7 Undertaxed Payments Rule

Undertaxed Payments Rule (UTPR)

The UTPR applies in respect of the income of low-tax Constituent Entities

The UTPR requires a UTPR taxpayer that is a member of an MNE Group to make an adjustment in respect of any top-up tax that is allocated to that taxpayer from a low-tax Constituent Entity of the same group.

The IIR has priority over the UTPR

No top-up tax shall be allocated under the UTPR if that low-tax Constituent Entity is controlled, directly or indirectly by a foreign Constituent Entity that is subject to an IIR which has been implemented in accordance with the GloBE rules. A top-up tax may be allocated under the UTPR from Constituent Entities located in the UPE jurisdiction if the MNE's ETR in that jurisdiction is below the agreed minimum rate.

Allocation of the top-up tax

The top-up tax is allocated to a UTPR Taxpayer in two steps as follows:

(a) First, if the UTPR Taxpayer makes any deductible payments to the low-tax Constituent Entity during the relevant period, the top-up tax of such Constituent Entity is allocated to the UTPR Taxpayer in proportion to the total of deductible payments made to that entity by all UTPR Taxpayers;

(b) Second, if the UTPR Taxpayer has net intra-group expenditure, in proportion to the total amount of net intra-group expenditure incurred by all UTPR Taxpayers.

The top-up tax allocated to a UTPR Taxpayer under each step is limited to an amount equal to the domestic covered tax rate multiplied by the gross amount of deductible intragroup payments taken into consideration in calculating its portion of top-up tax.

No top-up tax is allocated to UTPR Taxpayers that are located in jurisdictions where the MNE's jurisdictional ETR is below the agreed minimum rate.

Maximum amount of top-up tax that can be allocated under UTPR

The total top-up tax allocated under the UTPR from all low-tax Constituent Entities located in the UPE jurisdiction cannot exceed the top-up tax percentage multiplied by the total amount of deductible intragroup payments received by these low-tax Constituent Entities from foreign Constituent Entities.

Definition of UTPR Taxpayer

A UTPR taxpayer is any Constituent Entity that is located in a jurisdiction that has implemented the UTPR in accordance with the GloBE rules (a UTPR Jurisdiction).

Adjustment to be made under the UTPR

A taxpayer that is allocated top-up tax under the UTPR shall be denied a deduction for an intra-group payment or required to make an equivalent adjustment under domestic law that results in the taxpayer having an incremental tax liability equal to the allocated top-up tax amount.

7.1. Overview

457. The Undertaxed Payments rule (UTPR) has the same general purpose as the income inclusion rule (IIR). More specifically, the policy rationale of the UTPR is to protect jurisdictions against base erosion through intra-group payments to low-taxed entities while ensuring that, in aggregate, the application of the GloBE rules does not result in the MNE Group being subject to tax on its income in those jurisdictions where it operates in excess of the minimum rate. While the IIR and the UTPR have the same general purpose they have a different function and operate in a very different way. The IIR provides for a mechanism to collect the top-up tax based on a Parent's[1] direct or indirect ownership of the low-tax Constituent Entities. The UTPR serves, in part, as a backstop to the IIR and reduces the incentives for tax driven inversions by providing a mechanism for making an adjustment in respect of any remaining top-up tax in relation to profits of a Constituent Entity that is not in scope of an applicable IIR. The UTPR also has the purpose of addressing base erosion through deductible intra-group payments. By operating as a backstop and targeting base eroding payments the UTPR serves a hybrid purpose and different aspects of the rules in this chapter may serve one or the other purpose, depending on the situation. The UTPR operates through an allocation key that is based on, and therefore limited in its application to the extent of, intra-group payments.

458. Because the UTPR has the potential to apply in any jurisdiction where a Constituent Entity makes an intra-group payment and because the outcomes under UTPR will vary based on the amount of intra-group payments made by each entity, the UTPR is a more complex rule to apply and requires a greater amount of co-ordination between jurisdictions than the IIR. In practice, however, the scope for the application of the UTPR is expected to be relatively narrow. This is because the UTPR only applies to the income of a low-tax Constituent Entity when that low-tax Constituent Entity is not otherwise subject to an IIR that is implemented in accordance with the GloBE rules under the laws of another jurisdiction.[2] To simplify both the compliance with and the administration of the GloBE rules the taxpayer has the opportunity under the UTPR compliance procedures, described in Section 7.8 below, to certify that the UTPR does not apply because, for example, there are no low-tax Constituent Entities within the MNE Group or that all these entities are under the control of another Constituent Entity that applies an IIR that has been implemented in accordance with the GloBE rules.

7.2. The IIR has priority over the UTPR

459. The top-up tax computed in relation to the MNE's profits is either collected through the application of the IIR in a "Parent jurisdiction" or gives rise to a corresponding adjustment under the UTPR in a "UTPR jurisdiction". As mentioned previously, the IIR takes priority over the UTPR. Therefore, no top-up tax may be treated as giving rise to an adjustment under the UTPR in respect of a Constituent Entity that is controlled, directly or indirectly by a foreign Constituent Entity that is subject to an IIR in accordance with the GloBE rules. When the UTPR applies, the UTPR of several other jurisdictions could, however, apply in relation to the income of a single low-tax Constituent Entity and this Chapter explains how these UTPRs are to be coordinated so as to minimise complexity and avoid double taxation.

7.2.1. Interaction between IIR and UTPR when IIR applied at level of Intermediate Parent

460. In the situation where no IIR applies at the Ultimate Parent Entity (UPE) level, the IIR can apply at a sub-holding level.[3] Under these circumstances, and as discussed in Chapter 6 above, it is possible that the low-tax Constituent Entities located in a given jurisdiction are not all owned by the same Parent applying the same IIR. In this situation, some of the low-tax Constituent Entities will be within the scope of an applicable IIR while others may be in the scope of the UTPR. An example of this structure is illustrated in Example 6.3.1A. Whether the income of a low-tax Constituent Entity is covered by an IIR or a UTPR is therefore determined on an entity-by-entity basis, for each of these low-tax Constituent Entities. The test for determining whether the IIR will be the mechanism for taxing the income of a low-tax Constituent Entity (or whether that amount gives rise to an adjustment under the IIR) is based on a control test. The low-tax income of a Constituent Entity will be subject to adjustment under the IIR where there is another Constituent Entity in the ownership chain that controls this low-tax Constituent Entity and is subject to the IIR. Where there is no such Constituent Entity in the ownership chain, then that amount gives rise to an adjustment under the UTPR. Therefore the determination of whether the UTPR applies to the profits of a low-tax Constituent Entity should generally be a binary one that depends on whether or not such low-tax Constituent Entity is controlled by another foreign Constituent Entity that is subject to an IIR in accordance with the GloBE rules.

7.2.2. Excluding IIR tax imposed by a minority shareholder

461. It is expected that in most cases either the low-tax Constituent Entities will be controlled by another Constituent Entity that is subject to the IIR (and the UTPR will not apply) or their shares will be wholly owned by other Constituent Entities that are not subject to an IIR (and the UTPR will apply). There may be situations, however, where no Constituent Entity that controls the low-tax Constituent Entity is subject to an IIR but a foreign Constituent Entity owns a minority interest in the low-tax Constituent Entity and applies the IIR in respect of its (minority) share of the income of such low-tax Constituent Entity, as described in Section 6.3.1. The UTPR applies under such circumstances, because the low-tax Constituent Entity is not controlled, directly or indirectly, by another Constituent Entity in another jurisdiction which applies an IIR.[4]

462. To avoid taxation of the same low-tax income both in the hands of the UTPR Taxpayers and of the Constituent Entity that applies the IIR (because of the minority interest it owns in the low-tax Constituent Entity), the top-up tax allocated under the UTPR excludes the portion of the top-up tax that has already been imposed under the IIR.[5] This mechanism ensures that the IIR has priority over the UTPR, while avoiding multiple taxation of the same low-tax income as a result of the GloBE rules.

