By email to: PillarTwoConsultation@hmtreasury.gov.uk

29 March 2021

Dear Sir/Madam

Consultation on implementation of the OECD Pillar 2

PricewaterhouseCoopers LLP ("we" or "PwC") welcome the opportunity to respond to the above consultation. We are drawing on our work as advisers to a wide range of clients and also our expertise in international tax policy. We have not done any modelling of the impacts of any proposals for the purpose of this response; we have commented based on our general experience and expertise where we are able at this point.

We note that the consultation covers the application of the Pillar Two Model Rules, and how they may be implemented in the UK. We set out below our responses to the specific questions raised, as well as additional comments in respect of aspects of the proposed regime which we believe may require further consideration.

The introduction of a minimum tax system at the jurisdictional level is the most significant change in the corporate tax system of the last few decades. A jurisdictional level minimum tax system is also inherently complex for both business and tax authorities. The novelty and complexity of the new regime together with the typical lead time to develop or upgrade compliance and reporting systems implies that the 2023 planned implementation will be a substantial challenge for many multinational enterprises (MNEs). For this reason, careful consideration needs to be given to the timing of the introduction of the new rules.

In this regard, we note the importance of coordinating the timing of the GloBE implementation in the UK with the timing of other jurisdictions to ensure that UK business is protected as far as practical from the application of the Income Inclusion Rule (IIR) and the Under Taxed Profit Rule (UTPR) by overseas territories. The European Commission's Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union (the EC Directive) originally stated that the Model Rules will be in force from 1 January 2023 but the application of the rules could still be moved to 2024 in the context of the discussions at the European Union level.

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We also note that there is ongoing work by the Inclusive Framework (IF) on the implementation guidelines for the Model Rules which will clearly be an important development for jurisdictions seeking to adopt the new regime. The exact timeline for this work however appears to be somewhat unclear. This is particularly the case considering for example the uncertainties around the reform of Global intangible Low-taxed Income (GILTI) and Base Erosion and Anti-Abuse Tax (BEAT) in the US.

To the extent that the timeline of implementation is therefore delayed for key trading partners of the UK (e.g., in particular in the European Union (EU) and other G20 countries), there would appear to be pressing reasons for implementation for the UK to also be deferred. Accordingly, the anticipated state of implementation by other jurisdictions should be kept under review and further consideration given to a later adoption of the rules in the UK, if appropriate and considered desirable.

Should the new rules be in force in the UK on 1 April 2023, their application to financial years starting after 1 April 2023 would give business more time to adapt to the significant changes necessitated by Pillar 2. This may lead to a more proportionate introduction of the GloBE rules in the UK as it better aligns with the latest proposals in the EU and avoids the need for straddling periods which add additional complexity to an already complex set of rules.

The GloBE rules and the related policy responses (e.g., domestic minimum taxes) will increase the cost of investing in the UK and overseas. There are obvious economic and fiscal disadvantages to being the first economy to incur these costs if other key jurisdictions delay (or do not proceed with) the implementation of GloBE. This is particularly important in the current environment where the pace of both the global and the UK recovery remains uncertain (International Monetary Fund (IMF) World Economic Outlook, January 2022) and analysts forecast the UK will grow at a below par rate in 2023-2026 (Office for Budget Responsibility, October 2021; IMF World Economic Outlook, January 2022).

It is very important therefore that the UK's approach to the GloBE rules involves careful consideration of the timing of any implementation as well as the creation of a set of rules that is clear, coherent and as simple as possible to administer. As our response makes clear there are numerous practical considerations and interactions with domestic measures which need to be considered carefully and resolved.

If you have any questions, or would like to discuss any of the points in our response further, please do not hesitate to contact us.

Yours faithfully,

For and on behalf of PricewaterhouseCoopers LLP

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Abbreviation list

BEAT - Base Erosion and Anti-Abuse Tax
CbCR - Country-by-Country Reporting
CE - Constituent Entity
CTA 2009 - Corporation Tax Act 2009
DMT - Domestic Minimum Tax
DTA - Deferred Tax Asset
EC - European Commission
ETR - Effective Tax Rate
EU - European Union
GAAP - Generally Accepted Accounting Principles
GILTI - Global intangible Low-taxed Income
GloBE - Global Anti-Base Erosion Rules
IF - Inclusive Framework
IFRS - International Financial Reporting Standards
IIR - Income Inclusion Rule
IMF - International Monetary Fund
IP - Intellectual Property
JV - Joint Venture
MNEs - multinational enterprises
MPG - Multi-Parented MNE Group
MLI - Multilateral Instrument
NRCGT - Taxation of Non-Resident Capital Gains
PE - Permanent establishment
PID - Property Income Distribution
PwC - PricewaterhouseCoopers LLP
QDMT - Qualified Domestic Minimum Top-Up Tax
QII - Qualifying Institutional Investors
RDEC - Research & Development Expenditure Credit
REITs - Real Estate Investment Trusts
REIV - Real Estate Investment Vehicle
SSE - Substantial Shareholdings Exemption
UPE - Ultimate Parent Entity
UTPR - Under Taxed Profit Rule

Responses to specific questions

Chapter 3 Common approach

1. **Do you see any strong reason why UK legislation should not follow the OECD Model Rules as closely as possible to ensure consistency bearing in mind the limited flexibility permitted by the common approach?**

The OECD Model Rules and the Commentary leave considerable areas of uncertainty. In addition, a key element for the process of implementation, i.e. the implementation guidance has not yet been produced. Where there is flexibility permitted by the common approach, it will be important to factor into the domestic legislation the elements of the Commentary, as well as many of the key policy and technical remarks raised so far by technical bodies and business. Specifically in relation to the Commentary, aligning local legislation with the intent and design of the Model Rules as discussed in the Commentary (and other sources) will be important.

In our response to this consultation, we have set out a number of points in respect of matters of principle, suggestions for simplification and technical remarks which we believe warrant careful consideration. To prevent undue administrative costs (for taxpayer and HMRC alike) and consequential adverse economic and fiscal consequences , the implementation of Pillar 2 in the UK should be as simple to administer as possible and coherent with existing domestic policy choices whilst still achieving the overarching intent set out in the Model Rules.

2. **Do respondents have any views on how the common approach can be more effectively achieved at a global level?**

It will be important that there is a clear, well understood and consistent approach to the question of whether a particular jurisdiction's set of rules meets the common approach and is to be regarded as ‘qualifying’. It will be important that the approach taken by various jurisdictions of the IF is aligned, including when other regimes have a similar architecture to Pillar 2 but differ on certain important design features, e.g., they employ different definitions of the tax base.

Chapter 4 Scope

3. **Do respondents have any comments on the calculation of the €750m consolidated revenue threshold?**

It is important to align the in-scope Pillar 2 threshold with the Country-by-Country Reporting (CbCR) threshold for two reasons:

- Avoid increasing compliance costs by capitalising on the work that has already been carried out on CbCR by both business and tax administrations; and
- Ensure the (proposed) CbCR-based safe harbours operate as intended.

With this alignment in mind, the Pillar 2 implementation guidance should closely follow the CbCR guidance or, where needed, clarify any departure from it. For example, the CbCR Guidance suggests disposal proceeds and unrealised revaluation gains in respect of non-current assets may be included when testing for the CbCR threshold even though such items would generally not be treated as "revenue" under the International Financial Reporting Standards (IFRS). It is not clear that such an approach is warranted by the Pillar 2 rules.

