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SIDE BY SIDE BUT MISALIGNED: PARALLEL REFORM IN THE AGE OF PILLAR II

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The international tax system is undergoing its most significant reform in a century. Yet it remains unclear whether these reforms confront the structural weaknesses exposed by digitalisation. We explain how Pillar Two, and the OECD's Side by Side Package, address the symptoms of digitalisation. They do not address the underlying cause, embedded in the residence–source allocation framework. Using royalties as a proxy, we trace the historical development of taxing rights, we demonstrate how intellectual property mobility destabilised that architecture, and we frame the recent reforms as only symptomatic treatments. However, we argue that this does not render the reforms unsuccessful or merely preservative of a collapsing international tax framework. Through various mechanisms, the reforms materially constrain artificial profit shifting while preserving competition for substantive economic activity.

I. INTRODUCTION

The Foreword to the newly published OECD/G20 Base Erosion and Profit Shifting ('BEPS') Project's Side-by-Side Package states that the Project is 'in response to the challenges of digitalisation of the economy.'¹ This framing reflects the original rationale underpinning the OECD/G20 BEPS Project, although the policy objectives later expanded significantly during the development of Pillars One and Two. At least initially, the central concern was that digitalisation and the increasing mobility of intellectual property enabled multinational enterprises ('MNEs') to separate profits from the jurisdictions in which substantive economic activity occurred.

BEPS Actions 8 to 10 therefore formed part of a broader, coordinated reform project initiated by the OECD and G20 following the 2012 mandate to address profit shifting, culminating in the 2015 Final Reports.² These Actions targeted arrangements that artificially separated income from the

* Bachelor of Civil Law candidate at Oxford University; LLB (Hons I), BCom (Acc) at Bond University. As a past student of Professor Michelle Markham, I am deeply honoured to contribute to this special issue dedicated to her legacy. Michelle was a distinguished member of the Faculty of Law at Bond University and her passion for taxation law was infectious. Michelle's name is, in many respects, totemic with the discipline at Bond. I am grateful too for the assistance of tax barrister Mr David Marks KC in the preparation of this article. This paper seeks, in a modest way, to engage with themes that animated her scholarship.

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The views expressed in this article are solely those of the authors and do not represent the views of any affiliated organisations, institutions, or employers. All errors remain the authors' own and the usual caveats apply.

¹ Organisation for Economic Co-operation and Development, *Pillar Two Global Anti-Base Erosion Model Rules: Side-by-Side Package* (OECD Publishing, 2025).

² Organisation for Economic Co-operation and Development, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8–10 – 2015 Final Reports* (OECD Publishing, 2015); Organisation for Economic Co-

activities that generated it, particularly in the context of highly mobile intellectual property. They sought to realign royalty taxation with value creation by requiring that returns to intangible assets follow functions, assets, and risks, rather than mere legal ownership. Simply put, the goal was to shift focus toward substantive economic activity. However, despite being framed as a “bold” and partially fundamental reform, these measures operated within the existing arm’s-length framework and did not directly alter the underlying allocation of taxing rights, leaving the residence-source compromise largely intact.³ Accordingly, while the reforms strengthened the system’s robustness against certain forms of artificial profit shifting, they did not fundamentally alter the allocation of taxing rights themselves.

The reforms left substantial gaps within the international framework. As *de Mooij, Klemm and Perry* observed, BEPS ultimately ‘left the main building blocks of the framework itself untouched.’⁴ The unresolved issues associated with digitalisation, mobility, and low taxation were then increasingly framed as matters to be addressed through Pillars One and Two. In this sense, the Pillars were often presented as a continuation or completion of the BEPS Project.

However, characterising the relationship between BEPS and the Pillars as entirely continuous fails to capture an important policy shift. The objectives underlying the reforms expanded significantly over time. What began as a project directed principally toward artificial profit shifting, progressively evolved into a broader attempt to address minimum taxation and tax competition itself. This created substantial conceptual tension within the Global Anti-Base Erosion (‘GloBE’) Rules, referred to as Pillar Two.⁵ BEPS generally accepted low taxation where it was connected to substantive economic activity because the core concern was the artificial separation of profits from value creation. By contrast, broader anti-competition approaches potentially sought to constrain even genuine relocation of investment, production, and capital.

