To: European Commission

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Ref **KPMG contribution in response to the European Commission public consultation on the proposed Council Directive on ensuring a global minimum level of taxation for large multinational groups in the Union**

Dear Madam/ Sir,

KPMG[1] member firms in the EU (hereafter 'we') are pleased to provide comments on the European Commission's (EC's) proposal for a Council Directive on ensuring a global minimum level of taxation for large multinational groups in the Union (the Directive).

We note the challenges, for EU Member States and in-scope groups alike, in becoming ready for implementation of an EU minimum tax within the envisaged timelines and the need for proportionality when determining penalties for non-compliance with the proposed rules. It is widely recognised that the implementation of the OECD Model Rules will represent a significant administrative burden for in-scope groups.[2] The scale of this challenge will depend on the level of sophistication of finance systems, capacity of in-house tax and finance teams and the number of jurisdictions in which a group operates, but also on the extent of guidance available on the interpretation of the rules and the timeline for implementation. Currently, the Directive envisages the IIR provisions becoming effective on January 1, 2023.

We recognize that there is transitional relief for filing obligations. However, in our view, an effective adoption of the new OECD Model Rules will still be particularly challenging for many MNE groups. We believe that this challenge may be further exacerbated by a lack of legal certainty and inconsistent implementation and interpretation of the rules across the EU.

We have therefore attempted to highlight areas where we believe there is a need for further alignment of the legal text and definitions in the proposed EU Directive with the OECD Model Rules and instances in which the mechanisms proposed in the draft EU Directive lead to different results than those which would be obtained by applying the GloBE rules (for example, when allocating and providing credit for top up tax). We have also noted open questions regarding the application of the

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2 Business at OECD Pillar Two Business Advisory Group letter of January 6, 2022, [01-06-2022-Business-at-OECD-BIAC-6-Jan-Pillar-Two-Issues-Letter-1.pdf;] Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint, OECD Inclusive Framework on BEPS, October 2020, p.18, [Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS | en | OECD - https://www.oecd.org/.]

rules to large-scale domestic groups, in particular with regard to transitional arrangements and reporting requirements.

We trust that our comments will assist the European Commission in bringing clarity, legal certainty and alignment with the international consensus.

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1 Implementation process and on-going application

1.1 Consistent implementation timeline

According to the text of the proposed Directive, Member States will be required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by December 31, 2022 and to apply the rules from January 1, 2023 (January 1, 2024 for Article 11, 12 and 13). Furthermore, we understand that the French Presidency of the Council of the EU intends to "bring the implementation of this agreement […] at EU level" during their term, i.e. the first half of 2022[3].

We note that the Directive sets a minimum standard and that Member States are therefore, in principle, allowed to introduce the rules sooner than the timeline set out above. On the other hand, several Member States have raised concerns regarding their ability to finalize the adoption and implementation of the Directive into local law, given the specifics of their domestic legislative process[4].

Given the complexity of the new rules and the added challenge of applying these to an MNE Group that operates cross-border in the EU, we believe that the provisions of the Directive should apply consistently across the EU in terms of transposition timeline. We therefore propose that Member States should be discouraged from introducing the provisions of the Directive earlier than the deadline set by the EU. Furthermore, should some Member States be allowed a derogation from the transposition deadline due to national rules on the enactment of laws, we stress the need for clear transitional measures with respect to these Member States, if any. Such measures should give in-scope MNE groups the legal certainty needed to prevent this complex set of rules from becoming more burdensome and should prevent double taxation from occurring.

1.2 Double taxation dispute resolution

We note that the proposed Directive does not include specific provisions on double taxation dispute resolution. Whilst we acknowledge that the rules are generally designed in a such a way as to address potential instances of double taxation, we note that disputes may nevertheless arise e.g. where the rules and related Commentary leave room for interpretation, some of which have been highlighted throughout this contribution.

Member States can rely on Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the EU and on specific provisions in bilateral tax treaties to resolve double taxation disputes. However, Directive 2017/1852 only applies to disputes that arise from the application of agreements and conventions that provide for the elimination of double taxation of income and capital. By the same token, double taxation dispute resolution will only be available under some bilateral treaties that Member States have entered into and will only be relevant for issues related to top-up tax allocated and charged under the proposed Directive where the respective tax treaty allows for resolution of disputes on taxes not covered by it.

In order to ensure that taxpayers have access to effective dispute resolution procedures, a potential solution would be for the proposed Directive on minimum tax to also amend Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the EU to include disputes arising from the application of the GloBE rules in the EU, provided that this does not depart from the framework agreed upon at OECD level. Furthermore, the proposed Directive should clarify the framework for resolution of disputes

[3] Source: https://presidence-francaise.consilium.europa.eu/en/news/french-president-emmanuel-macron-press-conference-speech/.

[4] We note comments made by Sweden during the January 18, 2022 ECOFIN meeting, regarding the need to comply with the internal constitutional law making requirements. Source: Economic and Financial Affairs Council - Consilium (europa.eu).

with non-EU countries, e.g. by reference to relevant provisions of the OECD GloBE Implementation Framework, which is now being developed at OECD level, or other existing mechanisms.

The OECD Model Rules were developed on the understanding that a common approach would be applied by Inclusive Framework members. In this regard, it was anticipated that the rules would be widely adopted, and the European Union has quickly moved to take the lead in the implementation process. However, issues may arise where non-EU Member States fail to achieve approval domestically or if the timeline for approval is delayed indefinitely. In particular, this could prove challenging where non-EU jurisdictions impose taxes that do not qualify as GloBE covered taxes or as qualified IIR/ domestic top up taxes (and therefore the GloBE offset mechanisms will not be available). We would recommend that the EC actively considers this possibility with a view to ensuring that Member States have at their disposal appropriate tools to resolve potential disputes.

1.3 Penalties

We note that the proposed Directive lays down penalties for when an MNE group fails to comply with the obligations laid down in the Directive. An administrative pecuniary penalty amounting to 5% of turnover is prescribed for cases where a constituent entity does not comply with the requirement to file a top-up tax information return pursuant to Article 42. Given that the penalty provisions are linked to the failure of an in-scope entity to file the relevant top-up tax returns in a timely manner, it seems disproportionate to set the penalty by reference to the entity's turnover.

We suggest that a more appropriate approach would be to allow Member States to set the level of penalties in accordance with domestic legislation e.g. on similar obligations, such as filing of annual corporate income tax returns, provided that the penalty is effective, proportionate and dissuasive (in accordance with settled case-law of the Court of Justice of the European Union, e.g. case C-68/88 Commission v Greece).