We note that the Commentary is clear in that all revenue reported in the Consolidated Financial Statements of the MNE Group is to be taken into account for the purposes of the scope threshold. However, it is also important that the guidance to the Pillar 2 legislation contains example(s) to illustrate what is included in the definition of "revenue" for the purpose of the Pillar 2 in-scope threshold. For example, to the extent the revenue threshold was to be aligned to the CbCR threshold, it should be clarified that elements like those noted above (e.g. disposal proceeds and unrealised revaluation gains) are to be included within the revenue test if indeed that is the desired outcome.

4. Do respondents agree the IIR should only apply to groups that meet this threshold?

Larger MNEs currently in scope of the GloBE rules will struggle to adapt to the new system due to the inherent complexity of a jurisdictional level minimum tax system and the speed of its implementation. For many organisations, the cost of compliance may well be larger than the additional revenue collected: reporting and compliance systems will need to be changed and new, specific resources will need to be allocated to complying with Pillar 2. It is not clear therefore that it would be appropriate or indeed proportionate to extend these measures to smaller and generally more resource-constrained organisations which may in any event have more limited international footprints.

5. **Do respondents have any comments on the definition of a group or of a constituent entity?**

<u>Group</u>

In the same way as the in-scope threshold of EUR 750m should follow as closely as possible the definitions used in the CbCR, it follows that the definition of group should do the same. There are two main reasons for this:

- To avoid increasing compliance costs by capitalising on the work that has already been carried out on CbCR by both business and tax administrations; and
- To ensure the (possible) CbCR-based safe harbours operate as intended.

Permanent establishments (PE)

The Pillar 2 definition of a PE governs whether a PE is seen as a Constituent Entity (CE). Detailed guidance will be required for the application of the GloBE rules to PEs. In particular one of the difficulties lies with the definition of a PE for the purposes of the rules. The definition of PE refers to taxation in accordance with Article 7 of the OECD Model Tax Convention. Article 7 of the Convention allocates taxing rights but of course does not actually impose any taxation. Therefore it is unclear as to how the definition of PE is intended to apply to a branch located in a jurisdiction with which the head office jurisdiction has a treaty based on the OECD model but where the income of the branch is not taxed locally due to particular domestic provision. This could be because the jurisdiction of the branch exempts certain types of income, adopts different methods of allocation of income to branches under domestic rules so that it does not see all the income allocated under the treaty as being allocated to the branch for domestic tax purposes or indeed chooses not to exercise its taxing rights of the branch. An example of the latter could be a UK branch of a jurisdiction with which the UK has a treaty but where the branch has non trading income which is not subject to taxation under the UK domestic provisions.

We understand that the intention is that where the treaty allocates taxing rights to the branch location in accordance with Article 7 of the OECD Model, but the branch location simply does not exercise its taxing rights over any of the income in accordance with its domestic provisions, such a branch should not be regarded as falling within paragraph (a) of the PE definition and consideration then needs to be given as to whether the branch falls within paragraph (d) of the definition. The position is less clear however where the branch location taxes some of the income (albeit not the entire amount allocated under the terms of the treaty) because of perhaps different approach allocation of income under domestic provisions for example. It would however be helpful if this could be clarified.

6. Do respondents have any comments on the excluded entity rules and definitions?

Real Estate Investment Trusts (REITs)

We recommend that detailed consideration is given to how the rules are to be applied to the UK REIT regime to ensure that the REIT regime continues to operate in line with the Government's intentions

In some instances a UK REIT will be both a Real Estate Investment Vehicle (REIV) as defined, and the Ultimate Parent Entity (UPE). Therefore, one would expect that both it, and its >95% subsidiaries may all be excluded entities outside the scope of the Pillar 2 rules.

However, where this fact pattern is not fully met, and especially in the case of Group REIT members (which includes 75% (51% effective) subsidiaries and elected joint ventures held at least 40% by a REIT) are not held >95% by the parent, then there appears to be a very complex interaction between the excluded entity, REIV definition, investment company definition, treatment of investment companies and potential use of the Eligible Distribution Tax System rules.

As the UK tax collected in the REIT is via the withholding tax on the Property Income Distribution (PID), such tax will generally not be included in the accounts (as it is a liability of the shareholders). As such, for groups or REIT group companies which are not excluded and are in the Pillar 2 rules, it appears the only way of accessing that tax paid is through the eligible distribution tax system rules in Article 7.3 of the Model Rules. However, these rules are based on an entity by entity approach and as it is only the top REIT company making the PID whose dividends are liable to tax, it would seem that this regime would prima facie allocate all the Adjusted Cover Taxes only to this entity, even though the profits to which they relate could be earned in multiple group entities. This scenario also does not seem to meet any of the conditions in section 4.3 of the Model Rules to allocate tax paid by one entity to another.

The rules may still work on a blended basis if all the Group REIT entities are either i) all excluded, ii) all investment companies, or iii) all in the same jurisdiction. However, there will be many scenarios when different parts of the REIT group may fall into different categories:

i) If the top REIT company is the UPE, it and its >95% subsidiaries would potentially be excluded, but Group REIT companies that are owned less than 95% and REIT Joint Ventures (JVs) would be in either the investment company or main UK pool. These latter two pools are in the rules, but all the tax is currently allocated to the excluded business and therefore these two pools in the rules will result in tax free profits.

ii) If the excluded company rules are not in point, the top REIT company is still likely to be an investment company. However, less than 95% subsidiaries and REIT JVs may not be, and therefore these entities again would be in another pool, potentially earning GloBE income, but with no chance of having adjusted cover taxes allocated to them, despite their profits being included in the PID calculations.

Consideration should therefore be given to ensuring that, as far as possible, profits earned within the UK REIT regime be treated as excluded entity profits. Alternatively, there will need to be a mechanism to allocate the withholding tax on the PID distribution on a just and reasonable basis round the REIT Group companies to ensure it is matched with the underlying profits. In undertaking any such allocation, there should also be recognition for profits included in dividends paid to certain Qualifying Institutional Investors (QII) such as sovereign wealth funds and some foreign pension funds who are able to reclaim all of the withholding tax withheld (so under Article 7.3, no tax is recognised on these profits). This could be done in a similar way to Article 7.2 (UPE subject to a deductible dividend regime) whereby the amount of profits included in dividends paid to these investors are excluded from GloBE income profit or loss.

Real Estate Investment Vehicles

It would assist if the definition of a Real Estate Investment Vehicle is aligned with the definition of a UK REIT for the purpose of the UK rules. In particular, the widely held condition for each company would need to reflect that this test can still be met if the only reason the entity is not widely held is due to QII investors. Also, Group REIT members would need to be capable of tracing through to the top of the REIT to determine whether they are widely held, as on a standalone basis, they will generally not meet the condition.

UK property rich investment vehicles

A similar point arises in respect of the taxation of non-resident capital gains (UK NRCGT) for UK property rich investment vehicles outlined in Schedule 5AAA Taxation of Chargeable Gains Act 1992. The policy of the rules, especially the exemption elections in paragraph 12, was to ensure that no further UK tax would be payable compared to the position if the investors had held the underlying assets directly. This is achieved by exempting gains in the fund, but instead, taxing investors when the proceeds are distributed. The exemption is available to the fund and its 40% subsidiaries (on a proportionate basis), so again, there will be cases where the excluded entity rules may only apply to the fund and it’s 95% subsidiaries, but other entities qualifying for the exemption election will not be able to access the excluded entity rules as they are not held >95% by the qualifying fund. This will be particularly relevant for asset sales which fall within the scope of GloBE income.

