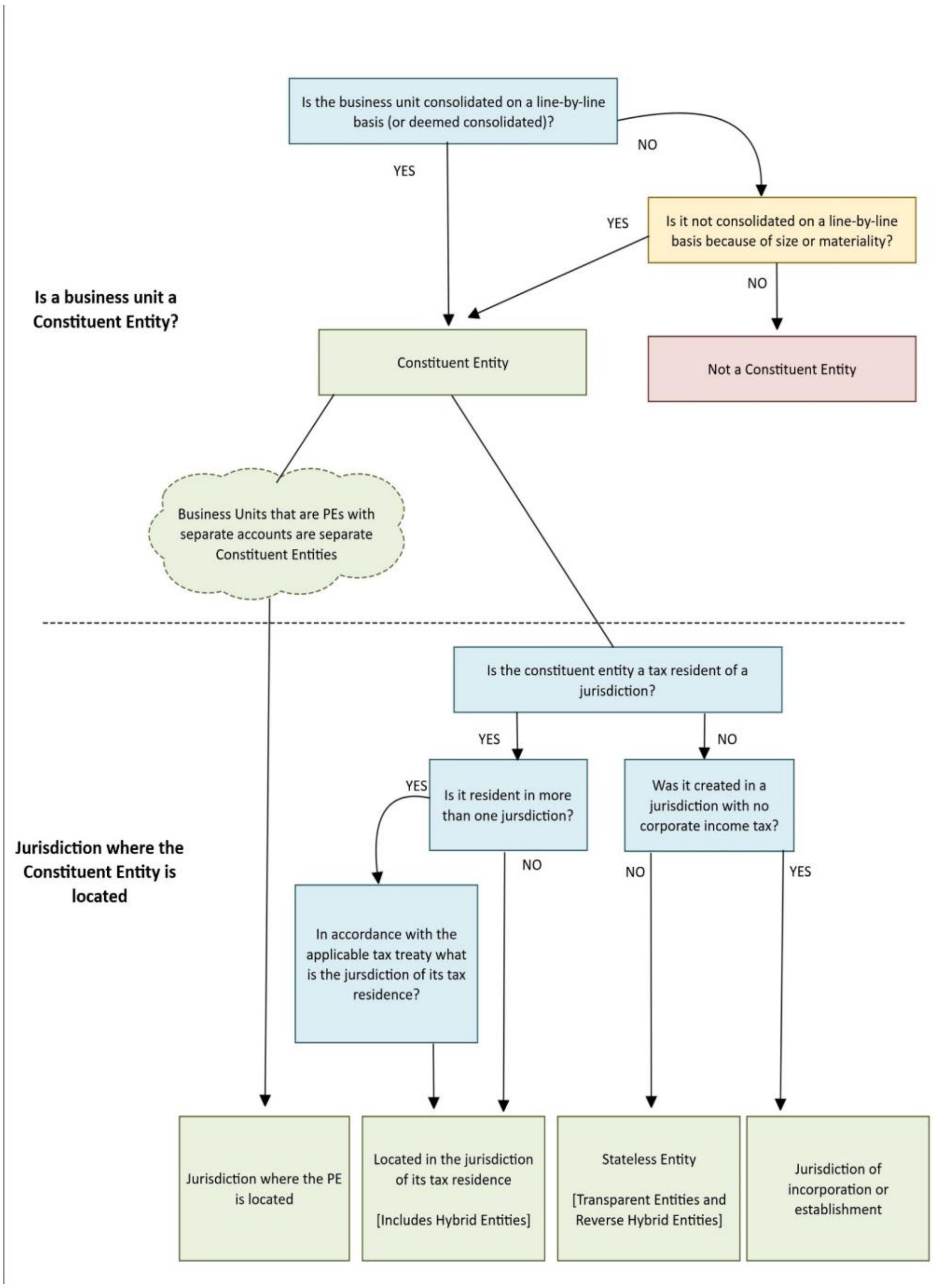
Annex A. Examples

Chapter 2 Flow Chart and Example

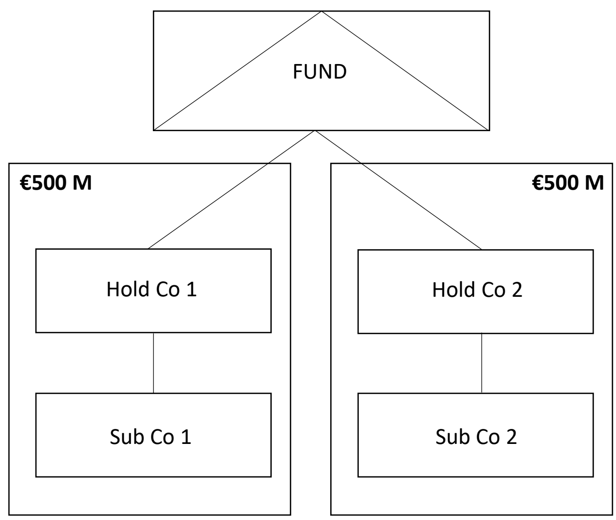
Flow Chart 2.2.2.



Example 2.4.3. Calculating consolidated revenue threshold for an MNE Group held by an Excluded Entity.

Facts

1. FUND is an investment entity that does not consolidate the accounts of its investments under IFRS 10. FUND is the majority shareholder of Hold Co 1 and Hold Co 2. These companies are the parent entities of two different MNE Groups whose consolidated revenue is EUR 500 million each. Separate consolidated financial statements are prepared for MNE Group 1 and MNE Group 2.



Question

2. Are MNE Group 1 and MNE Group 2 in the scope of the GloBE rules?

Answer

3. Both groups are out of the scope of the GloBE rules.

Analysis

4. MNE Group 1 and MNE Group 2 are considered to be separate groups because FUND is not required to consolidate with either of them on a line-by-line basis. Therefore, the consolidated revenue of MNE Group 1 and MNE Group 2 should be computed separately for purposes of the EUR 750 million threshold. The consolidated revenue of each MNE Group, i.e., MNE Group 1 and MNE Group 2, is below EUR 750 million.

5. If FUND were an entity required to consolidate Hold Co 1, Hold Co 2 and their subsidiaries on a line-by-line basis, but was an investment fund that fell within the definition of Excluded Entity under the GloBE rules then Hold Co 1 and Hold Co 2 would be treated as separate UPEs and, accordingly the computation of the threshold would be applied apply to the MNE Groups parented by Hold Co 1 and Hold Co 2.

Chapter 3 - Examples

Example 3.2.5- 1A.

Covered Taxes – Zakat

Facts

1. The Zakat levied on corporations by the Kingdom of Saudi Arabia is an example of a tax on both income and equity. The Zakat is levied at 2.5% on a Saudi's share of a resident company (also applies to citizens of Gulf Cooperation Council countries) but since it is imposed on income and equity it results in a higher effective rate. Corporate income tax is levied at 20% on a non-Saudi's share of a resident company or a non-resident's income from a permanent establishment in Saudi Arabia and a higher corporate income tax rate is imposed on Saudi working in the oil and gas industries. The corporate Zakat could be considered as an alternative to corporate income tax levied on a different basis.

2. The Zakat base is the total of the corporate taxpayer's current year's income and equity as calculated for financial accounting purposes after adjustments for certain items. In general terms these two elements of the Zakat base are determined as follows:

   a. The starting point for calculating the income portion of the Zakat base begins with the company's annual profit or loss as calculated for financial reporting purposes. This profit or loss is then adjusted by the changes to certain provisions or reserves, such as bad debts.

   b. The starting point for calculating the equity portion of the Zakat base begins by:

      i. calculating shareholder equity as determined under IFRS (excluding current year profit and any distributions); and

      ii. adjusting for the balance of certain provisions, including bad debts.

This amount is then increased by long-term liabilities and decreased by the cost of certain deductible assets to arrive at an adjusted net equity amount.

Question

3. Does the Zakat meet the definition of covered taxes under the GloBE?

Answer

4. The Zakat operates as a tax on income or equity or both and is therefore properly considered a covered tax for the purposes of the GloBE rules.

Analysis

5. Both components of the Zakat base meet the definition of a covered tax under the GloBE:

   (a) The first element of the Zakat base is on the company's income (i.e. adjusted profit or loss for the year). The adjustments for provisions and reserves is consistent with (but not a requirement of) the definition of an income tax for the purposes of the GloBE rules.

   (b) The second component of the Zakat base is a measure of adjusted equity. The equity component of the Zakat base is determined under financial accounting rules adjusted for certain provisions. This amount is then subject to a further adjustment that decreases the equity portion of the Zakat base to the extent that the company's deductible assets exceed its long-term debt.

6. Although this latter adjustment may have the effect of excluding a portion of the shareholder equity from the tax base, this feature of the Zakat does not disqualify it from being treated as a tax on the equity

of the corporation. The extent to which a corporation's liabilities are taken into account in determining equity under accounting and local law are a matter of domestic tax policy design which do not impact on the intended outcomes under the GloBE rules.

7. A company's liability for Zakat is calculated on the total of adjusted income and adjusted equity base or only on the income base (where the equity component is negative) or only the equity base (when the corporation has an operating loss). Thus, a profitable company will always be liable for Zakat on its income while a corporation that has an operating loss for the year will nonetheless be subject to Zakat on the adjusted equity portion of the Zakat base.

Example 3.3.6A. Distribution taxes modification with recapture.

Facts

1. The following example illustrates the methodology for addressing distribution taxes. X earns 100 of income in Year 1, 150 of income in Year 2, and 200 of income in Year 3. X distributes 50 of income in Year 3. Assume that the distribution tax rate in X's jurisdiction is 20%, the minimum tax rate is 12%, and the specified period for payment of distribution tax liability is two years.[1]

Question

2. How much of the accrued distribution tax is recaptured in Year 3?

Answer

3. Because X only paid 10 of distribution tax within the relevant period, 2 of accrued distribution tax is recaptured in Year 3.

Analysis

4. In Year 1, X accrues 12 of tax for GloBE purposes, which is the minimum tax on 100 of income. Accordingly, X's ETR for Year 1 is 12% and X's income is not subject to a top-up tax under the GloBE proposal. Similarly, in Year 2, X accrues 18 of tax for GloBE purposes on 150 of income and incurs no top-up tax liability. In Year 3, X accrues 24 of tax for GloBE purposes on 200 of income and X paid 10 of distribution tax in Year 3. As demonstrated in the table below, the 10 of distribution tax paid by X in Year 3 reduces the Year 1 outstanding balance of accrued minimum tax from 12 to 2. The 2 remaining balance of accrued minimum tax from Year 1 is treated as a reduction to the tax expense in the numerator of the ETR fraction in Year 3. Thus, X's ETR for Year 3 is 11% ([24 accrued minimum tax – 2 recapture of accrued minimum tax] / 200 GloBE tax base). X's GloBE tax liability for Year 3 is 2 ([200 GloBE tax base x 12%] - 22 tax expense), which equals the recaptured accrued minimum tax.

	Year 1	Year 2	Year 3
Income	100	150	200
Minimum Tax (12% tax rate)	12	18	24
Distribution tax paid	0	0	10
Distribution tax paid in excess of accrued tax outstanding balance (A)	0	0	0
Accrued tax for GloBE purposes (B)	12	18	24
Recapture of accrued tax in preceding tax year (C)	0	0	(2)
Total tax expense for ETR computation purposes (A + B – C)	12	18	22
Top-up tax (Min tax – Total tax expense for ETR computation purposes)	0	0	2

Example 3.3.6B. Distribution taxes modification with excess taxes paid.

Facts

1. Assume the same facts as in Example 3.7.4A, except that X distributed 200 in Year 3.

Question

2. How much distribution tax is accrued for purposes of GloBE in Year 3?

Answer

3. X accrues only 24 of distribution tax for GloBE purposes in Year 3.

Analysis

4. As demonstrated in the table below, X would accrue 14 of minimum tax that when added to the 10 of excess distribution tax paid in Year 3 would produce an ETR equal to the 12% minimum tax rate on 200 of income and no top-up tax liability.

5. The distribution tax of 40 (200 x 20%) would have eliminated the outstanding balances of accrued minimum tax for Year 1 (12) and Year 2 (18), and the excess (10) would have been included in the tax expense and numerator of the ETR fraction in Year 3. The minimum tax liability on 200 of income in Year 3 would be 24

	Year 1	Year 2	Year 3
Income	100	150	200
Minimum Tax (12% tax rate)	12	18	24
Distribution tax paid	0	0	40
Distribution tax paid in excess of accrued tax outstanding balance (A)	0	0	10
Accrued tax for GloBE purposes (B)	12	18	14
Recapture of accrued tax in preceding tax year (C)	0	0	0
Total tax expense for ETR computation purposes (A + B – C)	12	18	24
Top-up tax (Min tax – Total tax expense for ETR computation purposes)	0	0	0

Example 3.4.2A. Jurisdictional blending: Permanent establishments – assignment of income and taxes

Facts

1. Corp A (resident in jurisdiction A) is a Constituent Entity of an MNE Group whose Ultimate Parent Entity is tax resident in Jurisdiction X. Corp A has a permanent establishment located in jurisdiction B. Corp A has EUR 100 of profit before tax. Jurisdiction A exempts the income of foreign permanent establishments. Pursuant to the tax laws of jurisdiction B, Corp A is required to determine the portion of its income attributable to its permanent establishment located in jurisdiction B. Corp A determines that EUR 20 of its profit before tax is attributable to the permanent establishment and pays EUR 5 of tax in jurisdiction B on this basis.

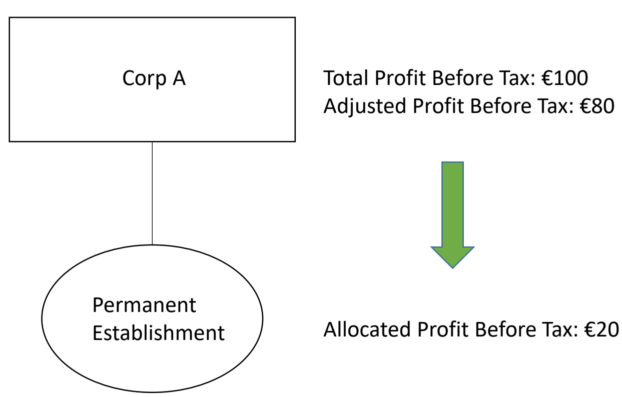
Question

2. To which jurisdictions are the income of permanent establishments and the taxes on that income assigned?

Answer

3. Under the rule, EUR 20 of profit before tax would be allocated to jurisdiction B. Any tax on that income is assigned to jurisdiction B.

Analysis



Example 3.4.2B. Jurisdictional blending: assignment of withholding taxes

Facts

1. Corp A (resident in jurisdiction A) owns Corp B (resident in jurisdiction B) and Corp C (resident in jurisdiction C). In Year 1, Corp B makes a EUR 100 royalty payment to Corp A. Jurisdiction B applies a 10% withholding tax to the payment. Also in Year 1, Corp C earns EUR 100 of profit before tax and pays EUR 20 of tax in jurisdiction C and pays a dividend to Corp A.2 Under the laws of jurisdiction A, Corp A includes the intra-group dividend in its taxable income, and after taking into account a foreign tax credit for the tax paid in jurisdiction C, Corp A pays EUR 5 of residual tax in jurisdiction A related to the intra-group dividend.

Question

2. To which jurisdictions are withholding taxes assigned?

Answer

3. Under the rule, EUR 10 of withholding tax is assigned to jurisdiction A and EUR 5 of tax is assigned to jurisdiction C.

Analysis

4. Each constituent entity's income is assigned to its tax jurisdiction of residence. The EUR 10 of withholding tax paid to jurisdiction B on the royalty received from Corp B is assigned to jurisdiction A because it is tax paid in respect of income assigned to jurisdiction A. The EUR 5 of tax paid in jurisdiction A with respect to the dividend from Corp C is assigned to jurisdiction C because it is paid in respect of income that was assigned to jurisdiction C.

Example 3.4.2C. Jurisdictional blending: CFC rule – assignment of taxes

Facts

1. Corp A (resident in jurisdiction A) wholly owns Corp B (resident in jurisdiction B). Corp B earns EUR 100 of profit before tax and pays EUR 5 of tax in jurisdiction B. Under the CFC rules of jurisdiction A, Corp A includes EUR 100 of income of Corp B computed pursuant to the jurisdiction A CFC rules in its taxable income, with a foreign tax credit for taxes paid in jurisdiction B. Assume the result is that residual CFC rule tax is paid in jurisdiction A.

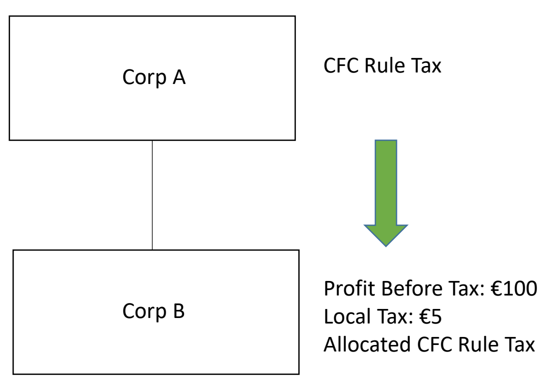
Question

2. To which jurisdiction are CFC B's income and taxes on that income assigned?

Answer

3. Under the rule, the CFC regime tax paid in jurisdiction A is assigned to jurisdiction B, which results in the taxes being assigned to the same jurisdiction as the underlying income.

Analysis



Example 3.4.2D. Jurisdictional blending: Hybrid entity – assignment of taxes

Facts

1. Corp A (resident in jurisdiction A) wholly owns Hybrid Entity B (resident in jurisdiction B). Hybrid Entity B is a corporation that is tax resident in jurisdiction B, but is tax transparent for purposes of jurisdiction A. Hybrid Entity B earns EUR 100 of profit before tax and pays EUR 20 of tax in jurisdiction B. Jurisdiction A does not exempt Corp A's share of the income of Hybrid Entity B and therefore Corp A includes the income of Hybrid Entity B in its taxable income, which is taxed in jurisdiction A less a foreign tax credit for taxes paid in jurisdiction B. Assume the result is that Corp A pays EUR 5 of residual tax in jurisdiction A.

