Notes Int'l*, Feb. 6, 2023, p. 743.

[9] Raising this question, see, *e.g.*, Heydon Wardell-Burrus, "Four Questions for UTPR Skeptics," *Tax Notes Int'l*, Nov. 7, 2022, p. 699.

[10] Picciotto, "Justifying the UTPR," *supra* note 7, at 667. Convincingly criticizing Picciotto in this respect, see VanderWolk, "Much Ado About Pillar 2," *supra* note 8, at 821; Goulder, "Confessions of a UTPR Skeptic," *supra* note 8, at 909.

[11] Valentin Bendlinger, *The OECD's Global Minimum Tax and Its Implementation in the EU — A Legal Analysis of GloBE in the Light of Tax Treaty and EU Law* 312 (2023).

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entities, these taxpayers are qualified as covered persons under OECD model convention article 1 because they will regularly qualify as persons resident in the country that levies the pillar 2 tax on them (OECD model convention articles 3(1)(a) and 4). Many thus argue that there is no conflict between pillar 2 and treaties — at least treaties containing a saving clause (article 1(3) of the OECD model convention and article 1(4) of the U.S. model tax convention) — because the latter explicitly states that the treaty should not restrict the residence state from imposing tax on its residents.

Although there are reasonable doubts about whether the saving clause really saves the application of pillar 2 taxes, even those arguing that it permits the collection of tax under the IIR and UTPR admit that it might not validate the application of these mechanisms for PEs and transparent entities because these are not considered to be resident persons under tax treaties.[12] Within the framework of pillar 2, PEs qualify as distinct CEs and, thus, as distinct taxpayers.[13] Both the QDMTT and UTPR can be collected from PEs as if the PEs were separate entities — only the collection of the IIR at the level of PEs is not possible, because a PE can never qualify as a parent entity.[14] A more in-depth look at the definition of covered persons under tax treaties requires a close examination of the provisions of article 3(1)(a) and (b) of the OECD model convention. Accordingly, a person can be a company, while a company is "any body corporate or any entity that is treated as a body corporate for tax purposes."[15]

For example, if the UTPR is levied on a transparent entity or a PE, it is being treated as a corporate body for tax purposes (if we anticipate for a moment that GLOBE taxes are covered by treaties, on this question, see below). Although, at least with respect to PEs, one could question whether a PE is a corporate body. Thus, although for corporate income taxes it is evident that neither transparent entities nor PEs qualify as resident persons, it can be questioned whether they could be considered resident persons if they are part of an MNE group within the scope of pillar 2, because they might be liable to tax on their own in the same way an opaque entity would be. This article aims to examine the following questions:

- First, who is the taxpayer or, who is the person covered when it comes to the analysis of the treaty compatibility of a pillar 2 tax collection? Is it the MNE group or one of its CEs? This will further raise the question of which CE is considered the taxpayer.
- Second, what kind of taxes use the collection mechanism of GLOBE? Are all GLOBE top-up taxes a single tax, or are they distinct taxes? Do treaties cover them?
- Third, must transparent entities and PEs be seen as liable to tax and qualify as residents under tax treaties?

Is the MNE Group or Its CEs the Taxpayer?

Pillar 2 Taxes CEs, Not Corporate Groups

According to article 1.1.1 of the GLOBE model rules, the "GloBE Rules apply to Constituent Entities that are members of an MNE Group that has an annual revenue of €750 million or more in the Consolidated Financial Statements."[16] The nature of GLOBE as a top-up to achieve a minimum tax level is unusual for a corporate tax. In contrast to standard domestic corporate income tax regimes, GLOBE does not apply to single corporate entities as such but to "members of an MNE Group." A single entity alone is only subject to the global minimum tax if it is part of an MNE group.[17] A group is a collection of entities whose assets and liabilities are included in the consolidated financial statements of the ultimate parent and requires that "at least one Entity or Permanent Establishment [. . .] is not located in the

[12] Even declared UTPR supporters do not deny potential treaty conflicts in these situations; see Christians and Shay, *supra* note 7, at 449; Reuven S. Avi-Yonah, "The UTPR and the Treaties," *Tax Notes Int'l*, Jan. 2, 2023, p. 45. Also on this issue, see Nikolakakis and Li, *supra* note 8, at 746.

[13] See article 1.3.1, GLOBE model rules (2021), *supra* note 1.

[14] See the intertwined definitions of the terms "parent entity," "ultimate parent entity," "intermediate parent entity," and "partially-owned parent entity" in Art 10.1, *id.*, explicitly excluding PEs from their scopes.

[15] OECD model convention, article 3(1)(b).

[16] GLOBE model rules, article 1.1.1 (2021), *supra* note 1.

[17] *See* Bendlinger, *supra* note 11, at 37.

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jurisdiction of the Ultimate Parent Entity."[18] Put differently, a business operation qualifies as an MNE group if it is a collection of entities whose financial accounts are combined in a single consolidated statement of a UPE and if at least one entity or PE of the collection of entities is located[19] in a different country.[20] A single entity can qualify as an MNE group (partnership groups), if it has at least one PE abroad and is not part of another MNE group.

Proponents of a future unitary approach for taxing MNEs have argued that the taxable subject for pillar 2 is the entire MNE group itself;[21] and indeed, there might be an argument that GLOBE "combines elements of the separate-entity and unitary approach."[22] However, this is not what the GLOBE model rules state. Article 1.1.1 says that the "GloBE Rules apply to Constituent Entities that are members of an MNE Group."[23] The GLOBE rules (the IIR and the UTPR) apply to the CEs that are members of the MNE group. Thus, in line with traditional corporate tax systems, it is not the MNE group itself that is the taxpayer but rather its separate members that are subject to the GLOBE rules. Contrary to traditional corporate tax systems, however, individual CEs of a group "will not be subject to the GloBE Rules unless they are members of an MNE Group."[24]

CEs: Transparent Entities and PEs

An exciting aspect of pillar 2's treaty compatibility question is that tax-transparent entities and PEs are considered separate CEs. According to article 1.3.1 of the GLOBE model rules, a CE includes either entities that are part of an MNE group or PEs of a main entity.[25] The term "entity" includes any legal person other than an individual or an arrangement that prepares separate financial accounts, such as partnerships or trusts, regardless of whether or how the arrangement is taxed.[26] Article 1.1.1 of the GLOBE model rules anticipates that the rules, at least in principle, can apply to flow-through entities and PEs. Further, the framework of pillar 2 does not distinguish between transparent and opaque CEs, or PEs. The GLOBE rules, at least in principle, apply to every CE in the same way.