7.2.3. Application of the UTPR to low-tax profits in the UPE Jurisdiction

Low-tax outcomes in the UPE jurisdiction

463. When the IIR and UTPR are introduced into domestic law, they will *not* apply to capture the domestic low-tax income from the perspective of the taxpayer (i.e. low-tax profits that arise in the same jurisdiction as the taxpayer). These domestic low-tax profits will however be covered by the rules of Constituent Entities located in other jurisdictions.

464. In the case of a subsidiary that is located in a different jurisdiction than its Ultimate Parent Entity, the jurisdictional scope of the UTPR will therefore include low-tax income that arises in the jurisdiction of the Ultimate Parent Entity in a relevant period. This application of the UTPR results from the fact that:

a. the profits made in the jurisdiction of the Ultimate Parent Entity are out of scope of any applicable IIR since any IIR that would apply in the parent jurisdiction would only cover “foreign” profits, i.e. profits made in all other jurisdictions than the parent jurisdiction, and

b. the jurisdiction of the Ultimate Parent Entity is a foreign jurisdiction from the perspective of the subsidiary jurisdiction applying the UTPR.

465. Therefore, in the situation where (i) the ultimate parent jurisdiction has implemented an IIR in accordance with the GloBE rules and (ii) the MNE's jurisdictional ETR falls below the minimum rate in the ultimate parent jurisdiction for a given period, both the IIR and the UTPR could apply within the group, but they would not apply in relation to the same low-tax income. The IIR would cover the MNE's low-tax income in all the subsidiary jurisdictions, while the UTPR only would apply to the profits made in the jurisdiction of the Ultimate Parent Entity ('the UPE jurisdiction'), and only if the MNE's jurisdictional ETR is below the agreed minimum rate in such jurisdiction in a relevant period.

Policy and design questions

466. The UPE jurisdiction is not expected to apply the IIR to its own domestic companies therefore, strictly from a technical perspective, the UTPR does not operate as a backstop to the IIR in this context but rather directly addresses the risk of base erosion in those cases where the UPE jurisdiction is subject to tax at below the minimum rate. Applying the UTPR to low tax profits of the UPE jurisdiction raises a number of policy and design challenges that do not arise when the rule is applied to subsidiaries of the MNE group. The application of the UTPR to the UPE jurisdiction could have a disproportionate impact on certain MNE Groups with de-minimis foreign operations. These adverse consequences could apply in circumstances where the UPE cannot structure out of the additional tax and compliance costs associated with the application of the UTPR by bringing itself within the scope of the IIR. Some of these challenges are addressed through the use of caps as discussed in Section 7.5.2 below. Technical work will explore further options for addressing these challenges. This could include options such as a credit for UTPR taxes paid due to timing differences in the UPE jurisdiction and a top-up tax mechanism for in-scope taxpayers.[6] The outcomes from this work will be incorporated into the development of model rules as described in Section 10.5.1.

7.3. Calculation of the top-up tax

467. The UTPR uses the same mechanics as the IIR for determining the MNE's jurisdictional ETR and the amount of top-up tax allocable under the rule. This includes the same definition of covered taxes and the application of any substance based carve-out.[7] Equally, the exclusions to the definition of Constituent Entity (for example, in respect of government entities) would apply under the UTPR and no top-up tax would arise, or be allocable under the UTPR, in respect of these entities.[8] Equally, the application of loss carry-forwards and excess taxes used to address timing differences apply in the same way to determine the ETR of each jurisdiction under both the IIR and UTPR.

468. Example 4.2.1A illustrates the application of a local tax carry-forward rule. In that example, a subsidiary pays excess taxes of 40 in year 1 which creates a local tax carry forward in that amount (assuming that this subsidiary is the only Constituent Entity in the relevant jurisdiction). While the subsidiary paid less than the minimum rate on its GloBE tax base in the subsequent year, it can carry forward the excess tax paid to increase its tax expense in year 2 up to the minimum rate. Accordingly, there would be no top-up tax liability under either the IIR or the UTPR in relation to this subsidiary's profits in year 2. Similarly, the loss carry-forward mechanism described in Section 4.2 would apply for the purpose of calculating the top-up tax under the UTPR.

469. Having the same mechanism to compute the top-up tax under the IIR and the UTPR improves co-ordination and reduces implementation and compliance costs, while ensuring that any adjustment does not result in over-taxation or in taxation in excess of economic profits. In addition, using the same top-up tax calculation mechanic under both the IIR and the UTPR aligns the expected outcomes under both rules, which allows the UTPR to operate as a meaningful backstop to the IIR, subject to certain limitations in

recognition of the UTPR's additional purpose of targeting base erosion outcomes. In order to operate as a meaningful backstop to the IIR, the UTPR needs to apply in situations where the IIR would have applied if it was introduced in the Parent jurisdiction. Failing to align the mechanics for computing the top-up tax under both the IIR and the UTPR would either lead to less effective or harsher outcomes under the UTPR than under the IIR. For instance, a rule that only applied to direct payments made to recipients located in jurisdictions that have a nominal CIT rate that is below the agreed minimum rate would be less effective than the IIR. On the other hand, a rule that would fail to apply the same blending approach, the same substance based carve-out and mechanisms to address timing differences as provided under the GloBE rules could produce outcomes that are harsher than those provided for under the IIR.

470. The UTPR uses the same calculation mechanic as the IIR to determine the corresponding amount of top-up tax allocable in relation to the profits in scope of the rule. Thus, for example, a withholding tax paid in relation to a particular payment made by a UTPR Taxpayer is taken into account for the computation of the ETR of the jurisdiction where the recipient Constituent Entity is located and does not reduce the amount of top-up tax allocated to this taxpayer under the UTPR. In accordance with the methodology described in Section 4.4, the amount of top-up tax that is allocable under the UTPR is determined in respect of each Constituent Entity located in a jurisdiction where the MNE's jurisdictional ETR is below the minimum rate (the "low-tax Constituent Entity"). The top-up tax attributed to a low-tax Constituent Entity under this mechanic is then allocated amongst the UTPR Taxpayers in accordance with the mechanisms set out in Section 7.4 below.

7.4. Allocation of the top-up tax

471. The top-up tax is allocated among entities that are subject to a UTPR in their jurisdiction. In general, the allocation of the top-up tax does not entail taxation of the profit of one entity in the hands of another. Rather the allocation of top-up tax operates as a co-ordinated way to connect the deductible intragroup payments made in one jurisdiction with low-tax outcomes in another jurisdiction. This connection is not, however, made by tracking through chains of intra-group deductible payments in order to connect the payment made by one Constituent Entity with the low tax outcomes of another. Rather the allocation keys applied by the UTPR apply an aggregate, proportionate approach that takes into account:

a. base-eroding intra-group payments made by those Constituent Entities within the MNE Group that are subject to the UTPR;[9] and

b. low-tax outcomes arising in those jurisdictions where that income is not subject to an IIR.

472. The UTPR then allocates the top-up tax arising in the low tax jurisdiction against the base eroding intra-group payments on a proportionate basis using a mechanical rule that is common to each jurisdiction applying the UTPR. To ensure a coordinated application of the rule, this allocation requires a common definition of its key components. This Section focusses on the design and the mechanics of the allocation keys, and the definition of the factors taken into account for the computation of the allocation keys (i.e. intra-group payments).

7.4.1. Overview – two-step approach

473. The top-up tax is allocated to a UTPR Taxpayer that is a member of the same MNE Group as the low-tax Constituent Entity as follows:

- First, if the UTPR Taxpayer makes any deductible payments to the low-tax Constituent Entity during the relevant period, the top-up tax that applies to the income of such Constituent Entity is allocated in proportion to the total of deductible payments made directly to the low-tax Constituent Entity by all UTPR Taxpayers;

- Second, if the UTPR Taxpayer has net intra-group expenditure, the remaining top-up tax is allocated in proportion to the total amount of net intra-group expenditure incurred by all UTPR Taxpayers.