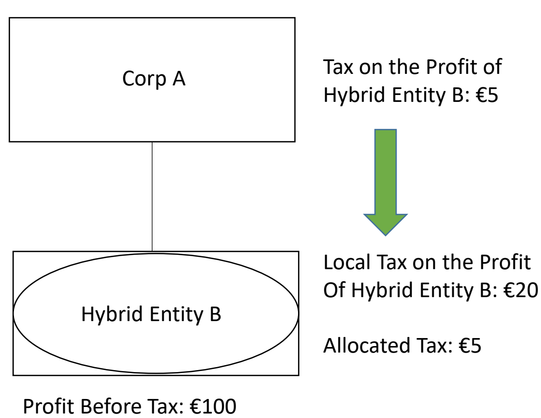
Question

2. To which jurisdiction are Hybrid Entity B's income and taxes on that income assigned?

Answer

3. Hybrid Entity B's income is assigned to its tax jurisdiction of residence, jurisdiction B. The EUR 5 of tax paid in jurisdiction A with respect to the income of Hybrid Entity B is assigned to jurisdiction B.

Analysis



Example 3.4.2E. Jurisdictional blending: Reverse-hybrid entity – assignment of taxes

Facts

1. Corp A (resident in jurisdiction A) wholly owns Reverse-Hybrid B (organised in jurisdiction B). Reverse-Hybrid B is treated as tax transparent for purposes of jurisdiction B and has no jurisdiction of tax residence. However, Reverse-Hybrid B is not tax transparent for purposes of jurisdiction A. Reverse-Hybrid B earns EUR 100 of profit before tax in Year 1. Jurisdiction A imposes EUR 5 of net basis tax on a EUR 100 dividend paid from Reverse-Hybrid B to Corp A in Year 1. Jurisdiction B imposes no tax on the income of Reverse-Hybrid B or the distribution to Corp A.

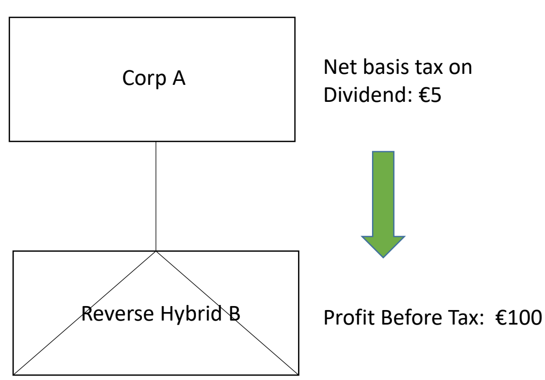
Question

2. To which jurisdiction are reverse-Hybrid B's income and taxes on that income assigned?

Answer

3. Reverse-Hybrid B's income is assigned to stateless because it has no jurisdiction of tax residence and its owner's tax jurisdiction does not treat the entity as tax transparent. The EUR 5 of tax paid in jurisdiction A related to the underlying income earned by Reverse-Hybrid B is assigned to stateless.

Analysis



Example 3.4.2F. Jurisdictional blending: Partially tax transparent & partially hybrid entity– assignment of income

Facts

1. Corp A (resident in jurisdiction A), Corp B (resident in jurisdiction B), and Corp C (resident in jurisdiction C), are constituent entities of MNE Group ABC. They each own equal shares of an entity, Partnership D. Partnership D is organized under the laws of jurisdiction D and is treated as a tax transparent entity by jurisdictions A, B, and D. Corp A and Corp B do not have a permanent establishment in jurisdiction D as a result of their ownership interest in Partnership D or otherwise. Corp A and Corp B are subject to tax in their respective jurisdictions on their share of Partnership D's income. Jurisdiction C does not treat Partnership D as tax transparent and Corp C does not have a permanent establishment in jurisdiction D. Partnership D earns EUR120 of profit in Year 1 and is not subject to tax in jurisdiction D.

Question

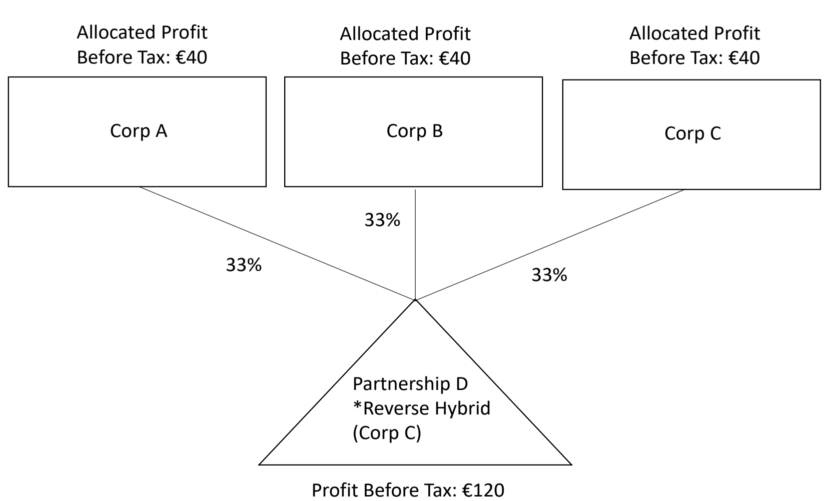
2. To which jurisdictions are the income of Partnership D and the taxes paid in respect of that income assigned?

Answer

3. Corp A and Corp B's share of Partnership D's income is assigned to their respective jurisdictions. Covered taxes paid by Corp A and Corp B on such income is assigned to jurisdiction A and jurisdiction B, respectively. Corp C's share of Partnerships D's income is assigned to the stateless jurisdiction.

Analysis

4. Partnership D is a stateless entity because it has no tax jurisdiction of residence. However, Partnership D's income is allocated to some of its owners in accordance with the partnership agreement because Corp A's and Corp B's tax jurisdiction treats Partnership D as a tax transparent entity. Accordingly, Corp A and Corp B are each allocated EUR 40 of profit before tax. The remainder of Partnership D's income – Corp C's EUR 40 share – is allocated to the stateless jurisdiction. Corp A and Corp B are subject to tax in Year 1 in their tax jurisdiction of residence on their allocable share of the partnership income. The tax paid by each partner on its share of the partnership income is assigned to that partner's tax jurisdiction of residence. Corp C is not subject to tax on its allocable share of the partnership income in Year 1. Therefore, no covered taxes are assigned to Jurisdiction D in Year 1.



Example 3.4.2G. Jurisdictional blending: Partially tax transparent & permanent establishments of its owners

Facts

1. The facts are the same as Example 3.4.2F, except that Partnership D is managed and controlled in jurisdiction D and regularly conducts business operations in jurisdiction D. Partnership D is treated as a tax transparent entity by jurisdictions A, B, and D. Under the law of jurisdiction D, Corp A, Corp B, and Corp C each have a permanent establishment in jurisdiction D and are subject to jurisdiction D's income tax on their share of Partnership D's income. In addition, Corp A and Corp B are subject to tax in their respective jurisdictions on their share of Partnership D's income. Jurisdiction C does not treat Partnership D as tax transparent. Partnership D earns EUR 120 of profit in Year 1.

Question

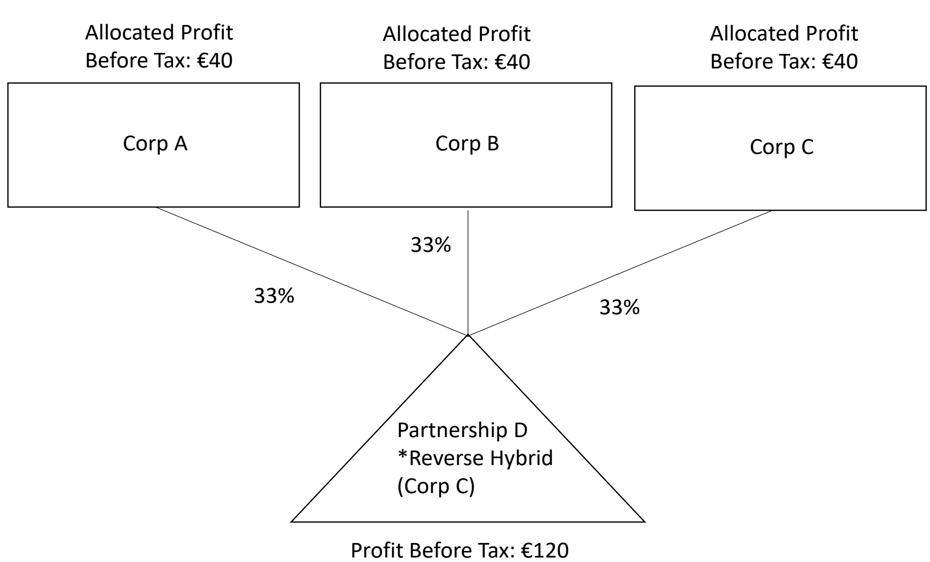
2. To which jurisdictions are the income of Partnership D and the taxes paid in respect of that income assigned?

Answer

3. The permanent establishments of Corp A, Corp B, and Corp C are treated as Constituent Entities (PE-Constituent Entities) of MNE Group ABC. Each PE-Constituent Entity's share of Partnership D's income is assigned to jurisdiction D. Covered taxes paid by the PE-Constituent Entities are assigned to jurisdiction D. Covered taxes paid by Corp A and Corp B on their shares of Partnership D's income are also assigned to jurisdiction D.

Analysis

4. Partnership D is a stateless entity because it has no tax jurisdiction of residence. However, Partnership D's income is allocated to Constituent Entities that are permanent establishments of its owners under the law of jurisdiction D. Jurisdiction D allocates the income among the permanent establishments of Corp A, Corp, B and Corp C accordance with the partnership agreement. Accordingly, each PE-Constituent Entity is allocated EUR 40 of profit before tax. The jurisdiction D income tax is allocated to jurisdiction D. In addition, Corp A and Corp B are subject to tax in Year 1 in their tax jurisdiction of residence on their allocable share of the partnership income. The tax paid by each partner on its share of the partnership income is assigned to jurisdiction D.



Chapter 4 – Examples

Example 4.2.1A. Local tax carry-forward

Facts

1. The following example illustrates the application of the local tax carry-forward rule where there was no IIR tax paid by the shareholder in a previous period. Assume that MNE-1 owns Subsidiary A, which is subject to tax in Jurisdiction A, and that the minimum tax rate is 10%. Subsidiary A's GloBE tax base is 1,000 in each of Year 1, Year 2, and Year 3. Subsidiary A pays 140 of tax in Year 1, 80 of tax in Year 2, and 50 of tax in Year 3. MNE-1 has never paid IIR tax in respect of Jurisdiction A.

Subsidiary A	Year 1	Year 2	Year 3
Income	1,000	1,000	1,000
Minimum tax (10%)	100	100	100
Local tax paid (Jurisdiction A)	140	80	50
Excess taxes	40	0	0
Local tax carry-forward used	0	20	20
Local tax carry forward remaining	40	20	0
GloBE Tax (top up to 10%)	0	0	30

Question

2. What is the GloBE tax liability and the GloBE tax carry-forward in Years 1-3?

Answer

3. The GloBE tax carry-forward at the end of Year 1 is 40, the end of Year 2 is 20 and the end of Year 3 is 0. The GloBE tax liability for Year 1 is 0, for Year 2 is 0, and for Year 3 is 30.

Analysis

4. As shown above, Subsidiary A paid excess taxes of 40 in Year 1, and MNE-1 creates a Year 1 local tax carry-forward in that amount. In Year 2, Subsidiary A paid less than the minimum tax on its GloBE tax base and used 20 of the local tax carry-forward to increase the tax expense in Jurisdiction A to the minimum rate. MNE-1 reduced its Year 1 local tax carry-forward by the amount used in Year 2. In Year 3, Subsidiary A increased its tax expense in Jurisdiction A by the remaining balance of the Year 1 local tax carry-forward to 70. However, even after adding the carry-forward to the Year 3 tax paid, the ETR computed for Subsidiary A's GloBE tax base is below the minimum tax rate (70 tax / 1,000 GloBE tax base = 7% ETR). Therefore, MNE-1 is subject to 30 of top-up tax (100 minimum tax – 70 tax expense) in respect of Jurisdiction A in Year 3.

Example 4.2.1B. IIR tax credit

Facts

1. The following example illustrates the application of the IIR tax credit. Assume that MNE-2 owns one subsidiary, Subsidiary A, in Jurisdiction A, and the agreed minimum tax rate is 10%. At the beginning of Year 4, MNE-2 had paid 100 of IIR tax in Year 2 and IIR tax of 20 in Year 3 in respect of Jurisdiction A. Prior to Year 4, Subsidiary A had never had excess taxes. In Year 4, Subsidiary A had 1,000 of income and paid 275 of tax in Jurisdiction A. In Year 5, Subsidiary A had 1,000 of income and paid 20 of tax in Jurisdiction A.

Subsidiary A	Year 2	Year 3	Year 4	Year 5
Income	1,000	1,000	1,000	1,000
Local tax paid (Jurisdiction A)	0	80	275	20
Minimum tax (10%)	100	100	100	100
IIR Tax (top up to 10%)	100	20	0	25
Excess taxes (local tax – min tax)	0	0	175	0
Local tax carry forward (excess tax – IIR tax credit created for year – excess taxes used to reduce top-up tax)	0	0	55	0
IIR tax credit used	0	0	0	25
IIR tax paid (aggregate)	100	120	0	0
IIR tax credit (aggregate)	0	0	120	95

Question

2. What is MNE-2's IIR tax credit in this scenario?

Answer

3. At the beginning of Year 6, MNE-2's IIR tax credit is 95, and its Year 4 Jurisdiction A local tax carry-forward is 0.

Analysis

4. As shown above, Subsidiary A paid 175 of taxes in excess of the minimum tax rate in Year 4. The excess taxes create IIR tax credits in respect of IIR taxes paid in years 2 and 3. The remaining 55 of excess taxes paid create a local tax carry-forward.

5. In Year 5, Subsidiary A paid 20 of IIR tax and increased its adjusted covered taxes by the 55 local tax carry-forward. Subsidiary A computed an ETR of 7.5% (i.e. below the minimum rate) and 25 of top-up tax. However, MNE-2 used its 25 of IIR tax credits to reduce the liability to 0. At the beginning of Year 6, MNE-2's local tax carry-forward is 0 and its IIR tax credits are 95.

Example 4.2.1C. Application of IIR tax credit to IIR tax arising in respect of a different jurisdiction

Facts

1. The following example illustrates how the IIR tax credit can be applied in respect of an IIR tax liability that arises in respect of a low-tax outcome in another jurisdiction. Assume that Parent is a corporation organized and subject to tax in Country A, which has adopted the GloBE proposal and the agreed minimum tax rate is 10%. Parent owns Subsidiary B in Country B and Subsidiary C in Country C. In Year 1, Subsidiary B earns 1,000 of income and pays no tax in Country B, and Subsidiary C earns 1,000 of income and pays 100 of tax in Country C. In Year 2, Subsidiary B earns 400 of income and pays 100 of tax in Country B, and Subsidiary C earns 1,000 of income and pays 20 of tax in Country C.

	Subsidiary B			Subsidiary C		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
Income	1,000	400	1,000	1,000	1,000	1,000
Local tax paid	0	100	100	100	20	100
Minimum tax (10%)	100	40	100	100	100	100
IIR Tax (top up to 10%)	100	0	0	0	80	0
IIR tax credit used	0	0	0	0	**60**	0
IIR Tax Paid	100	0	0	0	20	0
Excess taxes (local tax – min tax)	0	60	0	0	0	0
Local tax carry-forward (excess tax – IIR tax credit created for year)	0	0	0	0	0	0
IIR tax paid (aggregate)	100	40	40	0	20	20
IIR tax credit	0	**60**	0	0	0	0

Question

2. Can parent use an IIR tax credit arising with respect to Country B to reduce a subsequent IIR tax liability arising with respect to Country C ?

Answer

3. Yes.

Analysis

4. As shown above, Parent pays 100 of tax to Country A under the income inclusion rule in respect of income of Subsidiary B for Year 1 because the tax paid in Country B on Subsidiary B's income was below the minimum tax rate. In Year 2, Subsidiary B pays 60 of tax in Country B in excess of the minimum tax on income earned in Country B. Also in Year 2, Parent incurs 80 of income inclusion rule tax liability in respect of income earned by Subsidiary C that was subject to tax below the minimum rate.

5. At the end of Year 2, Parent creates an IIR tax credit of 60 as a result of the excess taxes paid in Year 2. Parent is eligible to use the IIR tax credit of 60 against its Country A IIR tax liability arising in respect of Country C in the same year. (The 60 IIR tax credit arising in Country B in Year 2 and used in Country C in Year 2 is highlighted in bold in the chart above.) After using the credit, Parent pays 20 of IIR tax with respect to Country C in Year 2. At the beginning of Year 3, Parent has 40 of IIR tax paid in Year 1 in respect of Country B and 20 of IIR tax paid in Year 2 in respect of Country C that has not given rise to an IIR tax credit.

Example 4.2.2A. Post-filing decrease in local tax liability.

Facts

1. The following example illustrates the application of the carry-forward adjustment approach to the treatment of post-filing decreases in local tax liability.

2. Assume that MNE1 is subject to an income inclusion rule in its jurisdiction of tax residence and owns a single entity, X Corp, that is tax resident in Jurisdiction X and that Local Tax Carry-forwards are allowed to be used to reduce the tax liability of the succeeding 10 years from the year in which they were created. X Corp's covered taxes in Jurisdiction X exceeded the minimum tax on its income by 100 in Year 1 and 80 in Year 2. Accordingly, X Corp established a Local Tax Carry-forward of 100 for Year 1 and 80 for Year 2.

3. In Year 3, X Corp initiated a refund claim with respect to 100 of tax paid to Jurisdiction X in Year 1. In Year 4, X Corp initiated a refund claim with respect to 30 of tax paid to Jurisdiction X in Year 2. In Year 6, X Corp and Jurisdiction X settled the Year 1 refund claim with a refund of 60 and Jurisdiction X refunded 30 with respect to the Year 2 refund claim. The refunds in Year 6 were a final determination of X Corp's refund claims in respect of Year 1 and Year 2. Prior to Year 6, X Corp had used 10 of its Local Tax Carry-forward from Year 1 in the computation of the Jurisdiction X ETR for a taxable year.

