



OECD releases consultation document on global anti-base erosion proposal

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The OECD Secretariat on November 8 released a public consultation document on technical and design issues regarding the GLoBE proposal, which would provide for global minimum taxation.

The consultation document, "[Global Anti-Base Erosion Proposal \("GloBE"\) Pillar-Two](#)," was prepared by the Secretariat of the OECD and expressly states that it does not represent the consensus view of the Inclusive Framework, the Committee of Fiscal Affairs (CFA), or their subsidiary bodies. Comments will assist members of the Inclusive Framework in the development of a solution for its final report to the G20 in 2020.

Background

In May 2019 the Inclusive Framework agreed to a "Programme of Work for Addressing the Tax Challenges of the Digitalisation of the Economy." The program 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. This element was the subject of a public consultation document issued on October 9, 2019, and with respect to which there will be a public consultation in Paris on November 21 and 22.

Pillar Two (also referred to as the "global anti-base erosion" or "GloBE" proposal) is the subject of the new public

consultation document. Pillar Two calls for the development of a coordinated set of rules to address ongoing risks from structures that allow multinational entities (MNEs) to shift profits to jurisdictions where they are subject to no or very low taxation. Specifically, as explained in the consultation document, the four component parts of the GloBE proposal are:

- 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;
- 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;
- 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 when the profits attributable to a permanent establishment (PE) or derived from immovable property (that is not part of a PE) are subject to an effective rate below the minimum rate; and
- 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 when the payment is not subject to tax at a minimum rate.

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

While comments are welcome on all aspects of Pillar Two, the consultation document seeks comments specifically on three technical design aspects of the GloBE proposal:

- 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;
- 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
- Stakeholders' experience with, and views on, carve-outs and thresholds that may be considered as part of the GloBE proposal.

Tax base determination: the use of financial accounts as a starting point for determining the tax base under the proposal

The consultation document seeks comments on whether using financial accounts, subject to agreed adjustments, could provide an appropriate base for measuring income and could simplify and reduce the compliance costs of the proposal. The document seeks views on the use of the accounting standard of the ultimate parent entity instead of the local generally accepted accounting principles (GAAP) of each entity, and on the acceptability of different standards. Consideration would also need to be given to cases in which consolidated financial statements are not prepared for any other purpose.

Recognizing that accounting profits may differ significantly from taxable profits, the document considers adjustments to accounting profits that could be required. The document seeks views on the types of material "permanent differences" between financial accounting income and taxable income that may need to be removed from the tax base. The document notes that "temporary differences" – such as differences between the timing of accounting depreciation and tax relief on capital expenditure, or the carry-forward of losses -- have distortive effects on effective tax rates that typically reverse in future years. Three basic approaches are described that could address the effects of temporary differences:

- Carry-forward of excess taxes and tax attributes;
- The use of deferred tax accounting; and
- Multi-year averaging.

Comments are sought on the advantages and disadvantages of each approach.

Blending: The extent to which a business can combine low-tax and high-tax income when calculating its effective tax rate/rates.

Blending can be done on a narrow or broad basis and three approaches are described:

- A worldwide blending approach – requiring a business to aggregate its total foreign income and total foreign tax. When the tax on the total foreign income is below the minimum rate, additional tax would be due.
- A jurisdictional blending approach – requiring businesses to aggregate amounts on a jurisdiction-by-jurisdiction basis, paying additional tax in respect of the income in those jurisdictions effectively taxed below the minimum rate.
- An entity blending approach – requiring the calculation of income, taxes, and effective tax rates of each individual group entity (and foreign branch).

The consultation document also describes the possibility of "local group blending," a variation of the entity blending approach that would allow for the results of entities within a

local tax consolidation or local group relief regime to be aggregated.

Each approach has different policy implications and implementation challenges, and the consultation document seeks views on the interaction between each approach and:

- Managing effective tax rate volatility;
- Obtaining the required level of financial accounts data;
- Allocating income between branches and head offices;
- The treatment of tax transparent entities (such as partnerships);
- Crediting taxes arising in other jurisdictions (for example, tax arising under controlled foreign company rules); and
- The treatment of dividends and other distributions.

Carve-outs and thresholds

Carve-outs to be considered include exceptions for regimes compliant with the standards of BEPS Action 5 on harmful tax practices and other substance-based approaches, a return on tangible assets, and for controlled corporations with related-party transactions below a certain threshold. Carve-outs may be based on a qualitative overall evaluation of the facts and circumstances or based on more quantitative objective criteria – for example, based on formulas.

Other related matters under consideration include using thresholds to restrict application of the rules based on the size of the group, de minimis thresholds, or specific industries. Views are sought on which options should be adopted or avoided.

Observation

The document does not discuss the minimum tax rate that might be agreed to, or specifically how the income inclusion rule would be coordinated with the other rules under consideration. Because US companies are already subject to a minimum tax through the US global intangible low-taxed income regime, they will be interested in whether or not the US parent entity or its non-US subsidiaries might be subject also to income inclusion rules in other jurisdictions through which they hold subsidiaries, the low-tax payment rule, or any new subject-to-tax rules.

Next steps

Comments on the consultation document are invited by December 2, 2019. A public consultation meeting will be held on December 9 at the OECD in Paris.

It is anticipated that a further public consultation document will be issued on the mechanics and operation of the undertaxed payment rule and the nature and scope of the subject-to-tax rule once the G20/OECD Inclusive Framework has developed a clearer outline of these rules.

The OECD hopes that political agreement on the architecture of both the global anti-base erosion proposal, and new nexus and profit allocation rules (Pillar One of the program of work) can be reached by June 2020.

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