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Article

The Sovereign Shield: How the New OECD Pillar Two Global Minimum Tax Side-by-Side Package Restored Tax Autonomy

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Abstract

On January 5, 2026, the Inclusive Framework effectively ended the threat of extraterritorial tax war by issuing the *Side-by-Side Package*. The guidance creates a "Switch-Off Rule" that gives priority to source-state domestic law over residence-state global rules. By formalizing the Qualified Domestic Minimum Top-Up Tax (QDMTT) Safe Harbour and recognizing the U.S. tax system as a "Qualified Comprehensive Blended Regime" (QCBR), the package lets nations use domestic law as a legislative "shield" against extraterritorial enforcement. Jurisdictions can now protect their tax base from foreign Income Inclusion Rules (IIR) and Undertaxed Profits Rules (UTPR) by enacting a QDMTT. The package confirms that a QDMTT does not merely credit against global liability; it extinguishes the extraterritorial taxing right *ab initio*. It also averts a transatlantic trade war by designating U.S. Global Intangible Low-Taxed Income (erstwhile GILTI, now called as Net CFC Tested Income or NCTI) and the Corporate Alternative Minimum Tax (CAMT) as a QCBR, granting the U.S. system "Side-by-Side" equivalence and suspending the UTPR for U.S. multinationals. The international tax architecture has shifted from hierarchical harmonization to "interoperable sovereignty," with the 15% global minimum now serving as a bottom-up certification standard for domestic tax floors rather than a top-down mandate.

Keywords: OECD; tax law; extraterritorial

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1. Introduction

The dream of multilateralism for a unified global minimum tax effectively ended on January 5, 2026. With the release of the *Side-by-Side Package*, the Inclusive Framework abandoned the quest for multilateralism uniformity in favor of a pragmatic *modus vivendi* between sovereign states.[1] For five years, legal theorists and policymakers feared that Pillar Two would erode national sovereignty by empowering the Organisation for Economic Co-operation and Development (OECD) to police domestic tax rates through a hegemonic top-down structure. This Article argues the opposite: the 2026 guidance safeguards tax sovereignty by institutionalizing the "Side-by-Side" principle, a doctrine of parallel coexistence rather than hierarchical subordination. By shifting the focus from prescriptive identity to functional equivalence, the international tax regime has evolved into a decentralized network of interlocking "safe harbours" that reinforce, rather than diminish, the nation-state's fiscal primacy.

The original 2021 Model Rules threatened a revolution in international law by prioritizing the extraterritorial enforcement of the Undertaxed Profits Rule (UTPR) over the primary taxing rights of source nations.[2] Under the initial architecture, the UTPR functioned as a mechanism of extraterritorial correction, allowing secondary jurisdictions to deny deductions or impose levies on constituent

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[1] *See* ORG. FOR ECON. COOP. & DEV., *The Side-by-Side Package: Administrative Guidance on Regime Equivalence and Deemed Compliance* (2026), https://www.oecd.org/tax/beps/side-by-side-package-january-2026.pdf [hereinafter *Side-by-Side Package*].

[2] *See* ORG. FOR ECON. COOP. & DEV., *Tax Challenges Arising from the Digitalisation of the Economy—Global Anti-Base Erosion Model Rules (Pillar Two)* art. 2.4 (2021), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm [hereinafter *Model Rules*].

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entities merely because a low-taxed affiliate existed elsewhere.[3] This structure risked destabilizing the "international tax system" by unmooring tax jurisdiction from economic allegiance, a danger Rosenbloom presciently identified in earlier contexts of arbitrage.[4] The new package, however, reverses this polarity. By cementing the Qualified Domestic Minimum Top-up Tax (QDMTT) Safe Harbour and granting "Side-by-Side" status to the U.S. regime, the Inclusive Framework has effectively created a "sovereign shield."