Question

4. What is the carry-forward adjustment in this scenario?

Answer

5. Beginning with the Year 6 ETR computation for Jurisdiction X, X Corp has 30 of Local Tax Carry-forward from Year 1 and 50 of Local Tax Carry-forward from Year 2 to increase the covered tax expense in the numerator of the ETR fraction to achieve a minimum tax rate in Jurisdiction X.

Analysis

6. The post-filing tax decreases in Jurisdiction X liability reduce X Corporation's Local Tax Carry-forwards for Year 1 and Year 2 by 60 and 30, respectively, as of the beginning of Year 6.

Example 4.2.2B. Post-filing increase in local tax liability.

Facts

1. The following example illustrates the application of the carry-forward adjustment approach to the treatment of post-filing decreases in local tax liability.

2. Assume that MNE2 is subject to an income inclusion rule in its jurisdiction of tax residence and owns a single entity, Y Corp, that is tax resident in Jurisdiction Y. In Year 1, MNE2 paid 80 IIR tax in respect of Jurisdiction Y. In Year 3, Jurisdiction Y asserted additional liability of 100 in respect of Year 1 and in Year 5, a Jurisdiction Y court determined, with finality, that Y Corp was liable for the additional 100 tax in respect of Year 1.

Question

3. What is the IIR tax credit and Local Tax Carry-forward in this scenario?

Answer

4. As of the beginning of Year 5, Y Corp first creates an IIR tax credit of 80 and then a Local Tax Carry-forward of 20 with respect to Year 1.

Analysis

5. MNE2 did not pay IIR tax in respect of Jurisdiction Y, and Y Corp did not pay excess tax in Jurisdiction Y, for any year subsequent to Year 1.

[1] The two year distribution period in the example is for illustrative purposes. The period that will apply for GloBE purposes has not yet been agreed by the Inclusive Framework.

[2] This sentence has been amended to reflect a comment made by Canada.

Chapter 6 - Examples

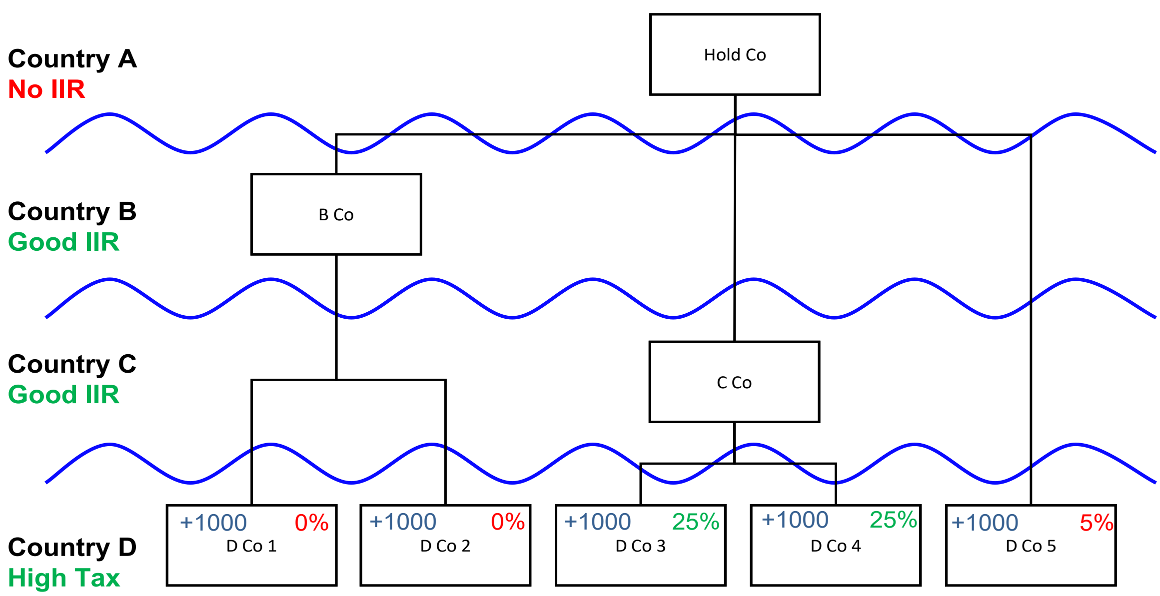
Example 6.1A. Computation of the ETR in cases where the UPE does not apply the IIR – High tax jurisdiction

Facts

1. The MNE Group consists of eight constituent entities located in jurisdictions A, B, C and D. Hold Co is a tax resident of Country A and is the Ultimate Parent Entity of an MNE Group subject to the GloBE rules. Hold Co owns directly the shares of B Co (tax resident in Country B), C Co (tax resident in Country C) and D Co 5 (tax resident in Country D). D Co 5 is subject to a tax rate of 5%.B Co owns the shares of D Co 1 and D Co 2 (tax residents in Country D) that are subject to a tax rate of 0%.

2. B Co owns the shares of D Co 1 and D Co 2 (tax residents in Country D) that are subject to a tax rate of 0%. C Co owns the shares of D Co 3 and D Co 4 (tax residents in Country D) that are subject to a tax rate of 25%.

3. Country B and Country C have adopted an income inclusion rule. Assume that the minimum rate is 11%.



Questions

4. How should the ETR of the Constituent Entities located in Country D be computed? Should jurisdictional blending apply across all the Constituent Entities of the MNE Group, or only between the Constituent Entities controlled by the Parents applying the IIR?

5. In this case, are B Co and C Co required to apply the IIR with respect to the income earned by the Constituent Entities located in Country D?

Answers

6. The ETR is computed considering all the Constituent Entities of the MNE Group located in the same jurisdiction regardless of the Parents applying the IIR.

7. In this case, B Co and C Co are not required to apply their IIR because Country D is considered a high tax country.

Analysis

8. The ETR of the Constituent Entities of the MNE Group is computed based on a jurisdictional blending approach. Therefore, a GloBE tax liability will arise when the ETR of a jurisdiction in which the MNE Group operates is below the agreed minimum rate.

9. In this example, B Co and C Co would be required to apply the IIR under the top-down approach because Hold Co is located in a jurisdiction that has not adopted the GloBE rules. However, they are not required to apply their IIR because their subsidiaries are located in a jurisdiction with an ETR above the minimum rate.

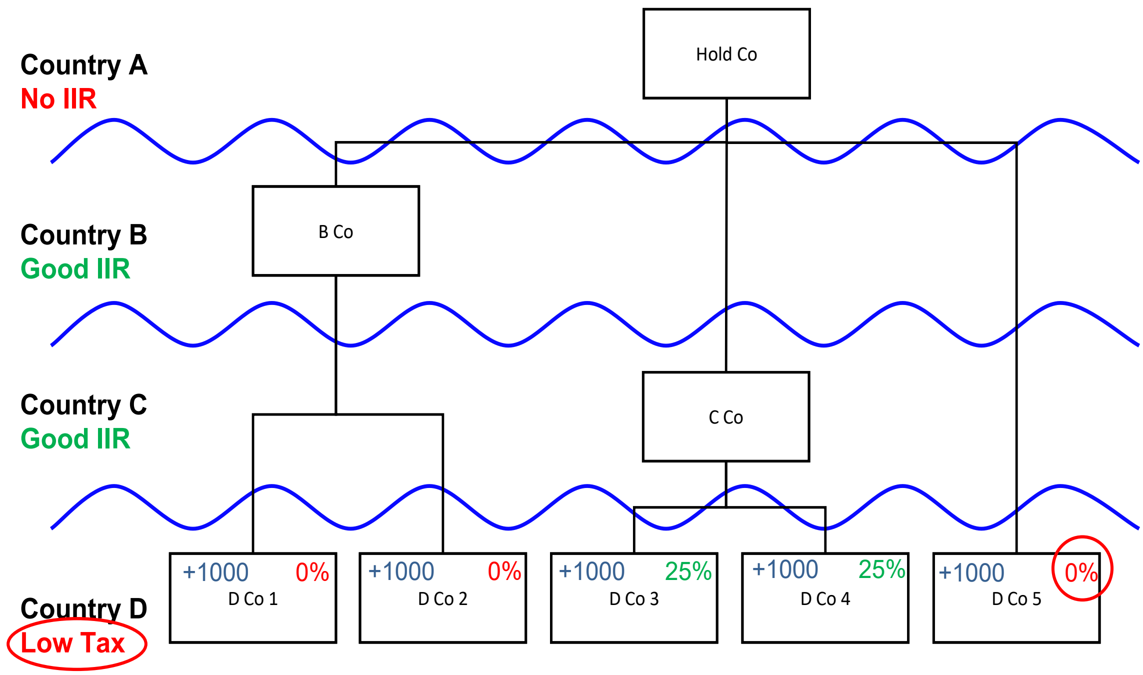
10. In this case, the ETR of the Constituent Entities located in Country D is of 11% (55 of tax paid divided by 5,000 of profits). The computation of the ETR is not affected by the fact that the different Constituent Entities located in Country D are owned by different Parents required to apply the rule (B Co and C Co). Therefore, the ETR in Country D is not below the minimum rate.

11. If jurisdictional blending was computed depending on the Parent applying the IIR, B Co would be required to apply the IIR because its two subsidiaries (D Co 1 and D Co 2) are subject to an ETR below the minimum rate. However, jurisdictional blending takes into account all the Constituent Entities of the MNE Group located in a jurisdiction regardless of the entities under control of the Parent applying the IIR. Therefore, all the Constituent Entities located in Country D are not subject to an ETR below the minimum rate.

Example 6.1B. Computation of the ETR in cases where the UPE does not apply the IIR – Low tax jurisdiction

Facts

1. The facts are the same as Example 6.1.1A, except that income of D Co 5 is exempt from tax in Country D.



Questions

2. How should the ETR of the Constituent Entities located in Country D be computed? Should jurisdictional blending apply across all the Constituent Entities of the MNE Group, or only between the Constituent Entities controlled by the Parents applying the IIR?

3. In this case, are B Co and C Co required to apply the IIR with respect to the income earned by the Constituent Entities located in Country D?

Answers

4. The ETR is computed considering all the Constituent Entities of the MNE Group located in the same jurisdiction regardless of the Parents applying the IIR.

5. In this case, B Co and C Co are required to apply their IIR because Country D is considered a low tax country.

Analysis

6. Country D is a low tax jurisdiction because the ETR on the income of Constituent Entities located therein (500/5,000 = 10%) is below the minimum rate of 11%. Accordingly, B Co and C Co are Parents because they own equity interests in Constituent Entities located in a low-tax jurisdiction and they are not controlled by another Constituent Entity that is subject to an income inclusion rule. The top-up tax percentage is 1% (11% minimum ETR – 10% ETR). Therefore, the top-up tax allocated in respect of each Constituent Entity located in Country D is 10 (1,000 adjusted income x 1%), for a total of 50.

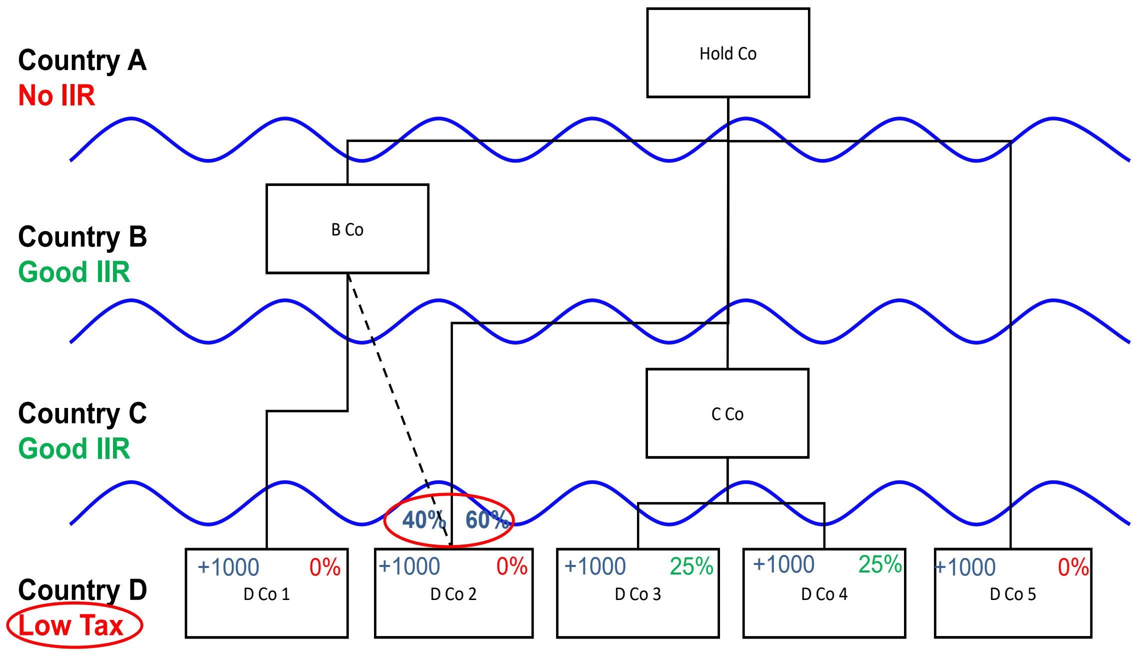
7. B Co and C Co are required to pay 20 each. In both cases, the Parent determines its share of the top-up tax by multiplying the top-up tax computed for each Constituent Entity by its ownership percentage of the entity (100% x 10).

8. D Co 5 is not controlled by a Parent. Therefore, the 10 of top-up tax computed in respect of D Co 5 is allocated to other Constituent Entities pursuant to the undertaxed payments rule.

Example 6.3.1A. Operation of the IIR in case of a non-controlling Parent

Facts

1. The facts are the same as Example 6.1B., except that shares of D Co 2 are owned by Hold Co (60%) and B Co (40%).



Questions

2. Are Parents required to apply the IIR to Constituent Entities that are not under their control?

3. In this case, is B Co required to apply the IIR with respect to the income of D Co 2?

Answers

4. Parents are required to apply the IIR to entities or arrangements even if they do not control them provided that they are both Constituent Entities of the same MNE Group.

5. B Co is required to apply the IIR with respect to 40% of the income of D Co.

Analysis

6. Country D is a low tax jurisdiction because the Constituent Entities located in such jurisdiction are subject to an effective tax rate test of 10%, which is below the minimum rate of 11%. The top-up tax percentage is 1% and the top-up tax computed under the rules of Chapters 3 and 4 for each Constituent Entity in Country D is 10 (1,000 adjusted income x 1%).

7. B Co's top-up tax liability is determined based on its ownership percentage. Therefore, B Co is required to pay 14. 10 with respect to the income of D Co 1 (100% x 10) and 4 with respect to the income of D Co 2 (40% x 10). B Co is required to apply the IIR to the income of D Co 2 because both entities are controlled by the UPE and are Constituent Entities of the MNE Group. The fact that B Co does not control D Co 2 is irrelevant for purposes of applying the IIR based on its ownership share.

8. As in Example 6.1B, C Co is required to pay $20 with respect to income of D Co 3 and D Co 4.

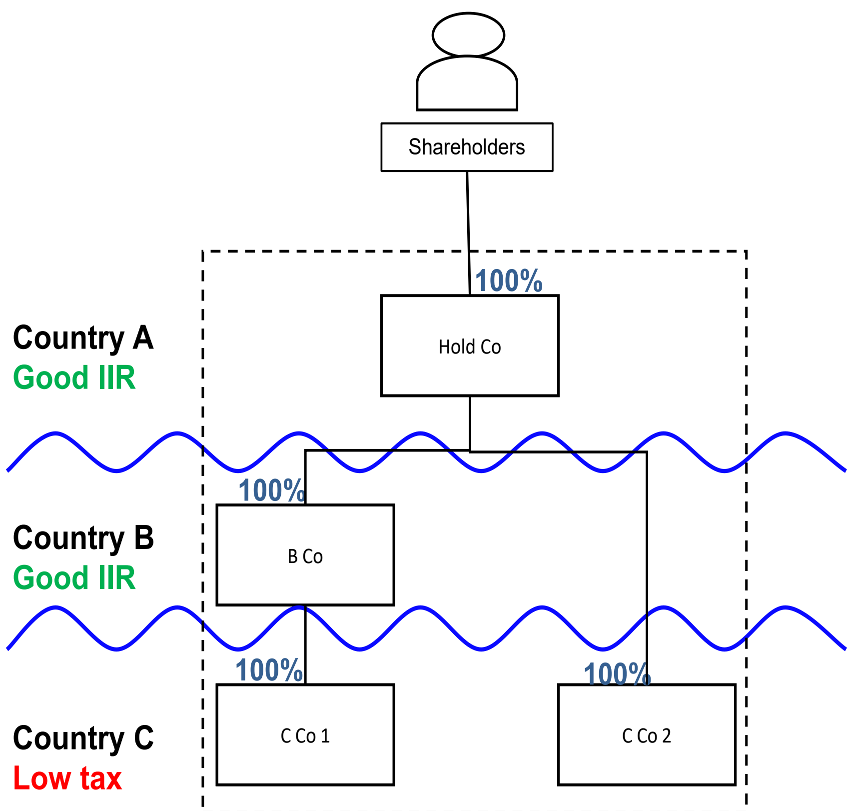
9. D Co 5 is not controlled by a Parent. Therefore, the 10 of top-up tax computed in respect of D Co 5 is allocated to other Constituent Entities pursuant to the undertaxed payments rule. In addition, the 10 top-up tax computed in respect of D Co 2 with a 4 credit for top-up tax allocated under the income inclusion rule is allocable to other Constituent Entities pursuant to the undertaxed payments rule.