2 Consistent application of the OECD Model Rules: General comments

KPMG appreciates the efforts made by the EC to ensure a harmonized and uniform implementation of the OECD Model Rules across EU Member States. In this respect, the Explanatory Memorandum accompanying the proposed Directive states that *"it is crucial that the global minimum tax reform is implemented in a sufficiently coherent and coordinated fashion"* and that *"only a common Union framework would prevent a fragmentation of the internal market in the implementation of them"* and *"provide taxpayers with legal certainty when implementing the rules"*.

There are a number of places in the GloBE rules where determinations by one tax administration are likely to have corresponding consequences for the application of the GloBE rules in other jurisdictions. Where the GloBE rules are not applied in a coordinated and consistent manner, risks of double taxation, tax uncertainty and excessive administrative burdens arise.

Consequently, the aim should be for EU implementation to be fully in line with the common approach as agreed on by the G20/OECD Inclusive Framework (IF), which requires IF members that adopt the Model Rules to implement and administer the rules consistently. The following sections are intended to highlight key areas where we believe that the proposed Directive is not fully in line with the common approach and where it might give rise to inconsistent application either within the Union or between the Union and non-EU jurisdictions.

2.1 Alignment of the legal text and definitions

KPMG is of the view that the text of the proposed Directive should remain as aligned to the text of the Model Rules as possible to ensure a coordinated interpretation of the GloBE rules between the EU and non-EU jurisdictions that apply the rules.

There are, however, a number of terms and definitions throughout the proposed Directive that deviate from the OECD Model Rules. Table 1 in the Appendix provides examples where the Directive uses different terms compared to the Model Rules. Similarly, inconsistencies might arise due to deviating definitions as shown in Table 2 in the Appendix. While it is assumed that these terms and definitions are interchangeable and shall not provide for any deviating interpretations, the use of different terms and definitions nevertheless causes the risk of inconsistent application between EU and non-EU, IF jurisdictions.

One such example, is Article 8 of the proposed Directive, which sets out the rules for allocation of the top-up tax under the income inclusion rule. The top-up tax due by a parent entity in respect of a low-taxed constituent entity (LTCE) is the parent entity's allocable share in the top-up tax for the LTCE for the fiscal year. Article 8 of the proposed Directive defines a parent entity's allocable share as the "proportion" of the parent entity's interest in the income of the LTCE. The proposed Directive does not provide any further guidance on how the proportion of the parent entity's interest should be determined. By contrast, the OECD Model Rules define, in Article 2.2, a parent entity's allocable share by reference to the parent entity's "Inclusion Ratio" – i.e. the ratio of (a) the GloBE income of the LTCE for the fiscal year, reduced by the amount of such income attributable to ownership interests held by other owners, to (b) the GloBE income of the LTCE for the fiscal year. The rules then go on to define the amount of GloBE income attributable to ownership interests held by other owners[5].

We understand that the intention is for the outcome of applying the rules in accordance with Article 8 of the proposed Directive to be in line with the result obtained by applying Article 2.2 of the Model Rules. We note, however, that the difference in wording and lack of detail on how the proportion of the parent entity's interest in the income of the LTCE should be determined may lead to a different outcome.

In order to avoid issues such as that described above in relation to Article 8 and as further shown in the Appendix, KPMG recommends that terms and definitions in the Directive should be brought in line with the Model Rules. Should the EC consider that this is not possible, we suggest that a comparison of the Articles of the proposed Directive with the OECD Model Rules, together with a clarification of any intentional differences.

Further comments on instances where differences in wording lead to a different outcome of the rules by comparison to the OECD Model Rules are included in Chapter 3 of this contribution.

[5] Article 2.2.3 of the OECD Model Rules: The amount of GloBE Income attributable to Ownership Interests in a Low-Taxed Constituent Entity held by other owners is the amount that would have been treated as attributable to such owners under the principles of the Acceptable Financial Accounting Standard used in the Ultimate Parent Entity's Consolidated Financial Statements if the Low-Taxed Constituent Entity's net income were equal to its GloBE Income and:

(a) the Parent Entity had prepared Consolidated Financial Statements in accordance with that accounting standard (the hypothetical Consolidated Financial Statements);

(b) the Parent Entity owned a Controlling Interest in the Low-Taxed Constituent Entity such that all of the income and expenses of the Low-Taxed Constituent Entity were consolidated on a line-by-line basis with those of the Parent Entity in the hypothetical Consolidated Financial Statements;

(c) all of the Low-Taxed Constituent Entity's GloBE Income were attributable to transactions with persons that are not Group Entities; and

(d) all Ownership Interests not directly or indirectly held by the Parent Entity were held by persons other than Group Entities.

2.2 Mechanism for cross-referencing to the OECD Commentary

The OECD Model Rules provide jurisdictions with a template for the domestic implementation of the GloBE rules, which is in large part mirrored in the proposed EU Directive. However, the Model Rules do not provide any guidance on the interpretation and application of the rules. For this reason, the OECD will release[6] a Commentary that is intended to promote a consistent and common interpretation of the GloBE rules and that will facilitate coordinated outcomes for both tax administrations and MNE Groups. The Commentary is expected to explain the intended outcomes under the rules and clarify the meaning of certain terms.

We believe that including a clear indication that Member States should rely on the OECD Commentary to the GloBE Model Rules, insofar as these are in compliance with EU law, would aid in ensuring consistency with the OECD Model Rules, as well as the consistent application of the rules by Member States. With a view to ensuring tax certainty for taxpayers, we recommend that, at a minimum, the Directive:

(i) is amended to include specific clarifications that are essential to the operation of the rules (e.g. with regard to whether the revenue of excluded entities is relevant for the determination of the revenue threshold test – further examples of such terms and provisions are included in Table 3 in the Appendix to this contribution.), and

(ii) prescribes to Member States a clear approach in terms of the relevance of OECD materials as sources of interpretation, as well as whether Member States should rely on a static interpretation (i.e. by reference to a specific version of the relevant documents), or dynamic interpretation (i.e. by reference to updated versions of the relevant documents).

Alternatively, the EC could consider publishing an equivalent EU Commentary, for example in the form of a regulation or a soft law instrument (e.g. FAQs) that could be updated by the EC whenever the OECD Commentary is modified. Any solution(s) chosen would need to take into account the dynamic character of the Commentary, the need for close alignment with the OECD Model Rules and ensure consistency with EU law and with the national laws of Member States.

