

Pillar Two: Global Anti-Base Erosion

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wts global

Main features

What

- » Proposal that focuses on the remaining BEPS issues exacerbated by digitalization and the broader tax challenges, and seeks to develop rules that are based on a minimum effective tax requirement

Why

- » To address the remaining BEPS challenges, such as profit shifting planning structures

Who

- » The scope of the Proposal includes all internationally operating businesses, and is not limited to highly digitalized businesses.

How

- » Development of a coordinated set of rules comprised of four component parts: the income inclusion rule, the undertaxed payments rule, the switch over rule and the subject-to-tax rule.

When

- » Final version of the proposal is expected to be delivered by the end of 2020

What

- » The Pillar Two Proposal (also referred to as the “GloBE” proposal) aims to develop a coordinated set of rules that jurisdictions have the right to apply where income is taxed at an effective rate below a minimum rate, and which seek to address remaining BEPS risk of profit shifting to entities subject to no or very low taxation.

Why

- » The purpose of the Proposal is to tackle the tax challenges of the digitalisation of the economy by:
 - › Providing jurisdictions with the ability to “tax back” group profits that are subject to a low effective rate.
 - › Ensuring that all internationally operating businesses pay a minimum level of tax
 - › Addressing remaining BEPS issues
 - › Present a multilateral solution to avoid uncoordinated rules, increased complexity and risk of over-taxation
 - › Reduce pressure on developing countries to grant tax incentives
 - › Address profit shifting risk from intangibles but not restricted to digital economy

How (I)

The Proposal is aimed at strengthening the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits through the creation of new rules that apply whenever the minimum effective tax rate is not met:

Parent country measures

Income inclusion rule

- » It would incorporate the income of a foreign branch or subsidiary (where taxed below a minimum rate) in the taxable base of the parent entity.

Switch-over rule

- » It would be inserted into double tax treaties to allow residence states to switch from an exemption to a credit method of double tax relief, in cases where profits of PE or immovable property had been taxed below a minimum rate.

Source country measures

Undertaxed payment rule

- » It would deny a deduction (or impose source-based taxation, such as a withholding tax) on a payment to a related party, where the payment is taxed below a minimum rate.

Subject-to-tax rule

- » It would be inserted into double tax treaties to deny certain treaty benefits, in cases where the item of income is not subject to tax at a minimum rate.
- » Possible extension to unrelated parties.

Income not
subject to tax
at a minimum
rate

How (II)

A. Tax base determination

- › Use of consolidated group financial accounts as the starting point for the determination of the taxable income.
- › The entity's accounting profit would be subject to adjustments to take into account permanent and temporary differences between accounting income and income under tax rules.
- › To be determined which financial accounting standard is more appropriate, so as to avoid distortions that could arise from the different accounting standards applied to the subsidiaries.
- › Important interaction between the existing domestic CFC rules and the GloBE proposal, although the OECD seems reluctant to introduce any carve-outs in the GloBE proposal.
- › Three approaches are proposed for 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.
- › Compliance, administration and tax policy issues should be considered.

How (III)

B. Blending

- › Blending is defined as the “mixing of income from different sources”
- › Different blending options, which represent different policy choices:
 - Worldwide
 - Jurisdictional
 - Entity level
- › All the blending approaches present challenges in their implementation which would need to be addressed, inter alia:
 - Interaction with the local tax consolidation or grouping rules.
 - Allocation of income between branch and head offices
 - Allocation of income from a tax transparent entity
 - Crediting of taxes that arise in another jurisdiction
 - Treatment of dividends and other distributions
 - Compliance costs implications

How (IV)

- » The GloBE Proposal calls for the design of appropriate carve-outs and thresholds, in line with the OECD's Programme of Work from May 2019 (“**PoW**”).

Carve-outs

- › Regimes compliant with the BEPS Action 5 to preserve the existing special regimes (i.e. R&D and IP regimes) and other substance based carve-outs.
 - However, under the PoW, the OECD explicitly states that the introduction of such carve outs could “undermine the policy intent and effectiveness of the proposal”.
- › A return on tangible assets
- › Controlled corporations with related party transactions below a certain threshold.
- › The appropriateness of carve-outs for specific sectors or industries should be explored.

Thresholds

- › Thresholds based on the turnover or other indications of the size of the group (e.g. the CbCR threshold of €750 million).
- › De minimis thresholds to exclude transactions or entities with small amounts of profit or related party transactions.

Key outstanding issues

- » Design of coordination and simplification measures, as well as thresholds and carve-outs, including interaction with BEPS Actions.
- » Compatibility with international obligations (in particular, with existing tax treaties or EU rules).
- » Potential technical, compliance and administrative implications.
- » PoW calls to explore the possible extension of the subject-to-tax rule to unrelated parties or to other treaty benefits beyond interest and royalties.
- » Need of consensus on the determination of the rate of the minimum tax and the use of financial accounts as a starting point for determining the tax base.

WTS Global Comments on Pillar Two

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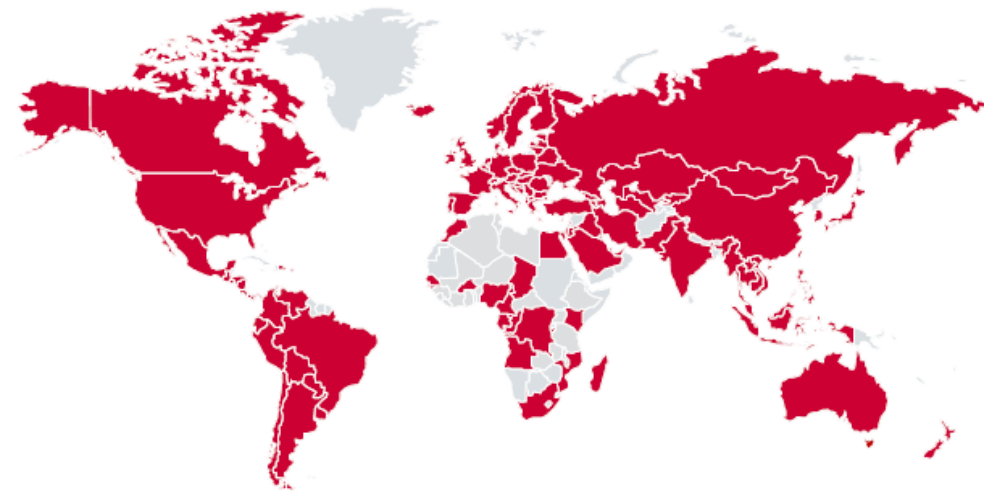
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