The **BEPS** Monitoring Group

COMMENTS ON THE MODEL RULES FOR A
GLOBAL ANTI-BASE EROSION MINIMUM CORPORATE TAX

These comments by the [BEPS Monitoring Group] (BMG) analyse the proposed model rules for a global anti-base-erosion minimum tax on corporate profits (the GloBE) issued by the G20/OECD Inclusive Framework on BEPS on 20 December 2021. The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This report has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It is based on our previous reports, and has been drafted by Sol Picciotto and Jeffery Kadet, with comments and contributions by Abdul Muheet Chowdhary, Tommaso Faccio, Séverine Picard, Sakshi Rai, Sudarshan Rangan and Jim Stewart.

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SUMMARY

The agreement that countries wishing to do so will introduce a global anti-base erosion tax (GloBE) was a historic breakthrough. Such concerted counter-measures could put a brake on the competition to reduce tax on the profits of multinational enterprises (MNEs), and perhaps even reverse it. They could also potentially assist a renewed attempt to rebalance the allocation of rights to tax MNE profits according to where they have real activities and value is created. Although the GloBE opens a new way forward, its direction and destination remain uncertain, and a longer-term solution will require continuing efforts on all sides.

In view of the importance of this initiative, we are publishing now our analysis of the Model Rules for the GloBE published on 20 December 2021, although neither the Commentary nor the Implementation Framework have yet been released. These rules are highly detailed and complex, and in our view it is both unrealistic and undesirable to expect any country simply to enact them verbatim in its domestic laws. The OECD cannot legislate for the world, nor is there a global tribunal that could resolve the many practical and interpretation issues they will inevitably raise.

In addition to language differences, countries have, and should retain, the right to introduce their own variants on the rules, consistent with the GloBE's aims and intended outcomes. Countries should give careful thought to what, if anything, they should enact and implement to protect their own tax base. The effectiveness of the GloBE depends ultimately on the willingness of countries to apply top-up taxes on MNE profits that they consider are

undertaxed due to base erosion and profit shifting, and the model rules cannot and should not restrict their freedom to do so. Flexibility is needed, to create a process of continued improvement and strengthening of the rules, which would be stifled if the current model rules were treated as a straight-jacket.

In particular, a 15% minimum effective tax rate is too low to effectively deter profit shifting, since the average global rate is 25%. Developing countries typically have even higher rates. Countries should remain free to adopt a higher rate, and willing countries should work together to ensure a progressive increase, otherwise the proposed floor would become a ceiling. It is also crucial to deter competition over the definition of the tax base, for example by allowing generous allowances for investments particularly in research and development or acquisition of intangible assets, and exploiting weaknesses in financial accounting standards. In section B of this report, we make some detailed suggestions for improvements that could be made to the model rules.

Countries should also be encouraged to adopt complementary measures to protect their tax base, such as minimum taxes on deemed profits, building on and extending measures that have been adopted in many developing countries. This is particularly important for the low- and middle-income countries that are mainly hosts to MNEs, since they would gain little or nothing directly from the GloBE itself, as it gives the prior right to MNE home or intermediary parent countries to apply a top-up tax. The rules have now introduced the possibility of a domestic minimum top-up tax (DMTT), which would have even higher priority. However, this would benefit mainly countries that act as investment hubs by offering low taxation for substantial profits channelled to intermediary conduit entities. The DMTT does nothing to combat the attribution of low profits to entities in host countries due to base erosion practices.

The GloBE should provide an incentive for host countries to raise their effective tax rate at least to the 15% minimum, since any undertaxed profits would in any case be taxed at that rate by home countries. Leading OECD countries have already adopted measures to protect their source tax base, which they intend to retain, such as the UK's diverted profits tax and the US's base erosion anti-abuse tax. Poorer countries have even more reason to do likewise. They should consider introducing or strengthening measures such as an alternative minimum tax on deemed or book profits, versions of which already exist in many countries. These are compatible with the GloBE, and should be regarded as an essential complement, to ensure that it contributes to both fair and effective taxation of MNE profits.

A. General Comments

The adoption of proposals for a global anti-base-erosion minimum tax (the GloBE) on the profits of multinational enterprises (MNEs) is a historic breakthrough. It is now more than a quarter-century since the G7 world leaders called on the OECD to vigorously pursue its work to limit the erosion of tax bases due to harmful tax competition resulting from globalisation.[1] Unfortunately, the approach adopted by the OECD at that time proved largely ineffective, and harmful tax practices greatly increased. The approach now adopted entails concerted counter-measures by states to defend their tax base, and has better prospects of success.

However, it is important to view this as a continuing process. The GloBE proposals open up a new way forward, but its direction and destination remain uncertain, and its difficulties should not be under-estimated. It is a significant achievement to reach consensus among a large number of countries, but this also has its drawbacks. The proposals mainly reflect the

[1] G7 Economic Communiqué, Lyon Summit, paragraph 16, available at http://www.g8.utoronto.ca/summit/1996lyon/communique.html

perspective and priorities of OECD countries, and since the last public consultation they have been weakened to obtain acceptance by some countries that have offered harmful preferential tax regimes and are reluctant to end such policies.

The GloBE should also be seen as part of a wider process. Its adoption offers an opportunity for other countries to adopt additional measures that would be more appropriate to defend their own tax base, and which should be considered compatible with the GloBE. Devising and implementing such measures will be a challenge for low-income countries, and many of them would in our view be better advised to put their scarce resources into these alternatives, rather than joining the GloBE scheme itself, which is highly complex and will be very difficult to administer.

Much of this complexity is because the scheme creates a new layer on top of existing methodologies for applying international tax rules, particularly 'arm's length' pricing of transactions between entities within an MNE group. Yet the practices of profit-shifting that the GloBE is designed to counter are rooted in the exploitation of the fundamentally flawed approach that taxation of MNEs should be based on the fiction that they consist of independent entities dealing with each other at arm's length. Only by shifting towards treating MNEs in accordance with the economic reality that they are unitary enterprises acting under central control and direction could they be effectively taxed according to where their real activities take place. The GloBE makes a tentative move in this direction through the design of the UTPR, and this should provide an impetus to reform tax rules so that MNEs are taxed on the share of profits reflecting real activities in each country (sales, employees and assets).

1. Aims, Design and Implementation

It is important to recall that the GloBE aims to establish a 'common approach'. Even members of the Inclusive Framework are not obliged to adopt the GloBE rules, while if they choose to do so they are required only to implement the rules 'in a way that is consistent with the outcomes provided for under Pillar Two, including in light of the model rules and guidance agreed to by the IF'.[2] This makes it very important to be clear about the intended 'outcomes'.

It should be made explicit that the aims of the GloBE are (i) to achieve the objective stated by the G20 in 2013, and all UN member states in the 2015 Addis Ababa Action Agenda,[3] of enabling MNEs to be taxed where they have real economic activities, and (ii) to put a brake on the competition to reduce corporate tax rates to attract investment, which damages all states in the long run, and to reverse the secular decline in corporate tax rates.