Both allocation keys apply on a period by period basis. Section 7.7 describes the rules used to determine the timing in the recognition of these payments.

7.4.2. Purpose and design of the allocation keys

474. A two-step approach based on related party payments and expenditures is consistent with the hybrid function of the UTPR. The UTPR is designed to operate as a back-stop to the IIR while also providing jurisdictions with a tool to protect themselves from the effect of base eroding transactions.

Purpose and design of the first allocation key

475. The first allocation key allocates the top-up tax to entities that make direct payments to a low-tax Constituent Entity. This allocation key ensures that the UTPR allocates top-up tax in priority to those jurisdictions where there is a readily identifiable and direct connection between the payment and shifting of intra-group profit. An allocation key that prioritises adjustments in respect of deductible intra-group payments made directly to a low-tax Constituent Entity is designed to capture the most obvious and straight-forward intra-group profit stripping arrangements. Direct payments to a low-tax Constituent Entity are the easiest to identify, which limits the number of potential adjustments under the rule and makes the rule simpler from a compliance and administration perspective.

Purpose and design of the second allocation key

476. Adjustments made under the first allocation key may not result in an allocation of the full amount of top-up tax. In such a case, the remaining top-up tax, after the application of the first allocation key, is allocated to the UTPR Taxpayers under the second allocation key in proportion to their net intra-group expenditures.

477. The second allocation key fulfils part of the UTPR's function in providing a back-stop to the IIR and seeks to neutralise any advantage an MNE Group may obtain from structuring around the first allocation key. A rule that allocated the top-up tax only in proportion to direct payments made by UTPR Taxpayers could be circumvented by routing intercompany transactions through an entity that is not subject to the UTPR so that there are no direct payments made to any low-tax Constituent Entity from a UTPR Taxpayer. The second allocation key provides a relatively simple way to address these conduit structures by allocating a proportionate share of the top-up tax of a low tax Constituent Entity against a Constituent Entity's net related party expenditure without the need to trace the destination of all the payments made by UTPR Taxpayers within the MNE Group.

478. The second allocation key is therefore intended in part to operate as a backstop to the first one by targeting intragroup funding structures that indirectly shift profit into low-tax jurisdictions. It further, however, operates as a simplified anti-conduit rule that uses a fungibility of money approach that effectively deems the amount of net profit shifted out of each UTPR Taxpayer as funding a proportionate share of the remaining low-tax profit on the MNE without having regard to the specificities of intra-group payment flows. This proxy is premised on the supposition that profit shifting risks are generally greater for those entities that have net related party expenditure and is generally expected to have the effect of pushing the taxing obligation into those entities that derive a more significant proportion of their income from third party sales. The second allocation key does not require the tax administration to establish a connection between an item of deductible expenditure and a pool of low tax income. The second allocation key aggregates the remaining pools of low tax income and allocates them in proportion to net related party expenditures. This aggregate / proportional approach seeks to protect the integrity of the GloBE outcomes while striking a

balance between a rule that is comprehensive and relatively simple to apply and avoiding the complexity associated with tracking flows of intragroup payments through chains of connected intragroup payments. In practice the net related party expenditure actually incurred by an entity may be manipulated. An MNE Group could seek to reduce net related party expenditure of a particular UTPR Taxpayer by pushing third party expenditure into that entity (such as interest on a bank loan) and recharging that expense intra-group (such as through a loan to another group member). However, provided there is a critical mass of jurisdictions that have adopted the UTPR, the effect of such a strategy may simply be to shift the resulting liability under the UTPR to another entity or jurisdiction.

479. The second allocation key, when applied in combination with the first one, operates as an effective backstop to the IIR without triggering the risk of over-taxation since it can only result in an adjustment to the extent that a top-up tax was computed in the first place, as explained in Section 7.3.

7.4.3. Mechanics of the allocation keys

Mechanics of the first allocation key based on direct intra-group payments

480. Perhaps the simplest way of shifting profit from a high-tax to a low-tax jurisdiction is to make an intra-group deductible payment from a high-tax to a low-tax entity. The first allocation key, which allocates the top-up tax in proportion to deductible intra-group payments made directly by UTPR Taxpayers to such entities, therefore aims at neutralising one of the most obvious ways of shifting profits into such jurisdictions.

481. For the first allocation key, the payments that are taken into consideration are the payments made directly by a UTPR Taxpayer to a low-tax Constituent Entity (i.e. a Constituent Entity located in a jurisdiction where the MNE's jurisdictional ETR is below the agreed minimum rate). Each UTPR Taxpayer is allocated a portion of the top-up tax that is computed in relation to the income of each low-tax Constituent Entity on an entity-by-entity basis in accordance with the following formula:

$$\frac{\textit{Direct intragroup payments from UTPR Taxpayer A to Low Tax Constituent Entity Z}}{\textit{All direct intragroup payments from all UTPR Taxpayers of the group to Low Tax Constituent Entity Z}}$$

482. For the purpose of this formula:

- "Direct intragroup payments from UTPR Taxpayer A to low-tax Constituent Entity Z" is the amount of deductible intra-group payments made directly by UTPR Taxpayer A to the low-taxed Constituent Entity Z; and
- "All direct intragroup payments from all UTPR Taxpayers of the group to low-taxed Constituent Entity Z" is the sum of all deductible intra-group payments made directly by any UTPR Taxpayer in the group to that entity.

Example 7.4.3A provides an illustration of the operation of the first allocation key.

Mechanics of the second allocation key based on net intra-group expenditure

483. The application of the first allocation key may not be enough to achieve the function of the UTPR as a backstop to the IIR. First, a low-tax Constituent Entity may not be in direct receipt of any payments received from UTPR Taxpayers, and in such circumstances, no top-up tax at all would be allocated to any UTPR Taxpayers under the first allocation key.[10] Second, even when direct payments are made, the top-up tax allocated to UTPR Taxpayers that made direct payments may be limited by the operation of the caps described below and some top-up tax would then remain unallocated.[11]

484. For those situations where a top-up tax is identified but is not (fully) allocated under the first allocation key, a second allocation key applies after the first one and allocates any remaining top-up tax. This second allocation key allocates such remaining top-up tax to UTPR Taxpayers in proportion to their

net intra-group expenditures. The UTPR Taxpayers with net related-party income are therefore excluded from this second allocation key.

485. For the second allocation key, all payments and receipts to and from other Constituent Entities (both domestic and foreign Constituent Entities) are taken into consideration in order to determine a UTPR Taxpayer's net intra-group expenditure. The payments taken into account for the first allocation key are included for the purpose of the second allocation key when they both apply. Including all deductible payments is simpler from a compliance and administration perspective. Including both foreign and domestic payments recognises that payments made to another UTPR Taxpayer (even if it is resident or established in the same jurisdiction) can be used as a conduit to fund the low-tax profits of an offshore entity.[12] Each UTPR Taxpayer is allocated a portion of the total remaining top-up tax that was not allocated under the first allocation key, in accordance with the following formula:

$$\frac{Net\ intragroup\ expenditure\ of\ UTPR\ Taxpayer\ A}{Sum\ of\ all\ net\ related\ party\ expenditure\ of\ UTPR\ Taxpayers}$$

486. For the purpose of this formula:

- "Net intra-group expenditure of UTPR Taxpayer A" is the difference between: (i) the sum of all deductible intra-group payments made by UTPR Taxpayer A and (ii) the sum of all related party income derived by such UTPR Taxpayer from deducible intra-group payments made by other Constituent Entities of the MNE Group, when such difference is positive; and
- "Sum of all net intra-group expenditure of UTPR Taxpayers" is the sum of all net intra-group expenditure of any UTPR Taxpayers.

487. Example 7.4.3B provides an illustration of the operation of the second allocation key. Example 7.4.3C provides an illustration of the operation of the second allocation key when one UTPR taxpayer has net related party income.

