From Worldwide Taxation to Expanded IIR: toward Tax Decluttering in Brazilian International Taxation

Da Tributação em Bases Universais à IIR Ampliada: em Direção ao Decluttering *Tributário na Tributação Internacional Brasileira*

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Abstract
Brazil's worldwide taxation regime is misaligned with both international trends and taxation theory. This article demonstrates the functional convergence between Pillar Two IIR and traditional CFC rules, arguing that their supposed compatibility reflects path dependence rather than rational tax policy. We propose an expanded IIR framework designed to replace both Brazil's current worldwide taxation system and the need for parallel CFC rules. The proposed model addresses functional gaps in standard GloBE IIR through dual-threshold architecture, safe harbour provisions and a tiered rate structure. This approach offers an opportunity for tax decluttering, eliminating institutional redundancy while maintaining robust protection against base erosion and profit shifting.
Keywords: income inclusion rule, CFC, worldwide taxation, decluttering, Pillar Two.

Resumo
O regime brasileiro de tributação em bases universais está desalinhado tanto das tendências internacionais quanto da teoria da tributação. Este artigo demonstra a convergência funcional entre a *IIR* do Pilar 2 e as regras CFC tradicionais, sustentando que sua suposta compatibilidade reflete dependência de trajetória e não uma política tributária racional. Propomos uma estrutura de *IIR* ampliada destinada a substituir tanto o atual sistema brasileiro de TBU quanto a necessidade de regras CFC paralelas. O modelo proposto supre lacunas funcionais da *IIR* padrão do GloBE, por meio de um sistema de

duplo limite, regras de *safe harbour* e estrutura de alíquotas escalonada. Esta abordagem oferece uma oportunidade para o *decluttering* tributário, eliminando redundâncias institucionais e mantendo proteção robusta contra erosão da base tributária e transferência de lucros.

Palavras-chave: regra de inclusão de renda, CFC, TBU, *decluttering*, Pilar 2.

Introduction

The contemporary international tax system faces a severe crisis of legitimacy and effectiveness, struggling to address the complexities of economic globalization and the sophisticated strategies employed by multinational enterprises – MNEs. This crisis has prompted comprehensive reform initiatives, most notably the OECD/G20 Base Erosion and Profit Shifting (BEPS) project and the Inclusive Framework Two-Pillar Solution. These developments create opportunities for jurisdictions to reassess their international tax regimes and pursue reforms that address both domestic policy objectives and international coordination demands.

Brazil's position in this evolving landscape proves particularly complex. The country maintains perhaps the world's most comprehensive worldwide taxation regime, subjecting all foreign profits of controlled entities to immediate domestic taxation regardless of distribution, location or income characteristics. This approach, established through Law 12,973/2014, places Brazil in increasing isolation as most jurisdictions have transitioned toward territorial systems with targeted anti-abuse measures. Simultaneously, Brazil has begun implementing the Pillar Two framework through Law 15,079/2024, which establishes the Qualified Domestic Minimum Top-up Tax (QDMTT) and mandates comprehensive reform of the country's worldwide taxation regime.

Article 40 of Law 15,079/2024 requires the Executive Branch to submit legislative proposals introducing both an Income Inclusion Rule (IIR) consistent with OECD Pillar Two guidelines and a reformed controlled foreign company (CFC) regime. This legislative mandate creates a demand for analyzing optimal design approaches for Brazil's international tax system.

This article argues that Brazil's implementation of Pillar Two presents an opportunity to achieve tax system decluttering by replacing both the current worldwide taxation regime and the need for separate CFC legislation with a carefully calibrated expanded IIR framework. Rather than perpetuating institutional redundancy through parallel systems addressing similar policy concerns, Brazil can adopt a unified approach that captures the anti-abuse benefits of traditional CFC rules while operating within the internationally coordinated Pillar Two framework.

The study operates across five analytical steps. First, we examine the fundamental theoretical inadequacies of current international tax principles, demonstrating that source and residence-based taxation face structural problems that superior alternatives could address, yet remain constrained by path dependence. Second, we analyze Brazil's worldwide taxation regime from theoretical and comparative perspectives, establishing that unilateral comprehensive taxation creates systematic competitive disadvantages for national MNEs. Third, we demonstrate the functional convergence between IIR and CFC rules, arguing that their supposed compatibility reflects institutional inertia rather than rational policy design. Fourth, we propose an expanded IIR framework designed to address the functional gaps preventing standard GloBE implementation from completely replacing traditional CFC legislation. Finally, we examine the legal and practical implementation requirements for the proposed reform, including constitutional considerations and revenue compensation mechanisms.

This analysis focuses exclusively on outbound investment measures, particularly the IIR framework and its relationship to CFC legislation. The Undertaxed Profits Rule (UTPR), while representing an important component of the Pillar Two framework, falls outside this article's scope due to its fundamentally different operational mechanisms and distinct legal considerations.

The proposed approach offers Brazil the opportunity to achieve international leadership in tax decluttering while addressing domestic policy objectives more effectively than current arrangements. By eliminating institutional redundancy, reducing compliance burdens, and aligning with international best practices, the expanded IIR framework could position Brazil as a model for pragmatic tax reform that captures theoretical insights within practical implementation constraints.

1. The fundamental inadequacy of source and residence-based taxation: theoretical alternatives and the persistence of suboptimal institutions

The international tax system, anchored in the traditional principles of source and residence-based taxation, faces a severe crisis of legitimacy and effectiveness in the twenty-first century. What began as a pragmatic solution to early twentieth-century revenue collection needs has evolved into a complex web of rules that systematically fails to address the fundamental challenges posed by economic globalization, technological advancement and the rise of multinational enterprises – MNEs. This section argues that the current income tax framework is structurally inadequate for modern economic realities and that, while superior theoretical alternatives exist, their implementation faces significant institutional constraints, rooted in path dependence.

The critique presented here operates on three analytical levels. First, we examine the fundamental conceptual flaws embedded in source and residence-based taxation, demonstrating that these principles rest on arbitrary historical choices rather than sound economic foundations. Second, we explore the theoretical alternatives that have emerged from decades of scholarly research, particularly consumption-based taxation and destination-based corporate income taxation, which offer demonstrable economic and administrative advantages. Finally, we confront the sobering reality that, despite their theoretical superiority, these alternatives face implementation barriers that appear insurmountable given the path-dependent nature of institutional development.

1.1. The arbitrary foundations and systemic failures of income taxation

The modern income tax system emerged not from careful economic design but from historical accident and administrative convenience. As John Cochrane observes, the income tax became dominant around 1913 primarily because "income was easier to measure than sales, value added, consumption, or other economically better concepts"[1].

This arbitrary foundation has generated what Cochrane terms a "century of cat and mouse" between taxpayers and tax authorities[2]. Each new avoidance strategy prompts regulatory responses, which in turn spawn more sophisticated avoidance techniques, creating an endless cycle of increasing complexity without corresponding improvements in economic efficiency. Rather than addressing the underlying structural problems, policymakers have consistently chosen to add layers of complexity, resulting in a system that imposes enormous compliance costs, while failing to achieve its objectives of efficiency and equity.

The theoretical foundations of residence or source-based taxation face even more fundamental challenges. As Devereux and de la Feria demonstrate, the traditional economic concepts of residence and source have become inadequate foundations for allocating corporate tax rights in the context of multinational enterprises[3]. The residence principle for corporations is inherently susceptible to profit shifting. Concerning the source principle, the core problem lies in the impossibility of meaningfully defining where profit is "generated" in an interconnected global economy. Modern MNEs create value through complex networks spanning multiple jurisdictions, making any attempt to allocate profits to specific sources inherently arbitrary. Devereux and de la Feria emphasize that multinational profits typically emerge from multiple geographic locations simultaneously, as companies strategically leverage diverse local conditions to optimize their

1 COCHRANE, John H. It's time the US abolished the income tax. *Chicago Booth Review*, 12 fev. 2024. Available at: https://www.chicagobooth.edu/review/its-time-us-abolished-income-tax. Accessed: 21 jul. 2025.