Hence, the common approach should be designed to encourage any measures by countries which contribute to these aims, and deter those which hinder them. The model rules for the GloBE that have now been issued are highly detailed and technical, but they cannot be set in stone. There is considerable scope for further development to make them more effective in achieving those aims and to improve their functioning, and any process of review and updating should be fully inclusive. States are, and should remain, free to join in with the common approach, and if they choose to adopt the GloBE to do so in their own way, provided that it is 'consistent with the outcomes'. Neither the OECD nor the Inclusive Framework have the power to enact binding global rules, nor to adopt binding interpretations of those rules. States remain sovereign, particularly in matters as important as taxation. It is

[2] Statement on a Two Pillar Solution, October 2021, p, 3.
[3] Para 23, available at https://sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf

important to retain sufficient flexibility to allow improvements that would remedy the defects and limitations of the current rules.

These are, in particular:

(i) the agreed minimum rate of 15% is low compared to the global average corporate tax rate of 25%, particularly when combined with the possibility of offering even lower rates (down to zero) on income carved-out by the substance test; this will continue to provide strong incentives to shift profits out of host countries where real activities take place;

(ii) the inclusion of the DMTT, as well as the substance-based carve-out, encourage continued tax competition, contrary to the GloBE's aims, and risks turning the minimum to a maximum;

(iii) the method of calculating the effective tax rate (ETR) encourages competition over the definition of the tax base, such as allowances for research and development, capital investment and depreciation, and acquisition of intellectual property rights and other intangibles (particularly for acquisitions made prior to December 2021); and

(iv) the use of financial accounting rules as the basis for calculating the ETR, albeit with some defined adjustments, reverses the normal approach in which tax authorities have powers of detailed examination that are independent of audited financial accounts, and allows MNE management considerable discretion in determining the relevant tax base.

Hence, countries should remain free to improve on the model rules in their own laws and regulations. The GloBE now gives the power to countries which wish to do so to ensure a minimum rate of tax on MNEs' global profits, and they should ensure that they use it effectively. This should provide counter-pressure against attempts to weaken the standard, and should also be used to support moves to strengthen it. The GloBE provides an opportunity to reverse the race to the bottom and to create movement upwards in effective corporate tax rates. The 15% rate now agreed should be regarded as the absolute floor, and not a ceiling. Countries should set a higher rate if they wish, and the aim should be to raise it progressively.

2. Allocation of Tax Rights and Rule Order

A major defect of the GloBE is that it gives a priority right to apply the top-up tax on undertaxed income to the home or intermediary country of the MNE, through the Income Inclusion Rule (IIR), and only a backup right to the host country to apply the Undertaxed Profits Rule (UTPR).[4] An alternative approach that we supported would have provided a balanced allocation based on a formula reflecting the MNE's presence in each country, that would be fairer and less complex.[5]

[4] The acronym UTPR is not defined within the model rules. Although the expression 'Undertaxed Payments Rule' was used in the October 2020 Pillar Two blueprint, some (e.g. the UK) have commented that 'Undertaxed Profits Rule' is more accurate. As we agree with this, we treat UTPR as being an acronym for this profits-focused defined term. Also, throughout this paper, in the context of the UTPR, we refer to the countries where operations take place as 'host countries'. It is these countries from which profits have been shifted and to which any UTPR Top-up Tax Amount would be allocated under the Article 2.6.1 formula.

[5] Picciotto, Cobham, Faccio, Garcia-Bernardo, Jansky and Kadet, 'For a Better GLOBE. METR: A Minimum Effective Tax Rate for Multinationals' *Tax Notes International* (2021) 101: 863-7, available at SSRN: https://ssrn.com/abstract=3796030

However, the GloBE does provide an incentive for host countries to raise their effective tax rate at least to the 15% minimum, since any undertaxed profits would in any case be taxed at that rate by home countries under the IIR (or potentially host countries under the UTPR in the rare situations where no Parent Entity or Intermediate Parent Entity applies the IIR). Provided that host country taxes are levied on income or profits, and hence treated as Covered Taxes for the GloBE, they would not increase the total tax on MNEs within the scope of the GloBE, and hence would not deter inward investment.

There is no need for countries to formally join the GloBE scheme to take such steps, so all host countries could benefit by ensuring that profits derived from that country are effectively taxed at least at the minimum rate. This would greatly contribute to the GloBE's intended outcomes of aligning tax with real activities, even if the measures adopted by a particular state are not explicitly included in the GloBE. Hence, such measures should be regarded as part of the common approach, even if designed and implemented by a country acting alone or in conjunction with others in a similar situation.

2.1 The Domestic Minimum Top-Up Tax (DMTT)

The model rules have now included a new provision, that allows countries to apply a domestic minimum top-up tax (DMTT), to ensure a minimum ETR of 15% on the profits that MNE subsidiaries declare in that country. A Qualified DMTT (one calculated in accordance with the GloBE rules) would be deducted from the top-up tax otherwise payable under the IIR (or the UTPR). Hence, it is this QDMTT that now has priority, over both the IIR and the UTPR.

While this has wider potential application, this measure would mainly benefit countries that provide low tax rates encouraging MNEs to attribute high levels of income there, often far in excess of their real activities in that country. These countries are tax haven conduits or hubs, acting as intermediaries between MNE home countries and the MNEs' operating affiliates in host countries. Introducing a DMTT would enable them to reduce the tax revenue losses they could suffer under the GloBE. Adding the DMTT to the GloBE could make it more likely that such countries might reduce their tax rates on MNE income even further, to retain their role as hubs.[6] Although the minimum ETR of 15% under the GloBE would establish a floor, the danger is that the DMTT could make tax competition more acute, so that it becomes the ceiling for all states.

Introducing a DMTT could also seem attractive to countries that wish to attract real investment in assets and jobs, by offering low or even zero tax rates protected by the substance-based carve-out. This is because it would ensure that any profits declared in that country in excess of the carved-out amount are taxed at least at the minimum rate in that country, rather than under the home country's IIR or the UTPR. This further exacerbates the damaging effects of the carve-out, which it should be the aim to eliminate, not enhance. Yet this also would contribute to the continuing tax competition that would turn the 15% rate into a ceiling.

The DMTT would not benefit the large number of countries that are only or mainly hosts to MNE operating subsidiaries, and are the main victims of base erosion and profit shifting. Under existing rules on allocation of income, MNEs can use so-called 'one-sided' transfer pricing methods to attribute at most low 'routine' profits to such activities, and these can be further reduced by deductions of inter-affiliate payments for fees, interest and royalties. It is

[6] See Devereux, Vella and Wardell-Burrus, 'Pillar 2: Rule Order, Incentives and Tax Competition' (2022), Policy Brief, Oxford University Centre for Business Taxation, p. 7-9, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4009002

these payments that are so commonly used to shift profits to the intermediary entities in low-tax conduit countries, which are designated as fulfilling functions such as management of treasury and finance, providing debt financing, licensing intellectual property rights, logistics, and other kinds of services.

The GloBE gives the prior right to tax the profits shifted out of host countries in this way to MNE home countries, under the IIR, which has priority over the UTPR. Now the conduit or hub country will be allowed to introduce a DMTT, which not only has priority over the IIR, but also over the UTPR. Thus, the host countries, which are the main victims of BEPS practices, are relegated to the last in the GloBE priority rules. Furthermore, the model rules now include a number of provisions that reduce the amount of the Top-Up Tax, as well as restricting application of the UTPR. These, which are discussed in more detail in section B below, include the narrowing of the UTPR mechanisms available for host countries to collect their share of Top-up Tax (item B.5), the reduction of the UPE's GloBE Income in the case of UPEs that are flow-through entities and that have certain interest holders (item B.6. below), and the exclusion from the UTPR of MNE groups during the 'initial phase' of their international activities (item B.7. below). It is also to be noted that the UTPR will come into effect in 2024, at the very end of the process. The sole item relevant to developing countries in the GloBE rules has been relegated to the very last.

