

Implementation Framework

OECD document release on 20 December 2022

On 20 December 2022 the OECD released three components of the Implementation Framework. These comprise guidance on Safe Harbors and Penalty Relief and public consultation papers on the GloBE Information Return and Tax Certainty.

An expected fourth component on Administrative Guidance has not been released and we anticipate that it will be released early next year.

Many businesses have been very keen to see the Safe Harbor, particularly in relation to Transitional Safe Harbors. As noted below, these have been largely developed whereas only the framework has been developed for Permanent Safe Harbors with further refinement required.

While the Safe Harbors are most welcome, it should be noted that many MNEs may need to deal with four domains of data over the next few years in relation to Pillar 2.

These domains of data are required for calculations for (1) the Model Rules; (2) the Transitional Safe Harbor which may involve several sub-calculations (3) the Permanent Safe Harbor which also may involve multiple sub-calculations and (4) data for any disclosures relating to Pillar 2 in the Financial Accounts. These calculations are likely to be different.

Safe Harbors and Penalty Relief

The Safe Harbors and Penalty Relief section contains three elements: agreement on the design of a Transitional Safe Harbor based on the CbCR rules; a regulatory framework for the development of a potential Permanent Safe Harbor and a common understanding for a Transitional Penalty Relief regime.

A. Transitional CbCR Safe Harbor

1. Scope of Amount B

The Transitional CbCR Safe Harbor is largely based on three sources of information.

The first source is the MNE's CbC Report. This must be a **Qualified CbC Report** which is a Country-by-Country Report filed using **Qualified Financial Statements**.

Qualified Financial Statements are the accounts used to prepare the Consolidated Financial Statements of the UPE or separate financial statements of each Constituent Entity provided, in broad terms, they are acceptable or authorised accounting standards and are reliable. Where a Constituent Entity is not included in the MNE groups Consolidated Financial Statements on the grounds of size or materiality, then the financial accounts used for preparation of the CbC Report are qualifying.

The second source is broadly the Income Tax Expense from the MNE's financial accounts. These financial accounts must also be Qualified Financial Statements. The Income Tax Expense is adjusted to exclude taxes that are not Covered Taxes as defined in the Model Rules and uncertain tax positions. With these adjustments, there forms the concept of **Simplified Covered Taxes**. A **Simplified ETR** is calculated by dividing a jurisdiction's Simplified Covered Taxes by its Profit (Loss) before Income Tax as outlined in the MNE's Qualified CbC Report.

The third source is the calculation of the **Substance-based Income Exclusion** as contained in the Model Rules.

2. Three alternative tests for the Transitional CbCR Safe Harbor

There are three alternative tests during the Transition Period that deem Top-up Tax in a jurisdiction for an entity or group of entities to be zero. This is subject to special rules and exclusions.

(i) De minimis test

To satisfy this test, the MNE must report Total Revenue of less than €10 million and Profit (Loss) before Income Tax of less than €1 million in the Qualified CbC Report for the Fiscal Year. This is similar to the De Minimis Exclusion in the Model Rules, however, this safe harbor operates on a single current year rather than a 3-year average which applies to the De Minimis Exclusion.

There is an exclusion from this test where a Constituent Entity is held for resale. Where there is an entity in a jurisdiction that is held for resale, then that jurisdiction cannot rely on the de minimis test where the sum of the revenues of Constituent Entities held for resale and the total CbCR Revenue (which would not include the resale entity revenue) equals or exceeds €10 million.

(ii) Simplified ETR Test

The Simplified ETR for a jurisdiction is the Simplified Covered Taxes divided by the Profit (Loss) before Income Tax in the Qualified CbC Report. If the Simplified ETR exceeds the Transition Rate for a year then the safe harbor applies.

The Transition Rate varies in the Transition Period. For the 2023 and 2024 years it is 15%. It is 16% for the 2025 year and 17% for fiscal years beginning in 2026.

(ii) Routine profits test

This test applies if the amount of the Substance-based Income Exclusion is greater than the jurisdiction's Profit or Loss before Income Tax in the Qualified CbC Report. The term 'routine' is to be contrasted with 'Excess Profits' upon which a Top-up Tax calculation is made under the standard rules. The Excess Profits are what remains after the Substance-based Income Exclusion. There is no 'short hand' for calculating the Substance-based Income Exclusion which is based on the level of payroll (which includes certain contractor payments) and tangible assets.

