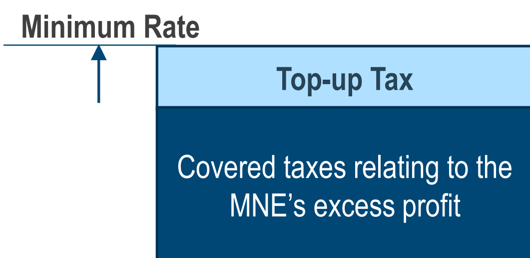
Overview of the Key Operating Provisions of the GloBE Rules

Figure 1. Simplified Top-up tax mechanism



Top-up tax mechanism

The GloBE rules apply a system of top-up taxes that brings the total amount of taxes paid on an MNE's excess profit in a jurisdiction up to the minimum rate of 15%.

Summary

The tax imposed under the GloBE Rules is a "top-up tax" calculated and applied at a jurisdictional level. The GloBE rules use a standardized base and definition of covered taxes to identify those jurisdictions where an MNE is subject to an effective tax rate below 15%. It then imposes a coordinated tax charge that brings the MNE's effective tax rate on that income up to the minimum rate (after taking into account a substance-based carve-out). The design of the GloBE Rules as a top-up tax facilitates the coordinated application of the GloBE Rules.

Steps in determining top-up tax liability for an MNE

This figure illustrates the steps that an MNE might undertake in order to apply the GloBE rules.

- In **Step 1** an MNE Group determines whether it is within the scope of the GloBE rules and identifies the constituent entities within the Group and their location.
- **Step 2** and **Step 3** determine the effective tax rate of each constituent entity.
- In the event an MNE is subject to an effective tax rate below 15% in any jurisdiction, **Step 4** sets out the mechanism for calculating the top-up tax in respect of that low tax jurisdiction.
- This top-up tax is then imposed on a group entity under an IIR or UTPR under **Step 5**.

Each of these Steps is described in further detail in the following information sheets.

Step 1 – Constituent Entities within scope

- Identify Groups within Scope and the location of each Constituent Entity within the Group

Step 2 – GloBE Income

- Determine Income of each Constituent Entity

Step 3 – Covered taxes

- Determine taxes attributable to Income of a Constituent Entity

Step 4 – Effective Tax Rate and Top-up Tax

- Calculate the Effective Tax Rate of all Constituent Entities located in the same jurisdiction and determine resulting Top-up Tax

Step 5 – IIR and UTPR

- Impose Top-up Tax under IIR or UTPR in accordance with agreed rule order

Step 1 – Constituent Entities within scope

Summary

MNE Groups are in scope of the GloBE rules if their consolidated revenue exceeds EUR 750m.

The Constituent Entities of an MNE Group include all the entities within the Group with any permanent establishment of a group entity being treated as a separate Constituent Entity. Excluded entities are, however, not within scope and excluded from the operation of the GloBE rules.

The location of each Constituent Entity is determined based on its local tax treatment.

Step 1 • Identify MNE Groups within scope

Step 2 • Identify Constituent Entities

Step 3 • Remove any Excluded Entities

Step 4 • Identify location of each Constituent Entity

Step 1 • Identify MNE Groups within scope of the GloBE Rules

EUR 750m consolidated revenue test. MNE Groups are in scope if the revenue in their Consolidated Financial Statements exceeds EUR 750m. The test is based on the two of the four Fiscal Years immediately preceding the tested Fiscal Year (Article 1.1.1) Special rules address the effect of mergers or demergers with respect to the consolidated revenue test (Article 6.1).

Step 2 • Identify Constituent Entities

Constituent Entities. Constituent Entities are those Group Entities that are subject to the operative provisions of the GloBE Rules. The term comprises all entities included in a group and permanent establishments (PEs) (Article 1.3.1).
Permanent Establishments. Any PE that is a Constituent Entity is treated as a separate Constituent Entity from the Main Entity and any other PE of the Main Entity (Article 1.3.2).

Step 3 • Remove any Excluded Entities

Excluded Entities. Excluded Entities are not subject to the operative provisions of the GloBE Rules however their revenue is still taken into account for purposes of the consolidated revenue test.

- Excluded Entities are Governmental Entities, International Organisations, Non-profit Organisations, and Pension Funds as well as any Investment Fund or Real Estate Investment Vehicle that is the UPE of the MNE Group (Article 1.5.1).
- The definition of Excluded Entities is also extended to cover some entities owned by excluded entities and that hold assets or invest funds and only carry out ancillary activities, or that mostly derive income that is excluded from the GloBE tax base. (Article 1.5.2).