Therefore, similar to the REIT issue, it will be important to preserve this key feature of the non-resident gains rules by allowing access to the UK NRCGT paid by the non-resident investors and eliminating from GloBE income such gains as are attributable to qualifying institutional investors who are exempt from UK tax on gains.

Acquiring entities

A final point on REIT’s and the taxation of non-resident capital gains for UK property rich investment vehicles is the deemed disposal of the assets prior to the regime ceasing to apply to a company (normally due to a share sale by the REIT/fund). However, under Article 6.2.1(c) it would appear an acquiring entity in the scope of the GloBE rules would be required to compute future calculations on the historical basis held by the company leaving these regimes rather than respecting the current market value recognised for UK tax. This would appear to have the effect that companies within the GloBE rules would be at a competitive disadvantage (as they will effectively inherit a latent gain) compared to a potential rival bidder who is outside of the rules. There is scope therefore for HMRC to consider how the GloBE rules may be introduced in the UK in a manner that preserves the policy intent of the existing legislation in these circumstances.

Non-profit organisations

Non profit organisations will generally be Excluded Entities and therefore whilst they may themselves be an Ultimate Parent Entity preparing consolidated accounts, they will not be subject to the GloBE rules, e.g., they will not apply an IIR. It is normal for non profit organisations to establish trading subsidiaries that are entirely owned by one or more Excluded Entity to carry on various related activities. It is not necessarily clear that these subsidiaries are themselves Excluded Entities as it may not be certain that their activities are 'ancillary' to those of their not for profit parent entity. It is common practice for these trading subsidiaries to make a Gift Aid payment of their profits to their charitable parent entity. Where this is the case, there will be no net tax payable at the level of the trading subsidiary. These Gift Aid payments are typically accounted for as distributions in the accounts of the subsidiaries.

Let’s now assume that the consolidated group meets the threshold to be within the scope of the rules. If one looks at the trading subsidiaries either on an aggregate basis or on a separate entity basis, then there is no (or little) covered taxes to allocate to these entities (due to the tax deductible Gift Aid payments). However, they have significant GloBE income as there does not appear to be any mechanism in the Model Rules to allow for a deduction for the Gift Aid payment when it is accounted for as a distribution. If this is correct, these trading entities end up being Low Tax entities with top up tax being charged either under a domestic minimum tax (DMT), to the extent it mirrors the Model rules or the UTPR.

This top up tax could have a significant detrimental effect on the charity sector and does not appear to be consistent with the aims of the GloBE rules or indeed domestic policy. Careful consideration needs to be given to ensuring that the domestic implementation of the rules appropriately addresses this issue to ensure that there are not unintended adverse consequences for the charity sector.

7. Do respondents have any views on the definitions of international shipping income?

The Commentary on the OECD Model Rules sets out that the exclusion for international shipping income is intended to be based on Article 8 of OECD Tax Convention. However, the additional conditions set out in Article 3.3.6 of the OECD Model Rules do not appear to be consistent with the OECD Model Treaty objective of exempting international shipping income more generally. The conditions in 3.3.6 appear very restrictive and do not take into account that shipping groups generally operate with ship ownership, brand ownership and operations (e.g., shoreside operations, port operations, crew management, marketing and ticket sales) separated in different companies often in multiple jurisdictions. The separate ownership structure is very common in the industry as often management and operations are centralised in one location but the ships are owned or are operated in other jurisdictions. In addition, vessel ownership is often ring-fenced in separate companies for flagging reasons and to ensure that external finance can be secured and ring-fenced against each ship and the vessel owning company individually. For example, the sales and marketing activities of a cruise line company will often take place in one main jurisdiction but the vessel owning companies and vessels will often be located in a different jurisdiction and the vessels would operate in international waters and touch multiple jurisdictions. The income generated from the sale of tickets, in this example, would be recorded in more than one company (and therefore in more than one jurisdiction) based on the arm's length principles and such income would often be exempt under various domestic shipping exemptions which are consistent with Article 8 of the Model Treaty or subject to local tonnage tax regimes. The conditions in 3.3.6 suggest that international shipping income of a CE which is located in a different jurisdiction to where the vessel owning entity company is located might not be excluded for the purposes of GloBE Income. We would suggest that this inconsistency in approach be given further consideration.

Chapter 5 Calculating the effective tax rate

8. Do respondents have comments on the practicalities of computing a constituent entity's accounting profit?

The starting point for the calculation of a CE's accounting profit (i.e., Financial Accounting Net Income (/Loss) included in the parent entity's consolidated accounts, without eliminating intra-group payments) is a data point that is not necessarily readily available in MNEs' systems. Hence, the first hurdle in the calculation of a CE's profit is a very practical one which may require changes to existing reporting systems. Other more detailed points are set out below.

Detailed guidance will be required on the application of Article 3.1.2 and in particular on the treatment of consolidation adjustments. At present it is not clear whether the correct approach is to:

1. Start with a CE's accounts converted into the Generally Accepted Accounting Principles (GAAP) used for the purposes of the consolidation (effectively the results before any consolidation adjustments); or

2. Start with the consolidated results and allocate them out to individual entities (essentially a disaggregation) reversing consolidation adjustments that eliminate intra group transactions.

The two approaches could potentially give rise to different results depending, for example, in the latter (disaggregation) approach what is done with consolidation adjustments (other than those simply eliminating intra-group transactions).

Differences in the two approaches could arise in three areas:

1) Materiality for group reporting (i.e,. deconsolidated numbers) will be higher than if starting at entity accounts;
2) Timing for group reporting is earlier in the reporting process than entity accounts. Hence, differences could arise as the extended time period results in new developments and perspectives to be considered;
3) Consolidation adjustments will cover a broad range of adjustments held at a group level. Examples are intra group eliminations, late company adjustments in the year end process, audit adjustments late in the process, foreign exchanges and hedging, policy alignment, purchase price accounting, 'group related item' such as stock options or bonus accruals, etc. Many of these adjustments will not be 'pushed down' into entity accounts or in a different period.

We note that in the Model Rules, it is unclear which accounting standard to use where an UPE prepares two sets of accounts. For example, a UK holding company listed in the US may need to prepare accounts in both IFRS and US GAAP. We note that para 6 of the commentary on Chapter 3 indicates that the appropriate Authorised Financial Accounting Standard is the one identified by the Authorised Accounting Body of the jurisdiction in which the UPE is noted. Where an entity is preparing multiple sets of consolidated accounts in different GAAPs, the GAAP used predominantly for the groups internal reporting may not always be the GAAP identified by the Authorised Accounting Body of the UPE jurisdiction. In these instances we believe that it would

be most practicable and flexible to allow the group the choice as to which set of consolidated accounts to use for the basis of the GloBE calculations.

9. Do respondents have comments on the adjustments made to the accounting profit? In particular, are there any uncertainties that could be clarified in the UK's domestic legislation whilst respecting the intended outcomes in the Model Rules?

Debt releases

The rules do not appear to include any adjustment to GloBE Income for gains arising from debt releases. This may give rise to unintended consequences, particularly where releases occur as part of insolvency or near-insolvency arrangements. Debt releases or debt-for-equity exchanges in such situations may give rise to large P&L profits. If such transactions result in a top up tax liability (which is likely particularly having regard to the application of Article 4.1.5), this could be problematic; insolvent or near insolvent companies will likely lack the funds to meet an additional tax liability. Generally, local tax rules aim to ease the burden of insolvency (by exempting any profit from tax arising in the release of the debt). More generally, if this results in a higher tax burden in such events, it makes lending to companies with any financial difficulty more expensive for banks, thus impacting their lending decisions.

