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# The UTPR and the (disguised) discrimination under tax treaties

B?a?ej Ku?niacki ( PwC Netherlands, Lazarski University and Singapore Management University) and Mees Vergouwen (Assistant professor at Leiden University and tax advisor at De Brauw Blackstone Westbroek, Amsterdam. ) · Friday, March 21st, 2025

*The authors are winners of the Mitchell B. Carroll Prize for the last two consecutive years, as awarded at the International Fiscal Association global congresses in 2023 and 2024 in Cancún (Mexico) and Cape Town (South Africa), respectively.**

The compatibility of the Undertaxed Profits Rule (UTPR) with tax treaties based on the OECD or the UN Model Tax Convention (MTC) is an overarching question for all multinational (MNE) groups in scope of GloBE rules and other stakeholders, including shareholders of the MNEs and States of their presence. So far, the main focus has been on the two questions: (i) does the UTPR qualify as a "tax covered" by a tax treaty within the meaning of article 2;[1] (ii) if so, is its application compatible with the distributive provisions, in particular article 7(1). A question that has received less attention is the relation of the UTPR to the non-discrimination provision. This question is important because the UTPR results in the imposition of a tax burden for a group entity depending on, essentially, whether the owners of a domestic enterprise are tax resident in jurisdictions that implemented the GloBE rules. Based on the non-discrimination provision under tax treaties, in particular article 24 (5), more burdensome taxation on the basis of the tax residence of the owners is prohibited. Considering that the tax residence of the owners may result in more burdensome taxation for group entities under the UTPR, we aim to highlight in this contribution how such taxation may give rise to an incompatibility with the non-discrimination provision under tax treaties.

*The discriminative nature of the UTPR*

The discriminative nature of the UTPR may be illustrated as follows. Assume that an MNE Group has an ultimate parent entity A. A holds shares in low-taxed group entity B, tax resident in a non-implementing jurisdiction, and group entity C, tax resident in an implementing jurisdiction. If A were resident in a non-implementing jurisdiction and, as such, would not levy the Income Inclusion Rule (IIR), C becomes subject to the UTPR in respect of the profits of the low-taxed B. If, however, A were tax resident in the same jurisdiction as C, no UTPR would be imposed on C because A would have applied the IIR. This example hence illustrates that the tax burden for C, tax resident in an implementing jurisdiction, is more burdensome if its owner, i.e., the ultimate parent entity, is resident in the other contracting state as compared to being a resident in the same jurisdiction as C. The key question with respect to this discrimination based on the tax residency of

the ultimate parent entity is whether it is prohibited by the non-discrimination provision in a tax treaty.

*The broad objective scope of non-discrimination in article 24*

In answering this question, the starting point is that the non-discrimination provision typically applies irrespective of the scope of article 2,[2] i.e. on all taxes rather than only taxes on income or capital or substantially similar taxes. Considering that the UTPR is clearly a tax, it falls within the scope of the non-discrimination provision irrespective of whether it were to qualify as an in-scope tax within the meaning of article 2. One of the reasons for the broad objective scope of the non-discrimination provision in tax treaties following the OECD or the UN MTCs could be the general importance of non-discrimination under international law.[3] More specifically to cross-border taxation, non-discrimination appears to function as a legal device to promote cross-border investment under tax treaties by removing obstacles stemming from discriminatory taxation.[4]

*The narrow material scope of article 24*

Although the objective scope of the non-discrimination provision in tax treaties patterned on the OECD or the UN MTC might be broad, its material scope seems narrow insofar as it covers, in principle, only overt, direct discriminations. Based on this narrow material scope, hidden or indirect forms of discrimination do not seem prohibited by tax treaties even if in most instances the less advantageous treatment burdens the person who is protected by that article.[5] In other words, the material scope of article 24 is limited to, and only prohibits, a less favourable treatment that is caused by one of the prohibited criteria mentioned in its paragraphs; discriminations resulting from other criteria do not violate such non-discrimination provision under tax treaties.[6] This might seem like a clear-cut distinction. However, it is generally acknowledged that article 24 cannot be circumvented by making the less favorable tax treatment dependent on criteria that are only superficially neutral, which would indicate that there is no direct, overt discrimination, but in substance negate the protection granted by the principle of non-discrimination under tax treaties (disguised discrimination).[7] The OECD explicitly acknowledges this in para. 1 of the Commentary to article 24 by indicating that the non-discrimination provision also covers disguised discrimination by providing the so-called “passport” example, i.e., a different treatment based on whether or not a person holds a passport issued by a contracting state would, although not directly based on nationality, constitute a prohibited (disguised) discrimination on the basis of nationality for the purposes of the non-discrimination provision. This example is obvious and pertains to a discriminatory situation of an individual. Clearly, there must be other examples of disguised discriminations, especially within the context of legal persons or entities other than individuals. Support for this view may be derived from international tax treaty jurisprudence wherein it is recognized that some forms of indirect discrimination, i.e., discrimination based on criteria that do not directly match the criteria mentioned in the non-discrimination provision, may also be precluded under non-the discrimination provision.[8]