As a result, Pillar Two developed inconsistent policy objectives.⁶ The GloBE framework simultaneously attempts to constrain tax competition through minimum taxation while also preserving competition for substantive activity through mechanisms such as the Substance-Based Income Exclusion (‘SBIE’). This movement both toward and away from a coherent international tax framework reflects what *Schön* describes as contradictory pressures within the reform project itself.⁷ The corollary is that it remains “unclear” whether the central objective of Pillar Two is combating ‘profit shifting or tax competition,’⁸ or whether it is attempting to pursue both simultaneously despite the tensions between those goals.

operation and Development, Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report (OECD Publishing, 2015).

³ John Vella, ‘The Global Minimum Tax and the Future of International Taxation’ (2025) 88(6) *Modern Law Review*, 1133, 1140 (‘Vella 2025’).

⁴ Ruud A de Mooij, Alexander D Klemm and Victoria J Perry (eds), *Corporate Income Taxes under Pressure: Why Reform Is Needed and How It Could Be Designed* (International Monetary Fund, 2021).

⁵ The project is broadly defined for the purpose of this paper to be the OECD/ G20 initiatives spanning from the 2012 BEPS Project to the implementation of the Pillars in 2021

⁶ OECD/G20 Inclusive Framework on BEPS, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (8 October 2021); Organisation for Economic Co-operation and Development, Tax Challenges Arising from the Digitalisation of the Economy – Pillar One Blueprint (OECD Publishing, 2020).

⁷ Wolfgang Schön, ‘Is There Finally an International Tax System?’ (2021) 13(3) *World Tax Journal*.

⁸ Richard Collier and John Vella, ‘GloBE: Formative Policies and Politics of Pillar 2’ in Werner Haslehner, Georg Kofler, Katerina Pantazatou and Alexander Rust (eds), *The Global Minimum Tax* (Edward Elgar Publishing, 2024).

Through these somewhat conflicting policy goals, Pillar Two and the Side-by-Side Package seek to stabilise the international tax system by treating the symptoms which arise as a result of digitalisation, but do not treat the cause. Understanding this distinction requires a clear explanation of the condition being treated.

First, “the cause” is best characterised as the structural misallocation of taxing rights, in which primary taxing rights are allocated based on economic allegiance. We trace the cause to historical decisions regarding the allocation of major income categories. The allocation occurred in a world where economic activity was assumed to be predominantly geographically anchored. Royalties are used as a proxy throughout this analysis. Importantly, the focus is first upon the upstream migration of intellectual property itself, namely the relocation of legal ownership of valuable intangible assets into low tax jurisdictions. This upstream movement determines where profits associated with the intellectual property are attributed to using transfer pricing mechanisms.

The downstream consequences then arise through the subsequent royalty payment structure flowing from that migration. Once intellectual property ownership has been relocated, operating entities in higher tax jurisdictions typically make deductible royalty payments to the low tax intellectual property holding entity. These downstream effects generate many of the visible “symptoms” associated with digitalisation and BEPS. More specifically, these symptoms include profit shifting, base erosion, treaty shopping, hybrid mismatches, and excessive interest deductions.

Finally, the “treatment” of these symptoms includes transfer pricing adjustments, anti-avoidance rules, and global minimum taxation under Pillar Two. Through mechanisms such as the IIR and UTPR, Pillar Two materially constrains the benefits of artificial profit shifting, while the SBIE preserves competition for substantive economic activity by excluding formulaic routine returns from top-up taxation.

