2 Scope of the GloBE rules

2.1. Overview

41. This chapter sets out the rules for determining whether a taxpayer is within the scope of the GloBE rules. The rules set out in this Chapter build on the definitions and methodology currently used by Inclusive Framework on BEPS members under BEPS Action 13 for Country by Country Reporting (CbCR) purposes. The GloBE rules generally apply to the MNE Groups and their Constituent Entities that are subject to CbCR obligations described in the BEPS Action 13 Report (OECD, 2015[1]) however the GloBE rules specifically exclude certain Ultimate Parent Entities, such as investment and pension funds, governmental entities (such as sovereign wealth funds) and international and non-profit bodies, which typically benefit from an exclusion or an exemption from tax under the laws of the jurisdiction where they are incorporated (Excluded Entities).

42. Section 2.2 identifies the MNE Groups and entities within the scope of the GloBE rules and Section 2.3 sets out the list of Excluded Entities. Section 2.4 discusses the consolidated group revenue threshold of EUR 750 million, including the methodology used to compute it and its implications in relation to the GloBE rules.

2.2. Identifying the groups and Constituent Entities in scope

Groups and Entities within the Scope of the GloBE rules

Group

The term "Group" means a collection of enterprises[1] related through ownership or control such that it is either required to prepare consolidated financial statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public securities exchange.[2]

MNE Group

The term "MNE Group" means any Group that includes two or more enterprises the tax residence for which is in different jurisdictions or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction.[3]

Constituent Entity

The term "Constituent Entity" means

(a) any separate business unit of an MNE Group that is included in the consolidated financial statements of the MNE Group for financial reporting purposes, or would be so included if equity interests of the Ultimate Parent Entity of the MNE Group were traded on a public securities exchange;

(b) any such business unit that is, or would be, excluded from the MNE Group's consolidated financial statements solely on size or materiality grounds; and

(c) any permanent establishment of any separate business unit of the MNE Group included in (a) or (b) above provided the business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes.[4]

A Constituent Entity does not, however, include a business unit that is an Excluded Entity.

Ultimate Parent Entity (UPE)

The term "Ultimate Parent Entity" or "UPE" means a Constituent Entity of an MNE Group that meets the following criteria:

(a) it owns directly or indirectly a sufficient interest in one or more other Constituent Entities of such MNE Group such that it is required to prepare Consolidated Financial Statements under accounting principles generally applied in its jurisdiction of tax residence, or would be so required if its equity interests were traded on a public securities exchange in its jurisdiction of tax residence; and

(b) there is no other Constituent Entity of such MNE Group that owns directly or indirectly an interest described in paragraph (a) above in the first mentioned Constituent Entity.

43. The definitions set out in the box above define the entities and operations that make up an MNE Group. These definitions are the same as those that are used for CbCR with minor drafting changes to accommodate the different design of the GloBE rules,[5] which is, in turn, built on the standards used for determining whether the operation of two enterprises or business units should be consolidated for financial reporting purposes.

44. Using the consolidation standard under financial accounting to define the scope of an MNE Group and the Constituent Entities within that group has a number of advantages. The rules that determine when an MNE is required to consolidate for accounting purposes are robust, comprehensive and relatively consistent across accounting standards. The use of a financial accounting standard also has benefits from the compliance perspective, because the application of the standard will, in many cases, be subject to review by independent financial accounting auditors. A definition of an MNE Group based on the relevant financial accounting standards may even reduce the incentive for that MNE Group to adopt structures designed to artificially exclude or include subsidiaries from the group. For example, an MNE may have an incentive to include a loss-making entity within its group in order to reduce its GloBE tax base in a jurisdiction. Aligning the definition of the MNE Group with that used for financial reporting purposes would, however, mean that including such an entity for GloBE purposes would have a corresponding deleterious impact on its consolidated profit for financial reporting purposes.

45. The definitions set out in the box above are based on those agreed under BEPS Action 13.[6] The Final Report on Action 13 adopted a three-tiered approach to transfer pricing documentation consisting of the master file, the local file and the CbCR report. The CbCR report requires an MNE Group to report information such as the income earned, taxes paid, and business activities carried out in each jurisdiction,

and a list of all of its Constituent Entities. Tax authorities use the information provided in the CbCR reports to assess high-level transfer pricing and other BEPS related risks. BEPS Action 13 has a different policy objective to that of Pillar Two. CbCR is a reporting obligation that is designed to promote transparency and improve risk assessment, while Pillar Two results in the actual imposition of a tax liability. Nevertheless aligning the definitions under CbCR and the GloBE rules should reduce compliance and administrative burdens for tax authorities and taxpayers. At the same time, the use of a consolidated accounting standard as a basis for defining the MNE Group allows other design features of the GloBE rules (such as the determination of the tax base) to leverage those same accounting standards.

2.2.1. Definition of Group and MNE Group

Definition of Group

46. The definition of "Group" under the GloBE rules is the same as that used in CbCR. A group is defined as a collection of enterprises that are consolidated for financial accounting purposes. This consolidation test is, in turn, based on a control test used for accounting. In general, the effect of this test is that two entities will be treated as part of the same Group where one entity controls the other or both entities are controlled by another entity. The definition of "Group" also extends to situations where an entity or arrangement carries on business activities in foreign jurisdictions exclusively through permanent establishments because the assets, liabilities, income, and expenses of the permanent establishments are included in the financial statements of the head office as if they were consolidated on a line-by-line basis.

MNE Group

47. The definition of "MNE Group" under the GloBE rules is also consistent with, and has the same outcomes as under, the CbCR rules. The definition of MNE Group incorporates a minor drafting difference from CbCR in that the group revenue threshold, which is incorporated directly into the definition of the MNE Group for CbCR purposes, is excluded from the definition used for GloBE purposes. While the GloBE rules apply the same revenue threshold as CbCR, this requirement is dealt with separately under the GloBE rules. The purpose of the MNE Group definition set out in the box above is to identify the MNE Group and the Constituent Entities that are part of the same group, rather than determine whether an MNE Group is subject to the GloBE rules. As such, the revenue threshold is more appropriately treated as a separate design element of the GloBE rules. See Section 2.4.1.

2.2.2. Definition of Constituent Entity

48. A Constituent Entity consists of a separate business unit that it is (or would have been) included in the consolidated financial statements of the MNE Group. As with CbCR, the GloBE rules apply a "deemed consolidation" test that treats a business unit as part of an MNE Group where that business unit would have been required to be consolidated had any of the equity interests of the Ultimate Parent Entity of the MNE Group been traded on a public securities exchange.

49. Any separate business unit that is excluded from the consolidated financial statements, or that would be excluded if the MNE Group prepared such statements, solely on size or materiality grounds is also a Constituent Entity. Lastly, a permanent establishment of a Constituent Entity is treated as a separate Constituent Entity. The definition of a Constituent Entity does not include those entities specifically identified as "Excluded Entities" in Section 2.3. Further explanation of the separate limbs of the Constituent Entity definition is set out below. A flow chart based on this Section is included in the Annex (see Flow Chart set out at Example 2.2.2).

(a) Business units (other than permanent establishments)

50. A business unit means an entity or arrangement such as a company or a partnership and is intended to have the same meaning as is used in the CbCR rules. In order to meet the definition of a Constituent Entity, the business unit must be "included in the consolidated financial statements of the MNE Group". A business unit will be Constituent Entity of an MNE Group when it is consolidated with the Ultimate Parent Entity under the applicable accounting standard of that parent. These consolidation requirements apply a control test that requires the operations of the Constituent Entity to be consolidated with the rest of the MNE Group on a line-by-line basis. A non-controlled entity is not consolidated on a line-by-line basis in the consolidated financial statements of the MNE Group but rather is separately reported under the equity method. Such an entity is not considered a Constituent Entity under subparagraph (a) of the definition. A business unit that is not consolidated on a line-by-line basis because it is subject to special reporting treatment under an applicable accounting standard, for example, on the grounds that the business unit is held for sale, should continue to be treated as a Constituent Entity for tax purposes as long as it otherwise remains sufficiently within the control of the Ultimate Parent Entity to fall within the consolidation requirements of the applicable accounting standard.