In particular, the lack of exclusion for debt releases is expected to impact the Financial Services sector, where more regulated businesses are required to hold a minimum amount of equity and subordinated debt or total loss absorbing capital instruments. Not only this, but it could impact the amount of regulatory capital. This is on the basis that banks and other regulated entities generally calculate their regulatory capital requirements taking into account the tax costs of any restructuring required.

Careful consideration needs to be given to the implementation of the GloBE rules and their interaction with the existing domestic treatments of debt releases and debt/ equity swaps such domestic treatments being based on developed policy reasons which do not appear to be in conflict with the aims of the GloBE rules. Further, in line with the UK's historic policy in this area consideration is needed to providing relief for a distressed group that is loss making, such that it can refinance (e.g., by way of a debt-for-equity swap) without giving rise to a top up tax on any credit that is not immediately taxable under local principles. This could be relevant to groups who are still impacted by the effects of COVID-19, or it could also be a widespread problem were there to be a future economic downturn.

Foreign currency gains and losses

In respect of the adjustment to GloBE income relating to 'asymmetric foreign currency gains and losses' (Article 3.2.1(f)), it will be necessary to ensure that the adjustments adequately deal with any book to tax differences that arise from the specific treatment of such items under UK legislation (e.g. through the application of the Disregard Regulations (Statutory Instruments 2004/3256)). A particular difficulty here is that asymmetric foreign currency gains and losses per their definition in Article 10 appear to only arise where tax and accounting functional currencies

are different. The Disregard Regulations of course apply in other situations as well, including where functional currencies are the same.

We understand from the Commentary that consideration continues to be given to ensuring that foreign exchange differences in respect of financial instruments hedging equity investments are to be treated in the same manner for GloBE Income purposes as the underlying equity instruments (movements in respect of which will generally be Excluded Equity Gains or Losses). There does not appear to be any underlying policy reason why the GloBE rules should necessitate the restructuring of commercial hedging arrangements.

Further, the definition of asymmetric foreign currency gains and losses uses language that implies that the four types of gains or losses must all apply (i.e., an 'and' test) rather than the definition applying to only one of the four types of gain or loss. The Commentary (and its accompanying examples) makes it clear that not all four sub paragraphs must apply. However, it would still be helpful for the UK legislation to clarify that the definition of asymmetric foreign currency gains and losses applies an 'or' test. Alternatively, the legislation could state that asymmetric foreign currency gains and losses include four types of gain or loss.

<u>Derivatives</u>

We note that 3.2 of the OECD paper contains no adjustment to GloBE Income for the following.

Derivatives subject to disregard regulations

Derivatives over currency, commodities, or interest rates commonly give rise to fair value movements in income statements of a company, even though these movements may be unrealised. The movements can be very material taking into account the size of the company, particularly in volatile markets. At present, the Disregard Regulations allow for these gains to be taxed on a basis that reflects the items being hedged, which generally aligns approximately to realisation of profits or losses. This is for the good policy reason that taxation on a fair value basis is likely to give rise to large and uncertain tax charges, to the point where a company may not easily be able to fund them. For example, the gain or loss on a long term interest rate swap could be many times a company's expected cash flow in any given year. If these items are not adjusted for in computing GloBE Income, this policy is undermined. Companies may be subject to large and unpredictable fluctuations in GloBE Income.

The position is particularly acute for derivatives within regulation 4 (net investment hedging) as these differences are permanent. Their effectiveness as a hedge of an investment is undermined.

In other instances where the disregard regulations apply, the differences may be timing differences (i.e., interest rate, commodity and fx derivatives within regulations 9, 8, and 7 respectively), and thus potentially within the scope of deferred tax adjustments which may mitigate the issue. It should be noted that derivatives with a duration of over five years are common, and therefore the "recapture" rule for unrealised deferred tax liabilities may not operate effectively.

There is also a practical difficulty in applying the deferred tax rule. For example, assume a derivative with multiple cash flows such as an interest rate swap, with a duration of (say) 10 years, with fair value gains in years 1-3, and fair value losses in years 3-10. How are the gains to be paired with losses to determine whether the gain in (say) year 2 reversed within five years or not?

Derivatives over shares

Typically, transactions such as options to buy, sell, or subscribe for shares constituting more than 10% of a company are accounted for as derivatives at fair value (i.e., with fair value gains and losses recognised each year in the statutory accounts) but taxed as capital gains items (i.e., on realisation, but with no taxable event where the option is exercised). Examples would be an option to acquire some or all the shares in a company - for example to buy-out the other party in a joint venture arrangement. The consequence would appear to be that unrealised amounts are taxed, which is contrary to the current policy. We note that the current capital gains regime for derivatives over shareholdings above 10% was introduced retroactively in 2006. When the general rules treating derivatives over shares as income were introduced in 2005 without such a carve-out, some large companies faced highly problematic tax charges on unrealised gains.

We note the rules contain scope for an election to tax assets on a realisation basis. It may be possible for companies to alleviate some of the above issues by such an election. However, given that the election appears to apply to all assets of a company, such an election may be administratively unworkable if there are lots of other assets which would otherwise be taxed on an accounts basis. It is also unclear whether the exercise of an option should be treated as "realisation" or not: clearly exercise of a call option to buy shares does not generally give the company the cash with which to pay tax.

<u>Definition of the Net Taxes Expense</u>

We note that in the definition of Net Taxes Expense in Article 10, paragraph (a) includes deferred taxes. It is therefore unclear why it was considered necessary to introduce a specific reference to deferred tax assets attributable to losses in part (b) of the definition. Accordingly further guidance will be required regarding the application of this definition.

<u>Transactions at arm's length</u>

We understand from the Commentary that the intention is that there should only be an adjustment for cross-border transactions for GloBE Income purposes where there has been an adjustment for underlying tax purposes. We note that the Commentary states the Implementation Framework will consider instances where the relevant tax authorities disagree as to whether or to what extent a transfer price needs to be adjusted. We think this has the potential to give rise to increased tax disputes with multiple jurisdictions, and therefore we would welcome further clarity on this as part of local legislation where possible.

In addition it is unclear how the provisions will work in practice when for example domestic transfer pricing adjustments are only agreed several years down the line (and after any GloBE

return has been submitted). Take the following example; Co A in a High Tax jurisdiction provides services for a charge of 100 to Co B located in a Low Tax jurisdiction. After several years the tax authorities in jurisdiction A complete their audit of CoA and it is agreed that the charge for the services should have been 120 at arm's length so a transfer pricing adjustment of 20 is made to increase Co A's domestic taxable income. Following the logic of the commentary the GloBE Income of CoB should be reduced by 20 and the top up tax in jurisdiction B reduced accordingly to avoid double taxation. There does not appear to be any provision in the model rules (in Article 4.6 or elsewhere) to allow for an adjustment to and repayment of top up tax in respect of an earlier year (as a result of a post filing adjustment). We consider that this may need to be addressed further in any implementation of the rules into domestic legislation.

For completeness, we note that it is not entirely clear why there is a need to adjust for losses on wholly domestic transactions but only where the loss is taken into account for an allocation to a PE and we would welcome further clarification on this provision.

Assets and liabilities subject to fair value or impairment accounting

Where an election is made under 3.2.5 the carrying value of an asset is determined by 3.2.5 (b). However this provision makes no reference to e.g. expenditure on an asset after its acquisition which should be taken into account in the calculation of any gain. The application of this provision will therefore require further consideration and clarification.