The exclusion from the operative provisions of the GloBE rules does not extend to an Excluded Entity's ownership interest in other Constituent Entities.

Step 4 • Identify location of each Constituent Entity

Entity located where it is tax resident. If an entity is tax resident in a jurisdiction based on its place of management, place of creation or similar criteria, it is located in that jurisdiction. In all other cases, it is located in the jurisdiction where it was created (Article 10.3.1). Flow-through entities are subject to special treatment under the rules (Article 10.3.2).
PE located where it is situated. A PE is located in the source jurisdiction where it is treated as a PE and subject to tax (Article 10.3.3). Special rules apply for PEs that are exempt from tax.

Step 2 - GloBE Income or Loss

Summary

Under Chapter 3, the amount of GloBE Income or Loss of a Constituent Entity is determined by taking the Financial Accounting Net Income or Loss for the Constituent Entity for the Fiscal Year under Article 3.1 and then adjusting the amount under Articles 3.2 through 3.5 to arrive at that Entity's GloBE Income or Loss.

GloBE Income or Loss is then allocated between a Permanent Establishment and Main Entity or to owners of a Flow-through Entity in accordance with local tax treatment

Step 1
- Determination of Financial Accounting Net Income

Step 2
- Adjust Financial Accounting Net Income or Loss to GloBE Base

Step 3
- Allocate GloBE Income or Loss to Permanent Establishments or Flow-through Entities, if necessary.

Step 1

- Determination of Financial Accounting Net Income

Financial Accounting Net Income or Loss The starting point for determining a Constituent Entity's GloBE income is the net income or loss that is used for preparing Consolidated Financial Statements of the Ultimate Parent Entity prior to the elimination of intra-group items. (Article 3.1).

Step 2

- Adjust Financial Accounting Net Income or Loss to GloBE Base

- The net income or loss determined under Step 1 is adjusted to eliminate a number of common book to tax differences where that adjustment is justified on policy grounds (Article 3.2). These adjustments include:
  - *Excluded Dividends; Excluded Equity Gain or Loss* – Avoids double counting of previously taxed income and aligns with participation exemptions and similar relief common to many IF jurisdictions
  - *Policy Disallowed Expenses* – Disallows deduction for illegal payments
  - *Stock-based compensation* – Prevents top-up tax arising in respect of book-to-tax differences associated with stock-based compensation plans.
  - *Asymmetric Foreign Currency Gains and Losses* – Adjustments are made to avoid distortions from arising where the functional currencies used for accounting and tax are different.
- Exclude International Shipping Income (Article 3.3)

Step 3

- GloBE Income or Loss allocated to Permanent Establishments or through Flow-through Entities where necessary)

- GloBE Income or Loss is allocated between a Permanent Establishment and Main Entity (Article 3.4) or to owners of a Flow-through Entity (Article 3.5) in accordance with local tax treatment. These allocation rules ensures an appropriate allocation of financial net income or loss between these Entities and their owners in line with the applicable local tax rules

Step 3 - Adjusted Covered Taxes

Summary

The amount of a Constituent Entity's Covered Taxes is determined by taking the Constituent Entity's current taxes for the Fiscal Year, adjusted to reflect certain timing differences. Covered Taxes are allocated from one Constituent Entity to another in certain cases. To the extent there are changes in tax liability after filing, additions or reductions to taxes are identified and allocated to a particular jurisdiction and time period.

Step 1
- Identification of Covered Taxes

Step 2
- Adjust Covered Taxes for temporary differences and prior year losses

Step 3
- Allocate Covered Taxes as necessary

Step 4
- Take post-filing adjustments into account

Step 1

- Identification of Covered Taxes

Identify Covered Taxes (Articles 4.1 and 4.2)**:** The starting point for the computation of Covered Taxes is the current tax expense accrued for Financial Accounting Net Income or Loss. Adjustments to the current tax expense amount are made under Articles 4.1.2 through 4.1.5 for GloBE purposes. Tax credits that are refundable after four or more years are treated as a reduction in covered taxes in the year such credits are granted. On the other hand, qualified refundable tax credits, which must be paid within four years, are added to covered taxes when such credits are used to reduce current tax expense.

