Tax Policy Alert

# OECD releases further Pillar Two GloBE Administrative Guidance and timeline update for Pillar One


20 December 2023

## In brief

The OECD Secretariat published the latest set of Administrative Guidance on the Global Anti-Base Erosion Model Rules (GloBE rules) of Pillar Two on 18 December 2023 intended to clarify the operation of the GloBE rules. This is the third set of administrative guidance, and along with the guidance released in February and July 2023 it will be incorporated into a revised version of the GloBE Commentary, which, according to the OECD, will be released in 2024. This latest release is the final set of guidance supplementing and clarifying the Pillar Two rules before they come into effect in many countries from 1 January 2024. Further guidance is expected in 2024 across a range of issues.

Concerning Amount A of Pillar One, a statement was also published noting that "members of the Inclusive Framework (IF) reaffirm their commitment to achieve a consensus-based solution and to finalise the text of the Multilateral Convention (MLC) by the end of March 2024, with a view to hold a signing ceremony by the end of June 2024." In addition to recognizing that work to resolve the outstanding issues on the text of the MLC will go on into 2024, the IF statement mentions that this includes work to extend the standstill on Digital Services Taxes (DSTs) and other relevant similar measures (which is currently set to expire at the end of this year).

## The takeaway

The key provision in the Guidance relates to new anti-arbitrage rules for the Transitional CbCR Safe Harbour (CbCR Safe Harbour). The new provisions are complex and will require detailed study. However, they appear to contain some significant new restrictions on the use of the safe harbour, which arguably go beyond what is necessary and are likely to impact structures that are commonplace today and not previously considered to be abusive.

The OECD's press release notes that the IF will produce further administrative guidance on an ongoing basis. The next batch is expected to be released in the first half of 2024 and will include guidance on the application of deferred tax liability recapture rules and the allocation of deferred taxes relating to cross-border taxes such as CFC Tax Regimes. No details were released regarding the peer review mechanism to determine rule qualification status. However, without further detail, the press release notes that the IF will implement a "robust and transparent peer review process and continue the ongoing work on the administrative framework and dispute resolution mechanisms with a view to providing a high level of tax certainty to stakeholders in applying the rules."

# In detail

## Further guidance on the Transitional CbCR Safe Harbour

The CbCR Safe Harbour allows MNEs to use data from their Country-by-Country Reports (CbCRs) to determine their effective tax rates (ETRs) for a limited period, subject to certain conditions and tests. The guidance further clarifies the application of the CbCR Safe Harbour, addressing the consistent use of data and what constitutes a qualifying CbCR (including where there are purchase price accounting adjustments). The guidance provides clarification with respect to the tested jurisdictions and the taxes that can be included as part of an entity's simplified covered taxes and also addresses the percentages to use in applying the routine profits test.

***Observation:*** *While much of the guidance regarding the sources of data for the CbCR Safe Harbour is straightforward, some portions may give rise to concerns for MNEs. For example, the guidance provides that post-year end adjustments (e.g., transfer pricing adjustments) to the financial statement data on which the CbCR is based are not permitted under the CbCR Safe Harbour. This does not reflect the reality for many MNEs that CbCRs are prepared using 'actual' numbers, which will typically reflect such post-year end adjustments. Accordingly, many MNEs will need to modify their approach to preparing their CbCR or else face the risk of disqualifying themselves from using the CbCR Safe Harbour.*

Probably the most important aspect of the guidance concerning the CbCR Safe Harbour relates to the treatment of 'Hybrid Arbitrage Arrangements' that arise from differences in the source of financial information or differences between tax and financial accounting treatment (but need not involve an actual hybrid instrument or arrangement). The guidance defines a 'Hybrid Arbitrage Arrangement' as an arrangement that is:

(i) a deduction / noninclusion arrangement;
(ii) a duplicate loss arrangement; or
(iii) a duplicate tax recognition arrangement.

The guidance generally provides that eligibility for the CbCR Safe Harbour should be determined based on the assumption that each party to a Hybrid Arbitrage Arrangement has treated the transaction in the same way. Accordingly, the CbCR Safe Harbour will not be available to the extent that inconsistent treatment of a Hybrid Arbitrage Arrangement would otherwise result in a jurisdiction qualifying for the CbCR Safe Harbour.