It's also important to note that a DMTT would apply only to in-scope MNEs. Hence, it would allow conduits and hubs to continue their 'beggar thy neighbour' harmful tax practices. We suggest that countries adopting the GloBE should require that a Qualified Domestic Minimum Top-up Tax must be imposed uniformly on all relevant taxpayers and not solely on in-scope MNEs. This would significantly simplify the application of the GloBE since the only countries that would likely implement such a tax applicable to all MNEs would be those host countries whose economies are most affected by large in-scope MNEs. Conduit or hub countries would be unlikely to implement it since it would end their attractiveness for out-of-scope MNEs and other taxpayers.

2.2 Tax Sparing

Countries with tax sparing provisions risk losing their tax base to home jurisdictions as the spared taxes are not considered as covered taxes for calculating the ETR of the CE. Thus, developing countries may lose a significant portion of their tax treaty rights.[7]

2.3 Measures to Protect Host Country Taxation

Enforcing the priority rules of the GloBE would result in unfair and unacceptable outcomes, contrary to the aims of Pillar 2 to reverse the race to the bottom in corporate tax. One remedy is for host countries to design a form of alternative minimum tax suitable for their own circumstances. To combat base erosion, this cannot be based on applying a minimum rate to profits attributed under current rules as does the DMTT, since the main problem for host countries is that MNEs attribute low profits to activities in those countries by using base erosion techniques.

In fact, many countries have already been deploying alternative minimum taxes, which can provide an effective and easy to administer method particularly for low income countries to

[7] See Kuldeep Sharma, Global Minimum Corporate Tax: Interaction of Income Inclusion Rule with Controlled Foreign Corporation and Tax-sparing Provisions, South Centre *Tax Cooperation Policy Brief 22*, 12 January 2022. Available from: https://www.southcentre.int/tax-cooperation-policy-brief-22-12-january-2022/

combat abuse.[8] The introduction of the GloBE should be seen as an opportunity for countries to introduce or strengthen such alternative minimum taxes, and extend their application to ensure strong defences against profit-shifting. Until now they have often been designed as a fall-back, because of the concern not to deter inward investment. Now they should be regarded as an essential element of rebalancing the application of the global minimum tax more fairly among countries where MNEs have real activities.

In particular, minimum taxes based on modified corporate income or deemed profits could both ensure that (i) profits are taxed at a minimum effective tax rate of 15% or higher, and (ii) the incentives for profit shifting are reduced by specifically targeting the sources of base erosion. Since they are based on measures of modified income or deemed profits, they should be accepted as Covered Taxes under the GloBE. Although not formally part of the GloBE scheme, they should be considered as complementary to it. Otherwise, MNEs face the risk of double taxation.

Indeed, it should be pointed out that some of the leading OECD countries have themselves adopted taxes aimed at countering erosion of their tax bases. The UK's Diverted Profits Tax and Australia's Multinational Anti-Avoidance Act were both enacted in 2015, with this aim. The US international tax reforms of 2017 included not only the GILTI, which inspired the GloBE's IIR, but also the BEAT (Base Erosion Anti-Avoidance Tax), which aims to protect the US tax base. These OECD country measures are compatible with the GloBE,[9] and the taxes they apply would be considered Covered Taxes, and hence reduce the tax that could be collected under an IIR by MNE home countries.

Hence, although the IIR has priority over a tax designed in line with the UTPR, it does not override other valid host country taxes on corporate income. Low-income countries that are mostly only hosts for foreign-based MNEs have even more reason to introduce taxes to protect their tax bases. These need to be designed to be compatible with their tax treaties. Where necessary, treaties that impose undue restrictions on such measures should be renegotiated.

As some developing countries have entered into tax agreements, either through special provisions in the applicable domestic law, or in investment contracts with foreign investors which contain tax incentives that are locked in by fiscal stabilisation clauses, the introduction of taxes to protect the source base may require the amendment of such laws and the renegotiation of contracts and agreements.

Members of the Inclusive Framework should both (i) support the implementation of measures that are consistent with the objectives of GloBE and (ii) allow and encourage developing countries to revise their tax regimes to remove incentives so as to ensure fair taxation and a level playing field between foreign-owned and local business, including removing, unwinding, or suspending provisions in their domestic laws or investment agreements without facing the risk of arbitration.

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[8] See Aslam and Coelho, An Effective Lower Bound: Characteristics and Impact of Corporate Minimum Taxation', IMF Working Paper No. 2021/161, available at https://www.imf.org/en/Publications/WP/Issues/2021/06/08/A-Firm-Lower-Bound-Characteristics-and-Impact-of-Corporate-Minimum-Taxation-49886 .

[9] The UK government's consultation paper on its implementation of the GloBE explains its intention to retain existing anti-avoidance measures that 'counteract arrangements which are designed to shift particular streams of income out of the UK tax base', because with UK's plan to increase the corporate tax rate to 25% 'there will continue to be a significant rate difference with the minimum rate of 15%, and therefore potential ongoing incentives and opportunities for tax planning': *OECD Pillar 2: Consultation on Implementation*, p. 58, available at https://www.gov.uk/government/consultations/oecd-pillar-2-consultation-on-implementation

2.4 The Subject to Tax Rule (STTR)

The Inclusive Framework's Statement on Pillar 2 includes a political commitment for participating countries to agree to include in their tax treaties a provision to allow the Subject to Tax Rule (STTR), although only for developing countries.

However, in our view the proposed STTR, as described in the statement of October 2021, offers little improvement on most existing OECD treaties. MNE host countries should aim to establish stronger protection of source taxation than such an STTR would offer.[10] Fortunately for low-income countries, many of them have few tax treaties, and their treaties are more often based on the UN model, that provides greater protection for source taxation. The UN Tax Committee has been continuing its work to strengthen source taxation. This should be regarded as an essential complement to the GloBE, since the GloBE rules themselves provide no clear benefit to developing countries, and in some respects could damage them.

3. Complexity and Compliance

The OECD's model rules take up nearly 70 pages, and the Commentary will likely take up many pages more. The technical detail is of a mind-numbing complexity even for specialists in international tax. This has indeed been pointed out by Business at the OECD (BIAC), which represents the MNEs employing the tax professionals who will be responsible for compliance by MNEs.[11] They suggest that the problem could be alleviated by the adoption of 'safe harbours'. However, we fear that the problem goes much deeper.

Complexity is inherent in the approach adopted, because its starts from the accounts of the individual constituent entities of each MNE group, many of which have hundreds of such affiliates.[12] Since these complex structures have been created and maintained, often for the primary purpose of minimising tax, by the corporate tax professionals themselves, it ill behoves them to complain of complexity. Our concern is rather with the difficulties this will create for tax officials administering the rules. All tax administrations are now inadequately resourced, but those from low-income countries will obviously find it much harder to deal with this level of complexity. Since many such countries would in any case derive little or no benefit from the GloBE, due to the priority rules, they are likely to be better advised to apply their scarce resources to devising measures that could protect their own tax base.