Step 2

- Adjust Covered Taxes for temporary differences and losses

- An adjustment is made to Covered Taxes by way of the Total Deferred Tax Adjustment amount to take temporary differences and prior year losses into account for GloBE purposes (Article 4.4).
- Article 4.4 includes a number of safeguards designed to protect the integrity of the ETR calculation under the GloBE rules. These safeguards include limiting the recognition of the deferred tax assets and liabilities to the minimum rate and a recapture rule to ensure that amounts claimed as Covered Taxes are actually paid within a set period of time.
- A simplified loss carry-forward equivalent may be elected under Article 4.5 in lieu of applying the deferred tax accounting rules set out in Article 4.4.which provides appropriate recognition of losses arising in no or low-tax jurisdictions.

Step 3

- Allocate Covered Taxes to other Constituent Entities as necessary

- Covered Taxes are allocated to other Constituent Entities when necessary (Article 4.3) Such taxes that may require allocation include CFC taxes, distribution taxes (withholding tax), and tax in respect of a Permanent Establishment, Tax Transparent Entity, or a Hybrid Entity.

Step 4

- Take post-filing adjustments into account

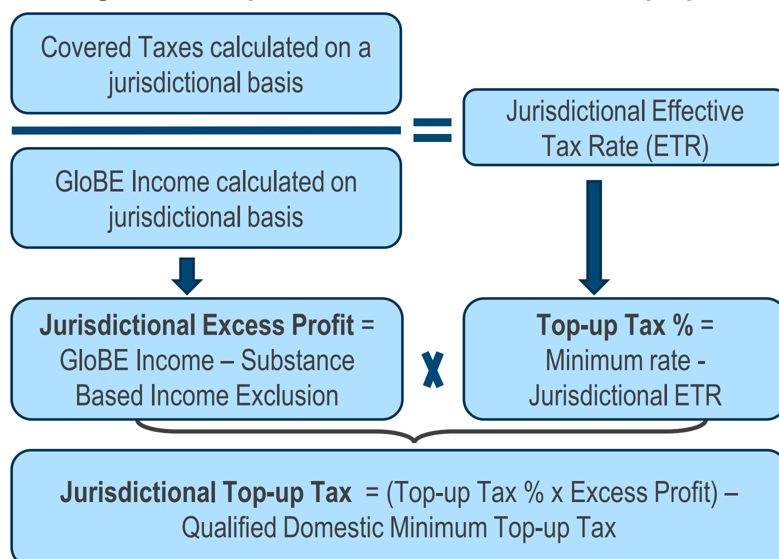
- Special rules apply when there is an adjustment to a tax liability for a prior year (e.g., as the result of an audit or the filing of an amended return to correct an error).
- These special rules require the ETR to be recalculated for a prior year where there is a material reduction in tax liability for that year. To the extent additional Top-up Tax liability results from the adjustment, such amount of Top-up Tax is paid in the current fiscal year (i.e., no amended return is required for the prior year). Increases in tax amounts for prior years are added to Covered Taxes in the current fiscal year. (Article 4.6)

Step 4 - Effective Tax Rate and Top-up Tax

Summary

Under Chapter 5 the Top-up Tax of each Low-Taxed Constituent Entity is computed by:
(i) calculating the Top-up Tax Percentage for each Low-tax Jurisdiction;
(ii) applying the Top-up Tax Percentage to the Excess Profits of the Jurisdiction;
(iii) deducting the amount of top-up tax imposed under a qualified domestic minimum tax; and
(iv) allocating the Jurisdictional Top-up Tax to the Constituent Entities in the Jurisdiction in proportion to their GloBE Income.

Figure 3. Computation of the Jurisdictional Top-up Tax



Step 1

- Computation of jurisdictional Top-up Tax for low-taxed jurisdictions

1. The amount of Covered Taxes with respect to a jurisdiction are divided by the GloBE Income in such jurisdiction to determine the Effective Tax Rate (ETR) for such jurisdiction. (Article 5.1)
2. When the ETR is below the Minimum Rate, the Top-up Tax percentage for the jurisdiction must be calculated. This is computed by subtracting the ETR from the Minimum Rate (e.g., if the ETR is 10%, the Top-up Tax percentage is equal to 15% - 10% = 5%). (Article 5.2.1)
3. The Top-up Tax percentage is then multiplied by the Excess Profit (Article 5.2.2) in the jurisdiction to determine the amount of Top-up Tax. The Excess Profit for the jurisdiction is equal to the GloBE Income less the Substance Based Income Exclusion (i.e., an excluded routine return on tangible assets and payroll) (Article 5.3).
4. Finally, the Top-up Tax for the jurisdiction is reduced by any applicable Qualified Domestic Minimum Top-up Tax. (Article 5.2.3)

Step 2

- Allocation of the Top-up Tax between Low Taxed Constituent Entities

- **Identification of Constituent Entities with GloBE Income.** The Jurisdictional Top-up Tax is allocated to Constituent Entities in the Low Tax Jurisdiction that have GloBE Income for the Fiscal Year (and in proportion to such income) in order to determine which entities trigger a charge to Top-up Tax under Step 5 (Article 5.2.4).

