

OECD releases model rules for global minimum tax

DECEMBER 23, 2021 9 MIN READ

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Authors: [Patrick Marley](#), [Amanda Heale](#), [Ilana Ludwin](#)

In this Update:

- The OECD released model Global Anti-Base Erosion Rules (GloBE) under Pillar Two to implement a global minimum tax on December 20, 2021
- The model GloBE rules set out the scope and mechanism of the proposed global minimum tax, which has two domestic components: the income inclusion rule (IIR) and the undertaxed payments rule (UTPR)
- The IIR and UTPR were previously described at a high level, but the model rules released earlier this week provide significant details on how these rules will apply and interact
- The model GloBE rules include information about its administration, including the information return filing process
- Implementation of the GloBE rules in Canada will not be straightforward and the proposed timeline is ambitious given Finance Canada's already extensive agenda
- A Commentary relating to the Model rules is expected in early 2022, which is expected to also address co-existence with the US Global Intangible Low-Taxed Income (GILTI) rules
- Further details on Pillar Two's treaty-based subject to tax rule (STTR) are expected in early 2022
- Public consultations on the new rules are expected in February and March of 2022

On December 20, 2021 the OECD released [model rules](#) to implement a global minimum tax. The Global Anti-Base Erosion Rules (GloBE) were developed under Pillar Two of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and were [approved in principle on October 8, 2021](#). The October agreement had provided for the development of model GloBE rules by the end of November 2021, a new multilateral instrument by mid-2022 and an implementation framework by the end of 2022.

The Pillar Two proposals included two rules for inclusion in countries' domestic tax systems — the income inclusion rule (IIR) and the undertaxed payments rule (UTPR) — and one treaty-based rule — the subject to tax rule (STTR). The model GloBE rules released this week address the domestic elements of Pillar Two, the IIR and the UTPR. They do not include any further information on the STTR, which is expected in early 2022.

Commentary on the proposed GloBE rules is expected in early 2022, together with details on proposed co-existence with the US GILTI rules. This commentary will be important to ensure a level playing field between the United States and other members of the Inclusive Framework (such as Canada).

Key features of the GloBE rules

The GloBE rules are intended to apply starting in 2023 but must first be implemented into the domestic law of Canada or other members of the Inclusive Framework. The GloBE rules will apply to multinational enterprises (MNEs) with annual global revenue of at least €750 million in two (or more) of the preceding four fiscal years. Certain entities — including certain governmental entities, non-profit entities and pension funds, as well as investment funds and real estate investment vehicles if they are the ultimate parent entity of the MNE — are excluded. Certain subsidiaries may also be excluded (i) where at least 95% of the value of the entity is owned directly or indirectly by excluded entities, and where the entity operates exclusively or almost exclusively to hold assets or invest funds for the benefit of excluded entities or carries out activities ancillary to excluded entities, or (ii) where at least 85% of the value of the entity is owned directly or indirectly by excluded entities, provided that substantially all of the entity's income is excluded dividends or excluded equity gains or losses. An election is available to not treat certain entities as excluded entities (which cannot be revoked for five years). Separately, international shipping income is generally excluded.

As expected based on the October agreement, the GloBE rules include a “top-up” tax to increase the effective tax rate to up to 15% for the subsidiaries and permanent establishments of an MNE in a jurisdiction. The amount of the top-up tax is computed by determining the MNE's effective tax rate, excess profits and top-up tax for each jurisdiction:

1. **Effective tax rate:** total income taxes divided by the total income/loss of an MNE's subsidiaries and permanent establishments in a jurisdiction. The model GloBE rules set out how to determine the income/loss and income taxes, which are generally based on the income/loss and income taxes for financial statement purposes (computed under IFRS or certain local countries' GAAP), as modified by a limited number of adjustments (e.g., excluded dividends and equity gains/losses, asymmetric foreign currency gains/losses, policy disallowed expenses, prior period errors and changes in accounting principles). Specific rules govern how to account for deferred income taxes, including a recapture mechanism for deferred tax liabilities that are included in computing the effective tax rate for a year but are not paid within five years. Transactions between different jurisdictions within an MNE group must be recorded at the same amount and in a manner consistent with the arm's length principle. An election is available to use tax rules (rather than accounting rules) for stock-based compensation deductions (which cannot be revoked for five years). Other five-year elections apply to assets/liabilities that are subject to fair value or impairment accounting, or for purposes of eliminating certain amounts within the same jurisdiction of a consolidated group. Special rules apply for allocating income and losses to different subsidiaries and permanent establishments within an MNE group (including through flow-through and hybrid entities), and for uncertain tax positions.
2. **Excess profit:** the income for the jurisdiction determined under the first step is reduced by a substance-based income exclusion equal to a percentage of the carrying value of (i) tangible assets (property, plant and equipment, natural resources, lessee's rights to use tangible assets and certain licences to use immovable property or exploit natural resources), and (ii) payroll costs in respect of that jurisdiction. The applicable percentage will be 8% and 10% respectively for the first year, then declining gradually over ten years to 5% for both.