The Side-by-Side Package operates alongside GloBE and is analysed within the “treatment” section to demonstrate how coordination and minimum tax alignment address the symptoms of digitalisation while accommodating the coexistence of materially different minimum tax regimes, particularly the United States’ globally blended NCTI framework. In this respect, the Package reflects both the practical necessity of continued US participation and the growing conceptual tensions within Pillar Two itself regarding minimum taxation, substantive activity, and tax competition.

We have divided our work into four parts. The first three parts follow the aetiology and progress of the condition as presently treated: the cause, symptoms, and present treatment. In the fourth part, we argue that while these reforms do not reconstruct the underlying residence-source allocation framework, they nevertheless represent substantial and politically necessary stabilisation measures within an evolving international tax system. By carefully identifying and regulating the symptoms generated by digitalisation, GloBE and the Side-by-Side Package do reduce artificial profit shifting. This creates the possibility that future reform, including the scheduled 2029 review, may assess whether continued management of the symptoms through coordinated minimum taxation and safe harbour mechanisms is itself a sufficient and sustainable response to the tensions exposed by digitalisation.

II. BACKGROUND

The international tax system is one of the most complex of legal frameworks.

A seemingly simple question, of whether royalty withholding tax is payable by a company, requires a detailed examination of the ‘voluminous and complex rules’ of international tax.⁹ It demands analysis of domestic law in both states and of the interaction between those regimes.

Such analysis begins by asking whether the source state imposes withholding on royalties, and at what rate; secondly, whether the residence state taxes foreign-sourced royalty income, and at what rate; and thirdly, whether either state applies limitations, exemptions, or recharacterisation rules. The analysis continues by considering whether both states characterise the payment consistently as a “royalty”, or whether one treats it as business profits or services income.¹⁰ To add to this analysis of the potential “royalty”, transfer pricing rules in each state may adjust the quantum of the payment and therefore the withholding base. So far, we have only considered the domestic tax treatment.

Under the OECD and UN frameworks, exemption systems generally extend relief to dividends to prevent recurrent corporate taxation. Such exemptions are not extended to interest and royalties, since those payments are usually deductible in the source state and therefore raise base erosion concerns.¹¹ Double taxation treaties may then allocate taxing rights or reduce withholding rates.¹² Then a multilateral instrument may modify existing bilateral treaties, introducing anti-avoidance standards or restricting treaty benefits.¹³

The complexity associated with the classification and allocation of royalty withholding taxes is a tale as old as time. This complexity is not accidental. As the UN Commentary observes, ‘it is the taxation of such items of income which has always been in dispute,’ in contrast to business profits and immovable property where ‘the primary right of the source country to tax has never been questioned.’¹⁴ Accordingly, we accept the complexity of the international tax system as a starting point, but we question the assumption that simplification is necessarily the appropriate solution. It follows in our view that while the characteristics for a “good” tax system are largely uncontroversially that it is “economically efficient, robust to profit shifting, easy to administer, and incentive compatible,”¹⁵ simplicity does not automatically follow.

As has been observed, ‘this complexity partly reflects the complexity of international business.’¹⁶ Modern multinational enterprises operate through sophisticated structuring mechanisms, including regimes such as the United States “check the box” rules and other cross border planning techniques that exploit differences in legal characterisation and tax treatment.

⁹ Vella 2025 (n 3) 1133, 1140

¹⁰ Witness the difference between the USA and Australia about payments for software as a service, highlighted in *Oracle Corporation Australia Pty Ltd v Commissioner of Taxation* 2025 ATC ¶20-975; [2025] FCAFC 145, [73]. Note also the difference between an international beverage company, and the Australian tax authority, over fees under a bottling agreement, in *Commissioner of Taxation v PepsiCo Inc* [2025] HCA 30; 99 ALJR 1211.

¹¹ United Nations, *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (United Nations, 2003) 20 [33] (‘UN Manual 2003’).

¹² Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (OECD Publishing, 2017) art 12; United Nations, *United Nations Model Double Taxation Convention between Developed and Developing Countries* (United Nations, 2017) art 12.

¹³ Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, opened for signature 7 June 2017, [2019] ATS 1 (entered into force 1 July 2019).