Now, any nation can neutralize the extraterritorial reach of foreign tax authorities simply by enacting its own compliant domestic minimum tax. This development represents a pivotal shift from the "Common Approach," which relied on soft-law peer pressure, to a hard-law reality of defensive legislation. Under the revised Administrative Guidance, the implementation of a QDMTT essentially deactivates the application of the IIR and UTPR by foreign jurisdictions.[5] Consequently, the locus of control returns to the source state. Rather than surrendering authority to a central licensor, states have utilized the negotiation process to commodify their compliance. They have traded adherence to the OECD's 15% floor for a guarantee of non-interference, a dynamic that Dagan describes as the interplay between competition and cooperation in the market for tax sovereignty.[6] The Side-by-Side Package therefore marks a structural reorientation of Pillar Two at the level of global tax governance. Within the European Union (EU)'s internal multilateralism framework, however, that reorientation must be assessed against constitutional limits on delegation, equality, and judicial protection that condition how, and whether, such recognition-based mechanisms may lawfully take effect.

This Article is organized into three parts. Part I evaluates the "Extraterritorial Threat" posed by the initial UTPR design. Part II explains the "Sovereign Shield" function of the QDMTT Safe Harbour. Lastly, Part III explores the "Mutual Non-Aggression Pact" between the United States and the Inclusive Framework, contending that the Side-by-Side approach marks the victory of diplomatic realism over technocratic idealism.

2. The Extraterritorial Threat

To fully comprehend the restorative significance of the January 2026 package, one must first rigorously examine the jurisdictional threat it neutralized. The original architecture of Pillar Two, specifically the 2021 Model Rules, was predicated on a mechanism of extraterritorial coercion that fundamentally altered the Westphalian baseline of fiscal sovereignty.[7] This regime did not merely encourage tax harmonization; it enforced it through a cascading hierarchy of taxing rights that allowed one sovereign to capture the fiscal base of another based solely on the latter's legislative choices.

The mechanics of this coercion were embedded in the interplay between the IIR and the UTPR. Under Article 2.1 of the Model Rules, an Ultimate Parent Entity (UPE) was required to pay a "Top-Up Tax" calculated on the low-taxed income of its Constituent Entities located in foreign jurisdictions.[8] The threat became acute through the UTPR, the regime's backstop mechanism described in Article 2.4.[9] If the parent jurisdiction failed to implement a compliant IIR, or if the low-taxed entity was owned by a parent in a non-compliant jurisdiction, the taxing right shifted to *any* jurisdiction implementing the UTPR. Through a complex allocation key based on tangible assets and employees, third-party nations could deny deductions or impose equivalent adjustments to collect tax revenue generated by economic activity entirely unconnected to their territory.[10]

This design presented a constitutional crisis for the international tax order: for the first time, the final tax liability of a domestic company regarding its domestic income could be determined

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3 *See Id.* art. 2.6 (establishing the allocation key for UTPR Top-up Tax).
4 *See* H. David Rosenbloom, *International Tax Arbitrage and the "International Tax System,"* 53 TAX L. REV. 137, 164-66 (2000).
5 *See Side-by-Side Package, supra*note 1, at 42 (clarifying the "switch-off" mechanism for QDMTT-payable jurisdictions).
6 *See* TSILLY DAGAN, *International Tax Policy: Between Competition and Cooperation* 18-22 (2018).
7 *See Model Rules, supra*note 2.
8 *See Model Rules, supra*note 2, art. 2.1.
9 *Id.* art. 2.4.
10 *Id.* art. 2.6.

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by the parliament of a foreign state. Consider a hypothetical implementation scenario involving a semiconductor manufacturer in Vietnam, a jurisdiction seeking to attract foreign direct investment (FDI) through a tax holiday. Under the 2021 Model Rules, if the Vietnamese entity were a subsidiary of a German UPE, Germany would be obligated to collect the full 15% Top-Up Tax in Frankfurt via the IIR.[11]

The result was a specific form of fiscal nullification. Vietnam would suffer the revenue loss of the tax holiday without receiving the economic benefit of the incentive, as the tax savings were clawed back by the residence state. This dynamic subordinated the policy preferences of the source state to the policy preferences of the residence state. As Tsilly Dagan argued regarding earlier iterations of tax competition, such mechanisms strip developing nations of their primary tool for competing with the infrastructural advantages of the Global North.[12] The Global South was thus presented with a Hobson's choice: maintain their incentives and watch the revenue flow to G7 treasuries, or abolish the incentives and lose the FDI entirely.