2.3 Mechanism for cross-referencing the GloBE Implementation Framework

The OECD's work on the GloBE Implementation Framework includes the development of jurisdictional safe harbors, which would be intended to limit compliance and the administrative burden for those aspects of an MNE's operations that are likely to be taxable at or above the minimum rate. No detail is provided at this stage on how the safe harbor will be designed. However, the GloBE Implementation Framework is currently being developed at OECD level and is expected to be released during the course of 2022.

In anticipation of such safe harbors, Article 8.2 of the Model Rules provides an option for MNE Group to elect to be exempt from the requirement to compute the jurisdictional ETR and top-up tax and allow tax administrations to deem the top-up tax for the constituent entities located in the safe harbor jurisdiction to be zero for a fiscal year when the MNE Group can demonstrate that those constituent entities meet the requirements of the GloBE safe harbor.

The proposed EU Directive does not currently contain a safe harbor election or any other reference to the OECD's work on safe harbors in this context. Furthermore, the proposed Directive does not provide the European Commission with the power to adopt delegated acts with respect to the GloBE Implementation Framework. Therefore, it does not appear that the proposed Directive provides for a mechanism that would allow measures and mechanisms – such as administrative safe harbors, that are agreed upon at the level of the OECD IF subsequent to the adoption of the Directive to be

[6] OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors (Indonesia, February 2022)

immediately reflected in EU implementation, i.e. without the need for a formal amendment of the text. In order to ensure continued alignment with the global rules and related frameworks and consistent implementation across the EU, we recommend that the EC considers the best means to reflect in EU implementation any such subsequent changes to the rules. For example, with regard to the safe harbors specifically, the proposed EU Directive could be amended to include an additional article that would mirror the provisions of Article 8.2 of the Model Rules and allow for the safe harbor election, which would be activated once the safe harbors are designed and agreed upon at global level. Similarly, the EU Directive could make reference to other clarifications on administrative procedures that may be part of the GloBE Implementation Framework, to allow for the GloBE rules to be administered in a consistent way and to limit unnecessary compliance and administrative burden for MNE Groups and tax administrations.

In addition, it is expected that the GloBE Implementation Framework shall further ensure that the charging provisions operate in a coordinated manner by developing processes and implementing a process to assist tax administrations in determining whether a minimum tax is considered as a qualified Income Inclusion Rule (IIR), qualified Undertaxed Payment Rule (UTPR) and qualified domestic minimum top-up tax. In this context, we appreciate that Articles 51 and 52 of the proposed Directive empower the EC to add, in an Annex to the Directive, a list of third country jurisdictions that have implemented a legal framework in their domestic law, which is considered by the EU to be a qualified IIR. This way, MNE Groups that are headquartered outside of the EU shall be in a position to assess whether the IIR applied by the UPE resident in a non-EU Member State is acceptable in the EU or – in the case of IIRs that do not qualify – whether the IIR should be applied by EU-based intermediate parent entities (IPEs). In the same vein, the EC should additionally be empowered to add a list of third country jurisdictions that have implemented and apply legal frameworks that are considered to be a qualified UTPR and qualified domestic minimum top-up tax. Furthermore, the assessment of equivalence – as defined in Article 51 of the proposed Directive – should make reference to and align with the assessment process that is developed as part of the GloBE Implementation Framework to ensure a coordinated collection of top-up taxes between EU and non-EU jurisdictions.

2.4 Additional safeguards for a coordinated application of the GloBE rules within the Union

As stated above, KPMG is of the view that it is important that the EU Directive promotes a consistent and common interpretation of the GloBE rules by referencing the OECD Commentary. To aid in achieving that consistency, we believe that the EC should consider adding additional lists to the Annex to the Directive in respect of terms and provisions where a common interpretation and application might still be at risk despite any guidance offered in the Commentary, such as:

- List of tax credits granted by Member States and that are considered as qualified refundable tax credits in accordance with Article 15 (5);
- List of taxes imposed in the Union that are considered as covered taxes in accordance with Article 19 (1);
- List of jurisdictions that that are nearly certain to have jurisdictional ETRs above the minimum rate and that would be eligible for a safe harbor election;
- List of EU and non-EU countries that apply a qualified domestic top-up tax;
- List of eligible distribution tax systems and qualified refundable imputation taxes.

The EC could be empowered to adopt such lists through delegated acts. However, it should be clarified how Member States would apply the Annexes, given their dynamic character (e.g. the date of application of new items on an existing list or of a new list), while keeping in mind the need for legal certainty for tax administrations and taxpayers.

More generally, the EC could consider collecting input from Member States and other EU stakeholders on areas of the GloBE Model Rules that remain unclear or that emerge once the rules become applicable, with a view to transmitting these concerns to the OECD in a coordinated manner.

3 Consistent application of the OECD Model Rules: Specific comments

In addition to our general comments, the following section shows areas in the proposed EU Directive that, according to our assessment, lead to different results than those which would have been obtained by applying the GloBE rules. It also raises open questions regarding the application of EU-specific provisions that we believe require further clarifications.

3.1 Deviations between Directive and Model Rules leading to different results

3.1.1 UTPR carry-forward mechanism

Under the Model Rules, UTPR top-up tax can be carried forward for imposition in a later year in the same jurisdiction to the extent that top-up tax allocations cannot be imposed immediately (Article 2.4.2 Model Rules). Where a UTPR jurisdiction does not fully impose top-up tax in accordance with the amount that it has been allocated for a given fiscal year, its UTPR percentage is reduced to zero for subsequent periods until the amount from the previous years has been collected (Article 2.6.3). This shall not apply if all jurisdictions with a qualified UTPR have a UTPR percentage of zero (Article 2.6.4).

While it is expected that the carry-forward mechanism would also be applied in the same manner at an EU-level, Articles 2.4.2 and 2.6.4 of the Model Rules are not explicitly reflected in the proposed text of the EU Directive, whereas Article 2.6.3 of the Model Rules is reflected in Article 13(8) of the proposed Directive. In the absence of a carry-forward mechanism to mirror the provisions of Article 2.4.2 of the Model Rules, jurisdictions that are not able to collect UTPR top-up tax in a fiscal year would not be allowed to impose the outstanding UTPR top-up tax in any subsequent fiscal years.