2 COCHRANE, John H. It's time the US abolished the income tax. *Chicago Booth Review*, 12 fev. 2024. Available at: https://www.chicagobooth.edu/review/its-time-us-abolished-income-tax. Accessed: 21 jul. 2025.

3 DEVEREUX, Michael; DE LA FERIA, Rita. Designing and implementing a destination-based corporate tax. *Oxford University Centre for Business Taxation Working Paper* n. 14/07, May 2014, p. 8.

global returns[4]. This fundamental reality undermines the conceptual coherence of traditional source-based approaches, rendering the classical economic notion of source largely obsolete for contemporary tax policy purposes.

In this context, sophisticated profit-shifting strategies are becoming more successful in the modern digital economy. Transfer pricing manipulation, debt shifting, and intellectual property migration represent rational responses to a system that lacks theoretical coherence. The OECD's BEPS initiative, while acknowledging these problems, fundamentally misdiagnoses them as implementation failures rather than structural design flaws.

The vulnerabilities of source and residence-based systems extend far beyond profit shifting. As demonstrated by Auerbach et al., current systems create systematic distortions across multiple dimensions of business decision-making[5]. These distortions impose deadweight losses that compound over time, reducing global economic welfare. The irony is that while governments compete fiercely to attract mobile capital through tax concessions, the overall effect is to reduce the global tax base available to all jurisdictions. The race to the bottom in corporate tax rates represents a classic collective action problem, where individual rational behavior produces collectively suboptimal outcomes.

1.2. Superior theoretical alternatives: consumption and destination-based taxation

The superior alternative to income taxation has been well-established in economic theory for decades. Consumption taxation avoids the fundamental problems that plague income taxation by focusing on what economists regard as the most appropriate tax base. This approach eliminates the bias against saving and investment that characterizes income taxation, while preserving compatibility with progressive distribution objectives through targeted transfer mechanisms and refundable tax credits for lower-income households[6].

The theoretical advantages of consumption taxation are sound. It eliminates the double taxation of capital income that occurs under income tax systems, thereby removing artificial distortions in intertemporal choice. It renders irrelevant the complex distinctions between debt and equity financing that create opportunities for manipulation under current systems. Most importantly, consump-

4 DEVEREUX, Michael; DE LA FERIA, Rita. Designing and implementing a destination-based corporate tax. *Oxford University Centre for Business Taxation Working Paper* n. 14/07, May 2014, p. 7.

5 AUERBACH, Alan et al. Destination-based cash flow taxation. *Oxford University Centre for Business Taxation Working Paper* n. 17/01, jan. 2017.

6 MELLO, Helio de. Entre a Regra de Ramsey e a seletividade: uma defesa da alíquota única na tributação do consumo. *Revista Tributária e de Finanças Públicas* n. 159. São Paulo, 2023, p. 59-86, p. 69-71; 75-79.

tion taxation naturally implements destination-based principles that eliminate the profit-shifting opportunities that afflict residence and source-based systems. Under a comprehensive consumption tax regime, the location of production and the tax residence of the producing company become irrelevant for tax purposes, as all goods and services are taxed where they are consumed, or in the place of residence of the consumer. This renders meaningless the common practice of establishing corporate tax residence in low-tax jurisdictions for purely tax-driven reasons.

Recognition of consumption taxation's theoretical superiority has led to the development of practical implementation frameworks, most notably the Destination-Based Cash Flow Tax (DBCFT) proposed by Auerbach, Devereux and colleagues. The DBCFT combines the economic benefits of consumption taxation with the administrative familiarity of corporate income taxation. As these authors demonstrate, the DBCFT displays exceptional economic efficiency properties by eliminating distortions in investment decisions, both regarding scale and geographic allocation, as well as corporate financing choices[7]. The proposed system eliminates the profit-shifting opportunities that characterize current regimes, making transfer pricing manipulation irrelevant: since exports are untaxed and imports are taxed, the declared prices of inter-company transactions have no effect on overall tax liability.

An alternative approach to achieving destination-based taxation involves implementing a destination-based corporate income tax (DBCIT), as proposed by Devereux and de la Feria. This approach is intended to transform corporate taxation by applying the destination principle directly to corporate income. The DBCIT uses a tax base similar to VAT but with the crucial difference that labor costs are deductible, making it effectively a tax on economic rent. The system determines destination primarily through customer location as a legal proxy, ensuring that corporate profits are taxed where sales occur rather than where production takes place. A key innovation is the proposed One-Stop-Shop (OSS) mechanism, where the country of production collects tax at the destination country's rate and transfers the revenue accordingly, similar to European Union VAT administrative procedures. This approach eliminates transfer pricing manipulation since intra-group transactions net out for tax purposes, while maintaining familiar administrative structures adapted from European VAT experience. The DBCIT thus offers a practical framework for destination-based business taxation that preserves the economic benefits of consumption taxation while operating within existing corporate tax institutional frameworks[8].

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7 AUERBACH, Alan et al. Destination-based cash flow taxation. *Oxford University Centre for Business Taxation Working Paper* n. 17/01, jan. 2017, p. 21.

8 DEVEREUX, Michael; DE LA FERIA, Rita. Designing and implementing a destination-based

1.3. Path dependence and the persistence of suboptimal institutions

Despite the compelling theoretical case for fundamental tax reform, the prospects for implementation remain remote due to what Douglass North termed *path dependence*: the tendency for institutional arrangements to persist even when superior alternatives are available[9]. North's analysis reveals that institutional frameworks create the underlying incentive systems that guide economic behavior, with their evolutionary path determining whether economies advance, stagnate, or decline[10].

Path dependence operates through multiple mechanisms that lock societies into existing institutional arrangements. Transaction costs make radical changes expensive and risky. Existing stakeholders develop vested interests in maintaining current systems. Cultural factors and *collective learning* create cognitive frameworks that make alternatives difficult to perceive or evaluate.

In the taxation context, path dependence manifests through the enormous infrastructure built around current systems. Tax professionals, government agencies, accounting firms, and MNEs have invested heavily in expertise specific to existing rules. Legal systems have evolved to support source and residence-based principles. International treaties embody these principles in binding commitments that are costly to modify.

The path dependence problem becomes particularly acute in international taxation due to coordination requirements. As Becker and Englisch observe in their analysis of destination-based tax proposals, concerning the EU, "in a Community of still 27 Member States, such a fundamental and ambitious reform of corporate taxation would probably fail to overcome the unanimity hurdles built into the founding treaties of the EU"[11].

The coordination problem extends beyond formal voting requirements to encompass deeper issues of national sovereignty and tax competition. Countries fear that unilateral moves toward superior tax systems will disadvantage them relative to nations that maintain existing approaches. This creates a classic prisoner's dilemma where the collectively optimal outcome remains unattainable despite its obvious benefits. Under these circumstances, international organizations like the OECD, while acknowledging the problems with current systems, remain committed to incremental reforms that preserve existing institutional structures.

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corporate tax. *Oxford University Centre for Business Taxation Working Paper* n. 14/07, May 2014, p. 9-22.

9 NORTH, Douglass C. *Institutions, institutional change and economic performance*. Cambridge: Cambridge University Press, 1990.

10 NORTH, Douglass C. Prize Lecture. *NobelPrize.org*, 1993. Available at: https://www.nobelprize.org/prizes/economic-sciences/1993/north/lecture/. Accessed: 21 jul. 2025.

11 BECKER, Johannes; ENGLISCH, Joachim. A European perspective on the US plans for a destination based cash flow tax. *Social Science Research Network*, 2017, p. 33.

The BEPS project exemplifies this approach: attempting to address profit shifting through additional rules and reporting requirements rather than confronting the fundamental design flaws that make such behaviors rational.