Although intended to facilitate uniform application of the GloBE, the issuing of these highly technical and detailed model rules would create further complexity if they are treated as more than guidance. The model rules themselves have no legal status or binding force. This can only occur once countries enact them into their domestic law, and they should do so in their own way, with variations reflecting their own situations. Domestic courts should remain free to interpret national tax legislation as is appropriate for each jurisdiction's legal system. The European Commission has already published a draft Directive for their implementation as part of EU law. Although this sticks closely to the terms of the model rules, it uses different

[10] See our comments on the Statement by the G24 in October 2021, particularly their call for a broader STTR, available at https://www.bepsmonitoringgroup.org/news/2021/10/5/comments-of-the-g24-on-the-proposed-two-pillar-solution.

[11] Letter of 6 January, available at https://biac.org/wp-content/uploads/2022/01/01-06-2022-Business-at-OECD-BIAC-6-Jan-Pillar-Two-Issues-Letter-1.pdf

[12] In contrast, the minimum effective tax rate (METR) proposal by Picciotto et al. (note 3 above) would be much simpler, as it starts from the group consolidated accounts; this would also make the adjustments of financial accounts for tax purposes to deal with issues such as timing differences easier; there would be no need for the carve-out since the allocation of rights to apply a top-up tax would be based on factors reflecting substance; and there would be a single rule for the top-up tax allocation, and no need to manage the interactions of different rules.

language. The Directive itself also does not automatically come into effect in the national laws of the EU member states, but must be implemented by them, also in their own ways. The EU is distinctive, in that it has a supranational Court which can resolve any issues of interpretation of the Directive that may arise. However, there would then be issues about the compatibility of these decisions with interpretations adopted by non-EU countries applying the GloBE. The US, which is obviously a key participant as the home country of a high proportion of in-scope MNEs, will not be expected to apply the detailed provisions of the model rules. [*We will need to see what the Implementation Framework says about GILTI (and BEAT) compatibility*] Nor should other countries.

Clearly, it is neither possible, nor indeed desirable, to enforce uniformity in the interpretation and application of the GloBE worldwide, and the OECD has no power to do so. Divergences are inevitable, and can and should be tolerated, as long as they do not detract from the effectiveness of the GloBE in achieving its intended outcomes. In practice, the power lies with the countries applying top-up taxes. It is they who must decide how far they are willing to tolerate the undermining of their tax bases by the harmful tax practices that the GloBE is designed to counteract. They cannot and should not be prevented by the GloBE from strengthening its standards, and counteracting any weakening due to lax implementation by others.

This applies in particular to the minimum rate of 15%. The average global statutory corporate tax rate is now 25%, and it remains higher in regions of the global South (28% in Africa, and 31% in South America).[13] The global average has declined steadily from a rate of 46% in 1980. The proposed minimum ETR of 15%, even if effectively implemented, will continue to provide a strong incentive for MNEs to shift profits out of countries that have rates of 25%, let alone the higher rates prevalent in many low income countries. As currently formulated, the GloBE will not effectively deter the use of profit-shifting structures even by those MNEs within its scope.

Recognising the great importance of this issue, there was considerable worldwide support when the US administration proposed a minimum rate of 21%, and the reduction to 15% was the regrettable price paid for achieving consensus. The aim of the GloBE should be not only to halt but to reverse this decline. To facilitate and encourage this, countries should use their freedom to determine their own tax rates, and set a higher minimum ETR if and when they wish to do so.

Flexibility is also desirable in applying the detail of the GloBE rules, provided that modifications are in line with the aims and outcomes. There will no doubt be further iterations of the oft-repeated concerns about the potential for double taxation. While we agree that double taxation is to be avoided as far as possible, we must point out that the primary reason why Pillar Two was deemed necessary is the pervasive use by MNEs of profit-shifting structures that result in double non-taxation. If MNEs were not using these structures, which artificially move profits out of jurisdictions where substantive operations take place and into zero and other low-taxed jurisdictions, then there would be little or no potential for double taxation. Where MNEs continue to shift profits to jurisdictions with tax rates below those in which they conduct real operations, then any potential double taxation they face is a consequence of their own actions. Hence, while working to avoid the potential for double taxation where possible, countries implementing the GloBE must act resolutely to create an

[13] These averages are weighted by GDP: see Sean Bray, *Corporate Tax Rates Around the World*, Tax Foundation, at https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/

administrable system that gets to a fair result, even if there is some unavoidable potential for marginal double taxation.

In the next Part we will draw attention to issues that we have identified with specific elements of the model rules. We understand that there is to be no public consultation on the published text, and there seems no intention to revise it at this stage. However, we urge countries to take account of these issues when deciding whether and how to implement the GloBE in their domestic law and administrative practices. We expect that the Inclusive Framework will in due course consider the need to modify the Rules, or the Commentary, to take account of any variations in the way in which the GloBE is applied or interpreted that may be material to its effectiveness.

B. Specific Comments

1. Computation of the GloBE Income or Loss

1.1 Reliance on Financial Accounts

The starting point for the GloBE is the Financial Accounting Net Income or Loss of each constituent entity (CE) of an MNE group, determined under the financial accounting standard used by its ultimate parent entity (UPE) (article 3.1.2). Where this is not ‘reasonably practicable’, another standard may be used, provided that it ensures ‘reliable’ information (3.1.3).

This will further widen the information asymmetries between taxpayers and tax authorities. Tax collection activities are determined by national tax laws that normally give powers of examination to tax authorities independently of audited financial accounts. Tax authorities should continue to apply these powers, and the approach adopted under the GloBE should not be seen as creating any presumption that the financial accounts must be accepted at face value.

Using financial accounts as the main source in measuring the tax base is very dependent on the quality of both the (often unaudited) accounts of CEs and group-wide audited accounts. In recent years many Member States of the EU and other countries have experienced serious deficiencies in audited accounts, for example most recently Wirecard. Such defects can result from exploitation of ambiguities or indeterminacies in the standards, or from negligent or even fraudulent practices.

There are differences in the way in which international accounting standards are adopted in national rules, and these rules also change over time, impacting on the tax base. They also frequently allow options in the treatment of income and expenditure. Even if rules are consistently applied by each MNE, there will be differences between MNEs. One example is whether expenses are capitalised or written off as expense against revenue. These differences allow scope for arbitrage opportunities in the choice of accounting standard. Even within an accounting framework, management may have significant discretion, for example as to how much tax should be accrued because of uncertain tax positions or expectations regarding the tax effects in future years when timing differences turn around. MNEs’ Annual Reports frequently include several pages of discussion of uncertain tax positions, occasionally due to ongoing litigation. For this reason, we advise against the use of the deferred tax approach for dealing with timing differences (see further below).

Hence, it is important that there should be effective scrutiny of such accounts by tax authorities. Those primarily concerned should be the MNEs’ home countries (assuming they intend to apply the IIR), which need to ensure that the data for calculating the ETR and the

Top-Up Tax are accurate and reliable; however, those of any jurisdiction applying a QDMMT would also be involved, and there will need to be appropriate exchange of information between them.

