

Public consultation document

Global Anti-Base Erosion Proposal (“GloBE”) - Pillar Two

8 November 2019 – 2 December 2019



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Global Anti-Base Erosion Proposal
(“GloBE”)
(Pillar Two)

Tax Challenges Arising from the Digitalisation of the Economy

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Background

In May 2019 the Inclusive Framework agreed a Programme of Work for Addressing the Tax Challenges of the Digitalisation of the Economy. The Programme of Work is divided into two pillars: Pillar One addresses the allocation of taxing rights between jurisdictions and considers various proposals for new profit allocation and nexus rules;

Pillar Two (also referred to as the “Global Anti-Base Erosion” or “GloBE” proposal) calls for the development of a co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.

The Secretariat has prepared a proposed “Unified Approach” under Pillar One that is based on the significant commonalities between the various profit allocation and nexus proposals. The Secretariat released a public consultation document on this unified approach on 9 October 2019.

This Consultation Document seeks comments on the Pillar Two proposals. While the consultation under Pillar One centres on the unified approach, this Consultation Document focusses on specific technical issues in respect of the GloBE proposal where input from stakeholders would be valuable in progressing the work.

Public Consultation Document

For purposes of this consultation, comments are welcome on all aspects of the Programme of Work on Pillar Two, but requested specifically on three technical design aspects of the GloBE proposal:

- a) the use of financial accounts as a starting point for determining the tax base under the GloBE proposal as well as different mechanisms to address timing differences;
- b) the extent to which an MNE can combine high-tax and low-tax income from different sources taking into account the relevant taxes on such income in determining the effective (blended) tax rate on such income; and
- c) stakeholders’ experience with, and views on, carve-outs and thresholds that may be considered as part of the GloBE proposal.

The comments provided will assist members of the Inclusive Framework in the development of a solution for its final report to the G20 in 2020. Some of the technical and design aspects of the GloBE proposal depend on policy choices to be agreed within the context of the Inclusive Framework. For example, the mechanics and operation of the undertaxed payment rule and the nature and scope of the subject to tax rule need to be further developed by the Inclusive Framework for a clearer outline of these rules to emerge, which could then benefit from further public consultation at a future point in time.

The proposals included in this consultation document have been prepared by the Secretariat, and do not represent the consensus views of the Inclusive Framework, the Committee on Fiscal Affairs (CFA) or their subsidiary bodies.

Interested parties are invited to send their comments no later than **Monday 2 December 2019**, 18:00 (CET), by e-mail to taxpublicconsultation@oecd.org in Word format (in order to facilitate their distribution to government officials). All comments should be addressed to the International Co-operation and Tax Administration Division, Centre for Tax Policy and Administration.

Please note that all comments on this public consultation document will be made publicly available. Comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective group, or the person(s) on whose behalf the commentator(s) are acting. Speakers and other participants at the upcoming public consultation meeting in Paris will be selected from among those providing timely written comments on this consultation document.

Public Consultation Meeting

The public consultation meeting on the developments under Pillar Two will be held on 9 December 2019, at the OECD Boulogne in Boulogne-Billancourt. The objective is to provide external stakeholders an opportunity to provide input on the ongoing work. Information on the public consultation meeting is available on the [OECD Website](#).

1. Introduction

1. In January 2019, the Inclusive Framework issued a Policy Note on Addressing the Tax Challenges of the Digitalisation of the Economy.¹ Under this Policy Note, the Inclusive Framework agreed, on a without prejudice basis, to undertake work on the following two pillars:

- Pillar One addresses the allocation of taxing rights between jurisdictions and describes proposals for new profit allocation and nexus rules based on the concepts of “significant economic presence” and the exploitation of “user participation” and “marketing intangibles” in a jurisdiction.
- Pillar Two (also referred to as the “GloBE” proposal) calls for the development of a co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.

2. The Inclusive Framework issued a Public Consultation Document on 13 February 2019, which sought input from external stakeholders on the specific proposals examined under Pillar One and Pillar Two.² The response was robust, with more than 200 written submissions running to over 2,000 pages.³ Stakeholders had the opportunity to attend in person and express their views at a public consultation held in Paris on 13 and 14 March 2019, which was attended by over 400 representatives from governments, business, civil society and academia.

3. Following this consultation, and in light of the public comments received, the Inclusive Framework agreed a Programme of Work⁴ at their meeting in Paris on 28-29 May 2019 based around the two pillars identified in the Policy Note.

1.1. Elements of Pillar Two

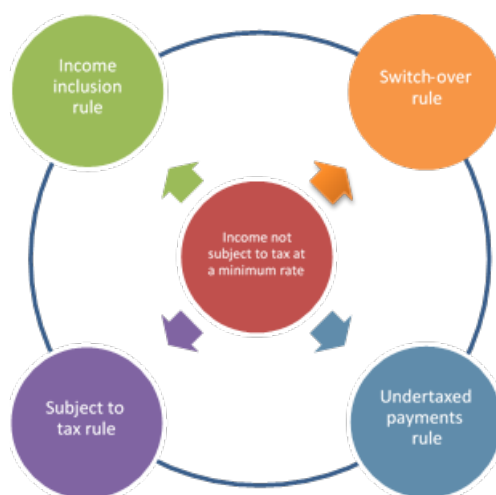
4. Under Pillar Two of the Programme of Work, members of the Inclusive Framework agreed to explore, on a without prejudice basis, issues and design options in connection with the development of a co-ordinated set of rules as illustrated in the diagram below.

¹ *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019, accessible through this [link](#).

² Public Consultation Document, *Addressing the Tax Challenges of the Digitalisation of the Economy*, 13 February – 6 March 2019, accessible through this [link](#).

³ All written submissions made to the Public Consultation Document are available at this [link](#).

⁴ *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, 28 May 2019, (PoW) accessible through this [link](#). The Programme of Work on Pillar Two is also set out in Annex B.



5. The four component parts of the GloBE proposal are:

- a) an **income inclusion rule** that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;
- b) an **undertaxed payments rule** that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at or above a minimum rate;
- c) a **switch-over rule** to be introduced into tax treaties that would permit a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to an effective rate below the minimum rate; and
- d) a **subject to tax rule** that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate.

6. These rules would be implemented by way of changes to domestic law and tax treaties and would incorporate a co-ordination or ordering rule to avoid the risk of double taxation that might otherwise arise where more than one jurisdiction sought to apply these rules to the same structure or arrangement.

7. Like Pillar One, the GloBE proposal under Pillar Two represents a substantial change to the international tax architecture. This Pillar seeks to comprehensively address remaining BEPS challenges by ensuring that the profits of internationally operating businesses are subject to a minimum rate of tax.⁵ A minimum tax rate on all income reduces the incentive for taxpayers to engage in profit shifting⁶ and establishes a floor for tax competition among jurisdictions.⁷ In doing so, the GloBE proposal is intended to address the remaining BEPS challenges linked to the digitalisation of the economy, but it goes even further and addresses these challenges more broadly.⁸ The GloBE proposal is expected to affect the behaviour of taxpayers and jurisdictions.⁹ It posits that global action is needed to stop a harmful race to the bottom on corporate taxes, which risks shifting the burden of taxes onto less mobile bases and may pose a particular risk for developing countries with small economies.¹⁰

⁵ PoW, ¶¶ 52 and 55.

⁶ PoW, ¶ 60; Public Consultation Document, ¶ 99

⁷ PoW, ¶ 62.

⁸ PoW, ¶¶ 52, 53, and 55; Public Consultation Document, ¶¶ 91.

⁹ PoW, ¶ 58;

¹⁰ PoW, ¶ 54.

8. Depending on its design, the GloBE proposal may shield developing countries from pressure to offer inefficient tax incentives.¹¹ The GloBE proposal is based on the premise that, in the absence of a coordinated and multilateral solution, there is a risk of uncoordinated, unilateral action, both to attract more tax base and to protect existing tax base, with adverse consequences for all jurisdictions.¹² The GloBE proposal should be designed to achieve these objectives consistent with principles of design simplicity that will minimise compliance and administration costs and the risk of double taxation.¹³ To that end, the Programme of Work calls for the consideration of simplifications, thresholds, carve-outs, and exclusions from the rules.¹⁴

1.2. Ongoing work and further consultation

9. The Programme of Work for Pillar Two specifies that the GloBE proposal will operate as a top-up to an agreed fixed rate. The actual rate of tax to be applied under the GloBE proposal will be discussed once other key design elements of the proposal are fully developed. The Programme of Work further sets out the key design issues that need to be addressed in the context of the GloBE proposal, including the determination of the tax base, the extent to which the rules will permit blending of low- and high-tax income and questions as to the need for (and design of) carve-outs and thresholds.

10. The Programme of Work also directs the Inclusive Framework to consider issues around rule coordination as well as the interaction of the GloBE proposal with other international and domestic tax rules in order to ensure that the proposal avoids the risk of double taxation, minimises compliance and administration costs, and that the rules are targeted and proportionate. Progress has been made in relation to these issues, with Inclusive Framework members actively engaged and identifying design solutions to address these challenges.

11. Some of the technical and design aspects of the GloBE proposal depend on policy choices to be agreed within the context of the Inclusive Framework. For example, the mechanics and operation of the undertaxed payment rule and the nature and scope of the subject to tax rule need to be further developed by the Inclusive Framework for a clearer outline of these rules to emerge, which could then benefit from further public consultation at a future point in time. For purposes of this consultation, comments are welcome on all aspects of the Programme of Work on Pillar Two (see Annex B), but requested specifically on three technical design aspects of the GloBE proposal:

- a) the use of financial accounts as a starting point for the tax base determination, as well as different mechanisms to address timing differences;
- b) the level of blending under the GloBE proposal, that is the extent to which an MNE can combine high-tax and low-tax income from different sources taking into account the relevant taxes on such income in determining the effective (blended) tax rate on such income; and
- c) experience with, and views on, carve-outs and thresholds considered as part of the GloBE proposal.