The political economy of tax reform further reinforces path dependence. Existing systems, however flawed, create well-defined sets of winners and losers with predictable political preferences. Proposed reforms, even when clearly superior in aggregate terms, create uncertainty about distributional consequences that mobilize opposition from potentially affected groups. The complexity of modern tax systems also creates information asymmetries that favor *status quo* preservation. Tax professionals possess specialized knowledge that gives them disproportionate influence in policy debates, yet their economic interests often align with maintaining complexity rather than pursuing simplification. Political leaders, facing multiple competing priorities and short-term electoral pressures, naturally gravitate toward incremental changes that minimize political risk.

Furthermore, the international nature of modern tax policy creates additional veto points that make comprehensive reform nearly impossible. Any country considering fundamental reform must anticipate responses from trading partners, potential treaty violations and complex transition problems that may not have clear solutions.

The analysis presented here reveals a profound paradox at the heart of contemporary international taxation. While economic theory clearly identifies superior alternatives to current source and residence-based systems, and while practical implementation frameworks have been developed by leading scholars, the prospects for meaningful reform remain virtually nil. The combination of path dependence, coordination problems, and political economy constraints appears to lock the international community into institutional arrangements that are deeply flawed. This situation represents a particularly clear example of what North identified as the general tendency for societies to persist with inefficient institutions[12].

The theoretical work examining destination-based corporate taxation and related reforms, while offering valuable tax policy insights, serves primarily as a demonstration of the considerable challenges in bridging the gap between optimal design and practical implementation, rather than as a straightforward tax policy roadmap. While scholars can identify clearly superior institutional arrangements, the path-dependent nature of institutional evolution ensures that societies often remain trapped in suboptimal equilibria despite full knowledge of better alternatives.

12 NORTH, Douglass C. Institutions, institutional change and economic performance. Cambridge: Cambridge University Press, 1990.

This reality has profound implications for the remainder of this analysis, particularly from the perspective of prescribing tax policy for Brazil. If fundamental reform of international tax principles appears unattainable at the global level, attention must turn to more modest reforms that work within existing institutional constraints while attempting to minimize the most egregious inefficiencies of current arrangements from a national perspective. Rather than pursuing theoretically superior but practically unachievable comprehensive reforms, Brazil must identify pragmatic policy adjustments that can meaningfully improve its international tax system within the current global institutional framework. The following sections explore whether such pragmatic improvements are possible within the Brazilian context, specifically through modification of controlled foreign company rules in conjunction with implementation of OECD Pillar Two measures.

2. Brazil's worldwide taxation in international context: theoretical considerations and the case for territorial transition

Brazil's comprehensive worldwide taxation regime represents a fundamental misalignment with both international trends and economic theory regarding optimal tax system design. While worldwide taxation may possess theoretical justification under specific conditions of global harmonization, its unilateral implementation creates systematic competitive disadvantages that economic analysis clearly identifies as suboptimal from a national perspective. This section demonstrates that Brazil's isolated adoption of worldwide taxation principles contradicts both empirical evidence of international best practices and theoretical prescriptions for optimal tax policy, compromising the international competitiveness of Brazilian companies.

2.1. Brazil's worldwide taxation regime in comparative perspective

Brazil's outbound tax system, as established by Law No. 12,973/2014, operates a comprehensive worldwide taxation regime that applies to all profits earned by controlled and affiliated entities abroad, regardless of their actual distribution, the location of the controlled entity, or the passive or active nature of the income. Under this system, profits from controlled entities abroad are deemed available to the Brazilian parent company when such profits are recognized in the foreign entity's financial statements. These profits are included in the domestic tax base at ordinary IRPJ and CSL rates (typically reaching a combined 34% rate). This approach fundamentally differs from typical controlled foreign company (CFC) rules implemented by most jurisdictions, which focus on specific anti-abuse purposes targeting passive income or low-tax arrangements rather than comprehensive income inclusion.

The historical evolution of the Brazilian regime reveals four distinct phases since 1995, each demonstrating the permanent tension between Supreme Court decisions and revenue collection objectives[13]. While most developed economies implemented comprehensive worldwide taxation during the 1960s through early 1980s, Brazil's belated adoption in 1995 proves particularly anachronistic. By that time, the international community had already begun its systematic movement away from such approaches[14]. Brazil's persistence with universal taxation becomes particularly problematic because the country consolidated this framework when most major economies, recognizing its competitive disadvantages, transitioned toward territorial regimes.

As Schoueri and Galdino observe, the characterization of the Brazilian regime as CFC legislation depends entirely on the definition adopted for such rules. If CFC rules are conceptualized as specific anti-avoidance rules (SAAR) aimed at tax avoidance situations involving low-tax jurisdictions, then Brazil clearly does not possess such rules[15]. Instead, it operates a full inclusion model that indiscriminately taxes foreign earnings across all business activities and jurisdictions, unlike the targeted approach that characterizes traditional CFC legislation, adopted by countries following territorial taxation principles[16].

The magnitude of Brazil's international isolation becomes evident when examining global trends. As documented by recent studies, of the 37 OECD member countries, 34 currently offer some exemption or deduction for foreign-source dividend income[17]. A notable example of this movement is the United States' adoption of a partial territorial system through the Tax Cuts and Jobs Act of 2017, where American corporations became entitled to full deduction of foreign-source dividends[18]. This overwhelming trend toward territorial taxation principles reflects practical responses to economic globalization and intensified international tax competition.

13 SCHOUERI, Luís Eduardo; GALDINO, Guilherme. Controlled Foreign Company legislation in Brazil. In: KOFLER, G. et al. (ed.). *Controlled Foreign Company Legislation*. IBFD, 2020, p. 1-3.

14 SANTOS, Ramon Tomazela. Territorial tax systems: motivations and key considerations for effective change. *Tax Notes International* v. 89, n. 10, March 5, 2018, p. 925-926.

15 SCHOUERI, Luís Eduardo; GALDINO, Guilherme. Controlled Foreign Company legislation in Brazil. In: KOFLER, G. et al. (ed.). *Controlled Foreign Company Legislation*. IBFD, 2020, p. 1.

16 SANTOS, Ramon Tomazela. A Ação 3 do Projeto BEPS e o regime brasileiro de tributação em bases universais na Lei n. 12.973/2014. *Revista Fórum de Direito Tributário* v. 15, n. 88, jul./ago. 2017, p. 101.

17 TAX FOUNDATION. Anti-base erosion provisions and territorial tax systems in OECD Countries. February 2024. Disponível em: https://taxfoundation.org/research/all/federal/anti-base-erosion-territorial-tax-systems/. Acesso em: 29 jul. 2025.

18 SANTOS, Ramon Tomazela. Territorial tax systems: motivations and key considerations for effective change. *Tax Notes International* v. 89, n. 10, March 5, 2018, p. 926.

International best practices focus CFC rules on income that enables base erosion and artificial profit shifting, while the Brazilian regime primarily aims at increasing tax collection, dispensing with analysis of abusive planning or artificial structures. The modifications introduced by Law No. 12,973/2014 did not bring the Brazilian system closer to international CFC rules but merely determined access to special taxation regimes without altering the fundamental principle of worldwide taxation[19].

2.2. Theoretical considerations: global versus national perspectives on optimal taxation

Economic analysis of international taxation establishes a fundamental distinction between global and national perspectives in evaluating optimal tax systems, with profound implications for policy design. This distinction demonstrates that conditions for optimality vary significantly according to the objective pursued by the tax system[20].

From the perspective of global optimality, the concepts of fiscal neutrality, Capital Export Neutrality (CEN), Capital Import Neutrality (CIN) and Capital Ownership Neutrality (CON), provide theoretical frameworks for evaluating different tax regimes. CEN, which favors worldwide taxation, maintains that investors should face identical effective tax rates regardless of investment location, preserving competitive neutrality between different investors in the same jurisdiction. CIN, supporting territorial taxation, implies that all investments within the same jurisdiction should face identical effective tax rates, preserving competitive neutrality between different investments in the same jurisdiction. CON, a more recent concept, focuses on the neutrality of corporate ownership decisions[21].