The use of CE-level Financial Accounting Net Income or Loss places great reliance on the recording of each CE's transactions, while the group-wide focus of in-house financial functions and outside auditors is most typically on consolidated results and not on individual entity results. Verifying the accuracy of these CE accounts will be difficult for a tax authority with the power to apply an IIR or a QDMMT.

For example, the calculation of the substance-based income exclusion relies on the expenditures of a CE on 'eligible tangible assets' in that jurisdiction and 'eligible payroll costs of eligible employees' in that jurisdiction. The term 'eligible employees' is widely defined, to include 'independent contractors participating in the ordinary operating activities of the MNE Group under the direction and control of the MNE Group', but 'eligible payroll costs' more specifically refers to 'employee compensation expenditures', which is more narrowly defined. First, whether specific independent contractors are 'under the direction and control of the MNE Group' is a subjective determination that relevant tax authorities will have little ability to audit or judge. Second, there are several categories of workers in many countries, and the status of personnel is often highly contested, particularly in the 'gig economy'. We discuss this further below.

In addition to the issue of the direct recording of each CE's transactions is the need to 'push down' to individual CEs any adjustments made in consolidation that are not mere eliminations of intragroup transactions (see article 3.1.2). Relevant tax authorities will need to consider the propriety of how such adjustments are spread over the MNE group's CEs.

1.2 Adjustments to the Financial Accounts

Specific adjustments are required to the financial accounting income or loss under article 3.2.1. These are important because financial accounts are compiled for very different purposes than calculating tax liability.

We are concerned about the effect on the calculation of GloBE Income or Loss of reserves accrued for uncertain liabilities, which are allowable under financial accounting rules. Such reserves decrease Top-up Tax, and are inconsistent with the tax principle of accounting only for actual expenses or liabilities. In addition, the high degree of management influence over such reserves is inconsistent with GloBE goals and principles. As a common example of such a reserve, where an MNE is the subject of a lawsuit, it will commonly accrue some amount to reflect its estimation of future obligations. Although such an accrual directly affects Financial Accounting Net Income or Loss, it is typically added-back in the taxable income calculation. The accrual of such a reserve would reduce Net GloBE Income and thus reduce the calculation of Top-up Tax in Article 5.2. We suggest that countries adopting the GloBE and the Inclusive Framework provide that reserves for uncertain liabilities and any similar accruals be added-back so that Net GloBE Income and Excess Profit, as the base for the Top-up Tax calculation, is not reduced by the accrual of such uncertain future liabilities.

Article 3.2.2 allows the MNE an election to use the tax deduction amount rather than the financial statement expense amount for stock-based compensation, on a jurisdiction-by-jurisdiction basis. This allows MNEs to cherry-pick the jurisdictions for which they will make this election. We see no compelling reason for this election, and recommend that financial statement expenses must always be used. This will eliminate management influence through cherry-picking over the computation of GloBE Income or Loss, which should as much as possible be calculated free of management influence. Also, use of the financial statement expense is much more consistent with the tax policy behind a minimum tax based on financial results as reported in financial statements. If the election is considered necessary, we recommend that it must be made for the MNE group as a whole. In the case of a jurisdiction that does not impose an income tax, the financial statement expense amount should anyway be used.

Article 3.2.5 provides for a jurisdiction-by-jurisdiction election to ignore fair-value or impairment accounting. We agree that such an election is appropriate. However, we believe that this should be a group-wide permanent election rather than a five-year jurisdiction-by-jurisdiction election. The election should not be structured in a manner that allows cherry-picking by jurisdiction or by type of asset. Consistency of treatment is infinitely preferable to allowing management to calculate every five years whether it would achieve lower GloBE Income by revoking previously made elections.

Article 3.2.8 provides a jurisdiction-by-jurisdiction five-year election for a UPE to apply its consolidated accounting treatment to eliminate income, expense, gains, and losses from transactions between Constituent Entities that are located, and included in a tax consolidation group, in the same jurisdiction for purposes of computing each such Constituent Entity's Net GloBE Income or Loss. For both consistency of treatment and as a simplification measure, we suggest that this be a permanent election and not a five-year election.

1.3 Exclusion of International Shipping Income

The exclusion of international shipping income is based on weak policy rationales, and countries should consider carefully whether to adopt it.

Furthermore, some of the provisions are over-broad and vulnerable to abuse. Article 3.3.2 (e) defines international shipping income to include 'the participation in a pool, a joint business or an international operating agency for the transportation of passengers or cargo by ships in international traffic'. Article 3.3.3 deals with qualified ancillary shipping income which is also exempt from the GloBE rules. Sub-section (e) includes 'investment income where the investment that generates the income is made as an integral part of the carrying on the business of operating the ships in international traffic'.

Article 3.3.6 reads:

> In order for a Constituent Entity's International Shipping Income and Qualified Ancillary International Shipping Income to qualify for the exclusion from its GloBE Income or Loss under this Article, the Constituent Entity must demonstrate that **the strategic or commercial management of all ships concerned is effectively carried on from within the jurisdiction where the Constituent Entity is located**. [Emphasis added.]

Given the ubiquitous use of tax havens and flags of convenience, there must be many situations where the 'strategic or commercial management of all ships concerned' is carried out in some location that is not the jurisdiction of the CE. Hence, it is very important that MNEs must clearly establish substantial management and operations so that they may not treat nominal or relatively minor activities as qualifying a CE for this exclusion. It should also be made clear that a management company, whether related or unrelated, located in a jurisdiction other than the jurisdiction of the Constituent Entity, will not qualify for this exclusion unless it can be factually established that strategic management is conducted within the jurisdiction. Strategic management should never be found where local directors or other local personnel work under the authority and direction of group personnel located outside of the jurisdiction of the Constituent Entity.

In addition, any standard reporting package that is developed for MNEs, must require that claims that one or more CEs qualify for this exclusion be supported by details of functions and activities that constitute strategic and commercial management with the specific locations of the personnel who perform these functions and activities and the locations of the personnel to whom they report or otherwise take directions.

2. Computation of Adjusted Covered Taxes

2.1 Top-Up Tax in a Year when there is a Loss

We note that the January 6, 2022 letter from BIAC urges that article 4.1.5 be reconsidered. We do not have the benefit of any knowledge of what internal Inclusive Framework discussions have been regarding the decision to include Article 4.1.5. as it is presently drafted over the alternative approaches that BIAC says that they previously presented. However, we simply note that it makes sense that a negative tax expense that has been realised that is in excess of the 15% minimum effective tax rate on the amount of a GloBE Loss for a jurisdiction should be recognised as a Top-up Tax. It will not be administratively difficult to determine, as it will use only the calculations a group has to make in the event of positive GloBE income, and it results in a current top-up tax, which is consistent with applying Pillar Two in as current a manner as possible on an overall basis. Further, whether in a particular year there is GloBE income or loss within a jurisdiction does not change the economics of the relationship between GloBE income or loss and covered taxes that are either paid by a CE or received back as a result of refunds or credits. As much as possible, the Top-up Tax should be calculated and paid on a current basis.