No allocation of top-up tax to a low-tax Constituent Entity

488. Among those entities that are subject to a UTPR, the allocation of the top-up-tax is limited to those Constituent Entities located in jurisdictions where the MNE's jurisdictional ETR is at or above the agreed minimum rate. In other words, no top-up tax is allocated under the UTPR to low-tax Constituent Entities.[13] When a low-tax Constituent Entity is not allocated any top-up tax, both the direct payments made by and the net intra-group expenditure of such low-tax Constituent Entity are disregarded for the application of the allocation key under the UTPR. Example 7.4.3D provides an illustration for this specific feature.

489. The MNE's jurisdictional ETR in a jurisdiction where it has suffered a loss for GloBE purposes is not computed (as it has no income in that jurisdiction). Allocating top-up tax to Constituent Entities located in jurisdictions where the MNE has suffered losses is justified as jurisdictions may be in a loss position because of base eroding transactions. For the purpose of applying the UTPR, Constituent Entities that are located in a jurisdiction where the MNE has suffered losses are not considered as low-tax Constituent Entities and therefore may apply the UTPR, provided a mechanism is applicable in that jurisdiction to impose, if necessary, an incremental amount of tax on loss-making companies as a result of the application of the UTPR in that jurisdiction.[14] This latter mechanism may not be necessary in practice if the relevant UTPR taxpayers that are allocated top-up tax are profitable whereas other Constituent Entities in the UTPR jurisdiction have incurred a loss.

490. The restriction on allocating top-up tax to Constituent Entities in low tax jurisdictions simplifies the application of the rule. In particular it prevents a cross-allocation of top-up tax between two low tax jurisdictions. The restriction prevents top-up tax being allocated away from high tax jurisdictions (where the profit shifting risks are greater) towards low tax jurisdictions, contrary to the purpose of the rule. Allocating top-up tax to low-tax jurisdictions could also undermine the effectiveness of the rule as a back-

stop to the IIR if it resulted in top-up tax being allocated to a Constituent Entity that is unable to make an equivalent adjustment under its domestic UTPR mechanism.

491. Jurisdictions that introduced the UTPR may, for a given MNE Group and a given year, be a jurisdiction where an MNE's jurisdictional ETR is below the agreed minimum rate due to the operation of certain tax incentives or other specific features in the tax system that result in the MNE's operations in that jurisdiction being subject to an ETR falling below the agreed minimum rate in a certain period. However, jurisdictions that wish to ensure that they can apply the UTPR in every year could ensure the jurisdictional ETR of every MNE operating in their jurisdictions is at least at the agreed minimum rate by introducing an annual domestic minimum tax on income with the same tax base and tax rate as the GloBE rules. Introducing such a minimum tax on income would make the exclusion ineffective for their jurisdiction.

7.4.4. Identification of intra-group payments

Overview

492. Both the amounts of payments and of net intra-group expenditure taken into account for the application of the UTPR are identified at the level of each UTPR Taxpayer. This Section provides more details on the identification of the amounts of intra-group payments taken into account for the purpose of the allocation keys of the UTPR.

Definition of deductible payments

493. A consistent and coordinated application of the UTPR requires a common definition of which payments are to be taken into account in applying the allocation keys. Building on the definition of deductible payments used in the BEPS Action 2 Report (OECD, 2015[1]), the definition of payments for the UTPR covers any expenditure that is paid or payable (including in respect of any future or contingent obligation to make a payment) during the relevant period. Payments are taken into account on an accrual basis.[15] The definition includes all current expenditure and receipts including rents, royalties, interest and fees paid for services and would also include amounts included as inventory costs.

494. The definition of payment only includes, however, payments that are generally deductible under the tax laws of the payer jurisdiction. Payments that do not meet the general criteria for being deductible in the jurisdiction where the payer is located are disregarded. For this purpose, specific limitations on deductibility or the application of anti-abuse provisions are not taken into account. If a payment meets the general criteria for being deductible in the jurisdiction where the payer is located, then the full amount of this payment is used for the allocation key. This approach could result in a top-up tax being allocated to a UTPR taxpayer for the full amount of a payment that is otherwise subject to deduction limitations under other rules that are applicable in the relevant jurisdiction, such as interest limitation or anti-avoidance rules for instance.[16] Adjusting the allocation to reflect specific limitations on deductibility of certain payments would not be consistent with the overall design of the UTPR. While the allocation keys are based on intragroup payments, they are intended to be readily comparable proxies for profit shifting rather than providing an accurate measure of the actual tax saved by each UTPR Taxpayer in respect of such payments. For example, the allocation keys are not adjusted for other factors that have a direct bearing on profit shifting such as the tax rate at which they were actually deducted. In addition, measuring the extent to which each payment effectively eroded the tax base of the UTPR Taxpayer would represent significant compliance and administration costs as well as increase the risk of disputes among jurisdictions.

Identification of intra-group payments and net intra-group expenditure

495. Intra-group payments are any deductible payments made by a Constituent Entity to another Constituent Entity of the MNE Group.[17] The net intra-group expenditure of a Constituent Entity is the

positive difference (if any) between: (i) the sum of all deductible intra-group payments made by such Constituent Entity to other Constituent Entities of the MNE Group and (ii) the gross amount of income derived by such Constituent Entity from deductible intra-group payments made by other Constituent Entities of the MNE Group.

496. Both the intra-group payments used for the first allocation key and the net intra-group expenditure of a Constituent Entity used for the second allocation key are identified on the basis of the information available in its financial books and records (adjusted for items that are not generally deductible under the laws of the payer jurisdiction).[18] For the purpose of the first allocation key, intra-group payments are identified on the basis of the financial books and records of the Constituent Entities located in the jurisdictions where the MNE's jurisdictional ETR is below the minimum rate.[19] In practice, these intra-group payments correspond to the related party revenues that these entities receive from UTPR Taxpayers. For the purpose of the second allocation key, the net intra-group expenditure of each UTPR Taxpayer is determined on the basis of income and expenses that are identified in each taxpayer's financial books and records.[20] The flow of intra-group payments will change from one period to the next so that, in different years, top-up tax may be allocated to different jurisdictions in each year depending on the mixture of net related party expenditures in that year. In order to provide certainty for MNE Groups in applying the rule on a consistent basis and to prevent the need for subsequent adjustments, the income and expenses that are identified in each taxpayer's financial books and records for the relevant period will be treated as definitive for the purposes of determining the allocation of top-up tax under the allocation keys.

Application of the UTPR to deemed payments made by or to permanent establishments

497. As explained in Section 2.2.2, permanent establishments are treated as separate Constituent Entities for the purpose of the GloBE rules. Deemed or notional payments from a permanent establishment to its head office or from the head office to its permanent establishment, as well as deemed payments between permanent establishments of the same head office that are recognised for tax purposes should be included in the definition of payments, provided they meet the general criteria for being deductible in the payer jurisdiction.[21] This applies to payments taken into account under either the first allocation key or the second allocation key.

7.5. Maximum amount of top-up tax that can be allocated (caps)

498. The UTPR is designed to operate as a backstop to the IIR. As such, the aggregate adjustments made under the UTPR in each jurisdiction cannot exceed the amount of top-up tax that is necessary to bring the MNE's ETR up to the minimum rate in each jurisdiction the MNE operates. In addition to the overall cap on the adjustments that can be made under the UTPR there are two further caps:

a. The first cap applies to the amount of top up tax that can be allocated to a UTPR Jurisdiction and it is based on the domestic covered tax rate applicable in that jurisdiction;

b. The second cap limits the total top-up tax that can be allocated in respect of the low tax income of the UPE jurisdiction and is based on the gross amount of deductible intra-group payments.