Joint Operations

51. The phrase "included in the consolidated financial statements of the MNE Group" also refers to situations where an MNE Group has an investment in a joint operation such that a proportionate share of the assets, liabilities, income, and expenditures of that business unit are included in the consolidated financial statements on a line-by-line basis.[7] Therefore, a business unit that is treated as a joint operation should be treated as a separate Constituent Entity if the income and expenses of the joint operation are included in the group's consolidated financial statements in proportion to the group's ownership interest in the business unit. The Constituent Entity is comprised, however, only of the MNE Group's share of the joint operation as reflected in the consolidated financial statements.

52. For example, a Constituent Entity may be a partner of a partnership that is treated as a joint operation for financial accounting purposes and the MNE Group includes 40% of the income, expenditures, assets, and liabilities of the partnership in its consolidated financial statements. This partnership is treated as a separate Constituent Entity under the GloBE rules, however its GloBE tax base is determined based on the MNE Group's share of the partnership's income, expenditures, assets, and liabilities that are included in the consolidated financial statements and the MNE Group will be treated as controlling that Constituent Entity to the extent of that income.

Resident enterprises

53. A Constituent Entity that is a tax resident will be treated as a Constituent Entity located in its jurisdiction of tax residence. The Constituent Entity's jurisdiction of tax residence is the jurisdiction where the business unit is liable for a covered tax on its income based on its place of management, place of incorporation, or similar criteria. The legal character of the business unit is not determinative of whether it should be treated as a Constituent Entity. For example, if a partnership or trust is considered tax resident in a jurisdiction, it should be considered as a separate Constituent Entity from its owners for the purposes of these rules.

54. Where a jurisdiction does not have a corporate tax system then an entity that is incorporated in that jurisdiction (and is not tax resident in any other jurisdiction) is treated as located in its jurisdiction of incorporation. Therefore, an entity or arrangement that is incorporated or established in a jurisdiction which does not impose covered taxes is treated as a Constituent Entity in its jurisdiction of incorporation or establishment, unless it is tax resident under the laws of another jurisdiction (for example, under a place of effective management test).

Tax transparent entities or arrangements

55. An entity or arrangement that is treated as tax transparent by all of its owners and in the jurisdiction where it is created will be treated as a Constituent Entity under the GloBE rules if, as set out above, its assets, liabilities, income, and expenses are consolidated on a line-by-line basis in the consolidated financial statements of the MNE Group. This treatment of a tax transparent entity consolidated on a line-by-line basis is consistent with the requirements for CbCR. Such a tax transparent entity should be treated as a stateless entity. Under the rules of Section 3.4.2, however, all the income and expenses (and corresponding covered taxes) of that entity may be allocated to other Constituent Entities in the group. These other Constituent Entities could include the owners of the transparent entity or any permanent establishment of that entity (or the owners). The fact that a business unit does not have profit, losses, or covered taxes allocated to it under the GloBE rules does not, however, prevent a tax transparent entity from being treated as a separate Constituent Entity.

Hybrid and reverse-hybrid entities

56. Applying the above criteria, a hybrid entity (i.e. an entity that is treated as a separate entity for tax purposes in its jurisdiction of incorporation or creation, but as transparent by its owners) should be considered a Constituent Entity that is located in the jurisdiction where it is treated as resident.[8] A reverse-hybrid entity (i.e., a business unit that is treated as tax transparent in the jurisdiction where it was created but as a separate entity for tax purposes in the jurisdiction of at least one of its owners), on the other hand, is treated as a Constituent Entity that is not located in any jurisdiction (i.e., a stateless entity).

Dual resident entities

57. There may be cases where a Constituent Entity could be considered a tax resident of more than one jurisdiction. This outcome would be incompatible with the GloBE rules, which determine the ETR and top-up tax liability on a jurisdictional basis. In line with the specific instructions of the CbCR template contained in the Action 13 Final Report (OECD, 2015[1]), this potential for dual residency should be resolved, solely for purposes of the GloBE rules, in accordance with the tax treaty tie breaker rule agreed between the jurisdictions where the entity or arrangement has dual-residence (even if the rules are only relevant to a particular treaty entitlement). Further work will be undertaken to develop rules for determining a Constituent Entity's tax residence in case of no applicable tax treaty tie-breaker rule, or if the tax treaty tie-breaker rule does not solve the issue (e.g., it requires competent authorities to solve the issue through a MAP or denies tax treaty benefits).

(b) No exclusion based on size or materiality

58. The GloBE definition of Constituent Entity follows the treatment under CbCR by going beyond financial accounting to capture entities or arrangements that otherwise would be excluded from the consolidated financial statements on the grounds of size or materiality. The purpose of this extension in the CbCR rules was to capture information about business units that were excluded from the consolidated financial accounts because of their low levels of income or profitability. While these entities may not be material from a financial reporting stand point, they may still be considered to raise transfer pricing risks because the business unit may not have been adequately rewarded for the functions performed, assets used, and risks undertaken by that business unit. These entities or arrangements are also considered Constituent Entities of the MNE Group for GloBE purposes for similar reasons. The GloBE rules are applied on a jurisdictional basis and though an entity may be immaterial in the overall MNE Group context, it may be material from the perspective of a particular jurisdiction (for example, under the undertaxed payments rule). Furthermore, treating these entities as Constituent Entities will not unduly increase compliance burdens on MNE Groups as they are already required to gather and submit information for purposes of CbCR. Subparagraph (b) of the definition also addresses the situation where the MNE Group does not

prepare consolidated financial statements because it is not required to consolidate all of its subsidiaries as none of them meet the size or materiality threshold.

(c) Permanent establishments

59. Finally, paragraph (c) of the definition of Constituent Entity treats a permanent establishment as a separate Constituent Entity (that is, separate from the Constituent Entity that owns it) provided that the permanent establishment has separate financial statements for financial reporting, regulatory, tax reporting, or internal management control purposes. The need to distinguish the separate business operations undertaken in the permanent establishment and the head office is particularly relevant for jurisdictional blending. It ensures that the tax rate on income earned through permanent establishments in another jurisdiction is not blended with income of the head office in a different jurisdiction. In that sense, it ensures parity in the treatment of foreign subsidiaries and permanent establishments of the MNE Group, which is consistent with the policy and design elements of the GloBE.

60. The term "permanent establishment" is not defined in the CbCR rules. For purposes of the GloBE rules, whether a permanent establishment exists is determined in accordance with the applicable tax treaty in force. In case there is no applicable tax treaty in force, then a permanent establishment would be deemed to exist in a jurisdiction if it has a sufficient business presence in such jurisdiction that the income of the operations are taxed on a net basis pursuant to the applicable domestic law. In these cases, a taxable business presence will generally be determined by reference to factors such as whether the Constituent Entity has a place of business in a foreign jurisdiction or whether it is present for a particular period, acting through an agent or any criteria of similar nature. For example, if a Constituent Entity is a partner in a tax transparent partnership and is treated as having a permanent establishment in a jurisdiction because the partnership is managed and controlled or conducts substantial operations in the jurisdiction, then the permanent establishment of that Constituent Entity is, itself, a separate Constituent Entity. See Annex, Example 3.4.2G. Furthermore, for purposes of the GloBE rules, a permanent establishment is deemed to exist if the residence jurisdiction of the Constituent Entity that owns the branch or similar establishment treats it as a separate taxpayer from its resident taxpayer. For example, a branch would be considered as a permanent establishment and a separate Constituent Entity if its income is subject to a branch exemption in the owner's residence jurisdiction. In these situations, the permanent establishment is deemed to exist even if the jurisdiction where the branch is located does not exercise any taxing rights.