We note that those jurisdictions would also not be allowed to impose UTPR top-up tax relating to a subsequent fiscal year as it would not be able to collect UTPR top-up tax from any previous years. This may give rise to double taxation situations where the UTPR jurisdiction that is not able to collect UTPR top-up tax is a non-EU jurisdiction. That non-EU jurisdiction would apply the carry-forward mechanism based on the Model Rules and would impose UTPR top-up tax relating to subsequent fiscal years once the amount from the previous years has been collected. The Directive, on the other hand, would require excluding that non-EU jurisdiction from the UTPR top-up tax allocation (by reducing the UTPR percentage to zero) and allocate the full UTPR top-up tax amount among the rest of UTPR jurisdictions.

We, therefore, recommend aligning the proposed EU Directive with the Model Rules and reflecting Articles 2.4.2 and 2.6.4 in respect of the UTPR carry forward mechanism in the text of the Directive in order to avoid double taxations risks for in-scope MNE Groups.

3.1.2 UTPR offset mechanism

Under the Model Rules, full relief from UTPR is available where all of the UPE's ownership interests in the LTCE are held directly or indirectly by one or more parent entities that are required to apply a qualified IIR (Article 2.5.2 Model Rules). A partial relief is available for amounts brought into the charge under a qualified IIR (Article 2.5.3 Model Rules).

Under the Directive, full relief from UTPR seems to be available only where the LTCE are wholly held by a UPE that applies the IIR or via an IPE that applies the IIR (by virtue of being located in an EU Member State or a third country jurisdiction that applies the IIR) (Article 13 (3) Directive). Partial relief is only available where the top-up tax has been collected in a third country that applies a qualified IIR

(Article 13 (4) Directive), whereas the text does not address the case where the qualified IIR is applied by an EU jurisdiction.

Example 1 in the appendix to this contribution aims to reflect the outcome of applying the Directive provisions *ad litteram* in cases where top-up tax is collected by an EU-based IPE. As highlighted in the example, full relief would not be available, which results in top-up tax seemingly being collected twice i.e. once under the IIR and a second time under the UTPR, leading to a double charging of the top-up tax. The example also raises the question of how the EU rules would interact with the GloBE rules introduced in a non-EU jurisdiction that provides for different top-up tax allocations. In an MNE group context, this could result in multiple different assessments being required if there are deviations in the manner in which jurisdictions implement the charging and offset mechanisms.

We therefore recommend aligning the proposed Directive with the Model Rules by amending the offset mechanism in the EU Directive as follows:

- Updating Article 13(3) in alignment with Article 2.5.2 of the OECD Model Rules (i.e. to provide a full reduction in the UTPR top-up tax amount where the full amount of IIR allocable to group (i.e. the UPE's ownership interest) has been collected by a parent entity; and
- Updating Article 13(4) to provide relief for IIR amounts collected by parent entities (reflecting Article 2.5.3 of the OECD Model Rules), irrespective of whether the parent entity is located in an EU or non-EU jurisdiction.

We recommend that the provisions of the Directive also clarify the application of the offset mechanism in situations where an UPE that is a constituent entity located in a Member State that is a low- tax jurisdiction and is subject to the IIR top-up tax together with its low-taxed constituent entities.

3.1.3 Income allocation rules for reverse-hybrid entities

According to Article 3.5.1 (c) of the Model Rules, the profits or losses of a constituent entity (CE) that is treated as transparent for tax purposes in its jurisdiction of incorporation or creation, but as a separate entity by its owners (i.e. reverse-hybrid entity) are assigned to the CE.

Article 18 (5) of the proposed Directive, however, provides that the financial accounting net income or loss of such flow-through entity shall be allocated to the reverse hybrid entity or the tax transparent entity only where the reverse-hybrid entity is the UPE. The proposed Directive does not contain rules for a situation where a reverse hybrid entity is not the UPE.

Where the income of reverse-hybrid entities is allocated to its owners for accounting purposes, the ETR calculation could deviate between EU jurisdictions and non-EU jurisdictions that apply the allocation rules as provided for in the Model Rules. As a result, top-up tax could be due for an EU parent in respect of the reverse-hybrid entity whereas a non-EU parent would deem the reverse-hybrid entity to be high-taxed.

In order to avoid such deviating assessments and to ensure consistent and common application of the GloBE rules between EU and non-EU jurisdictions instead, we recommend that the Directive is aligned with Article 3.5.1(c) of the Model Rules.

Should the EC consider that this is not possible or needed (for example, due to existing EU anti-hybrid measures), we suggest that the EC provides a clarification of that intentional difference.

3.2 Unclear provisions and other EU-specific comments

3.2.1 IIR allocation in respect of LTCEs located in the same jurisdiction

The proposed Directive requires the application of the IIR also in situations where an LTCE is located in the same jurisdiction as the taxable parent entity. We understand that the broadening of the scope to domestic entities is aimed at ensuring compatibility with primary EU law (i.e. the EU freedoms). As a result, the IIR as proposed by the EU Directive applies to all domestic LTCEs, including the parent entity itself, where the latter is located in a low-taxed Member State.

KPMG appreciates the EC's efforts to clarifying in paragraph 3 of Article 8 how the top-up tax is to be allocated in situations where the parent entity located in a Member State is an LTCE, i.e. the parent entity is required to collect the full amount of top-up tax for itself. Based on this provision, we understand that a UPE that is located in a low-taxed Member State and that is liable to top-up tax would need to collect top-up tax (as computed under Article 26) of 100% for itself and in proportion to its allocable share for any other LTCE located in the UPE's jurisdiction.

However, in our view, the application of Article 8(3) remains unclear in respect of situations where the low-taxed parent entity that is liable for top-up tax is not an UPE but an IPE or a Partially-Owned Parent Entity (POPE). We would welcome a clarification of the principles for allocating the top-up tax for such parent entities, i.e. whether the IIR top-up tax due by an IPE or POPE in respect of itself should include 100% of the top-up tax computed under Article 26 of the proposed Directive for that parent entity or whether it should be limited to the UPE's allocable share of the top-up tax for that entity. In addition, we would welcome a clarification on whether the top-up tax computed by an IPE/ POPE for other LTCEs located in the same Member State should be collected in proportion to the UPE's or the IPE's/POPE's allocable share.