Example 6.3.2A. Tax avoidance scheme using split-ownership structures

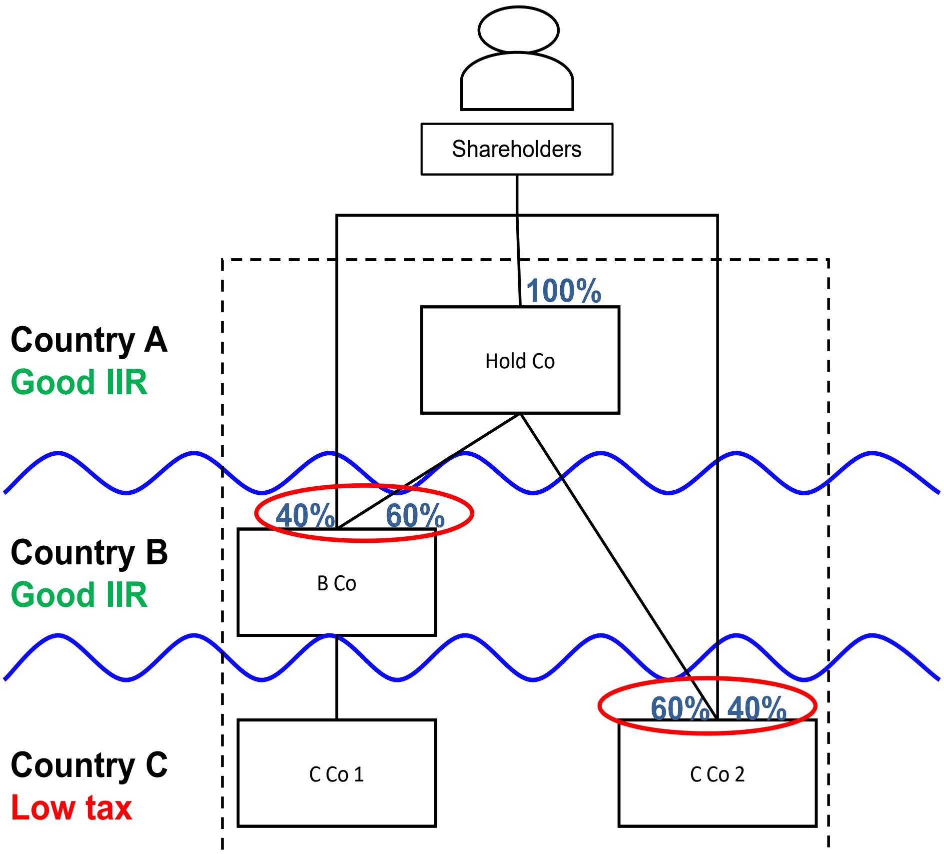
Facts

1. Hold Co is the Ultimate Parent of a family owned MNE Group subject to the GloBE rules. Hold Co owns all the shares of B Co, an entity located in Country B. B Co holds all the shares of C Co 1, an entity located in Country C. Hold Co also holds all the shares of C Co 2, an entity located in Country C.

2. The ETR of C Co 1 and C Co 2 is below the minimum rate. Therefore, Hold Co would be required to apply the income inclusion rule with respect to 100% of the income of C Co 1 and C Co 2. Assume that the split-ownership rules apply in cases where 10% or more of the equity interests of a Partially Owned Intermediate Parent are held directly or indirectly by persons that are not Constituent Entities of the MNE Group.



3. To avoid the GloBE rules, Hold Co spins-off 40% of its shares of B Co and C Co 2 to its own shareholders. If the ETR test and tax liability under the GloBE rules was based only in the Ultimate Parent's ownership percentage of C Co 1 and C Co 2, then this reorganization would cut GloBE tax liability by 40%.



Question

4. How will the split-ownership rules deal with this tax planning scheme?

Answer

5. The split-ownership rules only deal with Partially Owned Intermediate Parents. They do not deal with partially owned low-tax entities.

Analysis

6. According to the split-ownership rules, B Co would be required to apply the IIR. Therefore, this reorganization would not have an effect on the top-up tax paid under the GloBE rules with respect to the income of C Co 1.

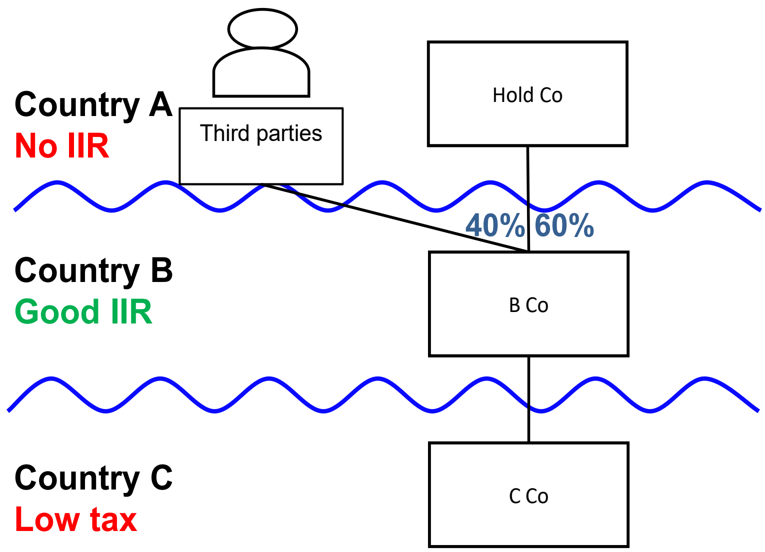
7. However, the split-ownership rules do not cover 40% of the income of C Co 2 because it is not a Partially Owned Intermediate Parent. In this case, the entity subject to low taxation is the partially owned Constituent Entity . This result would not change even if there was an intermediate entity between Hold Co and C Co 2 provided that the equity shares of the later are still owned by the shareholders of Hold Co.

Example 6.3.2B. Issues arising without split-ownership rules

Facts

1. The GloBE rules have not adopted split-ownership rules. The ETR and top-up tax of the low-taxed entities are computed based on the UPE's ownership share of the low-taxed income.

2. Hold Co is the UPE of an MNE Group subject to the GloBE rules. Hold Co is a tax resident of Country A, a jurisdiction that has not adopted the income inclusion rule. It owns 60% of the shares of B Co, a Constituent Entity of the group located in Country B that has adopted the GloBE rules. The remaining 40% of the shares of B Co are owned by minority shareholders that are not Constituent Entities of the MNE Group. B Co owns 100% of the shares of C Co, a Constituent Entity located in Country C. C Co has an effective tax rate of 0%. In this example, the minimum tax rate is 11%.



Questions

3. How would the GloBE rules operate without split-ownership rules in this situation?

4. What are the issues arising in the absence of split-ownership rules?

Answer

5. In this case, B Co would be required to apply the IIR because Hold Co is located in a jurisdiction that has not adopted the IIR. B Co would be required to apply the IIR with respect to 60% of the income of C Co because that it's the ownership percentage owned by the UPE. Hold Co would be effectively taxed at 36% because it owns 60% of the equity interests of the Parent applying the IIR, the remaining 24% would be borne by the minority interest holders.

6. The UPE would be subject to a lower IIR liability if the top-up tax is paid by an intermediate parent which is partially-owned. The minority interest holders would be impacted by part of the top-up tax that belongs to the UPE, even if the policy rationale was to exclude minorities.

Analysis

7. The GloBE could have adopted an approach in which the ETR and top-up tax are computed based on the UPE's ownership share of the low-taxed entity. If the UPE applies the IIR or if it is applied by an intermediate parent wholly owned by the UPE, then the rules work perfectly fine (regardless of exempting

income belonging to minorities) because the ETR and top-up tax are computed based on the UPE's ownership percentage on the low-taxed income.

8. However, if an intermediate parent entity that is not wholly-owned by the UPE is required to apply the rule, then a flaw in the IIR system would occur because the UPE would be subject to lower tax burden. In this case, the income belonging to minorities would be taxed even if the policy was to exclude these minority interests.

9. In this example, the top-up tax imposed by B Co's jurisdiction is limited to the Ultimate Parent Entity's ownership percentage of C Co. Therefore, B Co would apply the IIR with respect to 60% of the income of C Co. This means that Hold Co would effectively be paying top-up tax with respect to 36% of its ownership percentage (60% x 60% = 36%). The remaining 24% would indirectly impact the returns of the minority interest holders as they also own B Co, the entity subject to the IIR tax.

10. A way to solve this problem would be by applying the income inclusion rule based on the intermediate parent's proportionate share of the low-taxed income. This ensures that the Ultimate Parent Entity is indirectly subject to the income inclusion rule based on its proportionate share of the low-taxed income. In the example, this would mean that B Co would be required to apply the IIR with respect to 100% of the income of C Co. However, the effective tax rate and top-up tax computation would be changing depending on the parent entity or entities apply IIR, which would create another series of issues.

Adopted approach

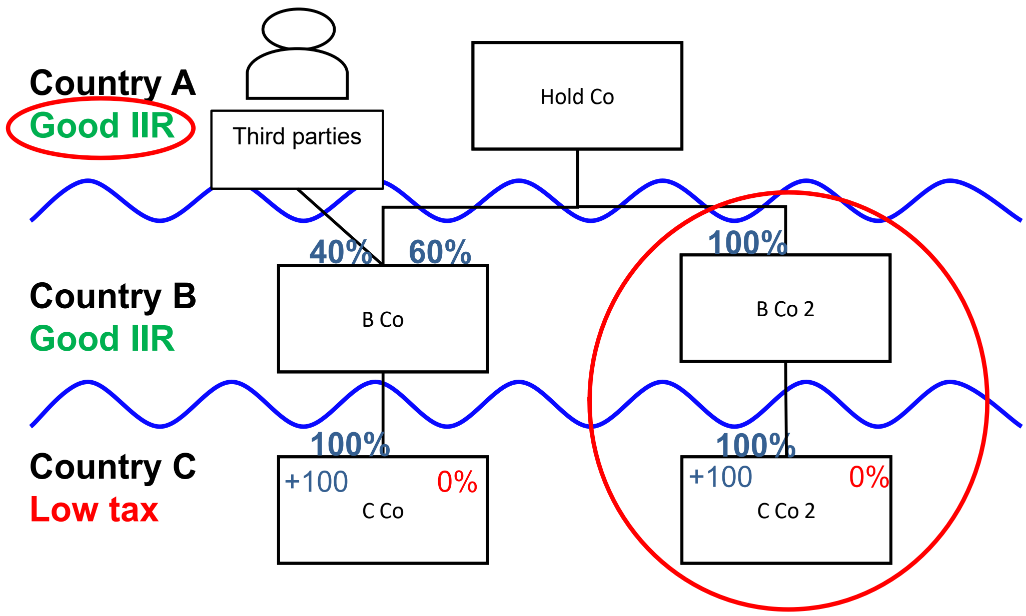
11. Under the adopted approach the top-up tax percentage computed for Country C is 11% (11% minimum rate – 0% ETR). Accordingly, the top-up tax computed for C Co is 11 [(100 (income) x 11% (top-up tax percentage)]. B Co computes its share of the top-up tax of C Co based on its ownership percentage of C Co, 100%, and pays 11 of top-up tax. Consequently, Hold Co effectively pays 6.6, while the remaining 4.4 of the tax cost is borne by the minority shareholders of B Co.

12. The top-up tax percentage computed for Country C is 11% (11% minimum rate – 0% ETR). If the top-up tax under the GloBE rules was based on Hold Co's ownership percentage of C Co, then Hold Co would be required to pay 6.6 of top-up tax (100 x 60% x 11%). However, Hold Co is located in a jurisdiction that has not adopted the GloBE rules. Therefore, under the top-down approach, B Co is required to apply the income inclusion rule. If B Co were required to pay 6.6, then Hold Co would be effectively paying 3.96. The tax cost of the remaining 2.64 would be borne by the minority shareholders.

Example 6.3.2C. Coordination between the UPE and POIP to apply the IIR

Facts

1. The facts are the same as Example 6.2.2B, except the GloBE rules include the split-ownership rules, Country A has adopted an income inclusion rule, and Hold Co also owns 100% of the shares of B Co 2 (located in Country B), an entity that holds 100% of the shares of C Co 2 (located in Country C). The income of C Co 2 is subject to an effective tax rate of 0%. Assume that the split-ownership rules apply in cases where 10% or more of the equity interests of a Partially Owned Intermediate Parent are held directly or indirectly by persons that are not Constituent Entities of the MNE Group.



Question

2. How would the IIR be applied in this situation?

Answer

3. B Co would be required to apply the IIR with respect to the income of C Co because it is a Partially Owned Intermediate Parent, while Hold Co would be required to exempt such income from its IIR and apply it only with respect to the income of C Co 2.

Analysis

4. The ETR of Country C is of 0%, and therefore, the top-up tax percentage is 11% [11% (minimum tax rate) – 0% (ETR)]. The top-up tax computed for C Co and C Co 2 is 11 each [(100 (income) x 11% (top-up tax percentage)].

5. Under the top-down approach, Hold Co is required to apply the income inclusion rule. However, B Co is also required to apply the income inclusion rule with respect to the income of C Co in accordance with the split-ownership rules because it is a Partially Owned Intermediate Parent.

6. B Co is required to pay 11 (100% x 11) under its IIR.

7. Hold Co is also required to apply the IIR. However, to avoid double taxation, it will compute its top-up tax only with respect to its share of C Co 2's income and therefore, it would be required to pay a tax of 11 (100% x 11).

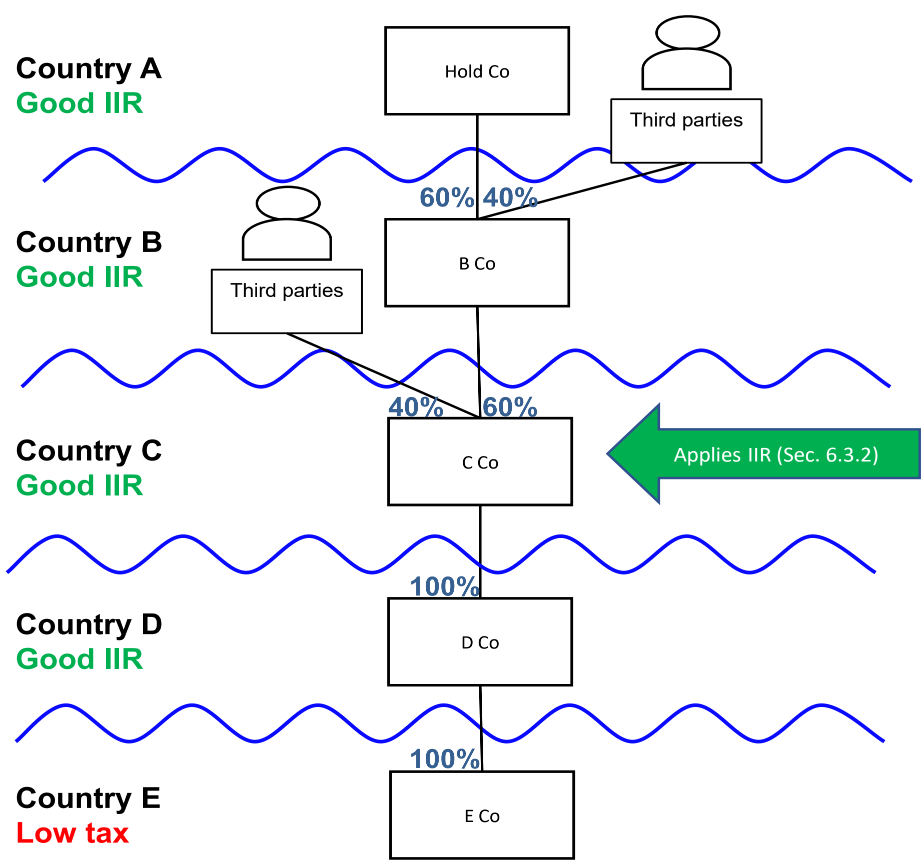
8. If there were no split ownership rules, Hold Co's tentative top-up tax for Country C Constituent Entities would be 17.6 [(60% x 11) + (100% x 11)] rather than the total of 22 top-up tax paid by the MNE Group (11 paid by B Co + 11 paid by Hold Co).

Example 6.3.2D. Coordination between two or more POIP

Facts

1. In this example, Hold Co is the Ultimate Parent Entity of an MNE Group subject to the GloBE rules. Hold Co is located in Country A. Hold Co holds 60% of the shares of B Co, an entity located in Country B. The remaining 40% of the shares of B Co are held by minority shareholders that are not Constituent Entities of the MNE Group. B Co holds 60% of the shares of C Co, an entity also located in Country C. The remaining 40% of the shares of C Co are held by minority shareholders that are not Constituent Entities of the MNE Group.

2. C Co owns 100% of the shares of D Co, an entity located in Country D. D Co holds 100% of the shares of E Co, an entity located in Country E and whose income is subject to an ETR below the minimum rate. The income of all other Constituent Entities is subject to tax above the minimum rate. The GloBE rules have been adopted by Countries A, B, C and D. Assume that the split-ownership rules apply in cases where 10% or more of the equity interests of a Partially Owned Intermediate Parent are held directly or indirectly by persons that are not Constituent Entities of the MNE Group.



Question

3. Which of these Constituent Entities are Partially Owned Intermediate Parents and which of them should have the priority to apply the IIR?

Answer

4. B Co, C Co, and D Co are all Partially Owned Intermediate Parents because more than 10% of their equity interests are held directly or indirectly by persons that are not Constituent Entities of the MNE Group (third parties).

5. C Co is required to apply the IIR under the split-ownership rules (Section 6.3.2). B Co and D Co are not required to apply the IIR with respect to the income of E Co.

Analysis

6. B Co is a Partially Owned Intermediate Parents because more than 10% of its equity interests are held directly by persons that are not Constituent Entities of the MNE Group (third parties). Likewise, C Co is also a Partially Owned Intermediate Parents because 10% or more of its equity interests are held directly and indirectly by persons that are not Constituent Entities (its minority equity interest holders and the minority interest holders of B Co). D Co is also a Partially Owned Intermediate Parent because 10% or more of its equity interests are held indirectly by that are not Constituent Entities of the MNE Group (the minority equity interest holders of C Co and the minority interest holders of B Co).

7. The next question that arises is which of these entities is required to apply the IIR. The answer to this question is important to ensure coordination between jurisdictions and avoid double taxation.

8. In accordance with the definition of a Parent under the top-down approach, this includes a Partially Owned Intermediate Parent. Therefore, all Partially Owned Intermediate Parents are also “Parents” in accordance with the top-down approach. The second paragraph of the split-ownership rules establish an exception to the top-down approach because it states that a Parent that holds at least a portion of the equity interests in the low-taxed Constituent Entity through a Partially Owned Intermediate Parent, shall not apply the IIR to the extent such income has already been subject to the IIR of the Partially Owned Intermediate Parent.