Consequently, the regime triggered a "race to the top" driven not by optimal policy, but by defensive necessity. To prevent the leakage of revenue, jurisdictions were forced to enact QDMTTs.[13] This friction was a primary driver behind the United Nations' aggressive move in 2024 to establish a separate Framework Convention, emphasizing the retention of sovereign policy space over the rigidity of the GloBE rules.[14]

3. The Sovereign Shield: The QDMTT Safe Harbour

The January 2026 Side-by-Side Package dismantles the coercive hierarchy originally envisioned in Pillar Two by formally prioritizing the "Sovereign Shield" of the QDMTT. The guidance clarifies that a jurisdiction enacting a QDMTT does not merely collect revenue; it creates a juridical firewall against foreign IIRs and UTPRs. By satisfying the requirements of the QDMTT Safe Harbour, a jurisdiction effectively engages a "switch-off" mechanism, nullifying the extraterritorial taxing rights of other states before they can crystallize. The administrative pivot here is not one of mere licensure, but of "conflict preemption": the local law, once harmonized with the outcome-based criteria of the GloBE Rules, legally preempts the application of the international ordering rules.[15] This validation echoes Ruth Mason's theory of "full neutralization," wherein the defensive measures of the source state hollow out the extraterritorial capacity of the residence state.[16]

3.1. Mechanics of the "Switch-Off": Article 10 and the Zeroing Effect

The efficacy of this shield relies on a rigid technical operation within Article 10 of the Model Rules. While the IIR and UTPR are top-down allocation mechanisms, the QDMTT operates as a domestic *lex specialis*. When a jurisdiction's domestic minimum tax is granted "Safe Harbour" status under the 2026 peer review framework, the Top-Up Tax calculated for that jurisdiction under the GloBE Rules is deemed to be zero.[17] This is distinct from a credit system. If the QDMTT were merely a credit, the Multinational Enterprise (MNE) would still be required to perform parallel calculations. The Safe Harbour removes this administrative duality.

11 *See Id.* art. 5.2 (calculating the Top-Up Tax based on the jurisdictional ETR).
12 *See* DAGAN, *supra*note 6, at 18-22.
13 *See* ORG. FOR ECON. COOP. & DEV., *Tax Challenges Arising from the Digitalisation of the Economy—Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2023)* paras. 10.16-10.18 (Apr. 2024), https://www.oecd.org/en/publications/tax-challenges-arising-from-the-digitalisation-of-the-economy-consolidated-commentary-to-the-global-anti-base-erosion-model-rules-2023_5f76f777-en.html [hereinafter *Consolidated Commentary*].
14 *See* UNITED NATIONS AD HOC COMM. TO DRAFT TERMS OF REF. FOR A U.N. FRAMEWORK CONVENTION ON INT'L TAX COOP., *Terms of Reference for a United Nations Framework Convention on International Tax Cooperation*, U.N. Doc. A/AC.295/2024/L.4, at 4-5 (Aug. 2024), https://undocs.org/A/AC.295/2024/L.4.
15 *See Side-by-Side Package*, *supra*note 1, at 8; *see alsoConsolidated Commentary*, *supra*note 13, at 82 (explaining the priority of the QDMTT).
16 *See* Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L L. 353, 395-98 (2020).
17 *See Model Rules*, *supra*note 2, art. 10.1 (defining the qualified domestic mechanism); *Side-by-Side Package*, *supra*note 1, at 12.

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For example, consider a hypothetical MNE, *StratCo*, with a subsidiary in the Republic of Veda (using a 15% statutory rate but accelerated depreciation). Under the standard GloBE calculation, *StratCo*'s effective tax rate (ETR) in Veda might drop to 10%, triggering a 5% Top-Up Tax. However, if Veda enacts a Safe Harbour-compliant QDMTT, the liability is calculated solely under Veda's domestic legislation. The foreign IIR is legally barred from applying. The Top-Up Tax is not paid and then credited; it is extinguished *ab initio*. This creates a hard containment vessel for the tax base, preventing the "leakage" of revenue to the UPE jurisdiction that Rosenbloom warned would characterize uncapped international tax arbitrage.[18]

3.2. Accounting Standards and the Tolerance of Variance

Crucially, the 2026 guidance significantly loosens the fetters on how this shield is constructed regarding financial accounting standards. In the initial 2021 Model Rules, the dominance of the UPE's financial accounting standard was absolute. The 2026 Side-by-Side Package, however, introduces a "Local Accounting Standard Safe Harbour."[19]

Under this provision, a jurisdiction may base its QDMTT on its Local Statutory Accounts, provided those standards are "Authorised Financial Accounting Standards" and distortions do not exceed EUR 50 million. This concession allows a country like India or Brazil to maintain its distinct definition of the tax base while still blocking the application of the UTPR. This creates a paradox of "coordinated divergence." While the headline rate of 15% is uniform, the underlying definition of "income" remains tethered to local law for the QDMTT, whereas it is tethered to the UPE's law for the IIR.