3.2.2 Rules on large-scale domestic groups

The Explanatory Memorandum notes that *"while the Directive, in general, closely follows the OECD Model Rules, it extends its scope to large-scale purely domestic groups, in order to ensure compliance with the fundamental freedoms."* As the current text of the proposed Directive appears to be drafted to cover MNE groups, it is therefore unclear whether a number of the provisions of the Directive should equally apply to large-scale domestic groups.

In this context, it is unclear whether a qualified domestic minimum top-up tax (Article 10) could equally be applied for a large-scale domestic group or if the IIR top-up tax provisions (Articles 5 to 9) must be applied by domestic groups. We would recommend that the text of the Directive is reviewed to ensure that appropriate references to MNE groups and large-scale domestic groups are included throughout the relevant provisions.

We also note that large-scale domestic groups are currently not included within the scope of the reporting provisions of the Directive (Article 42). We would welcome clarifications in this respect, confirming either that these groups are subject to the same reporting requirements as groups operating in multiple jurisdictions (i.e. include large-scale domestic groups in the scope of Article 42), or, should it be the intention of the European Commission to allow Member States to set out the reporting requirements for large-scale domestic groups, clarify that Member States can determine the level of reporting that is required by such groups.

While we welcome the transitional rule in Article 50, which provides a reduction in the top-up tax of a large-scale domestic group to zero for the first five fiscal years, it would be helpful if it could be clarified that this relief also extends to the reporting obligations of the large-scale domestic group.

However, this clarification may not be necessary where it is otherwise clarified that Member States shall determine the local reporting requirements for large-scale domestic groups.

In addition, Article 45 of the proposed Directive includes transitional provisions that allow MNE groups to take into account the deferred tax assets and deferred tax liabilities reflected in the financial accounts of CEs in a transition year. However, a similar provision does not appear to be provided for large-scale domestic groups. We would recommend that the text of the Directive is updated to allow large-scale domestic groups to also take into account deferred tax attributes in a transitional year as an inability to do so could result in distortions from an effective tax rate perspective.

3.2.3 Rules on domestic top-up taxes

The proposed Directive gives Member States the option to apply a qualified domestic top-up tax (QDTT) to CEs located in its territory, with the aim of allowing jurisdictions where levels of taxation below the agreed-upon minimum occurred to collect additional top-up tax. The Directives defines a qualified domestic top-up tax in Article 3(23) and provides broad information in Article 10 on how Member States that make this election should apply a QDTT and how other Member States should take into account QDTTs.

There are, however, a number of points that are not specifically addressed and the clarification of which would be beneficial. For example, in our view, the proposed Directive does not clarify whether the amount of qualified domestic top-up tax due should be determined for and imposed on each CE in that jurisdiction separately, including the UPE, where it is located in a QDTT jurisdiction, or whether the QDTT should be collected by a parent entity in that jurisdiction (mirroring the mechanics of an IIR). Should the intention be for the mechanics of a domestic top-up tax to be different compared to the general approach, i.e. computing domestic top-up tax for each CE, rather than jurisdictional blending and subsequent allocation to each CE, we would welcome clarifications on the determination of the domestic top-up tax.

Furthermore, the proposed text does not clarify whether the calculation of the excess profits of constituent entities located in the QDTT jurisdiction can be based on a domestic financial accounting standard (i.e. the generally accepted accounting principles of that Member State), or whether a QDTT must be based on the financial accounting standard used in the consolidated financial statements of the UPE in order to qualify. Should the intention of the European Commission be to allow Member States to use an acceptable domestic financial accounting standard (e.g. subject to adjustments to prevent any material competitive distortions) to compute the excess profits for the purposes of a QDTT, we suggest that the text should detail:

- How the top-up tax offset mechanism applied by a parent entity located in another Member State is intended to work. Article 10(2) could clarify whether the top-up tax due by CEs under a QDTT (that would reduce the amount of top-up tax computed by the parent entity) is the amount determined in accordance with the rules of the QDTT jurisdiction. In other words, it should be clarified whether the deduction should be the amount as brought into charge by the CEs in the QDTT jurisdictions, or if the domestic top-up tax should be restated under the financial accounting standard used in the consolidated financial statements of the UPE.

- The approach to cases where a QDTT is charged in excess of the top-up tax computed for that jurisdiction under the general rules in Article 26, particularly whether the QDTT may bring the top-up tax below zero and, for example, lead to a refund or credit against future charges.

Where the QDTT is computed in accordance with the UPE's accounting standard, we recommend that an exception to the general rule in the form of a safe harbor from the provisions on the computation of the top-up tax under Article 26 is provided. Under such a safe harbour provision, the top-up tax would not need to be calculated for CEs in Member States that apply a QDTT in accordance with the

UPE's acceptable accounting standard. In addition, we would recommend that the application of this safe harbor provision would also apply to the requirement to compute the jurisdictional ETR under Article 25 of the Directive and the reporting requirements under Article 42 of the Directive. A safe harbor of this nature would, in our view, be consistent with objectives of the safe harbor provisions discussed in the 2020 OECD Pillar Two Blueprint (e.g. the Country-by-Country reporting ETR safe harbor and the single jurisdictional ETR calculation to cover several years safe harbor), namely the desire for safe harbors to reduce the complexity and administrative burden associated with complying with the GloBE rules, particularly in the context of jurisdictional blending.

Article 10(3) of the proposed Directive introduces a mechanism whereby, where the amount of QDTT subtracted from the jurisdictional top-up tax in accordance with Article 26 has not been fully paid within the three following fiscal years, the unpaid amount should be added to the jurisdictional top-up tax computed in accordance with Article 26(3). In order to prevent instances where the top-up tax balance is double counted (added to the jurisdictional top up tax and collected by the Member State), we suggest that the paragraph should only allow the capture mechanism to apply when the domestic top-up tax can no longer be charged by that Member State, i.e. after the expiry of the three-year period.

3.2.4 International shipping exclusion

Article 16 of the proposed Directive contains an exclusion for qualifying shipping income, which is closely aligned with the qualifying shipping income exclusion contained in Article 3.3 of the OECD Model Rules. Both provisions are primarily based on the definition of shipping income in Article 8 of the OECD Model Tax Convention. According to paragraph 15[7] of the Preamble to the proposed Directive, the main reason for implementing the international shipping income exclusion is to cater for existing shipping tax regimes (such as tonnage tax regimes), under which international shipping income is often taxed pursuant to a separate set of rules from those of the mainstream corporate tax system.