Intra Group Financing Arrangement

It is assumed that in 3.2.7 an 'increase in taxable income' refers simply to a full inclusion in any computation of taxable profits and therefore, for example, there would still be an increase in taxable income even if the resulting profits were offset by losses brought forward. In particular, the Pillar 2 rules recognise that tax has been 'paid' on such a transaction on the basis that the utilisation of a DTA gives rise to an increase in the Adjusted Covered Taxes. Therefore, to the extent income is sheltered by brought forward losses, were the provision to apply it could result in potentially adverse and unintended outcomes for common intra group financing scenarios in the ordinary course of business, e.g., in the case of an UPE lending to a subsidiary in circumstances where the UPE is in a loss position (which can be common due to volatile elements such as foreign exchange). We presume that this is not intended to be the case?

This rule may be designed to discourage MNE Groups from entering into intra group financing arrangements that increase the effective tax rate (ETR) in a low taxed jurisdiction (i.e., the borrower) without a corresponding increase in the tax due for a high-taxed lender. We presume this provision is targeted at situations where the financial instrument has hybrid features and/or the resulting interest income is not included at all in taxable income (e.g., interest income is exempt income). We cannot discern an appropriate policy rationale for application of the provision simply because e.g., the lender is in a carry forward tax loss position.

UK grouping rules

It is presumed that the reference to tax consolidations in 3.2.8 would include the UK grouping rules but it would be helpful if this could be specifically confirmed.

It is worth noting that, as currently drafted, 3.2.8 could still give rise to one sided GloBE Income where there is an asset transfer to or from a flow through entity to another CE located in the same jurisdiction and that is in the same tax consolidation group, even though that flow through entity's income may be fully within the charge to tax for local purposes. This is because a flow through entity is a stateless entity for the purposes of determining its location as per 10.3.2(b), whilst 3.2.8 requires the transactions to be between constituent entities in the same location. There is therefore scope for consideration to be given to extending the benefit of this provision to transfers between flow through entities and entities located in the same jurisdiction as the members of the flow through entity.

Equity gains and losses

Capital Gains

The computation of capital gains for UK corporation tax purposes does not necessarily follow the computation of profits and losses for accounts purposes. Furthermore there are a number of reliefs such as reinvestment reliefs provided for in statute. These factors alone or in combination may result in taxable profits not being aligned with accounting profits which in turn may give rise to top up tax where domestic policy has clearly prescribed no, reduced or deferred taxation. We believe further consideration should be given to this when seeking to implement the GloBE rules into domestic legislation.

Substantial Shareholdings Exemption (SSE)

We note that in a number of instances the SSE may apply to exempt gains that do not fall within the definition of Exempt Equity Gains and Losses for the purposes of the GloBE rules. This in turn gives rise to the risk that top up tax may arise where domestic policy has specifically determined that any gain should be exempt. The impact of this potential conflict with and 'reversal' of a significant and clear domestic policy decision by the GloBE rules should be considered further as part of any implementation process.

FX movements on redeemable preference shares

It is not entirely clear that foreign exchange movements on redeemable preference shares (i.e., those accounted for as debt) are within the definition of Excluded Equity Gains or Loss. It would be helpful if this point could be clarified.

Additional Tier One Capital

Article 3.2.10 sets out the treatment for Additional Tier One Capital in the computation of GloBE Income or Loss. Given the definition in Article 10, article 3.2.10 applies only to the banking sector. However, the insurance sector has an identical fact pattern, and identical requirements, and therefore there does not appear to be any reason why 3.2.10 should not also apply to the insurance sector.

UK incentive regimes

Article 3.2.4 states that “Qualified Refundable Tax Credits” shall be treated as income in the computation of GloBE Income or Loss, and that “Non-Qualified Refundable Tax Credits” shall not. Article 4.1 sets out that “Qualified Refundable Tax Credits” should not form part of “Adjusted Covered Taxes” (and to the extent they are booked in current tax expense the credit is reversed). Article 4.1 also sets out that “Non-Qualified Refundable Tax Credits” should form part of “Adjusted Covered Taxes” (and to the extent they are not recorded in current tax expense then an adjustment needs to be made to take the amounts into account).

As such we would generally expect the benefit of the UK Research & Development Expenditure Credit (“RDEC”) to be preserved and not give rise to top-up taxes. However the benefit of other UK incentives such as Patent Box and Creative Sector Tax Reliefs would not be preserved and groups claiming these incentives may suffer top-up taxes under Pillar 2.

We note that HMRC may wish to consider whether the Patent Box and/or Creative Sector Tax Reliefs regimes should be redesigned to fall within the definition of Qualified Refundable Tax Credits. In the absence of amendments to the rules, these reliefs are likely to be less valuable to affected groups and therefore to be less effective in achieving their aims of attracting and retaining the desired highly skilled and culturally valuable jobs in the UK. In the case of film, television and video games tax relief in particular, the reliefs are a mechanism to provide up to 20% funding for certain qualifying productions. These activities are often transferable to other territories, and the international landscape is highly competitive with many countries offering direct funding and/or tax credits. As such, without changes to the rules, these UK industries could be adversely impacted contrary to the UK policy intent by the introduction of Pillar 2.

In respect of RDEC, we note that a step 2 amount carried forward would likely not fall within the definition of a Qualified Refundable Tax Credit. In addition, where the RDEC is capped due to a lower “total expenditure on workers” (Step 3 under s104N(2) CTA 2009) the RDEC may also not meet the definition of a Qualified Refundable Tax Credit. The application of the rules to businesses in these circumstances will require further consideration, and additional guidance will likely be needed.

10. Do respondents have views on the rules allocating profits between jurisdictions?

There appears to be a mis-match between the rules allocating taxes and the rules allocating income for flow through entities in certain circumstances. Take the example of Co A owns Co B which in turn owns Co C. Co C is a flow through entity. Co A sees Co B and Co C both as tax transparent entities and accordingly pays tax on Co C’s income. Co B however sees Co C as a reverse hybrid. Under the terms of the GloBE rules it appears that Co C ends up being a stateless entity with its income allocated to it accordingly. However there is no provision to allocate the tax paid by Co A on Co C’s income down to Co C thus giving rise to the risk of double taxation. This does not appear to be consistent with the policy of the GloBE rules and therefore further consideration should be given to this apparent anomaly.

11. What are respondents' views on the impact of the branch rules on business models involving branches taxed under the credit method?

We do not have any comments at this point.

12. Do respondents have views on the rules on Covered Taxes and their assignment?

There are cases where it is unclear if a specific duty or tax is levied on profits and income and hence, if it can qualify as a covered tax. Gaming duties are an example: some appear to be levied on profits, others on gross revenues. Other measures which could create uncertainty are the Overseas Receipts in respect of Intangible Property rules and the diverted profit tax. More of these cases will arise as tax systems evolve. In this context, it would be helpful if HMRC could provide further clarification as to what is included in Covered Taxes in 4.1 and 4.2, as well as a list of covered taxes to be updated regularly.

We note that in 4.3.3 the definition of Passive Income includes royalties. Royalties however can be received as part of a trading activity and are therefore not necessarily correctly regarded as passive. Consideration should be given to reflecting this point in the implementation of the rules.

13. Do respondents have views on how rules on timing differences work including whether there are any uncertainties around how the rules operate that could be further clarified in domestic law?