3. **Top-up tax:** excess profit multiplied by the top-up tax percentage (the difference between 15% and the effective tax rate for the jurisdiction), minus certain existing domestic minimum top-up taxes.

The primary liability for paying the top-up tax is imposed under the IIR on the highest parent entity of the MNE resident in a jurisdiction that has implemented the IIR. This liability is proportionate to the parent entity's ownership interest in the entities in respect of which the top-up tax is computed. Detailed rules are provided for allocating the IIR among different entities to address split-ownership.

To the extent any portion of the top-up tax is not paid under the IIR, the UTPR applies on a residual basis. The residual top-up tax is allocated amongst jurisdictions that have implemented the UTPR and in which an MNE has subsidiaries or permanent establishments. The allocation is based on the proportion of employees and value of tangible assets in the jurisdiction relative to the total employees and value of tangible assets of the MNE (equally weighted). The UTPR is collected by denying deductions that entities in the jurisdiction would otherwise be entitled to claim such that their increased cash tax expense equals the residual top-up tax allocated to that jurisdiction.

An annual election is available to prevent any top-up tax being imposed under the model rules in respect of jurisdictions in a year where an MNE has revenue of less than €10 million and income of less than €1 million (or a loss), as determined by averaging those amounts for the current and two preceding fiscal years. The model GloBE rules also provide for potential safe harbours, to be developed at a later date. Certain "start-up" MNEs are excluded from the application of the UTPR for the first five years when they would otherwise owe top-up taxes.

Additional rules apply to address corporate restructurings and holding structures — including mergers and demergers — or when a subsidiary or permanent establishment joins or leaves an MNE group during the year. These rules also address multi-parented MNE groups, joint ventures, and transfers of assets or liabilities as part of a reorganization.

Other rules apply to certain tax neutrality and distribution regimes (e.g., where an ultimate parent entity is a flow-through entity or is entitled to deduct dividend payments, or where taxes apply to earnings when they are distributed or deemed to be distributed). Five-year elections are also available to (i) treat certain investment entities as tax transparent where the owner is subject to tax on a mark-to-market basis at a rate that equals or exceeds the minimum rate, or (ii) apply a taxable distribution method to investment entities where the owner can reasonably be expected to be subject to tax on distributions at a rate that equals or exceeds the minimum rate.

The model rules call for each entity of an MNE either to file an information return or designate another entity in the jurisdiction to file on its behalf. Alternatively, an entity in another jurisdiction can file on its behalf if that other jurisdiction has a competent authority agreement that provides for the automatic annual exchange of GloBE information.

Implications and next steps

The model GloBE rules are drafted so that jurisdictions can implement them quickly. Of note, on December 22, 2021 the European Commission published a [proposed EU Directive \[PDF\]](#) to incorporate the Pillar Two rules into EU law. The GloBE rules are designed as a "common approach", meaning that countries are not required to adopt the rules, but they must accept their application by other Inclusive Framework members. Canada is expected to adopt the GloBE rules, although the timing for adoption is uncertain.

Numerous differences between Canada's existing tax system and the design of the GloBE rules will make their adoption a challenging process. In particular, Canada does not currently rely on consolidation or accounting income, which are central to the model GloBE rules. Instead, Canada's domestic income tax laws compute income on a legal entity basis and there are significant differences between income as determined for Canadian income tax purposes and as presented under IFRS or local country GAAP. Other areas that may create complexity include the interaction between the GloBE rules and Canada's CFC regime (the foreign accrual property income or FAPI rules), and disputes between two jurisdictions that result in an income reallocation — which can occur years after the fiscal year in which the income arose.

Moreover, Finance Canada has an extensive list of outstanding draft legislative proposals and consultations to implement previously announced initiatives. The 2021 Federal Budget proposed two important legislative amendments to address earnings stripping and "hybrid" transactions. Draft legislation on these proposals has not yet been released (although it was expected for the earnings stripping rule in summer of 2021, and for the anti-hybrid measures "later in 2021"). Budget 2021, which was released in April 2021, also promised to release a consultation paper on changes to Canada's international transfer pricing rules "in the coming months". The federal 2020 Fall Economic Statement released in November 2020 had similarly proposed to launch consultations "in the coming months" to amend Canada's general anti-avoidance rule. No consultation on either initiative has been released to date. For more information about these proposals, please see the Osler Updates dated [April 19, 2021](#) and [November 30, 2020](#).

Given the complexities of implementing the GloBE rules in Canada and the other outstanding items on Finance Canada's agenda, the OECD's proposal that the new rules be effective in 2023 is ambitious. Taxpayers will need extensive advance notice of the precise mechanics of Canada's implementation of the GloBE rules in order to determine the financial and administrative impact of those rules on their operations in a manner that allows for certainty, predictability and fairness. The importance of those principles was [recently emphasized by the Supreme Court of Canada](#) as being essential to a well-functioning tax system. Any proposed legislation to implement the GloBE domestically in Canada should be released by Finance Canada with sufficient opportunity for robust and meaningful stakeholder consultation.

For further information on the potential application of the Pillar Two rules in Canada, please contact any member of our [National Tax Group](#)