While Article 16 of the Directive is closely aligned with the OECD Model Rules, we have identified areas below which may warrant further consideration:

- *Definition of international shipping income*: Article 16 of the proposed Directive refers to Article 8 OECD Model Tax Convention definition of transportation of passengers or cargo by ship in international traffic (reference is made to this article). However, within the EU Maritime Guidelines, which form the basis for EU-approved tonnage tax regimes, transportation between a port and a location on the Continental Shelf also qualifies (or an activity at sea).

  We would recommend that the EC further considers how to align the proposed international shipping exclusion with the provisions of the EU Maritime Guidelines. We also note that there are a number of approved State aid decisions provided to Member States which are based on the EU Maritime Guidelines. We would therefore recommend that the EC considers how these regimes can be fully respected under the proposed Directive. In this regard, we note that this appears to be the intention of the EC based on paragraph 15 of the Preamble noted above,

[7] *"Due to its highly volatile nature and the long economic cycle of this industry, the shipping sector is traditionally subject to alternative or supplementary taxation regimes in Member States. To avoid undermining that policy rationale and allow Member States to continue applying a specific tax treatment to the shipping sector in line with international practice and State aid rules, shipping income should be excluded from the system."*

however, the current drafting of Article 16 does not appear to fully realize this intention (both in terms of excluded income / activities as well as different management requirements).

- Slot charter arrangements: Under the OECD GloBE Model Rules, slot charter arrangements should also qualify for the international shipping exclusion. However, under the proposed Directive, slot charters arrangements are treated as qualified ancillary shipping income (which include the 50%-test). We recommend that the proposed Directive is updated to align this provision with the OECD Model Rules.

Finally, for completeness, we note that the shipping regimes referenced above are not considered to be harmful preferential regimes by the OECD. In addition, it is worth noting that, where regimes are approved under the EU Maritime Guidelines of EU Member States, the international shipping exclusion should also apply to non-EU preferential shipping regimes that are not considered to be harmful by the OECD.

4 Conclusions

KPMG supports the EC's efforts in ensuring a harmonized implementation in the EU of the OECD GloBE Model Rules under Pillar Two, while safeguarding compliance with EU law. We believe that the proposed Directive is a strong first attempt at achieving these aims. We have highlighted a number of areas where we believe additional clarifications and alignment with the OECD Model Rules and related upcoming Commentary could contribute to the functioning of the Directive and a consistent implementation across the EU, while enhancing legal certainty for taxpayers.

KPMG appreciates the opportunity to contribute to the EU public consultation and is ready to elaborate on the above and discuss this topic at any future occasion.

Yours faithfully,

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5 Appendix

Table 1:

Model Rules	**Proposed EU Directive**
Top-up tax brought into charge (Article 2.3)	Top-up tax due (Article 9)
GloBE income or loss (Article 3)	Qualifying income or loss (Article 14, 15)
Current tax expense (Article 4)	Tax expense (Article 20)
Joint Venture subsidiary (Article 6.4)	Joint Venture affiliate (Article 34)
Qualified Domestic Minimum Top-up Tax	Qualified domestic top-up tax

Table 2:

Model Rules	Proposed EU Directive
A Parent Entity's Allocable Share of the Top-up Tax of a Low-Taxed Constituent Entity is an amount equal to the Top-up Tax of the Low-Taxed Constituent Entity as calculated under Chapter 5 multiplied by the Parent Entity's Inclusion Ratio for the Low-Taxed Constituent Entity for the Fiscal Year. A Parent Entity's Inclusion Ratio for a Low-Taxed Constituent Entity for a Fiscal Year is the ratio of (a) the GloBE Income of the Low-Taxed Constituent Entity for the Fiscal Year, reduced by the amount of such income attributable to Ownership Interests held by other owners, to (b) the GloBE Income of the Low-Taxed Constituent Entity for the Fiscal Year. The amount of GloBE Income attributable to Ownership Interests in a Low-Taxed Constituent Entity held by other owners is the amount that would have been treated as attributable to such owners under the principles of the Acceptable Financial Accounting Standard used in the Ultimate Parent Entity's Consolidated Financial Statements if the Low-Taxed Constituent Entity's net income were equal to its GloBE Income and: a) the Parent Entity had prepared Consolidated Financial Statements in accordance with that accounting standard (the hypothetical Consolidated Financial Statements); b) the Parent Entity owned a Controlling Interest in the Low-Taxed Constituent Entity such that all of the income and expenses of the Low-Taxed Constituent Entity were consolidated on a line-by-line basis with those of the Parent Entity in the hypothetical Consolidated Financial Statements; c) all of the Low-Taxed Constituent Entity's GloBE Income were attributable to transactions with persons that are not Group Entities; and d) all Ownership Interests not directly or indirectly held by the Parent Entity were	The IIR top-up tax due by a parent entity in respect of a low-taxed constituent entity pursuant to Articles 5, 6 and 7 shall be equal to the top-up tax of the low-taxed constituent entity, as computed in accordance with Article 26, multiplied by the parent entity's allocable share in such top-up tax for the fiscal year. A parent entity's allocable share in the top-up tax with respect to a low-taxed constituent entity shall be the proportion of the parent entity's interest in the income of the low-taxed constituent entity. *(Article 8 (1) and (2) Directive)*

held by persons other than Group Entities. *(Article 2.2 Model Rules)*	
Controlling Interest means an Ownership Interest in an Entity such that the interest holder: a) is required to consolidate the assets, liabilities, income, expenses and cash flows of the Entity on a line-by-line basis in accordance with an Acceptable Financial Accounting Standard; or b) would have been required to consolidate the assets, liabilities, income, expenses and cash flows of the Entity on a line-by-line basis **if the interest holder had prepared Consolidated Financial Statements**. *(Article 10 Model Rules)*	*"Controlling interest"* means an ownership interest in an entity whereby the interest holder is required, or would have been required, to consolidate the assets, liabilities, income, expenses and cash flows of the entity on a line-by-line basis, in accordance with an acceptable financial accounting standard. *(Article 3 (18) Directive)*
"Net Taxes Expense" means the net amount of any Covered Taxes accrued as an expense and any current and deferred Covered Taxes included in the income tax expense, including Covered Taxes on income that is excluded from the GloBE Income or Loss computation; […]. *(Article 10 Model Rules)*	"Net tax expense" means the net amount of [...] covered taxes accrued as an expense; […]. *(Article 15 (1)(a) Directive)*
A *"Joint Venture"* does not include: a) an Ultimate Parent Entity of an MNE Group that is subject to the GloBE Rules; b) an Excluded Entity as defined by Article 1.5.1; c) an Entity whose Ownership Interest held by the MNE Group are held directly through an Excluded Entity referred in Article 1.5.1 and the Entity: (i) operates exclusively or almost exclusively to hold assets or invest funds for the benefit of its investors; (ii) carries out activities that are ancillary to those carried out by the Excluded Entity; or (iii) substantially all of its income is excluded from the computation of GloBE Income or Loss in accordance with Articles 3.2.1(b) and (c). d) an Entity that is held by an MNE Group composed exclusively of Excluded Entities; or	n/a