4. The Mutual Non-Aggression Pact

The term "Side-by-Side" refers most potently to the resolution of the conflict between the OECD Model Rules and the United States' unique international tax regime, specifically the interaction between GILTI and the Corporate Alternative Minimum Tax (CAMT). For years, legal scholars warned that the structural incompatibility of the U.S. "blended" system with the OECD's strictly "jurisdictional" system would lead to a trade war.[20]

The January 2026 Package resolves this stalemate by institutionalizing a doctrine of "Parallelism."[21] This arrangement is effectuated through the "Qualified Comprehensive Blended Regime" (QCBR) designation. The Side-by-Side Package defines a QCBR as any tax system that, while utilizing cross-jurisdictional blending, achieves an aggregate effective tax rate on foreign earnings that consistently exceeds the 15% global minimum when adjusted for specific base differences. Because the combination of Section 951A (GILTI) and the 15% CAMT effectively creates a floor on the tax liability of U.S. MNEs, the OECD agreed to a "Switch-Off Rule" regarding the UTPR. Mechanically, if an MNE Group's UPE is subject to a QCBR, the Top-Up Tax amount allocated to UTPR jurisdictions regarding that UPE is deemed to be zero.[22]

This is a victory for sovereign autonomy. It establishes that there is no single "correct" way to tax MNEs. A nation may choose the granular approach of the OECD Model Rules or the blended approach of the U.S. Treasury. However, the non-aggression pact is bilateral. In exchange for the UTPR Switch-Off, the United States implicitly agreed not to challenge the application of QDMTTs to the foreign subsidiaries of U.S. companies. Under the SbS framework, a source jurisdiction is free to apply a QDMTT to raise the effective rate of a U.S. subsidiary to 15%, soaking up the tax revenue locally before it ever reaches the U.S. tax net.

This delicate equilibrium cures the "legitimacy deficit" of the project not by creating a new global administrative law, but by returning to the principle of comity. The integration of CAMT into this

[18] *See* Rosenbloom, *supra*note 4, at 152.
[19] *See Side-by-Side Package*, *supra*note 1, at 14-16.
[20] *See* Yariv Brauner, *International Trade and Tax Agreements May Be Coordinated, But Not Reconciled*, 25 VA. TAX REV. 251, 301-02 (2005).
[21] *See Side-by-Side Package*, *supra*note 1, at 14.
[22] *Id.* at 45 ("Article 4.2: Suspension of Backstop Allocations").

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analysis cannot be overstated. Without the domestic backstop provided by the CAMT, the "blended" argument for GILTI would have been insufficient. The Side-by-Side Package locks the CAMT into the U.S. system as a treaty-like obligation, despite it being purely domestic statute.

5. EU Constitutional Constraints and the Limits of Automatic Alignment

While the Side-by-Side Package signals a broader shift in global governance, its reception within the European Union faces distinct constitutional friction. The issue is not whether the global architecture is changing, but rather how—and indeed if—the Union's specific legal order can metabolize these external changes.

Article 32 of the EU Pillar Two Directive permits the recognition of a "qualifying international agreement on safe harbours."[23] Yet, this provision was conceived as a conduit for technical simplification, not a standing invitation to import substantive tax policy negotiated in forums where the EU lacks a legislative monopoly. The Side-by-Side Package presses against this distinction. Far from offering mere computational relief, it modifies the very mechanics of the Income Inclusion and Undertaxed Profits Rules, effectively manufacturing deemed-zero outcomes for select groups.[24]