3. Transition period

The Transitional CbCR Safe Harbor rules will only apply for Fiscal Years beginning on or before 31 December 2026 but will not include Fiscal Years that end after 30 June 2028. In practice groups with a Fiscal Year that begins in 2024 and will be subject to the IIR in 2024 and the UTPR in 2025 will benefit from a transitional period of three years for the IIR and two years for the UTPR.

A Transition Year operates on a jurisdiction-by-jurisdiction basis, such that if an MNE satisfies a Transitional Safe Harbor for one jurisdiction but not another, the safe harbor applies only to the jurisdiction that satisfies that test. However, there is a 'once out, always out' approach, such that if a jurisdiction does not satisfy a safe harbor test in a jurisdiction for a year, it is deemed not to satisfy the safe harbor test in subsequent years. This rule does not apply if an MNE commences new operations in a jurisdiction.

The Model Rules contain transitional rules for the recognition of deferred tax assets and making elections in relation to tax losses. These are contained in Article 9.1. Broadly the transitional safe harbor rules allow for deferral of those transitional calculations or elections until the safe harbor no longer applies.

The Transitional CbCR Safe Harbor does not require the exclusion of Additional Current Top-up Tax such as Article 4.1.5 which deals with certain circumstances involving losses and permanent differences. This simplifies the calculation.

4. Joint ventures, tax neutral UPEs and investment entities

Generally the Transitional CbCR Safe Harbor rules apply to Joint Ventures and JV Subsidiaries as if they were a separate group. Subject to certain qualifications and elections, this is also true of Investment Entities. There are also special rules for UPEs that are flow-through entities.

5. Net unrealised fair value losses greater than €50 million excluded

Where there is a Net Unrealised Fair Value Loss (i.e.. net of gains and excluding Portfolio Shareholdings), that loss is excluded from Profit (Loss) before Income Tax if the loss exceeds €50 million.

6. Exclusions from the Transitional CbCR Safe Harbor

There are four main exclusions from the Transitional CbCR Safe Harbor. They are Stateless Constituent Entities (e.g. certain Reverse Hybrids); multi-parented MNE Groups where there is not a single Qualified CbCR (e.g. certain staples); jurisdictions where an Eligible Distribution Tax System election has been made; and jurisdictions that have not benefited from a Transitional CbCR Safe Harbor in a previous year unless the MNE did not have Constituent Entities in that jurisdiction in the previous year (as discussed above).

7. Transitional CbCR Safe Harbor does not exclude complying with MNE group-wide requirements

Qualifying under the Transitional CbCR Safe Harbor will not exempt the MNE from complying with MNE group-wide requirements including preparation of a GloBE Information Return. This will likely request details of any safe harbors adopted.

B. Permanent Safe Harbors

Where an MNE does not meet the Transitional CbCR Safe Harbor it still may meet the conditions of a permanent safe harbor. The release outlines a framework for a potential Simplified Calculations Safe Harbor. These Simplified Calculations are to be provided in Agreed Administrative Guidance in the future.

The framework states that the Simplified Calculations must provide the same outcomes as the GloBE rules or that the outcomes that do not undermine the integrity of the GloBE rules. In determining whether a Simplified Calculation undermines the integrity of the GloBE rules may involve a cost-benefit analysis of the compliance burden and the potential revenue loss. Further consultation is due to occur with stakeholders.

The release points to similar tests to the Transitional CbCR Safe Harbors, but with nuanced differences such as an averaging formula for the De minimis test.

There is also discussion of the use of a simplified calculation for Non-Material Constituent Entities which are entities which are not included in the consolidated accounts solely by virtue of size or materiality.

C. Transitional penalty

In the Transition Period no penalties or sanctions should be applied in connection with the filing of a GloBE Information Return where a tax administration considers that an MNE has taken 'reasonable measures to ensure the correct application of the GloBE rules. While this is not defined reference is made to acting in good faith to understand and comply the GloBE rules.