The purpose of acknowledging transparent entities and PEs as distinct legal entities is the territorial allocation of profits.[27] Pillar 2 tests the level of effective taxation jurisdiction by jurisdiction. For this reason, it is necessary to separate income and tax attributable to a PE from income received by the main entity.[28] The same holds for transparent entities. As a rule, their income is either attributable to a PE — which again qualifies as a separate CE — or, if certain income is not attributable to a PE, to its CE shareholders.[29]

However, in specific cases, some income is attributable neither to a PE nor to shareholders. This happens when the transparent entity is the UPE of the MNE group.[30] If none of the shareholders of the transparent entity is part of the group, neither the shareholder nor a PE of the shareholder would be part of the group. Thus, there is a need to allocate the income of these entities by way of a fiction. Under article 10.3.2(a) of the GLOBE model rules, transparent UPEs are deemed to be located where they were created.[31] In this way, the income is clearly allocated to the

[18] GLOBE model rules, article 1.2.1 (2021), *supra* note 1.

[19] GLOBE model rules, article 10.3 (2021), on the location of CEs.

[20] Comprehensively on the scope of GLOBE, *see* Bendlinger, *supra* note 11, at section 4.2.

[21] *See*, *e.g.*, Picciotto and Kadet, "The Transition to Unitary Taxation," *Tax Notes Int'l*, Oct. 24, 2022, p. 453.

[22] Magalhães, *supra* note 7, at 1531.

[23] GLOBE model rules, article 1.1.1 (2021), *supra* note 1.

[24] GLOBE model rules (2022) "GloBE Commentary on article 1", *supra* note 1, para. 18.

[25] Article 1.3.1(a) and (b) GLOBE model rules (2021), *supra* note 1.

[26] *Id. See* the definition of the term "entity" in Art 10.1.1.

[27] On this, *see*, *e.g.*, the explanation set out in the OECD/G20 inclusive framework on base erosion and profit-shifting, "Tax Challenges Arising from Digitalisation — Report on Pillar Two Blueprint," para. 59 (Oct. 14, 2020). "The need to distinguish the separate business operations undertaken in the permanent establishment and the head office is particularly relevant for jurisdictional blending. It ensures that the tax rate on income earned through permanent establishments in another jurisdiction is not blended with income of the head office in a different jurisdiction."

[28] Bendlinger, *supra* note 11, at 46.

[29] *See* article 3.5, GLOBE model rules (2021), *supra* note 1.

[30] The case of transparent UPEs needed to be addressed explicitly by the GLOBE model rules. In the absence of taxation at the entity level, the ETR of transparent UPEs would always be zero and the shareholders of the UPE would never be part of the MNE group and not subject to pillar 2. For this reason, article 7.1 of the GLOBE model rules provides for a specific procedure to basically test the ETR of transparent UPEs based on the taxes paid by the transparent UPE's shareholders.

[31] *See* the deemed "location" for "flow-through entities" defined in article 10.3.2(a) of the GLOBE model rules (2021), *supra* note 1.

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jurisdiction of incorporation. This enables that jurisdiction to apply the QDMTT or IIR to such entities and ensures that the income is clearly allocated to that jurisdiction for the computation of the UTPR top-up tax, if the state of incorporation of the transparent UPE does not implement pillar 2.

On rare occasions, the income of a transparent entity may be neither attributable to a PE nor to its shareholders although the entity is not the UPE of the MNE group. This can be the case with reverse hybrid entities. According to article 10.2.1(b) of the GLOBE model rules, a reverse hybrid entity is fiscally transparent in the jurisdiction in which it was created but opaque in the residence state of its shareholders. These entities pose a risk that pillar 2 would neither allocate the income to the jurisdiction in which the entity was created nor to the jurisdiction in which its shareholders are resident: Both jurisdictions would assume that the income may be taxed by the other; the income would literally be stateless. The GLOBE model rules deem these entities to be located where they are subject to an IIR under article 10.3.2(a) of the GLOBE model rules, or, if not, consider them stateless under article 10.3.2(b). In the latter case, the ETR is tested on an entity basis as the only member of an MNE group within a fictious jurisdiction.[32] The GLOBE model rules define these entities as "Stateless Constituent Entities." Given the fact that, by definition, these entities are not liable to tax in any state, they do not pose any treaty issues from the outset.[33]

In summary, one can conclude that pillar 2 acknowledges that transparent entities and PEs are distinct taxpayers for its purposes. However, as neither transparent entities nor PEs are considered resident taxpayers for domestic laws and tax treaties, pillar 2 established a proxy for the concept of residency. Instead of referring to residency, the concept of location governed by article 10.3 of the GLOBE model rules determine the territorial allocation of CEs solely for purposes of pillar 2.[34] For nontransparent entities, pillar 2 relies on domestic tax and treaty residency as far as possible.[35] For tax-transparent entities and PEs, pillar 2 deems a specific location to assure a correct allocation of income and taxes between jurisdictions for purposes of the ETR computation.[36]

Relevancy for a Treaty Analysis of Pillar 2

Given that pillar 2 treats tax-transparent entities and PEs in the same way as treaty resident entities, they arguably meet all requirements for being a resident person under articles 1 and 4 of the OECD model tax convention.

Article 1 says the convention applies to "persons." The term, according to article 3(1)(a), includes "companies" and "any other body of persons." The U.S. model tax convention is even more specific. Article 3(1)(a) explicitly mentions estates, trusts, and partnerships. "Company" is defined in article 3(1)(b) of the OECD and U.S. model tax conventions as "any body corporate" or "any entity that is treated as a body corporate for tax purposes."