12. The remainder of this document is divided into the following sections:

- a) Section 2 considers the implications of using financial accounts as a possible simplification to determining the tax base and approaches to neutralising differences in financial accounts and taxable income;

¹¹ PoW, ¶ 54.

¹² PoW, ¶ 54.

¹³ PoW, ¶ 57, 70, and 78; PoW sections 2.1.3 and 4.1.2.

¹⁴ Id.

- b) Section 3 considers the issue of blending;
- c) Section 4 discusses carve-outs and thresholds; and
- d) This document also includes two Annexes. Annex A sets out a number of simplified examples illustrating the approaches for addressing temporary differences in the measurement of tax and accounting income. Annex B contains the Programme of Work on Pillar Two.

2. Tax base determination

2.1. Importance of a consistent tax base

13. The Programme of Work starts from the proposition that, in principle, the tax base would be determined by reference to the CFC rules or, in the absence of CFC rules, the domestic CIT rules of the shareholder's jurisdiction. Such an approach means, however, that each subsidiary of an MNE would need to recalculate its income each year in accordance with the tax base calculations in the parent jurisdiction. This is typically not the case with CFC rules which commonly have substance-based exclusions and may be limited to certain narrow types of passive income.

14. The requirement to recalculate the income of each subsidiary in line with the tax-base in the parent jurisdiction may result in significant compliance costs. It could also lead to situations where technical and structural differences between the calculation of the tax base in the parent and subsidiary jurisdiction result in an otherwise highly-taxed subsidiary being treated as having a low effective rate of tax for reasons unrelated to the policy underlying the GloBE proposal. For example, differences between jurisdictions in the calculation of the tax base, including timing differences such as the treatment of carry-forward losses and the recognition of income and expenses, could impact on the calculation of the effective rate of tax in different jurisdictions. Such differences in the design of different jurisdictions' tax bases would result in the application of the rule in cases that might not give rise to the policy concerns that are intended to be addressed by the GloBE proposal and could undermine the need to ensure transparent outcomes under Pillar Two. For example, two jurisdictions may apply the same minimum tax rate to the income of a subsidiary under the income inclusion rule. However if one jurisdiction has a very different tax base from the other, this could result in significantly different outcomes under Pillar Two, undermining the policy intent of creating a level playing field already reflected, for instance, in the agreement to pursue one common fixed percentage rate across jurisdictions. Equally, it may significantly increase compliance and administration burdens of an undertaxed payments rule if each entity making a payment were required to re-compute the recipient's income according to the rules for computing taxable income in the paying entity's tax jurisdiction.

2.2. Use of financial accounts to determine income

15. In order to improve compliance and administrability and to neutralise the impact of structural differences in the calculation of the tax base, the Programme of Work calls for the exploration of simplifications to help address these issues.

16. One simplification identified in the Programme of Work would be to start with relevant financial accounting rules subject to any agreed adjustments as necessary. The income calculated for accounting purposes would then be subject to agreed adjustments in order to align accounting income with a proper measure of taxable income. The income so determined would be used in the denominator of the effective tax rate fraction. Then, the numerator of the effective tax rate fraction could be based on the actual tax

liability or the tax expense accrued for accounting purposes, which may need to be further adjusted to remove accruals of tax related to a different period.

17. If financial accounting is to be used as a starting point for determining a common tax base under the GloBE proposal, consideration must be given to the choice of accounting standard to be applied by any particular MNE subject to the GloBE proposal. The first choice that must be made is between the accounting standard that is applicable to, or used by, the parent entity or the standard applicable to, or used by, the subsidiary in connection with its local reporting obligations. The next determination is which financial accounting standards will be acceptable for purposes of the GloBE proposal.

18. The simplest financial accounting standard for an MNE to use is one that it already used for other purposes. However, the various entities owned by an MNE may employ different accounting standards for different purposes, especially if they are organised or operate in different jurisdictions. For example, if an ultimate parent entity is organised in country X and owns a subsidiary in country Y that in turn owns a subsidiary in country Z, each of those entities may employ a different accounting standard for use in its own jurisdiction. Furthermore, the ultimate parent entity may apply International Financial Reporting Standards (IFRS) in its consolidated financial statements.

19. MNE groups that prepare consolidated financial statements compute the income of their subsidiaries using the financial accounting standard applicable to the ultimate parent entity of the group as part of the consolidation process. Thus, a subsidiary's income may be computed under the financial accounting standard applicable in its own jurisdiction (hereinafter local GAAP) and the standard used by the ultimate parent entity.

20. Computing the tax base using the local GAAP of the subsidiaries presents a number of challenges for tax administrations and runs counter to some of the GloBE policies. It may be difficult for a tax administration to audit the income of subsidiaries that use a different accounting standard than is required in the parent jurisdiction because the auditors may be unfamiliar with some or all of the accounting standards applied by the various subsidiaries. Obviously, the application of different standards to different subsidiaries could produce different results for otherwise similarly situated enterprises. More significantly, however, the use of different accounting standards creates the possibility of distortions arising from transactions between subsidiaries. In addition, it may significantly increase compliance and administration burdens of an undertaxed payments rule if each entity making a payment were required to re-compute the recipient's income according to its financial accounting standards.

21. Computing the tax base using the accounting standard used by the ultimate parent entity to prepare its consolidated financial accounts would address the issues described above. A single accounting standard applied to all subsidiaries would be more transparent and ensure that differences between subsidiary accounting standards do not produce distortions. In addition, compliance costs can be limited by requiring use of the accounting standard used by the ultimate parent entity to prepare its consolidated financial statements.

22. To serve as a starting point for determining the GloBE tax base, however, the ultimate parent entity's financial accounts need to be prepared under an acceptable set of financial accounting standards or generally accepted accounting principles (GAAP). IFRS are required for listed companies in many jurisdictions around the world and are accepted for listed companies in some jurisdictions that do not otherwise require IFRS. Similarly, a number of local GAAP accounting standards, such as United States GAAP and Japanese GAAP, are also accepted by securities regulators in jurisdictions that require a different accounting standard for domestic companies.

23. MNEs that are not listed may have no legal obligation to prepare consolidated financial statements under any financial accounting standard. It will be necessary to consider the range of available approaches to address the position of such MNEs. Furthermore, allowing the use of various financial accounting standards under the GloBE proposal may lead to different results when the ultimate parent entities of

different MNE groups are resident in different jurisdictions. Most of the differences among the accounting standards will be timing differences because financial accounting takes into account all income and expense of an enterprise. Some of the differences, however, may be permanent differences that require further consideration, and some of the timing differences may be so significant that they warrant the same consideration as permanent differences.

1. Questions for consultation

- a) Do you agree that the use of financial accounts as a starting point can provide an appropriate income base (for the computation of an effective tax rate) and would simplify and reduce the compliance costs of the GloBE proposal?
- b) What would be the consequences of using the accounting standards applicable to the ultimate parent entity of the MNE? Would you suggest a different approach?
- c) How would you recommend determining whether a financial accounting standard is an appropriate standard for determining the tax base under the GloBE proposal?
- d) Do you have concerns that allowing more than one financial accounting standard to serve as the starting point for determining the tax base under the GloBE proposal will place some MNEs at a competitive advantage due to variations in financial accounting standards among jurisdictions?
- e) There may be some instances where MNEs, particularly smaller MNEs, do not prepare consolidated financial statements for any purpose. How much of an issue do you think this is and for what types of MNEs? Where this is the case, how would you suggest the issue should be addressed?
- f) Are there additional or different considerations that apply to the tax base determination for purposes of an undertaxed payments rule?

2.3. Adjustments

24. The most straightforward approach to determining the net amount of low-taxed profits would be to take income and expense figures directly from an entity's financial statements without adjustment. This would be the simplest approach to apply and in many cases may provide a net income figure that is in line with taxable income of the subsidiary under local law. However, relying on the unadjusted figures in the accounts could mean that an entity's net profits for accounting purposes may be overstated or understated when compared to the amount reported for tax purposes.

25. The accounting profit reflected in an entity's financial statements could be adjusted to take account certain permanent and temporary differences between the income computed under financial accounting standards and under the income tax rules.

2.3.1. Permanent differences

26. Permanent differences are differences in the annual income computation under financial accounting and tax rules that will not reverse in the future. The distinction between permanent and temporary differences can be illustrated as follows: financial accounting standards may treat the change in market value of an asset as giving rise to income or loss in a particular accounting period. If the gain or loss on that asset will be subject to tax on disposal under the laws of the local jurisdiction, then the change in market value from one accounting period to the next will give rise to a temporary difference that will be brought back into alignment, or "reverse" in financial accounting parlance, once the asset has been sold.

If, however, the asset is not subject to tax on disposal then the recognition of income or loss in each year under financial accounting standards will give rise to a permanent difference.

27. Financial accounts include all income and expense. Thus, in the design of the GloBE tax base, adjustments for permanent differences will involve exclusion of categories of income or expense from the financial accounts. Excluding categories of income will narrow the tax base and excluding categories of expense will expand the tax base.

28. Permanent differences arise for a variety of reasons. For example, dividends received from foreign corporations and gains on the sale of corporate stock may be excluded from taxable income to eliminate potential double taxation. The need to adjust the tax base for dividends may depend, in part, upon the level of blending ultimately adopted in the GloBE proposal. Under a worldwide blending approach, the consolidated financial accounts should eliminate dividends and stock gains in respect of entities of the consolidated group without additional intervention. Under a jurisdictional or entity blending approach, however, the financial accounts of group entities in different jurisdictions would be prepared on a separate company basis and dividends received from a “separate” corporation ordinarily would be included in the shareholder’s financial accounting income.

29. Another permanent difference arises from the difference between the treatment of corporate acquisitions under financial accounting and tax rules. In a stock sale, the carrying cost of the acquired corporation’s assets may not change for tax purposes but ordinarily will be adjusted, upwards or downwards, to fair value under the accounting standards. Any disparity in the carrying cost of assets will produce permanent differences in the acquired corporation’s income, unless an adjustment is made.

