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States should take a prudential approach to the implementation of GLoBE rules to avoid ISDS

by
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According to the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), MNEs can structure their investments to ultimately erode their tax revenues, due to varying tax regimes worldwide. The two-pillar historic reform of the international tax system that seeks to address this issue could eventually impact investors' rights under international investment agreements (IIAs), leading to investor-state dispute-settlement (ISDS) situations. This *Perspective* aims to identify ways to avoid them, in light of the renewable energy ISDS cases against Spain.

Under the Pillar Two model rules, 145 jurisdictions agreed on a non-binding common approach to the implementation of the GloBE rules, which introduce a 15% global minimum corporate tax rate, intended to ensure that MNEs with revenue above EUR750 million pay this minimum tax on income arising in each of the jurisdictions where they operate. This "top-up tax" applies regardless of whether the host jurisdiction adopts the GLoBE rules or not, notwithstanding the carve-out for substance-based income.

As a result, low-taxing countries need to reconsider their tax incentives for MNEs, if these incentives lead to effective corporate tax rates below 15%, as in most cases these would be effectively nullified by the "top-up tax" in favor of home countries.[1]

This raises the question of whether—in the interest of not loosing tax revenues—a withdrawal of such incentives by host countries could entail state liability under IIAs (*inter alia*, for breach of fair and equitable treatment or expropriation clauses).[2] Some IIAs contain provisions carving out tax regulations from the substantive protections offered to MNEs (and some tribunals[3] have held that tax policies deserve deference)—but many do not.[4] Thus, despite the global consensus around the GLoBE rules, the answer will be fact- and treaty-specific.

From the experience of the renewable energy ISDS cases, states seeking to limit their exposure to international liability under IIAs should:

- *Avoid retroactive regulatory changes*. One of the primary reasons for arbitration claims against Spain in its investor-state disputes concerning renewable energy investments concerned retroactive changes in renewable energy policies. When implementing the GLoBE rules, states should not legislate retroactively.

- *Avoid sudden and drastic modifications of regulatory frameworks*. Most IIAs include fair-and-equitable-treatment provisions that protect investors from disruptions of regulatory stability and/or the frustration of legitimate expectations. Investors attracted by low-taxing frameworks affected by sudden reversions of those benefits (or paired with other major trade reforms)[5] could challenge the unpredictability attached to such actions (despite that the global minimum tax has been under negotiation worldwide for several years). Instead, states should establish transition periods for the progressive amendment of the regulatory framework.

- *Ensure that past investments are, at least, partially guaranteed.* One way to do so would be to complement regulatory changes with mitigating measures to secure profits from past investments. In some of the renewable energy proceedings, the challenged measures were not considered as treaty breaches as long as the profitability of the foreign investors was still positive. In doing so, however, states should avoid compensatory payments that, under the GLoBE rules, may risk their measures being non-qualifying.

- *Avoid closed-door legislative processes*. The uncoordinated and unilateral enactment of new regulatory standards impacting relevant stakeholders can easily give rise to costly controversies in terms of resources and reputation. Instead, states should promote transparent and inclusive legislative processes (in most cases, implementing the model rules, already under public debate), leading to consensus-based solutions with potential claimants.

Ultimately, tax incentives are used to attract FDI. Their withdrawal likely disrupts the operations of MNEs that expected tax frameworks to endure. Therefore, any reversal must be done in the most prudential and cooperative manner to provide some certainty and avoid costly ISDS situations. It remains controversial whether—in specific cases in which host countries that do not apply the minimum tax—home countries will apply the top-up tax. Also, it is not clear whether investors that experience tax-incentives withdrawals will bring ISDS cases, given that they would have to pay the full tax rate in any event, via the top-up tax. Either way, investors and states have a strong mutual interest in renegotiating any incentives impacted by the global minimum tax, to avoid the benefit of those incentives being eliminated by top-up taxes arising in other jurisdictions.

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[1] Or implement a qualifying domestic minimum top-up tax and collect the "top-up tax" at source.

[2] For example, Ireland was supposed to transpose the EU Directive 2022/2523 before the end of 2023, and lobby groups flagged concerns about the uncertainty this may create for major MNEs established there.

[3] See, e.g., PV Investors v. Spain.

[4] In Eiser v. Spain, the state was successfully challenged for establishing a 7% tax.

[5] In *op. cit*. Eiser v. Spain, the 7% tax was paired with the elimination of allowances for gas-fired electricity.

For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Chioma Menankiti, at clm2249@columbia.edu.

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