9. In this example, B Co is a Parent of C Co, through which it holds interests in the low-taxed Constituent Entity (E Co). Moreover, the low-taxed income is already subject to the IIR of C Co Therefore, B Co shall not apply the IIR because it is already subject to the IIR of C Co. The same analysis exempts Hold Co from applying the IIR because it is a Parent of C Co.

10. A different analysis is needed to determine which of the remaining Partially Owned Intermediate Parents should apply the IIR. In accordance with the second sentence of the first paragraph of the split-ownership rules, a Partially Owned Intermediate Parent shall not apply the IIR if all of its equity interests are held directly or indirectly by Constituent Entities required to apply the income inclusion rule.

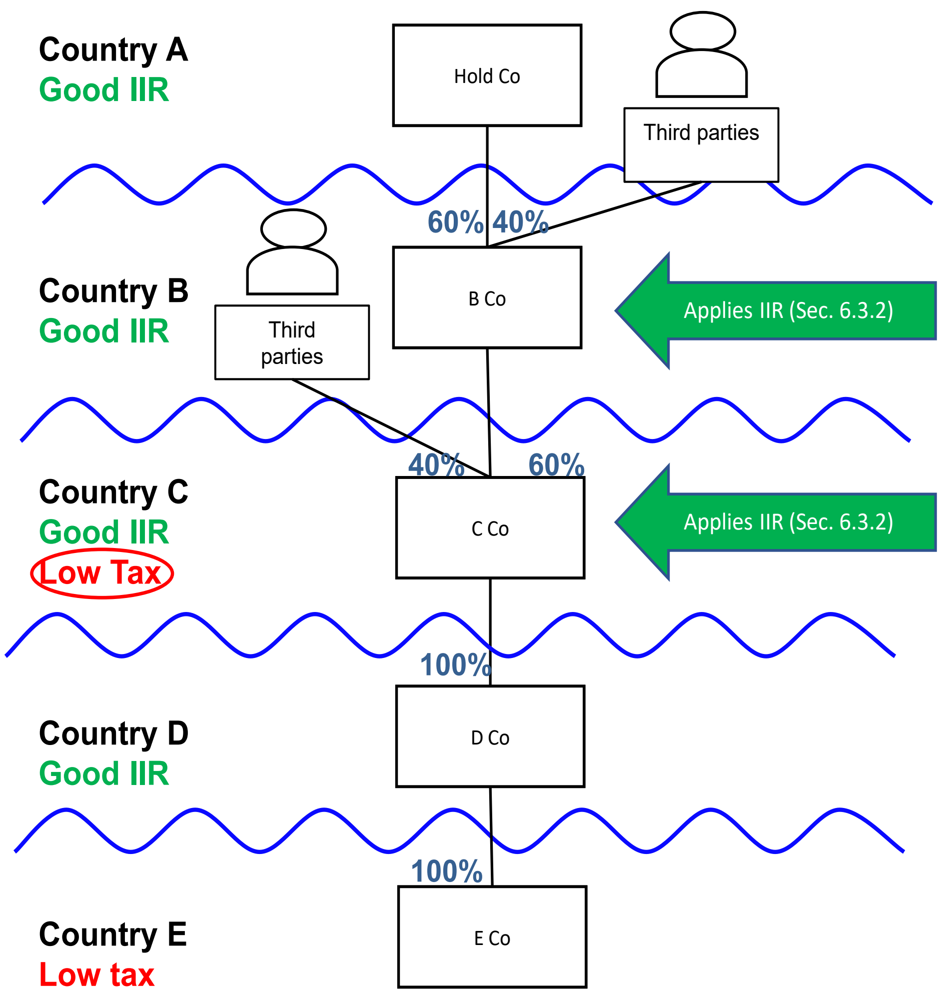
11. In this example, all the equity interests of D Co are held by C Co, a Constituent Entity subject to the IIR. Therefore, D Co shall not apply the IIR because C Co would apply the IIR to the low-taxed income. This follows the rationale of the top-down approach.

12. Therefore, C Co would be the only Partially Owned Intermediate Parent required to apply the IIR given that B Co and D Co are restricted to apply the IIR in this situation. Furthermore, Hold Co as a parent of C Co is also required not to apply the IIR.

Example 6.3.2E. Coordination between two or more POIP when one of them is subject to low taxation

Facts

1. The facts are the same as in Example 4.2.3D, except that the income of C Co is also subject to an effective tax rate below the minimum rate.



Question

2. Which of these Constituent Entities are Partially Owned Intermediate Parents and which of them should have the priority to apply the IIR?

Answer

3. As in Example 6.3.2D, B Co, C Co, and D Co are all Partially Owned Intermediate Parents because 10% or more of their equity interests are held directly or indirectly by persons that are not Constituent Entities of the MNE Group (third parties).

4. As in Example 6.3.2D, C Co is the only Parent and Partially Owned Intermediate Parent that is required to apply the IIR with respect to the income of E Co. However, B Co is a Partially Owned Intermediate Parent required to apply the IIR with respect to the low-taxed income of C Co.

Analysis

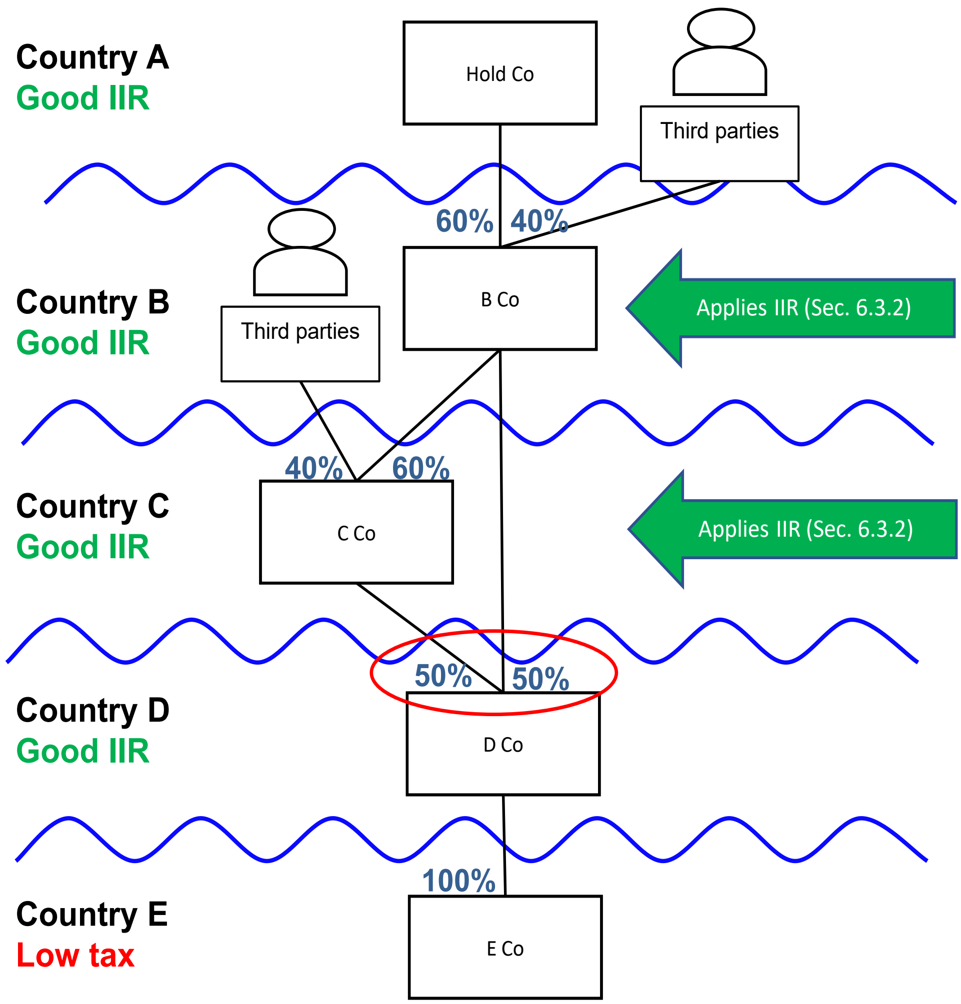
5. C Co is the only Parent and Partially Owned Intermediate Parent required to apply the IIR based on the analysis set out in Example 6.3.2D. given that the relevant facts are the same.

6. However, B Co is required to apply the IIR with respect to the income of C Co because it is a Partially Owned Intermediate Parent holding shares of a low-taxed entity. Hold Co has to exclude from its IIR the income of C Co because it was already subject to the IIR of B Co.

Example 6.3.2F. Coordination between two or more POIP in case they hold different equity interests of the low-taxed entity

Facts

1. The facts are the same facts as in Example 4.2.3D, except that C Co only holds 50% of the shares of D Co while the remaining 50% are held by B Co. Therefore, B Co owns indirectly 80% of the income of E Co (30% through its ownership of C Co and 50% through its ownership of D Co).



Question

2. Which of these Constituent Entities are Partially Owned Intermediate Parents and which of them should have the priority to apply the IIR?

Answer

3. As in Example 6.3.2D, B Co, C Co, and D Co are all Partially Owned Intermediate Parents because 10% or more of their equity interests are held directly or indirectly by persons that are not Constituent Entities of the MNE Group (third parties).

4. As in Example 6.2.3D, C Co still has priority to apply the IIR with respect to 50% of the income of E Co. However, B Co is still required to apply the IIR with respect to the other 50% of the low-taxed income.

Analysis

5. The analysis set out in Example 6.2.3D is the starting point with respect to 50% of the low-taxed income held through B Co, C Co and D Co. B Co is not required to apply the IIR because it is a Parent that owns this portion of the low-taxed income through a Partially Owned Intermediate Parent (C Co) that is required to apply the IIR.

6. The next question is what which Partially Owned Intermediate Parent should apply the remaining 50% held through B Co and D Co. In this case, D Co should not apply the IIR because is a Partially Owned Intermediate Parent whose all of its equity interests are held by Constituent Entities required to apply the IIR (B Co and C Co). Therefore, B Co would be required to apply the IIR with respect to the remaining 50% of the low-taxed income. This policy follows the rationale of the top-down approach and avoids indirectly taxing twice the income that belongs to the minority interest holders of C Co.

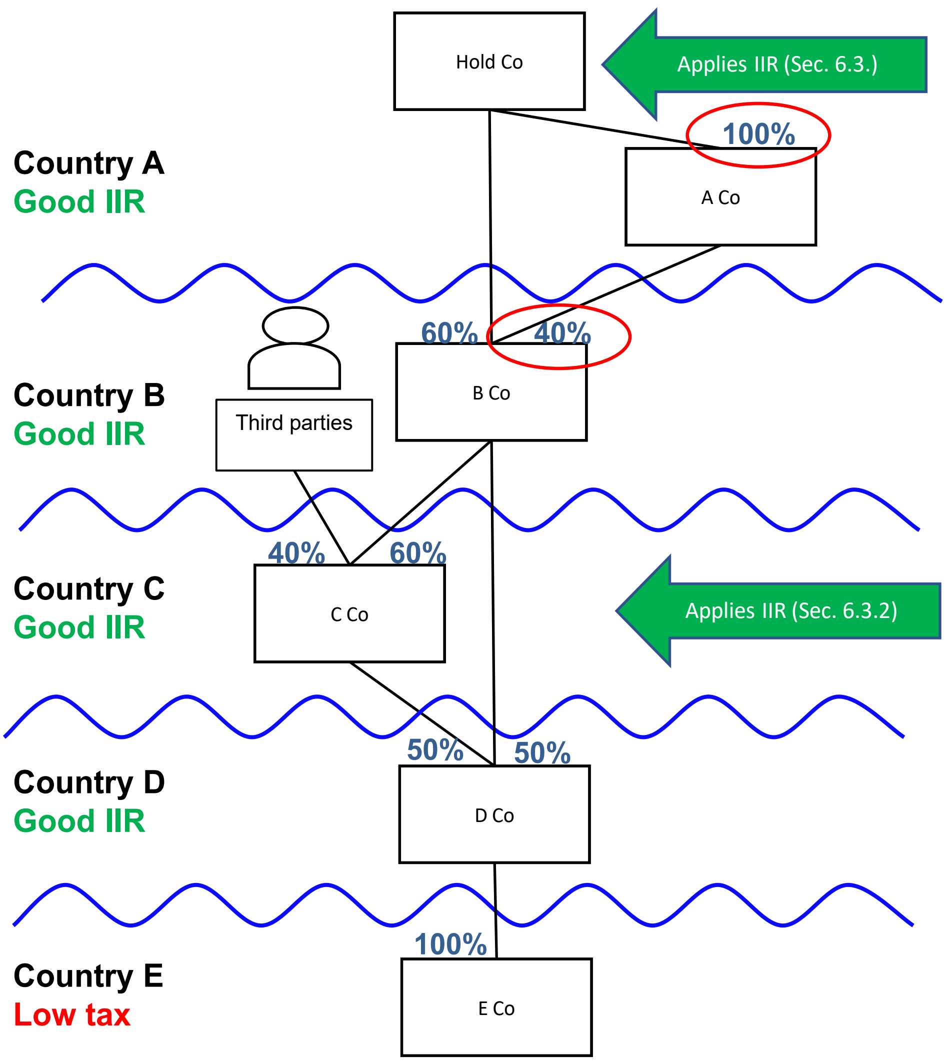
7. Hold Co is not required to apply the IIR with respect to the income of E Co because all of it has been subject to the IIR of a Partially Owned Intermediate Parents.

8. The fact that D Co is not controlled by B Co or C Co is not relevant because all of them are Constituent Entities of the same MNE Group as they are controlled by Hold Co.

Example 6.3.2G. Coordination between the UPE and a POIP when both are required to apply the IIR

Facts

1. The facts are the same as Example 4.2.3D except that 40% of the shares of B Co are held by A Co, a Constituent Entity of the MNE Group wholly owned by Hold Co.



Question

2. Which of these Constituent Entities are Partially Owned Intermediate Parents and which of them should have the priority to apply the IIR?

Answer

3. C Co and D Co are all Partially Owned Intermediate Parents because 10% or more of their equity interests are held directly or indirectly by persons that are not Constituent Entities of the MNE Group (third parties). B Co is not a Partially Owned Intermediate Parent as in Example 6.3.2D because all of its equity interests are directly or indirectly held by Hold Co.

4. As in Example 6.2.3D and 6.2.3F, C Co still has priority to apply the IIR with respect to 50% of the income of E Co. However, Hold Co is required to apply the IIR with respect to the remaining 50%.

Analysis

5. In this example, C Co and D Co are Partially Owned Intermediate Parents. B Co is not a Partially Owned Intermediate Parent because all of its equity interests are held by the UPE.

6. As in Example 6.2.3F, C Co has the priority to apply the IIR with respect to 50% of the income of E Co.

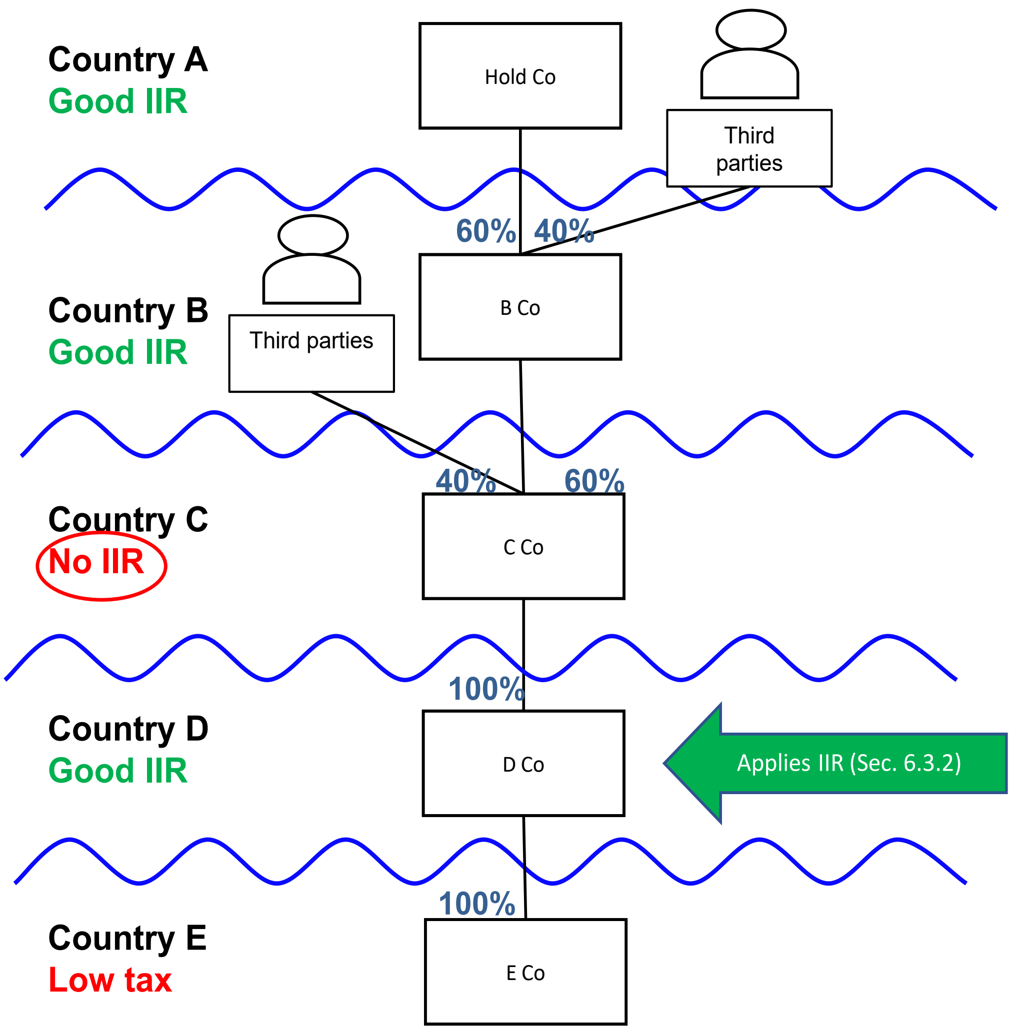
7. However, unlike Example 6.2.3F, Hold Co has the priority to apply the IIR before B Co in accordance with the top-down approach because the latter is not a Partially Owned Intermediate Parent. Therefore, Country B has to deactivate its IIR. However, Hold Co would only apply its IIR with respect of 50% of the income of E Co because the other 50% is already subject to an IIR of a Partially Owned Intermediate Parent (C Co) based on the split-ownership rules.