Devereux's analysis reveals that the choice between these approaches depends critically on the perspective adopted. From a global perspective, both territoriality and universality can theoretically achieve efficiency, provided they are uniformly adopted by all jurisdictions[22]. Complete harmonization would eliminate competitive distortions and allow neutrality principles to operate effectively. In such scenarios, worldwide taxation could achieve CEN while territorial systems

[19] SANTOS, Ramon Tomazela. A Ação 3 do Projeto BEPS e o regime brasileiro de tributação em bases universais na Lei n. 12.973/2014. *Revista Fórum de Direito Tributário* v. 15, n. 88, jul./ago. 2017, p. 108.

[20] DEVEREUX, Michael P. Taxation of outbound direct investment: economic principles and tax policy considerations. *Oxford Review of Economic Policy* v. 24, n. 4, 2008, p. 678-719.

[21] GALENDI, Ricardo André. Fundamentos da tributação de lucros no exterior entre competitividade e harmonização. *Revista Direito Tributário Atual* v. 33. São Paulo: IBDT, 2015, p. 390-395.

[22] DEVEREUX, Michael P. Taxation of outbound direct investment: economic principles and tax policy considerations. *Oxford Review of Economic Policy* v. 24, n. 4, 2008, p. 702-708.

could achieve CIN, with both potentially supporting CON under appropriate conditions.

The crucial insight from Devereux's analysis, though, concerns the national perspective on optimal tax policy. Assuming both domestic and outbound investment are financed marginally by inbound portfolio investment, and that the country lacks market power, there exists no convincing argument for taxing returns from outbound direct investment[23]. In this scenario, taxation of foreign profits merely raises the pre-tax rate of return required by companies, potentially placing them at competitive disadvantages in foreign markets.

2.3. National policy implications: competitive disadvantages and reform imperatives

The theoretical framework developed above demonstrates why Brazil's isolated adoption of worldwide taxation creates particularly severe problems. Santos observes that the main objection to comprehensive taxation systems focuses on harmful consequences for domestic company competitiveness abroad, but this problem arises specifically because of unilateral adoption by individual countries[24]. When Brazilian companies compete with multinationals from countries adopting territorial regimes for investments in low-tax jurisdictions, even legitimate investments with substantial economic substance, they face competitive disadvantages that may render economically efficient projects unviable.

From the national perspective, as Devereux demonstrates, adopting territoriality proves optimal regardless of policies adopted by other countries[25]. The consistent movement away from worldwide taxation systems toward territorial regimes combined with limited CFC rules reflects not merely political considerations but recognition that unilateral maintenance of universal systems imposes disproportionate competitive costs on domestic companies. The development of the OECD BEPS Project, particularly Action 3 on effective CFC rules, offers frameworks that reconcile anti-abuse objectives with preservation of business competitiveness[26].

Economic theory converges toward the conclusion that Brazil should abandon its worldwide taxation system and adopt territorial regimes accompanied by adequate instruments for preventing base erosion. Increasing global adoption of

23 DEVEREUX, Michael P. Taxation of outbound direct investment: economic principles and tax policy considerations. *Oxford Review of Economic Policy* v. 24, n. 4, 2008, p. 708-711.

24 SANTOS, Ramon Tomazela. Territorial tax systems: motivations and key considerations for effective change. *Tax Notes International* v. 89, n. 10, March 5, 2018, p. 928.

25 DEVEREUX, Michael P. Taxation of outbound direct investment: economic principles and tax policy considerations. *Oxford Review of Economic Policy* v. 24, n. 4, 2008, p. 711.

26 OECD. Designing effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project. Paris: OECD Publishing, 2015.

Pillar Two, with its Income Inclusion Rule (IIR), presents an opportunity for Brazil to reevaluate its international taxation regime, since the IIR possesses characteristics functionally similar to CFC rules.

This convergence suggests possibilities for replacing the current Brazilian regime with systems more aligned with international practices while achieving comprehensive base protection. Rather than maintaining isolated worldwide taxation that theory shows to be suboptimal from a national perspective, Brazil can transition to territorial principles with instruments for preventing base erosion that address legitimate policy concerns without imposing systematic competitive disadvantages on domestic enterprises.

The functional similarity between IIR and traditional CFC rules, which will be explored in detail in the following section, suggests that Brazil can achieve genuine institutional decluttering by implementing expanded IIR frameworks that eliminate need for parallel CFC legislation while maintaining robust protection against base erosion and profit shifting.

3. The functional convergence of IIR and CFC legislation: towards tax decluttering

The implementation of the OECD Pillar Two framework has generated intense academic debate regarding its relationship with existing CFC rules. While some observers emphasize the alleged differences between the GloBE IIR and traditional CFC legislation, this analysis demonstrates that the fundamental similarities between these regimes far outweigh their superficial distinctions. More importantly, the coexistence of both systems represents an institutional redundancy that contradicts basic principles of tax system design and administrative efficiency. This section argues that the supposed compatibility between IIR and CFC rules, as promoted by the OECD, reflects path dependence rather than rational policy design, and that Brazil's singular position, potentially implementing the IIR without parallel CFC rules to be preserved, offers an opportunity to achieve the institutional decluttering that international tax system urgently requires.

3.1. Beyond OECD rhetoric: the substantive convergence between IIR and CFC rules

Johanna Hey provides a penetrating critique of the alleged distinctions between the GloBE IIR and traditional CFC regimes. Despite OECD claims that the IIR and CFC rules serve different purposes, the author observes that the Pillar Two Blueprint fails to specify in which way their objectives diverge. Hey's insight reveals that the integration of substance-based carve-outs into the GloBE framework has fundamentally transformed its character, creating what she characterizes as "nothing else than an advanced CFC rule"[27]. This convergence represents a decisive departure from the original conception of a universal minimum tax toward a mechanism that operates according to principles familiar from decades of CFC rule development.

The core similarity lies in the basic operational mechanism: both systems require parent entities to include in their tax base income earned by controlled entities abroad when that income has been subject to insufficient taxation. Indeed, the Pillar Two Blueprint explicitly acknowledges this convergence, stating that "the operation of the IIR is, in some respects, based on traditional CFC rule principles and triggers an inclusion at the level of the shareholder where the income of a controlled foreign entity is taxed at below the effective minimum tax rate"[28]. This admission represents the OECD's implicit recognition that GloBE IIR, in essence, has evolved into a sophisticated variant of existing CFC rules.

The substance-based carve-outs prove particularly crucial to this convergence. By excluding routine returns based on formulaic assumptions related to tangible assets and payroll, the IIR effectively targets only excess returns, adopting an approach somewhat analogous to that employed by CFC regimes that distinguish between active and passive income. This evolution represents what Hey terms the "farewell to the original idea of a worldwide minimum tax"[29]. Rather than implementing comprehensive taxation of all foreign income below a specified threshold, which would approximate the regime to worldwide taxation, the GloBE system now focuses specifically on income that exhibits characteristics associated with base erosion and profit shifting.

The argument advanced by Brian Arnold regarding the theoretical foundations of international taxation provides additional support for this convergence analysis. Arnold's critique of the "single tax principle" demonstrates that this concept, frequently invoked to justify the GloBE framework, lacks historical foundation and represents unjustified revisionism rather than authentic interpretation of international tax principles. As Arnold observes, the "single tax principle" received virtually no attention until the OECD/G20 BEPS Project, with the primary historical emphasis being on eliminating double taxation rather than preventing double non-taxation[30]. This analysis reveals that the supposed theoretical distinc-

27 HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 7; 13.

28 OECD. Tax challenges arising from digitalization – Report on Pillar Two blueprint: inclusive framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing Oct. 2020); accompanied by the Public Consultation Document, Reports on the Pillar One and Pillar Two Blueprints, 12 Oct.-14 Dec. 2020 (OECD Publishing Oct. 2020), § 9.

29 HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 7.

30 ARNOLD, Brian J. The evolution of Controlled Foreign Corporation rules and beyond. *Bulletin*

tion between GloBE rules (allegedly based on the single tax principle) and CFC rules (allegedly based on residence-based taxation) lacks meaningful foundation.

