5 Simplification options

5.1. Overview

376. During the December 2019 Public Consultation (OECD, 2019[1]), many MNEs stressed that simplification measures are needed to reduce the complexity and administrative burden associated with complying with the GloBE rules, particularly in the context of jurisdictional blending.

377. Several submissions pointed out that large MNEs often operate in more than 100 jurisdictions and would be required to undertake the same number of ETR calculations under a jurisdictional blending approach. Other submissions expressed concern that, under jurisdictional blending, it would be necessary to compute the ETR in jurisdictions that are likely to be above the agreed minimum rate year-after-year, given the base and tax rate in these jurisdictions.

378. Against this background, the Inclusive Framework has explored several potential simplification measures, as set out below. These simplification measures would benefit from future public consultations with business and therefore no decision has been taken on which, if any, of these simplification measures to incorporate into the final design of the GloBE rules.

379. The simplification measures that have been considered in the Inclusive Framework, include:

a. Country-by-country reporting ETR safe-harbour;

b. De minimis profit exclusion;

c. Single jurisdictional ETR calculation to cover several years; and

d. Tax administrative guidance.

380. These simplification measures could be applied at the election of the taxpayer and could be layered on top of one-another such that multiple simplification measures could be applied simultaneously. It also may be the case that different aspects of the simplification measures could perhaps be combined.

5.2. Country-by-country reporting ETR safe-harbour

381. This simplification measure would allow MNEs to leverage the work done to prepare their annual CbC report. Large MNEs are required to file a CbC report containing, among other things, certain financial information pertaining to their allocation of global profits and tax liability. A CbC report contains jurisdictional financial information in two columns that could be useful for purposes of computing jurisdictional ETRs for the GloBE rules: (i) Profit (Loss) before Income Tax; and (ii) Income Tax Accrued (Current Year).

382. This simplification measure would likely best operate as a safe-harbour. For example, if the jurisdictional ETR based on the CbC report was above a certain threshold, which could be set above the agreed minimum rate, then no further work would be required for that jurisdiction. In other words, the filing of the CbC report would be all that is required for that jurisdiction for purposes of the GloBE rules.

383. At least two restrictions would be required. First, the simplification measure would only be available for MNEs that prepare their CbC report based on the parent's consolidated financial accounts, which is an option, but not a requirement, under the CbCR rules. Based on initial consultations, a large majority of MNEs use the parent's consolidated accounts as their CbC data source. Assuming that to be the case, restricting the use of this simplification measure based on CbC data source would not be expected to materially reduce its reach and impact. Furthermore, MNEs that do not currently use the parent's consolidated accounts could change their data source and avail themselves of the simplification measure. If this simplification measure was to create an incentive for MNEs to converge to the parent's consolidated accounts as their CbC data source it would result in the attendant benefit of improving CbC risk assessment for tax administrations.

384. The second restriction is that several adjustments would need to be made which relate to differences between the financial information reported in CbC reports and the financial information required for calculating a jurisdictional ETR in accordance with the GloBE rules. Ideally, a jurisdictional ETR could be computed by simply dividing Income Tax Accrued (Current Year) by Profit (Loss) before Income Tax as reported for each jurisdiction in the CbC report. However, the unadjusted information in these two columns will not suffice for an accurate jurisdictional ETR computation. Nonetheless, adjustments could be made to produce a reasonably reliable approximation of the jurisdictional ETR, as described below.

5.2.1. Required adjustments

385. Profit (Loss) before Income Tax could be adjusted as follows:

(a) Any income or loss of non-group members reported in Profit (Loss) before Income Tax under the equity method of accounting would need to be removed;

(b) Permanent adjustments required under the GloBE rules to financial accounting income would need to be added to or subtracted from Profit (Loss) before Income Tax; and

(c) Subject to ongoing public consultation and further discussion in the Inclusive Framework, other adjustments may also be required.