The Total Deferred Tax Adjustment Amount is defined by reference to the deferred tax expense in a Constituent Entity's financial accounts and not by reference to the charge included in the Consolidated Financial Statements. The two amounts could be different. The book carrying value of an asset in the Consolidated Accounts could be different from the book carrying value of an asset in the Constituent Entities accounts for example in the case of an intragroup transfer an asset may be held at historic carrying value in the Consolidated Accounts whereas in the Constituent Entities accounts the carrying value will be based on the amount paid (typically current market value) for the asset. This difference in carrying value would in turn give rise to a difference in the calculation of the deferred tax expense. Accordingly further guidance is required on how to arrive at the Deferred Tax Adjustment Amount in the GloBE rules.

The requirement in Article 4.4.1 to recompute the deferred tax expense at 15% (where that is lower than the local rate) appears to have the potential to give rise to top up tax even where the effective rate of tax is higher than the minimum rate. The concept underpinning deferred tax is that the timing of income and expense recognition is different for accounting and tax purposes. A deferred tax expense is therefore in essence a credit for corporation tax paid on the underlying profits in a different period. The corporation tax is obviously paid at the local statutory rate, which may be higher than the minimum rate. As there is no mechanism for the carry forward or back of any excess tax, recomputing the deferred tax at the lower minimum rate appears to inevitably give rise to a risk of top up tax where there are favourable book-to-tax differences (i.e. permanent deductions that are brought into account for local tax purposes but not for accounting purposes) in the period in which the Deferred Tax Asset (DTA) unwinds. It is not clear how this outcome

achieves the general principles of Pillar 2 and consideration should be given to whether there is an ability to amend or otherwise limit the application of the provision to avoid anomalous results.

Having regard to Article 4.4.1(e) there is no definition of “tax credit”, whilst there are very limited examples of tax credits within the Commentary. It would be helpful for guidance to clarify what a tax credit is, including a list of credits which fall within this definition that is maintained on a regular basis.

It would be helpful if the terminology in article 4.4.2 is clarified in respect of ‘paid’ and whether this should also be taken to mean where deferred tax has reversed.

Further clarity should be provided that sets out which assets are capable of being tangible assets as referred to in Article 4.4.5(a) as well as the application of 4.4.5(c). Tangible assets generally consist of property that is classified as Property, Plant and Equipment for financial accounting purposes. Additional clarity would therefore also be needed on whether e.g., mine or oil and gas exploration and development costs can be part of the Recapture Exception Accruals when deducted as incurred or amortised over a brief period for tax purposes and then capitalised into the natural resource asset for accounting purposes. There may be many significant assets that are capitalised for accounting purposes where it may not be entirely clear whether they are to be regarded as “tangible” as set out in this article if the term is to be limited to Property, Plant and Equipment. We assume that the term ‘tangible’ is simply used in contradistinction to ‘intangible’ and so tangible assets are intended to cover all assets that are not ‘intangible’. Adopting too narrow a definition for ‘tangible’ assets would appear to result in differences in treatment for different activities where there is no reason for such differences having regard to the policies underlying the GloBE rules.

Adjustments set out in 4.6.1 do not appear to permit or provide the option to adjust for material increases in Covered Taxes in the prior year whilst it requires material decreases to be adjusted. As such, this is a one sided approach: for example, in case of an increase in Covered Taxes, the taxpayer would not be able to reduce or eliminate a top up in a previous year;this would not be counterbalanced by a decrease or elimination of the top up tax in the current year whenever the ETR of the current year is above 15%. It would appear more consistent and logical for the provision to operate symmetrically addressing both increases and decreases in Covered Taxes for prior years. We also note that there is a slight discrepancy between the Model Rules (which states an increase in Covered Taxes shall be recognised in the current year) compared to the Commentary (which states that 4.6.1 permits this treatment). It should therefore be made clear whether this treatment is mandatory.

Further, we note that by the time GloBE returns are filed, taxpayers may be expected to know the actual tax applicable to a particular year. It may therefore be helpful if the taxpayer had the option of correcting the covered tax for the year they are filing the GloBE return for (noting that the adjustment will be in tax expense in the consolidated accounts in the subsequent year).

Chapter 6 Calculating the top up tax

14. Do respondents have any comments on the special provisions for computing the ETR and top up of investment entities, joint ventures or minority owned constituent entities?

It is not entirely clear why it was felt necessary to calculate the top up tax for Minority-Owned Constituent Entities separately per Article 5.6. In particular further clarifications on Article 5.6 would be helpful regarding the following points:

- Is Article 5.6 intended to apply to Minority-Owned Constituent Entities that are part of a separate MNE group, also within the scope of the Pillar 2 rules?
- The interaction between Article 5.6.1 and 5.6.2 is unclear. For example, 5.6.2 states "this provision" does not apply if the Minority-Owned Constituent Entities is an Investment Entity. This begs the question as to whether 5.6.1 can apply to Investment Entities.

In addition to the points above regarding Minority-Owned Entities, examples will greatly assist business to understand how the Joint Ventures rules (Article 6.4) are intended to apply and interact with other rules.

To determine each UPE's share of top up tax in a Multi-Parented MNE Group (MPG), each UPE must determine its Allocable Share (2.2.3) requiring each UPE to consider "hypothetical Consolidated Financial Statements" to determine the Ownership Interests held by non-MNE Group members. In most cases, each UPE of an MPG that is a dual listed company arrangement does not prepare separate Consolidated Financial Statements. While it is difficult to consider hypothetical Consolidated Financial Statements without in fact preparing them, nonetheless it should be clarified that the rule does not in fact require the preparation of accounts. Requiring preparation of accounts creates significant additional cost and it would be most proportionate to allow affected groups discretion on how they address the requirements.

15. Do respondents have views on the process for calculating top up tax?

Loss making entities

The effect of Article 4.1.5 appears to give rise to a top up tax even when a jurisdiction is in an overall loss position. It is not entirely clear that this is consistent with the overall aim of Pillar 2 to ensure profits are subject to a minimum tax. Consideration should be given to whether there is any ability to amend or otherwise limit the application of this rule. In this regard we note that there does not appear to be any ability to reduce any top up tax liability by a substance based carve out in these circumstances.

The application of article 4.1.5 could have specific implications for the UK economy, given the UK is often the location of choice for the headquarters of many MNEs. It is not uncommon for UK headquartered groups with limited UK operations to be loss making in the UK. This can be for a variety of reasons including debt taken on at the UK level not fully passed down to the overseas operations, together with other head office costs borne by the UK. Should these companies have favourable book tax permanent differences giving rise to tax losses higher

than accounting losses, article 4.1.5 will imply a top up tax on any such permanent differences.

The drawbacks of article 4.1.5 are particularly significant in distressed situations. A possibly large number of debt restructurings may give rise to P&L credits which would potentially suffer a top up tax due to the lack of carve out from the GloBE rules for such credits. This does not seem to accord with the domestic policy of allowing such restructurings to occur without prohibitive tax liabilities. The outcome of the application of article 4.1.5 does not seem to be in line with the policy underlying the GloBE rules that ensure profits suffer a minimum 15% tax charge. In the situation described in this paragraph, there is no real economic profit.

Tangible assets

The concept of “tangible assets” is key in the functioning of many sections of the GloBE rules: deferred tax, Undertaxed Profits Rule (UTPR) and the substance based carve out. As far as possible the definition should be consistently used across the various sections and calculations of the Pillar 2 ETR and the top up. If different definitions are required this should be explicitly addressed. Further comments on the concept of tangible assets may be found under question 13 above.