61. A branch or similar establishment of a Constituent Entity that meets the definition of a permanent establishment is treated as a separate Constituent Entity of the MNE Group in the jurisdiction in which it is located. Whether the permanent establishment is considered to be owned by another Constituent Entity under local law or tax treaties is not relevant for GloBE purposes. For example, when a UPE that is tax transparent maintains a branch in another jurisdiction that qualifies as a permanent establishment, that permanent establishment is treated as a Constituent Entity of the MNE Group for GloBE purposes, even if under local law or tax treaties it is considered a permanent establishment of the owners of the UPE.

2.2.3. Definition of the Ultimate Parent Entity

62. The definition of Ultimate Parent Entity (or UPE) is a keystone definition in the sense that it is used as a reference point for the application of other GloBE rules. For example, the definition is used to identify all the controlled entities that comprise the MNE Group including the identification of Excluded Entities and the definition is important for the mechanics of the income inclusion rule which are described below in Chapter 6.

63. The UPE is the Constituent Entity that directly or indirectly owns a controlling interest in all the other Constituent Entities that are part of the same MNE Group. The UPE is the entity that is or would be required to consolidate the financial accounts of all other Constituent Entities in the MNE Group. Paragraph (b) of the definition of Ultimate Parent Entity clarifies that an entity is not an Ultimate Parent Entity if there

is another entity in the group that owns sufficient interest in that entity that it would be required to consolidate the entity's accounts with its own. Generally, this element of the definition means that there is no entity within the MNE Group that owns a controlling interest in the Ultimate Parent Entity. However, it also applies to exclude an entity that owns the controlling interests in the Ultimate Parent Entity but that is not required to consolidate its accounts with those of the Ultimate Parent Entity. For example, investment entities such as funds may be permitted to report their investments, including majority ownership interests, in an MNE Group under the fair value method rather than consolidated accounting. These investment entities would, accordingly, not be treated as the UPE of such MNE Groups.

2.2.4. Associates and joint ventures

64. Accounting rules, such as IFRS 10, typically require the Ultimate Parent Entity to fully consolidate on a line-by-line basis, the assets, liabilities, income and expenditures of the entities or arrangements that it controls. This control test is based on de facto control and may apply to treat an entity or arrangement as consolidated even where the parent holds less than a majority stake in the equity interests of the entity or arrangement.

65. Where the Ultimate Parent Entity does not have direct or indirect control over the entity or arrangement it will not be required to consolidate the operations of an Associate or joint venture on a line–by-line basis. In this case the profit (or loss) of this entity is required to be reported under the equity method unless the investment is recognised as a non-current financial asset.[9] Entities and arrangements reported under the equity method will not be considered as Constituent Entities that are members of the MNE Group under the GloBE rules.

Associates

66. Under IFRS, an Associate is an entity or arrangement over which the investor has significant influence. An investor is presumed to have significant influence over an investment when the investor holds at least 20% of the investee's voting power.[10] Associates (entities or arrangements)[11] are typically reported under the equity method and therefore excluded from the definition of a "Constituent Entity" because that entity is not under the control of the Ultimate Parent Entity. Moreover, that same entity could be a subsidiary and fully consolidated on a line-by-line basis in the financial statements of another MNE Group, which would make it a Constituent Entity of that other group. Applying the GloBE rules to an Associate could therefore lead to significant complications in the applications of the GloBE rules where the same entity would be subject to the IIR and UTPR applied by different MNE Groups in different jurisdictions. For these reasons, an entity or arrangement should only be a Constituent Entity of the MNE Group if it is a business unit whose assets, liabilities, income, and expenditures are consolidated on a line-by-line basis in the consolidated financial statements of the MNE Group.[12] Section 8.2.2 discusses the application of a simplified income inclusion rule with respect to low-taxed income of Associate entities or arrangements.

Joint ventures

67. A joint venture is an arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.[13] Joint ventures are excluded from the definition of a "Constituent Entity" because they do not have a single controlling equity interest holder and will generally be reported under the equity method of each MNE Group. The income of joint ventures may be subject to a simplified version of the income inclusion rule in accordance with Section 8.2.2 and may be treated as Orphan Entities under Section 8.3.

2.2.5. Use of acceptable accounting standards in defining MNE Group

68. The definitions set out above rely on the accounting principles applied, or that would be equity interests of the MNE Group were traded on a public securities exchange in its jurisdiction of tax residence, by an MNE Group in preparing consolidated financial statements for financial reporting purposes. As set out above, a Constituent Entity is any separate business unit that is included (on a line-by-line basis) in the consolidated financial statements of the MNE Group. Therefore, acceptable accounting standards and, in particular, the consolidation requirements of those standards play an important role in defining the scope of the GloBE rules.

69. The final report on Action 13 (OECD, 2015[1]) does not specify the use of any particular accounting standard for CbCR. Under CbCR, an MNE Group that is not required to prepare consolidated financial statements, may choose between its local general accepted accounting principles ("local GAAP") or the International Financial Reporting Standards ("IFRS"), except that if the Ultimate Parent Entity has its tax residence in a jurisdiction that requires a specific accounting standard for companies whose shares or interests are traded on a public securities exchange, the MNE Group must use that accounting standard. Jurisdictions with no securities exchange may specify one or more jurisdictions with a securities exchange that would be considered acceptable for these purposes. These rules apply equally to an MNE Group that prepares consolidated financial statements but is not required to do so.

70. The GloBE rules with respect to the determination of an acceptable accounting standard are set out below in Section 3.3.3. Applying the requirements of an applicable accounting standard in the context of the consolidation test will ensure consistency in the rules for determining the scope of the MNE Group. Moreover these determinations are likely to already be subject to examination by an independent financial accounting auditor. The requirements for determining acceptable accounting standards are discussed further in Section 3.3.3 below.

2.3. Excluded entities

71. Provided they meet the conditions in the definitions below, certain entities or arrangements that would otherwise be at the top of the group ownership chain are excluded from the application of the GloBE rules. These are investment funds, pension funds, sovereign wealth funds, government bodies, international organisations, and non-profit organisations. Further consideration will be given for cases where the exclusion should still apply in respect of a Constituent Entity that is not otherwise the UPE, such as certain life insurance and pension structures that are consolidated within an MNE Group and whose income is not beneficially owned by the MNE Group.

72. The entities or arrangements excluded from the scope of the GloBE rules all have a particular purpose and status under the laws of the jurisdiction in which they are created or established. This status is likely to result in that entity not being exposed to domestic income tax in order to preserve a specific intended policy outcome under the laws of that jurisdiction. The domestic tax outcome may, for example, be designed to ensure a single layer of taxation on vehicles used by investors (e.g. funds) or on retirement plans used by employees, or because the entity is carrying out governmental or quasi-governmental functions. The tax policy objectives of the domestic tax exemption for these types of entities neither are inconsistent with the tax policy objectives of the GloBE rules nor create a competitive distortion that would undermine the tax policy objectives of the GloBE proposal. Subjecting the income of such entities to tax under the GloBE rules would undermine the policy objectives that the domestic jurisdiction is seeking to achieve by granting the exemption without furthering the tax policy objectives of the GloBE rules.