This would suggest that undertaking a due diligence process or an independent certification that reasonable measures have been taken may be beneficial for clients.

GloBE information return

On 20 December 2022 the OECD have released a consultation paper on the GloBE Information Return with comments due by 3 February 2023.

Development standardized GloBE information return

The GloBE Model Rules prescribe the development of a standardized GloBE Information Return ('GIR') that provides information on the tax calculations made by the MNE Group which enables tax administrations to evaluate the correctness of a Constituent Entity's GloBE tax liability and to perform an appropriate risk assessment. Article 8.1.4 of the GloBE Model Rules provides an outline of the items of information to be included in the GIR.

With the release of the public consultation document for the GIR a further outline is provided for the data points needed for an MNE Group to calculate its GloBE tax liability and to provide the information and tax calculations to the tax administrations. The public consultation document opens with an introduction on the background of the GIR and the need for a public consultation and then outlines in Annex A1 the data points combined with explanatory guidance in Annex A2.

1. Background – balance between administrative requirements and compliance concerns

The Inclusive Framework formed a multi-disciplinary Focus Group in May 2022 to work on developing a standardized GIR. In developing the data points and explanatory guidance that could be used for the GIR, the Inclusive Framework has sought to strike an appropriate balance between administrative requirements and compliance concerns. The information and tax calculations to be filed should be sufficiently comprehensive to allow tax administrations to evaluate the tax liability of a Constituent Entity under the GloBE Rules and perform an appropriate risk assessment. At the same time the Inclusive Framework also sought to avoid unnecessary information collection, computation, or reporting requirements on MNE Groups or exposing taxpayers to multiple, uncoordinated requests for further information in each implementing jurisdiction.

2. New compliance requirements for MNE groups

Under the GloBE Rules MNE Groups will be obligated to prepare a GIR, as well as preparing local tax returns where Top-up Tax is due under a QIIR, QUTPR or QDMTT.

The obligation to prepare a GIR is separate from the local tax return requirements. The operation of tax filing and payment obligation rules is left to the determination of each implementing jurisdiction based on the design of that jurisdiction's existing tax filing and payment procedures.

3. Development data points for GIR – no final form

The Focus Group has identified a set of data points that an MNE Group may need to collect, in order to calculate the MNE Group's GloBE tax liability. In Annex A1 of the paper the data points are set out which are considered sufficient to calculate the MNE Group's GloBE tax liability and they are sorted into the following sections: i. General information, ii. Corporate structure, iii ETR computation and Top-up Tax computation, and iv. Top-up Tax allocation and attribution.

The data points are organized into tables to facilitate a common understanding of each data point, as well as the relationship between them and their connection to the underlying GloBE calculation mechanics. It is made clear, however, that the current overview provided does not necessarily represent the final form of the GIR but should be seen as the first step in the process of developing common information filing and exchange requirements.

Further to the input received in the last public consultation on the GloBE Implementation Framework the Focus Group is continuing work on the development of centralized filing requirements and the appropriate mechanisms to allow tax administrations to automatically exchange GloBE information collected, including a framework of bilateral and multilateral competent authority agreements and IT-solutions to support the exchange of information, in particular a dedicated XML schema.

The detailed scope of information that needs to be made available to a tax authority, whether through local filing or exchange of information, is still subject to discussion. In this respect the Inclusive Framework is exploring what the implications and burdens of segmenting the information reported under the GIR would be, when different sets of data points may be made available to each implementing jurisdiction depending, for example, on the MNE Group's corporate structure.

4. Data points and explanatory guide (Annex A1)

In Annex A1 of the public consultation document the data points are set out which are considered sufficient to calculate the MNE Group's GloBE tax liability, sorted into the following sections:

General information, which includes general information about the MNE Group and the Filing Constituent Entity, including for example who is the MNE, what is the reporting fiscal year, who will be the Filing Constituent Entity, what is the functional currency used for the Consolidated Financial Statements.

Corporate structure, which includes information about the corporate structure of the MNE Group, including for example the requirement to provide details on the UPE, details on each Constituent Entity's ownership structure, whether it is required to apply the IIR and whether the UTPR could apply with respect to such Constituent Entity, details on any Excluded Entities, as well as information about changes to the ownership structure that took place during the Fiscal Year.