499. These two caps are described in further detail below.

7.5.1. Limitation on top-up tax allocable to a UTPR Jurisdiction

500. The first cap is applied by the jurisdiction making the adjustment under the UTPR. The total amount of top-up tax that can be allocated under the first allocation key in respect of direct payments to a low tax Constituent Entity cannot exceed the domestic covered tax rate applicable in the jurisdiction of the UTPR

Taxpayer[22] multiplied by the amount of the deductible direct payments that are taken into account to apply the rule (numerator of the first allocation key).

501. The second allocation key allocates the amount of top-up tax between UTPR Taxpayers in proportion to the amount of their net related party expenditure. The total amount of top-up tax that is allocated in respect of this allocation key is also subject to a limitation. This top-up tax cannot exceed the domestic covered tax rate applicable in the jurisdiction of the UTPR Taxpayer[23] multiplied by the gross amount of the deductible intragroup payments that are taken into account to apply the rule (without deducting intragroup income). These payments are all intragroup payments made by UTPR Taxpayers, except those that were already taken into account for computing the cap under the first allocation key.

7.5.2. Limitation of top-up tax that can be allocated from UPE jurisdiction

502. The low-tax Constituent Entities located in the subsidiary jurisdictions can be covered either by the IIR (in priority) or the UTPR (as a secondary mechanism) however the low-tax income of the Constituent Entities located in the UPE jurisdiction cannot be subject to any IIR, and only the UTPR can apply in respect of such low-tax income. As the entity at the top of the ownership chain, the UPE cannot structure itself out of the UTPR and into the IIR in order to limit compliance costs or access the full benefits of timing adjustments such as the IIR tax credit. This may leave the MNE that is headquartered in a low tax jurisdiction with a proportionately larger tax burden than a subsidiary of an MNE Group operating in the same jurisdiction. As explained above, a domestic minimum tax on income, however, could be introduced in the jurisdiction of the UPE for in-scope taxpayers. Such a domestic minimum tax on income would aim at ensuring that the MNE's jurisdictional ETR in the ultimate parent jurisdiction is at least equal to the agreed minimum rate and would prevent the application of the UTPR in other jurisdictions in relation to profits made in the ultimate parent jurisdiction.

503. The application of the UTPR to the parent may have a disproportionate impact on certain MNE Groups that have little foreign operations outside the UPE Jurisdiction. Where the UPE is subject to a low level of taxation in the parent jurisdiction then its limited offshore operations could be significantly and adversely impacted by the application of the UTPR, potentially making it uneconomic for the group to expand offshore. The application of the UTPR could be triggered even in those cases where low-tax domestic profits of the Parent do not raise any BEPS risks. Therefore, the cap discussed in this section is designed to mitigate the impact of the UTPR on the UPE jurisdiction by limiting the application of the UTPR in these cases to the foreign intragroup income of the Constituent Entities located in the UPE jurisdiction. The cap applies when the low-tax income in the UPE jurisdiction exceeds the total amount of intragroup payments received by all Constituent Entities located in the UPE jurisdiction.

504. This cap limits the total amount of top-up tax to be allocated ("allocable top-up tax") in respect of the UPE Jurisdiction by reference to the foreign intra-group revenue of all Constituent Entities located in that Jurisdiction. The basis for computing the top-up tax allocable in respect of low-tax outcomes arising in the UPE Jurisdiction is therefore the minimum of:

- the GloBE income of the Constituent Entities located in the UPE Jurisdiction, computed in accordance with the rules described in Chapters 3 and 4, and
- the total amount of foreign intragroup revenue of all Constituent Entities located in that jurisdiction.

Calculation of the limited amount of top-up tax when the cap applies

505. When the GloBE income of the Constituent Entities located in the UPE Jurisdiction that is computed in accordance with the rules described in Chapters 3 and 4 exceeds the total amount of foreign intragroup revenue of all Constituent Entities located in that jurisdiction, the maximum top-up tax allocable in respect of the Ultimate Parent Jurisdiction is computed as per the following formula:

$$Top\ up\ Tax\ Percentage\ x\ Foreign\ intragroup\ revenue\ of\ all\ LTCE\ in\ the\ Ultimate\ Parent\ Jurisdiction$$

506. For the purpose of this formula:

- "Top-up Tax Percentage" means the difference between the minimum ETR and the ETR as calculated for that jurisdiction in the relevant period under the GloBE rules after adjusting for any excess taxes in that jurisdiction (same as for the general case described above); and
- "Foreign intragroup revenue of all LTCE in the Ultimate Parent Jurisdiction" is the sum of intra-group revenue received from any foreign Constituent Entity (including UTPR Taxpayers and other Constituent Entities) by all low-tax Constituent Entities located in the UPE jurisdiction (see further details below).

507. For the purposes of determining the amount of Foreign intra-group revenue of all low-tax Constituent Entities, all foreign intragroup sources of revenue would be taken into account, regardless of whether the payer was a UTPR Taxpayer or not. The Foreign Intragroup revenue is identified in accordance with the rules described Section 7.4.4 on the identification of intragroup payments.[24] This revenue would not include, however, domestic revenue (both intragroup and third party) or foreign third party sources of revenue. In order to avoid MNEs structuring their intragroup transactions to maximise the effect of this limitation, the rule could contain an anti-avoidance feature that treated an MNE that made direct sales from a low-tax jurisdiction to customers using related party agency structures including commissionaire arrangements (rather than buy-sell structures) as making those sales through a buy/sell company (and thereby recognising a payment to a low-tax Constituent Entity, which would decrease the impact of the cap). Further technical work will be necessary to explore the need for a targeted rule that provides for appropriate outcomes without imposing undue compliance or administrative burdens. Example 7.5.2A provides an illustration of the operation of this limitation.

508. When such a cap applies, the maximum amount of top-up tax is computed on an entity-by-entity basis, similarly to what is described above under the general case. Therefore, when the cap applies, the Adjusted GloBE income of each low-tax Constituent Entity subject to the UTPR is further adjusted, in accordance with the following formula:

$$\frac{Adjusted\ GloBE\ income\ of\ LTCE\ A}{Adjusted\ GloBE\ income\ of\ all\ LTCE}\ x\ Foreign\ intragroup\ revenue\ of\ all\ LTCE$$

509. For the purpose of this formula:

- "Adjusted GloBE income LTCE A" is the Adjusted GloBE income of a given low-tax Constituent Entity (A)
- "Adjusted GloBE income of all LTCE" is the sum of all Adjusted GloBE income of all low-tax Constituent Entities in the UPE jurisdiction, irrespective of the source of such income; and
- "Foreign intragroup revenue of all LTCE" is the sum of intra-group revenue received from any foreign Constituent Entity (including UTPR Taxpayers and other Constituent Entities) by all low-tax Constituent Entities located in the UPE jurisdiction (see further details above).

510. The amount of top-up tax that is allocable under the UTPR in respect of a low-tax Constituent Entity would then be equal to:

$$Adjusted\ GloBE\ Income\ of\ low\ tax\ Constituent\ Entity\ A\ after\ limitation\ x\ Top\ up\ Tax\ Percentage$$

511. For the purpose of this formula:

- "Adjusted GloBE Income of low tax Constituent Entity A after limitation" is the Adjusted GloBE income of a given low-tax Constituent Entity (A) after it has been further adjusted as per the mechanism described above; and

- "Top-up Tax Percentage" means the difference between the minimum ETR and the ETR as calculated for that jurisdiction in the relevant period under the GloBE rules after adjusting for any excess taxes in that jurisdiction (same as for the general case described above).

Impact of the cap on the UTPR

512. The UTPR is designed to operate as a back-stop to the IIR while also providing jurisdictions with a tool to protect themselves from the effect of base eroding transactions. This cap on the amount of tax that can be allocated in respect of the jurisdiction of the Ultimate Parent strikes an appropriate balance between these two functions.