386. Income Tax Accrued (Current Year) could be adjusted as follows:

(a) Withholding taxes and net basis taxes paid in respect of dividends from a group member would need to be moved from the shareholder's jurisdiction to the jurisdiction where the underlying income arose or to the distributing subsidiary's jurisdiction;

(b) CFC taxes should be assigned, where possible, to the jurisdiction in which the underlying income arises (i.e. to the jurisdiction of the CFC) and should be excluded from the ETR computation if the underlying income is excluded.1

(c) Withholding taxes paid in respect of dividends received from a corporation accounted for using the equity method would need to be removed;

(d) Covered taxes that are not income taxes for financial accounting purposes would increase Income Tax Accrued (Current Year);

(e) Refunds of tax would need to be treated as a reduction of Income Tax Accrued (Current Year); and

(f) Subject to further discussion in the Inclusive Framework, other adjustments may also be required.

387. It is possible that some of the adjustments, as described above, could be incorporated into the actual CbCR rules. However, several of the necessary adjustments may not; and they would then need to be made in addition to what is required for CbCR.

388. Notwithstanding the required adjustments described above, starting with the CbC report and making adjustments would likely be simpler for an MNE compared to the alternative of computing the jurisdictional ETR from the ground-up. MNEs already have the systems and processes in place to efficiently and reliably compile their CbCR information. Further, some of the required adjustments may not be difficult to determine. For example, it should be relatively straightforward to determine the amount of withholding taxes on dividends paid to a jurisdiction as well as the amount of income tax refunds received from a jurisdiction. Some of the other adjustments may not be necessary to compute a "conservatively-low" jurisdictional ETR.

389. One further option could be to incorporate deferred tax accounting information into the determination of an ETR safe-harbour. This option would combine the information presently provided in the CbC report with the information on the MNE's deferred tax accounting position in each jurisdiction where it operates, in order to provide a more accurate picture of the MNE's expected tax liability in each jurisdiction without the burden of computing and tracking carry-forwards and tax credits. The BEPS Action 13 report includes specific instructions that Income Tax Accrued (Current Year) "should not include deferred taxes or provisions for uncertain tax liabilities" (OECD, 2015[2]) (page 34). This is appropriate in the CbCR context as it focuses on the current tax in a jurisdiction for the fiscal year. However, in calculating an ETR for a particular jurisdiction, this can create a mismatch between the calculation of Profit (Loss) before Income Tax, which is calculated under financial accounting principles, and Income Tax Accrued (Current Year), which is essentially based on taxable profits calculated under tax rules in the relevant jurisdiction. The GloBE rules for addressing temporary differences compensate for this mismatch using carry-forwards and a tax credit mechanism. This option would eliminate the need to compute and track the carry-forwards and tax credits for jurisdictions in which the MNE consistently reports an ETR in excess of the safe-harbour ETR. Consideration would be required for instances in which the MNE is above the safe-harbour ETR for one or more prior years, but below the safe-harbour ETR in the current year and whether this would require the MNE to go back and compute its carry-forward attributes for the prior years.

390. As part of the CbCR 2020 review, consideration is being given to including movements in deferred tax as an additional column alongside Income Tax Accrued (Current Year). If an additional column is not added, the definition of Income Tax Accrued (Current Year) could potentially be amended, so as also to include movements in deferred tax.

5.3. De minimis profit exclusion

391. Another simplification measure could consist of excluding jurisdictions from the GloBE rules which have less than a certain percentage of the MNE Group's pre-tax profit. This may result in a significant reduction of compliance costs, while continuing to ensure that the GloBE rules remain effective in addressing some of the most important tax planning structures using low taxed principal or entrepreneurial IP structures.

392. Under these structures, an MNE shifts the ownership of valuable IP into a vehicle that is subject to low effective rates of taxation. The vehicle then exploits the IP and/or enters into manufacturing and/or sales and marketing arrangements with other group entities which often allow the IP vehicle to capture the full return from the exploitation of that IP. The net effect of these arrangements is that significant amounts of profits are rolled-up into the IP vehicle with the other entities in the group deriving only nominal returns.

393. The changes to the transfer pricing guidance that were introduced under Actions 8-10 of the BEPS Action Plan prevent MNEs from shifting intangible income into such IP vehicles unless they perform relevant functions in respect of the development, enhancement, maintenance, protection and exploitation of the transferred intangible (commonly referred to as DEMPE functions). The requirement imposed on the IP holding vehicle under Actions 8-10 to undertake the related DEMPE functions impedes the MNE from splitting the ownership of its valuable IP amongst a large number of different low taxed IP vehicles.[2]

394. A de minimis profit exclusion rule would build on these operational constraints imposed on MNEs by Actions 8-10. It would operate by targeting the GloBE rules at only those jurisdictions above a certain de minimis profit threshold.[3] Because IP vehicles will generally be the most profitable within the group, a low de minimis threshold, such as 2.5% of the group's pre-tax profit, would ensure the GloBE rules applied to all the MNE's IP vehicles while avoiding the compliance burden associated with applying the rule to every jurisdiction.