*The forms of discrimination prohibited by article 24(5)*

The passport example above relates to a (disguised) discrimination based on nationality. In addition to prohibiting discrimination based on nationality, article 24 (5) also prohibits discrimination based on the residence of the owners of a domestic enterprise.[9] In this respect, this

provision reads as follows:

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

As indicated above, the UTPR can result in more burdensome taxation for a subsidiary as a result of, *inter alia*, the tax residence of the ultimate parent entity, as well as other parent entities in an MNE Group. Hence, it seems justified to assess the compatibility of the UTPR with this paragraph of the non-discrimination provision. In assessing whether this is the case, a narrow and formalistic interpretation of the non-discrimination provision would lead to the conclusion that the UTPR's more burdensome taxation for a subsidiary cannot be regarded as a result of a direct, overt discrimination on the basis of the tax residence of a parent entity. This is because the more burdensome taxation of a subsidiary would not be linked only to the tax residency of its direct or indirect parent entities; the more burdensome taxation is only triggered if top-up-taxes are not levied and collected from such parent entities. Consequently, the imposition of the UTPR would not be solely linked to the tax residency of a parent entity but also to the extent to which top-up taxes are levied and collected from it.[10] Due to this dual cause of the UTPR's imposition, the UTPR cannot qualify as a direct, overt discrimination prohibited by article 24(5) because the foreign shareholding as such is not decisive in this respect; it could, at best, result in an indirect discrimination.[11] As a consequence, the more burdensome taxation would only be the result of an indirect discrimination, which is not prohibited by article 24(5).

Whereas there may not be a prohibited discrimination under a narrow and formalistic interpretation because the UTPR is not solely linked to the tax residence of a parent entity, it should be borne in mind that article 24 prohibits disguised discrimination in addition to direct, overt discrimination. Hence, the fact that foreign ownership of a domestic enterprise is one of the decisive criteria within the context of the UTPR, may still be relevant within the context of assessing the compatibility of the UTPR with the non-discrimination provision. Consequently, the key question to be answered is whether the UTPR can be regarded as resulting in a disguised, prohibited, discrimination that does not seem to escape the gravity pull of article 24(5).

*Can the UTPR give rise to a disguised discrimination?*

In assessing the key question as to whether the UTPR gives rise to a disguised, prohibited, discrimination, it seems necessary to make a comparison of a subsidiary with a foreign resident parent entity with the counterfactual scenario of a hypothetical resident parent entity all else being equal.[12] If the subsidiary of a foreign tax resident in a non-implementing jurisdiction is subject to the UTPR whereas in a purely domestic situation of an implementing jurisdiction they will never be subject to such taxation, then it seems that a disguised discrimination may be construed insofar as it is subject to a more burdensome taxation in a cross border situation in comparison to a purely domestic situation as this more burdensome taxation seems to be inextricably linked to the residence criterion.[13] This would, for example, be the case insofar as a state which imposes a top-up tax via the UTPR on a subsidiary of a foreign tax resident would not do so in respect of a subsidiary of a domestic tax resident due to the collection of the top-up-tax earlier on either through the QDMTT or the IIR. In this situation, all else being equal, the shift of tax residency of a