¹⁴ UN Manual 2003 (n 11) [60].

¹⁵ Vella 2025 (n 3), 1140.

¹⁶ Ibid.

In fact, it is against this backdrop of structural and commercial complexity that the underlying condition becomes apparent. The instability of the allocation framework is not revealed by simplicity, but by the strain placed upon it by modern economic realities. However, as will be explained, the response need not be the wholesale abandonment of the existing architecture or its complete replacement with a new system. Rather than stripping the framework back to its foundations, the more immediate task is to understand how contemporary reforms interact with and in doing so expose, the allocative misalignment at its core.

III. THE CAUSE

Many scholars who write on the ‘existing system’s absurd complexity,’¹⁷ agree that the underlying cause is ‘primarily ... the system’s fundamental structure.’¹⁸ To this extent, the paper engages directly with what *Devereux* and *Vella* identify as the first and most ‘significant problem’ with the international tax system: the inadequacy of the 1920s residence-source compromise.¹⁹

The modern treatment of royalties emerged from the League of Nations’ attempt to resolve double taxation through structured allocation rather than abstract allegiance. As *Jogarajan* explains, ‘the doctrine of political allegiance soon gave way to taxation based on the residence of the taxpayer or the source of the income.’²⁰ This produced a system of ‘classification and assignment of sources’²¹ that divided income into categories and allocated taxing rights accordingly. This system has been saliently described as a ‘creature’ of the 1920’s when the income tax was relevantly ‘in childhood.’²²

Before diving further into the history, as *Vann* observes, writing on tax treaty history remains ‘at the very early stage of simply uncovering the sources, much like an archaeological dig.’²³ In this way, the paper does not profess to include a complete account of the circumstances leading to the current system.

From the beginning, capital importing states favoured source taxation, while capital exporting states preferred residence taxation based on ability to pay.²⁴ Early tax treaties were already structurally biased toward residence taxation and tolerated gaps that allowed double non-taxation.²⁵

Royalties during this time were classified as returns to personal intellectual labour. They were linked to the creator’s residence rather than territorial production. The corollary was that under the framework of economic allegiance, primary taxing rights were allocated to the state of residence

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Michael P Devereux and John Vella, ‘Are We Heading towards a Corporate Tax System Fit for the 21st Century?’ (2014) 35(4) *Fiscal Studies* 449.

²⁰ Sunita Jogarajan, *Double Taxation and the League of Nations* (Cambridge University Press, 2018) (‘Jogarajan’), 10.

²¹ Ibid, 20.

²² Michael J Graetz, ‘The David R Tillinghast Lecture: Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies’ (2001) 54(3) *Tax Law Review* 261.

²³ Richard Vann, ‘Writing Tax Treaty History’ in G.Maisto (ed), *Current Tax Treaty Issues* (IBFD, 2020). Even modern tax practice involves tax archaeology, with the need to retain year-by-year reprints and handbooks, to deal with new assessments of old tax years, and to press (or defend) claims of professional negligence by reference to standards and knowledge at the time tax advice was given. This is another sign of complexity.

²⁴ Jogarajan (n 20), 11.

²⁵ Reuven Avi-Yonah, ‘The First US Tax Treaty and its Influence’ (2024) 52 *Intertax*, 5-7.

rather than to the source state. In *Cleave's* view, the elimination of taxes at source and the priority to be accorded to residence taxation was the primary policy of the United Kingdom,²⁶ and early drafts even contemplated 'no taxation at source of dividends, interest or royalties.'²⁷ The London Model similarly sought to encourage capital export 'by limiting taxation to the country where income was ultimately received.'²⁸

The 1928 Model Conventions stabilised the separation between royalties and business profits. Business profits required a permanent establishment. Royalties did not. Yet the Mexico and London Drafts revealed continuing disagreement between member states. The post war settlement has been described by scholars as a 'political compromise' between residence and source positions.²⁹ As *Willis* observed, 'here we see already the conflict of views between the capital-importing and capital-exporting countries,' even though the economists had 'put forward the principle of 'economic allegiance' and favoured a pure residence basis.'³⁰ *Cui* later argues that the 1923 Report 'reflected a fundamental disagreement' and that any suggestion of early consensus 'has little historical basis.'³¹

Over time, however, royalties ceased to resemble the literary and artistic payments that buttressed arguments in the original debates. It is here that the misalignment begins to surface: a system built upon geographically anchored assumptions no longer reliably aligns taxing rights with contemporary economic activity.