Property leases

It would also be helpful if clarity is provided regarding how property held for a lease between CEs is to be treated for the purposes of Article 5.3.4 (and elsewhere in the rules) . If property used for intra group leases were somehow excluded (or otherwise disadvantaged) this could entail taxpayers in undertaking unnecessary restructuring of their commercial operations.

Safe harbour rules

We note that the safe harbour rules refer to Chapter 5. However, top up tax can arise under Article 4.1.5 separately to the application of Article 5.2. It should therefore be clarified if the safe harbour is capable of switching off any top up tax under both Articles 5 and 4.1.5.

Substance-based carve outs

The rules state for substance-based income exclusions the carrying value of Eligible Tangible Assets are net of accumulated depreciation, amortisation, or depletion and including any amount attributable to capitalisation of payroll expenses. It should be clarified that the carrying value is not to be reduced for impairment losses. Including impairment losses in the carrying value does not necessarily appear to be consistent with the policy intent of the substance-based income exclusion to recognise investment. Consistent with this approach the fact that it’s been impaired should have no bearing on the fact that the investment has been made. Furthermore it is noted that excluding impairments from 5.3.5 is consistent with the calculation of Globe Income at 3.2.1 where impairments are also ignored.

Chapter 7 Charging mechanisms

16. Do respondents have any comments on how the IIR provisions should be reflected in the UK domestic legislation while respecting the agreed outcomes in the OECD Model Rules?

There is scope for the top up tax paid by a UK company under the IIR to be deemed to be Corporation Tax, or a brand new tax with its own collection mechanism. The choice of collection mechanism (corporation tax or a new tax) could have implications for the application of bilateral treaties. More generally, we note that a number of commentators have already expressed concerns regarding the Top Up Tax and whether it is consistent both with treaties and customary international law due to the lack of nexus between the low tax entity and the entity that ends up paying the Top Up Tax. Uncertainty in this area potentially leading to future litigation is clearly undesirable. We therefore believe that further consideration should be given to the possible use of say a Multilateral Instrument (MLI) to reduce any concerns in this area.

17. Do respondents have any views on how information or administration challenges with the split ownership rules could be addressed in the implementation framework?

We do not have any comments at this point.

18. Do respondents have views on how the UTPR should be brought into charge in the UK?

We do not have any comments at this point.

19. Do respondents have any other comments on the UTPR provisions in the OECD Model Rules?

It appears that the intention of 2.5.2 is that a Minority-Owned Constituent Entity's top up tax is reduced to zero for the purposes of UTPR even where the full top up tax may not actually be collected under the IIR provided the UPE of the consolidated Group applies an IIR. It would be helpful if this was confirmed.

Where 2.5.2 applies such that all CEs are subject to an IIR and accordingly the Top Up Tax to be collected under UTPR is set to zero. Consideration should be given to the administrative filing requirements and any simplifications that can be introduced to ensure the compliance burden is proportionate.

It appears that 2.6.3 can result in no current year Top up Tax being allocated to a particular jurisdiction no matter how small the brought forward unrecovered amount is. Consideration should perhaps be given to whether it may be appropriate to allocate some Top Up Tax to a jurisdiction if the brought forward amount is small such that there is capacity in the current year to absorb additional Top Up Tax.

We note that the provisions dealing with the situation where the UPE is a Flow-through entity in Article 7.1 require inter alia knowledge regarding the tax position of the members of the flow through entity (see 7.1.1 (a)). This is clearly administratively very difficult in the case of a widely held entity. Guidance should therefore be provided as to how this condition (and in particular the ‘reasonable expectation’ in 7.1.1 (a) (ii)) may be satisfied in practice.

Chapter 8 Transition rules

20. Do respondents have views on how rules on the transition rules work including whether there are any uncertainties around how the rules operate that could be further clarified in domestic law?

Guidance will be required in respect of tax attributes on transition as to what is meant by 'disclosed' in the accounts (Article 9.1.1). In particular clarification will be required as to whether regard is had to the Consolidated Accounts, the Constituent Entity Accounts or both/either. For example take a historic transfer of an asset from Company A to Company B for market value cash consideration. This would be accounted for at market value from an entity accounts perspective but at historic carrying value on consolidation. If Company B has market value tax basis then on consolidation there would be a DTA based on the difference between market value and historic carrying value, however in the CE books prepared under parent GAAP there would not be a DTA (assuming no difference between book and tax amortisation). This question is relevant to the approach taken to deferred tax by the rules more generally and not just a point for the Transitional provisions as noted in the response to question 13 above.

Furthermore, in respect of Article 9.1.1, it appears that the intention is that the utilisation of tax attributes brought forward into the regime will generally be subject to the application of Article 4.4.1. However, para 5 of chapter 9 of the commentary is clear that there is no requirement to recalculate the tax attributes (e.g., the deferred tax assets) as if the GloBE rules had applied when those attributes arose. Accordingly, it appears that Article 4.4.1 (a) does not require any adjustment to the deferred tax expense when a deferred tax asset arising under the transitional rules is utilised, even where that deferred tax asset may relate to items that would not have been taken into account in a GloBE income calculation (e.g., a tax deductible loss arising from the disposal of an equity interest). It would be helpful if this could be confirmed in guidance and if such guidance would then clarify further how the remaining parts of Article 4.4.1 apply in the case of the utilisation of transitional assets.

Deferred tax assets relating to losses on the disposal of shares taking place after 30 November 2021 are not brought forward into the regime even where a gain on those shares would have been taxable under local tax law. It appears that this asymmetric treatment is also reflected in Article 4.1.3 where any tax on a gain on the sale of shares is excluded from Covered Taxes. However, a tax deductible loss on the sale of shares could give rise to top up tax. This means that a top up tax could arise simply because a jurisdiction taxes and relieves gains and losses on share disposals. This asymmetry does not seem in keeping with the principles of the rules and consideration should be given as to whether there is an ability to allow for losses (and gains) on equity transactions to be brought into where they are fully taxable (or deductible).

By virtue of Article 9.1.3, there appears to be a restriction on the step up in the basis of an asset on an intra group transfer after 30 November 2021. This is true even if the gain on the disposal was taxable, which appears to lead to potential double taxation. This is on the basis that if a company inherits a lower base cost for Pillar 2 purposes, any future disposal could lead to taxation under Pillar 2 even though it has potentially been taxed previously on the initial transfer. The rationale for this is not clear and consideration should be given to whether there is the ability to allow for a step up when the corresponding gain has been subject to taxation.

More generally detailed guidance will be required on the operation of 9.1.3. We understand that the intention of the provision is to restrict the basis on which depreciation is calculated going forward for GloBE income purposes to the historic carrying value. There remain some uncertainties however in exactly how the provision will apply in practice.

For example, consider a series of intra group transfers of intellectual property (IP) with a 5 year life. Let's assume IP had originally been transferred prior to the transition period from Company A to Company B for cash of 100, which was equal to its market value. The carrying value in A had been 50. In the accounts of B in the following period, the amortisation charge is 20 (based on a 5 year useful life compared with the 100 carrying value), but in the consolidated accounts, on the basis that the intragroup transactions are ignored for consolidated accounting purposes, the amortisation in the consolidated accounts is 10 resulting in a consolidated carrying value of 40. Consider now a scenario where B then transfers the IP to another group company, Company C, (within the transition period) when the IP's market value was 120. Article 9.1.3 states that the basis in C shall be per the disposing entity's carrying value (i.e. B's carrying value of 80). This appears to be the case notwithstanding the fact that the carrying value of the IP in the consolidated accounts is 40. We note here that, based on the application of Article 6.3.1, the starting point for deferred taxes and asset carrying values appears to be the entity accounts. It appears from the Model Rules and the Commentary, that there is no recognition of a step up in the asset carrying value, and that this is in line with the policy intent of Pillar 2. On this basis, the asset carrying value for GloBE purposes appears to be a value of 80 (i.e. B's carrying value) and we presume, that the amortisation taken into account in calculating C's GloBE income going forward is based on the carrying value of 80. A question remains however regarding the calculation of the DTA for GloBE purposes in these circumstances. We understand that the intention is that a DTA should be established based on the difference between the GloBE carrying value of 80 and C's tax basis of 120. It would be helpful if these points could be clarified in guidance.