Article 3(1)(b) of the U.S. model tax convention further adds the phrase "according to the laws of the Contracting State in which it is resident" to the second alternative. However, this addition only clarifies because the treaty is only applicable to resident persons. It seems the addition reflects an amendment made to the OECD commentary during its 2014 update.[37] What does it mean for transparent entities and PEs?

The person test in article 1 of both the OECD and U.S. model tax conventions is regularly met for transparent entities. If recognized as having legal capacity under the national law of the

[32] For detail on reverse hybrid entities in the GLOBE model rules, *see* Bendlinger, *supra* note 11, at 66-68.

[33] On the contrary, stateless PEs under article 10.3.3(d) of the GLOBE model rules could give rise to treaty issues if the place of business is considered a PE under the treaty, but nevertheless qualifies as a stateless PE under letter d of the GLOBE model rules' PE definition. This issue goes beyond the scope of this article.

[34] *See id.*, at 61 for location concept.

[35] Articles 10.3.1 and 10.3.4 GLOBE model rules (2021), *supra* note 1.

[36] *Id.*, articles 10.3.2 and 10.3.3.

[37] "OECD Model Tax Convention on Income and on Capital: Commentary on Article 3, para. 3," (Nov. 21, 2017). "The term 'company' means in the first place any body corporate. In addition, the term covers any other taxable unit which is treated as a corporate body for the purposes of the tax law of the Contracting State of which it is a resident." While both sentences have been in the commentary since the OECD model tax convention of 1977, the last part of the second sentence, "for the purposes of the tax law of the Contracting State of which it is a resident," was added in 2014, which seems to mirror the content of the last part of article 3(1)(b) of the U.S. model tax convention of 2016.

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country of incorporation, a transparent entity is a corporate body, and a corporate body qualifies as a person under the first alternative in article 3(1)(b) of both conventions, irrespective of whether it is treated as a corporate body for tax purposes.[38]

However, pillar 2 might also recognize PEs as persons, although the analysis is not as straightforward as it is for transparent entities, because one could question whether a PE is a corporate body in the first place. Under standard corporate and individual tax rules, a PE is an inseparable part of a taxpayer as a corporation and can probably not be seen as a corporate body itself, because common tax rules would not qualify PEs as corporate bodies. But even if one does not see a PE as a corporate body, the PE could meet the second alternative in article 3(1)(b) of the OECD and U.S. model tax conventions because under pillar 2, as has been shown, a PE is considered a separate CE and is thus, "an entity that is treated as a body corporate for tax purposes[39] [according to the laws of the Contracting State in which it is resident]."[40]

The term "entity" is broad and by assuming that PEs are CEs it is not farfetched to assume that a PE is to be considered as an entity under the second alternative of article 3(1)(b). Finally, there is little doubt that the PE is "treated as a body corporate for" purposes of GLOBE (assuming GLOBE taxes are covered by the treaty), because this is exactly what the GLOBE model rules do by establishing PEs as separate members of MNE groups. This reading of article 3(1)(b) of the OECD and U.S. model tax conventions is further confirmed by the OECD commentary, in which it is noted that the second alternative of the provision covers "any other taxable unit which is treated as a body corporate"[41] and a PE certainly is a "taxable unit" under pillar 2 rules. Outside the framework of pillar 2 this would be inconceivable in most jurisdictions, because domestic laws regularly do not recognize PEs to be corporate bodies under domestic corporate or tax laws.

To qualify as a person alone, however, does not entitle the person to a treaty's benefits. Rather, article 1 of the OECD and U.S. model tax conventions require the person to be a resident of one or both contracting states; and in any case, article 4(1) of both conventions define the term "resident of a Contracting State" as a person "who, under the laws of that State, is liable to tax therein."[42] Usually, tax-transparent entities and PEs would fail this test. For PEs in particular, this is even made explicit in the second sentence of article 4(1) of the OECD model tax convention, in which it is clarified that a person "who is liable to tax in that State in respect only of income from sources in that State"[43] cannot qualify as a resident. The U.S. model tax convention adds further that the same holds true for a person who is only liable to tax in respect "of profits attributable to a permanent establishment in that contracting state."[44] So how can transparent entities or PEs qualify as residents for pillar 2 purposes?

Assuming that the QDMTT, the IIR, or the UTPR are covered taxes under article 2 of the OECD and U.S. model tax conventions, transparent entities and PEs are "liable" to the same tax rules as nontransparent entities, potentially on the worldwide income of the whole MNE group. The argument that the second sentence of article 4(1) of both conventions would exclude residency for PEs is not necessarily persuasive because the PE's liability to pillar 2 is not limited to sources in that state. Instead, it is the essence of the UTPR to make even a single PE subject to tax on an MNE group's global profits. To affirm treaty residency of transparent entities or PEs, the question is whether pillar 2 tax principles mean that transparent entities and PEs are indeed liable to tax under article 4(1) of the OECD and U.S. model tax conventions. To answer this question, it is necessary to determine whether tax treaties cover pillar 2 taxes.

[38] *See id.*, at para. 2.

[39] Article 3(1)(b), OECD model tax convention (2017).

[40] Article 3(1)(b), U.S. model tax convention (2016).

[41] *See* second sentence of OECD model tax convention (2017): "Commentary on Article 3," *supra* note 37, at para. 3.

[42] Article 4(1), OECD model tax convention (2017).

[43] *Id.*

[44] Article 4(1), U.S. model tax convention (2016).

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Are Pillar 2 Taxes Covered by Tax Treaties?

Scope of Article 2 OECD and U.S. Model Tax Conventions

According to article 2 of the OECD and U.S. model tax conventions, the material scope of tax treaties is restricted to certain kinds of taxes. This affects the personal scope of the treaty: A person can only be considered a resident if the person is liable to tax, and there is little doubt that liable to tax means liable to covered taxes as defined in article 2 of the OECD convention. According to article 2(1), the convention covers "taxes on income or capital." Thus, the question arises whether a top-up tax levied as a QDMTT, IIR, or UTPR qualifies as covered taxes within the meaning of article 2. If tax treaties do not cover taxes levied by way of GLOBE rules, this would mean that there should be no conflict between them and GLOBE rules.[45] An analysis of pillar 2's relation to tax treaties would be unnecessary.