parent entity is decisive for the level of taxation for its subsidiary. If resident in a non-implementing jurisdiction, the subsidiary becomes subject to more burdensome taxation in respect of undertaxed profits of low-taxed subsidiaries (or the parent entity itself) as compared to a resident parent entity in an implementing jurisdiction; in this latter situation, no UTPR would be imposed on the subsidiary because undertaxed profits would already be levied and collected from the resident parent entity. This indicates that there is room for the position that the UTPR gives rise to a disguised discrimination on the basis of tax residency of the direct or indirect parent entity of a subsidiary and its direct or indirect ownership or control, which is prohibited under tax treaties.[14] Such discrimination is disguised because the UTPR does not rely directly only on the criterion of a foreign tax residency but, rather, on the ostensibly neutral criterion of whether the foreign parent entity is resident in an implementing jurisdiction and would subject the profits of its low taxed subsidiaries, as well as its own profits, to a tax rate (ETR) below 15%. If such foreign parent entity would not be resident in an implementing jurisdiction which does not levy and collect top-up taxes from such parent entity, then its subsidiaries (constituent entities of the MNE's group) in implementing jurisdictions face more burdensome taxation as a result of the UTPR all else being equal. [15]

It follows from the above that a key factor for the application of the UTPR on a subsidiary is whether a parent entity of a subsidiary has a tax residence in an implementing jurisdiction. The negative answer means that the UTPR will most likely apply, while the affirmative one that it will not apply. In domestic situations it will then never apply because a jurisdiction, which has the UTPR in force, is always an implementing jurisdiction. From the perspective of the subsidiary, the ostensibly neutral criterion of whether the foreign parent entity is resident in an implementing jurisdiction and would subject the profits of its low taxed subsidiaries, as well as its own profits, to a tax rate (ETR) below 15% effectively entails a disguised discrimination. As a result of this disguised discrimination, it is less attractive – in terms of its own tax burden – for a subsidiary to have a parent entity in a non-implementing jurisdiction as compared to a parent entity in an implementing jurisdiction or a domestic parent entity. This indicates that the UTPR creates an obstacle to cross border investments and commerce by means of a discriminatory unsolvable double taxation based on foreign ownership as the UTPR would not apply domestically.

The mentioned obstacle triggers tensions with the relevant purposes of tax treaties. Indeed, the principal purpose of tax treaties to eliminate such obstacles within the scope of their provisions.[16] The specific purpose of article 24 is to remove obstacles stemming from discriminatory taxation caused by, in particular, ownership by non-residents.[17] This reveals that the obstacle resulting from the UTPR may be regarded as being contrary to such purposes. As a result, the disguised discrimination caused by the UTPR creates obstacles to cross border investment and commerce. Such an obstacle may then be regarded as contrary to the specific purpose of article 24(5) and as jeopardizing the effectiveness of this non-discrimination provision if it were compatible with it.

Consequently, the effectiveness of article 24(5) may indicate that, based on the obstacle created by the disguised discrimination of the UTPR based on foreign ownership, the UTPR must be regarded as prohibited by article 24(5) notwithstanding that the UTPR would not result in a direct, overt discrimination.

Other arguments for the position that the UTPR is incompatible with article 24(5) because it results in a disguised discrimination may be derived from the following arguments, which go beyond the

scope that blog post and require a separate analysis:[18]

- An interpretation of article 24(5) in a good faith, which requires to give to those provisions meaning that most fully reflects the common intention of the parties to the tax treaty, and to understand the concept of non-discrimination in a way that gives effect to the provisions of the tax treaty in the fullest possible way, with each of its terms and provisions being considered relevant and giving effect to the purposes of the tax treaty to the fullest possible extent;[19]
- A consideration of the attempts of the OECD to design the UTPR so that states applying the UTPR will circumvent their obligations under tax treaties, and thus levy tax despites tensions with articles 7 and 9 due to the extraterritorial reach of the UTPR, apparently against the allocation of taxing rights among States under tax treaties;[20]
- An interpretation of article 24(5) in accordance with the principle of systemic integration under 31(3) (c) VCLT, which requires an interpreter to take into account “any relevant rules of international law applicable in the relations between the parties”.[21] Such rules may, for example, include rules stemming from the non-discrimination provisions under the EU treaties,[22] human rights treaties and similar provisions under the investment treaties, i.e. international investment agreements (IIAs) and other IIAs of relevance to the MNEs in scope of pillar 2;[23]I
- A relevant tax treaty case law around the globe according to which the non-discrimination under tax treaties does not only prevent a direct but also indirect or disguised discrimination.[24]

*Mees Vergouwen received the award for the book “The Effect of Directives Within the Area of Direct Taxation on the Interpretation and Application of Tax Treaties” in 2024 while B?a?ej Ku?niacki for the book “Beneficial Owner in International Taxation” in 2023. *See* more information here: https://www.ifa.nl/research-awards/mitchell-b-carroll-prize.