ETR computation and Top-up Tax computation, which includes information about the Effective Tax Rate and Top-up Tax computations for those jurisdictions where Constituent Entities or members of JV Groups are located, including providing various table overviews of amongst others the Computation of GloBE Income (Loss) and the Computation of Adjusted Covered Taxes, and all elements which should be considered in this respect, a table overview of any elections made in accordance with the relevant provisions of the GloBE Rules. This section also incorporates the simplified compliance procedures associated with any agreed safe Harbors, whereby reference is made to the de minimis exclusion of article 5.5 of the GloBE Rules, and a Transitional CbCR Safe Harbor Election.

Top-up tax allocation and attribution, which includes information on the attribution of Top-up Tax as well as those implementing jurisdictions where such Top-up Tax is payable in accordance with the agreed rule order. It further provides more details on the computation of each Parent Entity's Allocable Share of Top-up Tax to apply the IIR and on the computation the UTPR Top-up Tax Amount, if any, as well as of the UTPR Percentage for each UTPR Jurisdiction, where applicable.

In Annex A2 the Explanatory guidance is provided for the data points, which follows the outline of the sections of Annex A1.

Public consultation

The Inclusive Framework seeks feedback on the GIR and on the information to be collected, calculated, reported and exchanged under the GIR. The request for feedback includes several points for exploration, such as (i) possible simplifications to the ETR calculation, (ii) how these can be incorporated into the design of the GIR, (iii) sharing comments to identify situations where an MNE Group should not be required to collect all data points, or where it could collect different data points, (iv) providing comments on the explanations in the explanatory guidance as set out in Annex A2, and (v) sharing views on the potential implications and burdens of a segmentation approach to making available different sets of data points to implementing jurisdictions. No indication is yet provided on when the Public Consultation will be launched.

Tax Certainty

The OECD has also released a public consultation paper on Tax Certainty for the GloBE rules dealing with dispute prevention and dispute resolution.

Dispute prevention

The paper deals with dispute prevention mechanisms noting that, as a starting point, the Globe Model Rules, Commentary and Administrative Guidance to come should form a good foundation for consistency of interpretation. It notes that the multilateral review process for recognising the 'qualified' status for the IIR, UTPR and DMTT will add to this consistency. It states that potentially policy issues could be brought to the Inclusive Framework and the various Working Parties to be clarified through Agreed Administrative Guidance, but not specific factual issues.

The paper also notes that common risk assessment mechanisms such as the International Compliance Assurance Program and APAs could be extended or used as a base to develop a mechanism for GloBE purposes to give rise to greater certainty.

Dispute resolution

On dispute resolution mechanisms, the paper focuses on the possibility to adapt Mutual Agreement Procedures (MAP) so that an MNE could refer a matter to a competent authority in a jurisdiction where actions in that jurisdiction are potentially not in line with GloBE Rules. The competent authority would then be empowered to resolve the issue with the other jurisdictions concerned and implement the agreement notwithstanding domestic time limits. Rules could be developed on the nature of issues to be covered, such as whether inconsistency of outcomes arising from domestic law is sufficient to trigger a referral or whether there must actually be a case of double taxation. Other options considered involve the use of a Multilateral Convention, exchange of information mechanisms, use of tax treaties and the creation of a reciprocal dispute resolution mechanism in domestic law along with the implementation of the GloBE rules.

Request for input

With these options in view, the paper asks stakeholders for specific examples. Can stakeholders outline examples where two jurisdictions are likely to apply the rules in a different manner, notwithstanding the Model Rules, Commentary, future Agreed Administrative Guidance and the processes to be adopted in 'qualifying' certain regimes through a multilateral review process.

In addition the consultation paper asks for examples where double taxation could arise with two implementing jurisdictions imposing Top-up Tax on the same item of GloBE Income? (The paper also asks where different interpretations of the GloBE rules should be addressed by a dispute resolution procedure even where an MNE has not suffered double taxation.)

Finally, stakeholders are asked if they would propose other mechanisms for tax certainty not currently considered by the Inclusive Framework.

Consultation feedback is due by 3 February 2023.

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