Article 2 of the OECD model tax convention leaves little doubt that any top-up tax levied might be within its ambit. First, it is clear that pillar 2 imposes a tax. If a contracting state implements the global minimum tax along the lines of the GLOBE model rules, QDMTT, IIR, and UTPR are compulsory payments.[46] One might argue that the way the top-up tax is levied might deviate from standard corporate tax systems, but article 2(1) of both conventions make it clear that the "manner in which [a tax] is levied"[47] is irrelevant for its qualification as a covered tax.

Second, it also seems that the QDMTT, IIR, and UTPR levy taxes on income. They collect an amount of top-up tax on excess profits (GLOBE income minus the substance-based income exclusion). GLOBE's base determination also allows for deduction of expenses, which is usually understood as a strong indication of a tax on income, although the term "income" does not necessarily have to be associated with a net base.[48] In any case, the fact that the GLOBE base is called "GloBE Income or Loss" indicates a parallel to corporate taxes; and also economically, GLOBE aims to be an add-on or substitute for corporate taxation, even if one might argue, that pillar 2 goes beyond this. For this reason, it seems clear that GLOBE taxes do qualify as taxes on income as defined in article 2(1) of the OECD model tax convention.

Third, under article 2(4) of the OECD convention, "the Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, existing taxes."[49] Indeed, one could question whether GLOBE is either identical or substantially similar to a common corporate tax system because it is only levied if and to the extent that the ETR is below the minimum rate of 15 percent.[50] But the same could be argued in favor of substantial similarity of GLOBE to existing income taxes because GLOBE is a mere substitute for a corporate tax burden.

Finally, GLOBE levies a tax in the absence of sufficient domestic taxation and taxes "in place of existing taxes," arguably, in place of nonexistent source taxation or source taxation that is below an ETR of 15 percent. Is there an argument that taxes collected under GLOBE are not covered by tax treaties?

The strongest argument could be that in 2024 there is not a single tax treaty that refers to a QDMTT, IIR, or UTPR in the typical list of covered taxes in article 2(3) of the OECD model tax convention. It is true that the list in article 2(3) is, according to the OECD commentary on article 2, not exhaustive.[51] Nevertheless, there are still tax treaties in force in which the covered taxes article is limited to a comprehensive list of covered taxes.

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[45] This had been claimed by Christians and Shay, *supra* note 7, at 454.

[46] *See also* Ana Paula Dourado, "The Pillar Two Top-Up Taxes: Interplay, Characterization, and Tax Treaties," 50(5) *Intertax* 395 (May 1, 2022).

[47] Article 2(1), OECD model tax convention (2017).

[48] On article 2(3) of the OECD model tax convention, *see* Martin Klokar, "Chapter 5: The List of Taxes According to Article 2(3) OECD Model Convention 1982 and 2017," *Taxes Covered Under Article 2 of the OECD Model* (19) section 5.2 (2020).

[49] Article 2(4), OECD model tax convention (2017).

[50] *See also* Luc De Broe, "Some EU and Tax Treaty Law Considerations on the Draft EU Directive on Global Minimum Taxation for Multinationals in the Union," 50(12) *Intertax* 882 (2022).

[51] OECD Model Tax Convention on Income and on Capital: Commentary on Article 2, para. 6 (Nov. 21, 2017).

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For these, it would be difficult to argue that the contracting states intended an IIR or UTPR top-up tax to be captured by the tax treaty.[52] This is all the more true if a tax treaty is concluded subsequently to domestic adoption of pillar 2 by one of the two contracting states. In this case, one could only see pillar 2 taxes covered by extensively interpreting the separate items of the tax treaty's list of covered taxes. If, for example, the exhaustive list referred to the corporate tax of both contracting states, one could interpret the term "corporate income tax" in such a way that it covers the tax on MNE groups levied by the global minimum tax. However, if a specific tax treaty contains an equivalent provision at least like article 2(2) of the OECD model tax convention, it seems almost impossible to see any GLOBE top-up tax falling outside the tax treaty's scope.[53]

Nevertheless, Allison Christians and Steven E. Shay[54] have taken a minority view with respect to the question whether a UTPR qualifies as an income tax under article 2: "No precedent for the UTPR has been identified so far, nor are we aware of authority that would support the view that the UTPR is identical or substantially similar to any tax treaty partner's existing covered tax under a U.S. tax treaty."[55] Eventually, the authors conclude that the UTPR is not a tax on profits but rather a sort of excise tax.[56]

This view, however, is unconvincing. First, the OECD itself considers both IIR and UTPR as covered taxes because otherwise its elaborations on tax treaty compatibility in the blueprint[57] and the commentary[58] would be superfluous. The same holds true for the GLOBE model rules themselves, because article 10.3.5 of the GLOBE model rules states that at least the IIR might be applied to certain dual resident entities "unless it is restricted by an applicable Tax Treaty in force." If one assumes that article 10.3.5 does not merely refer to restriction because of a treaties' nondiscrimination provision (which usually also applies to noncovered taxes), what is the point if it is clear that pillar 2 is not a covered tax?

Second, even more persuasively, neither IIR nor UTPR are minimum taxes as such. Instead, they are collection mechanisms for an amount of top-up tax to be calculated from an amount of GLOBE income multiplied by the so-called jurisdictional top-up tax (which is the difference between the minimum rate of 15 percent and the jurisdictional ETR). It can be conceded that the UTPR is:

- an "innovation" to tax profits received by different taxpayers;
- neither identical nor substantially similar to other mechanisms to collect income taxes; and
- that the UTPR liability is several steps removed from the taxable profit of the related entity.[59]

However, this does not change the fact that, as article 2 presupposes, the UTPR imposes a tax on income; and already article 2(1) states that the model tax convention "shall apply [. . .] irrespective of the manner in which [the income tax is] levied."[60]

However, this might be different for DTAs that do not contain a provision corresponding to article 2(1). In this case, a QDMTT, IIR, or UTPR could only be considered covered taxes by way of an autonomous interpretation of the respective covered taxes article.