IV. THE SYMPTOMS

The symptoms that developed from the cause were the systematic relocation of taxable profits without any corresponding relocation of real economic substance.

Because the residence–source framework allocated taxing rights based on legal ownership rather than underlying value creation, multinational groups were able to separate the location of intellectual property from the location of economic activity. Yet this reliance on legal ownership assumes that ownership of intangibles can be clearly and consistently determined.

While this article does not attempt to provide a full account of the transfer pricing implications of intangible ownership, *Markham* observes that the OECD Guidelines 'do not set out specific rules for establishing the ownership of intangible assets for transfer pricing purposes.'³² She further notes that 'the criteria for what may be considered legal ownership are not set out' and in her view, the 'economic ownership test appears to be the yardstick most closely aligned with economic realities.'³³ This ambiguity was exacerbated by increased corporate structure complexity.

²⁶ Michael Lang and Ekkehart Reimer (eds), *History of Double Taxation Conventions in the Pre-BEPS Era* (IBFD, 2020) ch 18 (Cleave) [18.1.3.3] ('Lang and Reimer').

²⁷ *Ibid.*

²⁸ UN Manual 2003 (n 11) [60].

²⁹ Lang and Reimer (n 26) [18.3.1]; see also Wei Cui, 'False Idols in the Early History of International Taxation' (Working Paper, 14 October 2024) ('Cui'); Robert Willis, 'Great Britain's Part in the Development of Double Taxation Relief' [1965] *British Tax Review* 270, p.275 ('Willis').

³⁰ Willis (n 29).

³¹ Cui (n 29).

³² Michelle Markham, *The Transfer Pricing of Intangibles* (Kluwer Law International, 2005).

³³ *Ibid.*

Continuing with royalties as the proxy for digitalisation concerns, as multinational enterprises expanded and intangible assets became central to corporate value creation, royalties became highly mobile instruments capable of shifting substantial profits across borders. MNE groups, through IP cost-sharing arrangements or transfers of intellectual property, were able to locate legal or economic ownership of patents, trademarks, and software in low-tax jurisdictions and channel profits through deductible royalty payments from high-tax countries.

The effect was an erosion of the source country's tax base. Source states responded through the development of withholding taxes as an administrative solution. Even where residence taxation was normatively preferred, enforcement by tax authorities favoured source collection. Withholding in source countries was therefore necessary to ensure tax was collected before funds left the jurisdiction. This concurrently addressed the two-pronged issue of information asymmetry and non-resident compliance risks. Royalty withholding tax, in turn, became both a revenue collection mechanism and a protective measure against base erosion. However, this was only one dimension of a broader problem that also included hybrid mismatch arrangements, excessive interest deductions, and treaty shopping (among other avoidance measures).

Against this background, the OECD and G20 launched the Base Erosion and Profit Shifting ('BEPS') project in 2012, amid growing concern that multinational enterprises were exploiting gaps in the international tax framework. The drafters sought to implement "bold" and "fundamental" reforms to address various issues. One of the central concerns was the use of highly mobile intellectual property.³⁴ BEPS, through 15 directives, sought to realign taxing rights with substantive economic activity and strengthen anti-abuse rules.

