Application of GMT to International Tax Planning Structures

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IBFD

The Home of International Taxation

Agenda

The Home of
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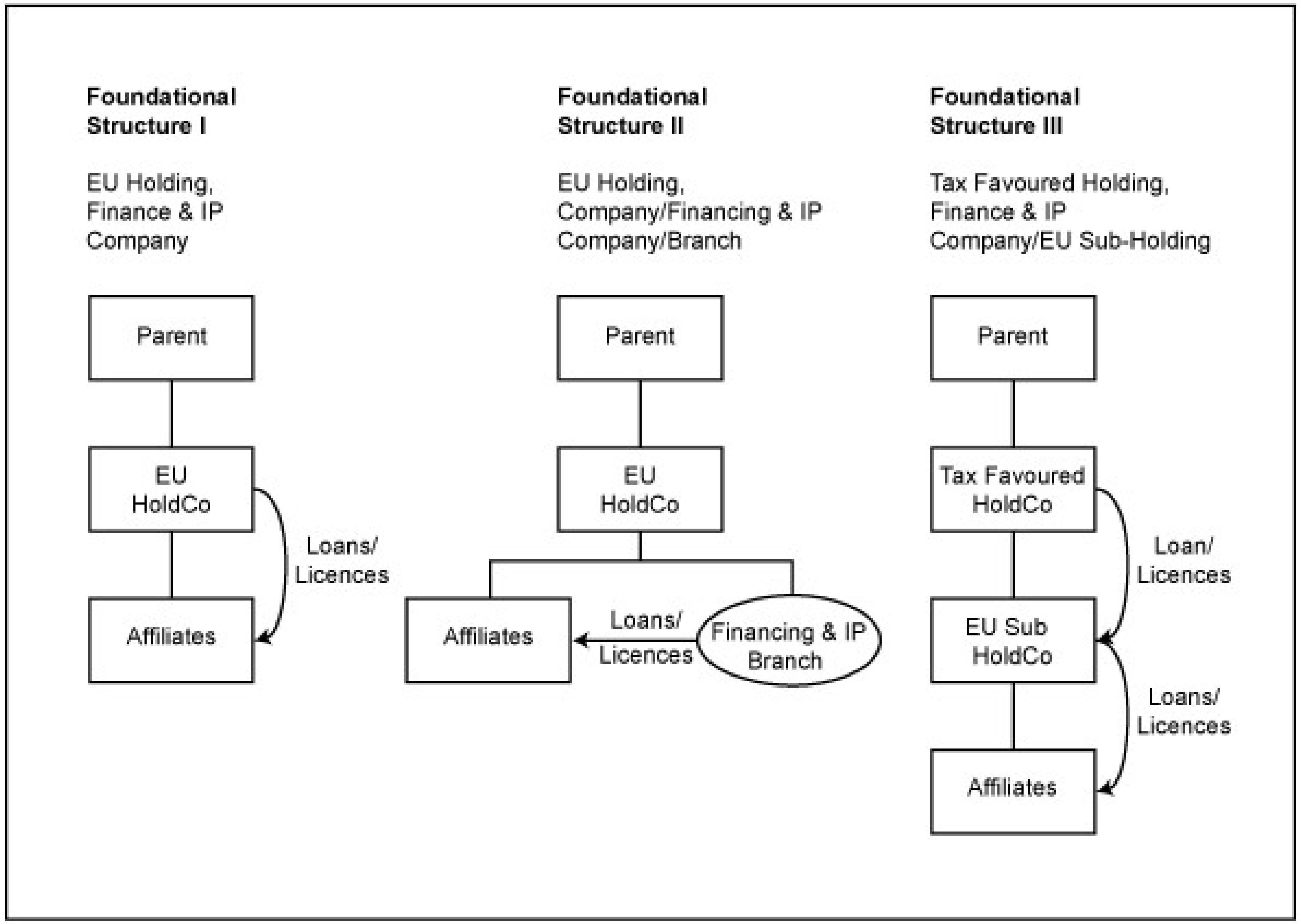
Conditions Facilitating International Tax Planning

- Tax competition among countries
  - Home countries
  - Destination countries
  - Intermediate jurisdictions
- Differences in tax rates
  - Sovereignty consideration
  - Tax incentives
- International taxation rules designed to promote cross border trades by removing taxation barriers
  - Tax treaties ensuring mitigation of double taxation
  - Arm’s length principle
- Inconsistencies across different countries create more opportunities for cross border tax structuring