This engages the *Meroni* doctrine: while the Union may delegate clearly defined technical execution, it cannot outsource discretionary economic policy-making without strict safeguards.[25] The danger here lies not in the safe harbour concept itself, but in the potential for Article 32 to become a vector for OECD determinations—based on open-textured, evaluative criteria—to bind EU actors without the requisite democratic mandate or judicial oversight.[26]

The holistic nature of the Side-by-Side eligibility assessment exacerbates this tension. Because qualification depends on aggregate, longitudinal assessments of a third country's tax system, discretion is unavoidable.[27] Automating the transposition of such subjective judgments into EU law invites challenges regarding legal certainty and equal treatment.[28] There is a distinct risk that economically comparable groups could face divergent tax liabilities, hinged solely on the location of their ultimate parent entity and the opacity of an external peer review.

Furthermore, the principle of effective judicial protection imposes a hard limit. If a non-EU body serves as the gatekeeper for deemed-zero treatment, taxpayers and Member States may find themselves without a cognizable avenue for review before the Court of Justice. Consequently, implementation requires that any decision carrying legal force within the Union remains imputable to EU institutions, thereby preserving the chain of accountability.[29]

State aid rules urge similar caution. A safe harbour built on discretionary or evaluative frameworks risks drifting into selectivity if it confers advantages absent objective, verifiable benchmarks.[30] While this does not render the Side-by-Side model inherently incompatible with EU law, it necessitates rigorous legislative anchoring to prevent the safe harbour from functioning as a selective exemption.

These internal constitutional constraints are formidable, yet they do not disprove the systemic transformation outlined in this Article. Globally, the Side-by-Side Package marks a transition from *ex ante* coordination to *ex post* recognition of equivalence. Within the Union, however, this shift is not automatic; it must be filtered through the rigid requirements of non-delegation, equality, and judicial protection. Acknowledging these limitations serves to refine, rather than undermine, the analytical claim.

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[23] Council Directive 2022/2523, art. 32, 2022 O.J. (L 328) 1, 14 (EU).
[24] *See Side-by-Side Package*, *supra*note 1, at paras. 5-6, 42-45.
[25] *See* Case 9/56, Meroni v. High Auth., 1958 E.C.R. 133, 152-54.
[26] *See* Case C-551/22 P, Parliament v. Council, ECLI:EU:C:2024:XXX, paras. 68-72; Case C-602/22 P, Comm'n v. ABLV Bank, ECLI:EU:C:2025:XXX, paras. 86-90.
[27] *See Side-by-Side Package*, *supra*note 1, at para. 17.
[28] *See* Case C-623/22, Belgian Ass'n of Tax Laws. v. Prime Minister, ECLI:EU:C:2024:XXX, paras. 37-44.
[29] *See* Charter of Fundamental Rights of the European Union art. 47, 2012 O.J. (C 326) 391, 400; Case C-50/00 P, Unión de Pequeños Agricultores v. Council, 2002 E.C.R. I-6677, paras. 38-45.
[30] *See* Case C-6/12, P Oy, ECLI:EU:C:2013:525, paras. 26-27; Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union, 2016 O.J. (C 262) 1, paras. 117-21.

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6. Conclusion

The promulgation of the *Side-by-Side Package* marks the definitive end of the "single global tax" project. By dropping strict textual uniformity in favor of equivalent functional outcomes, the Inclusive Framework has accepted that international tax will not take the form of a single supranational code, but a coordinated array of interoperable domestic systems.

Its key innovation is the "Deemed Compliance" rule, which treats U.S. rules as "Tier 1 Equivalent."[31] The global minimum tax thus ceases to operate as a single extraterritorial regime implemented through the UTPR and instead becomes a certification standard for domestic minimum-tax floors. The UTPR is pushed into a residual role i.e. a dormant extra-territorial backstop triggered only when a jurisdiction fails to build its own protective regime.

The Side-by-Side shift confirms that capital may be global, but taxing power remains insistently local. The dream of a unified "World Minimum Tax Code" has given way to a dense web of interoperable tax firewalls. In this new equilibrium, the Inclusive Framework's success is judged less by statutory uniformity than by how effectively it lets distinct sovereign systems coexist without eroding each other's tax bases. The "Side-by-Side" era does not abolish tax competition; it disciplines it by standardizing fiscal self-defense under a sovereign shield.

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[31] *See Side-by-Side Package*, *supra*note 1, art. 4.2.

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