Memo

To International Co-operation and Tax Administration Division,
OECD/CTPA

From KPMG International[1]

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Ref KPMG Comments on Public Consultation Document: Pillar Two – Tax Certainty for the GloBE Rules

Thank you for the opportunity to respond to the Public Consultation Document entitled *Pillar Two – Tax Certainty for the GloBE Rules*.

Overall, tax certainty is a critical factor for the Pillar Two project and cannot be underestimated. It is difficult to foresee all potential areas of dispute and uncertainty, and the infrastructure developed to deal with certainty needs to be robust. We outline our thoughts on how this may be achieved:

- A register of requests and the responses should be maintained and should form part of the (authoritative) Administrative Guidance.

- Administrative Guidance, including further guidance following introduction of the rules, should be authoritative in the sense that taxpayers' actions consistent with it should be exempt from interest and penalties and that jurisdictions should be assessed, via a peer review mechanism, against its implementation. Clarity over effective dates and individual jurisdictional implementation would be welcome.

- The interaction of Pillar Two with potential adjustments as a result of, for example, transfer pricing rules is complex, due to divergent objectives and timing of effects. We recommend early notification by the taxpayer, via the domestic tax authority, to other potentially affected tax authorities (those within the

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ownership chain) of likely interactions and relief from interest and penalties to the extent that Top-up Tax is ultimately increased.

- Although the GloBE Rules will be enacted and applied in a similar way across jurisdictions, different interpretations may result in inconsistent outcomes. While important, dispute prevention mechanisms will only provide secondary measures for dealing with disputes and cannot be expected to avoid all disputes. An effective dispute resolution mechanism should be initiated to safeguard the access to justice as envisaged by the OECD.

- Uncertainty persists around the interaction of GAAR (and potentially other domestic anti-avoidance) regimes and the GloBE rules. There should be agreement that provided, and to the extent, that an MNE's actions are consistent with the intention to reduce tax competition, a GAAR should not apply to those actions. Alternatively or as well, a minimum quantitative threshold for the application of a domestic GAAR, taking into account the global Top-up Tax due by the MNE during the year, could be introduced.

- The mechanisms for international dispute prevention do not appear directed at disputes that might arise from the application of existing international tax rules (e.g., PE thresholds) and their interaction with the GloBE rules. A threshold of PE significance might help to limit complexity and uncertainty in the application of the GloBE rules, at least in the interim.

- At present there is a lack of clarity about the consequences jurisdictions will face for introducing a non-qualifying IIR, UTPR or DMTT. Ultimately this could leave taxpayers facing double taxation.

- Likewise, there are potentially many issues (essentially any with a qualitative test) where jurisdictions may apply the GloBE rules in an inconsistent manner. For this and the previous point we encourage increased guidance to support certainty.

Referral to the Inclusive Framework - general

It is noted that the Inclusive Framework is a policy body that could deal with issues of interpretation but not arbitrate specific disputes. Specific technical and administrative issues with the GloBE rules are likely to arise frequently in future, due to ambiguities in the guidance and consequent difficulties with, and differences in, interpretation. If there is a clear and timely process for the Inclusive Framework, with the assistance of the OECD Secretariat to deal with issues of interpretation, this would contribute significantly to the level of certainty surrounding Pillar Two. In our view:

- All stakeholders should be able to request the Inclusive Framework, through the OECD Secretariat, to consider issues of rule interpretation and application.

- Responses to such requests should form Administrative Guidance upon which MNEs should be able to rely at all times (as a permanent measure) without penalty or interest.

- A register of issues should be kept and made public including targeted timeframe for resolution.

- Jurisdictions should be encouraged via peer review to embody the Administrative Guidance (as updated from time to time) directly in their domestic law or in guidance on interpretation.

To our understanding, to-date the development of the GloBE rules and guidance has been conducted by WP11, as directed by the Inclusive Framework. Looking ahead, the Inclusive Framework may already be considering the optimal mechanism for soliciting and assessing ongoing requests for interpretative clarity. One possible approach worth considering is the IASB's interpretative committee arrangements for considering questions on accounting standards and determining whether a standard needs amendment or clarification.

Detailed considerations regarding further agreed administrative guidance from the OECD

The consultation paper, at paragraph 2, rightly notes that 'further' agreed administrative guidance (AG) will play an important role in reducing the risk of different interpretations or applications of the GloBE rules across jurisdictions. An important matter to address, in advance of the rules coming into effect in jurisdictions, is how such 'further' AG is intended to apply for a given fiscal year. (We are commenting on the assumption that the AG being issued in 2023 will be integrated into the Commentary and be applied by all relevant tax authorities. As such the focus here is on 'further' AG, posted to the OECD website after the rules are 'live'.)