8. D Co on the other hand, is not required to apply the IIR because all of its equity interests are held by Constituent Entities required to apply the IIR (Hold Co and C Co).

Example 6.3.2H. Coordination between two or more POIP and an intermediate parent located in a jurisdiction with no IIR

Facts

1. The facts are the same as in Example 4.2.3D, except that Country C has not adopted the income inclusion rule.



Question

2. Which of these Constituent Entities are Partially Owned Intermediate Parents and which of them should have the priority to apply the IIR?

Answer

3. B Co and D Co are Partially Owned Intermediate Parents because 10% or more of their equity interests are held directly or indirectly by persons that are not Constituent Entities of the MNE Group (third parties). C Co is not a Partially Owned Intermediate Parent in accordance with the split-ownership rules.

4. D Co is required to apply the IIR under the split-ownership rules (Section 6.3.2). B Co is not required to apply the IIR with respect to the income of E Co.

Analysis

5. Unlike Example 6.3.2D, C Co is not a Partially Owned Intermediate Parent because it is not located in a jurisdiction that has adopted an IIR. Therefore, this means that either B Co or D Co should be required to apply the IIR.

6. In this case D Co is not subject to the restriction stated in the second sentence of the first paragraph of the split-ownership rules because not all of its equity interests are held by a Constituent Entity required to apply the IIR. B Co only owns (indirectly) 60% of the equity interests of D Co. Therefore, D Co is required to apply the IIR.

7. B Co on the other hand cannot apply the IIR because it is a Parent that holds a portion of the equity interests of the low-taxed Constituent Entity (E Co) through a Partially Owned Intermediate Parent (D Co) that has applied the IIR in accordance with the second paragraph of the split-ownership rules. Therefore, B Co is required to exclude the income of E Co from the IIR.

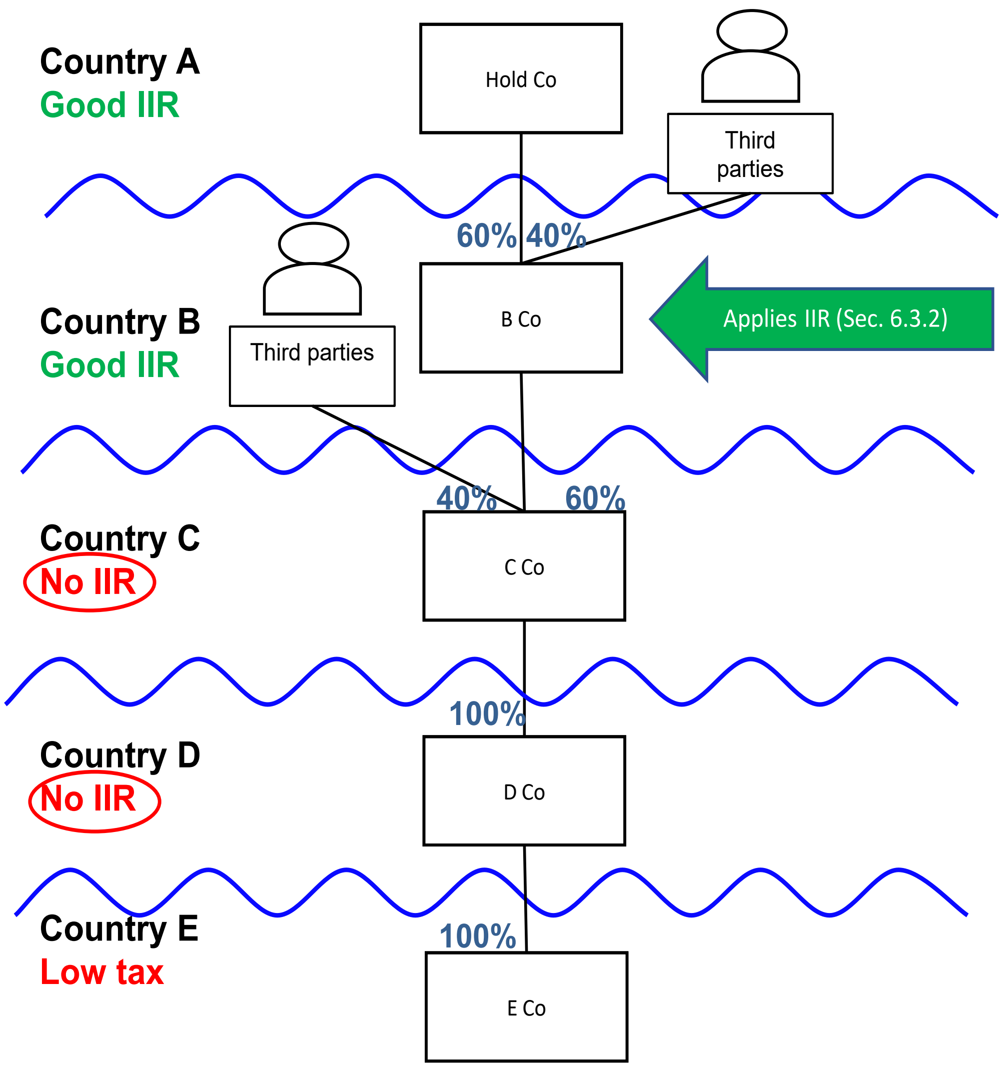
8. Likewise, Hold Co is required to exclude from its IIR the income of E Co because it was already subject to the IIR of a Partially Owned Intermediate Parent (D Co).

9. The result of applying the rules ensures that all of the low-taxed income is subject to the GloBE rules. If B Co was required to apply the rule, it would only apply it with respect to 60% of the low-taxed income.

Example 6.3.2I. Coordination between a POIP and two intermediate parents located in a jurisdiction with no IIR

Facts

1. The facts are the same as in Example 4.2.3D except that Countries C and D have not adopted the income inclusion rule.



Question

2. Which of these Constituent Entities are Partially Owned Intermediate Parents and which of them should have the priority to apply the IIR?

Answer

3. B Co is the only Partially Owned Intermediate Parent and has priority to apply the IIR before Hold Co.

Analysis

4. In this example, only B Co is a Partially Owned Intermediate Parent. C Co and D Co do not meet the definition of a Partially Owned Intermediate Parent because they are located in jurisdictions that have not adopted the IIR. Therefore, B Co is required to apply the IIR with respect to E Co's income.

5. B Co would be required to collect 60% of the top-up tax for E Co because it only owns indirectly 60% of its equity interests. The remaining 40% would not be taxed under the GloBE rules because they are not subject to an IIR and because the UTPR would not apply because E Co is controlled by a Constituent Entity subject to an IIR.

6. Hold Co is required to exempt the income of E Co from its IIR because it is the Parent of an Intermediate Parent Entity applying the IIR.

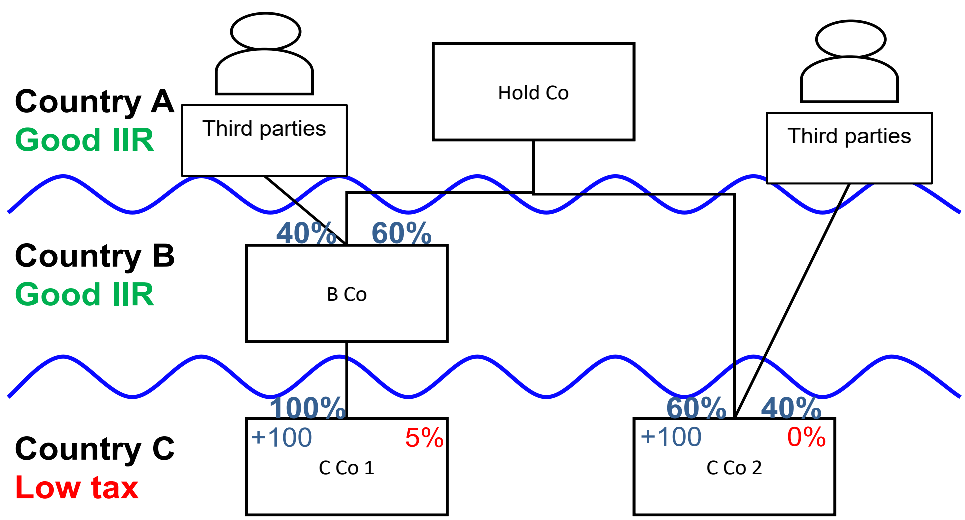
Example 6.3.2J. Difference between a POIP and a partially owned low-taxed entity

Facts

1. Hold Co is the UPE of an MNE Group subject to the GloBE rules and is located in a jurisdiction that has adopted the IIR. Hold Co holds 60% of the shares of B Co, an entity located in Country B. The remaining 40% of the shares are held by minority shareholders that are not Constituent Entities of the MNE Group. Country B has adopted the IIR. B Co owns 100% of the shares of C Co 1, a Constituent Entity located in Country C.

2. Hold Co also holds 60% of the shares of C Co 2, an entity located in Country C.

3. The income of C Co 1 (100) is subject to a covered tax of 5, while the income of C Co 2 (100) is exempt. In this example, the minimum tax rate adopted by the GloBE rules is 10%. Assume that the split-ownership rules apply in cases where 10% or more of the equity interests of a Partially Owned Intermediate Parent are held directly or indirectly by persons that are not Constituent Entities of the MNE Group.



Question

4. What is the amount of income earned by the Constituent Entities located in Country C subject to the GloBE rules and the amount of top-up tax paid by the MNE Group?

Answer

5. The amount of income subject to the GloBE rules is 160 and the amount of top-up tax paid by the MNE Group is 12.

Analysis

6. The ETR of C Co 1 and C Co 2 is of 2.5%. Therefore, the MNE Group is required to pay a tax of 15. The top-up tax for C Co 1 and C Co 2 is 7.5 each [100 (income) x 7.5 ETR difference]

7. Hold Co is required to apply the IIR based on its ownership percentage in accordance with the top-down approach (Section 6.3). B Co is also required to apply the IIR based on the split-ownership rules (Section 6.3.2).

8. B Co is required to pay 7.5 (100% x 7.5). On the other hand, Hold Co applies the IIR only with respect to the income of C Co 2 because the income of C Co 1 was already subject to the IIR of B Co and therefore, is required to pay 4.5 (60% x 7.5).

9. The MNE Group paid a total top-up tax of $12 ($7.5 paid by B Co + $4.5 paid by Hold Co). The split-ownership rules do not apply to income of C Co 2 because the low-taxed entity is the partially owned entity (not the Partially Owned Intermediate Parent). Therefore, the remaining 3 of tax that corresponds to 40% of the income of C Co 2 would not be collected by the MNE Group. In certain situations, the simplified version of the IIR could apply to the income of C Co 2.

Chapter 7 – Examples

Example 7.4.3A. Example of operation of the first allocation key of the UTPR (without any cap)

Facts

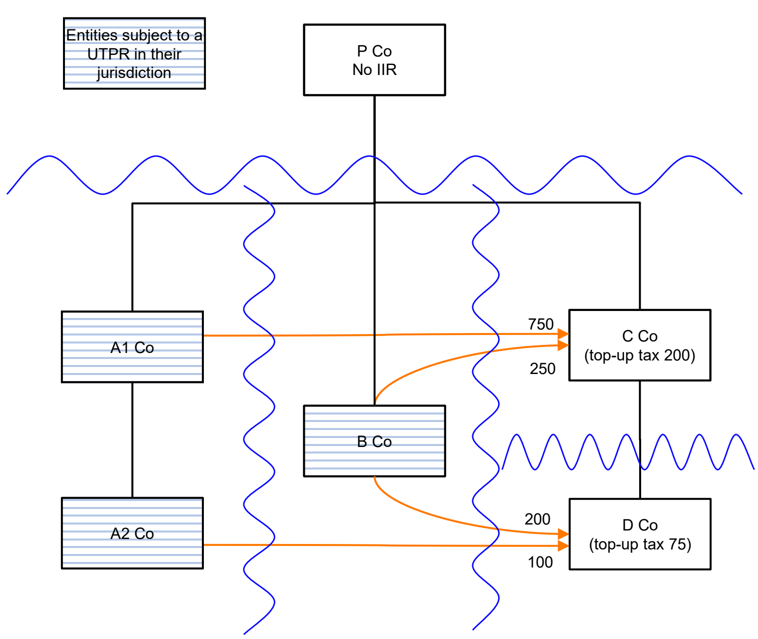
1. An MNE is parented in jurisdiction P and operates in jurisdictions A, B, C and D. It is further assumed that the MNE's jurisdictional ETR in jurisdiction P (the Ultimate Parent jurisdiction), jurisdiction A and jurisdiction B is above the minimum rate. P Co directly owns all of the equity interests in A1 Co, B Co and C Co. A1 Co owns all of the equity interests in A2 Co and C Co owns all of the equity interests in D Co. A1 Co and A2 Co are tax resident in the same jurisdiction (jurisdiction A). B Co, C Co and D Co are tax resident of jurisdiction B, jurisdiction C and jurisdiction D respectively. Jurisdictions A and B introduced the UTPR.

2. This MNE's jurisdictional ETR in jurisdictions C and D are below the minimum rate. A top-up tax is computed in relation to the profits made in these two jurisdictions. The top-up tax amounts to 200 and 75 in relation to the profits made in jurisdictions C and D respectively.[1] There is no income inclusion rule that applies in relation to the profits made in jurisdictions C and D because jurisdictions P and C have not implemented the income inclusion rule.

3. The direct payments structure involving Constituent Entities established in jurisdictions where the MNE's jurisdictional ETR is below the minimum rate is as follows:

- A1 Co made payments to C Co. These payments amounted to 750.
- A2 Co made payments to D Co. These payments amounted to 100.
- B Co made payments to C Co and to D Co. These payments amounted to 250 and 200 respectively.

4. The following chart summarises these facts.



Question

5. How are the top-up taxes computed in relation to the profits made in jurisdictions C and D allocated under the first allocation key of the UTPR?

Answer

6. Each of the amounts of top-up tax (200 and 75) is allocated as follows:

- The top-up tax allocated to A1 Co amounts to 150 (75% x200)
- The top-up tax allocated to A2 Co amounts to 25 (33.33% x 75)
- The top-up tax allocated to B Co amounts to 100 (25% x 200 + 66.66% x 75)

7. The effect of a potential cap on the amount allocated under the first allocation key is disregarded for the purpose of this example. If a cap applied and limited the amount of top-up taxes allocated under the first allocation key, the remaining amount of top-up tax would be allocated under the second allocation key.

Analysis

8. If the MNE has an effective tax rate that is below the agreed minimum rate in several jurisdictions where it is operating, the first allocation key would be applied to the top-up tax owed in relation to the profits made in each jurisdiction separately. The example provided here aims at illustrating this mechanism. The effect of a potential cap on the amount allocated under the first allocation key is disregarded for the purpose of this example.

Allocation of the top-up tax computed in relation to the profits made by C Co

9. The top-up tax computed in relation to the profits made by C Co is allocated to UTPR Taxpayers established in jurisdictions A and B in proportion to the direct payments these entities made to C Co. The proportions of direct payments received by C Co are as follows:

UTPR Taxpayers	Amount of direct payments made to C Co	Proportion of direct payments
A1 Co	750	$\frac{\mathbf{750}}{\mathbf{1000}} = \mathbf{75\%}$
B Co	250	$\frac{\mathbf{250}}{\mathbf{1000}} = \mathbf{25\%}$
Total	1000	100%

10. The top-up tax computed in relation to the profits made by C Co amounts to 200. The top-up tax is allocated to UTPR Taxpayers established in jurisdictions A and B in proportion to the amount of direct payments computed above. This mechanism results in the following allocation:

UTPR Taxpayers	Proportion of direct payments	Allocated top-up tax
A1 Co	75%	$\mathbf{75\%\ x\ 200 = 150}$
B Co	25%	$\mathbf{25\%\ x\ 200 = 50}$
Total	100%	200

11. The effect of a potential cap on the amount allocated under this allocation key is disregarded for the purpose of this example. If there remains any unallocated top-up tax on the profits made in jurisdiction C after this cap applies, it will be allocated under the second allocation key.

Allocation of the top-up tax computed in relation to the profits made by D Co

12. The top-up tax computed in relation to the profits made by D Co is allocated to UTPR Taxpayers established in jurisdictions A and B in proportion to the direct payments these entities made to D Co. The proportions of direct payments received by D Co are as follows:

UTPR Taxpayers	Amount of direct payments made to D Co	Proportion of direct payments
A2 Co	100	$\frac{\mathbf{100}}{\mathbf{300}} = \mathbf{33.33\%}$
B Co	200	$\frac{\mathbf{200}}{\mathbf{300}} = \mathbf{66.66\%}$
Total	300	100%

13. The top-up tax computed in relation to the profits made by D Co amounts to 75. The top-up tax is allocated to UTPR Taxpayers established in jurisdictions A and B in proportion to the amount of direct payments computed above. This mechanism results in the following allocation:

UTPR Taxpayers	Proportion of direct payments	Allocated top-up tax
A2 Co	33.33%	$\mathbf{33.33\%\ x\ 75 = 25}$
B Co	66.66%	$\mathbf{66.66\%\ x\ 75 = 50}$
Total	100%	75

14. The effect of a potential cap on the amount allocated under this allocation key is disregarded for the purpose of this example. If there remains any unallocated top-up tax on the profits made in jurisdiction D after this cap applies, it will be allocated under the second allocation key.