In any case, a treaty containing a covered taxes article patterned on article 2(1) covers the QDMTT, IIR, and UTPR. Regarding treaty compatibility, the OECD referred to article 1(3) of its model tax convention and paragraph 81 of the commentary on article 1 addressing controlled foreign corporation regimes and, for example, in article 10.3.5 of the GLOBE model rules, the OECD has confirmed that it considers pillar 2 taxes to be covered under article 2 of the OECD model tax convention. If the OECD didn't

[52] For the same conclusion, see Klokar, *supra* note 48, at section 5.5.

[53] Drawing the same conclusion, see De Broe, *supra* note 50, at 882.

[54] Christians and Shay, *supra* note 7, at 450-451.

[55] *Id.*, at 451.

[56] *Id.*, at 448-449 and 454.

[57] "Tax Challenges Arising from Digitalisation — Report on Pillar Two Blueprint" (2020), *supra* note 27, at paras. 679-696.

[58] "GloBE Commentary on Article 2 GloBE Model Rules" (2022), paras. 2 and 47.

[59] This argument has been put forward by, although not directly related to, the interpretation of article 2 of the OECD model tax convention. *See* Wardell-Burrus, *supra* note 9, at 701.

[60] Article 2(1), OECD model tax convention.

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consider QDMTT, IIR, or UTPR to be covered taxes under article 2, these references would be irrelevant.[61]

Pillar 2: A Single Tax or Multiple Taxes?

Having concluded that pillar 2 taxes, in principle, qualify as income taxes covered under article 2 of both the OECD and U.S. model tax conventions, the next question is whether pillar 2's collection mechanism, the QDMTT, IIR, and UTPR, represent a single tax or separate taxes.

What unifies all three GLOBE collection mechanisms is the determination of the actual minimum tax liability, that is, the amount of top-up tax. The top-up tax is the top-up that needs to be collected for a low-taxed CE to reach the minimum tax level of 15 percent. The amount of top-up tax is calculated in the same way, whether it is collected by the QDMTT, IIR, or UTPR.[62] The way QDMTT liability is computed might slightly deviate and allows for minor simplifications. Still, a QDMTT is required to be "equivalent to the GloBE Rules" and must comply with the cornerstones of pillar 2.[63]

However, not all three mechanisms necessarily collect the same amount of top-up tax, and they do apply to different taxpayers. The QDMTT is applied at the level of the entity that earned the low-taxed profits for which the tax is levied. A top-up tax allocated to a low-tax constituent entity (LTCE) will be collected by the same entity irrespective of the amount of ownership interest held by the MNE group.[64] In other words, the tax attributable to nongroup shareholders is subject to the minimum tax. The IIR, however, only applies if the LTCE did not itself pay a QDMTT and only collects the amount of top-up tax equal to the LTCE's parent entity's "allocable share of the top-up tax."[65]

The issue can best be demonstrated by means of an example. AB-Group consists of two CEs. CE A, located in state A, holds 70 percent of CE B, located in state B. Top-up tax of 100 has been allocated to CE B. If state B implements a QDMTT, it will collect the total amount of top-up tax, including that attributable to the minority shareholder's share in low-taxed profits. If state B does not apply a QDMTT, the IIR would collect only 70 of top-up tax, because the collection of the IIR is limited to CE A's allocable share of CE B.

Eventually, the UTPR kicks in as a backstop if the top-up tax is not collected via a QDMTT or an IIR. This is the UTPR's only limitation. If the LTCE is subject to a QDMTT, there is no top-up tax remaining to collect for the UTPR. If all of the UPE's ownership interests in the LTCE are held by parent entities required to apply the IIR, the UTPR exempts top-up tax attributable to minority shareholders because GLOBE then reduces the UTPR top-up tax to zero.[66] Only if not all the UPE's ownership interests are subject to the IIR will the UTPR avoid being restricted to the UPE's allocable share of the top-up tax and, just like the QDMTT in the example above, can also collect top-up tax attributable to minority shareholders.[67]

Thus, there are several arguments why the three mechanisms could be seen as different taxes:

1. The three mechanisms address different persons. The QDMTT is applied by the LTCE receiving the low-taxed income itself, the IIR is applied at the level of the LTCE's parent, and the UTPR applies to any member (whether opaque, transparent, or a PE) of the MNE group that is in a country that implemented pillar 2.
2. The three mechanisms potentially apply in different countries.
3. As pointed out above, the amount of top-up tax is not necessarily identical.
4. Not all forms of CEs are subject to the same rules. The IIR, for example, never applies to PEs because PEs can never be parent entities under the GLOBE model rules; the IIR only applies to UPEs, intermediate

[61] Bendlinger, *supra* note 11, at 315.

[62] Article 5, GLOBE model rules (2021), *supra* note 1.

[63] Article 10.1.1, GLOBE model rules (2021), *supra* note 1, *see* definition of the term QDMTT.

[64] "Tax Challenges Arising From Digitalisation — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)," para. 118.10 as amended by the OECD/G20 BEPS Project (Feb. 2, 2023).

[65] On the computation of the allocable share, *see* article 2.2 of the GLOBE model rules (2021), *supra* note 1.

[66] Article 2.5.2, GLOBE model rules (2021), *supra* note 1.

[67] Article 2.5.3, GLOBE model rules (2021), *supra* note 1.

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parent entities, and partially owned parent entities.[68]

Does this imply QDMTT, IIR, and UTPR are different taxes?

There are many reasons to doubt that the QDMTT, IIR, and UTPR are different taxes. First, the fact that the tax is collected by different entities does not make a difference. Jurisdictions can decide to collect the same tax in different ways. Although dividends received by nonresident corporations might be subject to a withholding tax at source, the same jurisdiction might tax resident corporations on dividends received. However, whether levied by a withholding tax or tax assessment does not make a difference. In both situations the jurisdiction applies the same corporate tax; the fact that the tax is collected differently if the dividend is received by a nonresident taxpayer is irrelevant. Otherwise, the list of covered taxes in tax treaties would regularly be insufficient, because a mere reference to corporate tax would not cover corporate taxes collected by way of a withholding tax.