30. Permanent differences also arise, when for domestic policy reasons, the taxable income base excludes certain types of income or disallows certain deductions. Examples include income exclusions for interest on government debt and government grants and disallowance of deductions for entertainment expenses, bribes, and fines.

2. Questions for consultation

- a) What are the material permanent differences between financial accounting income and taxable income that are common across jurisdictions and that you think should be removed from the tax base without undermining the policy intent of the GloBE proposal?
- b) Do you have views on the methods that could be used for dealing with permanent differences?
- c) Do you have any comments on the practicality of making adjustments for permanent differences?
- d) Do you think any other adjustments to the financial accounts require attention?

2.3.2. Temporary differences

31. Temporary differences are differences in the time for taking into account income and expense that are expected to reverse in the future. Temporary differences are not differences in the types of income or expense allowed in the calculation of net income; instead, they are differences in the proper time for including items of income and expense in the calculation of net income. Assuming no changes to local tax law, these temporary differences will not affect the total amount of local taxes the entity will be required to pay over its lifetime. Examples of temporary differences include differences in depreciation methods, deductions for reserves, the allowance of loss carry-forwards, and the treatment of instalment sales. Temporary differences can also arise with respect to deferred tax liabilities such as in the case of taxes on the distribution of profits.

32. Temporary differences can be the sole cause of a low cash effective tax rate at the beginning of the temporary difference and a high cash effective tax rate upon reversal (or vice versa) when the tax liability in the effective tax rate computation is based on the tax liability as shown in the tax returns for the relevant year. Separate from the approaches specifically designed to address the potential for volatility in the effective tax rate of a group entity from one period to the next further discussed below, it is noted that in the absence of such mechanisms the choice of blending (see Section 3 below) may also have an important practical impact on this issue.

Approaches to addressing temporary differences

33. Three basic approaches to addressing the problem of temporary differences – (i) carry-forward of excess taxes and tax attributes, (ii) deferred tax accounting and (iii) a multi-year average effective tax rate – are described below. These basic approaches could be tailored and elements of the different approaches could be combined to better or more efficiently address specific problems.

(i) Carry-forward of excess taxes and tax attributes

34. The effects of temporary differences can be addressed with three rules that allow for the carry-forward of excess taxes and tax attributes. Under the first rule, taxes paid by a subsidiary to a jurisdiction in excess of the minimum tax rate in a year would be carried forward and treated as tax paid in a subsequent year in which the local tax paid by the subsidiary falls below the minimum tax rate. The second rule applies in the opposite situation and would allow the tax paid by a parent corporation under the income inclusion rule with respect to a subsidiary's income to be refunded or credited against another tax liability of the parent corporation when local tax paid by the subsidiary is in excess of the minimum tax rate. Under the third rule, operating losses of a subsidiary corporation would be carried forward and used to reduce the financial accounting income of the subsidiary. All three carry-forwards would be tracked through memorandum accounts maintained by the parent corporation.

35. The loss carry-forward rule would operate similar to a tax loss carry-forward, except that the loss carry-forward would be determined by reference to the net loss determined under financial accounting. Like a loss carry-forward under tax rules, the loss carry-forward rule would prevent taxation under the GloBE proposal in excess of economic income.

36. The carry-forward for excess tax paid in the subsidiary jurisdiction would generally apply in cases where the temporary difference is due to accelerated taxable income or deferred tax expenses in the subsidiary's jurisdiction. These differences will result in the subsidiary's taxable income exceeding financial income in earlier periods which may cause the tax paid in the subsidiary jurisdiction to exceed the minimum tax rate under the income inclusion rule. When the temporary difference reverses in a subsequent year, the subsidiary's taxable income will be lower than its financial income which may cause the tax paid in that period to be lower than the minimum tax rate potentially triggering a tax charge under the income inclusion rule. By allowing taxes paid to the subsidiary jurisdiction in excess of the minimum tax rate in earlier years to be carried forward and treated as tax expense in a subsequent year, the rule would smooth-out book / tax differences in the timing in the recognition of income and expense. Operation of this rule is illustrated by Example 1 in Annex A.

37. Depending on the circumstances, the excess taxes available as a carry-forward could exceed the amount of tax necessary to eliminate only the temporary difference, leaving some of the carry-forward available to eliminate permanent differences. However, the carry-forward could be adjusted so that it only remedies temporary differences. This could be done by determining the amount of the carry-forward based on the minimum tax applicable to the accelerated taxable income, and then allowing the carry-forward to be used only in the year in which the temporary difference reverses.

38. The carry-forward for income inclusion rule tax paid would generally apply in the opposite situation, that is, in the case of temporary differences that arise from deferred taxable income and accelerated tax expenses. These differences will result in the subsidiary's financial income exceeding taxable income in earlier periods which may cause the tax paid in the subsidiary jurisdiction to be lower than the minimum tax rate potentially triggering tax liability under the income inclusion rule. When the temporary difference reverses in a subsequent year, the subsidiary's taxable income will exceed its financial income which may cause the tax paid to the subsidiary jurisdiction to exceed the minimum tax rate in that year. By allowing a refund or credit of the tax paid under the income inclusion rule when and to the extent that the temporary difference results in tax paid to the subsidiary jurisdiction in excess of the minimum tax rate, the carry-forward prevents the income inclusion rule from imposing tax in excess of the minimum tax rate. This carry-forward would need to be coordinated with the carry-forward of excess taxes to prevent double-counting. In other words, to the extent income inclusion rule taxes are creditable or refundable in respect of excess local tax paid in a year, those excess local taxes should not also be creditable against future liability under the income inclusion rule. The operation of this carry-forward is illustrated in Example 2 of Annex A.

39. Like the carry-forward for excess taxes paid, this carry-forward does not automatically distinguish between temporary and permanent differences. However, it could be designed so that a carry-forward is created only when a temporary difference arises and the carry-forward is available as a credit after a temporary difference reverses.

(ii) Deferred tax accounting

40. Another approach to addressing the effects of temporary differences on the effective tax rate is through the use of deferred tax accounting rules under the financial accounting standard used to compute the GloBE tax base.

41. In simple terms, deferred tax accounting determines the tax expense for the period based on the financial income for the period, irrespective of the tax due with respect to that period.

- When the actual tax due is less than the tax expense on the financial income (because taxable income is deferred), deferred tax accounting accrues the full tax expense and creates a deferred tax liability that is extinguished later when the tax on the tax deferred income becomes due to the tax authority.
- When the actual tax due exceeds the tax expense on the financial income (because the taxable income is accelerated), deferred tax accounting excludes the additional tax paid with respect to the accelerated income from the tax expense and creates a deferred tax asset that is eliminated when the financial tax expense arises.

42. In this way, deferred tax accounting could eliminate swings in the effective tax rate calculation caused by temporary differences. Importantly, taxpayers preparing financial statements under IFRS and other commonly used financial accounting standards already apply deferred tax accounting as part of their financial reporting process. Examples 3-5 in Annex A illustrate the operation of deferred tax accounting.

43. One advantage of using deferred tax accounting to address temporary differences is that deferred tax assets and liabilities attributable to temporary differences are computed on a taxpaying entity-by-taxpaying entity basis and can generally only be netted in determining the tax expense of the same taxpaying entity. This feature of deferred tax accounting means that large MNEs that prepare financial statements pursuant to IFRS and other commonly used financial accounting standards are already computing financial income and tax expense on an entity-by-entity basis for accounting purposes. Consequently, computing the effective tax rate based on deferred tax accounting reduces the additional compliance burden on those MNEs.

(iii) Multi-year averaging

44. The GloBE proposal could address volatility caused by the periodic differences between the GloBE tax base and the tax base in the subsidiary jurisdictions by computing the annual effective tax rate based on the total taxes paid and total income of the relevant subsidiaries over a multi-year period that includes the current year and a specified number of preceding years. A multi-year averaging approach would not necessarily require the development of separate rules for the carry forward of losses, excess taxes and other tax attributes, and therefore has the benefit of simplicity.

(iv) Factors to consider

45. There are a number of compliance, administration, and tax policy considerations that would need to be considered in the design of the rules for addressing temporary differences under the GloBE proposal. Some challenges are applicable to all the approaches and some are specific to one or two of the approaches.

46. One consideration is the extent to which an approach is confined to addressing temporary differences. Unless further mechanisms are introduced to limit the credit carry-forward, the carry-forward approach would allow the taxpayer to shelter both temporary and permanent differences in the determination of the tax base. Similarly, without some limitation mechanism, the multi-year average effective tax rate computation would also average the tax effects of permanent and temporary differences. Such limitations may, however, be complicated to apply and administer. Deferred tax accounting on the other hand is more targeted to addressing only temporary differences.

47. Consideration will need to be given to placing time limitations on all three approaches. A multi-year average effective tax rate computation would require agreement on the averaging period, recognizing that it would not address temporary differences that extend beyond the averaging period. Similarly, the carry-forward approach would also need to consider a limitation on the time period that excess taxes or losses could be carried forward. In addition, there may be excessively long deferral periods associated with some deferred tax liabilities or assets created under financial accounting that may not be appropriate for the GloBE proposal. For example, if a tax deduction is allowed with respect to a purchased intangible asset that is not amortizable under financial accounting (such as a brand name) the deferred tax liability that arises at the time of the tax deduction may not reverse until the business is sold or liquidated.

48. Changes to the tax rate in a subsidiary jurisdiction creates challenges under both the carry-forward approach and deferred tax accounting. The carry-forward approach would need to consider the extent to which excess tax paid in previous years under a higher tax rate should be eligible to be carried forward and credited against future income taxed at a lower rate. Deferred tax accounting may give rise to volatility when a jurisdiction changes its tax rate because adjustments to the deferred tax assets and liabilities are made when the tax rate changes and are not matched with the relevant income.