In addition to the above clarification will be required regarding the use of the term 'transfer' in 9.1.3. Is this a reference to a legal concept of transfer, an accounting concept or a tax concept? We understand that the intention is that the starting point (as for all other parts of the GloBE rules) should be based on the accounting treatment. That being the case however further guidance will be required for situations such as the allocation of an asset from a PE to its head office or vice versa where there is clearly no transfer at legal entity level.

Chapter 9 Reporting and payment

21. Do respondents have views on the proposed approach to reporting?

There are likely to be considerable issues in practice regarding the implementation of the filing obligations (Article 8.1). In particular, the information to be declared is very extensive and could become even more onerous if local requirements are introduced in addition to those set out in the Model Rules. It will be important that this is addressed, possibly in the OECD Implementation Framework.

The OECD model GloBE rules are currently silent on providing a specific unilateral process to audit GloBE returns. A number of questions arise. As domestic legislation takes precedence over an OECD model, does HMT / HMRC envisage a globally agreed process or an MLI to be established to override domestic legislation? If not, is it expected that the GloBE returns will fall within similar UK Corporate Tax Administration rules, such as the powers and time limits to open enquiries and issue assessments? Having a global time limit is likely to be beneficial to create certainty and reduce business costs. Further consideration is also required regarding how any outcome of any enquiry or assessment is resolved or appealed and whether there are differences between a UK headed group and a foreign headed group.

It would also be helpful to clarify explicitly how individual tax jurisdictions Corporate Tax (CT) enquiry / audit outcomes which impact ETRs interact with the GloBE calculation. Given the UK time limits and powers to issue a discovery assessment is 4 years and longer depending on the behaviours (and if appealed through the tribunal process a resolution can take substantially longer to achieve), a question arises regarding how HMRC will give effect to the adjustments which can impact historic years, specifically in relation to the UK's domestic rules and powers, but also foreign tax jurisdictions' powers to amend relevant ETRs.

Transfer Pricing (TP) is an area in recent years where there have been many adjustments to the UK tax returns impacting the ETR. Frequently the outcome of a TP enquiry is that there is double taxation and the Mutual Agreement Procedure (MAP) process is initiated to eliminate the double taxation. This raises a question regarding whether HMT / HMRC consider MAP to be a potential solution to resolve impacts on ETR and top up taxes. If so, a further question follows regarding how does HMT / HMRC propose to deal with territories where there is no route to MAP through the treaty or the treaty does not have an arbitration clause resulting in further uncertainty.

22. Do respondents have views on the approach taken to collecting liabilities under the IIR or UTPR?

We do not have any comments at this point.

23. Do respondents have views on the time limit for notifying the group is in scope of the Globe?

We do not have any comments at this point.

24. Do respondents have views on whether payments should be made quarterly or annually for Pillar 2?

We do not have any comments at this point.

25. Do respondents have views on an appropriate payment deadline for Globe liabilities?

Requiring payment of top up taxes 9 months after the end of the financial year in scope could be challenging for business, given the novelty of the GloBE system and the fact that information and calculations would need to be carried out across several different jurisdictions.

As a practical matter, consideration should be given to deferring the payment and possibly aligning its deadline with that of the submission of the Pillar 2 return (15 months after the end of the financial year).

26. Do respondents have views on the importance of giving credit interest for early payments?

We do not have any comments at this point.

27. Do respondents have views on making UK constituent entities joint and severally liable for any (UK) Globe debts?

We do not have any comments at this point.

Chapter 10 Simplification

28. What are respondents' views on a CBCR based safe harbour and how it should be designed?

Given the already extensive compliance burden of the rules themselves, any safe harbour to be effective, needs to ensure as few as possible additional calculations are performed and are based on information already held or readily available. This suggests that any safe harbour based on CBCR should follow as closely as possible the information already included in the CBCR return with any necessary calculations being based thereon and as straightforward as possible.

Consideration should also be given to further non-CbCR based safe harbours. For example a safe harbour could perhaps be based on the presence of a qualifying DMT in a jurisdiction.

29. How could timing differences be addressed within a CBCR safe harbour design? Do they need to be?

We do not have any comments at this point.

30. Do respondents have views on how the rules should address when a business moves from the safe harbour into the main Pillar 2 regime?

We do not have any comments at this point.

Chapter 11 Further work in the OECD

31. Do respondents have any comments on this further implementation work?

We do not have any comments at this point.

Chapter 12 Domestic minimum tax

32. Do respondents agree that a DMT could help to reduce compliance costs for businesses?

Compliance burden

It is unclear whether compliance costs of Pillar 2 will be reduced by the application of a DMT, especially if MNEs will have to comply with DMTs in many different jurisdictions and, at the same time, the Pillar 2 return and its calculations will require to be filed in any event. Nonetheless, as noted above a safe harbour based on the existence of a DMT could help reduce some of the compliance burden.

Overall, the effect on compliance costs will depend on the specific design of the DMT. So as not to increase the compliance burden dramatically, the following could be considered:

- DMTs only apply to companies subject to a top up tax;
- Rules are in alignment as far as is possible and appropriate with Pillar 2 Model Rules to avoid having to make two different sets of calculations; and
- There is general international standardisation (through perhaps the Implementation Framework at OECD level) of DMTs to avoid as far as possible a scenario where every country has different rules; and
- The implementation rules recognise that in some cases, a UK company may not have sufficient access to information to prepare a DMT return based on consolidated GAAP GloBE rules.

Top up tax credit

A full credit in relation to the overall top up tax is allowed for a Qualified Domestic Minimum Top-Up Tax (QDMT) by virtue of Article 5.2.3. Therefore, in many cases, this will reduce the GloBE Top-up Tax to nil. However, QDMT paid or accrued in excess of the Top-up Tax computed under the GloBE Rules will not reduce the GloBE Top-up Tax below zero or result in a refund of, or credit against future, Top-Up Tax under the GloBE Rules. As such, this could lead to double taxation. Consideration therefore needs to be given to the design of the QDMT such that to the

extent there are any differences in the basis of calculation which could give rise to excess tax provision is made to reduce, refund or give credit for this in a future period.

33. Do respondents have views on whether the DMT should apply to both UK headed and foreign headed groups?

We do not have any comments at this point.

34. Do respondents agree that the DMT should only apply to groups with over €750m of revenue to align with the P2 population?

We do not have any comments at this point.

35. Do respondents have any comments on the policy design of the DMT?

We do not have any comments at this point.

Chapter 13 Wider reforms interaction with existing BEPS measures

36. Do respondents consider there are reforms which would have a significant benefit in reducing compliance burdens without exposing the UK tax base to material risks?

We do not have any comments at this point.

Chapter 14 Assessment of impacts

37. Do you have any comments on the summary of impacts?

We do not have any comments at this point.