The fact that different countries might apply a QDMTT, IIR, or UTPR does not make a difference either. Pillar 2 coordinates all three mechanisms to establish a minimum tax level. The GLOBE model rules are a coordinated set of rules. Also, the fact that the amounts of top-up tax collected by the different mechanisms may vary does not necessarily mean that the three mechanisms are different taxes. Rather, the tax base and the applied rate and the jurisdictional top-up tax percentage are still the same. Although the IIR, for example, only collects the amount of top-up tax attributable to ownership interest and leaves parts of the top-up tax attributable to nongroup shareholders uncollected, the tax base remains unchanged. The fact that certain amounts of top-up tax might remain uncollected if QDMTT is not applied is not sufficient to distinguish QDMTT as a different tax. For these reasons, I am convinced that pillar 2 is a complete system and should be seen as a single tax.

However, even if one were to see them as different taxes, it would not matter for treaty purposes. Treaties apply to taxes on income, and the OECD model tax convention also applies to taxes on capital. Article 2(1) of the OECD model tax convention distinguishes between taxes on income and taxes on capital and clarifies in article 23B(1) that an income tax cannot be credited against a tax on capital.[69] However, treaties do not distinguish among income taxes. Even if one of the contracting states levies multiple income taxes, for the treaty it is the income that matters, as the distributive rules only allocate taxing rights on income, and do not restrict the contracting states in how they tax that income. Thus, if a contracting state collects corporate tax and a top-up tax, regardless of which collection mechanism is applied, the treaty would see the sum of the income taxes under article 2(1) and would not separate taxes.

Nevertheless, the way the top-up tax is collected, either by QDMTT, IIR, or UTPR, can make a difference in the treaty analysis, because it might affect different residents in different countries. If the LTCE is obliged to collect the QDMTT on its own profits, this is likely in line with the treaty because the LTCE's residence state, in most situations,[70] would already have the right to levy tax. For the IIR and the UTPR, treaty issues are more likely to occur because both impose tax on the LTCE's income at the level of different taxpayers. Once it is seen that the taxpayers of pillar 2 are the CEs themselves and not the MNE group, the IIR and UTPR raise the question of which CE can rely on the treaty. This will be addressed in the following subsection.

Which CE Is the Taxpayer?

GLOBE's jurisdictional blending approach and the fact that individual CE's liability to owe tax depends on their membership in the MNE group makes it challenging to determine which CE is to be considered the taxpayer. It has been pointed out that article 1.1.1 of the GLOBE model rules clearly states that it is the CEs and not the

[68] The definitions of intermediate parent entities and partially owned parent entities explicitly excludes PEs from qualifying, *see* GLOBE Model Rules article 10.1.1.

[69] *See* OECD model tax convention on income and on capital: commentary on article 23, para. 70 (Nov. 21, 2017).

[70] For further thoughts on potential QDMTT treaty incompatibilities, *see* Bendlinger, *supra* note 11, at 321.

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group as such. However, for treaty purposes, it is also important to know which of the CEs is the taxpayer that could actually claim the benefits of a treaty. This question is not answered by article 1.1.1, which only states "GloBE Rules apply to Constituent Entities." It's a difficult issue because the IIR and the UTPR collect the tax that is determined by the profits of an LTCE, a resident of a different country. But even the QDMTT might force an LTCE to collect taxes on profits of a different taxpayer: If there are multiple CEs within the same low-tax jurisdiction, an individual CE might be subject to a QDMTT even if, by itself, it would not be taxed at a lower rate at all. GLOBE's jurisdictional blending mixes all the MNE group's income within the jurisdiction, raising the question of which of the CEs, in fact, is the taxpayer?

Fadi Shaheen recently compared the UTPR with a withholding tax. He argued that a UTPR is a "mathematical, conceptual, and legal equivalent of a 100 percent withholding (or branch) tax on a deemed distribution by the UTPR entity (or PE) equal to the entity's (or PE's) UTPR liability."[71] This is a strong argument. Under this understanding, the CE — whether an opaque or transparent entity, or a PE — collecting the tax would merely be a withholding agent for a different entity, either the UPE because the UPE is the controlling entity that would finally receive the income; or the LTCE itself, because this is the person that actually received the income. It seems that if one assumes that the UTPR is equivalent to a withholding tax, the tax is withheld for the LTCE and not the UPE.

However, there is much to suggest that the collection mechanisms are not withholding taxes at all but rather similar to CFC mechanisms in corporate tax regimes. The CE collecting the tax should be seen as the taxpayer in pillar 2. Some authors, like Heydon Wardell-Burrus, have argued that "the UTPR liability is several steps removed from the taxable profit of the related entity"[72] and therefore the pillar 2 collection mechanisms are not comparable to CFC legislation, because it would be impossible to "'trace' from the undertaxed profits of an enterprise in an undertaxed jurisdiction to the UTPR liability."[73]

There is no reason to disagree with the idea that the pillar 2 liability is not necessarily "traceable" within the CEs of the MNE group. However, I don't believe that this is sufficient to distinguish CFC regimes. The UTPR top-up tax amount is the sum of top-up tax calculated for each LTCE.[74] Importantly, even the UTPR is at least traceable to the jurisdiction that generated the GLOBE income, and GLOBE allocates income mostly following treaty principles. Therefore, the UTPR top-up tax can very well be traced not necessarily to a single entity but at least to the contracting state in which the income had been received.