49. All three approaches described above entail some degree of recordkeeping burden. Under a carry-forward approach, taxpayers would need to maintain memorandum accounts that track the amount of the excess taxes and losses that are available for carry-forward, and tax administrations would need to be able to verify those memorandum accounts. Taxpayers would need to maintain similar records supporting their computations under a multi-year average. Deferred tax accounting may impose, little additional recordkeeping burdens on taxpayers, except where for instance, they would be adjusted to conform with the policy objectives of the GloBE proposal (see below paragraph 51).

50. Further consideration would also need to be given to whether (and to what extent) credits should be eligible to be carried forward when there is a change in ownership of the subsidiary. Similarly, an averaging approach would also require special transition rules to deal with acquisitions and dispositions of subsidiaries and to address the particular year in which taxpayers first become subject to the GloBE proposal.

51. Deferred tax accounting has some specific challenges that would need to be considered in the context of the GloBE proposal. Unlike the tax liability reflected in the income tax returns, the financial accounting tax expense is based, in part, on expected future tax liability, and thus involves judgment on the part of the company preparing the financial statements. Deferred tax accounting may not deal adequately with loss situations in respect of low-tax jurisdictions. For example, the deferred tax asset arising from an operating loss may be less than the minimum tax rate, potentially exposing the MNE to tax under the income inclusion rule when there is no underlying economic income.

52. Finally, a multi-year average effective tax rate computation may also complicate the process of dealing with errors and subsequent adjustments.

3. Questions for consultation

- a) Do you have any comments on the use of carry-forward of losses and excess tax as a mechanism for addressing temporary differences under the GloBE proposal?
- b) Do you have any comments on the use of deferred tax accounting as a mechanism for addressing temporary differences under the GloBE proposal?
- c) Do you have any comments on the use of a multi-year approach to measure the average effective tax rate as a mechanism for addressing temporary differences under the GloBE proposal?
- d) Do you have any comments on what limitations (if any) should be imposed on the normal financial accounting rules for deferred tax assets and liabilities and the practicalities of imposing those limitations?
- e) Do you see opportunities for potential abuse in any of the approaches for addressing temporary differences described above? Do you have suggestions for designs to prevent those abuses?
- f) Do you have any suggestions for alternative mechanisms for dealing with temporary differences?
- g) Do you have any additional comments on Section 2, including comments based on experiences with existing regimes that you suggest should be adopted or avoided?

3. Blending

53. Because the GloBE proposal is based on an effective tax rate (“ETR”) test it must include rules that stipulate the extent to which the taxpayer can mix low-tax and high-tax income within the same entity or across different entities within the same group. The Programme of Work refers to this mixing of income from different sources as “blending”.

54. Blending can be done on a narrow or broad basis, from a complete prohibition on blending to full blending of all foreign income. A broad approach to blending that allows an MNE to mix income and tax across different entities and jurisdictions will generally have the effect of reducing an MNE’s potential tax liability under the GloBE proposal. The ability to blend low- and high-tax income across a wide range of entities and jurisdictions will allow the MNE to avoid a charge to tax even though a certain portion of that total income may be subject to tax at a low rate. However, a global blending approach may sometimes also create adverse effects from a taxpayer’s perspective where such an approach leads to an inclusion of all income irrespective of whether it is subject to high or low tax abroad where it may be subject to further adjustments at the level of the parent that are made for domestic tax purposes such as the offset of domestic tax reliefs or expense allocation rules that limit entitlement to foreign tax credits.

55. The Programme of Work calls for the exploration of different blending options ranging from blending at the entity level to blending at global group level with a particular focus on blending at the jurisdictional and global level.

- a) A worldwide blending approach would require the MNE to aggregate its total foreign income and the total foreign tax on that income. An MNE would be subject to tax under the GloBE proposal where the tax on the total foreign income was below the minimum rate. The MNE’s liability for additional tax under the GloBE proposal would be the amount necessary to bring the total amount of tax on that foreign income up to the minimum rate.
- b) A jurisdictional blending approach would require the MNE to apportion its foreign income between different taxing jurisdictions. An MNE would be subject to tax where the tax on the income apportioned to that jurisdiction was below the minimum rate. The MNE’s liability for additional tax under the GloBE proposal would be the aggregate or sum of the amounts necessary in each jurisdiction to bring the total amount of tax on the income in the jurisdiction up to the minimum rate. One model of such an approach would aggregate the income and tax paid by all the members of the MNE group that were tax resident in the same jurisdiction (together with income of, and tax paid by, any branch established in that jurisdiction) in order to calculate the total income arising in that jurisdiction and the taxes on that income. An MNE would be subject to a top-up tax in respect of the income allocated to each jurisdiction where the tax paid on that income was below the minimum rate.
- c) An entity blending approach would require the MNE to determine the income and taxes of each entity in the group (as well as the income of domestic entities that was attributable to a foreign branch). An MNE would be subject to tax under the GloBE proposal where the effective tax rate of a foreign entity (or foreign branch) was below the minimum rate.

56. Entity, jurisdictional and worldwide blending represent different policy choices. While each can be said to meet the policy objective of ensuring that all internationally operating businesses pay a minimum

level of tax on their foreign income, the jurisdictional and entity approaches are more granular. Under a worldwide blending approach an MNE would be required to pay an average minimum rate of tax on all its foreign income whereas under an entity approach an MNE will pay tax at or above the minimum rate with respect to each group entity. Finally, under a jurisdictional approach the MNE pays tax at or above the minimum rate in each foreign jurisdiction where it operates. Whilst global blending may potentially result in lower overall compliance costs (depending on the final design of the rule) the difference in policy objectives will make this approach less effective in creating a floor for tax competition.

57. All three different approaches to blending raise different challenges, as further explained below. Each approach may also present its own unique challenges. For instance, an entity blending approach may need to consider how to deal with the effect of tax grouping or consolidation regimes that apply to the subsidiary under local law. For example a group entity may be a member of a local tax group which allows the entity to take advantage of tax reliefs generated through the operations of other group members. In this case the entity's actual tax liability in a period will not reflect the amount of tax that would otherwise have been payable on that entity's income if that entity had been subject to tax on a standalone basis.

58. One way of addressing this issue would be to permit blending by entities that were members of a group that is consolidated or to the extent one entity takes advantage of group tax relief for local tax purposes (a local group). This local group blending would allow the income and tax expense of certain group entities to be aggregated to the extent the local tax consolidation or grouping rules permitted the blending of such items.

59. The key issues with local group blending that would need to be addressed include: determining the extent to which the rules of the foreign tax system allowed the relevant income items to be blended or tax liabilities to be shared (e.g. losses); how the mechanisms used in a tax consolidation or grouping regime reconcile with the use of the financial accounts for measuring the tax base under the Globe Proposal and the extent to which this approach creates incentives for tax planning or otherwise unnecessary group restructuring.

4. Questions for Consultation

- a) How would you assess the general compliance costs and economic effects of a GloBE proposal that is based on either an entity, jurisdictional or worldwide blending approach?

3.1. Effect of blending on volatility

60. As set out in Section 2 above, temporary differences can give rise to volatility in effective tax rates attributable to temporary differences. The ability to blend the income and tax expense of subsidiaries in the effective tax rate computation may mitigate some of that volatility. For example, if one subsidiary incurs a loss that offsets the income of another subsidiary, blending the income and tax expense of those entities in the effective tax rate computation essentially takes into account the loss currently in the effective tax rate computation without the need for a carry-forward. Other temporary differences may similarly offset among entities whose income and tax expense are blended. A worldwide approach to blending provides more opportunities for temporary differences arising in different entities to offset each other in the same period, which depending on the circumstances and the particular design may have beneficial or sometimes adverse effects for a taxpayer.

61. A worldwide blending approach does not however directly address temporary differences or volatility year-on-year, rather it simply allows the MNE to smooth over some of the volatility resulting from these timing differences by allowing the offset of profits and losses and allowing surplus tax arising in a high-tax jurisdiction in one reporting period to be credited against low-tax income arising in another jurisdiction in the same period but not in future periods. The ability of the worldwide blending approach to

manage volatility will depend both on the size of the group and the nature of its operations. The worldwide blending approach will tend to provide more benefits to larger MNEs with significant and diversified operations across a number of low- and high-tax environments.

5. Questions for consultation

- a) In the absence of any of the approaches for addressing temporary differences discussed in Section 2, do you consider that a worldwide approach would be effective at managing the volatility issues discussed above?

3.2. Use of consolidated financial accounting information

62. Section 2 of this Public Consultation document discusses some of the implications of using the MNE's financial accounts as the starting point for calculating the tax base under the GloBE proposal and adjusting them as necessary. One option considered in that Section would be to determine the group's earnings by reference to the consolidated financial statement prepared under the relevant accounting standards used at the ultimate parent entity level. A global blending approach would then require the income to be separated between the MNE's domestic and foreign operations, whereas a jurisdictional or entity blending approach would require this income to be further broken down to ultimately show a jurisdictional or entity level view. This could require the MNE to have or prepare un-consolidated financial accounting information for each member of the group where this was not already prepared or available. Similarly, if it was decided to take the tax numbers derived from financial accounts (and adjusted as necessary), further operational steps may be required to separate out the MNE's foreign tax either on a worldwide, jurisdictional or entity basis. Thus, the different approaches may have different compliance cost implications.

6. Question for Consultation

- a) Assuming that the MNE's income for purposes of the GloBE proposal would be determined by reference to financial statements (adjusted as necessary) and assuming further that an MNE already prepares consolidated financial accounts, what are likely to be the compliance implications for MNEs in (i) separating the income and taxes of their domestic and foreign operations under a worldwide blending approach, (ii) separating the income and taxes to a jurisdictional level, or (iii) breaking down income and taxes to an entity level?
- b) How would these compliance implications change if the income for purposes of the GloBE proposal was determined by reference to the rules used for calculating the tax base in the shareholder jurisdiction?