73. In many cases, the entities described in this Section would not be Constituent Entities under the generally applicable rules discussed in Section 2.2. For example, investment and pension funds are likely to be "investment entities" that are not required to consolidate with investments that they control and,

therefore, would not meet the definition of a Constituent Entity. These entities will also typically be portfolio investors, often are unlikely to have foreign operations and in most cases will not hold controlling interests in foreign subsidiaries. However, in the interest of certainty, these entities have been expressly excluded, with the decision on exclusion guided by three key principles:

- Whether the tax policy rationale for the residence jurisdiction providing a nil or low rate of taxation for the sector is consistent with the GloBE tax policy rationale;
- Whether the exclusion is necessary to avoid the compliance and administration costs that might otherwise arise where such entities derive income that could fall within the scope of the rules;
- Whether an exclusion would be contrary to the policy of the GloBE rules by creating material competitive distortions as compared to other internationally operating businesses.

74. The list of Excluded Entities identified in this Section is intended to be in line with existing international tax principles and the policy of the GloBE rules, while providing certainty and consistency of treatment of these listed entities. The term “entity or arrangement” is intended to be broad and accommodate the different legal forms that such body may have, including public authorities.

75. The exclusions from the GloBE rules are specific to the entities or arrangements listed and do not extend to the entities that are controlled by the Excluded Entity but which do not themselves fall within any of the defined categories set out below. The definition can, however, extend to an entity or arrangement that is established and operated to hold assets or invest funds for the Excluded Entity (i.e. pure holding vehicles). This extension to the definition does not exclude an entity or arrangement that is carrying on or managing a commercial trade or business of the MNE Group. An entity or arrangement would not be treated as carrying on a trade or business if all or substantially all of its income is comprised of passive income (such as dividends, interest, and capital gains). Thus, for example, if an Excluded Entity such as a Governmental Entity or Non-profit Organisation holds a controlling stake in an MNE Group that otherwise exceeds the consolidated revenue threshold set out in Section 2.4 below, then the GloBE rules will continue to apply to all the members of that MNE Group other than the Excluded Entity.

Excluded Entities - Definitions

Excluded Entities

An entity that would otherwise be an Ultimate Parent Entity that is an investment fund, pension fund, governmental entity (including sovereign wealth funds), international organisation, or non-profit organisation will not be treated as a Constituent Entity of an MNE Group and will be excluded from the scope of the GloBE rules.

Investment Fund

Investment Fund means an entity or arrangement that meets all of the following criteria set out in paragraphs (a) to (f) below:

(a) it is designed to pool assets (which may be financial and non-financial) from an Excluded Entity or a number of investors (at least some of which are not connected);

(b) it invests in accordance with a defined investment policy and/or to reduce transaction costs and research and analytical costs and/or to spread risk collectively;

(c) it is primarily designed to generate investment income and/or gains or protection against a particular or general event or outcome;

(d) investors have a right to return from the assets of the fund, or income earned on those assets, based on the contributions made by those investors;

(e) the fund, or the management of the fund, is subject to the regulatory regime for investment funds in the jurisdiction in which it is established or managed (including appropriate anti-money laundering and investor protection regulation); and

(f) it is managed by fund management professionals on behalf of the investors.

The definition also includes any entity or arrangement that is wholly-owned or almost exclusively owned, directly or indirectly, by one or more Investment Funds or other Excluded Entity and that does not carry on a trade or business but is established and operated exclusively or almost exclusively to hold assets or invest funds for the benefit of such Investment Funds or other Excluded Entity.

Pension Fund

Pension Fund means an entity or arrangement that is established by a government (including any political subdivision or local authority) to provide social security, retirement or ancillary and incidental benefits or is established and operated in a jurisdiction exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that jurisdiction or one of its political subdivisions or local authorities.

The definition also includes any entity or arrangement that is wholly-owned, directly or indirectly, by one or more Pension Funds or established by a government (including any political subdivision or local authority) and that does not carry on a trade or business but is established and operated exclusively, or almost exclusively, to hold assets or invest funds for the benefit of Pension Funds.

Governmental Entity

Governmental Entity means an entity or arrangement that meets all of the following criteria set out in paragraphs (a) to (d) below:

(a) it is established by a government (including any political subdivision or local authority thereof);

(b) it has the principal purpose of:

i. managing or investing that government's or jurisdiction's assets through the making and holding of investments, asset management, and related investment activities for the government's or jurisdiction's assets; or

ii. fulfilment of a government function; and

iii. does not carry on a commercial trade or business;

(c) it is accountable to the government on its overall performance, and provides annual information reporting to the government; and

(d) its assets vest in such government upon dissolution and to the extent it distributes net earnings, such net earnings are distributed solely to such government with no portion of its net earnings inuring to the benefit of any private person.

The definition also includes any entity or arrangement that is wholly-owned, directly or indirectly, by a Governmental Entity and that does not carry on a trade or business but is established and operated to hold assets, manage and invest funds, or conduct related investment activities for the benefit of that Governmental Entity.

International Organisation

International Organisation means any intergovernmental organisation (including a supranational organisation) or wholly owned agency or instrumentality thereof, that meets all of the following criteria set out in paragraphs (a) to (c) below:

(a) it is comprised primarily of governments;

(b) it has in effect a headquarters or substantially similar agreement (for example, arrangements that entitle the organisation's offices or establishments in the jurisdiction (e.g. a subdivision, or a local, or regional office) to privileges and immunities) with the jurisdiction in which it is established; and

(c) it is prevented by law or its governing documents from inuring its income to the benefit of private persons.

The definition includes any entity or arrangement that is wholly-owned, directly or indirectly, by an International Organisation, and that does not carry on a trade or business but is established and operated exclusively or almost exclusively to hold assets or invest funds for of the benefit of that International Organisation.

Non-profit Organisation

Non-profit Organisation means an entity or arrangement that meets all of the following criteria:

(a) it is established and operated in its jurisdiction of residence:

(i) exclusively for religious, charitable, scientific, artistic, cultural, athletic, or educational purposes; or

(ii) as a professional organisation, business league, chamber of commerce, labour organisation, agricultural or horticultural organisation, civic league or an organisation operated exclusively for the promotion of social welfare;

(b) it is wholly exempt from income tax in its jurisdiction of residence;

(c) it has no shareholders or members who have a proprietary or beneficial interest in its income or assets;

(d) the income or assets of the non-profit organisation may not be distributed to, or applied for the benefit of, a private person or non-charitable entity other than:

(i) pursuant to the conduct of the entity's charitable activities;

(ii) as payment of reasonable compensation for services rendered or for the use of property or capital; or

(iii) as payment representing the fair market value of property which the entity has purchased, and

(e) upon termination, liquidation or dissolution of the entity or arrangements, all of its assets must be distributed or revert to a Non-profit Organisation or to the government or any Governmental Entity of the entity's jurisdiction of residence or any political subdivision thereof;

but does not include any entity or arrangement carrying on a commercial trade or business that is not directly related to the purposes for which it was established.

Certain UPEs subject to tax neutrality regimes

The income of a UPE may be excluded from the GloBE rules where that income qualifies for tax neutral treatment under a tax transparency or taxable distribution regime in the jurisdiction where that entity is established or incorporated provided that the owners of the UPE are subject to an immediate tax on their share of the entity's income at a rate that equals or exceeds the minimum rate.

Investment funds

76. The need to preserve the tax neutrality in respect of investment funds is a widely recognised principle that underpins the design of the international tax rules. Under this principle, investment funds may be eligible for a special exemption, deduction, or other preferential treatment under the laws of the jurisdiction where they are established, to put the investors in the same position as if they had invested in the underlying assets of the fund directly, rather than through an investment fund vehicle.