Furthermore, Arnold's analysis exposes the conceptual confusion underlying claims that the IIR operates according to different principles than traditional CFC legislation. Both systems effectively implement residence-based taxation with the objective of preventing base erosion and profit shifting. The GloBE system's use of formulaic substance carve-outs does not alter this fundamental character. It merely represents a broader mechanism for distinguishing between legitimate business activities and arrangements primarily motivated by tax considerations. Indeed, as Hey points out, "action 3 already mentioned an excess profits approach as a possible, though not yet used at that time, way of defining attributable CFC income"[31].

The technical operation of both systems further reinforces their functional convergence. Traditional CFC rules typically calculate inclusion amounts by applying domestic tax accounting rules to determine the controlled entity's income, then testing whether the effective foreign tax rate falls below a specified threshold. The IIR follows precisely the same logic, albeit with standardized accounting adjustments and a uniform 15% threshold. As Hey notes, this standardization could represent significant simplification compared to the complex recalculations required under many existing CFC regimes[32].

In essence, both IIR and CFC rules seek to prevent the erosion of the domestic tax base through artificial profit shifting to low-tax jurisdictions. Both systems are embodied in residence-based taxation while accommodating legitimate international business activities. Rather than constituting a revolutionary departure from existing principles, the IIR represents an evolutionary refinement of CFC rules.

3.2. The redundancy of parallel regimes and the imperative for decluttering

The recognition of functional convergence between IIR and CFC rules immediately raises a question: do jurisdictions actually need both a GloBE IIR and the traditional CFC frameworks recommended in the 2015 OECD BEPS Action 3 report?

One of the most significant failures in contemporary international tax policy design is the creation of redundant institutional architecture that imposes enormous compliance costs without corresponding benefits. Rather than remov-

for International Taxation v. 73, December 2019, p. 632.

31 HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 10.

32 HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 13.

ing existing complexity before introducing new measures, policymakers have consistently layered new rules atop existing frameworks.

The international movement toward tax decluttering has gained momentum through increased recognition of the considerable and unnecessary costs of overlapping and redundant regulations. As documented by the Tax Foundation, the OECD has initiated a decluttering project, acknowledging that international tax rules have become unwieldy and require systematic simplification[33]. In this context, The European Union has committed to reducing administrative burdens by 25% overall and 35% for small and medium enterprises, explicitly recognizing that the proliferation of tax rules creates barriers to economic activity[34].

Countries implementing Pillar Two IIR while retaining existing CFC legislation create precisely the type of redundancy that modern decluttering efforts seek to eliminate. As observed by German and Dutch policymakers in their December 2024 joint statement, the minimum tax should serve as "the starting point of an effort to 'declutter' international tax rules"[35]. This recognition implicitly acknowledges that rational policy design would eliminate redundant mechanisms rather than perpetuating parallel systems.

The path dependence explanation for this redundancy proves particularly illuminating. Countries maintain existing CFC rules alongside new IIR requirements not because such duplication serves any coherent policy objective, but because institutional inertia makes fundamental reform appear too costly or politically risky. As Hey observes, the OECD has shown little interest in simplifying the international tax system throughout the BEPS process, with national legislators similarly reluctant to reduce complexity and instead remaining cautious to not create new loopholes[36].

This institutional conservatism produces systematically suboptimal outcomes. If international tax policy were designed from scratch, incorporating current knowledge about base erosion techniques and administrative capabilities, no rational observer would propose the coexistence of CFC rules with a parallel IIR system addressing the same concerns through different methodologies. The European Economic and Social Committee explicitly recognizes this problem, cautioning that "Pillar 2 may overlap with certain provisions in the Anti-Tax Avoid-

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33 Tax Foundation. Decluttering international tax rules. February 8, 2024. Disponível em: https://taxfoundation.org/blog/decluttering-international-tax-rules/. Acesso em: 22 jul. 2025.

34 European Economic and Social Committee. The need for tax simplification. June 12, 2025. Disponível em: https://www.eesc.europa.eu/en/news-media/need-tax-simplification. Acesso em: 22 jul. 2025.

35 Tax Foundation. Global tax agreement: details & analysis. February 27, 2025. Disponível em: https://taxfoundation.org/blog/global-tax-agreement/. Acesso em: 22 jul. 2025.

36 HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 13.

ance Directives, particularly regarding Controlled Foreign Company (CFC) rules" and recommending that "Member States should review existing CFC rules and consider repealing or modifying those that have become unnecessary"[37].

Brazil's position in this context offers an opportunity to avoid the institutional redundancy that characterizes other jurisdictions that implemented Pillar Two. The country's current worldwide taxation system, while problematic for the reasons identified in the previous section, creates the possibility of implementing a clean transition to the IIR framework without maintaining parallel CFC legislation.

Law No. 15,079/2024, which establishes Brazil's QDMTT, mandates that the Executive Branch submit to Congress a legislative proposal to reform the worldwide taxation rules with a view to introducing the IIR in accordance with the OECD Pillar Two guidelines, and a CFC regime. While Article 40's main provision appears to contemplate two distinct regimes, the substantive legislative intent becomes evident through the four guiding directives established in the article's items: (i) protection and prevention of tax base erosion, especially through profit shifting between entities; (ii) international competitiveness of Brazilian companies with productive investments abroad; (iii) the necessity to balance rule precision with the reduction of administrative and compliance burdens, including the possibility of adopting objective criteria for determining the elements that compose the norm; and (iv) prevention or elimination of double taxation.

A careful analysis of these directives reveals that an expanded IIR framework that obviates the need for separate CFC legislation would more effectively fulfill the legislature's substantive objectives than maintaining parallel systems. The third directive explicitly prioritizes the reduction of administrative and compliance burdens, goal that is better served by a unified framework rather than overlapping systems. This approach would position Brazil as a leader in international tax simplification, while achieving the legislature's substantive policy goals.

The analysis presented here reveals that the supposed compatibility between IIR and CFC rules reflects institutional inertia rather than optimal policy design. The functional convergence between these systems, demonstrated through their shared operational mechanisms and policy objectives, suggests that their coexistence represents precisely the type of redundancy that international decluttering efforts seek to eliminate. Brazil's opportunity to implement a streamlined approach offers both domestic benefits and the possibility of international leadership in tax system design. The following section will examine how this approach

[37] European Economic and Social Committee. The need for tax simplification. June 12, 2025. Disponível em: https://www.eesc.europa.eu/en/news-media/need-tax-simplification. Acesso em: 22 jul. 2025.

might be structured to capture the benefits of both systems while avoiding their redundant complexity.

4. A proposal for an expanded Income Inclusion Rule (IIR)

The implementation of OECD Pillar Two presents Brazil with an opportunity to address the tax regimes redundancy identified in the previous section while reforming its problematic worldwide taxation model. This section proposes an expanded IIR framework designed to replace both Brazil's current worldwide taxation system and the need for parallel CFC legislation. While acknowledging the functional gaps that prevent the standard GloBE IIR from completely supplanting traditional CFC rules, the analysis demonstrates that carefully calibrated modifications can achieve comprehensive anti-avoidance coverage within a simplified institutional framework.

4.1. The functional gaps in the standard GloBE IIR

Despite the functional convergence between IIR and CFC rules established in the previous section, significant limitations prevent the standard GloBE IIR from completely replacing traditional CFC legislation. These limitations stem from specific gaps that explain widespread skepticism regarding complete CFC replacement through standard IIR implementation.

Hey's analysis reveals the fundamental limitation in high-tax jurisdictions: the GloBE IIR demonstrates lower effectiveness than most existing CFC regimes, particularly when the Pillar Two minimum effective tax rate (ETR) remains at relatively modest levels. From the perspective of multinational enterprises in high-tax countries, income shifting to achieve ETRs of 15% remains economically attractive compared to domestic rates of 25%, 30%, or higher[38]. This proves particularly problematic for Brazil, where combined IRPJ and CSL rates (in most cases, 34%) significantly exceed the 15% GloBE minimum threshold.