3.3. Allocating income between branch and head office

63. Under each of the blending approaches, it will be necessary to develop an agreed approach for allocating income between the branch and head office jurisdictions. In this case, one way to apportion the income of the entity between these jurisdictions would be to apportion that income under the same principles that inform the corresponding allocation of taxing rights between the branch and head office jurisdiction. Where a group entity is only subject to tax in a jurisdiction on its branch income, it will typically be required, under the laws of that jurisdiction, to prepare accounts for tax purposes showing how much of the entity's income is subject to tax in that jurisdiction. The principles that inform this allocation could also be applied to apportion a corresponding amount of income under the GloBE proposal. Once the income has been apportioned it may be necessary to attribute the tax paid in the head office to the branch

jurisdiction in line with the CFC crediting mechanism described below thereby treating the tax paid in the head office in respect of the branch income as tax paid in the branch jurisdiction.

64. The key difference between an entity or jurisdictional approaches and a worldwide approach is that in the latter case branch income allocation would need to be done only for the domestic to foreign context and not also for the foreign to foreign context. Thus, these adjustments may be less onerous than those required under the jurisdictional and entity blending approach.

7. Question for Consultation

- a) How would you suggest to apportion the income of an entity between the branch and the head office and do you think it should follow what is done for tax purposes?
- b) What are the compliance implications of such an allocation under a worldwide, jurisdictional and entity blending approach?
- c) Is the compliance impact smaller for those MNEs that are subject to CbC reporting requirements and that are already required to report the income of a branch and head-office separately even where no such requirement exists under financial accounting rules?

3.4. Allocating income of a tax transparent entity

65. Under each of the blending approaches, it will be necessary to develop an agreed approach for allocating income of a tax transparent entity. Some group entities, such as partnerships, may be treated as transparent for tax purposes by the jurisdiction in which they are organised or incorporated. These fiscally transparent entities may not be subject to tax on their income in any jurisdiction because this income is allocated to other group members who may be taxable on their share of the income. The fact that income is derived by a fiscally transparent entity would not normally be expected to give rise to significant compliance issues where all the owners of that entity are tax resident in the jurisdiction where the fiscally transparent entity is organised. However, where one of the partners is tax resident in another jurisdiction the effect of this allocation for tax purposes may be to shift income (and the tax liability on that income) to another group entity in another taxing jurisdiction. Accordingly, each blending approach would need to incorporate a mechanism recognising the impact of fiscal transparency on the taxation of group members.

66. Principles similar to that used for apportioning income between the branch and head office could also be used to apportion the income of partnerships and other fiscally transparent entities. A partnership may allocate all of its income to other group entities in accordance with the terms of the partnership agreement. These allocations will typically be shown in the partnership accounts. Provided that local law asserts taxing rights over the partners based on the allocations mandated by the partnership agreement and reflected in these accounts then those accounts could also be used as a basis for determining the allocation of the tax base under the GloBE proposal. The key difference with the branch example described above is that, in the branch case the effect of this allocation is to split the tax base of the group entity between two taxing jurisdictions, while this allocation would have the effect of shifting income to another group entity that may be in another jurisdiction.

67. Again, the key difference between the entity or jurisdictional approaches and the worldwide approach is that the above operations under the worldwide approach would only need to be done for the domestic to foreign context and not the foreign to foreign context, thus likely making the worldwide approach less onerous than the jurisdictional or entity approach.

8. Question for Consultation

- a) How would you suggest to apportion the income of a transparent entity and do you think it should follow what is done for tax purposes?
- b) What are the compliance implications of such an allocation under a worldwide, jurisdictional and entity blending approach?
- c) Is the compliance impact smaller for those MNEs that are subject to CbC reporting requirements and that are already required to report the income of a transparent entities separately even where no such requirement exists under financial accounting rules?

3.5. Crediting taxes that arise in another jurisdiction

68. Although it will depend on the particular mechanisms used in the design of the income inclusion rule, taking into account CFC and other taxes levied under the laws of a third jurisdiction would not need to be problematic under a worldwide blending approach. Worldwide blending could allow the MNE to treat any tax imposed by a foreign jurisdiction on any item of foreign income as “creditable”, no matter which jurisdiction imposes the tax or where that income arose. Accordingly, a worldwide blending approach makes it unnecessary for the MNE to determine whether an item of income derived by a foreign entity was taxable at the level of the branch or the head office of that entity. Neither would there be any need to determine whether that item of income was potentially subject to taxation under the laws of another foreign jurisdiction (for example, under a CFC rule). In each case, the tax paid on that income could be creditable under the GloBE proposal, whether that tax was paid at the level of the branch, head office or under the CFC rules of an intermediary jurisdiction.

69. Under a jurisdictional or entity approach however, the tax paid under a CFC rule in a foreign jurisdiction, for example, is tax paid on income that arises in another jurisdiction. A failure to align the income and tax paid on that income could be seen as understating the effective tax rate for the jurisdiction or entity in which the underlying income arises and overstating the taxes paid, and effective tax rate, on income in the other jurisdiction or entity.

70. One way of achieving an alignment could be to treat the tax paid under the CFC rule as paid in the jurisdiction or entity where the income is treated as arising. This credit-transfer mechanism for determining the MNE’s tax liability in a given foreign jurisdiction could be applied to any situation where income arising in one jurisdiction or entity is taxed in another jurisdiction. For example in the case of income that is allocated to a branch as described above, any tax paid on that income at the level of the head office could be treated as tax paid in the branch jurisdiction although other simplification options may be available in respect of branch income that is fully taxable at the level of the head-office.

9. Question for Consultation

- a) How would you suggest dealing with attributing taxes that arise in another jurisdiction or entity under a jurisdictional or entity blending approach?
- b) What comments, if any, do you have on the practicality of crediting taxes paid in an intermediate jurisdiction or entity, such as under a CFC rule, against income of the subsidiary or branch?

3.6. Treatment of dividends and other distributions

71. Assuming that the income taken into account under the GloBE proposal were to be calculated based on the group’s consolidated financial income then this consolidation should automatically disregard

the effect of intra-group transactions (including dividends).¹⁵ However, a jurisdictional or entity blending approach which looks at the financial income of each group entity will require adjustments to be made for dividends and other distributions from group members if these amounts are treated as income for the payee for financial reporting purposes but exempt from tax or eligible for equivalent relief under the laws of the payee jurisdiction.

72. Dividends and other distributions could be excluded from the determination of income under a jurisdictional or entity approach on the assumption that the underlying earnings of the distributing entity will already have been subject to tax at the minimum rate. If dividends are excluded then it may also be appropriate to exclude any source country withholding taxes on those dividends from being treated as creditable taxes of the distributing entity's owner under the GloBE proposal. In order to avoid such taxes not being creditable in any jurisdiction, such taxes could, however, be treated as an additional tax on the earnings of the distributing entity. Alternatively the dividends could be included in income under the GloBE proposal (together with any withholding taxes on those dividends) in those cases where the dividend is included in income by the payee. There may be further options for the treatment of both intra-group and portfolio dividends based on the way they are treated under local law. These options may include treating the withholding tax as a tax on the payee in line with the legal incidence of taxation.

10. Question for Consultation

- a) Assuming that the starting point for calculating the income of the MNE under the GloBE proposal is based on the financial accounts do you have any comments on the practicality of dealing with taxation of dividends under worldwide, jurisdictional and entity blending approaches?
- b) Do you have any comments on how the taxation of dividends should be dealt with under the GloBE proposal?
- c) Are there any other issues that you wish to highlight regarding worldwide, jurisdictional or entity blending?

¹⁵ If the group income is determined based on an aggregation of the separate entity income of each foreign subsidiary determined using the tax base of the parent jurisdiction, whether adjustments are needed to exclude dividends received from lower-tier group entities will depend on the rules for computing the tax base in the parent jurisdiction.

4. Carve-outs

73. The Programme of Work calls for the exploration of possible carve-outs as well as thresholds and exclusions to restrict application of the GloBE proposal.

74. Specifically, the Programme of Work calls for the exploration of carve-outs, including for:

- a) Regimes compliant with the standards of BEPS Action 5 on harmful tax practices, and other substance-based carve-outs, noting however such carve-outs would undermine the policy intent and effectiveness of the proposal.
- b) A return on tangible assets.
- c) Controlled corporations with related party transactions below a certain threshold.¹⁶

75. The Programme of Work also calls for the exploration of options and issues in connection with the design of thresholds and carve-outs to restrict application of the rules under the GloBE proposal, including:

- a) Thresholds based on the turnover or other indications of the size of the group.
- b) De *minimis* thresholds to exclude transactions or entities with small amounts of profit or related party transactions.
- c) The appropriateness of carve-outs for specific sectors or industries.¹⁷

76. While the accounting adjustments that represent permanent differences (discussed in connection with the tax base in Chapter 2 above) could operate in a manner similar to carve-outs, they are generally more limited in scope than the types of broad-based exclusions encompassed by the carve-outs discussion in the Programme of Work. Adjustments to the GloBE tax base in order to align it with the domestic tax base will reduce any permanent differences.

77. The decision on carve-outs and thresholds is mainly a policy question involving issues related to tax policy and legal analysis. The existence and design of any carve-outs or thresholds will also impact on the neutrality of the tax system and on activities generating positive or negative externalities. As noted in Section 4.1(3) of the Programme of Work, it is also necessary to ensure that the rules to be designed are compatible with existing international obligations, including where appropriate the EU fundamental freedoms. Therefore, the design of the GloBE proposal rules, will need to take into account their interactions with such international obligations.

78. The existence and design of any carve-outs or thresholds will also impact on compliance and administration costs for MNEs and tax administrations. The precise nature of these impacts will depend on the specific design of such carve-outs or thresholds, which can either reduce or increase compliance costs.

79. A carve-out or exclusion can apply on a qualitative, facts-and-circumstances basis, or an objective, formulaic basis. Those options can be varied and tailored in numerous ways, depending upon the carve-out and what is sought to be achieved. Facts and circumstances carve-outs can be tailored to an evaluation of certain specified facts and circumstances or they can be based on all the facts and circumstances that

¹⁶ See *PoW* - Sections 2.1(3) and 3.1(2).