2.2 Taxes Due and Payable and Deferred Tax Accounting

Our understanding of the October 2020 Pillar Two blueprint was that the covered taxes numerator for the ETR calculation was on a basis of the taxes as reflected in actual tax returns (see para. 296). The earlier discussion of the carry-forward' approach versus the 'deferred tax accounting' approach concluded in para 294:

> … Although maintaining memorandum accounts in respect of carry-forwards is somewhat burdensome, it is a familiar exercise for both taxpayers and tax administrations. Accordingly, while there appear to be some advantages with a deferred tax accounting approach the members of the Inclusive Framework do not consider that such an approach would serve as an appropriate mechanism to address timing differences. …

Now, we see in Article 4 that what we might call a hybrid 'deferred tax approach' is being used rather than the "carry-forward approach".

Aside from the terms of Article 4 being very complex and difficult to comprehend, Article 4 appears to have been written on the assumption that the current tax expense (Article 4.1.1) and deferred tax liabilities (Article 4.4.1) accrued in the financial accounts are easily broken down into their component parts. For example, in regard to the current tax expense, it is assumed that the taxpayer will know how much of the current tax expense relates to an uncertain tax position or is not expected to be paid within three years of the last day of the Fiscal Year. Similarly, in the case of the deferred tax expense, it is assumed that there will be exact known amounts of deferred taxes attributable to each uncertain tax position, and similarly for valuation adjustments.

This ability to accurately break down the current and deferred tax expenses into identified components with specific amounts may not reflect reality. Rather, the aggregate amounts of current and deferred tax expenses within the financial accounts may reflect management judgments on the aggregate level of the current and deferred tax expenses for the jurisdiction (which could include specific tax risks of which management is aware, but which have not been include as an identified component). In such cases, the sum of the possible tax effects for identified components may be more or less than the total current and deferred tax expenses.

In addition to this, in consolidation, management may adjust the aggregate amount of current and deferred tax expenses up or down to reflect their judgment of group-wide risks, or perhaps in some cases as a means to manage the level of group-wide earnings. There may be no good way to push such adjustments made centrally back to the Constituent Entities in each separate jurisdiction. It goes without saying that any outside auditor focus will be primarily on the reasonableness of the group-wide level of risk and not the component make-up of each jurisdiction's current and deferred tax expenses. Further, the amounts at issue will often be below the outside auditor's materiality level for the group as a whole, but those amounts will still be very material to applicable jurisdictions and the amount of IIR and UTPR taxation.

We urge both countries adopting the GloBE, and the Inclusive Framework, to seriously consider going back to the 'carry-forward' approach and rejecting this 'deferred tax accounting' approach for the following reasons:

- The complexity of Article 4 is mind-numbing. In contrast, the "carry-forward approach" described in paras. 295 – 318 of the October 2020 Pillar Two blueprint is understandable and appropriate.
- The component numbers to implement Article 4 will often not be available.
- Even if management makes the effort to establish these component numbers, this means that management's judgment is being substituted for objective actual cash tax payments. In particular, para. 293 in the October 2020 Pillar Two blueprint stated:

> 293. The principal policy risk of deferred tax accounting, however, is that it relies on a taxpayer's estimate of future liability for tax in a subsidiary jurisdiction to determine its current liability under the GloBE rules. The carry-forward approach, in contrast, relies on actual tax liabilities existing at the time tax liability under the GloBE rules is determined.

- Finally, actual tax liabilities and not management-influenced financial accounts should be the basis for determining the ETR numerator, and thus GloBE IIR and UTPR obligations.

We believe that the "carry-forward approach" along with the various safeguard mechanisms as described in the Pillar Two blueprint provides a fair result for taxpayers and a much better and more administrable approach for both taxpayers and tax administrators. With reliance on amounts as reflected in actual tax filings (which will typically be understated by taxpayers rather than overstated), much of the complication within Article 4 will be avoided, including most or all of the Article 4.6 complications for post-filing adjustments and tax rate changes.

2.3 Recasting Deferred Tax Expense at the Minimum Rate

Article 4.4.1 requires that the deferred tax expense be recast at the Minimum Rate in cases where the applicable tax rate is above the Minimum Rate. This has the effect of reducing the Total Deferred Tax Adjustment Amount, which is added to a Constituent Entity's Adjusted Covered Taxes. The result, of course, is the potential for a Top-up Tax that would be higher than if the full deferred tax expense were included in the Total Deferred Tax Adjustment Amount.

The BIAC letter of January 6 referred to above explains, in part:

> … Recasting deferred tax amounts at the Minimum Rate does not provide recognition of the actual rate of tax that will be borne in respect of the relevant underlying timing difference when looking at the annual ETR, and will result in Top-up tax both in respect of timing and permanent differences. …

As explained above, we recommend rejecting this “deferred tax accounting approach” in favour of the “carry-forward approach”. On the assumption, though, that this recommendation is not taken and countries decide to implement a “deferred tax accounting approach”, we recommend that they apply Article 4.4.1 with no changes.

The principal reason for this recommendation is that deferred tax expense, along with the deferred tax liability, reflects taxpayer assumptions about an uncertain future. It is not, as the letter says, ‘the actual rate of tax that will be borne in respect of the relevant underlying timing difference’. Such taxpayer assumptions include belief about the effective tax rate that will apply to timing differences in future years when they reverse. It also includes assumptions about the continued operations of the taxpayer as well as the taxpayer’s profitability, which is important since future profitability is ordinarily necessary for timing differences to have real tax effect in the years of reversal.

Such assumptions, especially in these early years of application of Pillars One and Two, are particularly suspect, which strongly suggests conservatism from the standpoint of including all deferred taxes within the Total Deferred Tax Adjustment Amount, which is added to a Constituent Entity’s Adjusted Covered Taxes. First, it seems likely that some number of jurisdictions that have tax rates above the defined 15% minimum will be under some competitive pressure to reduce their rates to 15%. Second, as MNEs experience the effects of Pillar Two, some will undoubtedly unwind or reorganize their profit-shifting structures through mergers or other corporate restructurings. Such changes will have varying effects on existing deferred tax liabilities by jurisdiction.

In view of the uncertainties mentioned above, a conservative approach of limiting the recognition of deferred tax expense to the Minimum Rate is eminently sensible.

2.4 Adjustment of the Total Tax Adjustment Amount

Article 4.4.2.a should be corrected to read:

> The Total Deferred Tax Adjustment Amount is adjusted as follows:
>
> (a) Increased by **the deferred tax expense with respect to** any Disallowed Accrual or Unclaimed Accrual paid during the Fiscal Year;

3. Computation of the ETR and Top-Up Tax

3.1 Substance-based Income Exclusion

The status of personnel is important for both the Allocation of Top-Up Tax for the UTPR (Article 2.6.1) and the Substance-based Income Exclusion (Article 5.3). However, this status has different implications in these two contexts.

In the allocation of the top-up tax for the UTPR, the formula in Article 2.6.1 depends in part on the ‘number of employees’, which is defined for the purposes of the UTPR in Article 10.1.1 to include ‘independent contractors participating in the ordinary operating activities of the Constituent Entity'. We agree that this expansive definition is appropriate for allocating UTPR, which should reflect the taxpayer group's real activities by jurisdiction. Especially in view of the extent of gig-economy business and the influence and effect that they have on the jurisdictions in which they operate, this means that gig workers must be included in allocating the UTPR, and the Commentary should make this clear.