Conventional CFC regimes typically subject passive income to full inclusion in the parent entity's tax base, resulting in taxation at normal domestic rates. The standard IIR's 15% ETR provides less protection against base erosion than comprehensive CFC taxation at domestic rates. Arnold's analysis reinforces these concerns, concluding that extending CFC rules proves preferable to implementing minimum-tax approaches and that minimum tax adoption would not eliminate the need for CFC rules addressing passive income and certain business income categories[39].

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[38] HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 11-12.

[39] ARNOLD, Brian J. The evolution of Controlled Foreign Corporation rules and beyond. *Bulletin for International Taxation* v. 73, December 2019, p. 648.

The threshold limitations represent equally significant concern. Hey notes that, regarding country-by-country reporting, it has been demonstrated that EUR 750 million minimum threshold results in the exclusion of roughly 85% to 90% of multinational enterprises from the reporting scope, while the reports continue to be filed by corporate groups that account for approximately 90% of total business revenues. Nevertheless, the author states that applying CFC regimes exclusively to large multinational enterprises with consolidated revenues exceeding EUR 750 million appears unlikely. Restricting CFC rules to very large MNEs would undermine their deterrent function and incentivize smaller groups to exploit base erosion opportunities without meaningful risk of sanction[40].

This creates substantial coverage gaps, as traditional CFC regimes, despite often containing *de minimis* provisions, generally apply irrespective of total group revenue, thereby offering broader deterrent effects, across MNEs of varying sizes. The main concern is not revenue collection, since, as demonstrated above, the EUR 750 million threshold maintains coverage of a significant portion of corporate revenues. Rather, the issue lies in the market distortions that arise from the absence of CFC taxation for corporate groups below this threshold, which tends to render such groups artificially more competitive, undermining the level playing field that CFC legislation should preserve.

4.2. Addressing functional gaps through IIR expansion: a framework for tax decluttering

The identification of functional gaps need not preclude adopting an expanded IIR as a comprehensive replacement for CFC rules. The proposed framework addresses these limitations through three primary modifications: adjusted threshold requirements, safe harbour provisions and differentiated rate treatment for passive income. This approach recognizes that the standard GloBE framework provides a foundation for comprehensive anti-avoidance coverage, but requires calibration to address the specific concerns that motivate traditional CFC legislation.

4.2.1. Threshold architecture and safe harbour framework

The proposed framework implements a dual-threshold architecture that balances administrative efficiency with comprehensive coverage requirements. The first threshold, set significantly below the EUR 750 million GloBE standard, would trigger application of the expanded IIR to multinational enterprises that pose meaningful base erosion risks but fall outside standard Pillar Two coverage.

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40 HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 11-12.

The determination of this lower threshold should reflect the fundamental objective of *de minimis* provisions: addressing situations where administrative costs exceed intended neutrality benefits. From a microeconomic perspective, this implies setting the threshold at the point where the marginal cost of compliance and enforcement matches the marginal benefit in terms of maintaining the intended tax structure and minimizing distortions. While precise threshold determination requires empirical analysis beyond this work's scope, the principle clearly indicates a level significantly below the EUR 750 million Pillar Two standard.

For multinational enterprises falling between the proposed Brazilian threshold and the EUR 750 million Pillar Two threshold, the framework would implement carefully designed safe harbour provisions. These safe harbours serve the dual function of reducing compliance burdens for genuinely low-risk enterprises while maintaining comprehensive coverage of potential base erosion situations. The safe harbour criteria should incorporate probabilistic indicators that identify enterprises unlikely to engage in significant profit shifting activities.

Potential safe harbour criteria might include geographic concentration of operations in high-tax jurisdictions, predominant engagement in activities with inherent location-specific requirements, limited use of intellectual property licensing structures, and historical patterns of effective tax rates consistent with operational substance. These criteria would operate as rebuttable presumptions, allowing enterprises to demonstrate low base erosion risk while preserving the tax administration's ability to apply the IIR where specific evidence suggests potential abuse.

Nevertheless, the proposed framework maintains full GloBE compliance for MNEs above the EUR 750 million threshold. No safe harbours beyond those explicitly provided in OECD guidance would be available for these enterprises, ensuring that the Brazilian IIR remains qualified under international standards and preserves the harmonization benefits that justify adopting Pillar Two framework.

4.2.2. Differentiated rate treatment: a tiered approach

The most significant functional gap between standard GloBE implementation and comprehensive CFC replacement relates to passive income treatment. Traditional CFC rules typically subject passive income to full domestic taxation, reflecting recognition that such income exhibits high mobility and limited connection to genuine business activities. The standard GloBE uniform 15% minimum ETR provides insufficient protection against passive income shifting in high-tax jurisdictions.

The proposed framework addresses this gap through a tiered rate structure that differentiates treatment based on income characteristics while preserving the substance-based carve-outs that represent the GloBE framework's principal innovation. This approach recognizes that different types of income pose varying levels of base erosion risk and merit correspondingly differentiated treatment.

The tiered structure operates according to three categories that reflect both economic substance and base erosion risk profiles:

A) Income from substantive activities: The framework preserves the substance-based carve-out mechanism for income that qualifies under GloBE rules, reflecting recognition that such income represents genuine business activities with meaningful economic substance. The carve-out calculation, based on formulaic returns on payroll and tangible assets, provides an objective mechanism for distinguishing between income that reflects genuine value creation and income that may result from profit shifting arrangements.

The substance-based approach offers several advantages over traditional active vs. passive income distinctions. The formulaic calculation reduces opportunities for manipulation through minor changes in business structure or legal characterization. The focus on payroll and tangible assets creates direct connections to real economic activities that are inherently difficult to shift for purely tax purposes. The global standardized calculation methodology enhances predictability and reduces compliance costs compared to jurisdiction-specific substance tests.

B) Excess returns from non-passive activities: Income that exceeds the substance-based carve-out but does not qualify as passive income under traditional CFC definitions would remain subject to the standard 15% ETR threshold. This category captures income that exhibits characteristics of potential base erosion, exceeding routine returns from business activities, but does not display the extreme mobility associated with passive income categories.

The 15% threshold for this category maintains alignment with international GloBE implementation while providing meaningful base protection. Enterprises earning excess returns through genuine innovation, market position, or operational efficiency would face top-up taxation only when effective tax rates fall significantly below international norms. This approach preserves incentives for legitimate business activities while addressing clear cases of insufficient taxation.

C) Passive income: Income qualifying as passive under traditional CFC definitions would be subject to Brazil's normal corporate income tax rates (IRPJ plus CSL), with a floor at the 15% ETR to maintain GloBE compliance. This approach preserves the comprehensive anti-avoidance protection that characterizes traditional CFC rules while operating within GloBE computational and coordination mechanisms.

The passive income category addresses the core concern that motivates CFC legislation: highly mobile income with limited connection to genuine business activities. Traditional CFC rules recognize that passive income – including dividends, interest, royalties, and similar categories – can be easily shifted to low-tax jurisdictions without corresponding shifts in underlying economic activities. The proposed framework maintains full domestic rate taxation for such income, ensuring that Brazilian enterprises cannot obtain competitive advantages through passive income shifting.

The determination of passive income categories should align with established international practices while incorporating necessary adaptations for Brazilian legal and economic circumstances.

The framework's floor provision, ensuring that passive income faces at least 15% effective taxation even when subject to Brazilian tax benefits, addresses situations where domestic tax incentives for IRPJ and CSL might result in effective tax rates below the international minimum threshold. This mechanism ensures that tax benefits granted by Brazilian legislation cannot undermine the minimum taxation objectives.

4.3. IIR framework components and CFC building blocks

The viability of replacing traditional CFC rules with an expanded IIR depends on whether GloBE framework components can adequately address functional requirements identified by the OECD as essential for effective CFC legislation. The Action 3 report identifies six fundamental building blocks[41]: (i) rules for defining a CFC; (ii) CFC exemptions and threshold requirements; (iii) definition of CFC income; (iv) rules for computing income; (v) rules for attributing income; (vi) rules to prevent or eliminate double taxation.