¹⁷ See *PoW* - Section 4.1.2.

the decision-maker deems relevant. Objective criteria carve-outs can be based on a formula with reference to one or more bases. However, they can also be based on multiple criteria, including the results of several different formula or ratios. Moreover, these formulaic approaches can be designed so that they exclude the income of an entire entity, all or part of a particular type of income, or part of all income.

80. Carve-outs based on facts and circumstances can be targeted or tailored to the specific situations intended to be covered and may be more resistant to abuse. On the other hand, they are more difficult to design and increase complexity as well as compliance and administration costs much more than objective tests. The difficulty of design and complexity often increase the more targeted the carve-out is intended.

81. Therefore, carve-outs and exclusions that are based on facts and circumstances analysis may generate uncertainty for taxpayers and be more difficult for tax administrations to administer.

82. Carve-outs based on objective criteria are simpler to apply and administer than carve-outs that depend on a facts and circumstances analysis. However, a carve-out based on specific identifiable criteria (such as asset values) may pose additional compliance costs if the taxpayer is required to produce and maintain documentation to prove they qualify for the exclusion. The mechanical, formulaic nature of these types of carve-outs also means that they may be over- or under-inclusive. In addition, they may be more easily subject to manipulation and may need to be accompanied by anti-abuse rules, which may, themselves, be a facts and circumstances test.¹⁸

83. Thresholds that are based on broad criteria, such as total revenue or profit, may be easier from an administration and compliance perspective than a specific carve-out tied to a particular feature of a particular taxpayer. Thresholds can, however, create volatility for taxpayers who operate near the envelope set by the threshold.

84. The experience of taxpayers in applying carve-outs and thresholds under existing regimes will be instructive in evaluating design options for the GloBE proposal.

11. Question for Consultation

- a) Do you have any comments, based on your own experience, as to the preferred design of a carve-out taking into account factors such as simplicity, compliance costs, certainty, incentives and behavioural impacts?
- b) Are there any technical or compliance considerations that would make you concerned about a particular type of carve-out (i.e. based on facts and circumstances or on a formulaic approach), or suggest that there should be no carve-outs at all? If so, please explain based on your own experience.
- c) Would you favour thresholds based on the size of the taxpayer? If so, please give your reasons and suggest a metric that you think should be used.
- d) Would you favour any *de minimis* carve-outs? If so, what type of carve-out do you consider would result in the right balance between compliance costs and benefits?
- e) Would you favour a carve-out for specific sectors or industries? If so, please state the sector or industry, explain your reasons and share thoughts on how such a carve-out could be operated with as little compliance cost and uncertainty as possible.
- f) Do you have any additional comments on carve-outs, including comments based on experiences with existing regimes that you suggest should be adopted or avoided?

¹⁸ For example, an anti-abuse rule may provide that a carve-out does not apply where the taxpayer qualifies for the carve-out as a result of engaging in a transaction or arrangement with a principal purpose of tax avoidance, with the principal purpose determined by reference to all the facts and circumstances.

Annex A. Examples

This Annex illustrates the application of the carry-forward of excess taxes and tax attributes in Examples 1 and 2 and illustrates the application of deferred tax accounting in Examples 3-5, as described in Section 2 of this document. The facts of the examples are based on the potential application of the income inclusion rule. However, the examples are not intended to suggest that these approaches are any less feasible for addressing temporary differences on the applicability of other elements of the GloBE proposal. The minimum effective tax rate used in the examples set out in this Annex is simply for illustrative purposes only. No inference should be drawn on the rate that will ultimately be agreed for the GloBE proposal.

1. **Example 1 – Accelerated taxable income.** A Co., a tax resident of Country A, owns B Co., a tax resident of Country B. For Country B tax purposes, B Co. includes 100 in income in Year 1 and deducts 20 of expenses. For financial accounting purposes, however, B Co. includes 50 in income and deducts 10 of expenses in each of Year 1 and Year 2. Assume that the tax rate in Country B is 20% and the minimum tax rate is 15%. In Year 1, B Co. pays 16 of tax on 80 of taxable income. The minimum tax on the 40 GloBE tax base is 6, therefore, the excess in Year 1 is 10. In Year 2, 6 of Excess Tax Carry-forward is used to bring the ETR up to the minimum tax rate of 15% on the 40 of GloBE tax base, which eliminates any potential tax liability under the income inclusion rule.

Example 1	YEAR 1		YEAR 2	
	Inclusion rule (Book)	Country B (Tax)	Inclusion rule (Book)	Country B (Tax)
Income	50	100	50	0
Expenses	(10)	(20)	(10)	(0)
Net income	40	80	40	(0)
Tax paid	(16)	(16)	0	0
Minimum tax (15% x Net income)	(6)		(6)	
Excess Tax (= Tax paid – Minimum Tax)	10		0	
Tentative Inclusion Rule Tax	-		6	
Excess Tax Carry-forward Used	-		(6)	
Inclusion Rule Tax	-		0	
Remaining Excess Tax Carry-forward	10		4	

2. **Example 2 – Accelerated tax depreciation deductions.** A Co., a tax resident of Country A, owns B Co., a tax resident of Country B. For Country B tax purposes, B Co. accrues 80 of financial and taxable income in Year 1 and Year 2. B Co. purchases an asset for 80 in Year 1 and the purchase price is fully deductible in Year 1 under Country B tax law. B Co. depreciates the asset using the straight-line method over two years for financial accounting purposes. Assume that the tax rate in Country B is 20% and the minimum tax rate is 15%. In Year 1, B Co. pays 0 tax in Country B and A Co. pays 6 of tax under the income inclusion rule (40 tax base x 15% - 0 tax paid). In Year 2, B Co. pays 16 of tax on 80 of income, an ETR of 20%. B Co.'s 16 tax paid in Year 2 exceeds the minimum tax in Year 2 by 10 (16 tax paid – (40

tax base x 15%)). Because the local tax exceeds the minimum tax, 6 of income inclusion rule tax can be credited or refunded because the carry-forward is less than the excess tax paid. The carry-forward of excess tax paid also would be reduced to 4 (10 excess tax paid – 6 credit or refund allowed in respect of income inclusion rule carry-forward).

Example 2	YEAR 1		YEAR 2	
	Inclusion rule (Book)	Country B (Tax)	Inclusion rule (Book)	Country B (Tax)
Income	80	80	80	80
Expenses	(40)	(80)	(40)	(0)
Net income	40	0	40	80
Tax Paid	-	0	(16)	(16)
Minimum tax (15% x Net income)	(6)		(6)	
Excess Tax (= Minimum tax – Tax paid)			10	
Inclusion Rule Tax	(6)		0	
Credit Allowed (lesser of Carry-forward & Excess Tax)	0		6	
Balance of Creditable IR Tax Carry-forward	(6)		0	

3. **Example 3 – Accelerated taxable income.** A Co., a tax resident of Country A, owns B Co., a tax resident of Country B. For Country B tax purposes, B Co. includes 100 in income in Year 1 and deducts 20 of expenses. For financial accounting purposes, however, B Co. includes 50 in income and deducts 10 of expenses in each of Year 1 and Year 2. Assume that the tax rate in Country B is 20% and the minimum tax rate is 15%. In Year 1, B Co. pays 16 of tax on 80 of taxable income. B Co.'s tax liability in Country B on 40 of financial income is only 8 (40 x 20%). B Co. creates a deferred tax asset of 8 (40 x 20%) because the 40 of additional taxable income will be included in financial income in a subsequent year. The tax expense for financial accounting purposes is equal to the tax paid to B Country (16) less the increase in the deferred tax asset (8), or 8. B Co.'s effective tax rate in Year 1 is 20% (8 tax expense / 40 GloBE tax base). In Year 2, the taxable income and tax paid is zero but financial accounting income is 40. The deferred tax asset is reduced by 8 and the current tax expense is increased by 8. This matches the 8 of tax paid in Year 1 to the 40 of financial accounting income deferred until Year 2 and again produces an effective tax rate of 20% in Year 2.

Example 3	YEAR 1		YEAR 2	
	Inclusion rule (Book)	Country B (Tax)	Inclusion rule (Book)	Country B (Tax)
Income	50	100	50	0
Expenses	(10)	(20)	(10)	0
Net income	40	80	40	0
Tax paid	(16)	(16)	0	0
Deferred Tax Asset	8		(8)	0
Tax expense	(8)		(8)	
Minimum tax (15% x Net income)	(6)		(6)	
Inclusion Rule Tax Paid	n.a.		n.a.	

4. **Example 4 – Accelerated tax depreciation deductions.** A Co., a tax resident of Country A, owns B Co., a tax resident of Country B. For Country B tax purposes, B Co. accrues 80 of financial and taxable

income in Year 1 and Year 2. B Co. purchases an asset for 80 in Year 1 that is deductible in Year 1 under Country B tax law. B Co. depreciates the asset using the straight-line method over two years for financial accounting purposes. Assume that the tax rate in Country B is 20% and the minimum tax rate is 15%. In Year 1, B Co. pays 0 tax on 0 taxable income. B Co.'s tax liability in Country B on 40 of financial income is 8 (40 x 20%). B Co. creates a deferred tax liability of 8 (40 x 20%) because the related 40 of taxable income will be included in a subsequent year. The tax expense for financial accounting purposes is equal to the tax paid to B Country (0) plus the increase in the deferred tax liability (8), or 8. This matches the tax expense to the related income, even though the tax is not yet due. B Co.'s effective tax rate in Year 1 is 20% (8 tax expense / 40 GloBE tax base). In Year 2, the taxable income is 80 and tax paid is 16, but financial accounting income is 40. The deferred tax liability is reduced by 8 and the current tax expense is also reduced by 8. This produces an effective tax rate of 20% in Year 2.