It appears most likely that the main mechanism, through which respect for further AG will be ensured, is the peer review mechanism to assess whether a particular jurisdiction's GloBE (IIR, UTPR and/or DMTT) are 'qualified' (it is assumed that, while desirable, a GloBE MLC will be harder to agree and so the peer review will do the heavy lifting). In the Chapter 10 definitions of qualified IIR, UTPR and DMTT, it is provided that these must be implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Commentary. In this regard Article 8.3.1 of the GloBE rules requires a tax administration to apply the GloBE rules in accordance with any agreed AG. In addition, as we understand it, further AG would be integrated into the Commentary. As such, obtaining 'qualified' status would appear to require a jurisdiction to follow the AG.

This then begs the question of how the further AG should be applied for a given year. Say that Co A is a group subsidiary in a low tax jurisdiction. Its jurisdiction of tax residence applies a DMTT. It could also conceivably be subject to IIR at Parent level, and UTPR at the level of sister subsidiaries. For 2024 (financial year ended December 2024 – first year of GloBE application to the group) a SBIE calculation needs to be made for Co A. Say the DMTT has a filing date (for 2024) of Dec 2025 and the GloBE information return will be filed June 2026. In Feb 2025, a posting is made to the OECD website with a 'further' AG clarification on the calculation of payroll for the SBIE. To what extent will this be factored (consistently) into the TUT calculations for the DMTT, IIR and UTPR in the three separate jurisdictions in question?

Several considerations come to mind:

- Would the OECD clarify to which financial year the Jan 2025 AG item should apply for all jurisdictions (i.e., for 2024 or just from 2025)?

- To the extent that the AG item is intended to apply to the 2024 TUT calculation, how can it be ensured that this can be given effect for each of the IIR, UTPR and DMTT in the different countries in question? Jurisdictions may differ on whether their domestic legislation can directly reference guidance issued at OECD level and, if so, they may differ on its dynamic or static effect. If jurisdictions take the position that they must first bring the 'further' AG items into domestically issued guidance, then they may differ on whether these can apply retroactively. Some jurisdictions could conceivably determine that a given AG item should be effected through a change to domestic law, rather than just being issued as a tax authority interpretation. In this regard it was notable that the draft UK GloBE legislation, released in summer 2022,

brought certain elements of the GloBE Commentary into the draft legislation itself.

- These considerations then interact with the design of the Peer Review, and the manner in which it assesses whether a given jurisdiction's GloBE rules are giving effect to AG items in law and in practice.

- Clarity on the manner of implementation of 'further' AG items will also be important in facilitating the proper treatment of GloBE tax for financial reporting purposes.

It would be of great value to taxpayer certainty if the IF could address these issues and find a coordinated approach between the jurisdictions. It is acknowledged that there may be 'teething issues' in the early years of GloBE application, where jurisdictions may have different positions on which version of the AG should be applicable to a given year. While these are being progressively addressed through the peer review and dispute resolution processes, at the very least the IF should make clear that an MNE, where it follows the latest IF-mandated version of the AG for a given year in arriving at its TUT positions, should be relieved from penalties or interest.

As a further point, the IF's register of GloBE issues (referred to above) should be clear on which GloBE rule items have been modified through new guidance, when the guidance was issued, and when the IF treats it as taking effect. This will be of great value to taxpayers when filing GloBE information returns and when asserting to tax authorities that they have followed the relevant version of the guidance. A user-friendly, searchable index is crucial. Efforts should be made to give taxpayers advance notice of when further AG items are set for release, so that they do not miss important new guidance, with year-end dates/holidays particularly in mind.

Mechanisms developed where an upward adjustment in one country (e.g., Transfer Pricing) reduces the level of Top-up Tax. Simplified means of Top-up Tax reduction. Interest and penalties.

The purpose of Pillar Two and the purpose of domestic anti-avoidance rules affecting international arrangements (including, though not limited to, transfer pricing rules) are not completely aligned. TP and other regimes are directly aimed at protecting the domestic revenue by adjusting the profits of resident entities. Pillar Two, however, also has the objective of "put[ting] a floor on tax competition". This distinction can be seen when considering the interested parties to a cross-border transaction: under transfer pricing, the relevant jurisdictions are those of the taxpayer entity potentially subject to a transfer pricing adjustment, and of the related counterparty. These two interested jurisdictions will often have agreed, via a Double Taxation Convention, a Mutual Agreement Procedure under which their competent authorities will seek to relieve double taxation.