395. Effectively, this simplification measure puts a ceiling on the number of jurisdictional ETR calculations. For example, if the de minimis threshold were to be set at 2.5% of the group's pre-tax profit, then a maximum of 40 jurisdictional ETR calculations would be required, rather than the 100 or more calculations that may otherwise be required. In order to apply this simplification measure, MNEs would still be required to compute the pre-tax profit for every jurisdiction; however, MNEs would only need to compute covered taxes for jurisdictions with profits above the de minimis threshold. To reduce the compliance burden of computing pre-tax profit for every jurisdiction, it may be possible to use unadjusted CbC data (or potentially adjusted for the same items described in the context of the CbCR ETR safe-harbour), assuming the CbC data source was the parent's consolidated financial accounts.

396. Setting the de minimis threshold at a relatively low percentage should prevent an MNE from fragmenting its IP holdings among a large number of low tax structures in order to avoid the GloBE rules. Given the nature of the DEMPE functions required to support the transfer of the IP, it would not seem likely or commercially practical, at an operational level, for an MNE to divide its IP amongst a sufficiently large number of jurisdictions to reduce the profitability of each IP vehicle below the de minimis threshold.

397. In order to be implemented, further technical work would be required in several areas, including:

a. Whether the denominator of the de minimis calculation would be global pre-tax profit (i.e., including the parent jurisdiction) or foreign pre-tax profit (i.e., excluding the parent jurisdiction);

b. The treatment of losses, which absent an adjustment could upset the ceiling feature of the simplification measure;

c. How to best coordinate this rule with the management of temporary differences, in particular how to deal with jurisdictions that bounce in and out of scope from year-to-year;

d. Whether further rules are necessary to neutralise the risk of fragmentation; and

e. Where to set the de minimis percentage balancing simplification with other considerations, including the overall effectiveness of the GloBE rules.

398. A de minimis based simplification measure could also be structured as a fixed de minimis threshold, such as EUR 100,000, rather than a relative de minimis threshold, such as 2.5% of group profit. The benefit of the relative threshold is it puts a ceiling on the number of jurisdictional ETR calculations for every MNE whereas a fixed threshold would apply differently across MNEs and in some cases may not result in material simplification. These two approaches could also perhaps be combined, for example, the lesser of 2.5% of group profit and EUR 100,000.

5.4. Single jurisdictional ETR calculation to cover several years

399. This simplification measure would be designed to require an MNE to perform the jurisdictional ETR calculation for every jurisdiction in the base year. But, in the case that the ETR of a particular jurisdiction exceeded a certain threshold rate (in the base year or any subsequent year) then the MNE would not be required to compute the ETR for that jurisdiction for the next 3-5 years (the grace period). The threshold rate could be set above the agreed minimum rate.

400. A key element of this simplification measure would be balancing simplification with accuracy and potential for distortions. On the one hand, the grace period would need to extend for several years in order to provide material simplification. On the other hand, the longer the grace period the more likely it is to hide or overlook inaccuracies and distortions.

401. Certain restrictions would be required to make this simplification measure acceptable to governments. An example of such a restriction is to require MNEs to make an annual representation that no business change occurred over the grace period. Special anti-abuse rules may also be required. For example, rules may be needed to address situations whereby an MNE structures intercompany transactions designed to spike the ETR in the base year in order to escape the GloBE rules in the grace period. Special rules may also be needed to address situations whereby a jurisdiction could introduce a regime with balloon tax payments designed to spike the ETR in the base year, with no-tax or low-tax in the grace period.

402. A key disadvantage of this simplification measure is that MNEs would be required to establish all the necessary processes and systems in every jurisdiction in order to compute the base year ETR. Therefore, an MNE with operations in 120 jurisdictions would still be required to undertake 120 jurisdictional ETR calculations in the base year. Once an MNE has established all the necessary processes and systems, it may not be significantly more work to compute the jurisdictional ETR every year. In other words, this simplification measure may not deliver meaningful simplification.