Total amount of top-up tax allocated under the first allocation key

15. The top-up tax computed in relation to the profits made in jurisdictions C and D are cumulative. Therefore, UTPR Taxpayers established in jurisdictions A and B are allocated the following top-up tax:

UTPR Taxpayers	Top-up tax allocated in relation to the profits made in jurisdiction C	Top-up tax allocated in relation to the profits made in jurisdiction D	Total top-up tax
A1 Co	150	n.a.	150
A2 Co	n.a.	25	25
B Co	50	50	100
Total	200	75	275

16. As a result of the first allocation key, the total amount of top-up tax of is allocated as follows:

- The top-up tax allocated to A1 Co amounts to 150
- The top-up tax allocated to A2 Co amounts to 25
- The top-up tax allocated to B Co amounts to 100

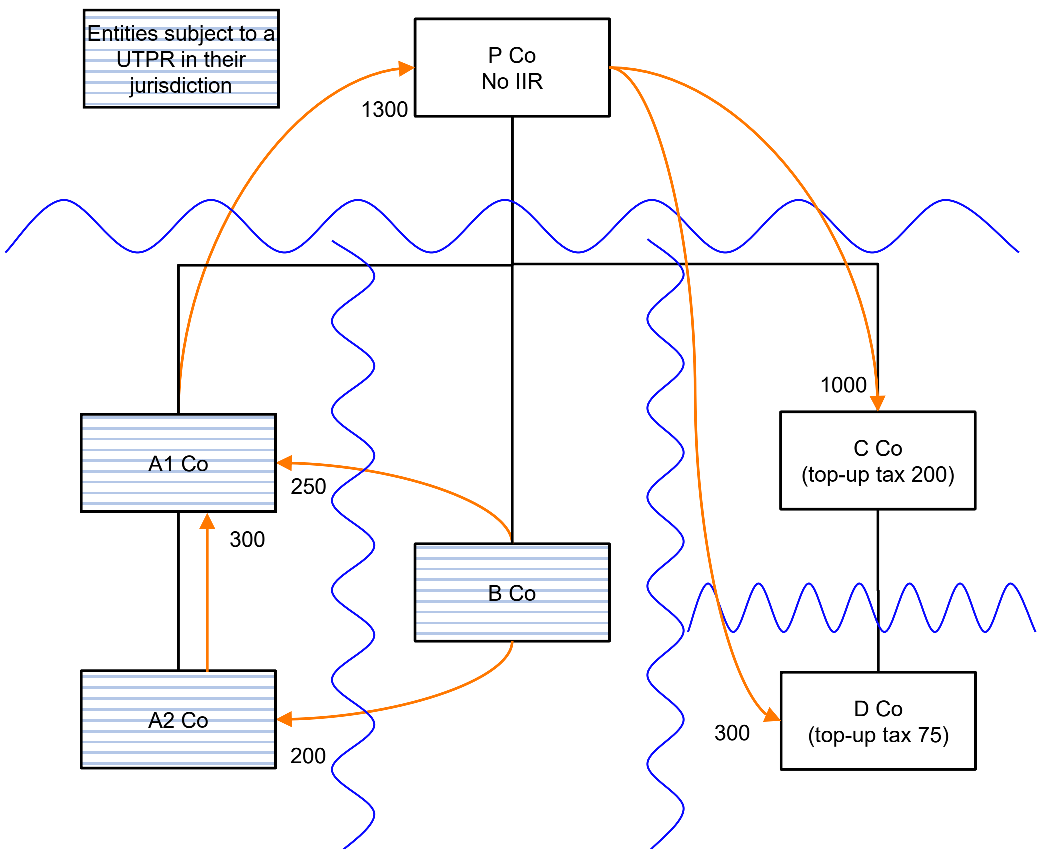
17. The effect of a potential cap on the amount allocated under this allocation key is disregarded for the purpose of this example. If there remains any unallocated top-up tax on the profits made in jurisdiction C or D after this cap applies, it will be allocated under the second allocation key.

Example 7.4.3B. Example of the operation of the UTPR when the first allocation key does not apply

Facts

1. The same facts as for Example 7.4.3A are assumed for this example, except for the fact that no direct payments are made by entities subject to a UTPR to entities located in jurisdictions where the MNE's jurisdictional ETR is below the agreed minimum rate. Therefore, no top-up tax is allocated under the first allocation key and only the second allocation key applies.

2. The following chart summarises these facts.



Question

3. How are the top-up taxes computed in relation to the profits made in jurisdictions C and D allocated under the UTPR?

Answer

4. The first allocation key of the UTPR does not apply in this fact pattern. The second allocation key applies to the remaining (i.e. total in this case) amount of top-up tax.

5. The second allocation key of the UTPR allocates such a total amount of top-up tax (200 + 75 = 275) in proportion to net intra-group expenditure of the UTPR Taxpayers. The net intra-group expenditure of A1 Co, A2 Co and B Co are respectively 58%, 8% and 34% of the aggregated amount of the sum of their net intra-group expenditures.

6. These entities are therefore allocated a portion of top-up tax as follows:

- The top-up tax allocated to A1 Co amounts to 159.5 (58% x 275)

- The top-up tax allocated to A2 Co amounts to 22 (8% x 275)
- The top-up tax allocated to B Co amounts to 93.5 (34% x 275)

Analysis

7. The first allocation key of the UTPR does not apply in this fact pattern. Under the second allocation key, all remaining top-up taxes (i.e. those that were not allocated under the first allocation key) are aggregated to form one pool of top-up tax that is allocated in proportion to each UTPR Taxpayer's net intra-group expenditure.

8. The set of related party transactions results in the following amounts of net intra-group expenditure:

UTPR Taxpayers	Related party Income	Related party expenses	Amount of net intra-group expenditure
A1 Co	300 + 250 = 550	1300	550 – 1300 = (750)
A2 Co	200	300	200 – 300 = (100)
B Co	-	250+200 = 450	(450)

9. The proportion of net intra-group expenditure can be computed on the basis of these net intra-group expenditures computed at the entity level.

UTPR Taxpayers	Amount of net intra-group expenditure	Proportion of net intra-group expenditure
A1 Co	(750)	$\frac{750}{1300} = 58\%$
A2 Co	(100)	$\frac{100}{1300} = 8\%$
B Co	(450)	$\frac{450}{1300} = 34\%$
Total	(1300)	100%

10. The total amount of top-up tax can then be allocated amongst A1 Co, A2 Co and B Co in proportion to their net intra-group expenditure.

UTPR Taxpayers	Proportion of net intra-group expenditure	Allocated top-up tax
A1 Co	58%	$58\%\ x\ 275 = 159.5$
A2 Co	8%	$8\%\ x\ 275 = 22$
B Co	34%	$34\%\ x\ 275 = 93.5$
Total	100%	275

11. The difference with the top-up tax allocated under the second allocation key in Example 4.3.2A results from the fact that, under the second allocation key, the top-up tax is aggregated before being allocated to all Constituent Entities in proportion to their net intra-group expenditure.

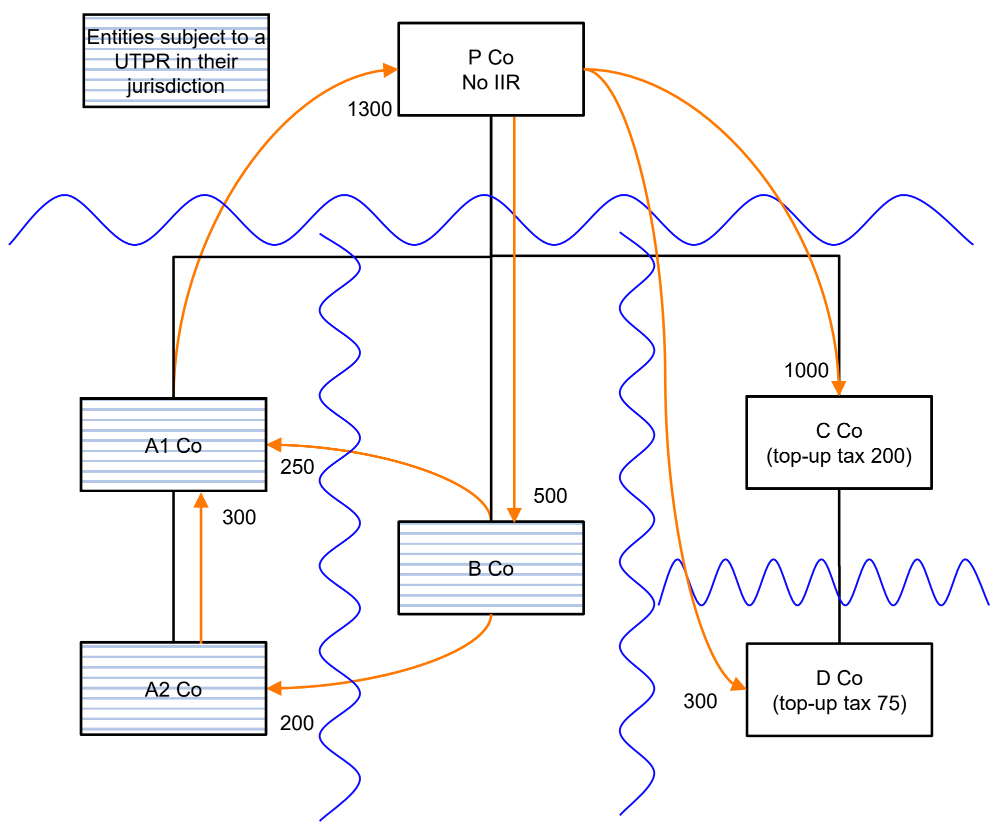
Example 7.4.3C. Example of the operation of the UTPR when the first allocation key does not apply and one entity has net related party income for the purpose of the second allocation key

Facts

1. The same facts as for Example 7.4.3B are assumed for this example. It is further assumed that B Co received an intragroup payment for an amount of 500 from P Co.

2. The following chart summarises these facts.

Question



3. How are the top-up taxes allocated in relation to the profits made in jurisdictions C and D under the UTPR?

Answer

4. The first allocation key of the UTPR does not apply in this fact pattern. The second allocation key applies to the total amount of top-up tax.

5. The second allocation key of the UTPR allocates such a total amount of top-up tax (200 + 75 = 275) in proportion to net intra-group expenditure of the UTPR Taxpayers. The net intra-group expenditure of A1 Co and A2 Co are respectively 88% and 12% of the aggregated amount of the sum of their net intra-group expenditures. The net related party income of B Co is disregarded for this purpose.

6. These entities are therefore allocated a portion of top-up tax as follows:

- The top-up tax allocated to A1 Co amounts to 242 (88% x 275)
- The top-up tax allocated to A2 Co amounts to 33 (12% x 275)

Analysis

7. The first allocation key of the UTPR does not apply in this fact pattern. Under the second allocation key, all remaining top-up taxes (i.e. those that were not allocated under the first allocation key) are aggregated to form one pool of top-up tax that is allocated in proportion to each UTPR Taxpayer's net intra-group expenditure.

8. The set of related party transactions results in the following amounts of net intra-group expenditure:

UTPR Taxpayers	Related party Income	Related party expenses	Amount of net intra-group expenditure
A1 Co	300 + 250 = 550	1300	550 – 1300 = (750)
A2 Co	200	300	200 – 300 = (100)
B Co	500	250+200 = 450	Net related party income

9. The proportion of net intra-group expenditure can be computed on the basis of these net intra-group expenditures computed at the entity level. Entities with net related party income are disregarded for this purpose.

UTPR Taxpayers	Amount of net intra-group expenditure	Proportion of net intra-group expenditure
A1 Co	(750)	$\frac{\mathbf{750}}{\mathbf{850}} = \mathbf{88\%}$
A2 Co	(100)	$\frac{\mathbf{100}}{\mathbf{850}} = \mathbf{12\%}$
B Co	Net related party income	n.a.
Total	(850)	100%

10. The total amount of top-up tax can then be allocated amongst A1 Co and A2 Co in proportion to their net intra-group expenditure.

UTPR Taxpayers	Proportion of net intra-group expenditure	Allocated top-up tax
A1 Co	88%	$\mathbf{88\%\ x\ 275 = 242}$
A2 Co	12%	$\mathbf{12\%\ x\ 275 = 33}$
Total	100%	275

Example 7.4.3D. Example of the operation of the UTPR when a Constituent Entity subject to the UTPR is resident in a jurisdiction where the MNE's jurisdictional ETR is below the minimum rate

Facts

1. The same facts as for Example 7.4.3B are assumed for this example. It is further assumed that B Co is established in a jurisdiction where the MNE's jurisdictional ETR for the current year is below the agreed minimum rate.

Question

2. How are the top-up taxes allocated in relation to the profits made in jurisdictions C and D under the UTPR?

Answer

3. The first allocation key of the UTPR does not apply in this fact pattern. The second allocation key applies to the total amount of top-up tax.

4. The second allocation key of the UTPR allocates such a total amount of top-up tax (200 + 75 = 275) in proportion to net intra-group expenditure of the UTPR Taxpayers. B Co is not eligible to apply the UTPR because it is established in a jurisdiction where the MNE's jurisdictional ETR is below the minimum rate. Therefore, the net intra-group expenditure of B Co is disregarded for this purpose.

5. The net intra-group expenditure of A1 Co and A2 Co are respectively 88% and 12% of the aggregated amount of the sum of their net intra-group expenditures.

6. These entities are therefore allocated a portion of top-up tax as follows:

- The top-up tax allocated to A1 Co amounts to 242 (88% x 275)
- The top-up tax allocated to A2 Co amounts to 33 (12% x 275)

Analysis

7. The first allocation key of the UTPR does not apply in this fact pattern. Under the second allocation key, all remaining top-up taxes (i.e. those that were not allocated under the first allocation key) are aggregated to form one pool of top-up tax that is allocated in proportion to each UTPR Taxpayer's net intra-group expenditure.

8. Only the Constituent Entities that are eligible to apply the UTPR are taken into account for this purpose. B Co is not eligible to apply the UTPR and is not a UTPR Taxpayer because it is established in a jurisdiction where the MNE's jurisdictional ETR is below the minimum rate. Therefore, the net intra-group expenditure of B Co is disregarded for this purpose.

9. The set of related party transactions results in the following amounts of net intra-group expenditure for the UTPR Taxpayers:

UTPR Taxpayers	Related party Income	Related party expenses	Amount of net intra-group expenditure
A1 Co	300 + 250 = 550	1300	550 – 1300 = (750)
A2 Co	200	300	200 – 300 = (100)

10. The proportion of net intra-group expenditure can be computed on the basis of these net intra-group expenditures computed at the entity level. UTPR Taxpayers with net related party income are disregarded for this purpose.

UTPR Taxpayers	Amount of net intra-group expenditure	Proportion of net intra-group expenditure
A1 Co	(750)	$\frac{\mathbf{750}}{\mathbf{850}} = \mathbf{88\%}$
A2 Co	(100)	$\frac{\mathbf{100}}{\mathbf{850}} = \mathbf{12\%}$
Total	(850)	100%

11. The total amount of top-up tax can then be allocated amongst A1 Co and A2 Co in proportion to their net intra-group expenditure.

UTPR Taxpayers	Proportion of net intra-group expenditure	Allocated top-up tax
A1 Co	88%	$\mathbf{88\%\ x\ 275 = 242}$
A2 Co	12%	$\mathbf{12\%\ x\ 275 = 33}$
Total	100%	275

Example 7.5.2A. Illustration of the operation of the limitation of top-up tax that can be allocated from UPE jurisdiction

Facts

1. P Co is the ultimate parent company of an MNE group in scope of Pillar Two rules and directly owns three subsidiaries: A Co, B Co and C Co.

2. P Co and its subsidiaries are located in jurisdictions P, A, B and C respectively.

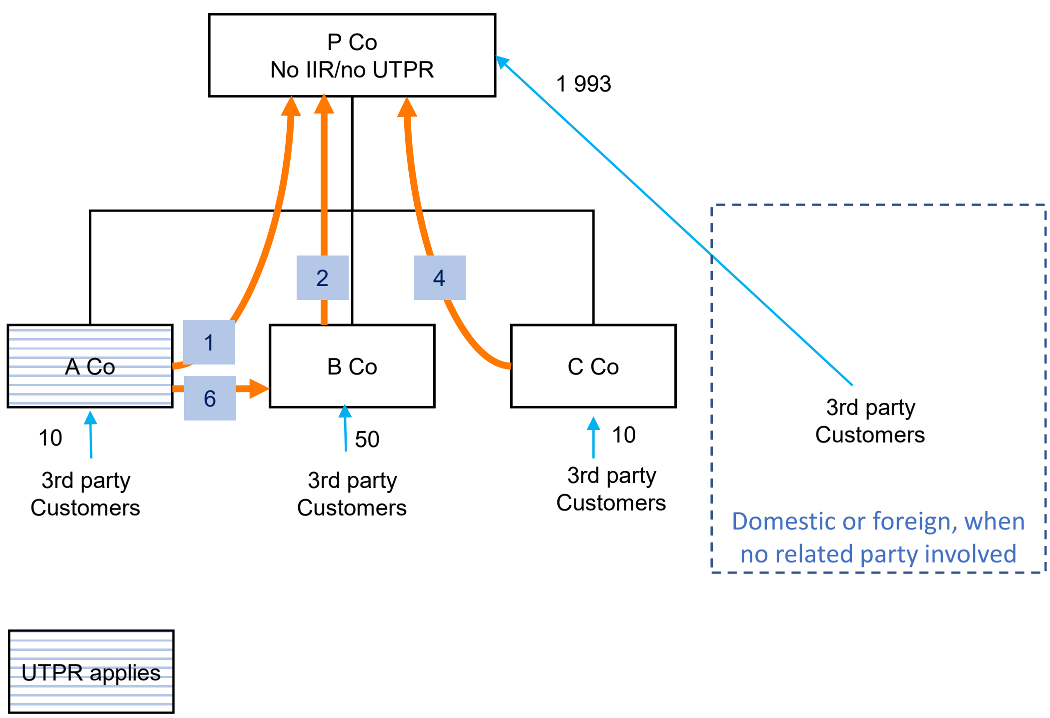
3. P Co has a total revenue of 2 000m and expenses of 1 800m. P Co's profit is 200m and it is subject to a 9% ETR in jurisdiction P, while the minimum rate is 10%.

4. The MNE's ETR in jurisdictions A, B and C is above the minimum rate.

5. Only jurisdiction A has introduced the UTPR. A Co is subject to a 20% CIT rate in its jurisdiction.

6. A Co made a direct payment of 1m to P Co and another payment of 6m to B Co. B Co and C Co also made direct payments to P Co of 2m and 4m respectively.