Example 4	YEAR 1		YEAR 2	
	Inclusion rule (Book)	Country B (Tax)	Inclusion rule (Book)	Country B (Tax)
Income	80	80	80	80
Expenses	(40)	(80)	(40)	(0)
Net income	40	0	40	80
Tax paid	0	0	(16)	(16)
Deferred Tax Liability	8		(8)	
Tax expense	(8)		(8)	
Minimum tax (15% x Net income)	(6)		(6)	
Inclusion Rule Tax Paid	n.a.		n.a.	

5. **Example 5 – Loss carry-forward tax deduction.** A Co., a tax resident of Country A, owns B Co., a tax resident of Country B. In year 1, B Co. accrues 50 of income and 65 of expenses for both financial accounting and taxable income. In Year 2, B Co. accrues 50 of income and 30 of expenses for both financial accounting and taxable income. B Co. is allowed to carry-forward the loss and deduct it against future taxable income. At the end of Year 1, B Co. expects to earn 20 of taxable income in the reasonably foreseeable future.

Example 5	YEAR 1		YEAR 2	
	Inclusion rule (Book)	Country B (Tax)	Inclusion rule (Book)	Country B (Tax)
Income	50	50	50	50
Expenses	(65)	(65)	(30)	(30)
Operating income	(15)	(15)	20	20
Carry forward loss			-	(15)
Net income	0	0	20	5
Tax Paid	0	0	(1)	(1)
Deferred Tax Asset	3	0	(3)	0
Tax expense	3		(4)	
Minimum tax (15% x Net income)	0		(3)	
Inclusion Rule Tax Paid	n.a.		n.a.	

Annex B. Programme of Work on Pillar Two

This Annex is copied from the Programme of Work, specifically paragraphs 50 -78. For purposes of this Annex the paragraph numbering starts at 1 and the box numbering has been eliminated.

Chapter III – Global anti-base erosion proposal (Pillar Two)

1. Under Pillar Two, the Members of the Inclusive Framework have agreed to explore an approach that leaves jurisdictions free to determine their own tax system, including whether they have a corporate income tax and where they set their tax rates¹, but considers the right of other jurisdictions to apply the rules explored further below where income is taxed at an effective rate below a minimum rate. Within this context, and on a without prejudice basis, the members of the Inclusive Framework have agreed a programme of work that contains exploration of an inclusion rule, a switch over rule, an undertaxed payment rule, and a subject to tax rule. They have further agreed to explore, as part of this programme of work, issues related to rule co-ordination, simplification, thresholds, compatibility with international obligations and any other issues that may emerge in the course of the work.
2. Consistent with the Policy Note *Addressing the Tax Challenges of the Digitalising Economy*, approved on 23 January 2019, Members of the Inclusive Framework agree that any rules developed under this Pillar should not result in taxation where there is no economic profit nor should they result in double taxation.
3. This part sets out the global anti-base erosion (GloBE) proposal which seeks to address remaining BEPS risk of profit shifting to entities subject to no or very low taxation. It first provides background including the proposed rationale for the proposal and then summarises the mechanics of the proposed rules together with a summary of the issues that will be explored as part of the programme of work.
4. While the measures set out in the BEPS package have further aligned taxation with value creation and closed gaps in the international tax architecture that allowed for double non-taxation, certain members of the Inclusive Framework consider that these measures do not yet provide a comprehensive solution to the risk that continues to arise from structures that shift profit to entities subject to no or very low taxation. These members are of the view that profit shifting is particularly acute in connection with profits relating to intangibles, prevalent in the digital economy, but also in a broader context; for instance group entities that are financed with equity capital and generate profits, from intra-group financing or similar activities, that are subject to no or low taxes in the jurisdictions where those entities are established.²
5. The global anti-base erosion proposal is made against this background. It is based on the premise that in the absence of multilateral action, there is a risk of uncoordinated, unilateral action, both to attract more tax base and to protect existing tax base, with adverse consequences for all countries, large and small, developed and developing as well as taxpayers. It posits that global action is needed to stop a harmful race to the bottom, which otherwise risks shifting taxes to fund public goods onto less mobile bases including labour and consumption, effectively undermining the tax sovereignty of nations and their elected legislators. It maintains that developing countries, in particular those with smaller markets, may also lose in such a race. Over recent decades, tax incentives have become more widespread in developing countries as they seek to compete to attract and retain foreign direct investment.³ Some studies have found that, in developing countries, tax incentives may be redundant in attracting investment.⁴ Revenue forgone from tax incentives can also reduce opportunities for much-needed public spending on infrastructure, public

services or social support, and may hamper developing country efforts to mobilise domestic resources. There is evidence that tax incentives are frequently provided in developing countries in circumstances where governments are confronted with pressures from businesses to grant them.⁵ Depending on its ultimate design, the GloBE proposal could effectively shield developing countries from the pressure to offer inefficient incentives and in doing so help them in better mobilising domestic resources by ensuring that they will be able to effectively tax returns on investment made in their countries. The proposal therefore seeks to advance a multilateral framework to achieve a balanced outcome which limits the distortive impact of direct taxes on investment and business location decisions. The proposal is also intended as a backstop to Pillar One for situations where the relevant profit is booked in a tax rate environment below the minimum rate.

6. Recognising, as stated in the Action 1 Report, that it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes, the scope of the anti-base erosion proposal is not limited to highly digitalised businesses. By focusing on the remaining BEPS challenges, it proposes a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax. In so doing, it helps to address the remaining BEPS challenges linked to the digitalising economy, where the relative importance of intangible assets as profit drivers makes highly digitalised business often ideally placed to avail themselves of profit shifting planning structures.

GloBE proposal

7. The proposal seeks to address the remaining BEPS challenges through the development of two inter-related rules:

1. an **income inclusion rule** that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate; and
2. a **tax on base eroding payments** that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless that payment was subject to tax at or above a minimum rate.

8. These rules would be implemented by way of changes to domestic law and double tax treaties and would incorporate a co-ordination or ordering rule to avoid the risk of economic double taxation that might otherwise arise where more than one jurisdiction sought to apply these rules to the same structure or arrangements.

9. The combined rules are intended to affect behaviour of taxpayers and jurisdictions alike which is expected to limit the revenue impact of rule order for jurisdictions. Rather, rule order will need to be determined by reference to principles of good rule design including effectiveness, simplicity and transparency.

Income inclusion rule

10. The income inclusion rule would operate as a minimum tax by requiring a shareholder in a corporation to bring into account a proportionate share of the income of that corporation if that income was not subject to an effective rate of tax above a minimum rate. This rule could supplement a jurisdiction's CFC rules.

11. The income inclusion rule would ensure that the income of the MNE group is subject to tax at a minimum rate thereby reducing the incentive to allocate returns for tax reasons to low taxed entities. The income inclusion rule would have the effect of protecting the tax base of the parent jurisdiction as well as

other jurisdictions where the group operates by reducing the incentive to put in place intra-group financing, such as thick capitalisation, or other planning structures that shift profit to those group entities that are taxed at an effective rate of tax below the minimum rate.

Top up to a minimum rate

12. The work programme would explore an inclusion rule that would impose a minimum tax rate. This approach is consistent with a policy of establishing a floor on tax rates by ensuring that a multinational enterprise (MNE) would be subject to tax on its global income at the minimum rate regardless of where it was headquartered. Consideration could be given to an exception to this principle in the case of income taxed below the minimum rate and benefiting from a harmful preferential regime, which would then be taxed at the higher of the minimum rate or the full domestic rate.

13. In general terms, it is contemplated that this rule would apply where the income is not taxed at least at the minimum level – that is, it would operate as a top up to achieve the minimum rate of tax.⁶ A top-up to a minimum rate increases the likelihood of the proposal resulting in a transparent and simple global standard that sets a floor for tax competition and makes it easier to develop consistent and co-ordinated rules. It would further increase the likelihood of achieving a level playing field for both jurisdictions and MNEs and reduces the incentive for inversions and other restructuring transactions designed to take advantage of low effective rates of taxation below the threshold.

14. A minimum tax tied to each country's corporate income tax (CIT) rate would result in a more complex and opaque international framework given the significant variance in CIT rates across Inclusive Framework members. For jurisdictions with high domestic CIT rates, such a design would create a cliff-edge effect for income that was subject to tax at around the minimum tax rate threshold.

Use of a fixed percentage

15. The work programme would explore an approach using a fixed percentage rather than a percentage of the parent jurisdiction's CIT rate or a range or corridor of CIT rates.

16. While there is precedent in the CFC context for using a percentage of the parent jurisdiction's CIT rate, this approach would give rise to significant variations in the rates used under the inclusion rule, which would result in a rule that is not in line with the intended policy of the GloBE proposal in addressing the risks associated with low-taxation. It would not result in a level playing field and make it difficult to co-ordinate such a rule with the undertaxed payments rule, significantly increasing the risk of double taxation.

17. Another possible approach would be to use a range or corridor of minimum rates depending on other design elements of the inclusion rule that impact on the effective rate of tax. However, it would be difficult for jurisdictions to quantify the impact of different design features and determine how that translates to an appropriate rate thereby resulting in potentially arbitrary and less transparent outcomes, making it harder for jurisdictions to co-ordinate their rules, thereby increasing compliance and administration costs and leading to a greater risk of double taxation.

18. An approach based on a fixed percentage tax rate is the simplest option from a design perspective. It provides greater transparency and facilitates rule co-ordination, thereby reducing administration and compliance costs. It also helps maintain a level playing field for jurisdictions and taxpayers and reduces the incentives for tax driven inversions and other restructuring transactions.

Exploration of simplifications

19. The programme of work starts from the proposition that in principle the tax base would be determined by reference to the rules that jurisdictions already use for calculating the income of a foreign subsidiary under their CFC rules, or in the absence of CFC rules, for domestic CIT purposes. Such an

approach means, however, that each subsidiary of an MNE would need to recalculate its income in accordance with the tax base calculations in the parent jurisdiction. This may result in significant compliance costs and lead to situations where technical and structural differences between the calculation of the tax base in the parent and subsidiary jurisdiction could result in an otherwise highly taxed subsidiary being treated as having a low effective rate of tax for reasons unrelated to the policy drivers underlying the GloBE proposal.