For the application of a bilateral tax treaty, this is sufficient because tax treaties only allocate taxing rights for income to one or both contracting states. If, for example, the UTPR forces the German PE of a U.S. UPE to collect tax on the income of an LTCE in Singapore, it is a matter of the German-Singapore DTA whether the UTPR is permissible under the treaty. It is a question of whether Germany's taxing right is restricted in regards to the low-taxed income from Singapore that the UTPR aims to tax. This situation is exciting, because a PE, under the traditional concept of tax treaties, is never considered to be a resident person and, thus, Germany would not be in a position to invoke the saving clause, to which the OECD regularly refers, to justify pillar 2's treaty compatibility. However, a PE is a CE and under pillar 2 it is potentially subject to tax on the income of the whole MNE group's worldwide income. If an MNE group operated in a zero-tax jurisdiction and held just one single PE in a pillar 2 jurisdiction, the PE would collect 15 percent of the whole group's worldwide income. Thus, one could very well ask whether the PE could be considered a resident person liable to tax in the PE state in which it is subject to the UTPR.

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[71] Fadi Shaheen, "Is the UTPR a 100 Percent Tax on a Deemed Distribution?" *Tax Notes Int'l*, Oct. 16, 2023, p. 321.

[72] This argument has been put forward by, although not directly related to the interpretation of article 2 of the OECD model tax convention, see Wardell-Burrus, *supra* note 9, at 701.

[73] This argument has been put forward by Wardell-Burrus, although not directly related to the interpretation of article 2 of the OECD model tax convention, see *id.*

[74] Art 2.5.1. GLOBE model rules (2021), *supra* note 1.

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Are Transparent Entities and PEs Residents Under Pillar 2?

The Liable to Tax Test

As has been shown, transparent entities and PEs can be considered legal persons under article 3(1)(a) of both the OECD and U.S. model tax conventions, and pillar 2 subjects them to a tax that is covered by article 2 of both conventions. This leaves us with the last question: If transparent entities and PEs are part of an MNE group, does pillar 2 transform them into treaty residents, usually not considered liable to tax under tax treaties?

I admit that this might seem like a weird question. Usually, article 1(2) of the OECD model tax convention and article 1(6) of the U.S. model tax convention only consider transparent entities to pass the residency test if one of the contracting states taxes the received income as derived by a resident. For PEs, the U.S. model convention, even more explicitly than that of the OECD, states that a resident "does not include any person whose tax is determined . . . only of income from sources in that Contracting State or of profits attributable to a permanent establishment in that Contracting State."[75] However, the reference to "only of income from sources in that Contracting State," used by both the OECD and the U.S. model tax conventions, makes all the difference. Within the framework of pillar 2, a single CE is liable to tax on an MNE group's global profits. If an MNE group operates in 100 jurisdictions, and it establishes a single PE in the one jurisdiction that applies a UTPR, the single PE could collect the minimum tax regarding all the profits received in all the other jurisdictions. Does a minimum tax liability that only kicks in with regard to low-taxed profits justify treating a transparent entity or PE as being liable to tax in general?

With this interpretation of liable to tax, it is difficult to see why transparent entities and PEs that are part of an MNE group subject to pillar 2 should not be seen as liable to tax. It is regularly acknowledged that liable to tax is not equal to subject to tax. The fact that a specific company does not pay taxes does not mean that it does not qualify for residency status. A corporation that receives losses is certainly liable to tax under domestic laws, even if the tax liability in a given year is zero. The same is true if a corporation primarily receives income exempt from tax.

Because many jurisdictions of the inclusive framework, particularly OECD member countries, regularly apply participation exemption regimes, every holding company would be at risk of losing residency status solely because most of its income is not subject to tax. Thus, it is common sense that the phrase "liable to tax" does not mean that the income must be subject to tax in the residence state. According to an IRS revenue ruling, neither the fact that an entity might be allowed to deduct dividends paid to its shareholders nor that it is exempt from tax means that it necessarily fails the liable to tax test.[76]

There is therefore little doubt that transparent entities and PEs would meet the liable to tax test. Article 1.1.1 of the GLOBE model rules already clarifies that any CE is, in principle, liable to tax on the MNE group's worldwide income. That the respective transparent entity or PE might not be obliged to pay a tax is insignificant, because under article 3(1)(a) of both the OECD and U.S. model tax conventions, liable to tax does not require that the person be subject to tax, but rather that it is covered by the tax in principle. For this reason, one can conclude that both transparent entities and PEs that are part of an MNE group subject to pillar 2 could qualify as residents under tax treaties of the state in which the transparent entity or PE is located under article 10.3. of the GLOBE model rules. Transparent entities or PEs that are not part of a group within the scope of pillar 2 would, however, not qualify as residents, because they would not be liable to tax on their worldwide income where they are located. Why is the potential residency status of transparent entities and PEs significant for the pillar 2 vs. treaties discussion?

The point is that jurisdictions could employ the saving clause to defend claims against pillar 2's treaty compatibility, if top-up tax is collected from a transparent entity or a PE, because both

[75] Last sentence of article 4(1) U.S. model tax convention.

[76] Rev. Rul. 2000-59, 2000-52 IRB 1, IRC section 894.

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would be considered residents. This, however, does not necessarily mean that the saving clause indeed "saves" the residence state from treaty violations. I have already expressed my doubts elsewhere.[77]

Further, the residency test alone does not necessarily mean that a transparent entity or a PE is entitled to treaty benefits. If one assumes that they could qualify as residents, their treaty entitlement could be further restricted by a limitation on benefits clause. However, this question goes beyond the scope of this article.

If a PE Qualifies as a Resident, Is the Entity a Dual Resident?

However, what might be relevant for the potential residency status of PEs is whether granting this status would qualify the head office (in the terminology of the GLOBE model rules: the main entity) to be a dual resident. Article 4(3) of the OECD model tax convention requires that the residency status of an entity be established by employing a mutual agreement procedure. If the MAP fails, the OECD convention denies any benefits to the dual resident entity. The U.S. convention of 2016 is even more restrictive. According to article 4(4), dual resident companies "shall not be treated as a resident of either Contracting State."[78] Does this mean granting a PE residency status because of pillar 2 liability transforms an entity into a dual resident?