Foundational Structures



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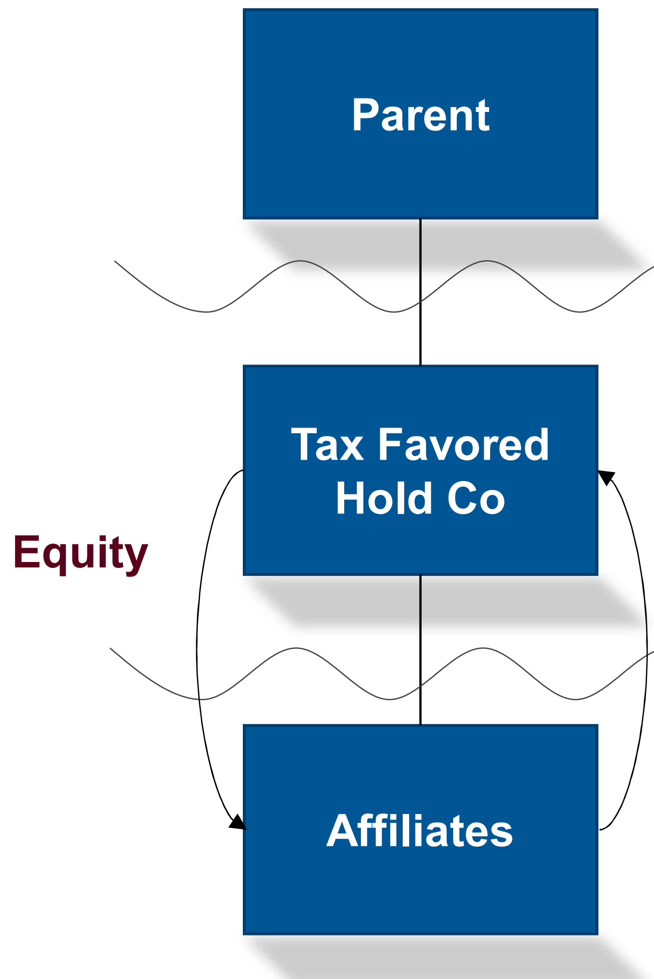
Post BEPS Holding Company Structure



Deferral of home country taxation

Action 3 CFC Rules

Pillar 2 – IIR?

Action 5 – Harmful Tax Competition

Actions 8, 9 10 – Functions, Assets and Risks

Pillar 2 – QDMTT?

Dividends

Action 6 – Treaty Abuse

Pillar 2 – UTPR?

Definition of Excluded Dividends: Article 3.2.1.(b)

Second adjustment item under Article 3.2.1, defined in Article 10.1

- Excluded Dividends means *dividends or other distributions received or accrued* in respect of an Ownership Interest, *except for* :
  - (a) a Short-term Portfolio Shareholding, *and*
  - (b) an Ownership Interest in an Investment Entity that is subject to an election under Article 7.6. [Emphasis added]

Relevant Definitions (defined in Article 10.1):

- Short-term Portfolio Shareholding
- Ownership Interest
- Portfolio Shareholding

Short-Term Portfolio Shareholding

Dividends or other distributions received or accrued in respect of:	Portfolio Shareholding (i.e. carrying rights to less than 10% of the profits, capital, reserves or voting rights of the distributing entity)	Non-Portfolio Shareholding (i.e. carrying rights to at least 10% of the profits, capital, reserves and voting rights of the distributing entity)
Short-term shareholding (i.e. economically held **for less than one year)**	**Included dividends**	Excluded Dividend
Non- Short-term shareholding (i.e. economically held for at least one year)	Excluded Dividend	Excluded Dividend