4.3.1. Definition of CFC and control requirements

The GloBE framework defines controlled entities through consolidated financial statements tests rather than complex legal and economic control definitions characterizing many CFC regimes. This approach provides standardization advantages by utilizing internationally recognized financial reporting principles while eliminating technical gaming opportunities afflicting jurisdiction-specific control tests[42]. The emphasis on financial reporting control naturally aligns with information requirements necessary for IIR compliance, reducing administrative burden compared to systems requiring separate control determinations for tax purposes.

4.3.2. Exemptions and threshold requirements

The threshold and safe harbour framework described above addresses OECD building block requirements while improving upon traditional CFC ap-

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41 OECD. Designing effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project. Paris: OECD Publishing, 2015, p. 11.

42 ENGLISCH, Joachim; BECKER, Johannes. International effective minimum taxation – the GloBE proposal. *World Tax Journal* v. 11, n. 4, 2019, p. 500.

proaches. Substance-based carve-outs represent a more sophisticated mechanism for exempting genuine business activities than conventional active vs. passive income distinctions. Limiting coverage to specific income categories represents one of the most significant weaknesses of classic CFC regimes, creating compliance costs and circumvention opportunities[43]. The formulaic carve-out approach provides greater resistance to manipulation while maintaining focus on income that genuinely raises base erosion concerns.

4.3.3. Definition and computation of income

The GloBE framework's standardized financial accounting starting point, combined with predetermined adjustments, creates more consistent and less manipulable income measurement than jurisdiction-specific computational rules characterizing most CFC regimes. This standardization reduces many technical arbitrage opportunities arising when different jurisdictions apply domestic tax accounting rules to determine CFC income.

4.3.4. Attribution rules and anti-double taxation measures

International coordination mechanisms address double taxation concerns that represent primary CFC design considerations. Within this framework, Pillar Two attribution rules satisfy essential OECD requirements while providing simplifications relative to traditional CFC approaches. The focus on ultimate parent entity liability, combined with ordering rules preventing double taxation within multinational groups, creates more streamlined attribution than complex shareholder-level calculations characterizing many CFC regimes.

5. Legal aspects for implementing the proposal: litigation risks and legislative recommendations

This section examines the principal legal considerations for implementing the proposal developed in previous Section: abandoning Brazil's worldwide taxation regime and introducing an expanded IIR. Rather than pursuing a dogmatic or doctrinal analysis to determine the most legally sound position, this analysis adopts the perspective of a tax policy formulator, evaluating the need for Constitutional Amendment or National Tax Code modification through complementary law to mitigate litigation risks before implementing the measure through ordinary law.

Beyond constitutional and legal compatibility questions, the analysis addresses practical implementation considerations, including legislative framework

43 HEY, Johanna. The 2020 Pillar Two blueprint: what can the GloBE income inclusion rule do that CFC legislation can't do? *Intertax* v. 49, Issue 1, 2021, p. 12.

design and compensation mechanisms to address potential revenue effects of the proposal.

5.1. Constitutional and legal framework: risk assessment and implementation requirements

The constitutional challenges concerning GloBE implementation have international precedents, most notably Switzerland's experience where voters approved a constitutional amendment in a public vote on 18 June 2023 to enable Pillar Two adoption[44]. The Swiss constitutional amendment specifically allows deviations from "the principles of generality and equity of taxation and the principle of taxation according to economic capacity" to accommodate Pillar Two rules, demonstrating that constitutional adjustments may be necessary to prevent litigation after GloBE implementation[45].

Andrade's constitutional analysis reveals incompatibilities between Pillar Two provisions and Brazilian constitutional principles, particularly regarding the equality principle. The author's analysis suggests that the differentiation criteria adopted by OECD recommendations lack constitutional justification in Brazil, meaning that IIR (and, *a fortiori*, UTPR) implementation would conflict with the equality principle[46].

The principal Brazilian Supreme Federal Court (STF) decision addressing related issues (ADI 2,588) provides limited guidance for predicting judicial responses to Pillar Two implementation. This case, which required over a decade for resolution, demonstrates the absence of cohesion among individual Justices' votes, making it unsuitable as a reliable foundation for predicting Court positions on new international tax measures[47]. Moreover, the focus of that decision (the equity method and the characterization of abuse) does not directly correspond to the aspects that may be subject to questioning regarding GloBE rules[48].

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44 EY. Switzerland votes to amend Constitution to allow Pillar Two implementation. *Global Tax Alert*, June 21, 2023. Disponível em: https://www.ey.com/en_gl/technical/tax-alerts/switzerland-votes-to--amend-constitution-to-allow-pillar-two-impl. Acesso em: 31 jul. 2025.

45 ANDRADE, Leonardo Aguirra de. As regras recomendadas pelo Pillar Two e a sua relação com o ordenamento jurídico brasileiro. *Revista Direito Tributário Internacional Atual* v. 12, ano 6. São Paulo: IBDT, 2º semestre 2023, p. 138-139.

46 ANDRADE, Leonardo Aguirra de. As regras recomendadas pelo Pillar Two e a sua relação com o ordenamento jurídico brasileiro. *Revista Direito Tributário Internacional Atual* v. 12, ano 6. São Paulo: IBDT, 2º semestre 2023, p. 204-206.

47 STF (Brazilian Supreme Federal Court). Direct Action of Unconstitutionality No. 2,588/DF, Justice Rapporteur Ellen Grace, Justice Joaquim Barbosa (final rapporteur), decided on April 10, 2013.

48 ANDRADE, Leonardo Aguirra de. As regras recomendadas pelo Pillar Two e a sua relação com o ordenamento jurídico brasileiro. *Revista Direito Tributário Internacional Atual* v. 12, ano 6. São Paulo: IBDT, 2º semestre 2023, p. 165.

Despite these analytical limitations in existing precedents, political considerations suggest low probability that the STF would declare OECD-recommended measures unconstitutional. The Court's general deference to international organizations, combined with widespread international adoption of Pillar Two measures, favors strong presumptions towards the acceptance of the OECD framework, representing powerful incentives for constitutional accommodation rather than confrontation. Indeed, the OECD's institutional legitimacy and broad international consensus supporting Pillar Two implementation would complicate judicial decisions to declare such measures unconstitutional, as this would position Brazil against international consensus and potentially undermine its participation in global economic coordination mechanisms.

That said, the most significant legal challenge to IIR implementation involves compatibility with article 43 of the National Tax Code, which establishes income availability as a fundamental requirement for federal income taxation. This provision, which represents the core of income tax legal framework, limits taxation to the *availability* of income to taxpayers, creating potential conflicts with IIR approaches that may include income not directly available to Brazilian parent entities.

Brazilian doctrine and jurisprudence consistently recognize that CSL[49] remains subject to Article 43 of the National Tax Code. This consensus means that structuring the proposed expanded IIR as a CSL top-up tax – similar to Brazil's QDMTT implementation through Law 15,079/2024 – would not provide effective means of avoiding Article 43 availability requirements.

The inclusion of paragraph 2 in Article 43 of the National Tax Code through Complementary Law 104/2001 did not resolve availability questions, as this provision appears to delegate ordinary law authority to establish availability "conditions and timing" rather than eliminating availability requirements entirely[50]. The provision maintains income availability as a fundamental prerequisite while providing legislative flexibility in determining when and how availability occurs. This interpretation suggests that IIR implementation could face challenges based on taxation of unavailable income under current National Tax Code provisions, since IIR provides for the taxation of income over which Brazilian entities lack free disposal power. Therefore, GloBE categorical approach, which applies predetermined criteria regardless of actual availability circumstances, may be understood as contrary to the legal mandate of Article 14 of the National Tax Code.

49 The CSL (Social Contribution on Profits) is a Brazilian tax on profits that is considered covered by the Double Taxation Conventions according to Article 2.