e) a JV Subsidiary. *(Article 10 Model Rules)*	
Investment fund means an Entity that meets all of the criteria set out in paragraphs (a) to (g) below: (a) it is designed to pool assets (which may be financial and non-financial) from a number of investors (**some of which are not connected**) (b) it invests in accordance with a defined investment policy; (c) it allows investors to reduce transaction, research, and analytical costs, or to spread risk collectively; (d) it is primarily designed to generate investment income or gains, or protection against a particular or general event or outcome; (e) investors have a right to return from the assets of the fund or income earned on those assets, based on the contributions made by those investors; (f) the Entity or its management is subject to a regulatory regime in the jurisdiction in which it is established or managed **(including appropriate anti-money laundering and investor protection regulation**); and (g) it is managed by investment fund management professionals on behalf of the investors. (*Article 10 Model Rules*)	'investment fund' means an entity or arrangement that meets the following conditions: (a) it is designed to pool financial and non-financial assets from a number of **mostly non-related investors;** (b) it invests in accordance with a defined investment policy; (c) it allows investors to reduce transaction, research and analytical costs or to spread risk collectively; (d) it is primarily designed to generate investment income or gains, or protection against a particular or general event or outcome; (e) its investors have a right to return from the assets of the fund or income earned on those assets, based on the contribution they made; (f) it, or its management, is subject to the regulatory regime for investment funds in the jurisdiction in which it is established or managed; and (g) it is managed by investment fund management professionals on behalf of the investors; *(Article 3 (25) Directive)*
"Ownership Interest" means **any equity interest that carries** rights to the profits, capital or reserves of an Entity, including the profits, capital or reserves of a Main Entity's Permanent Establishment(s). *(Article 10 Model Rules)*	….'ownership interest' means **any rights to** the profits, capital or reserves of an entity, or a permanent establishment; *(Article 3(20) Directive)*
Number of Employees, for the purposes of the UTPR percentage, means the total number of employees on a full-time equivalent (FTE) basis of all the Constituent Entities **resident for tax purposes** in the relevant tax jurisdiction. For this purpose, independent contractors participating in the ordinary operating activities of the Constituent Entity are reported as employees.	The number of employees shall be the number of employees on a full-time equivalent basis of all constituent entities **located** in the relevant jurisdiction, including independent contractors provided that they participate in the ordinary operating activities of the constituent entity. *(Article 13(6) Directive)*

(Article 10 Model Rules)	
"Portfolio Shareholding" means Ownership Interests in an Entity that are held by the MNE Group and that carry rights to less than 10% of the profits, capital, reserves, **or voting rights** of that Entity at the date of the distribution or disposition. *(Article 10 Model Rules)*	[…] an ownership interest in an entity of less than 10% (a "portfolio shareholding") in respect of which a constituent entity is entitled to all or substantially all of the rights to profits, capital or reserves, […] at the date of the distribution. *(Article 15(1)(b)(i) Directive)*
"*Qualified Refundable Tax Credit*" means a refundable tax credit designed in a way such that it must be paid as cash or available as cash equivalents within four years from when a Constituent Entity **satisfies the conditions** for receiving the credit under the laws of the jurisdiction granting the credit. A tax credit that is refundable in part is a Qualified Refundable Tax Credit to the extent it must be paid as cash or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving the credit under the laws of the jurisdiction granting the credit. **A Qualified Refundable Tax Credit does not include any amount of tax creditable or refundable pursuant to a Qualified Imputation Tax or a Disqualified Refundable Imputation Tax.** *(Article 10 Model Rules)*	'qualified refundable tax credit' means: (a)a refundable tax credit designed in such a way that it is payable as a cash payment or a cash equivalent to a constituent entity within four years from the date when the constituent entity **is entitled to receive** the refundable tax credit under the laws of the jurisdiction granting the credit; or (b)if the tax credit is refundable in part, the portion of the refundable tax credit that is payable as a cash payment or a cash equivalent to a constituent entity within four years from the date when the constituent entity is entitled to receive the partial refundable tax credit; (*Article 3(32) Directive)*
Qualified Domestic Minimum Top-up Tax means a minimum tax that is included in the domestic law of a jurisdiction and that: (a) determines the Excess Profits of the Constituent Entities located in the jurisdiction (domestic Excess Profits) in a manner that is equivalent to the GloBE Rules; (b) operates to increase domestic tax liability with respect to domestic Excess Profits to the Minimum Rate for the jurisdiction and Constituent Entities for a Fiscal Year; and (c) is implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Commentary, provided that such jurisdiction does not provide any benefits that are related to such rules.	'qualified domestic top-up tax' means a top-up tax that is implemented in the domestic law of a jurisdiction and that: (a) provides for the determination of the excess profits of the constituent entities located in that jurisdiction in accordance with the rules laid down in this Directive and the application of the minimum tax rate to those excess profits for the jurisdiction and the constituent entities in accordance with the rules laid down in this Directive; and (b) is implemented and administered in a way that is consistent with the rules laid down in this Directive and does not allow the jurisdiction to provide any benefits that are related to those rules; *(Article 3(23) Directive)*

A Qualified Domestic Minimum Top-up Tax may compute domestic Excess Profits based on an Acceptable Financial Accounting Standard permitted by the Authorised Accounting Body or an Authorised Financial Accounting Standard adjusted to prevent any Material Competitive Distortions, rather than the financial accounting standard used in the Consolidated Financial Statements. *(Article 10 Model Rules)*	