Short-Term Portfolio Shareholding: Key Points

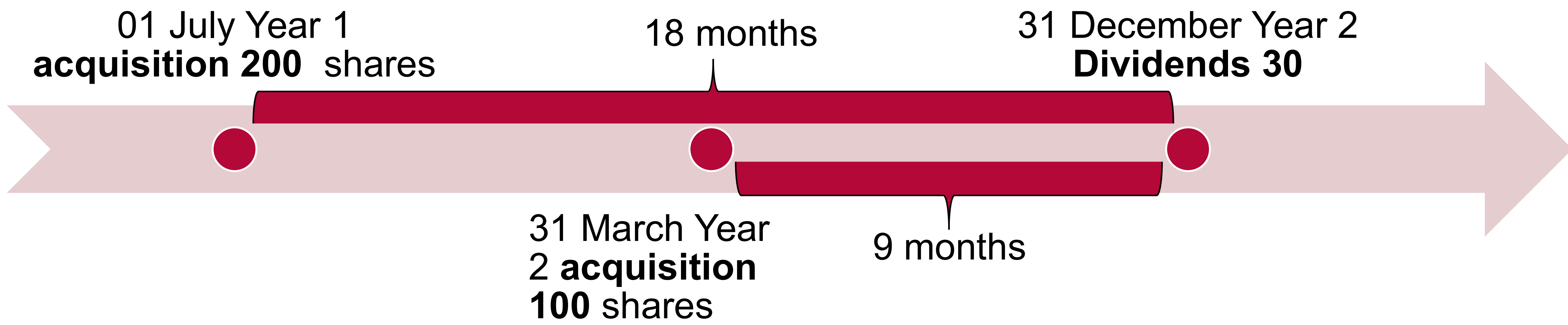
- The 10% threshold needs to be checked at the MNE Group Level
- Conflict of qualification: Interests in entities classified as non-equity under accounting standards fall outside this rule, regardless of tax treatment.
- Hybrid instruments more guidance in the Commentary and Article 3.2.7

Excluded Dividend and Short-term Portfolio Shareholding: Example 1* - Facts

- The 10% threshold needs to be checked at the MNE Group Level
- A Co is a constituent entity of a multinational enterprise (MNE) group.
- B Co, unrelated to A Co, has issued 10,000 ordinary shares, all of which have equal rights to profit distributions and capital.
- **1 July, Year 1:** A Co acquires 200 common shares in B Co.
- **31 March, Year 2:** A Co acquires an additional 100 common shares in B Co.
- **31 December, Year 2:** B Co distributes EUR 0.10 per share.
- A Co holds a total of 300 shares in B Co at the time of distribution.
- A Co is part of an MNE Group and holds less than 10% of B Co, classifying its holding as a **Portfolio Shareholding.**

*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.1(b)- 1

Excluded Dividend and Short-term Portfolio Shareholding: Example 1 - Answer



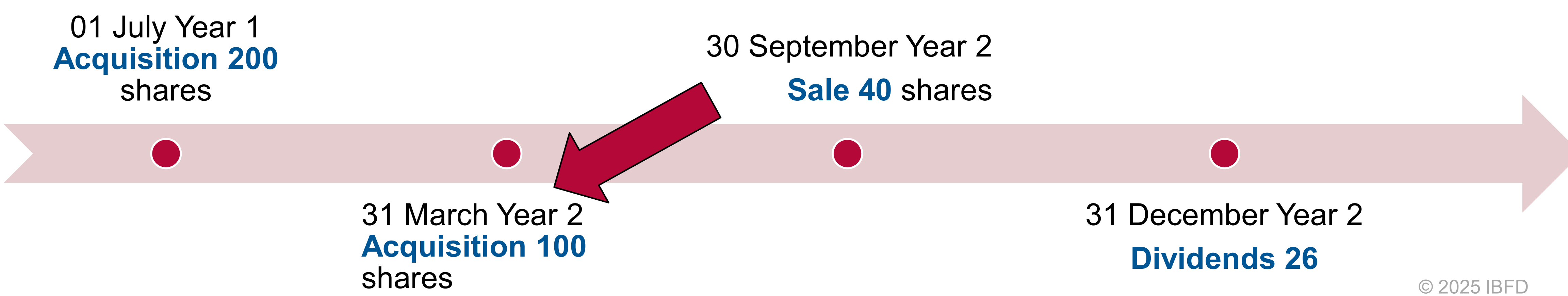
- Out of A Co’s 300 shares in B Co, 100 shares are considered a Short-term Portfolio Shareholding since they were held for less than 12 months at the time of the dividend date.
- The dividends on the 100 short-term shares (€10 = 100 shares x €0.10 per share) will be included in A Co’s GloBE income.
- For the remaining 200 shares, only 20 of the dividends will be treated as an Excluded Dividend under the GloBE Rules (Article 3.2.1(b))