403. If this option were to be pursued, it may be preferable to compute the base year ETR based on covered taxes and income data from multiple consecutive years rather than a single year, to safeguard against inappropriate exemptions. A multi-year approach should not be particularly onerous from a compliance perspective, since the MNE would have already configured its systems to compile all relevant data, and performed all the relevant calculations, in respect of the first year, which should facilitate doing so in respect of a multiple years.

5.5. Tax administrative guidance

404. This simplification measure seeks to reduce instances where MNEs prepare and tax administrations need to review a large number of ETR calculations that consistently show that the ETR exceeds the agreed minimum rate year-after-year. For these “low-risk jurisdictions”, tax administrations that were following a risk-based approach would eventually stop reviewing an MNE’s ETR for operations in these jurisdictions and MNEs that were required to continue determining their ETR for compliance purposes would legitimately question the associated compliance costs. Therefore, the question is whether this ex-post result could be avoided by establishing a structured and transparent ex-ante process with overall lower costs for businesses and tax administrations alike.

405. This simplification measure would establish an ex-ante process whereby tax administrations (via the Inclusive Framework) would work together with stakeholders, for instance, via a business advisory group, to identify jurisdictions where the tax base does not materially depart from the GloBE tax base (other than in areas where different accounting-tax approaches are common and low-risk, for example dividends may be taxable under local tax rules) and the tax rate is sufficiently high. For instance, this work could determine that Jurisdiction X, given its tax base and tax rate, would almost always result in an ETR above the minimum tax rate and hence absent a change in that jurisdiction’s tax rules, MNEs would enjoy a presumption that their ETR in that jurisdiction exceeded the agreed minimum rate. Further work would be required to identify all the relevant factors that would be considered in the determination process.

406. The mechanism could work such that tax administrations would publish guidance (developed within an Inclusive Framework process) that set out jurisdictions deemed to be low-risk and then MNEs would not be required to perform the ETR calculation for those jurisdictions, unless a tax authority

specifically requested it within a certain period of time, potentially by reference to the statute of limitation rules in the respective jurisdictions. If the ETR calculated at the tax authority's request was below the agreed minimum rate, the MNE would be subject to tax under the GloBE rules on the relevant income but would not be subject to underpayment or other tax penalties with respect to the income that benefitted from the presumption. To be most effective, tax administrations participating in such an ex-ante process and working alongside relevant stakeholders, could focus their effort in the period after the GloBE rules are finalized, and before the rules are effective or the first filing obligation deadline.

407. The determination of "low-risk" could apply to all MNEs operating within a certain jurisdiction, or it could be restricted to MNEs within or without certain sectors. For example, it may be the case that in a certain jurisdiction virtually every MNE is likely to be above the agreed minimum rate, except MNEs in a certain sector because of sector-specific tax incentives. In such a case, the low-risk determination could apply to every MNE, except for MNEs in that particular sector. In the case of a sectoral approach, consideration would be required for the treatment of firms that operate across multiple sectors.

408. In general, the low-risk determination would apply every year (i.e., without a time restriction), but would require a re-determination in the case of tax law revision or reform that materially changed the jurisdiction's tax base and/or tax rate. For this purpose, a notification process could be set.

409. This option may require tax authorities to dedicate significant resources to understanding the design and potential impact of different countries' tax systems. However, it is recognised that tax authorities would need to undertake a risk assessment process even in the absence of this simplification measure and that there would be benefits in terms of synergies and certainty in developing definitive guidance, and that the key challenge therefore would be to design a technical, non-political and transparent process to achieve it.

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OECD (2015), *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264241480-en. [2]

Notes

[1] See Section 3.4.2 on *Assignment of income and taxes of entity to each jurisdiction* for the approach for the treatment of CFC income and related taxes in the ETR calculation under the GloBE.

[2] Since this simplification measure relies on DEMPE concepts to protect against fragmentation risk, it would only be available in jurisdictions that follow the guidance provided in BEPS Actions 8-10.

[3] Consideration may be given to different mechanisms (e.g., profit-size threshold) to achieve a same or similar result.

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