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Top-20 questions and answers on new GloBE Model Rules Commentary

Tax leaders and their organizations continue to work through potential implications of the GloBE Model Rules, following the 14 March Inclusive Framework release or a 228-page Commentary, supplemented by an OECD Secretariat document containing 24 examples, including structural diagrams and tables highlighting key features of the rules. A full KPMG analysis of the document is available here. Below, we offer a selection of questions and answers about the Commentary based on queries received to date.

1. What is said about the consistency of the rules?

The Commentary notes that the common approach does not require jurisdictions to adopt the rules, but, where a jurisdiction does adopt them, it should not apply the rules in a manner that is inconsistent with the outcomes provided for under the Model Rules. It states that if a country were to introduce a rule similar to an Income Inclusion Rules (IIR) but with a lower threshold than €750m turnover, that would not undermine the rules or the rule order. However, if a country were to introduce a UTPR with a lower revenue threshold, this *would* undermine the rule order, and be considered contrary to the basic design because it could make such UTPR the primary rule in respect of a group with revenues exceeding the lower revenue threshold, but falling below €750m, rather than a backstop rule to the IIR.

2. What does the Commentary say on how the revenue threshold of €750m is determined?

Generally, this is determined looking at whether the threshold is passed in two of the previous four years. This is based on the Consolidated Financial Statements, without adjustments for minority equity interests. The revenue of Excluded Entities is included in the testing. For mergers of two groups, one looks to the sum of the two groups pre-merger, adjusted for transactions that occur between the groups. For demergers, one considers the two demerged groups separately, and considers the €750m threshold in the first year following the demerger, and for the second to fourth years, looks at whether each demerged group has annual revenues of €750m or more in at least two of the fiscal years following the demerger.

3. Can an IIR apply to companies in the same jurisdiction as the IIR entity?

Yes. The Commentary says that some Inclusive Framework members may wish to extend the application of the IIR to domestic entities to ensure there is no discrimination against foreign entities. In these cases, the implementing jurisdiction can introduce further rules to require the Parent Entity to include Top-up Tax for a domestic Low Taxed Constituent Entity and indeed for any Top-up Tax of the Parent Entity itself.

Any IIR applied domestically is subject to the same top-down ordering rule as applies in respect of any other IIR.

4. Is it true that top-up tax can be paid in respect of a jurisdiction with a loss?

One of the more controversial aspects of the Model Rules is Article 4.1.5 which requires top-up tax in a jurisdiction with a GloBE loss, if there is a permanent benefit between the GloBE tax base and the local tax base. The Commentary confirms this result and provides an example whereby an MNE Group has a top-up tax liability of 7.5 in a jurisdiction with a GloBE loss of 100 and local tax loss of 150, with the difference being a permanent benefit. The top-up tax liability of 7.5 is computed as the minimum rate (15%) multiplied by the amount of the permanent difference (50).

5. Will the basis step-up and deferred taxes associated with asset transfers taking place during the implementation period be disregarded?

Another controversial aspect of the Model Rules is Article 9.1.3 which denies basis step-up and related deferred taxes associated with asset transfers (other than inventory) between Constituent Entities taking place after 30 November 2021 and before the commencement of a Transition Year. There was an expectation that the Commentary may soften this rule by targeting it at only non-taxable asset transfers, but that did not happen.

6. How are taxes paid under Pillar One treated?

The Model Rules were unclear regarding how taxes paid under Pillar One (Amount A) would be treated, specifically to which Constituent Entity, and therefore, jurisdiction, these taxes would be allocated. The Commentary confirms that taxes paid under Pillar One are treated as a covered tax under the GloBE Rules and will be taken into account by the Constituent Entity that takes into account the income associated with such tax for purposes of calculating its GloBE Income or Loss.

The Commentary also explicitly excludes Digital Services Taxes from the definition of Covered Taxes.

7. What is a Partially Owned Parent Entity (POPE)? And what if a POPE owns another POPE?

Where various parent entities are required to apply the IIR rule, a top-down approach applies except where there is a POPE (an entity less than 80% owned by the MNE Group). Where this occurs, the POPE has the primary taxing rights, and the parent entities up the chain will reduce their Allocable Shares of top-up tax based on the amount collected by the POPE. Where a POPE has a controlling interest in another entity, it is also a POPE. If the lower POPE is wholly owned by the higher POPE, the primary taxing right lies with the higher POPE. If not, the primary taxing right lies with the lower POPE with credit moving up the chain based on the Allocable Share of Ownership Interests.

8. What measures can a country take to apply the UTPR?

The rules provide a country a significant degree of flexibility. The UTPR may be applied through a denial of a deduction for payments both to a group company or to a third-party company to achieve the appropriate level of Top-up Tax – going beyond this a deduction denial could be for depreciation, amortization, or even for notional expenses. It also states that the UTPR might be applied by means of an 'equivalent adjustment'. The Commentary then states that the adjustment of the UTPR will depend on other domestic law provisions and a 'jurisdictions international obligations including those under Tax Treaties'.

9. What other points are made in the Commentary about UTPRs?

There are a few points. A reduction in losses in a current year will not suffice. There must be an additional cash tax expense in the current year. Also, the rules do not prescribe how a UTPR Top-up Tax is allocated to entities in a jurisdiction. That is left for the jurisdiction to determine, although it says that the rules should contain an adjustment priority to the extent possible. The Commentary does say that rules should apply to wholly owned entities first and then partially owned. A UTPR allocation that does not result in a cash tax cost is carried forward to the next year, but that country does not get a UTPR allocation in future years until the cash tax cost is met. This rule is applied on an MNE-by-MNE basis and does not impact UTPRs allocated for other MNEs in that jurisdiction. The Commentary says that the UTPR calculations are intended to be based on CBCR reports, although this is not stated in the Model Rules.