Excluded Dividend and Short-term Portfolio Shareholding: Example 2* - Facts

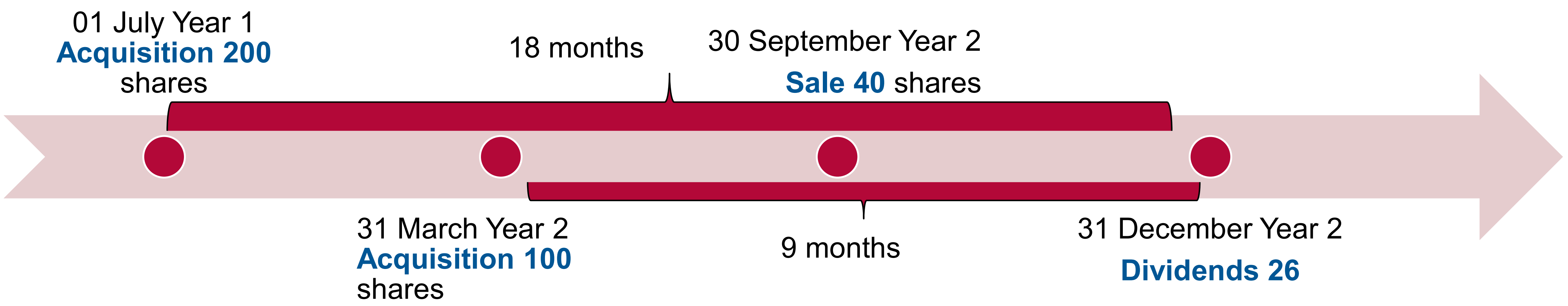
Facts are the same as example 1, except that:

- **30 September, Year 2**: A Co disposes of 40 B Co shares.
- **31 December, Year 2**: B Co distributes a dividend of EUR 0.10 per share.
- A Co receives dividends on its remaining shares in B Co at that time.
- At the date of the dividend distribution, A Co holds 260 shares in B Co.
- Commentary to Article 3.2.1, the sale of shares follows the last-in, first-out (LIFO) principle.
- Therefore, A Co is treated as having sold 40 shares from the 100 shares acquired on 31 March, Year 2.

*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.1(b)- 2



Excluded Dividend and Short-term Portfolio Shareholding: Example 2 - Answer



Out of these, **60 shares** are classified as a **Short-term Portfolio Shareholding** under the GloBE Rules because A Co has held these shares for less than 12 months.

- The dividend on these 60 shares (EUR 6 = 60 shares x EUR 0.10 per share) will be **included in A Co's GloBE income**.

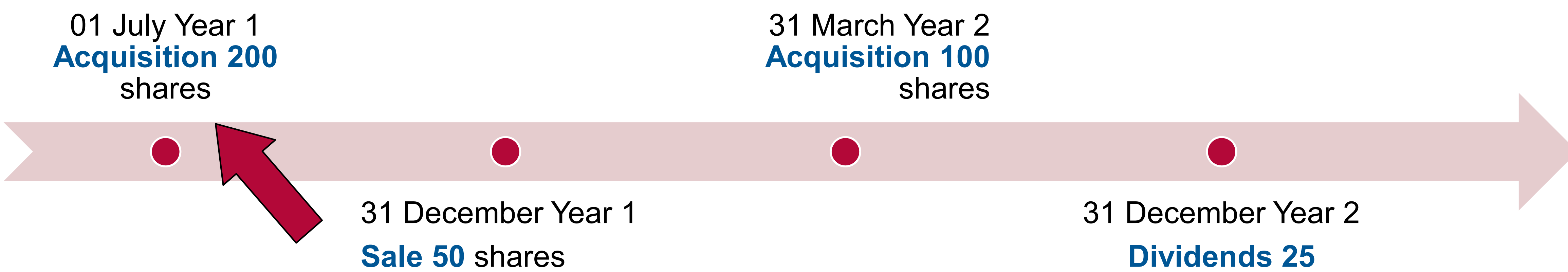
The dividend on the remaining **200 shares** (EUR 20 = 200 shares x EUR 0.10 per share) will be treated as an **Excluded Dividend** under Article 3.2.1 of the GloBE Rules.