77. The tax treatment of the investment fund is not driven by a need or desire to attract investment from one jurisdiction to another, but rather to allow collective investments to be made through the fund without imposing any additional tax burden on the investment return. This policy goal is relevant across all types of investment funds, including widely held collective investment vehicles such as mutual funds, as well as alternative investment funds generally open to a smaller group of investors. There are a range of fund vehicles that may be used to deliver tax neutral outcomes for investors and the operation of the GloBE rules should not distort these choices.

78. The tax neutrality of the fund does not mean that the investment returns earned by the fund go untaxed. The investment return will be subject to tax to the extent that the source country has chosen to impose taxation (e.g. by way of withholding tax on an investment return)[14] and a further layer of taxation may be imposed in the hands of the ultimate investor either on distribution or as the investment return accrues. The recent advances in tax transparency, such as through the Standard for Automatic Exchange of Financial Account Information in Tax Matters, have further strengthened the ability of tax administrations to access the information necessary to ensure that fund income is subject to the correct amount of taxation under the laws of the investor's jurisdiction of residence.

79. The fact that the fund itself is not exposed to tax for the above policy reasons does not therefore trigger the concerns that underpin the policy rationale for the GloBE rules. The neutrality of funds is a specific and generally supported tax policy rationale, which would be undermined if the GloBE rules were applied to the income of the fund resulting in an otherwise tax neutral investment vehicle being subject to an additional layer of taxation under the laws of another state. Given this approach is already widely adopted in domestic taxation systems, an exclusion for investment funds from the GloBE rules also does not provide a competitive advantage or create economic distortions. It is therefore appropriate to preserve the tax neutrality policy, by ensuring that fund vehicles are not exposed to the GloBE rules.

80. The definition of investment fund draws on the definition of "investment entity" in IFRS 10, European Union Alternative Investment Fund Managers Directive 2011/61/EU (AIFMD), and the IMF definition of collective investment schemes used in the Balance of Payment statistics. As set out in the box above, an investment fund is an entity or arrangement that is designed to pool assets from unrelated investors (or an Excluded Entity or Entities) and that is managed by professionals on behalf of those investors. The assets of a fund include both financial and non-financial assets including rights to such assets such as options. The definition applies only to an entity or arrangement established for the purpose of collective investment which is regulated as such, whether directly in the jurisdiction where the fund is established, or indirectly through a requirement in the jurisdiction of the investment fund that it be managed by a regulated fund manager (which may be established and regulated in a different jurisdiction). The definition does not apply to unregulated investment vehicles such as family held companies.

81. The exclusion does not require that the fund benefit from a special tax status under the laws of the jurisdiction where it is established but requires that the entity or arrangement has the hallmarks of a collective investment vehicle, which include a professional manager investing under a defined investment policy. Fund management professionals may include custodians or brokers that are responsible for implementing the fund's investment policy and executing transactions on behalf of the fund. The definition requires that there be an Excluded Entity as an investor, or at least two unconnected investors in the entity or arrangement but does not otherwise limit the types or number of investors.

82. The final part of the definition recognises that an Investment Fund may use special purpose vehicles to hold assets or to make certain investments. Such entities or arrangements essentially function as part of the infrastructure of the fund itself, and should be treated as part of the Excluded Entity. The exclusion for special purpose vehicles does not extend to entities that carry on or otherwise have responsibility for managing a trade or business of the MNE Group itself. The definition also provides for cases where the entity or arrangement is held by more than one separate Investment Fund, or by one or more Investment Funds together with another Excluded Entity such as a pension fund. The definition also accommodates cases where, for regulatory or commercial reasons, the fund manager may be required to hold a de minimis shareholding in the entity or arrangement.

83. The definition of Excluded Entity set out in the box above applies to entities in the MNE Group that are at the top of the ownership chain. This definition, however, does not comprehensively address the issues associated with controlled investment funds (i.e. a fund that is controlled by a Constituent Entity of an MNE Group that is not an Excluded Entity). For example, further technical rules may be required to avoid the potential application of the IIR to a controlled fund under the top-down approach and the split-ownership rules. Further guidance may also be required as to the treatment of controlled investment funds under the UTPR. The Inclusive Framework will undertake further technical work regarding the treatment of investment funds to identify whether further rules are needed to preserve the tax neutral outcomes for investment funds under Pillar Two and to consider the application of the GloBE rules to controlled investment funds and the outcomes of this work will be incorporated into the model rules.

2.3.1. Pension funds

84. In many jurisdictions, pension funds are tax exempt in respect of the income they generate for the beneficiaries of the fund. A significant number of jurisdictions use the approach of "exempt – exempt – taxed", where the contribution to the fund is tax exempt, the income generated by the pension fund is tax exempt, and the return is taxed in the hands of the beneficiary upon distribution. The tax exemption of a pension fund may be achieved through a number of mechanisms, for example, by treating the pension fund as a transparent entity for domestic tax purposes, or by granting a specific exemption or preference under domestic tax law.

85. The policy rationale for this treatment is to encourage employees and firms to put in place structures that allow the employee to spread their employment earnings more evenly over their lifetime and to do this in a way that achieves consistency in the tax treatment for the employee. In an economic sense, these vehicles bring taxes on employment income closer to the design of a consumption tax by deferring the imposition of tax until income is actually spent. The "exempt – exempt – taxed" model encourages employees to defer a portion of their employment earnings by allowing them to capture, in full, the untaxed value of any investment returns that accrue up to the time of distribution. This tax policy is viewed as increasingly important by a number of Inclusive Framework members that consider such investment vehicles to be an important tool in addressing the need to support ageing populations. In the case of pension plans for government employees, taxation of the pension fund would simply result in an inefficient circular flow of taxation and expenditures as the government would need to increase the contributions to the fund to meet the pension's tax liabilities. A similar logic applies in respect of private pension funds, where there is a public interest in ensuring a stable retirement income to reduce the

pressure on the public social security system, and where imposing taxation in the short term would raise revenue from one source to fund another.

86. The exclusion of Pension Funds from the IIR and UTPR preserves the ability of governments to meet their domestic tax policy goals, which have informed the tax treatment of their pension funds. To do otherwise would undermine the policy of maximising the returns earned by the pension fund structure for the beneficiaries. Pension Funds, which effectively operate as a tax preferred personal savings account do not otherwise compete with other internationally operating business. It is therefore appropriate to preserve that policy, by ensuring that Pension Funds are not exposed to the minimum tax.

87. The definition of pension fund follows the definition of "recognised pension fund" used in the OECD Model Tax Convention (OECD, 2017[2]), Article 3, paragraph (i). The definition has been modified to remove reference to the fund being taxable as a separate person in the jurisdiction of formation, to allow for pension funds formed in a different legal arrangement such as a trust. The definition applies to both public and private Pension Funds provided it is a regulated investment vehicle providing services to individual members of the public (or a defined category thereof). The definition has been modified to accommodate cases where an entity that performs the function in sub-paragraph (b) of holding assets or investing funds for the pension fund is not owned by that pension fund but is established by a government.

2.3.2. Governmental Entities

88. In some cases, a government entity may hold an investment in an MNE Group. In most cases, these investments of government entities will be held through a sovereign wealth fund. Sovereign wealth funds are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses or receipts resulting from commodity exports.[15] The function of a sovereign wealth fund is to invest these amounts for the purpose of managing a country's future fiscal needs, stabilising a country's balance of payments and in order to strike an appropriate balance between domestic consumption and savings.

