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KPMG report: Initial analysis of model rules for global minimum tax under OECD/G20 Inclusive Framework

The OECD/G20 Inclusive Framework on base erosion and profit shifting (BEPS) on 20 December 2021 released a report of model rules—the "Global Anti-Base Erosion" (GloBE) rules—under Pillar Two.

The document contains 70 pages (15 of which are definitions) as the model rules for a global minimum tax at 15% for multinational enterprises (MNEs) with a turnover of more than €750 million.

It is anticipated that a document providing further commentary on the rules will be released early next year.

Overview

The model rules released on 20 December 2021 differ from the original Blueprint (October 2022) on Pillar Two—read ***TaxNewsFlash***—in significant ways.

- The adoption of the new rules is based on a "common approach" which means that jurisdictions are not required to adopt the rules, but if they choose to do so, they will implement the rules consistently with the model.

- The rules are due to be brought into law in each participating jurisdiction through domestic law changes in 2022, to be effective in 2023 for the income inclusion rule (IIR) and in 2024 for the under-taxed payments rule (UTPR).

    - The IIR imposes top-up tax on a parent entity with respect to low-taxed income of a constituent entity.

    - The UTPR denies deductions or provides for a similar adjustment for group entities to the extent that there is top-up tax that has not been taxed under the IIR.

The determination of whether top-up tax is required—either through the IIR or the UTPR—is based on a complex calculation of the effective tax rate (ETR) for a jurisdiction. The model rules use modified deferred tax calculations for the timing differences and the treatment of losses.

There is an elective substance-based carve-out that may reduce the profits that are subject to top-up tax. This is based on the level of payroll and the carrying value of certain tangible assets, within a jurisdiction. The rules also provide for a domestic top-up tax when countries can impose a specific tax in their own jurisdiction to lift the ETR on certain profits, excluding those that are subject to a substance-based exclusion, to the minimum rate of 15%.

There are exclusions for pension funds, government, international and non-profit organizations as well as investment funds and real estate investment vehicles that are ultimate parent entities.

It is proposed that there will be certain safe harbor rules, although these have yet to be developed.

Also excluded from this Pillar Two package are the proposals for a "subject to tax rule" which is proposed to apply to certain payments including interest and royalties when the nominal tax rate on a payment falls below a minimum rate of 9%. The final scope of these rules is yet to be determined and expected in early 2022.

The Pillar Two rules apply blending on a jurisdiction-by-jurisdiction basis. The United States has proposed modifications to the rules on global intangible low-taxed income (GILTI) which are currently based on global blending. The model rules provide that "consideration will be given to the conditions" under which the U.S. GILTI regime will co-exist with the GloBE rules "to ensure a level playing field."

Work on Pillar One—which deals with new rules on the allocation of a portion of residual profit of MNEs with initially a turnover of greater than €20 billion and profit before tax margins above 10% of revenue to market jurisdictions—is progressing and announcements are expected in 2022. These rules and the "subject to tax rule" will require modifications to tax treaties anticipated to occur through a multilateral instrument.

Read a **December 2021 report** [PDF 299 KB] prepared by KPMG tax professionals that provides a policy perspective on the Pillar Two agreement

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