513. First, this cap does not affect the ability of the UTPR to operate as a backstop to the IIR because it only applies in respect of low-tax income of Constituent Entities that are located in the Ultimate Parent Jurisdiction. The UTPR still mirrors the outcomes of the IIR in respect of low-tax outcomes arising in subsidiary jurisdictions. Therefore, the cap still reduces the incentives for tax driven inversions. In addition, as the IIR would not have applied to the profits made in the UPE jurisdiction, applying a cap to these low-tax profits under the UTPR does not provide for a better outcome than what applies under the IIR.

514. Second, this cap does not affect the UTPR as providing jurisdictions with a tool to protect themselves from the effect of base eroding transactions. If the MNE's ETR in the Ultimate Parent Jurisdiction is below the agreed minimum rate, three scenarios could occur:

- If the low-tax Constituent Entities in the UPE jurisdiction have not received any intra-group revenue from foreign Constituent Entities, the cap would result in the UTPR not applying at all. Indeed, the intragroup revenue would be zero and no top-up tax would be allocated, even if the MNE Group has made low-tax profits in that jurisdiction
- If the amount of all foreign intragroup revenue received by the low-tax Constituent Entities in the UPE jurisdiction was lower than the amount of their profits, this cap would limit the amount of top-up tax allocated under the UTPR
- Finally, if the Foreign intra-group revenue of all low-tax Constituent Entities located in the UPE jurisdiction exceeded the amount of Adjusted GloBE income made by such low-tax Constituent Entities, then this cap would not apply.

515. In the first and second scenarios (where there is either no foreign intragroup revenue in the parent jurisdiction or when such revenue does not exceed the amount of low-tax income of Constituent Entities located in the UPE jurisdiction), the cap limits the effect of the UTPR to the gross amount of the foreign intragroup revenue. However, under the second scenario, the potential base eroding transactions that could be used in the group to fund low-tax profits in the Ultimate Parent Jurisdiction are still subject to an adjustment under the UTPR. In the third scenario (where the foreign intragroup revenue exceeds the amount of low-tax income of Constituent Entities located in the UPE jurisdiction), the cap has no effect at all. In this case, the MNE does not derive any competitive advantage from a GloBE perspective in being headquartered in a jurisdiction that is low-tax and that did not introduce the IIR.

7.6. Definition of UTPR taxpayer

516. Only the Constituent Entities of the group that are subject to a UTPR in the jurisdiction where they are located are (required and) eligible to apply the rule ("UTPR Taxpayers"). Therefore, the top-up tax is allocated only among Constituent Entities that are subject to a UTPR in the jurisdiction where they are located. Constituent Entities that are not subject to a UTPR in the jurisdiction where they are located are not allocated any top-up tax.[25]

517. Allocating the top-up tax to entities that are not subject to a UTPR would significantly reduce the effectiveness of the rule, because the top-up tax allocated to those entities would not be collected. Therefore, Constituent Entities that are not subject to a UTPR in the jurisdiction where they are located are not allocated any top-up tax in respect of their own deductible payments. Consequently, both the payments made by (and the net intra-group expenditure of) Constituent Entities that are not subject to a UTPR in the jurisdiction where they are located are disregarded for the computations of the allocation keys.

518. A UTPR Taxpayer may consist of only one Constituent Entity or several Constituent Entities that are located in the same jurisdiction. Several Constituent Entities can form only one UTPR Taxpayer, for instance, if they belong to a tax consolidated group under the tax laws of that jurisdiction. Combining several Constituent Entities into a single UTPR Taxpayer has the effect of aggregating the amounts of intra-group payments that these Constituent Entities made to or received from any other Constituent Entities. In addition, this also results in disregarding the intragroup payments made between the Constituent Entities that form the same UTPR Taxpayer. Combining these Constituent Entities should not affect the total amount of top-up tax that is allocable to the UTPR Taxpayers. This should also not affect the top-up tax that these Constituent Entities would be allocated under the first allocation key. This could, however, affect the amount of top-up tax that they would be allocated under the second allocation key if, for instance the only intragroup payments that these entities were involved in were intragroup payments that are between them and that would be disregarded. The possibility to combine or not several Constituent Entities in a given jurisdiction to form one single UTPR Taxpayer depends on the domestic law of this jurisdiction.

7.7. Adjustment to be made under the UTPR

7.7.1. Domestic law mechanism

519. The rules set out above describe a coordinated mechanism which allocates top-up tax among the UTPR Taxpayers of the MNE Group. This allocation provides UTPR jurisdictions with the basis for calculating the amount of the adjustment to be made under the UTPR in these jurisdictions. The GloBE rules do not, however, prescribe the mechanism by which this adjustment must be made. This is a matter of domestic law implementation that is left to the jurisdictions that choose to adopt the UTPR. The adjustment could be through a limitation or a denial of a deduction for payments made to related parties or could be in the form of an additional tax. The form in which the adjustment is made will depend on the existing design of the domestic tax system and should be co-ordinated with other domestic law provisions and a jurisdiction's international obligations including those under tax treaties. For example, a jurisdiction that provides an allowance for corporate equity could choose to reduce that allowance to reflect an allocation of top-up tax. Another jurisdiction may require a taxpayer to make an adjustment under the UTPR by including an additional amount of deemed income representing a reversal of related party expenses incurred in current or prior periods.

520. In certain cases, the jurisdiction may allow the adjustment to be made by a taxpayer other than the UTPR Taxpayer that is allocated the top-up tax. For example, taxpayers in a UTPR jurisdiction may be consolidated for tax purposes or form part of a local tax group that allows members of the group to share the benefit of expenditure, credits or taxes paid. For such jurisdictions, the most straight-forward way of making the adjustment could be at the level of the local tax consolidated group rather than on an entity by entity basis.[26] In every case, however, the adjustment should result in the imposition of additional tax in the jurisdiction that is calculated by reference to intragroup payments (as provided for under the allocation key) and the adjustment should take effect within the same period that the top-up tax is allocated. In the event that it is not possible to make a full adjustment in that period then the adjustment should be made in the following period or as soon as reasonably practicable (see below Section 7.7.4 on the timing of the UTPR adjustment). The domestic design of the UTPR should ensure that the rules operate as an effective

backstop to the IIR by imposing an additional tax that is incremental to the tax that the taxpayer would otherwise have paid under the ordinary domestic rules for calculating taxable income.

7.7.2. Extent of the denial of a deduction or deduction limitation

521. If the UTPR adjustment takes the form of a denial of a deduction (or a limitation of the deduction of intragroup payments), the extent to which it applies depends on the top-up tax allocated to a UTPR Taxpayer. The amount of deduction that needs to be denied is obtained by dividing the amount of top-up tax allocated to the UTPR Taxpayer by the CIT rate to which this entity is subject. For instance, if a UTPR Taxpayer is allocated a top-up tax of 10 and is subject a 25% CIT rate, denying this entity the deduction of a payment of 40 (= 10 / 25%) results in the same incremental tax cost (40 x 25% = 10).[27]

522. The maximum top-up tax allocated to an entity will de facto be capped if the UTPR operates as a denial of a deduction. The denial of a deduction results in an incremental tax burden on the payer that is equal to the CIT rate on the total amount of expenses that are treated as non-deductible under the rule. However, a jurisdiction can introduce a carry-forward mechanism that would ensure that the tax liability is carried forward if the top-up tax allocated to the payer did not result in an adjustment in the current year. See below the Section 7.7.4 on the Timing of the UTPR adjustment.

7.7.3. Information requirement

523. Most of the information necessary to apply the UTPR relates to foreign entities and foreign transactions from the perspective of the jurisdiction applying the UTPR and may not be directly available in the tax return of the UTPR Taxpayer or to the tax administration. Therefore, it is necessary to ensure that the UTPR Taxpayers and the MNE will provide the information necessary to compute and allocate the top-up tax. Section 7.8 below provides further details about standardised mechanisms that can be contemplated to obtain such information from the taxpayer. [28]

7.7.4. Timing of the UTPR adjustment

524. The UTPR is calculated based on the intra-group payments made during the relevant period. Under the first allocation key, the allocation is determined based on the total intra-group payments received by the low-tax Constituent Entity in the period for which top-up tax has been allocated. Under the second allocation key, the allocation is determined based on the net intra-group expenditure for the accounting period of the UTPR Taxpayer that ends during the period for which top-up tax has been allocated.