The interested parties under Pillar Two are potentially wider, also including the jurisdictions of one or more parent entities. Existing bilateral treaties do not envisage this wider scope and likely to be ineffective in reconciling the above two aims with the prevention and timely resolution of double taxation or non-taxation.

Nor does Article 3.2.3 of the Pillar Two Model Rules resolve this problem. Art 3.2.3 requires transactions between Group Entities to be priced consistently with the arm's length principle and recorded at the same price for GloBE purposes for all affected Constituent Entities. Where this is not the case in practice, an adjustment must be made such that the arm's length price is reflected. The Commentary recognises that such adjustments may result in an asymmetry: under a unilateral APA; where a domestic (tax-only) TP adjustment is made by one or more of the Constituent Entities; or as the result of a tax authority audit. Art 3.2.3 then provides for a compensating adjustment "where necessary to prevent double taxation or double non-taxation under the GloBE Rules" except for "under-taxed" jurisdictions. Whilst there are arrangements to allow for recalculation of Top-up Tax under Art 4.6, this is for the purpose of computing additional Top-up Tax, not to

permit a refund to the taxpayer where subsequent developments have meant the original Top-up Tax was excessive. A further set of rules to deal with the interaction of GloBE with domestic rules is therefore required.

In addition, the mechanisms for adjusting GloBE profits implicitly assume that the extent and timing of an adjustment are known in time for an adjustment to the GloBE computation to be made. This will often not be the case – a transfer pricing adjustment may be finalised in some time, potentially years, after the year to which it relates. It is also possible that the relevant tax authorities may disagree on the adjustment to be made in order to restore the arm's length principle. While the adjustment itself may be subject to Competent Authority agreement under the terms of a treaty between the relevant countries, provision should be made to extend the effect of such an agreement to a consequential GloBE adjustment. It would be preferable for such provision to fall under the terms of a multilateral instrument, as the taxing jurisdiction under the IIR may not be either of the two jurisdictions involved in the transfer pricing adjustment. The terms of such an instrument would need to allow for the time delay noted above.

One approach could be to recommend, via Administrative Guidance, a mechanism for an MNE to notify the tax authority at the commencement of a transfer pricing enquiry that the transaction in question may affect the Top-Up tax paid by a group entity. The notification could result in a requirement for the relevant competent authorities (the notified tax authority and those others within the ownership chain) to consult on the matter, including to exchange information, with respect to the domestic transfer pricing enquiry to ensure that wider consequences are understood at the outset. Where such a potential dispute arises, no penalties or interest should be imposed in respect of any additional top-up tax.

The need for robust legal protection

The absence of legal protection and the access to multilateral dispute resolution may result in double taxation or taxation not in line with the Model GloBE Rules. Although the GloBE Rules will be enacted and applied in a similar way across jurisdictions, different interpretations may result in inconsistent outcomes. Under the current GloBE Rules, access to justice is not safeguarded.

Dispute prevention mechanisms

Dispute prevention mechanisms will only provide secondary measures for dealing with disputes and cannot avoid all disputes.

The option to agree on an APA or ATR does not exist in all OECD countries. Also, for interpretation differences, only a BAPA or MAPA would lead to the desired result. Currently not all countries or tax treaties provide a legal basis for a bilateral/multilateral agreement, which should be implemented in model treaties to give a proper basis for advance legal certainty.

Although ICAP can be seen as a dispute prevention mechanism, it does not provide legal certainty. Under the current ICAP, jurisdictions do not have to reach conclusions with respect to covered risks, the outcome is not binding for all countries involved, and even if an agreement is reached, outcome letters are not binding and do not prevent tax authorities from subsequently changing their position.

Dispute resolution mechanisms

Creating a dispute resolution mechanism in domestic law, does not have to result in an effective solution for double taxation as countries may have a different interpretation of the GloBE rules. As indicated, the provisions of article 25 of the OECD Model Tax Convention do likely not provide for any legal protection

relating to the Pillar Two taxation, as the GloBE rules are not the subject of existing tax treaties. Besides that, relying on tax treaties has some limitations. Not all jurisdictions that implement the GloBE rules have treaty relations with each other. And if taxpayers already have access to the MAP under a DTT, this is not in all cases enforceable by taxpayers, or binding for tax authorities.

Given the far-reaching impact that the GloBE rules may have on MNEs, an effective dispute resolution mechanism should in our view be initiated, to safeguard the access to justice as envisaged by the OECD. A multilateral convention would have the preference, to achieve that interpretation and qualification disputes can be solved between jurisdictions. An MLC (even if agreed) would only provide for full legal protection in case of an enforceable procedure, where taxpayers would have the option to enforce the competent authorities to enter into an agreement, and if necessary to start binding arbitration. Taxpayers should have access to a MAP procedure and should be able to initiate this, not only in case of double taxation but also in case of taxation not in accordance with the GloBE rules. The only way to achieve an effective mutual agreement procedure, is that an agreement should be enforceable between countries, and the outcome should be binding. Further, the possibilities for jurisdictions to deny access to arbitration should be limited to situations of tax fraud.