This was a significant shift from a system that had previously focused on eliminating double taxation, to one increasingly concerned with preventing base erosion and profit shifting. BEPS cosmetically addressed several symptoms of the cause, yet the perceived persistence of base erosion set the stage for a more comprehensive treatment under Pillars I and II.³⁵

V. THE TREATMENT [OF THE SYMPTOMS]

Fast forward eight years to the implementation of "the most significant reform of the system in a hundred years,"³⁶ Pillars I and II.

While the agreement proceeds in two parts, 'much of the hype is due to the expected impact of the Global Minimum Tax included in Pillar Two.'³⁷ Pillar II introduces a Global Minimum Tax ('GMT') designed to ensure that large multinational groups pay a minimum level of tax in each jurisdiction in which they operate.

As *Armour* explains, it 'imposes a top-up tax on 'undertaxed profit' where the effective tax rate falls below the agreed minimum: and does so through a coordinated set of rules including the Income

³⁴ Organisation for Economic Co-operation and Development, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing, 2013) 10.

³⁵ A detailed discussion of how this was achieved is outside the scope of this paper but see Vella 2025 (n 3); Michael P Devereux and John Vella, 'Are We Heading towards a Corporate Tax System Fit for the 21st Century?' (2014) 35(4) *Fiscal Studies* 449.

³⁶ Vella 2025 (n 3); noting some disagreement as to the significance of the reforms Reuven S Avi-Yonah, 'The International Tax Regime at 100: Reflections on the OECD's BEPS Project' (2021) 75 *Bulletin for International Taxation* 522, 526.

³⁷ Vella 2025 (n 3).

Inclusion Rule ('IRR') and the Under-Taxed Profits Rule ('UTPR'). Importantly, in contradistinction to redesigning the allocation of taxing rights, the rules are targeted at limiting profit shifting by setting a floor beneath tax competition. This is where the main issue arises in the view of scholars of international tax reform.³⁸

Through architectural metaphors, *Vella* conceptualises these reforms as 'a superstructure of rules added on top of the existing structure to contain the destabilising incentives it creates and thus stop it from collapsing.'³⁹

Vella characterises GloBE as an 'anchor that stops the system from drifting too far towards destination.' He argues that, once implemented, it will make it harder, both politically and technically, to move towards destination based or unitary alternatives. That, he concludes, increases the likelihood that the origin-based system will persist for years to come. On that account, Pillar II risks entrenching a flawed architecture. It may represent a poor policy choice if systemic redesign is the objective. Importantly, *Vella* acknowledges that the characterisation of the issue in such a way is quite 'a broad view.'⁴⁰

In our view, the issue of profit shifting of royalties from low tax to high tax jurisdictions has been partially addressed. While accepting that GloBE stabilises and thereby preserves the existing allocation framework, this article views such stabilisation as diagnostically productive. The imposition of a GMT does not resolve the allocative weakness. But by constraining profit shifting and exposing the structural tension between origin-based taxation and digital value creation, it clarifies the nature of the underlying problem. Importantly, however, recognition of those tensions does not necessarily require abandonment of the existing international tax framework altogether. Rather, the reforms demonstrate that the current system remains capable of adaptation, coordination, and meaningful constraint of highly mobile profit shifting, even if the underlying residence-source compromise continues to involve contestable and imperfect allocations of taxing rights.

Pillar II and the Side-by-Side Package expand the legislative and administrative framework of international taxation. However, these reforms respond to concrete and economically significant concerns. Those concerns arise from the saleability and transferability of intellectual property, and from the ability of multinational groups to relocate profits through the manipulation of royalty payments from high to low-tax jurisdictions.

The corollary of the mobility of intellectual property, often structured through cost sharing arrangements and intra-group licensing, are various structural incentives for base erosion that demanded regulatory intervention. In this respect, the BEPS reforms address real distortions in two principal ways: first, by neutralising the tax advantages of relocating intellectual property, through the imposition of a jurisdiction-specific minimum tax; and secondly, by coordinating and constraining parallel domestic minimum tax regimes to prevent arbitrage and duplication.