7. This set of simplified assumptions and the relevant amounts are summarised in the chart below.



Question

12. What is the top-up tax allocated to A Co under the UTPR?

Answer

13. The top-up tax allocated to A Co, after taking into account the limitation of top-up tax that can be allocated from UPE jurisdiction, is 70,000.

Analysis

14. The top-up tax percentage is the difference between the minimum rate (assumed to be 10%) and the MNE's ETR in the low-tax jurisdiction (assumed to be 9%). The top-up tax percentage for Jurisdiction P under this fact pattern is 1%.

15. In this scenario, the foreign sources of intragroup revenue do not exceed the low-tax Income in the low-tax Jurisdiction.

- The foreign sources of intragroup revenue in Jurisdiction P amount to 1m + 2m + 4m = 7m
- The total amount of Adjusted GloBE income in Jurisdiction P is equal to P Co's income since there are no other Constituent Entities established in Jurisdiction P. This income amounts to 200m.

16. Since the foreign sources of intragroup revenue do not exceed the low-tax Income in the low-tax Jurisdiction, a limitation applies to the allocable top-up tax computed above.

17. The limitation is computed by applying the top-up tax percentage to the foreign sources of intragroup revenue in Jurisdiction P, i.e.:

$$1\% \text{ x } 7m = 70{,}000.$$

18. The top-up tax allocated in the group would therefore be limited to 70,000 in this example.

19. This limited amount of top-up tax would be allocated in full to A Co under the UTPR as a result of the first allocation key since A Co is the only entity of the group subject to the UTPR and it has made direct payments to P Co.

20. Assuming this subsidiary was subject to a 20% CIT rate in its jurisdiction, denying the deduction of the payment of 1m would result in a maximum top-up tax of 200,000. This cap would not be reached and A Co would be allocated the whole top-up tax of 70 000.

Chapter 9 - Examples

Example 9.3.1A. – Interaction between adjusted nominal rate computation and exemption under tax treaty elimination of double taxation provisions

Facts

1. Imagine that States R and S have a tax treaty including a royalty article following Article 12 of the OECD Model, but including the STTR; and that State R has adopted the Article 23 A exemption method in the elimination article. State R has a statutory rate of 20% but, under a special regime applying to certain royalty income, excludes 80% of the income from tax. Without any other adjustment, this will mean that only 20% of the income is subject to the 20% rate, producing an adjusted nominal rate of 4%.

2. Imagine also that the agreed adjusted nominal trigger rate for the purposes of the STTR is 7.5% and that all the other conditions for its application are met. SCO, a resident of State S, makes a covered royalty payment to RCO, a resident of State R.

Question

3. How would the STTR apply in these circumstances?

Answer

4. The effect of taking the treaty exemption into account would be to reduce the adjusted nominal rate to 0% and increase the top-up tax that can be applied in State S to 7.5%, depriving State R of its 4% taxing right and reallocating an exclusive taxing right to State S (up to the agreed minimum rate).

Analysis

5. Because the adjusted nominal tax rate applied to the royalty payment, before taking account of State R's obligation to provide an exemption under Article 23 A, is below the 7.5% trigger rate, State S is prima facie entitled to apply a top-up tax of 3.5% under the STTR. State R is only obliged to provide an exemption under Article 23 A where State S may tax in accordance with the treaty. Solely as a result of the STTR being triggered, State S is permitted to tax the income in accordance with the treaty. State R is then obliged to exempt the income in accordance with Article 23 A. The effect of taking account of this treaty obligation when computing the adjusted nominal rate is to reduce that rate to 0% and increases the top up rate to the full 7.5% trigger rate.

Example 9.3.3A – Interaction between the application of the STTR and tax treaty elimination of double taxation provisions (exemption)

Facts

1. The facts are the same as example 9.3.1A., apart from the obligation on State R to apply the exemption method under Article 23 A of the OECD Model is not taken into account in computing the adjusted nominal rate for the purposes of the STTR.

Question

2. How would the STTR apply in these circumstances?

Answer

3. The effect of disregarding the treaty exemption when computing the adjusted nominal rate is that the adjusted nominal rate in State R is 4%. This is the effect of the domestic law exclusion of 80% of the income from tax. The top-up rate that State S can apply is therefore 3.5%.

Analysis

4. State R has a statutory rate of 20% but, under a special regime applying to certain royalty income, excludes 80% of the income from tax. This will mean that only 20% of the income is subject to the 20% rate, producing an adjusted nominal rate of 4%. The adjusted nominal trigger rate for the purposes of the STTR is assumed to be 7.5% and all of the conditions for the rule to apply are met. SCO, a resident of State S, makes a covered royalty payment to RCO, a resident of State R. Because the adjusted nominal tax rate applied to the royalty payment is below the 7.5% trigger rate, State S is entitled to apply a top-up tax of 3.5% under the STTR. State R is now obliged to exempt the income in accordance with Article 23 A.

Example 9.3.3B. – Interaction between the application of the STTR and tax treaty elimination of double taxation provisions (credit)

Facts

1. The facts are the same as example 9.3.3A, except that State R applies the credit instead of the exemption method.

Question

2. How would the STTR apply in these circumstances?

Answer

3. As in example 9.3.3A, the adjusted nominal rate in State R will be 4% and the top-up rate that can be applied in State S is 3.5%. The result is that the payment is taxed at 4% (split between 0.5% net of credit relief in State R and 3.5% in State S).

Analysis

4. State R would now apply its tax at 4% and provide a credit against that tax for the 3.5% tax applied in State S. State S would apply a top-up tax of 3.5%.

Example 9.3.3C. – Effect of switching-off tax treaty elimination of double taxation provisions where the STTR applies

Facts

1. The same facts as examples 9.3.3A and 9.3.3B above.

Question

2. What is the effect of switching-off tax treaty elimination of double taxation provisions where the STTR applies?

Answer

3. The effect of this under both the exemption and credit methods would be that State R would tax the item of income at 4%, without providing any exemption or credit under Article 23 A or B, and State S would apply a top-up tax at 3.5%. There would be no reallocation of taxing rights away from the residence jurisdiction.

Analysis

4. In order to achieve these outcomes, the residence jurisdiction's obligation to provide exemption or credit under the elimination of double taxation provisions of a tax treaty could be switched-off where the source jurisdiction is only exercising a taxing right in accordance with the treaty because it is applying a top-up tax in accordance with the STTR.

Example 9.3.3D. – Effect of tax treaty elimination of double taxation provisions where the conditions for the STTR to apply are met, but the source jurisdiction is permitted to apply a higher treaty rate than the top-up rate (no restriction)

Facts

1. Imagine that a treaty permits the source jurisdiction to tax royalties at the rate of 5% and includes the STTR. Consistent with the ordering rule approach outlined in paragraph XX of the report, the source jurisdiction can apply the higher of that existing treaty rate and the top-up rate. Adapting the facts of example 9.3.3C, and because 5% is higher than the 3.5% top-up rate in that example, the source jurisdiction is permitted to apply the 5% rate.

Question

2. How would the STTR apply in this scenario?

Answer

3. In this scenario, the STTR is triggered (because all of the conditions for its application are met) but it is not applied (because the source jurisdiction is exercising an existing taxing right that does not depend upon those conditions and which results in a higher rate of source taxation). State S is therefore taxing in accordance with the treaty, other than solely because the STTR is triggered, and State R is obliged to eliminate double taxation by exemption or credit.

Analysis

4. If the residence jurisdiction's obligation to exempt the income or provide a credit under the elimination of double taxation provisions in the treaty were not restricted in this scenario, the residence state will either exempt the income or provide a credit for the tax applied in the source jurisdiction (up to the amount of the residence jurisdiction's tax on the same income). Applying the exemption method will result in no tax in the residence jurisdiction and a 5% tax in the source jurisdiction, with the result that the total tax is 5%. Applying the credit method will have the same result, with the residence jurisdiction providing a credit against its own tax for the tax applied on the income in the source jurisdiction. This will cover in full the 4% tax in the residence jurisdiction, leaving no net tax paid there, and the source jurisdiction will tax at 5%. In each case, the total residence and source jurisdiction tax is 5%, which is below the agreed minimum rate (assumed to be 7.5%).

Example 9.3.3E. – Effect of tax treaty elimination of double taxation provisions where the conditions for the STTR to apply are met, but the source jurisdiction is permitted to apply a higher treaty rate than the top-up rate (proportionate restriction)

Facts

1. The same facts as example 9.3.3D.

Question

2. How could the “cliff-edge” effect illustrated above be addressed?

Answer

3. Although the outcome illustrated in example 9.3.3D. does not disturb the position obtaining before the STTR came into contemplation, it does mean that the combined residence and source taxation of a covered payment in respect of which all the conditions for the STTR to apply are met will be lower than it would be if the rule had applied to produce a top-up tax. To avoid this outcome, without depriving the source jurisdiction of its bilaterally agreed right to tax the income at a rate above the top-up, the residence jurisdiction’s obligation to provide relief by way of exemption or credit could be proportionately limited. The effect of this will bring the combined rate in the residence and source jurisdictions up to the agreed minimum rate under the STTR (assumed to be 7.5%).

Analysis

4. The effect of applying a proportionate restriction when applying the elimination of double taxation provisions in a tax treaty would be:

- Under exemption method – the residence jurisdiction would exempt 37.5% of the income over which it has taxing rights before the application of the elimination provisions in the treaty, bringing its rate down from 4% to 2.5%. (To achieve the target 2.5% rate, the proportion of the income taxable in the residence jurisdiction at 4% will need to be reduced to 2.5/4 x 100 = 62.5%, requiring an exemption of 37.5% of the income.)
- Under the credit method – the residence jurisdiction would provide a credit for the 5% source jurisdiction tax capped at 1.5% (instead of the full 4%), leaving the residence jurisdiction applying tax at 4% - 1.5% = 2.5%.

  In both cases, the combined residence and source jurisdiction tax would then be equal to the minimum rate under the STTR (assumed to be 7.5%).

[1] These top-up taxes are assumptions

Chapter 10 - Examples

Example 10.2.1A. - Interaction between the STTR and the income inclusion rule

Facts

10. The MNE Group consists of four constituent entities located in jurisdictions A, B and C. Hold Co is a tax resident of Country A and is the Ultimate Parent Entity of an MNE Group subject to the GloBE rules. Hold Co owns directly the shares of B Co (tax resident in Country B), C Co 1 (tax resident in Country C).

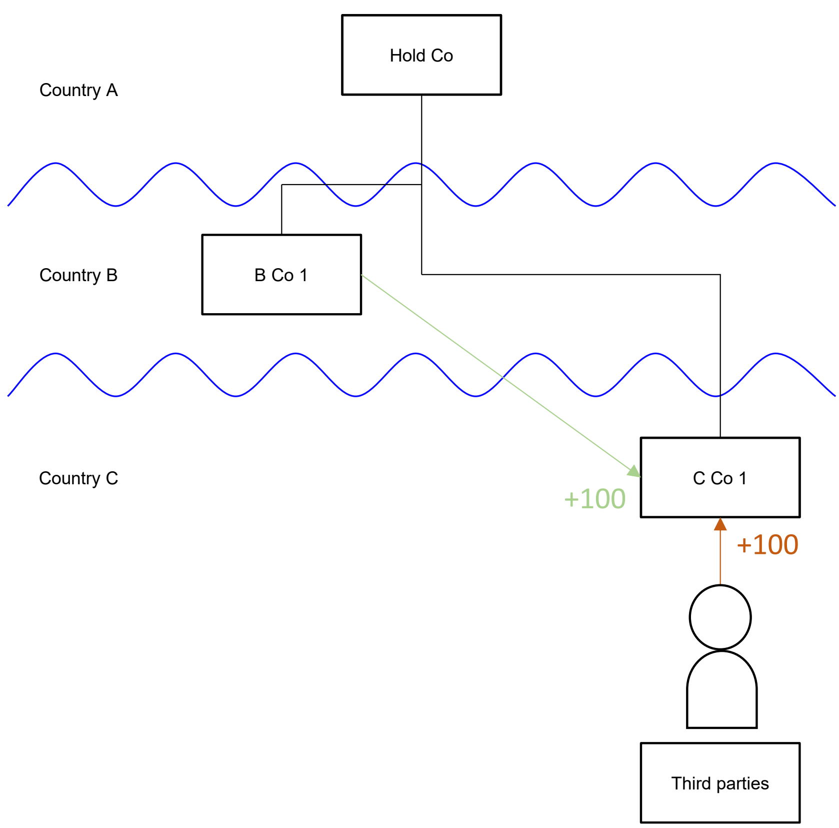
11. C Co 1 holds valuable intangible property of the group and licenses it to B Co, which made a payment of 100 to C Co 1. Country C has a corporate tax rate of 25% and a preferred regime that exempts 80% of royalty income. C Co 1 also receives other foreign source payments of 100 from third parties that are not taxable in Country C. It is assumed that Hold Co and B Co have no income.

12. Hold Co is subject to an Income Inclusion Rule in Country A.

13. Countries B and C have a tax treaty that follows the OECD Model Tax Convention (OECD, 2017[1]) and contains a STTR.

14. It is assumed that the minimum adjusted nominal tax trigger rate for the purposes of the STTR is 7.5% and that the minimum rate for the GloBE rules is 10%.

15. This set of simplified assumptions and the relevant amounts are summarised in the chart below.



Question

16. How do the STTR and the income inclusion rule (IIR) interact under these assumptions?

Answer

17. The top-up tax imposed under the STTR is 2.5 and is levied in Country B, while the top-up tax imposed under the IIR after taking into account the tax imposed under the STTR is 12.5, levied in Country A.

Analysis

18. The STTR applies first, before any operation of the IIR. The payment received by C Co 1 is subject to an adjusted nominal tax rate of 5%, which is obtained by reducing the nominal CIT rate of 25% by 80% because of the exemption of 80% of the income.

19. Because the adjusted nominal rate is below 7.5%, and the payment is a covered payment under the STTR, the STTR applies in country B. B Co is required to withhold at the top-up rate of 2.5%, which is the difference between the minimum rate (7.5%) and the adjusted nominal tax rate (5%).

20. Hold Co is subject to an IIR in Country A. The IIR operates similarly to a CFC rule by requiring a parent company to bring into account and tax the profits of a subsidiary that are subject to an effective tax rate below the minimum rate.

21. The effective tax rate is determined by dividing the amount of covered taxes by the amount of profits. Covered taxes include withholding taxes imposed by source jurisdictions. The effective tax rate of C Co 1 is computed as follows:

- Covered taxes: 2.5 (2.5% of withholding tax under the STTR[1] x 100) + 5 (CIT imposed in country C) = 7.5
- Tax base (assumed to be equal to the amount of the income for the purpose of this example): 100+100 = 200.
- ETR = Covered tax / Tax base = 3.75%

22. The ETR of C Co 1 is below the minimum rate. Therefore, Hold Co is required to apply the IIR in respect of the income of C Co 1. The top-up tax percentage is 10% - 3.75% = 6.25%. The top-up tax imposed under the IIR is 6.25% x 200 = 12.5.

Example 10.2.1B. - Interaction between the STTR and the undertaxed payments rule

Facts

1. The facts are the same as in Example 6.2.1A, but Country A has not introduced the IIR, whereas Country B has introduced an undertaxed payments rule.

2. It is further assumed that the CIT rate applicable in Country B is 20%.

Question

3. How do the STTR and the undertaxed payments rule (UTPR) interact under these assumptions?

Answer

4. The top-up tax imposed under the STTR is 2.5 and is levied in Country B, while the top-up tax imposed under the UTPR after taking into account the tax imposed under the STTR is 12.5, levied in Country B as well.

Analysis

5. The STTR applies first, before any operation of the UTPR. The payment received by C Co 1 is subject to an adjusted nominal tax rate of 5%, which is obtained by reducing the nominal CIT rate of 25% by 80% because of the exemption of 80% of the income.

6. Because the adjusted nominal rate is below 7.5%, and the payment is a covered payment under the STTR, the STTR applies in country B. B Co is required to withhold at the top-up rate of 2.5%, which is the difference between the minimum rate (7.5%) and the adjusted nominal tax rate (5%).

7. Hold Co is not subject to an IIR in Country A. The undertaxed payments rule serves as a backstop to the income inclusion rule by allowing other subsidiaries of the MNE Group to make an adjustment to intra-group payments and collect the top-up tax that was not collected under the IIR.

8. The effective tax rate is determined under the UTPR with the same mechanics as under the IIR, by dividing the amount of covered taxes by the amount of profits. Covered taxes include withholding taxes imposed by source jurisdictions. The effective tax rate of C Co 1 is computed as follows:

- Covered taxes: 2.5 (2.5% of withholding tax under the STTR[2] x 100) + 5 (CIT imposed in country C) = 7.5
- Tax base (assumed to be equal to the amount of the income for the purpose of this example): 100+100 = 200.
- ETR = Covered tax / Tax base = 3.75%

9. The ETR of C Co 1 is below the minimum rate. Therefore, B Co is allocated a top-up tax in respect of the income of C Co 1. The top-up tax percentage is 10% - 3.75% = 6.25%. The top-up tax imposed under the IIR is 6.25% x 200 = 12.5. The amount of deduction that needs to be denied is obtained by dividing the amount of top-up tax allocated to the UTPR Taxpayer by the CIT rate to which this entity is subject. B Co is subject to a CIT rate of 20% and therefore Country B can deny the deduction of 12.5/20% = 62.5.

References

OECD (2017), *Model Tax Convention on Income and on Capital*, OECD Publisher, Paris, https://doi.org/10.1787/mtc_cond-2017-en. [1]

Notes

[1] The timing of recognition of the withholding tax is the same as that of the income, provided the payment is made no later than during the financial year that follows the one when the income was accrued for financial purposes. Therefore, even if the income was accrued for financial purposes the year preceding the one when the payment actually occurred (and the withholding tax was actually paid), the withholding tax would be considered as a covered tax during the same financial year.

[2] The timing of recognition of the withholding tax is the same as that of the income, provided the payment is made no later than during the financial year that follows the one when the income was accrued for financial purposes. Therefore, even if the income was accrued for financial purposes the year preceding the one when the payment actually occurred (and the withholding tax was actually paid), the withholding tax would be considered as a covered tax during the same financial year.

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