As regards the substance-based income exclusion, the focus should be solely on workers for which the CE actually accepts the responsibility of employer and that are resident in the country concerned. Commonly, gig economy MNEs treat those providing services through their platform, such as drivers, as independent contractors, avoiding obligations under local employment law. Independent contractors are nevertheless included in the definition of 'eligible employees' in article 10.1.1. However, the exclusion is based on the 'eligible payroll costs' of these 'eligible employees'. This is defined more narrowly in article 10.1.1 as 'employee compensation expenditures (including salaries, wages and other expenditures that provide a direct and separate personal benefit to the employee, such as health insurance and pension contributions), payroll and employment taxes, and employer social security contributions'.

This creates a logical inconsistency. The aim of the exclusion is to reflect the real activities of the CE in that jurisdiction. Both in general law and under tax principles, the activities of an independent contractor are not considered as those of its principal. Furthermore, payments to independent contractors cannot be considered to constitute employee compensation expenditures. The status of independent contractor is fundamentally inconsistent with that of an employee, which necessarily involves a relationship of dependence. It should be made clear that independent contractors are not 'eligible employees' for the purposes of the exclusion. Consistent with the MNE's *voluntary* choice of legal form and that decision's real and material effect on its legal obligations toward these personnel, the costs of such personnel should not be included within the base for the payroll carve-out.

We have also noted above the high degree of subjectivity that is involved in determining whether specific independent contractors will be 'under the direction and control of the MNE Group'. Especially given that the status of many gig workers in numerous countries is the subject of disputes and varying court decisions, an easy-to-administer objective standard is called for. That objective standard is that the CE actually accepts the obligations of an employer and does not treat personnel as independent contractors.

The amount of the substance-based income exclusion would be grossly inflated by the inclusion in it of stock-based compensation. Some local managers, particularly of an entity that is designated as fulfilling strategic functions, may have their remuneration greatly inflated by the grant of equity, usually in the parent entity. This could have a significant effect on the size of the tax base and the amount of Top-Up Tax.

4. Corporate Restructurings and Holding Structures

4.1 Provision to Reverse Effect of Intra-Group Asset Transfers

We note that Article 6.3.4 provides an election to provide consistent treatment when the holding values of assets are adjusted to fair value for tax purposes. This of course makes good sense. We also note and applaud the inclusion of Article 9.1.3 to require asset transfers after December 2021 to be brought into the GloBE based on the carrying value on the books of the disposing entity upon disposition. Article 9.1.3 is particularly important because of the strategy that some MNEs have already implemented, and more will doubtless adopt until Pillar Two becomes effective, to intentionally create artificial deductions that could significantly reduce tax payments, including Top-up Tax for many years following implementation of Pillar Two, unless countered. It should be noted that this also takes advantage of generous capital allowances and provisions for amortisation and depreciation particularly of intangible assets, that are notoriously hard to value.

This strategy entails intra-group transfers of assets, in particular of intangible assets. These transfers, which are solely tax motivated and have no actual economic effect aside from tax savings, provide a stepped-up basis in the transferred assets that create artificial depreciation, amortization, and other deductions that reduce tax in the jurisdiction of the transferee. Such transfers have been made at what is presumably the highest valuation the MNEs can justify without being blatantly fraudulent. These MNEs, of course, only make such intra-group asset transfers when neither the jurisdiction of the transferor CE nor the home jurisdiction of the MNE through CFC or other rules taxes the transfer. Thus, while there is no tax cost to the step-up in asset basis, there is a full deduction through depreciation, amortization, etc. in the jurisdiction of the transferee.

We see no reason for limiting Article 9.1.3 to transfers that occur after 30 November 2021. Rather, this Article 9.1.3 should apply to *all* such transfers that occur before the commencement of a Transition Year and for which there is still undepreciated or unamortized basis as of the beginning of the Transition Year. In recognition of the possibility that some such transfers were not tax motivated, Article 9.1.3 could include an exception to the extent that a transferor has, in fact, incurred tax on gain from the transfer. The Article could provide that the acquired assets should be brought into the GloBE based on the carrying value increased by the gain multiplied by the quotient of the actual tax rate paid divided by the Minimum Rate.

The blatant nature of these asset transfers that have occurred must be seen as unacceptable. The valuations in some of these transactions have been in the many billions of dollars (so much that they've distorted the aggregate country statistics of jurisdictions such as Ireland). Consequently, the Top-up Taxes under the GloBE could be understated by billions for many years.[14]

This is a known issue.[15] MNEs do not have any moral right to reap the benefits of disingenuous restructuring that they implemented knowing that it constituted tax avoidance at best, and perhaps in some cases outright tax evasion. Article 9.1.3 should be strengthened, and should be effectively applied to deal with this known loophole that has been actively exploited by many MNEs.

4.2 Treatment of Demerger Transactions

Article 6.1.1(c) concerns the 'demerger' of an existing group into two or more groups, each of which is termed 'a demerged Group'. In short, once demerged, a resulting 'demerged Group' will only be in scope of the GloBE under Article 1.1 if it has annual revenues of €750 million or more in years after the year of the demerger.

There are some number of privately-owned groups and closely-held listed groups that are in-scope, but which would have the practical flexibility to restructure through demerger transactions. This could turn highly profitable segments that use aggressive profit-shifting

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[14] This has been shown in detail by Martin Sullivan ('Ireland Rivals United States for Onshoring IP', *Tax Notes Federal*, 31 January 2022), who has documented tens of billions of recorded deferred tax assets that result from capital allowances claimed due to hundreds of billions in asset transfers by Apple and twenty other named MNEs.

[15] See Jim Stewart, 'CbC Reporting and Measuring Effective Tax Rates', *Tax Notes International*, May 31, 2021.

structures into ‘demerged Groups’ that would fall below the €750 million revenue threshold. There appears to be nothing in the GloBE rules that would prevent such demerger transactions, which would not be covered by the Article 6.5 Multi-Parented MNE Group rules except in the rare circumstances of there being a Stapled Structure or a Dual-listed Arrangement.

The extent of the taxes that could be avoided through a restructuring that allows a profitable segment to fall outside the scope of the GloBE is such that Article 6.1.1(c) is inappropriate. Rather than looking solely to the revenue of the ‘demerged Group’ in years following the demerger transaction, any ‘demerged Group’ should be treated as being in-scope for the six years following the year of the demerger. In our view, there should be no exceptions to this treatment, but if it were felt necessary a de minimis rule such as that in Article 5.5.1 could be provided. Instituting any subjective business need requirement would be insufficient since MNEs have been experts for decades in finding business reasons to make tax-motivated changes. Rather, what is needed is a clear rule that any demerger will not change the in-scope status of the two or more groups that result from a demerger transaction for an extensive period of time.

Dual-listed Arrangements, Stapled Structures and Multi-Parented MNE Groups

The term Dual-listed Arrangement has been given a very narrow definition, since it will only apply where all five of the listed conditions are met. Given the high motivation that MNEs will have to demerge so as to allow profitable business divisions to take profit-shifting structures out of the scope of the GloBE, this definition must be broadened.