89. Different approaches to the taxation of sovereign wealth funds are taken around the world. They are generally treated as tax exempt in the jurisdiction where they are established, although in some countries, sovereign wealth funds are not tax exempt and otherwise pay ordinary tax in respect of their income. In the source jurisdiction, the practice is more varied. In some source jurisdictions, the income of a foreign sovereign wealth fund may be entirely exempt from tax or only in respect of certain types of income (such as being limited to non-commercial investment income). This exemption may apply by virtue of domestic tax law or only where such treatment is granted under a double tax treaty. The different approaches to the taxation of sovereign wealth funds reflect different domestic national interests and mutual arrangements between jurisdictions. It also reflects that there is a variety of policy views, such as different concepts of sovereign immunity.

90. Where a Governmental Entity such as a sovereign wealth fund has a low ETR under the GloBE this is likely to reflect the specific tax treatment granted to that entity because of the exercise of its government functions. In such a case, it would seem counter-intuitive to require a top-up tax. If it were otherwise, the GloBE rules could have the effect that the government in the residence jurisdiction would be incentivised to impose taxation on itself in order to prevent its own revenue being exposed to a top-up tax by other governments through the UTPR.

91. The reference in the definition to "established by government" limits the scope to governmental entities that are public in nature, including where established by specific statute or as a wholly-owned government corporation. To ensure that the exclusion for governmental entities does not result in competitive distortions with respect to internationally operating businesses, the exclusion only applies to entities that have the principal purpose of managing or investing that government or jurisdiction's assets and / or fulfilment of a government function such as the administration of programmes for the general public

with respect to the common welfare. It does not apply if the entity is carrying on or managing a commercial trade or business. For the avoidance of doubt, carrying out the principal purpose of the entity (as described in (b)(i) and b(ii) of the definition above) does not constitute carrying on a commercial trade or business.

2.3.3. International organisations

92. The rationale for excluding international organisations is similar to that which applies to the exclusion for Governmental Entities. International organisations such as supranational organisations or development finance organisations are funded by governments. Taxing these organisations on their low tax profit would undo the benefit of the tax exemptions granted to these organisations by agreement under international law. The definition of international organisation follows the definition used in the Standard for Automatic Exchange of Financial Account Information in Tax Matters (OECD, 2014[3]). The language in paragraph (b) includes an explanation of a “substantially similar agreement” which is taken from Commentary to that Standard.

2.3.4. Non-profit organisations

93. There is a range of non-profit organisations that work for a public purpose, without a view to returning profit to shareholders. Jurisdictions generally provide a tax exemption to such entities, recognising their public purpose, to encourage contributions to such entities, and to maximise the returns available for the intended public good. The provision of these tax exemptions is generally subject to a series of domestic law conditions that must be satisfied, and which are scrutinised by the tax administration.

94. The definition of non-profit organisation follows the definition of “Active Non-Financial Entity (NFE)” (paragraph (h)) used in the Standard for Automatic Exchange of Financial Account Information in Tax Matters. Where non-profit organisations have been granted a domestic tax exemption, the GloBE rules would not operate to reverse this treatment. Given the non-profit purpose of such entities, the exclusion of these entities from the GloBE rules should not give rise to a risk of competitive distortion between non-profit organisations and internationally operating business.

95. The exclusion does not apply to an MNE that is headed by a non-profit foundation or similar type entity that simply serves as the holding company for an internationally operating commercial business. A non-profit organisation that engages in business activity unrelated to the charitable purpose will also not qualify for this exception from the GloBE rules. Moreover, the exclusion is restricted to entities that do not distribute their income or assets to private persons or non-charitable organisations other than in particular situations described in the box above.

2.3.5. UPEs subject to certain tax neutrality regimes

96. In order to provide a tax neutral outcome for investors, a jurisdiction may treat certain entities or arrangements as transparent for tax purposes or permit that entity or arrangement to make taxable distributions to its investors. Under these tax transparency and taxable distribution regimes, the tax on the entity’s income is effectively paid at the level of the owner, either by taxing that owner directly on its allocable share of the entity’s income (in the case of a tax transparent vehicle) or by taxing the owners on a deductible dividend or other distribution paid by the entity (in the case of a taxable distribution regime).

97. The treatment of tax transparent and taxable distribution entities that are Constituent Entities is discussed in Sections 3.4.2 and 3.3.4. These rules ensure that any covered tax paid on allocated or distributed income at the shareholder level is taken into account under the GloBE rules and is treated as tax paid on such income.

98. However, where the entity subject to these tax transparency or deductible dividend regimes is the Ultimate Parent Entity, then the owners that pay the tax on the underlying income will not be Constituent

Entities of the MNE Group and therefore their tax liability will not be taken into account in computing the entity's ETR under the GloBE rules and accordingly could give rise to a UTPR adjustment. Accordingly, special rules are required to address these regimes.

99. The rules set out in the box above allow an entity that is the UPE of the MNE Group to exclude its own income from the potential application of the UTPR where that income qualifies for tax neutral treatment under a tax transparency or taxable distribution regime in the jurisdiction where that entity is established or incorporated. In order for a UPE to benefit from this exclusion, the regime must meet the following criteria:

a. the owners are subject to tax in that jurisdiction on their share of the entity's income,

b. the owner's tax liability arises immediately, and

c. the owners are subject to tax at a rate that equals or exceeds the minimum rate.

100. These criteria are described in further detail below.

Tax transparency regimes

101. Tax transparency regimes represent the most common approach to single level taxation. Under these regimes, the entity or arrangement is not subject to tax on its income. Instead, the income of the entity is passed through to the owners proportionally and taxed at the owner level. Because the entity is not itself subject to tax, absent special rules, its income would, in many cases, be subject to tax under the GloBE rules because the ETR on that income would generally be zero.

102. The owners of the UPE are not Constituent Entities, and therefore, any taxes paid by the owners would not ordinarily be taken into account in the computation of the ETR under the GloBE rules. Absent a special rule, tax transparency at the level of the UPE would produce a GloBE tax liability because the income of the UPE would be subject to a nil rate of tax. The UPE's income may be subject to tax in the hands of the owners and thus not subject to low rates of tax overall. However, the GloBE rules generally do not take account of tax paid by owners that are not Constituent Entities for two reasons. First, they are not taxes paid by the MNE Group and the GloBE rules apply to MNE Groups and seek to ensure that they are subject to a minimum level of tax on their income, not that owners of MNE Groups are subject to a minimum level of tax on their income. Second, assigning tax paid by non-Constituent Entity owners to Constituent Entities is not feasible, in part, because the UPE does not control its owners and cannot demand that they provide the necessary information. Even if such owners were willing to provide such information, it would be difficult to separate their tax liability on the entity's income from their liability with respect to other income unless the jurisdiction applied a schedular regime for the entity's income.

103. Nevertheless, there may be circumstances where tax administrations can be confident that the owners of a tax transparent entity are subject to tax above the minimum rate on the entire income of the entity. An illustration of this type of tax transparency regime is given in Example 2.3.6A in relation to the treatment of "S corporations" under Sections 1361 – 1379 of the US Federal Revenue Code.

104. An S corporation has three characteristics that indicate its income will be subject to tax in the hands of the shareholders at above the minimum rate:

a. The first is that the owners of the S Corp must be US tax residents.

b. The second is that the owners are subject to immediate taxation on their share of the income as if they earned the income directly.

c. The third is that the owners are generally subject to tax on their share of the income.

105. These characteristics mean that, by virtue of the design of the S Corporation regime, the owners of the S corporation can be expected to be subject to an immediate US tax on their share of the entity's

income at a rate that equals or exceeds the minimum rate. The S corporation regime is therefore an example of tax neutrality regime where the income that is attributable to the shareholders should be excluded from the calculation of GloBE income. The same principles set out in the paragraph above can be applied to determine whether other tax transparency regimes should benefit from this exception.