In my view that is not the case. If one assumes that a PE is liable to tax on its worldwide income because it is subject to a pillar 2 tax in the state in which it is located, the PE is to be considered a separate resident. This is a consequence of the fact that pillar 2 treats the PE as a separate CE. Pillar 2 puts PEs and their head offices on equal footing and treats them as individual taxpayers. Thus, if a PE qualifies as a resident for treaty purposes because it is part of an MNE group within the scope of pillar 2, it must be seen as a distinct resident from its main entity.

[77]Bendlinger, *supra* note 11, at 329.

[78]Article 4(4), U.S. model tax convention (2016).

Conclusion

Many authors have already concluded that pillar 2's relationship with treaties is odd.[79] This article finds another oddity that has not yet received much attention: Transparent entities and PEs might qualify as residents under tax treaties if they are CEs of an MNE group subject to pillar 2 and are located in a jurisdiction that requires them to collect a top-up tax, whether through a QDMTT, IIR (IIR liability is only conceivable with respect to transparent entities, not PEs), or UTPR. Both transparent entities and PEs do qualify as persons under article 3(1)(a) of the OECD model tax convention and both, despite not being subject to unlimited tax liability under standard corporate tax systems, are subject to a comprehensive liability to tax under pillar 2. Minimum taxes levied under the framework of pillar 2 are covered taxes under article 2 of the OECD model tax convention, and because transparent entities and PEs are deemed to be separate CEs and qualify as separate taxpayers under pillar 2, they meet the liable to tax test of article 4(1) of both the OECD and U.S. model tax conventions.

That this conclusion is not an absolute absurdity is also confirmed by the German implementation act of the EU pillar 2 directive (Mindeststeuergesetz[80]), of which section 100 reads:

> The taxation under this law or a different foreign provision, which is equivalent to the provisions of the Directive (EU)

[79]For skepticism over pillar 2's treaty compatibility, *see, for example*, De Wilde, "Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification," Kluwer International Tax Blog (Jan. 12, 2022); VanderWolk, "The UTPR is Inconsistent with the Nexus Requirement of Tax Treaties," *supra* note 8; VanderWolk, "The UTPR Disregards the Need for Nexus," *supra* note 8, at 545; Goulder, "Pillar 2 and Tax Treaties: MLI, Where Are Thou?" *supra* note 8, at 775; VanderWolk, "Much Ado About Pillar 2," *supra* note 8, at 821; Goulder, "Confessions of a UTPR Skeptic," *supra* note 8, at 907 et seq.; VanderWolk, "The UTPR Is Far From Becoming Part of Customary International Tax Law," *supra* note 8, at 1069; VanderWolk, "The UTPR: Taxing Rights Gone Wild," *supra* note 8, at 1369; VanderWolk, "The UTPR Is Flawed: A Response to Prof. Picciotto," *supra* note 8; VanderWolk, "Tax Treaties Pose Problems for the UTPR," *supra* note 8; Boidman, "UTPR's Effect on Outside Shareholders: Another Reason to Oppose?" *supra* note 8, at 189; VanderWolk, "The UTPR, Treaties, and CFC Rules: A Reply to Avi-Yonah and Schler," *supra* note 8, at 187; Nikolakakis and Li, "UTPR: Unprecedented (and Unprincipled?) Tax Policy Response," *supra* note 8, at 743.

[80]Gesetz zur Gewährleistung einer globalen Mindestbesteuerung für Unternehmensgruppen (Mindeststeuergesetz — MinStG), BGBl. 2023 I Nr. 397.

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> 2022/2523, does not establish entitlement to the benefits of a convention on the avoidance of double taxation. [Translated by the author.]

The provision, when examined closely, can only be interpreted as a deliberate treaty override. This underscores the German legislature's recognition of the potential risk of pillar 2 making certain entities or PEs liable to tax, granting them unintended residency status.

Indeed, granting residency status to transparent entities and PEs might have weird consequences and bring new arguments into the discussion of pillar 2 and treaties. On the one hand, there might be an argument in favor of pillar 2's treaty compatibility because implementing jurisdictions could employ the saving clause to avoid potential conflicts between pillar 2 legislation and tax treaties. On the other hand, a residency qualification for transparent entities and PEs could have much more far-reaching consequences because it would grant PEs access to its jurisdiction's global treaty network.

The aim of this article is not to twist existing treaty principles. On the contrary, my goal is to show, once again, that the relationship between pillar 2 and tax treaties is still unresolved, raising multiple questions that need answers. Surprisingly, the OECD does not seem to be pushing for a multilateral treaty to make pillar 2 a binding source of public international law. Many authors[81] have rightly called for a multilateral agreement to avoid normative conflicts between pillar 2 and treaties from the outset. I therefore have no choice but to once again fully endorse the call for a multilateral solution to untangle the weird relationship between pillar 2 and tax treaties. Whether or not this claim is realistic in the current political climate, however, is a different matter. ■

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[81] *See* Johannes Becker and Joachim Englisch, "International Effective Minimum Taxation — The GLOBE Proposal," 11(4) *WTJ* 524 (2019); Li, "The Pillar 2 Undertaxed Payments Rule Departs From International Consensus and Tax Treaties," *Tax Notes Int'l*, Mar. 21, 2022, p. 1401; David G. Noren, "Modifying Bilateral Income Tax Treaties to Accommodate Pillar Two UTPR Rules," 63(25) *Tax Management Memorandum* 8 (Dec. 5, 2022); Goulder, "Pillar 2 and Tax Treaties: MLI, Where Are Thou?," *supra* note 8, at 775; De Wilde, "Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification," *supra* note 8, at section 2.3; VanderWolk, "Much Ado About Pillar 2," *supra* note 8, at 823; De Broe, "Some EU and Tax Treaty Law Considerations on the Draft EU Directive on Global Minimum Taxation for Multinationals in the Union," *supra* note 50, at 885; Filip Debelva and De Broe, "Pillar 2: An Analysis of the IIR and UTPR From an International Customary Law, Tax Treaty and European Union Law Perspective," 50(12) *Intertax* 905-906 (2022); Antonio Tomassini and Marica De Rosa, "Uncertainties Hold Back Achievement of OECD Pillar 2 Goals," 51(2) *Intertax* 190 (2023).

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