525. Absent an MNE having staggered year-ends for its Constituent Entities, the UTPR adjustment could be made in the same year as when the jurisdictional ETR of the MNE is below the agreed minimum rate in the relevant low-tax Jurisdiction. As mentioned above (Section 7.7.1), it is acknowledged that, if the top-up tax allocated to a UTPR Taxpayer cannot be imposed in the year of adjustment (for example, because the taxpayer does not have a sufficient amount of deductible related party expenses to support the adjustment) the adjustment could be carried over and imposed in a subsequent year provided the rule is likely to result in an incremental tax liability within a reasonable period of time [2 to 3 years]. Under such circumstances, the UTPR Taxpayer should not suffer any penalties for not being imposed the top-up tax in the previous years.

7.8. Compliance and administration of the UTPR

7.8.1. Overview

526. The UTPR will apply as a backstop to the IIR. This means the UTPR will not apply to the low-tax income of a Constituent Entity where that entity is owned directly or indirectly by another Constituent Entity that applies the IIR to those low-tax Profits.[29] To simplify both the compliance with the UTPR and the administration of the rule in instances where the UTPR should not apply, the taxpayer would be offered the possibility to certify that such an IIR applies and/or that the structure of the MNE it belongs to does not leave any low-tax profits that could be subject to the UTPR.[30] This Section describes the content of the relevant certifications that the taxpayer would be expected to provide to the tax administration for that purpose.

527. On the other hand, when the UTPR is applied, it is likely that the operation of the rule may need to be coordinated with the UTPRs in several other jurisdictions where the MNE operates. This co-ordination is necessary to ensure that the total amount of the top-up taxes does not exceed the amount necessary to bring the aggregate tax in respect of UTPR adjustments up to the agreed minimum rate. As explained above, the top-up tax computed and then allocated to a given UTPR Taxpayer depends on the amount of profits made in such jurisdictions, the tax paid on such profits and the total volume of intra-group payments that are potentially subject to adjustment under the UTPR. Both from a compliance and administration perspective, there will be benefits in applying a coordinated approach. Most of the information required to identify these amounts and to apply the rule will be the same for each jurisdiction applying the UTPR. In addition, the consistent application of the UTPR in each jurisdiction is critical to ensure that it does not result in the MNE being subject to an aggregate tax burden that is above the minimum rate. To simplify both the compliance with the UTPR and the administration of the rule, the taxpayer would provide this information in a standardised format to the tax administration in the jurisdictions where the UTPR applies. This Section further describes the content of standardised self-assessment returns that the UTPR Taxpayer would be expected to provide for that purpose.

7.8.2. Certification requirements in instances where the UTPR should not apply

528. There are several instances where the UTPR should not apply, either as a result of the prior application of an IIR rule or because the conditions required to apply the UTPR are not met. The basis for excluding the UTPR will depend on the structure of the MNE Group, the jurisdictions where it operates and its tax profile (e.g. the absence of low-tax profits). For example, the UTPR will not apply in any jurisdiction where the MNE operates if:

- the Ultimate Parent Entity of MNE Group is resident in a jurisdiction where an IIR applies and the MNE's jurisdictional ETR in the parent jurisdiction is at or above the agreed minimum rate;
- the MNE's jurisdictional ETR is at or above the agreed minimum rate in every jurisdiction where its Constituent Entities are located; or
- the nature of the intra-group payments of the UTPR taxpayer cannot lead to any top-up tax being allocated to that taxpayer.

529. The content of the certification required to avoid the application of the UTPR in each jurisdiction are further described below for each of those instances. Most of the information necessary to apply the UTPR relates to foreign entities and foreign transactions from the perspective of the jurisdiction applying the UTPR and may not be directly available to the Constituent Entities although they can be prepared at the Ultimate Parent level. Therefore, these certifications could be provided by the Constituent Entity itself or by the MNE's Ultimate Parent Entity.[31]

530. The type of information contained in the certifications is the same for all UTPRs to which the UTPR Taxpayers of the MNE Group are subject. Therefore, the compliance with the rule and its administration can be simplified by requiring those taxpayers to provide such certification under a single format. The format and content of the certificate would be developed as part of the work on implementation. In any instances, however, the tax authorities in UTPR jurisdictions would be able to assess the facts and computations underlying such certifications.

Certification that no adjustment required under UTPR due to prior application of IIR

531. If the low-tax Constituent Entities (or, a fortiori, all members) of the group are controlled by a Constituent Entity located in another a jurisdiction where an IIR applies, the IIR mechanism ensures that the MNE Group is liable for a top-up tax on the profits made in the low-tax jurisdictions where it operates (except from the parent jurisdiction). For this exception from the UTPR to apply, the applicable IIR(s) should be designed in accordance with the principles described in this report, which is further discussed in Chapter 10. As a matter of simplification, it is contemplated that part of the work on implementation could include compiling and publishing a list of the IIRs that have been designed in accordance with the principles described in this report.

532. As discussed in Section 7.2.3, any applicable IIR would not cover the profits made in the parent jurisdiction. Therefore, to be exempted from the application of the UTPR, the taxpayer would also need to certify that the ETR in the parent jurisdiction is at or above the agreed minimum rate. Such certification could be based on the simplifications that are discussed in Chapter 5 and that will be further developed as part of the work on implementation.

Certification that no adjustment required because ETR is at or above the agreed minimum rate

533. If the MNE's jurisdictional ETR is at or above the agreed minimum rate in every jurisdiction where its Constituent Entities are located, neither the IIR nor the UTPR apply. Therefore, if the taxpayer certifies that this is the case, the UTPR should not apply, even in the absence of any applicable IIR within the group.[32] For that purpose, the certification will also incorporate the simplifications that are discussed in Chapter 5 and that will be further developed as part of the work on implementation.

Certification that intra-group payments cannot result in allocation of top-up tax

534. The nature of the intra-group payments of a given UTPR Taxpayer does not lead to any top-up tax being allocated to that taxpayer when (i) it has not made any intra-group payments to entities located in jurisdictions where the MNE's jurisdictional ETR is below the agreed minimum rate and (ii) it has net related party income (and not net related party expenses) for the purpose of applying the rule. Under such circumstances, the top-up tax that may be due because of low-tax profits arising in the MNE Group would be allocated to other taxpayers. Certifying that this is the case is likely to operate at the Constituent Entity's level and involves the jurisdiction where this Constituent Entity is located only. It would not avoid the application of the UTPR in other jurisdictions where the MNE operates. However, the information necessary for this certification would be required in other jurisdictions as it affects the operation of the allocation keys.

7.8.3. Standardised self-assessment return to apply the UTPR

535. The information required to apply the UTPR will need to be provided by the taxpayer to the relevant tax administrations. As most of the information required to apply the UTPR in each jurisdiction is the same, a standardised self-assessment return that the MNE would prepare and use in order to comply with the UTPR could be developed as part of the work on implementation. These standardised self-assessment

returns could be provided by the UTPR Taxpayer itself or by the MNE's parent entity under the same format.[33] A number of benefits for MNEs and tax administrations in using such standardised information have been identified:

- It would reduce the burden on MNEs which would be able to provide the same documentation in each jurisdiction where they operate
- It would facilitate a consistent application of the rule
- It would facilitate the review by tax administrations that would gain experience in working with standardised templates
- It would facilitate the multilateral working by tax administrations
- It would be possible to develop guidance to support tax administrations and MNEs in completing and using standardised templates.