First, through the IRR and UTPR, Pillar II imposes a top up tax where profits arising in a particular jurisdiction are taxed below the agreed minimum rate. This directly undermines the incentive to shift intellectual property to low tax jurisdictions and extract profits through deductible royalty payments from higher tax countries. Where a multinational group locates its patents or software in a low tax entity and receives royalty income subject to minimal taxation, the top up tax neutralises

³⁸ Ibid.

³⁹ Vella 2025 (n 3).

⁴⁰ Ibid 1136, 1138, 1159.

the benefit of that relocation. In this way, the profitability of digital profit shifting through intra group licensing structures is materially reduced.

Further, the SBIE calculation preserves competition for substantive economic activity as firms may continue relocating real investment and production in response to tax incentives. It functions as a formulaic proxy for routine (or “normal”) returns associated with substantive economic activity, thereby separating those returns from residual profit. The SBIE, while in many respects an arbitrary calculation that substitutes a cap of 5.5% of payroll or the depreciation of tangible assets for GloBE income to leave excess profits, in essence, allows firms to compete for real and substantive economic activity. This brings the policy goals of Pillar Two closer to profit shifting incentives and more of a continuation of BEPS, which fundamentally proposed that low tax rates are only concerning if also linked to a country with marginal real activity.

The Side-by-Side package buttresses this perspective through the Substance Based Tax Incentive (“STBI”) Safe Harbour, which provides that certain tax incentives will be tolerated under Pillar Two if they are linked to substantive economic activity. That is, “incentives that are provided in relation to substantive activities in a jurisdiction are less susceptible to BEPS risks” (Side-By-Side Package 2026). Therefore, the SBIE permits certain expenditure or production-based incentives to receive favourable treatment within the GloBE effective tax rate calculation where they reflect real activity.

In a digital economy, where intellectual property can be relocated independently of real functions, this distinction is significant. It limits the effectiveness of purely tax motivated IP migration by ensuring that incentives unconnected to substantive activity are more likely to be dealt with through top up taxation.

Secondly, the Side-by-Side Package addresses the interaction between Pillar Two and existing domestic minimum tax regimes, particularly the United States’ NCTI regime. Rather than requiring all jurisdictions to adopt the GloBE framework identically, the Package permits qualifying minimum tax systems to operate in parallel where they satisfy agreed eligibility criteria. In substance, the Package attempts to coordinate overlapping minimum tax regimes so that they interact alongside one another rather than imposing cumulative layers of top-up taxation upon the same profits.

Operationally, the Side-by-Side framework principally functions through a bifurcated safe harbour structure. The Side-by-Side Safe Harbour may provide full relief where a qualifying domestic minimum tax regime is regarded as sufficiently comparable to GloBE, while the UPE Safe Harbour provides more limited protection against the application of foreign UTPRs where the ultimate parent entity jurisdiction already imposes an acceptable minimum level of taxation. Together, these mechanisms seek to prevent multiple jurisdictions from imposing overlapping top-up taxes upon the same undertaxed profits. In practical terms, the Package attempts to preserve international coordination while accommodating the continued operation of materially different domestic minimum tax systems.

The most significant regime accommodated by the Package is the United States’ NCTI framework, which emerged from the 2025 OBBBA reforms and replaced the earlier GILTI regime introduced under the 2017 Tax Cuts and Jobs Act. Broadly, NCTI imposes a minimum level of US tax upon foreign income earned through controlled foreign corporations by requiring US multinational enterprises to include globally blended foreign income within the US tax base. Unlike GloBE, which generally applies jurisdiction-by-jurisdiction calculations, NCTI permits highly taxed foreign income to offset low-taxed foreign income across jurisdictions through global blending. The regime

also operates without the ordinary GloBE revenue threshold and provides a 40% deduction alongside a 90% foreign tax credit.