106. The treatment of tax transparent regimes described in this Section is limited to the income of the UPE and the treatment is limited to income taxable under the laws of the UPE jurisdiction. In most instances, the income allocated to the owner will be taxable in the UPE jurisdiction on the basis of the residency of the owner, however where the income is allocated to a non-resident but remains taxable in the UPE's jurisdiction at or above the minimum rate on the basis of source then this income would similarly be excluded from the GloBE rules. Further technical work will be undertaken to determine whether and to what extent taxes levied under the law of UPE jurisdiction on the income of a foreign Constituent Entity (such as domestic tax on a foreign branch) should also be included within the ETR calculation under the GloBE rules.

Distribution deduction regimes

107. Jurisdictions may provide tax regimes that are designed to produce a single level of taxation on certain cooperative or pooled activities of taxpayers. Under these regimes, the corporation is generally subject to tax on its income, but is allowed a deduction for certain distributions to owners or participants in the collective enterprise. Distribution deduction regimes are generally available for investment funds and other passive investment vehicles which are excluded from the scope of the GloBE rules. Corporations subject to distribution tax regimes that qualify as investment funds under Section 0 will be excluded from the definition of UPE under the exclusion for investment funds and no special rule is needed. However, in a narrow range of cases an active businesses may be entitle to make deductible distributions to its shareholders. For example, an agricultural cooperative corporation that buys apples from its members and markets them collectively may be allowed a deduction for distributions of profits from apple sales to each member in proportion to the corporation's purchases of apples from the member. In most cases, co-operative companies are unlikely to meet to consolidated revenue threshold necessary to bring them within the scope of the GloBE rules. However where a company that benefits from a distribution deduction regime is the UPE[16] of an MNE Group that is not an Excluded Group.

108. The income of the entity should only be exempt from the GloBE rules if the owners are subject to tax in the jurisdiction on their share of the entity's income, the owners' tax liability arises immediately, and the owners are subject to tax on the distributions at a rate that equals or exceeds the minimum rate. Typically, to qualify for the distribution deduction, distributions must be made during the entity's tax year or within a brief period after the end of the year. For GloBE purposes, the second criteria is considered met if the distribution occurs within a reasonable period following the end of the entity's tax year. Under these circumstances, a UPE subject to a distribution deduction regime is permitted to deduct distributions in the same manner as permitted under local tax law in computing its income for GloBE purposes.

109. The principles discussed above have been used to inform the treatment of tax regimes that are intended to preserve tax neutrality. The foregoing discussion broadly describes the types of tax regimes to which the rules apply but does not describe or address all the design features of tax neutrality regimes that may fall within the rules. For those Inclusive Framework on BEPS members that introduce the GloBE rules it is expected that they will assess their own tax neutrality regimes against the principles discussed in this Section. As described further in Section 10.5.2 the same multilateral process for determining whether a jurisdiction has introduced an IIR in line with GloBE requirements could be used to assess whether a jurisdiction's tax neutrality regime was consistent with the principles set out in this Pillar Two Blueprint.

2.3.6. Application of the GloBE rules to international shipping

110. The GloBE rules are designed to apply to all operating businesses. The exclusion of any specific sector could raise additional BEPS risks and fairness issues among different business sectors and jurisdictions. This could undermine the effectiveness of the GloBE rules. However, the unique features of the international shipping industry will require further work on whether, and to what extent, the GloBE rules should apply to this industry.

111. The international shipping industry is subject to special tax rules. The capital intensive nature, the level of profitability and long economic life cycle of international shipping has led a number of jurisdictions to introduce alternative or supplementary taxation regimes for this industry. Taxes, such as tonnage taxes, may result in less volatile outcomes for shipping and provide a more stable basis for long term investment. The widespread availability of these alternative tax regimes means that international shipping often operates outside the scope of corporate income tax. Including international shipping within the scope of the GloBE rules would therefore raise policy questions in light of the policy choices of these jurisdictions.

112. Additionally, if international shipping was included within the scope of Pillar Two, questions have been raised regarding the implications of this, noting that the revenue effect may be limited given the design includes an unlimited loss carry-forward, a formulaic substance-based carve-out and tonnage taxes would constitute covered taxes. Finally, the typical operating model of an international shipping firm is such that most shipping income is sourced from third parties or other group members that are subject to low or alternative taxation regimes. This operational structure may render the undertaxed payments rule an ineffective back-stop to the income inclusion rule meaning that applying the GloBE rules could lead to competitive distortions and unstable outcomes.

2.4. Consolidated Revenue Threshold

Excluded MNE Groups

MNE Groups having total consolidated group revenue below EUR 750 million or equivalent in the immediately preceding fiscal year of the Group, are excluded from the application of the GloBE rules. For the purposes of this rule:

(a) The consolidated group revenue threshold is applied to all those Constituent Entities that are owned and controlled by the same Ultimate Parent Entity.

(b) The term “fiscal year” means the annual accounting period with respect to which the Ultimate Parent Entity of the MNE Group prepares its financial statements.

113. The GloBE rules will apply to MNE Groups that have annual consolidated revenue of EUR 750 million or more in the immediately preceding fiscal year or a near equivalent in domestic currency. This is the same threshold that applies under the CbCR rules.[17]

2.4.1. Consolidated revenue threshold

114. The general rule set out in the box above limits the application of the GloBE rules to MNE Groups whose consolidated group revenue is at least EUR 750 million. The EUR 750 million threshold has several advantages.

115. **Synergies with the CbCR rules**, which are used for other elements of the GloBE rules, such as the definitions set out above that deal with the composition of the MNE Group. Furthermore MNE's that are not subject to CbCR have no independent financial reporting reason to separately report the income of the branch and head office of the same entity as they are required to under the GloBE rules. The use of the same threshold may also facilitate the use of simplification options.

116. **Use of financial accounts.** A number of design elements of the GloBE rules rely on consolidated financial accounts. A significant majority of in-scope MNE Groups are publicly accountable (listed) companies that are already required to report consolidated financial information to investors under IFRS or an equivalent standard.[18] A lower threshold would pick up more private companies that are not required to prepare consolidated financial accounts (or where they do it may be in local GAAP).

117. **Avoid adverse impacts on SMEs.** The use of the CbCR reporting threshold will exclude small and medium enterprises (SMEs) operating in more than one jurisdiction, where the application of these rules could be a significantly greater burden. A EUR 750 million revenue threshold will mean that between 85% and 90% of MNE Groups will be outside the scope of the rules. This, in turn, reduces the pressure on Inclusive Framework on BEPS members to provide carve-outs from the GloBE rules for SMEs that benefit from targeted domestic tax incentives.

118. **It preserves the impact of the GloBE rules**. MNE Groups that are within the scope of CbCR earn over 90% of global corporate revenues. Accordingly the threshold preserves the impact of GloBE rules.

2.4.2. Previous fiscal year

119. The EUR 750 million threshold is determined by reference to the total consolidated group revenue of the MNE Group during the immediately preceding fiscal year. This mirrors the rules for determining the MNE Groups to which the CbCR rules apply.[19] Therefore, whether an MNE Group is required to apply the GloBE rules is based on the preceding year's consolidated revenue regardless of whether its consolidated revenue is below or above the threshold in the year for which it is applying the rules.