Exceptions

- GloBE rules provide for de mininimis exclusion and allow for development of safe-harbours

De Minimis Exclusion (Article 5.5)
- For jurisdictions where the MNE has (i) an Average GloBE Revenue that is less than €10m and (ii) an Average GloBE Income or Loss that is either a loss or less than €1m, computed on a three-year average basis.

GloBE Safe Harbours (Article 8.2)
- Any safe-harbours to be developed as part of the GloBE Implementation Framework will limit compliance and administration burden for those aspects of an MNE's operations that are likely to be taxable at or above 15% on a jurisdictional basis.
- The final design of any safe harbours will be developed further in consultation with business and stakeholders, and reflected in the Implementation Framework to be released in 2022.

Step 5 – IIR and UTPR

Summary.

The Top-up Tax is first imposed under the IIR on a parent entity with an ownership interest in the low-taxed constituent entity.

If there is any residual amount of Top-up Tax that remains unallocated after the IIR applies, the UTPR allocation mechanism results in a liability to Top-up Tax in the jurisdictions that introduced the UTPR.

- Step 1 – Identification of the Parent Entity liable for the Top-up Tax under the IIR
- Step 2 – Determination of amount of Top-up Tax paid by the Parent Entity under the IIR
- Step 3 – Identification of the remaining amount, if any, that is allocable under the UTPR
- Step 4 – Liability for residual Top-up Tax in the UTPR Jurisdictions through a UTPR adjustment

Step 1 – Identification of the Parent Entity liable for the Top-up Tax under the IIR

- **Ultimate Parent Entity.** The Ultimate Parent Entity (UPE) of the MNE Group is primarily liable for the Top-up Tax of all Low-Tax Constituent Entities (Article 2.1.1).
- **Top-down approach**. If the UPE is not required to apply an IIR, the Top-up Tax is imposed on the next Intermediate Parent Entity in the ownership chain that is subject to the IIR (Articles 2.1.2 and 2.1.3).
- **Partially-owned parent entities.** A Partially-Owned Parent Entity is a Constituent Entity that has more than 20% of the Ownership Interests held by non-group members. In this case Top-up Tax is imposed on the Partially-Owned Parent Entities that are subject to the IIR in priority to the top-down approach (Articles 2.1.4 and 2.1.5).

Step 2 – Determination of amount of Top-up Tax paid by the Parent Entity under the IIR

- **The Top-up Tax is attributed to Parent Entities in proportion to their Allocable share.** The Allocable Share of Top-up Tax is determined on the basis of a Parent Entity's Inclusion Ratio, i.e. the share of the profits of the Low-Taxed Entity attributable to that Parent Entity on the basis of accounting standards (Article 2.2).
- **Offsetting mechanism**. If several parent entities are liable for the Top-up Tax under the IIR in respect of the same low-taxed constituent entity, the parent entity that is higher in the ownership chain shall reduce its top-up tax by the amount being paid by a lower-tier intermediate parent entity or partially-owned parent entity (Article 2.3).

Step 3 – Identification of the remaining amount, if any, that is allocable under the UTPR

- **Backstop mechanism**. If there is low taxed income beneficially owned by a UPE that is *not* brought into charge under an IIR then the low-taxed income is subject to the back-up mechanism of the UTPR (Article 2.5).
- **UPE jurisdiction.** The UTPR can also apply in respect of the Top-up Tax that arises in relation to the low tax outcomes in the UPE Jurisdiction.
- **UTPR limitation.** There is a limitation of the application of the UTPR when an MNE is in its initial phase of expanding abroad (Article 9.3)

Step 4 – Liability for residual Top-up Tax in the UTPR Jurisdictions through a UTPR adjustment

- **Allocation key.** The UTPR Top-up Tax amount identified in Step 3 is allocated among the UTPR jurisdictions by applying a two-factor allocation key based on (i) the net book value of tangible assets held and (ii) the number of employees employed by all the Constituent Entities that are located in such UTPR Jurisdictions. (Article 2.6)
- **UTPR Adjustment.** The UTPR Top-up Tax amount allocated to a jurisdiction is collected through a denial of a deduction for any deductible expense (or an equivalent adjustment under domestic law). (Article 2.4)