Connection between GAARs and GloBE established

Uncertainty persists around the interaction of GAAR (and potentially other domestic anti-avoidance) regimes and the GloBE rules. In addition, GAAR regimes vary in scope. This presents difficulties for taxpayers seeking to obtain assurance on the appropriateness of their filing position and creates substantial risk with respect to the potential for future adjustments and associated penalties in the event of a later challenge.

Commentary on dispute resolution mechanisms mainly deals with differing interpretations of the GloBE rules. However, as seen above in the context of the interaction of GloBE with transfer pricing rules, at least as concerning are disputes over the interaction with domestic rules. Two possible sources of dispute arise: (a), whether, and to what extent, actions taken by groups to avoid the application of the GloBE rules may be countered by a domestic GAAR; and (b) the availability of an adjustment or other relief from double taxation should the application of a GAAR change a group's jurisdictional ETR.

The issues and potential resolution under source (b) above are likely to be similar to those for transfer pricing and other domestic anti-avoidance rules. Hence this section focuses on concern (a).

A GAAR results in a significant power granted to a tax authority to apply, under certain circumstances, taxation based on a "deemed" set of facts that differs from the actual facts. This may result in substantial uncertainty for taxpayers. Recognizing this, existing principles normally permit a GAAR to be invoked where there is some element of "abuse" or artificiality to the arrangements in question, such that the "principal purpose" is a tax avoidance one. This is often one in which the form of the underlying transactions may comply with the legal requirements in the jurisdiction, but the substance differs, and/or the result is one contrary to the intention of, or at least not envisaged by, the legislature in question. For instance, the Commentary to the 2017 OECD Model Tax Convention provides that "a guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions."

This purpose of GAAR regimes does not sit comfortably with the more mechanical approach of Pillar Two to meeting its objectives. It may well be the case that actions taken by a taxpayer reduce the level of Top-up Tax payable, but there should be agreement that provided, and to the extent, these actions are consistent with the

objectives of Pillar Two, a GAAR should not apply to these actions. In other words, a domestic GAAR should not apply to recharacterize or re-price arrangements that are consistent with the GloBE objectives, solely for the reason of a purpose and/or effect that Top-up Tax is reduced, regardless of the existence or otherwise of surrounding commercial circumstances. At least, no interest or penalty should be imposed in relation to the relevant arrangements.

Rather than (or in addition to) a motive / effect test, another option would be to introduce a quantitative threshold for the application of a domestic GAAR by reference to the global Top-up Tax due by the MNE during the year. For example, assume that an MNE has a global TUT liability of EUR100 million for 2024. Jurisdiction X (say) stands to collect TUT of EUR5 million under its UTPR, primarily with regard to the MNE's Jurisdiction Y entities. Jurisdiction X objects to transactions, put in place between Jurisdiction Z and Jurisdiction Y, which lower the TUT calculated for Jurisdiction Y and would lead to a reduction of EUR1 million in Jurisdiction X's UTPR take (assume that this is the entire change in Jurisdiction Y TUT through the transactions, all of it being picked up under the Jurisdiction X UTPR). Jurisdiction X wishes to use its GAAR to recalculate the Jurisdiction Y TUT.

A threshold could be imposed so that deemed avoidance amounting to less than, say, 5% of global TUT should not be regarded as undermining the GloBE rules' ability to reduce tax competition. In the above example this would mean that the threshold is EUR5 million (EUR100 million x 5%) and, as the EUR1 million at stake under the GAAR is less than this, India would be required to forgo the GAAR adjustment in this case.

A greater threshold for this purpose, perhaps of 10% or 20%, could be regarded as beneficial to tax certainty. Likewise, application of such a rule to other domestic anti-avoidance regimes could further support the GloBE objectives.

Consideration could also be given to an aggregated threshold, where the sum of individual thresholds exceeds a certain sum.

Another approach may involve a transitional stand still provision. This could incorporate the following:

- that, at least at the inception of GloBE GAARs are not be treated as applying to taxes imposed as part of the GloBE regime:

- that the GloBE already includes many design features intended to anticipate and address avoidance transactions, but to the extent that additional concerns might arise in the initial years of GloBE implementation, they should be made the subject of IF review and, where warranted, corrective design changes (going forward); and

- that, with the experience gained from the first years of implementation, a better-informed evaluation of the application of domestic GAARs (or perhaps an internationally-accepted, Globe-specific GAAR) could be undertaken.