[1] Whenever we refer to any “article”, it means an equivalent of the relevant article of the OECD or the UN MTC, as included in a tax treaty, unless indicated otherwise.

[2] Although 24(6) of the OECD MTC says “The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.”, some treaties deviate from it, e.g. art. 24(4) of the Brazil-Netherlands tax treaty (1990) says “In this Article, the term “taxation” means taxes to which this Convention applies.” Accordingly, the actual scope of non-discrimination provision shall always be carefully examined in each and every tax treaty.

[3] In particular, non-discrimination is one of core elements of the rule of law, which aligns “with core values that any system of law deserving of the name, whether domestic or international, aims for.” See A. Reinisch & S. W. Schill (eds), “Introduction” in “Investment Protection Standards and the Rule of Law” (Oxford University Press 2023), p. 17.

[4] N. Bammens & F. Vanistendael “Article 24: Non-Discrimination – Global Tax Treaty Commentaries – Global Topics”, IBFD (2023), sec. 1.1.2.1.

[5] A. Rust, “Non-discrimination. Art. 24” in A. Rust & E. Reimer (eds.), “Klaus Vogel on Double Taxation Conventions”, Wolters Kluwer Law & Business (2022), p. 1908.

[6] *Ibidem.*

[7] Bammens & Vanistendael, *supra* n. 4, sec. 1.1.2.2. *Cf.* Commentary on article 24 of the OECD

MTC, para. 1: “whilst paragraph 1, which deals with discrimination on the basis of nationality, would prevent a different treatment that is really *a disguised form of discrimination* based on nationality such as a different treatment of individuals based on whether or not they hold, or are entitled to, a passport issued by the State.”

[8] E.g. the German Federal Tax Court (*Bundesfinanzhof*), 8 Sept. 2010, Case I R 6/09, Bundessteuerblatt II 2013, para. 189; The Indian Authority for Advance Rulings (AAR), 17 Aug. 2016, *Banca Sella SpA v. Assistant Director of Income Tax*, 2016-TII-372-KOL-TP-SB.

[9] Rust, *supra* n. 5, p. 1909.

[10] A. Christians & S. E. Shay, “The Consistency of Pillar 2 UTPR With U.S. Bilateral Tax Treaties,” Tax Notes Int’l, Jan. 23, 2023, pp. 45-452; T. Masuda, “The Compatibility of the UTPR and Japan’s Tax Treaties”, 114 Tax Notes International (May 20, 2024), pp. 1136-1141; R. Matteotti, “Tax issues related to the introduction of the international top-up tax UTPR as part of the GloBE minimum tax in Switzerland”, Expert opinion provided to the Swiss Confederation represented by the General Secretariat of the Federal Department of Finance, Archiv für Schweizerisches Abgaberecht (ASA) (2024-2025), p. 214.

[11] V. Bendlinger, “The OECD’s Global Minimum Tax and its Implementation in the EU: A Legal Analysis of Pillar Two in the Light of Tax Treaty and EU Law”, Kluwer Law International (2023), pp. 328-329.

[12] N. Bammens, “The Principle of Non-Discrimination in International and European Tax Law”, IBFD (2012), 191 et seq.

[13] *Cf.* in respect to article 24(4) and the UTPR in the form of a denial of deduction, J. Englisch & J. Becker, “International Effective Minimum Taxation – The GLOBE Proposal”, 11 Word Tax Journal 4 (2019), 523. Compatibility with article 24(4) has lost its relevance since the UTPR is no longer a payments rule (a denial of deduction), but a profits rule (an additional tax).

[14] *See* A. Nikolakakis & J. Li, “UTPR — No Taxation Without Value Creation!”, Tax Notes Int’l, April 3, 2023, pp. 51-52; J. Li, “The Pillar 2 Undertaxed Payments Rule Departs From International Consensus and Tax Treaties”, Tax Notes Int’l, March 21, 2022, p. 1407. *Cf.* S. Douma et al., “The UTPR and International Law: Analysis From Three Angles”, Tax Notes Int’l, May 15, 2023, pp. 873-874.