Importantly, however, GloBE and NCTI embody materially different conceptions of minimum taxation. GloBE is fundamentally directed toward constraining profit shifting through jurisdictional blending while simultaneously preserving competition for substantive economic activity through the SBIE. By contrast, NCTI prioritises the global competitiveness of US headquartered multinational enterprises through worldwide blending and contains no ordinary GloBE style SBIE carve-out. The Side-by-Side Package therefore does not merely coordinate technically equivalent systems. Rather, it facilitates the coexistence of inherently different approaches to minimum taxation operating within the same international framework. The bifurcated approach of the Side-by-Side Package highlights that, while GloBE and NCTI sit “side-by-side”, they may in fact be misaligned.

This has shifted the central debate surrounding Pillar Two toward whether the coexistence of GloBE and NCTI creates materially different competitive conditions for US and non-US multinational enterprises. On one hand, US firms may benefit significantly from global blending because highly taxed foreign income can shield low-taxed income elsewhere within the group, thereby reducing the marginal cost of maintaining profits in low-tax jurisdictions. This may reduce the amount of restructuring or aggressive profit shifting required to achieve comparatively favourable outcomes. On the other hand, non-US firms operating fully within GloBE may in some circumstances receive more favourable treatment where substantial substantive economic activity exists within low-tax jurisdictions because the SBIE excludes a formulaic return associated with payroll and tangible assets from top-up taxation.

Accordingly, the competitive implications of the Side-by-Side framework remain uncertain and highly context dependent. The extent of any advantage may depend upon whether profits are primarily substance-rich or highly mobile and substance-poor. More broadly, the coexistence of GloBE and NCTI raises deeper questions about whether Pillar Two remains a coherent international minimum tax framework at all, or instead operates as two parallel systems pursuing different policy objectives regarding profit shifting, substantive economic activity, and tax competition. The proposed 2029 Inclusive Framework stocktake will therefore be significant not only in assessing competitive distortions and strategic jurisdictional behaviour arising from the coexistence of GloBE and NCTI, but also in evaluating whether continued treatment of the symptoms of digitalisation is itself a sufficient long-term response.

VI. CONCLUSION

Recent reforms, including Pillar Two and the Side-by-Side Package, have merely addressed the symptoms of digitalisation rather than the cause. The core weakness lies in the historical misallocation of taxing rights developed under the League of Nations compromise. Digitalisation severed the assumed connection between economic allegiance, legal ownership, and value creation. As intellectual property became mobile and central to multinational profit allocation, the original residence-based structure ceased to be viable.

Importantly, Pillar II and the Side-by-Side Package mitigate profit shifting through minimum taxation and coordination rules. But they preserve the origin-based structure, rather than reconstructing it. However, taken together, these measures represent a serious and coordinated treatment of the symptoms generated by the mobility of intellectual property and the manipulation of royalty flows. Through the IIR and UTPR, Pillar Two creates strong incentives for jurisdictions

to adopt domestic minimum taxes and retain taxing rights locally, because failure to do so permits other jurisdictions to collect the top-up tax instead. Simultaneously, the SBIE preserves competition for genuine substantive economic activity by excluding formulaic returns associated with payroll and tangible assets from top-up taxation. The Side-by-Side Package further reflects the practical reality that meaningful international coordination is unlikely to succeed without US participation and therefore accommodates the coexistence of GloBE and the United States' globally blended NCTI regime.

Importantly, recognising that these reforms do not fully address the underlying residence-source allocation tensions does not mean the reforms are unsuccessful or merely preserving a collapsing system. The allocation of taxing rights between source and residence jurisdictions has always involved compromise, contestability, and strategic behaviour, with international tax operating as a continual "cat and mouse" process between tax planning and regulatory response. In this respect, the fact that Pillar Two and the Side-by-Side Package primarily address symptoms rather than the structural cause is not necessarily a criticism. The reforms materially constrain profit shifting, coordinate minimum taxation, and stabilise important aspects of the international framework while preserving sufficient flexibility for substantive economic competition and continued international cooperation.

Whether the forthcoming review in 2029 will move beyond symptom management, toward reconsideration of the allocation system itself, remains to be seen. But the conditions for that conversation have now been made visible.