***Observation:*** *Going beyond what seems necessary to prevent abuse of the CbCR Safe Harbour can be observed in a number of provisions, among them: disallowance of the safe harbour not just for anti-arbitrage arrangements entered into after December 2022, but also as a result of minor changes to any arrangements entered into before that date; an overly broad definition of deduction/non-inclusion transactions that could include regular tax attributes such as net operating losses (NOLs); and the lack of any corresponding adjustment provision for so-called 'with and without' transactions, where a disallowed deduction from income is added back to income, but any reduction in tax related to that disallowed expense is not added back into taxes (i.e., the numerator) resulting in an overly-reduced ETR. Further, and of particular interest to US groups, the 'duplicate loss arrangement' rule or 'double deduction' rule potentially affects all US groups that directly own foreign permanent establishments (PEs) or foreign*

*disregarded entities (DRE), as the guidance provides no dual inclusion income relief mechanism. This arguably results in any 'regarded' deduction for US tax purposes leading to a loss of the deduction at the directly-owned foreign PE or DRE for purposes of the Transitional CbCR Safe Harbour, if such PE or DRE is in a loss position, or becomes in a loss position due to the deduction.*

CbCR Safe Harbour results must be adjusted for MNE Groups that have entered into a Hybrid Arbitrage Arrangement after **15 December 2022**, the release date of the original Safe Harbour guidance. If a jurisdiction is unable to apply the guidance on Hybrid Arbitrage Arrangements by reference to transactions entered into after 15 December 2022, based on constitutional grounds or other superior law, that jurisdiction can adopt this Administrative Guidance as if references to '15 December 2022' were replaced with '18 December 2023.'

***Observation:*** *MNE Groups that have implemented transactions prior to 18 December 2023 that would otherwise be subject to this guidance may not be if the MNE Groups are subject to Pillar Two in a jurisdiction that does not permit retrospective legislation. This seems to recognise that the date on which the rules come into effect will vary significantly from jurisdiction to jurisdiction.*

There is also a statement that further guidance "will be provided to address hybrid arbitrage arrangements, including those addressed in this guidance, that may otherwise affect the application of the GloBE rules outside the context of the Transitional CbCR Safe Harbour."

***Observation:*** *Making adjustments for such arrangements when applying the CbCR Safe Harbour tests may result in unintended outcomes for many businesses who have put in place transactions or arrangements since 15 December 2022. Businesses should carefully consider the impact of this broad anti-arbitrage guidance on the expected CbCR Safe Harbour outcomes. In addition, as noted above, the anti-arbitrage rules would impact not only new arrangements but also pre-existing arrangements that have been modified since 15 December 2022.*

## Administrative Guidance on application of GloBE Rules

The guidance addresses the definition of 'revenue' for purposes of the EUR 750 million threshold, the treatment of Constituent Entities that have a different fiscal year or a different tax year than the UPE, and the treatment of Constituent Entities that have a different fiscal year to the tax year.

Financial entities that may not record gross amounts from certain transactions in their financial statements should consider those items similar to revenue under the UPE's financial accounting standards. The guidance mentions examples as 'net banking product' or 'net revenues.'

## Further Administrative Guidance on the allocation of Blended CFC Taxes

The guidance further clarifies how to allocate the CFC tax incurred under a Blended CFC Tax Regime to entities located in jurisdictions in which the GloBE Jurisdictional ETR is below the applicable rate for the Blended CFC Tax Regime, using the formula set out in the previous Agreed Administrative Guidance on this topic. The guidance notes that in some cases, an MNE Group may not be required to compute a GloBE Jurisdictional ETR if, for example, the entities located in a jurisdiction are eligible for a safe harbour. In short, the guidance provides that for jurisdictions in which an MNE Group elects to apply the CbCR Safe Harbour, the MNE Group must use that jurisdiction's Simplified ETR as calculated under the CbCR Safe Harbour guidance in lieu of the GloBE Jurisdictional ETR. For a jurisdiction for which the MNE Group has elected the QDMTT Safe Harbour, the GloBE Jurisdictional ETR must be determined based on the taxes and income used to determine the ETR for the jurisdiction pursuant to the jurisdiction's QDMTT.

### Filing and notification obligations

The GloBE rules extend the filing and notification deadline to 18 months after the end of the reporting fiscal year that is the transition year. The new Administrative Guidance further provides that the due date for filing and notification obligations for any fiscal year shall not be before 30 June 2026. This relief is intended to address situations where the MNE Group has a short reporting period in the first fiscal year in which it comes within the scope of the GloBE rules, which would otherwise accelerate the filing and notification deadline and impose additional burdens on the MNE Group and tax administrations.

***Observation:*** *Certain countries, for example Belgium, may need to revisit the domestic timelines put in place for IIR or QDMTT reporting, as some jurisdictions require filing by an earlier deadline.*

### Simplified Calculation Safe Harbour for Non-Material Constituent Entities

The guidance provides for Simplified Income, Revenue and Tax Calculations for Non-Material Constituent Entities (NMCEs) as part of the framework for a Simplified Calculations Safe Harbour. This will provide a permanent gateway test similar to the Transitional CbCR Safe Harbour for MNE Groups to avoid detailed adjustments that would otherwise be required under the GloBE Rules, subject to certain conditions and tests.

### See also

Policy on Demand: Will Morris on Pillar Two answers and surprises

## Let's talk

For a deeper discussion of how these OECD developments might affect your business, please contact:


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