[15] Consider that sometimes, e.g. for some of the Chinese MNEs, which do not have tax residency in China and which UPEs have tax residency in Cayman Islands or British Virgin Islands (BVIs), the UTPR may lead to top-up-tax in States from where the MNEs actually come from and where they have the most of their economic substance. *See* N. Noked & J. Wang, “Chinese companies in tax havens”, Journal of International Economic (Sept. 27, 2024), pp. 533-534. However, it is a very rare example and, as of today, purely theoretical, because China did not implement pillar 2.

[16] The Commentary to Art. 1 of the OECD Model, para. 54: the principal purpose of tax treaties “is to promote [(…)] exchanges of goods and services, and the movement of capital and persons”, i.e. to promote international trade and investment. The main operational purpose of tax treaties is the elimination of international double taxation.

[17] Bammens & Vanistendael, *supra* n. 4, sec. 1.1.2.1.

[18] The authors of this contribution continuously develop and refine the reasoning in respect of that topic in their common and individual academic and tax advisory environments.

[19] F. Engelen, "Interpretation of Tax Treaties under International Law", IBFD (2005), pp. 131-132; R. Vann, "Interpretation of Tax Treaties in New Holland" in H. van Arendonk et al. (eds), "A Tax Globalist: Essays in Honour of Maarten J. Ellis", IBFD (2005), p. 147. *Cf.* The Arbitral Tribunal administered by the Permanent Court of Arbitration (PCA), 25 May 2005, Award in the Arbitration regarding the Iron Rhine ('Ijzeren Rijn') (Railway between the Kingdom of Belgium and the Kingdom of the Netherlands), Vol. 27, RIAA, paras 49, 64; M. Fitzmaurice, "The Practical working of the Law of the Treaties" in M. Evans (ed.), "International Law", Oxford University Press (2003), pp. 189-190.

[20] Douma et al., *supra* n. 14, 869-873. *See* also sections "Prevention of extraterritorial taxation as a relevant justification for the U.S. defense measures" and " Prevention of tax treaty dodging as a relevant justification for the U.S. defense measures" below.

[21] *See* more C. McLachlan, *The Principle of Systemic Integration and Article 31(3)(C) of the Vienna Convention'*, International & Comparative Law Quarterly 2 (2005), p. 280.

[22] In this respect reference could, for example and by analogy, by made to the line of reasoning in CJEU, 12 Sept. 2006, C-196/04 (*Cadbury Schweppes*) in paragraphs 43-45. The circumstance that the top-up taxes would have been levied and collected from the parent entity if it were resident in the same state as the subsidiary, would not be decisive as the fact remains the same that the subsidiary is subject to the UTPR in respect of profits of another legal person if its parent entity is a non-resident. Reference may furthermore be made to the line of reasoning in CJEU, 4 Oct. 2022, C-585/22 (*X BV*), para. 38 wherein it was ruled that an apparently objective criterion relating to the level of taxation at the level of a lender can give rise to an indirect discrimination based on the location of, in that case, such lender.

[23] *See* more the two sub-sections below. For the application of the principle of systemic integration in order to factor in rules stemming from EU treaties and IIAs for purposes of interpretation of tax treaties *see*, respectively: L. De Broe, "Should Courts in EU Member States Take Account of the ECJ's Judgment in the Danish Beneficial Ownership Cases When Interpreting the Beneficial Ownership Requirement in Tax Treaties?" in G. Maisto, "Current Tax Treaty Issues: 50th Anniversary of the International Tax Group", IBFD (2020), sec. 16.2.1; B. Ku?niacki & S. van Weeghel, "VCLT and the peaceful coexistence of tax and investment treaties: a case study of limited MFN clauses and the FET standard", World Tax Journal 1/2025, sections 1-2.

[24] E.g. the German Federal Tax Court (*Bundesfinanzhof*), 8 Sept. 2010, Case I R 6/09, Bundessteuerblatt II 2013, para. 189; The Indian Authority for Advance Rulings (AAR), 17 Aug. 2016, *Banca Sella SpA v. Assistant Director of Income Tax*, 2016-TII-372-KOL-TP-SB. *See* also other case law of relevance to the current analysis: The UK First-Tier Tribunal (FTT), *Felixstowe Dock and Railway Company v. HMRC*, 9 Dec. 2011, paras 61-62; The Dutch Supreme Court (*Hoge Raad*), HR nr. 28 674, Dutch Supreme Court (27 April 1994), paras 4.1-4.4.

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