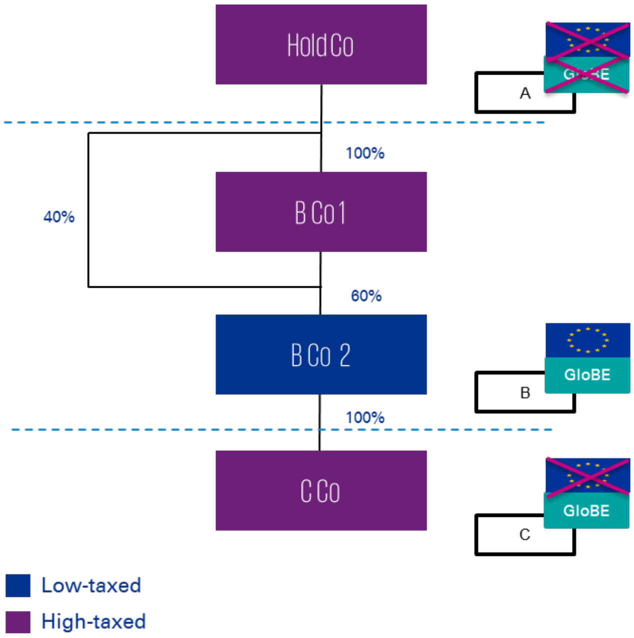
Table 3:

Provisions expected to be clarified in the OECD Commentary	**Model Rules**	**Proposed EU Directive**
Revenue from Excluded Entities / minority-owned CEs to be taken into account for purposes of the consolidated revenue test	Article 1.1	Article 2
Definition of Recapture Exception Accruals	Article 4.4.5	Article 21 (8)
Collection and allocation of top-up tax for Minority-owned groups	Article 5.6	Article 30
Collection and allocation of top-up tax for Joint Ventures	Article 6.4	Article 34
Treatment of unrecognized pre-regime losses	Article 9.1	Article 45

Example 1

Facts

Hold Co is the UPE of an MNE Group and is tax resident in jurisdiction A that has not adopted GloBE rules. Hold owns 100% of B Co 1 and 40% of B Co 2 (both tax resident in jurisdiction B which is an EU Member State). The remaining 60% of B Co 2 is owned by B Co 1 which is deemed a controlling interest. B Co 2 owns 100% of C Co (tax resident in jurisdiction C). Jurisdictions B and C have both adopted qualified IIR and UTPR. Jurisdiction B is considered low-taxed.



Assessment (Model Rules)

a) IIR

Hold Co (UPE) is not subject to top-up tax since jurisdiction A does not apply the IIR. Following the top-down approach, B Co 1 is subject to top-up tax under the IIR as it is the next parent down the ownership chain (IPE). B Co 1 is subject to IIR based on its allocable share in respect of those low-taxed constituent entities in which it has a direct or indirect equity interest. B Co 2 is not allowed to apply the IIR because a controlling interest in B Co 2 is held by an IPE subject to IIR (B Co 1). The ETR of jurisdiction B is less than the minimum rate. However, the Model Rules do not provide for the possibility to apply the IIR where the jurisdiction of the taxable parent is low-taxed.

b) UTPR

The total top-up tax amount for jurisdiction B is to be collected under the UTPR by all jurisdictions that are subject to a qualified UTPR and where constituent entities are located, namely jurisdictions B and C.

Assessment (EU Directive)

a) IIR

In contrast to the Model Rules, the proposed EU Directive allows for the IIR to be applied where the parent jurisdiction (in this case, jurisdiction B) is low-taxed. The IIR therefore applies at the level of B

Co 1 which is located in an EU Member State. The jurisdictional top-up tax of jurisdiction B is allocated among B Co 1 and B Co 2in proportion to their respective GloBE income to their aggregated GloBE income. B Co 1 collects the full top-up tax amount computed for itself and for B Co 2 in proportion to its allocable share in B Co 2 (60%).

b) UTPR

UTPR applies in this scenario as the UPE is located in a third country jurisdiction that does not apply a qualified IIR. The total UTPR top-up tax amount for jurisdictions B is equal to the sum of all top-up tax allocated to low-taxed constituent entities in jurisdictions B and C, respectively. It is then necessary to assess whether the UTPR amount for both jurisdictions can be fully or partly reduced.

Despite the fact that top-up tax has already been collected under the IIR (B Co 1 collects the full amount for itself and 60% in relation to B Co 2), the full amount for jurisdiction B also needs to be collected under the UTPR due to the fact that the UTPR top-up tax amount cannot be reduced under Articles 13 para. 3 and 4 of the Directive.

No reduction under Article 13 (3) of the proposed Directive is available as B Co 2 is not wholly held by a UPE that applies IIR or via an IPE that applies IIR (by virtue of being located in an EU Member State or a third country jurisdiction that applies IIR). In this case, B Co 2 is partially held by a UPE that does not apply IIR and B Co 1 is wholly held by a UPE that does not apply IIR. While B Co 1 is itself a parent entity that applies IIR to its own top-up tax, it does not appear, based on the wording of the proposed EU Directive, that B Co 1 could reduce its UTPR amount to zero as it is not held by a parent entity that applies IIR. As such, it does not appear that relief is available under Article 13 para. 3 of the proposed Directive for top-up tax attributable to B Co 1 or B Co 2.

A reduction in the UTPR top-up tax amount is also not available under Art. 13 (4) of the proposed Directive, as this provision is limited to amounts collected under IIR in a third country jurisdiction. A reduction in respect of IIR collected by B Co 1 (for itself and B Co 2) in an EU Member State does not appear to be available based on the wording of the proposed Directive.

Comment

This example demonstrates that the provisions of Article 13 of the EU Directive do not follow the UTPR mechanism as formulated under the Model Rules. In general, the intention of Articles 2.5.2 and 2.5.3 of the Model Rules is to reduce the UTPR top-up tax amount for cases where the relevant top-up tax is fully (Article 13 (3)) or partly (Article 13 (4)) collected under the IIR elsewhere in the group. However, based on the current wording of the proposed Directive, full relief from UTPR seems to be available only where the low-taxed constituent entities are wholly held by a UPE that applies the IIR or via an IPE that applies the IIR (by virtue of being located in an EU Member State or a third country jurisdiction that applies the IIR). Partial relief is only available where the top-up tax has been collected in a third country that applies a qualified IIR. This appears to ignore cases where top-up tax is collected by an EU-based IPE and full relief is not applicable and results in top-up tax seemingly being collected twice under the IIR and the UTPR, leading to double taxation.

The example also raises the question of how the EU rules would interact with the GloBE rules introduced in a non-EU jurisdiction (jurisdiction C) that provide for different outcomes. If this analysis was expanded across an MNE group, this could result in multiple different assessments being required if there are deviations in the manner that jurisdictions implement the GloBE rules.