50 ANDRADE, Leonardo Aguirra de. As regras recomendadas pelo Pillar Two e a sua relação com o ordenamento jurídico brasileiro. *Revista Direito Tributário Internacional Atual* v. 12, ano 6. São Paulo: IBDT, 2º semestre 2023, p. 195.

To implement expanded IIR framework while minimizing litigation risks, the amendment of Article 43 of the National Tax Code through complementary law enactment may represent the most advisable approach. The modification could amend paragraph 2 of Article's 43 to establish that, for foreign-source income, IRPJ tax events occur, under terms defined by ordinary law, upon patrimony increases, regardless of availability. This formulation would provide clear legislative authorization for IIR implementation while limiting the exception to foreign-source income.

However, part of Brazilian doctrine considers income availability requirements implicit in constitutional income tax provisions, meaning that National Tax Code modifications might face constitutional challenges[51]. Some scholars argue that availability requirements derive directly from constitutional income tax definitions rather than merely complementary law provisions, creating potential obstacles to legislative modification efforts.

Despite these theoretical challenges, the risk of Supreme Federal Court determination that OECD Pillar Two recommendations violate Brazilian constitutional provisions remains low for previously discussed political reasons. Nevertheless, constitutional amendment proposals should not be discarded as preventive measures to ensure maximum legal certainty and prevent litigation.

5.2. Implementation Framework and Revenue Compensation

From formal implementation perspectives, consolidating Pillar Two norms represents the recommended approach. Implementing IIR through modification of Law 15,079/2024, which introduced Brazil's QDMTT, would create unified legislative framework for all Pillar Two measures while capitalizing on shared conceptual foundations. Both IIR and QDMTT operate through similar computational mechanisms and address comparable policy objectives, making legislative consolidation both practical and theoretically sound.

Law 15,079/2024 already establishes foundational frameworks for minimum taxation concepts, standardized calculation methodologies, and international coordination mechanisms that would support expanded IIR implementation. Building upon existing QDMTT infrastructure would reduce implementation costs while ensuring consistency between different Pillar Two components.

Legislative consolidation would also facilitate future modifications as international Pillar Two frameworks evolve. Maintaining unified legislation for all Pillar Two measures would ensure consistent interpretation and application while

[51] ANDRADE, Leonardo Aguirra de. As regras recomendadas pelo Pillar Two e a sua relação com o ordenamento jurídico brasileiro. *Revista Direito Tributário Internacional Atual* v. 12, ano 6. São Paulo: IBDT, 2º semestre 2023, p. 191.

simplifying compliance requirements for affected enterprises. This approach reflects best practices in international tax coordination, where jurisdictions increasingly adopt comprehensive frameworks rather than piecemeal measures.

In particular, the fact that the expanded IIR encompasses features that extend beyond the Pillar Two Blueprint, as proposed in Section IV, should not lead to the adoption of separate legislation, as if the tax consequences arising from the lower threshold and the application of domestic rates to passive income derived from parallel CFC rules. Although such features exceed the standard GloBE rules, they share the same underlying concepts and legal frameworks. The advantages of decluttering stem precisely from maintaining a single regime for the taxation of foreign controlled entities.

The substitution of worldwide taxation with expanded IIR framework would likely generate revenue losses, as the proposed system targets specific base erosion situations rather than comprehensive foreign income taxation. While optimal tax rule design should focus on fundamental tax principles, such as equality and neutrality, rather than revenue objectives – which should be calibrated through rate adjustments – the fiscal impact on public accounts cannot be disregarded.

Revenue compensation should focus on taxpayers currently subject to excessively low effective tax rates. Although combined IRPJ and CSL nominal rates in Brazil typically reach 34%, numerous tax benefits and favorable treatments enable various taxpayers to achieve ETRs below 15%. Brazil's QDMTT application should provide precise identification of such taxpayers, as the additional CSL applies specifically to enterprises with effective rates below the 15% threshold. Thus, the implementation of expanded IIR replacing worldwide taxation should include programmatic provisions requiring revenue shortfall compensation through review of tax treatments that trigger QDMTT.

Since QDMTT applies only to multinational enterprises above GloBE thresholds, reviewing tax benefits that generate additional CSL liability should produce greater revenue than the top-up tax itself. This revenue differential suggests that comprehensive benefit review could compensate for worldwide taxation abandonment while improving overall tax system efficiency.

Conclusion

This analysis demonstrates that Brazil's current international tax regime suffers from fundamental design flaws that create systematic competitive disadvantages while failing to achieve satisfactory policy outcomes. The comprehensive worldwide taxation established through Law 12,973/2014 represents an anachronistic approach that isolates Brazil from international trends and imposes disproportionate costs on domestic enterprises competing in global markets. Economic theory converges toward the conclusion that unilateral maintenance of a worldwide taxation regime proves suboptimal from a national perspective, regardless of policies adopted by other countries.

This study reveals that, while economic theory clearly identifies superior alternatives to current source and residence-based systems, relying on destination-based taxation, path dependence and coordination problems appear to lock the international community into inefficient institutional arrangements. This reality necessitates pragmatic approaches that achieve meaningful improvements within current frameworks rather than pursuing theoretically superior but practically unachievable comprehensive reforms.

The functional convergence between Income Inclusion Rule and traditional controlled foreign company legislation reveals that the supposed compatibility between these systems reflects path dependence rather than rational tax policy. Despite OECD rhetoric emphasizing their distinct purposes, both mechanisms operate through identical basic principles: requiring parent entities to include in their tax base income earned by controlled entities abroad when subject to insufficient taxation. The evolution of the GloBE framework, particularly through substance-based carve-outs, has transformed the IIR into what is essentially an advanced CFC rule, making their coexistence a clear example of the institutional redundancy that contemporary decluttering efforts seek to eliminate.

The expanded IIR framework proposed here addresses the functional gaps that prevent standard Pillar Two implementation from completely replacing traditional CFC legislation. The model operates through two innovations that collectively provide comprehensive anti-avoidance coverage within a streamlined institutional framework. First, a dual-threshold architecture extends coverage beyond the EUR 750 million GloBE standard to capture smaller multinational enterprises that pose meaningful base erosion risks, while implementing carefully designed safe harbour provisions that reduce compliance burdens for genuinely low-risk enterprises.

Second, the proposal implements a tiered rate structure that differentiates treatment based on income characteristics. Income qualifying for GloBE substance-based carve-outs, reflecting genuine business activities with meaningful economic substance, receives formulaic protection based on returns on payroll and tangible assets. Excess returns from non-passive activities remain subject to the standard 15% effective tax rate threshold, maintaining international alignment while providing meaningful base protection. Most significantly, passive income faces full domestic IRPJ and CSL rates with a 15% ETR floor, preserving the comprehensive anti-avoidance protection that characterizes traditional CFC rules while operating within GloBE framework.

From a legal implementation perspective, the primary challenges involve compatibility with Article 43 of the National Tax Code, which establishes income availability as a fundamental requirement for taxation. While theoretical constitutional challenges exist, political considerations suggest low probability of Supreme Federal Court determination that OECD-recommended measures violate Brazilian constitutional provisions. Nevertheless, modification of Article 43 through complementary law represents the most advisable approach for minimizing litigation risks while providing legislative authorization for expanded IIR implementation.

The revenue implications of substituting worldwide taxation with the proposed framework require careful management through comprehensive review of tax benefits that enable taxpayers to achieve ETRs below 15%. Brazil's QDMTT application should provide precise identification of such tax benefits, creating opportunities for revenue compensation that simultaneously improves overall tax system efficiency. Since reviewing tax benefits affecting large MNEs should generate greater revenue than the top-up tax itself, a comprehensive tax benefit review could offset worldwide taxation abandonment while enhancing competitive neutrality.

Brazil's opportunity to implement a streamlined expanded IIR represents more than domestic policy optimization. It offers international leadership in demonstrating how countries can achieve tax system decluttering while maintaining robust base protection. By eliminating tax regimes redundancy, the proposed approach could serve as a model for pragmatic reform that captures theoretical insights within implementation realities.

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