120. Paragraphs 1 and 2 of the rule make reference to a "fiscal year". Taxable years can vary from one jurisdiction to another. Some jurisdictions use the calendar year as their taxable year, while others use a different period (e.g., some jurisdictions allow taxpayers to choose their taxable year). A fiscal year could also have an irregular duration because the entity or arrangement was created and/or started business operations in that calendar year. These differences justify the need to define fiscal year for purposes of the GloBE rules. An MNE Group may have Constituent Entities in jurisdictions with different required or permitted taxable years. However, the MNE Group will use the same fiscal year for all of its Constituent Entities in its consolidated financial reports because the GloBE tax base is determined primarily based on the MNE Group's consolidated financial statements. Given that CbCR Model Legislation already has a definition of "Fiscal Year" and the similarities between the CbCR and GloBE rules, the rule mirrors the CbCR definition, which is based on the MNE Group's fiscal year for consolidated financial accounting purposes.

2.4.3. Calculating the consolidated revenue threshold

121. The threshold set out above applies based on the consolidated revenue of the MNE Group. As explained in Section 2.2, the definition of MNE Group under the GloBE rules, like CbCR, relies on the UPE's applicable financial accounting standard to determine whether a subsidiary's accounts are consolidated and thus whether it is a Constituent Entity. The consolidated revenue of all Constituent Entities is included in the determination of the threshold irrespective of whether the MNE Group owns all of the equity interests in the Constituent Entity. Stated differently, no deduction for amounts that accrue to minority interest holders in a Constituent Entity should be made in the determination of the MNE Group's

total revenue. However, the revenue of two MNE Groups or different standalone entities that are not part of the same consolidated financial statement should not be aggregated even if they are controlled by the same person (e.g. an individual).

122. This situation could arise in the case of investment entities that control two different MNE Groups. According to IFRS 10, investment entities are not required to consolidate an investment in a subsidiary, unless the main purposes and activities of the subsidiary is to provide services related to the investment entity's activities. Thus, an investment entity that is the controlling shareholder of two or more MNE Groups would typically not consolidate these groups into its financial statements and would not be considered as the Ultimate Parent Entity of these groups.

123. This is illustrated in Example 2.4.3 of Annex A where an investment fund controls two separate MNE Groups with annual consolidated revenue of EUR 500 million each. If the investment entity meets the definition of an investment entity in accordance with IFRS 10 or similar financial accounting standards, the entity will not be required to consolidate the MNE Groups. In these cases, each MNE Group would typically have separate consolidated financial statements, and these groups would be considered as separate MNE Groups. As such, they would separately determine whether they meet the threshold described in this Section.

124. The approach set out in the previous paragraphs is in line with CbCR rules. CbCR rules do not consider investment funds or entities as the Ultimate Parent Entity of an MNE Group unless accounting rules instruct them to consolidate with investee companies. The Guidance on the Implementation of CbCR states that investment funds or entities that are investees are not considered as Constituent Entities or part of a Group or an MNE Group unless they are consolidated by the Group.

125. The entities that are excluded from the GloBE rules are not considered as Constituent Entities of an MNE Group. Therefore, the revenue of these entities is excluded from computation of the threshold even if they are consolidated on a line-by-line basis in the financial statements of an MNE Group. Furthermore, given that these entities would not qualify as the Ultimate Parent Entity of an MNE Group, the subgroups that they control would be accounted as if the Excluded Entity was not the parent entity for consolidation purposes. This is also illustrated in Example 2.4.3 of Annex A, in which FUND can be an entity excluded in accordance to Section on excluded entities. Moreover, the consolidated revenue of the remaining Constituent Entities of MNE Group may need further adjustments for purposes of the threshold computation. For example, any intragroup payments from the Excluded Entity to the rest of the MNE Group should be reflected for purposes of the revenue threshold because these payments are eliminated in the consolidated financial statements.

126. Further work could be undertaken to consider whether the consolidation threshold should be supplemented with a targeted anti-avoidance rule to avoid the fragmentation of a single MNE Group into different subgroups in order to avoid the EUR 750 M threshold. This work would need to take into account the on-going work on the 2020 Country-by-Country (BEPS Action 13 Minimum Standard) review process and the outcomes from this work would be incorporated into the development of model rules (see Section 10.5.1 below).

References

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OECD (2014), *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, OECD Publishing, Paris, https://doi.org/10.1787/9789264216525-en. [3]

Notes

[1] The term “enterprise” is used in definitions of “Group” and “MNE Group” in the CbCR Model Legislation. This term is included in the definition to maintain consistency between GloBE and CbCR definitions. For these purposes, the term “enterprise” is broadly equivalent to the term “business unit” which is used as part of the definition of Constituent Entity.

[2] See BEPS Action 13 Report (p. 39) (OECD, 2015[1]).

[3] See BEPS Action 13 Report (p. 39) (OECD, 2015[1]).

[4] See BEPS Action 13 Report (p. 39) (OECD, 2015[1]).

[5] In brief, and as described further below, the differences between the definitions under CbCR and GloBE are: 1) the reference to “Excluded Group” (subsection (ii)) was eliminated from the definition of “MNE Group” because the GloBE rules deal with the EUR 750 million threshold in a separate rule; 2) the term “business unit” was eliminated from subparagraph (a) from the definition of “Constituent Entity” to clarify the operation of the deemed consolidation test; 3) a last sentence was added to the definition of “Constituent Entity” to make reference to the excluded entities in accordance with the Section 0. Minor formatting changes have also been made to align with the overall design of the GloBE rules.

[6] The definitions for CbCR are currently being evaluated as part of the 2020 Country-by-Country Reporting (BEPS Action 13 Minimum Standard) review process.

[7] This is in line with paragraph 20 of IFRS 11 as well as the Guidance on the Implementation of Country-by-Country Reporting (December 2019) (OECD, 2019[4]). See *Treatment of an entity owned and/or operated by more than one unrelated MNE Groups* (p.19).

[8] Under this section, an entity or arrangement is created in a jurisdiction if it was incorporated, organized, or created based on the domestic laws of such jurisdiction.

[9] Typically, where the MNE’s stake in a company is less than 20%, it would report its investment in its consolidated financial statements as a non-current financial asset e.g., IFRS 9 – Financial Instruments.

[10] Paragraph 3 of IAS28. IFRS Foundation.

[11] "Associate" is an accounting term which is different to the term "associated enterprise" as used in the context of transfer pricing.

[12] This includes joint operations where a portion of its assets, liabilities, income, and expenditures are consolidated on a line-by-line basis. See section 2.2.2.

[13] Paragraph 16 of IFRS 11. IFRS Foundation.

[14] Double taxation treaties typically limit the source country's taxing rights over dividends, interest and capital gains derived by a resident of another country. However for procedural reasons, investment funds and / or fund investors cannot always effectively claim the withholding tax relief to which they are entitled under such treaties, leading to over-taxation.

[15] See International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds — Generally Accepted Principles and Practices — "Santiago Principles" (IWG, 2008[5]), October 2008, Annex 1; also replicated in 2017 Model Tax Convention (OECD, 2017[2]), Commentary on Article 4, paragraph 8.5

[16] Special rules are prescribed in section 3.3.4 for the treatment of dividends distributed by Constituent Entities that are subject to distribution tax regimes and for dividends received by Constituent Entities from corporations subject to distribution tax regimes. Those rules would ensure that the Constituent Entity's income would not be subject to the GloBE rules at the entity level simply due a dividends paid deduction, thus preserving the jurisdiction's single level of tax policy, while simultaneously ensuring that the MNE Group's share of the entity's income remains subject to the GloBE rules.

[17] See further discussion in Section 10.3.

[18] See section 3.3.1 below on *Profit or loss determined in accordance with financial accounting standard*.

[19] This rule is currently under review as part of the 2020 Review of Country-by-Country Reporting.

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