536. The format and content of the forms that could be part of the standardised self-assessment return will be developed as part of the work on implementation. This information is likely to include, for each period:

- A list of all jurisdictions in which the MNE has Constituent Entities and the MNE's jurisdictional ETR in each of these jurisdictions, as well as the balances in the pools of carry-forwards for losses, local taxes and IIR tax credits;
- The total amount of top-up tax arising in that period for jurisdictions where the MNE's jurisdictional ETR is below the agreed minimum rate, which would be computed based on the net income and taxes paid in each jurisdiction where the MNE operates;
- The total amount of intra-group payments made by each UTPR Taxpayer to each low-tax Constituent Entity;
- The total amount of top-up tax imposed in the year as a result of the first allocation key;[34]
- If there is top-up tax remaining after this first allocation, the net intra-group expenditure of each UTPR Taxpayer.

7.8.4. Local filing of the relevant information

537. Requiring each UTPR Taxpayer to provide the certifications or standardised self-assessment returns described previously implies that it is able to collect such information either from its Ultimate Parent Entity or from other group entities. However, the UTPR Taxpayer may not be in the best position to collect such information. The Ultimate Parent Entity would be in a better position to collect such information from all the group entities and may collect some of this information for consolidation purposes already. Although the UTPR Taxpayer will be required to provide the self-assessment return or certifications, the Ultimate Parent Entity could in practice prepare these documents and provide them to each tax administration in jurisdictions where it has a Constituent Entity, on behalf of its Constituent Entity. This could be compared with the approach currently adopted with respect to an MNE's master file which (assuming requirements correspond with the BEPS Action 13 recommendations) may be prepared centrally but is filed separately in each jurisdiction where required. In order to facilitate administration the local UTPR Taxpayer would, in any event, remain jointly responsible for providing the local tax administration with the information needed in order to apply the rule including the determination of the top-up tax allocated to that UTPR Taxpayer.

References

OECD (2015), *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report*, OECD Publishing, https://doi.org/10.1787/9789264241138-en. [1]

Notes

[1] The definition of Parent is set out in Section 6.2 and may include a Partially Owned Intermediate Parent.

[2] See also section 7.2 on the priority of the IIR over the UTPR

[3] See section 6.3 on the Top-Down Approach

[4] An example of this type of structure is illustrated in Example 6.3.1A of the Annex.

[5] See above Section 4.4 on the Computation of the ETR and the top-up tax

[6] In most cases the tax rate in the UPE jurisdiction will be above the minimum rate. However this could also be achieved by the UPE Jurisdiction adopting an alternative domestic minimum tax which uses the same tax base calculation mechanics as the GloBE. Further technical work would need to be done however in setting out the precise interaction between the GloBE rules (for example in relation to the application of the carve-out amount).

[7] As described in Section 4.3, the carve-out is intended to operate as a mechanical adjustment to the calculation of the ETR in a jurisdiction and is not intended to have further consequences for applying the allocation mechanisms under the IIR or UTPR. The fact, for example, that an intra-group payment could be considered, in whole or in part, as a return on the use of tangible assets or payroll, does not mean that the payment (or a portion of that payment) should be excluded from the intra-group payments taken into account under the UTPR allocation keys described in Section 7.4 below.

[8] See, however, section 7.5 on the limitations that are specific to the UTPR.

[9] The term “base-eroding intragroup payments” used in this section is a generic term that does not suggest a motive to such payments or a purpose test that would be needed in order to identify those payments that should be subject to the UTPR. See section 7.4.4 for further details about the identification of intragroup payments.

[10] See Section 7.6 on the Definition of UTPR Taxpayer.

[11] See Section 7.5 below on the Maximum amount of top-up tax that can be allocated

[12] However, as noted below, intra-group payments made by a Constituent Entity to another Constituent Entity in the same jurisdiction will be disregarded if both Constituent Entities form a single UTPR Taxpayer under the domestic tax law of this UTPR jurisdiction. See Section 7.6 on the definition of UTPR Taxpayer.

[13] One of the simplification options discussed above in Chapter 5 is to explore further the use of deferred tax assets/liabilities to compute the ETR. If these simplification options are further developed, the UTPR taxpayers would also be covered by such a mechanism. For instance, if a jurisdiction was considered to

be a high-tax jurisdiction in application of these simplifications, the UTPR taxpayers located in such a jurisdiction would be allocated top-up tax.

14 As mentioned in Section 7.7, the top-up tax allocated to a UTPR Taxpayer that is in a loss-making position could be collected in a subsequent period.

15 See paragraph 242 of BEPS Action 2 Report and 423-424 of BEPS Action 2 Report (OECD, 2015[1]).

16 The interaction with existing domestic rules is expected to be treated under domestic law, as clarified under Section 7.7.

17 Intra-group payments made by a Constituent Entity to another Constituent Entity in the same jurisdiction are disregarded if both Constituent Entities (possibly with other Constituent Entities located in the same jurisdiction) form a single UTPR Taxpayer under the domestic tax law of this UTPR jurisdiction. See Section 7.6 on the Definition of UTPR Taxpayer.

18 Section 7.7 describes the rules used to determine the timing in the recognition of these payments.

19 A reconciliation may be needed in the case where there are differences between entity-level accounts and consolidated accounts, or between payments recorded in the entity-level accounts of entities in different jurisdictions. This reconciliation process could be done as part of the self-assessment process described in Section 7.8, and involve the Ultimate Parent Entity as referred to in the section on Local filing of the relevant information.

20 The Constituent Entities may not be held to the same extent by the same controlling entities. This, however, is not relevant for the identification of the amount of intra-group payments to be used in the allocation keys under the UTPR. Assuming the UTPR Taxpayer is wholly owned by an Ultimate Parent Jurisdiction that controls 80% of a low-tax Constituent Entity, for instance, the amounts of intra-group payments used for the allocation key are not adjusted to reflect the difference in the ownership of those entities.

21 If the profit allocation between the head office and its permanent establishment does not rely on deemed payments, and no such deemed payments are recognised for tax purposes, then no deemed payments are recognised between the head office and its permanent establishment for the purpose of the UTPR.

22 The domestic covered tax rate applicable in the UTPR jurisdiction is the combined rate of the relevant UTPR jurisdiction's covered taxes, which includes the CIT as well as other taxes such as sub-national taxes provided they are a covered tax (see Section 3.2).

23 The domestic covered tax rate applicable in the jurisdiction of the UTPR taxpayer is the combined rate of the relevant UTPR jurisdiction's covered taxes, which includes the CIT as well as other taxes such as sub-national taxes provided they are a covered tax (see Section 3.2).

24 Consistently with these rules, the Foreign Intragroup revenue does not include, for instance, payments made by Constituent Entities that are not generally deductible under the tax laws of the payer jurisdiction.

25 The rules for determining the location of a Constituent Entity are set out in Chapter 2.

26 Alternatively, under the domestic law of a UTPR Jurisdiction, the tax consolidated group itself could be the UTPR Taxpayer. Under such circumstances, the payments made by Constituent Entities would be aggregated for the purpose of applying the UTPR and the payments that occurred within the tax consolidated group would be disregarded for the application of the UTPR. See Section 7.6 on the Definition of UTPR Taxpayer

[27] The UTPR could also take the form of an additional tax. An additional tax could be achieved either by collecting the top-up tax directly or, for instance, by recognising an additional taxable income at the level of the UTPR Taxpayer.

[28] Each jurisdiction could design an appropriate mechanism (e.g. penalties) under its own domestic law to ensure it is provided with the relevant information.

[29] See above Section 7.2 on the priority of the IIR over the UTPR

[30] Such an IIR would need to be designed in accordance with the GloBE rules.

[31] See Section 7.8.4 about the local filing of the relevant information.

[32] For instance, if the MNE Group is subject to a domestic minimum tax based on the same base as the GloBE rules in a given jurisdiction, the MNE's jurisdictional ETR in that jurisdiction is at the agreed minimum rate and there will be no top-up tax allocated under the UTPR in respect of that jurisdiction.

[33] See Section 7.8.4 about the local filing of the relevant information.

[34] A record should also be kept of whether any top-up tax allocated but not imposed is imposed in a later year.

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