10. What do you need to be able to say a jurisdiction has a Qualified IIR?

The Qualified IIR must be 'in force' for the relevant year. It would be insufficient to say it was anticipated. Questions might arise if it is substantively enacted for accounting purposes but not yet 'in force'.

11. How are income and expenses treated when they don't go through the P&L but are included in Other Comprehensive Income (OCI) for determining GloBE Income or Loss?

OCI income which includes gains and losses on debt and equity instruments, certain FX movements and changes in liabilities on pension plans are generally excluded. There is an exception for certain gains and losses where a Revaluation Method is adopted.

12. Who determines whether a deviation from the UPE's accounting standard in respect of an item included in the

Constituent Entity's Financial Accounting Net Income is minor and inconsequential and below a materiality threshold?

The financial auditor's acceptance of a deviation without qualification is 'good evidence' that a deviation is immaterial. If the accounts are qualified it is relevant, but not conclusive, evidence that the deviation is material.

13. Excluded Dividends are not included in GloBE Income or Loss. What about expenses directly related to the derivation of those Excluded Dividends? What about Excluded Equity Gains and Losses?

Although some tax regimes link such expense to the derivation of exempt income in connection with a participation exemption, the GloBE rules do not. The Commentary states this is for simplicity. Some tax regimes link currency hedge gains and losses to the underlying equity interest. The Commentary states that consideration of a similar rule will be considered in the implementation consultation.

14. Can a stock-based compensation election to follow the tax treatment rather than the accounting treatment apply to non-employees?

Yes. It can apply to non-employees. The tax treatment will follow the local taxation rules. The stock-based election must be undertaken on a jurisdiction-by-jurisdiction basis as is for 5 years.

15. Must GloBE Income or Loss be adjusted for the Arm's Length Principle?

Broadly yes, for cross border transactions, except in very limited circumstances where it gives rise to double taxation or double non-taxation. Broadly, no adjustments are required for same country transactions except where a sale or other transfer gives rise to a loss. However, Constituent Entities and Minority Sub-groups in the same jurisdiction are required to apply the Arm's Length Principle.

16. Does deferred tax operate on an aggregated or an item-by-item basis?

Deferred Tax Adjustments can be recorded on an item-by-item basis or an aggregated basis provided it is at the same deferred tax rate. Note that deferred tax liabilities must be monitored on an item-by-item basis to determine if the 5-year reversal requirement is satisfied, unless covered by the recapture exception. This may present practical difficulties for many organizations.

17. Can one obtain a refund for prior year adjustments and loss carrybacks under GloBE rules?

No. The adjustments are made in the redetermination year or the year of recognition for losses and one does not recalculate prior years to obtain a refund.

18. Can the Substance-based Income Exclusion of one entity be used to reduce the Excess Profit of another entity?

Yes, if they are in the same jurisdiction and subject to the same blending. Substance based Income Exclusion is calculated on a jurisdiction-by-jurisdiction basis.

19. How does one determine payroll and tangible assets where employees or assets work or are used in more than one jurisdiction under the Substance-based Income Exclusion?

The Commentary states that guidance will be developed to assist in administrative simplicity.

20. What does the Commentary leave ambiguous?

While the Commentary provides further gloss on the framework under which a tax administration could challenge the use of a GloBE safe harbor, such as how a jurisdiction could show it is 'affected' by use of the safe harbor, the specifics of the safe harbors are still to be set out under the GloBE Implementation Framework. It remains to be seen how a safe harbor based (say) on CBCR data (as earlier proposed) would deal with GloBE tax imposed when a jurisdictional ETR is above 15%, e.g., where 4.1.5 applies to impose additional current top up tax.

The Commentary does not provide a conclusive answer to when an MNE might be deemed to exist. The definition of consolidated financial statements in the rules indicated that collections of entities under common control could be obliged to prepare consolidated financial statements, where they do not already do so, and be subject to GloBE taxation as a group. The Commentary does not go further in explaining the circumstances in which this might apply.

While the Commentary provides some guidance on how taxes are to be allocated in the case of PEs and CFCs, it also acknowledges that more detailed rules will be needed for specific country tax regimes. A common methodology for allocation of such taxes will be developed under the GloBE Implementation Framework. As such, for the moment it cannot be definitively said how such allocations will be performed to arrive at precise ETR estimates.

In connection with the substance-based income exclusion, the Commentary acknowledges that further work will be needed in relation to staff working for an MNE in multiple jurisdictions, as well as assets used in multiple jurisdictions. This is also anticipated under the GloBE Implementation Framework.

The Commentary provides some detail on what will be required to be reported in the GloBE Information Return. However, the specifics await further work under the GloBE Implementation Framework.

While the rules provide for the use of deferred tax attributes existing at the beginning of the transition year, open issues remain on how they can be recognized, e.g., the meaning of 'reflected or disclosed' in the financial accounts. Agreed administrative guidance is to be developed under the GloBE Implementation Framework.

The operation of the rules turns on whether IIRs, UTPRs, and domestic minimum taxes, put in place by jurisdictions, are recognized as “qualified”. While the Commentary does provide some clarity, such as on the types of benefits to constituent entities which could lead to disqualification, full clarity is awaited under the GloBE Implementation Framework.

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