20. For example, differences between countries in the treatment of carry forward losses and the timing of recognition of income and expenses could impact on the calculation of the effective rate of tax in different jurisdictions. Structural differences in the design of different jurisdictions' tax bases could result in the application of the rule in cases that might not give rise to the policy concerns that are intended to be addressed by the inclusion rule.

21. In order to improve compliance and administrability for both taxpayers and tax administrations and to neutralise the impact of structural differences in the calculation of the tax base, the programme of work will explore simplifications. Simplifications could also serve to make the rules more transparent and help with co-ordination in the operation of the rules.

22. One simplification could be to start with relevant financial accounting rules subject to any agreed adjustments as necessary. The starting point for such an approach could be the financial accounts as prepared under the laws and relevant accounting standards of the jurisdiction of incorporation or establishment, which would be subject to agreed upon adjustments to reflect timing and permanent differences between tax and financial accounting rules. Other simplification measures could also be explored as part of the programme of work.

Inclusion Rule

The programme of work would explore options and issues in connection with the design of the income inclusion rule. These options and issues are expected to include:

1. A design that operates as a top up to a minimum rate but with an inclusion at the full rate for income taxed at below the minimum rate and benefitting from a harmful preferential regime;
2. A test for determining when income has been subject to tax at a minimum effective rate whereby:
 - a. the tax rate would be based on a fixed percentage;
 - b. the tax base would in principle be determined by reference to the rules applicable in the shareholder jurisdiction, but
 - c. the design would consider simplifications with a view to reduce compliance costs and avoid unintended outcomes including exploring the possible use of financial accounting rules as a basis for determining net income (with appropriate adjustments including for losses and the timing of recognition of income and expenses).
3. The possible use and effect of carve-outs, including for:
 - a. Regimes compliant with the standards of BEPS Action 5 on harmful tax practices, and other substance based carve-outs, noting however such carve-outs would undermine the policy intent and effectiveness of the proposal.
 - b. A return on tangible assets.
 - c. Controlled corporations with related party transactions below a certain threshold.
4. Different options of blending,⁽¹⁾ ranging from blending at the entity level to blending at global group level with a particular focus on blending at the jurisdictional versus global level; and
5. All other relevant design and technical issues, including:
 - a. co-ordination with other international tax rules, such as withholding tax rules and other source based taxation rules, transfer pricing rules and adjustments, CFC and other inclusion rules;
 - b. co-ordination between inclusion rules where, for instance, in a tiered ownership structure several jurisdictions may apply the rule;
 - c. ownership thresholds;
 - d. rules for the attribution of income and calculation of tax paid on that income; and
 - e. rules for calculating the investor's tax liability.

⁽¹⁾ *Blending refers to the ability of taxpayers to mix high-tax and low-tax income to arrive at a blended rate of tax on income that is above the minimum rate.*

24. There is a need to ensure that the income inclusion rule applies to foreign branches as well as foreign subsidiaries. For example, in the case of profits attributable to exempt foreign branches, or that are derived from exempt foreign immovable property, the income inclusion rule could be achieved through a switch-over rule that would turn off the benefit of an exemption for income of a branch, or income derived

from foreign immovable property, otherwise provided by a tax treaty and replace it with the credit method where that income was subject to a low effective rate of tax in the foreign jurisdiction.

Switch-over rule

The programme of work would explore options and issues in connection with the design of the switch-over rule. These options and issues are expected to include:

1. The design of a switch-over rule for tax treaties that would allow the state of residence to apply the credit method instead of the exemption method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to tax at an effective rate below the minimum rate; and
2. A design that, as much as possible, is simple to implement and to administer.

Tax on base eroding payments

25. The second key element of the proposal is a tax on base eroding payments that complements the income inclusion rule by allowing a source jurisdiction to protect itself from the risk of base eroding payments. More specifically, this element of the proposal would explore:

- an *undertaxed payments rule* that would deny a deduction or impose source-based taxation (including withholding tax)⁷ for a payment to a related party if that payment was not subject to tax at a minimum rate; and
- a *subject to tax rule* in tax treaties that would only grant certain treaty benefits if the item of income was subject to tax at a minimum rate.

26. The undertaxed payments rule denies a deduction or a proportionate amount of any deduction for certain payments made to a related party unless those payments were subject to a minimum effective rate of tax.

Undertaxed payments rule

The programme of work would explore options and issues in connection with the design of the undertaxed payments rule. These options and issues are expected to include:

1. A rule that would achieve a balance between a number of design principles including effectiveness to achieve its stated objectives, design compatibility and co-ordination with other rules, avoidance of double taxation and taxation in excess of economic profit, and minimising compliance and administration costs; and
2. A range of different design options including a consideration of:
 - a. the types of related party payments covered by the rule (including measures to address conduit and indirect payments);
 - b. the test for determining whether a payment is “undertaxed”, which will include dealing with loss situations;
 - c. the nature, extent and operation of the adjustment to be made under the rule (including whether it should be on the gross amount of the payment or limited to net income); and
 - d. the possible use and effect of carve-outs including those referred to in [the box] above.

27. The proposal also includes a subject to tax rule which could complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and denying treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate. This rule contemplates possible modifications to the scope or operations of the following treaty benefits, with priority given to interest and royalties:

- a. The limitation on the taxation of business profits of a non-resident, unless those profits are attributable to a permanent establishment. (Article 7 of the OECD Model Convention)
- b. The requirement to make a corresponding adjustment where a transfer pricing adjustment is made by the other Contracting State (Article 9 of the OECD Model Convention)
- c. The limitation on taxation of dividends in the source state (Article 10 of the OECD Model Convention)
- d. The limitations on taxation of interest, royalties and capital gains in the source state (Articles 11-13 of the OECD Model Convention)
- e. The allocation of exclusive taxing rights of other income to the state of residence (Article 21 of the OECD Model Convention)

28. There are a number of broad issues to be explored in connection with the subject to tax rule, including the benefits of a withholding tax over a deduction denial approach, the degree of overlap with the undertaxed payments rule, and timing issues also considering the overall principle that any rule should include measures to avoid double taxation.

29. The proposal also contemplates the exploration of the application of a subject to tax rule to unrelated parties as regards Articles 11 and 12 of the OECD Model Convention. The programme of work would explore risk areas that may justify an extension to unrelated parties or to other treaty benefits beyond interest and royalties. For instance, whether there are certain arrangements, using structured, but

otherwise unrelated arrangements that could achieve tax outcomes inconsistent with what is intended by the GloBE proposal.

Subject to tax rule

The programme of work would explore options and issues in connection with the design of the subject to tax rule. These options and issues are expected to include:

1. Broad issues including:
 - a) the need to amend bilateral tax treaties and other cost benefit considerations of a subject to tax rule next to an undertaxed payments rule;
 - b) the design of a subject to tax test and the degree of overlap with the test for low taxation under an undertaxed payments rule;
 - c) the operation of any withholding tax particularly where the effective rate of tax on the payment may not be known at the time the payment is made and including the need to address issues of possible double taxation;
 - d) the identification of risks that would merit the extension of the subject to tax rules to payments between unrelated parties; and
2. Different rule designs, taking into account the specificities of the particular treaty benefit, the learnings from work on the undertaxed payments rule limited to interest and royalties, but also identifying risks that would merit the extension of the scope to other types of payments.

Rule co-ordination, simplification, thresholds and compatibility with international obligations

30. Further work will also be required on rule co-ordination, simplification measures, thresholds and carve-outs to ensure the proposal avoids the risk of double taxation, minimises compliance and administration costs and that the rules are targeted and proportionate. This work will address the priority in which the rules would be applied and how they interact with other rules in the broader international framework. In this context it is important to analyse the interaction between this proposal and other BEPS Actions. It will also explore compatibility with international obligations (such as non-discrimination) including, for EU members, the EU fundamental freedoms and how that compatibility could depend on the rule's detailed design.

Co-ordination, simplification, thresholds and compatibility with international obligations

The programme of work would explore options and issues in connection with the design of co-ordination, simplification and threshold measures including interaction with BEPS Actions. These options and issues are expected to include:

1. Co-ordination between the undertaxed payments rule, subject to tax rule and income inclusion rule to minimise the risk of double taxation, including simplification measures that could further reduce compliance costs; and
2. Thresholds and carve-outs to restrict the application of the rules under the GloBE proposal, including:
 - a) Thresholds based on the turnover or other indications of the size of the group;
 - b) *De minimis* thresholds to exclude transactions or entities with small amounts of profit or related party transactions; and
 - c) The appropriateness of carve-outs for specific sectors or industries.
3. Compatibility with international obligations (and, where appropriate, the EU fundamental freedoms).

References

¹ Previous OECD studies, including OECD (2008), *Taxation and Economic Growth*, Working Paper No. 620, have suggested that there may be efficiency benefits in improving the design of the corporate income tax and reducing its relative weight in a country's tax system. However, these studies, which were issued before the BEPS Project was launched, did not consider the proposals currently under discussion under Pillar Two. Current proposals should be designed in a way that preserves the ability of jurisdictions to determine their own tax systems

² Other members are of the view that the rules explored within this pillar may affect the sovereignty of jurisdictions that for a variety of reasons have no or low corporate taxes in particular where they target income arising from substantive activities.

³ See, for example, IMF, OECD, UN, and World Bank (2015), *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment*, A Report to the G-20 Development Working Group, pp. 8-9.

⁴ *Ibid.*, pp. 11-12.

⁵ *Ibid.*, pp. 35-36.

⁶ Countries would, of course, remain free to tax a subsidiary's income (or particular categories of income) at a rate higher than the minimum rate as they already do under their CFC rules.

⁷ For treaty-related aspects see the subject to tax rule.