Note that we're not advocating that GAAR be turned off in any case where taxes other than those arising under GloBE are in play.

Rules around assertions of a Permanent Establishment to obtain GloBE revenue

In the consultation paper, it appears that the dispute resolution mechanism proposals are directed at tackling inconsistent outcomes arising from different interpretations of the GloBE Rules. Per paragraph 27 this could be extended to inconsistent outcomes arising from variant domestic incorporation of the GloBE Rules in different jurisdictions. However, it does not appear that the mechanisms would be directed at disputes that might arise from the application of existing international tax rules (e.g., PE thresholds) and their interaction with the GloBE rules. With the existence of a PE (as per treaty or domestic law definitions) in a jurisdiction giving rise to a constituent entity (CE) for GloBE purposes (with attendant taxing rights) this could become an area of contention.

It appears that, for addressing PE disputes connected to GloBE imposition, reliance will still be placed on the existing MAP infrastructure. It might be asked whether this will be sufficient to address the number of possible disputes that could arise in the early years of operation of the GloBE rules, as tax administrations and taxpayers are still in the 'learning phase'. For example, at present there may be instances in which tax administrations assert taxing rights under Service PE thresholds, for which the grounds may be viewed as quite tenuous. While taxpayers could contend this the amounts in question may not, at present, be seen to merit invoking MAP. In other instances, jurisdictions may seek to impose tax on outbound payments, with forex regulator remittance clearances contingent on the payment of this tax. This may be done in the form of a PE tax imposition. At present taxpayers may take the view that submitting to this imposition is simply the price of facilitating the remittance. Another instance might be PE tax impositions on representative offices, which could arguably be pushed back against under the preparatory and auxiliary articles of tax treaties – at present this may not be seen to be worth the expense involved.

However, the GloBE rules give the recognition of such PEs far greater significance, with the CEs they give rise to potentially having significant UTPR taxing rights. In view of the disputes to which these could give rise, there could be merit in considering how more tenuous PE assertions might not (initially) give rise to CEs for GloBE purposes. A threshold of PE significance might help to limit complexity and uncertainty in the application of the GloBE rules until taxpayers and tax authorities have an opportunity to revisit such situations and address them more fully.

Implications of non-qualified status

The GloBE Implementation Framework assumes that the multilateral review process that will establish whether a jurisdiction's IIR, UTPR or DMTT is recognized as having "qualified" rule status will create an incentive for jurisdictions to align their domestic rules with Model GloBE Rules and accompanying Commentary and Administrative Guidance. We are concerned that this may not always be the case; that there is a lack of clarity about the consequences jurisdictions will face for introducing a non-qualifying IIR, UTPR or DMTT; and that ultimately this could leave taxpayers facing double taxation.

For example, if a jurisdiction introduces a non-qualified DMTT, this should not result in this tax being disregarded by other jurisdictions when they apply the IIR or UTPR. Instead, any tax incurred under a non-qualified DMTT should be accounted as a Covered Tax, when determining whether said jurisdiction is low tax for the purpose of GloBE. The treatment of a non-qualified IIR or UTPR raise more difficult technical and legal questions, including whether such rules are compatible with a jurisdiction's existing international obligations as defined in relevant bilateral tax treaties. However, again, would like to reemphasize that it is critical that rules governing the interaction between qualified and non-qualified minimum tax regimes do not result in businesses facing double taxation and seek to provide certainty in where a jurisdiction's rules lack qualified status.

Two jurisdictions apply the rules in a different manner
There are a potentially wide range of issues where jurisdictions may apply the GloBE rules in an inconsistent manner. The following is a short list of examples. Essentially, any test which is qualitative will fall within this domain.

(a) Different interpretations of the deemed consolidation rule
(b) Whether an entity is an Excluded Entity having regard to the ancillary income test
(c) For an investment fund whether it satisfies various tests such as designed to pool assets, tolerance on a test of whether a return is proportionate to contribution and whether it is sufficiently subject to a regulatory test such as AML
(d) Scope of the shipping income exemption in a wide array of activities
(e) The concept of taxes in lieu of income tax in the definition of covered taxes
(f) In-scope contractors in the payroll test for the Substance Based Income Exclusion
(g) Application of the post-filing adjustments rules in Article 4.6. In particular, as the GloBE information return is to be lodged 15-18 months after fiscal year end, might this facilitate the factoring of post-balance date adjustments, up to the GloBE information return filing date, into ETR calculations for the year?

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