We suggest that the definition be amended to read as follows:

> **Dual-listed Arrangement** means any arrangement involving two or more Ultimate Parent Entities of separate Groups, for which any one or more of the following apply:
>
> (a) the Ultimate Parent Entities agree to combine their business by contract alone;
>
> (b) pursuant to contractual arrangements the Ultimate Parent Entities will make distributions (with respect to dividends and in liquidation) to their shareholders based on a fixed ratio;
>
> (c) their activities are managed as a single economic entity under contractual arrangements while retaining their separate legal identities; or
>
> (d) the Ultimate Parent Entities prepare Consolidated Financial Statements in which the assets, liabilities, income, expenses and cash flows of all the Entities of the Groups are presented together as those of a single economic unit.

The definition of Stapled Structure has also been drafted too narrowly. Given the high motivation that MNEs will have to demerge so as to allow profitable business divisions to continue profit-shifting structures unaffected by Pillar Two, this definition must be broadened. In this regard, especially with the potential for entities to demerge where the ownership is relatively narrow, the requirement in the draft rule that a Stapled Structure must include Consolidated Financial Statements that include all group entities must be eliminated.

We suggest that a more appropriate definition would be as follows:

> **Stapled Structure** means an arrangement entered into by two or more Ultimate Parent Entities of separate Groups, under which 50% or more of the Ownership Interests in the Ultimate Parent Entities of the separate Groups are by reason of form of ownership, restrictions on transfer, or other terms or conditions combined with each other, and cannot be transferred or traded independently, or in connection with

> the transfer of one of such interests the other such interests are also transferred or required to be transferred.

Consistent with the above broadening of the definitions of Dual-listed Arrangement and Stapled Stricture, Article 6.5 concerning multi-parented Groups must be amended by deleting clauses (b) and (c).

5. The UTPR

5.1. Method of Application

As we have consistently argued, it is inappropriate and unfair that the application of the UTPR by host countries that are the source of the profits that are shifted to low-tax jurisdictions should be regarded as a mere final fall-back. Now that the QDMTT has also been included the UTPR has an even lower priority.

We now find further limitations on the UTPR's method of application and its scope.

The Pillar Two blueprint of October 2020 (para. 519) stated that the UTPR could be 'through a limitation or a denial of a deduction for payments made to related parties **or could be in the form of an additional tax'** [emphasis added].

The model rules Articles 2.4.1 and 2.4.2 now only mention the denial of a deduction or 'an equivalent adjustment under domestic law'. No mention is made of an additional tax. This could easily be done by amending Article 2.4.1 to read

> Constituent Entities of an MNE Group located in [insert name of implementing-Jurisdiction] shall be denied a deduction (or required to make an equivalent adjustment **or pay an additional tax** under domestic law) in an amount resulting in those Constituent Entities having an additional cash tax expense equal to the UTPR Top-up Tax Amount for the Fiscal Year allocated to that jurisdiction.

There is no reason why host jurisdictions should accept this restriction of their right to impose taxes to protect their tax base. This is further confirmation that they would derive little or no benefit from the GloBE, and should instead devise their own measures to protect their tax base.

5.2. Exclusion from the UTPR of MNE Groups in the Initial Phase of their International Activity

We are not aware of the reasons for the inclusion of Article 9.3. We are concerned, though, that its scope of application (Constituent Entities in six or fewer jurisdictions and €50 million or less of tangible assets in all jurisdictions other than the Reference Jurisdiction) will allow some aggressive profit-shifting MNEs to avoid any Top-up Tax for the five year term of Article 9.3.4.

In brief, it seems likely that there will be some number of in-scope highly profitable MNEs that conduct internet- based business models that meet these two conditions. Some such MNEs conduct the bulk of their activities within one jurisdiction and have little need for personnel or operations in the jurisdictions where users and customers are located. Often, as part of a profit shifting structure, such an MNE may establish a foreign group member in a low-tax jurisdiction. In addition, the home jurisdiction of some such MNEs will be a tax haven or other low-taxed jurisdiction that will choose not to impose an IIR. The UTPR may be the only mechanism with which to collect Top-up Tax from such MNEs.

While we accept that the Inclusive Framework may have determined that there are legitimate needs for this sort of transition rule, we believe that the broad coverage of this provision sets a bad precedent for two reasons.

First, this broadly-drafted provision will effectively exempt some MNEs, especially those conducting internet-based business models, from any liability for Top-up Tax for five years.

Second, this provision applies solely to the UTPR. If there is a Parent Entity jurisdiction that imposes the IIR, then that jurisdiction will collect the Top-up Tax. This appears to be just one more rule that demonstrates not only the inappropriate priority of the IIR over the UTPR, but the UTPR's further weakening by additional inappropriate rules that erode the scope for its application.

Given the above, we suggest that countries adopting the GLoBE and the Inclusive Framework eliminate Article 9.3 completely.

If adopting countries and/or the Inclusive Framework choose to retain Article 9.3, then this provision should be significantly narrowed so that the only MNEs covered are those that the Inclusive Framework explicitly intends to cover. This provision should explicitly not apply to other MNE situations, such as those conducting the internet-based business model described above.

6. Miscellaneous

6.1 UPE that is a Flow-through Entity or Subject to Deductible Dividend Regime

Articles 7.1.1(b) and (c) provide what will be in some limited number of cases an elimination of GloBE Income and, thus, any Top-up Tax that would be attributable to the eliminated GloBE Income. In short, if a UPE is a Flow-through Entity and a holder of a 5% or less interest in the UPE's profits and assets is resident in the UPE jurisdiction and either a natural person or a Governmental Entity, an International Organisation, a Non-profit Organisation, or a Pension Fund, then the GloBE Income attributable to that ownership interest is ignored. As a result, assuming that the UPE jurisdiction does not impose its own IIR (which seems likely to be the case when the UPE itself is a flow-through entity), there will be less Top-up Tax that would be subject to any Intermediate Parent Entity's IIR or any host country UTPR.

While perhaps there are other motivations, we assume that this was meant as a simplification and de minimis rule. Given, however, that in-scope MNEs will have met the €750 million threshold, a 5% ownership interest is anything but de minimis.

Considering that the UTPR is already greatly weakened by the IIR priority and the newly added QDMTT, including an effective exemption from potentially material amounts of UTPR that arises at the UPE level is very inappropriate.

Because all in-scope MNEs will be very material in size, we suggest that adopting countries and the Inclusive Framework completely delete both Articles 7.1.1(b) and (c). The only appropriate reduction in GloBE Income and any resulting potential UTPR should be what is now in Article 7.1.1(a). If any applicable natural person or a Governmental Entity, an International Organisation, a Non-profit Organisation, or a Pension Fund in fact is subject to tax at the 15% minimum rate or higher, then the GloBE Income attributable to those owners' interests will be covered by Article 7.1.1(a).

If adopting countries and/or the Inclusive Framework determine that they want to retain Articles 7.1.1(b) and (c) due to simplification and de minimis concerns, then the percentage should be reduced from '5% or less' to '1% or less'.

The above discussion and suggestions apply as well to Articles 7.2.1(a)(iii), (b), and (c), which concerns deductible dividend regimes.

6.2 Investment Entity Tax Transparency Election and Taxable Distribution Method Election

Articles 7.5.2 and 7.6.6 provide for each of their respective treatments a five-year election. For both consistency of treatment and as a simplification measure, we suggest that countries adopting the GLoBE and the Inclusive Framework make these permanent elections and not five-year elections.

6.3 Transitional Relief for Filing Obligations

As a minor drafting point, it appears that “Transitional Year” in Article 9.4.1 should be “Transition Year”.