Excluded Dividend and Short-term Portfolio Shareholding: Example 3* - Facts

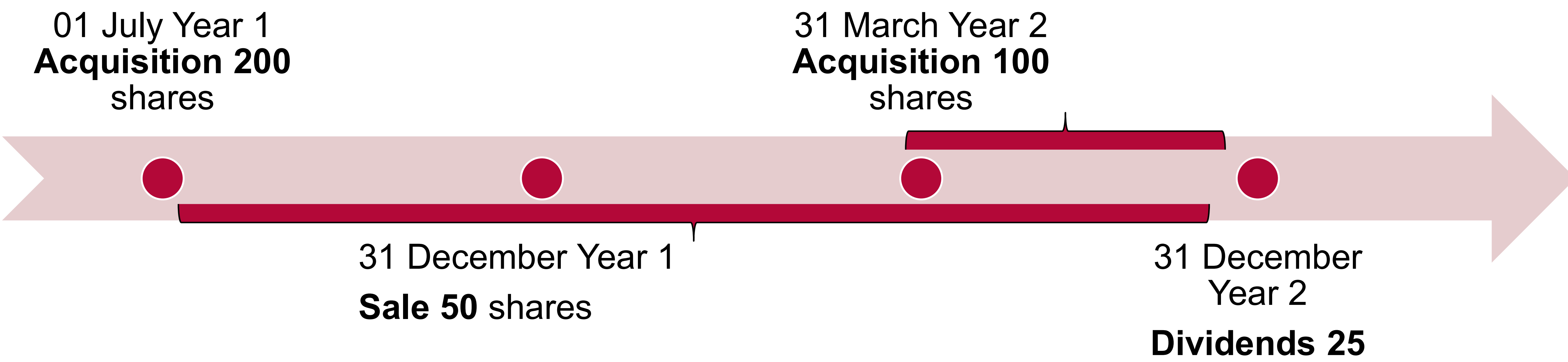
Facts are the same as example 1, except that:

- **December, Year 1**: A Co disposes of 50 shares. The sale of shares is deemed to be a sale of the most recently acquired shares. Thus, A Co is treated as having disposed of shares acquired on 1 July, Year 1.
- **31 March, Year 2:** A Co acquires an additional 100 shares in B Co.
- **By 31 December, Year 2**: B Co distributes a dividend of EUR 0.10 per share. The remaining shares held by A Co will be categorized into long-term and short-term holdings for dividend treatment.
- At the date of the dividend distribution, A Co holds 250 shares in B Co.

*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.1(b)- 3



Excluded Dividend and Short-term Portfolio Shareholding: Example 3 - Answer



- **100 shares** are classified as a **Short-term Portfolio Shareholding** under the GloBE Rules because A Co has held them for less than 12 months.
    - The dividend received on the 100 short-term shares amounts to EUR 10 (calculated as 100 shares x EUR 0.10). This amount will be included in calculating A Co's GloBE income.
- For the remaining 150 shares, only 15 of the dividends received will be classified as an Excluded Dividend under Article 3.2.1 of the GloBE Rules.

Definition of Excluded Equity Gains or Losses: Article 3.2.1.(c)

- Third adjustment item under Article 3.2.1, defined in Article 10.1
- Excluded Equity Gain or Loss means the *gain, profit or loss included* in the Financial Accounting Net Income or Loss of the CE arising from:
  - (a) gains and losses from *changes in fair value* of an *Ownership Interest*, except for a Portfolio Shareholding;
  - (b) profit or loss in respect of an *Ownership Interest* included under the *equity method* of accounting; and
  - (c) gains and losses from disposition of an Ownership Interest, except for a disposition of a Portfolio Shareholding. [Emphasis added]

Excluded Equity Gains or Losses: Key Points

- Encompasses three categories of gain or loss attributable to an Ownership Interest (i.e. does not apply to other assets)
- Impairments and reversal of impairments would normally fall outside the scope of this article
- Excludes any gain, profit or loss included in the Other Comprehensive Income

Gains or Losses on Disposition

Gains and losses arising from the disposition of	**Portfolio Shareholding (i.e. carrying rights to less than 10% of the profits, capital, reserves or voting rights of the distributing entity)**	**Non-Portfolio Shareholding (i.e. carrying rights to at least 10% of the profits, capital, reserves and voting rights of the distributing entity)**
Short-term shareholding (i.e. economically held for **less than one year**	**Included gain/loss**	Excluded gain/loss
Non-Short-term shareholding (i.e. economically held for at least one year)	**Included gain/loss**	Excluded gain/loss

Impact of Excluded Equity Gains or Losses

First type: Changes in fair value

- Excluded fair value **gains** require a **negative** adjustment
- Excluded fair value **losses** require a **positive** adjustment
- **No adjustment** is required if fair value gains and losses are recorded in the **OCI**.

Second Type: Equity method accounting

- Joint Ventures or Associates holds a significant but non-Controlling Interest in an Entity, ordinarily between 20% and 50%
- Equity method **net income** is a **negative** adjustment
- An equity method **loss** is a **positive** adjustment

Third Type: Gains or losses on disposition

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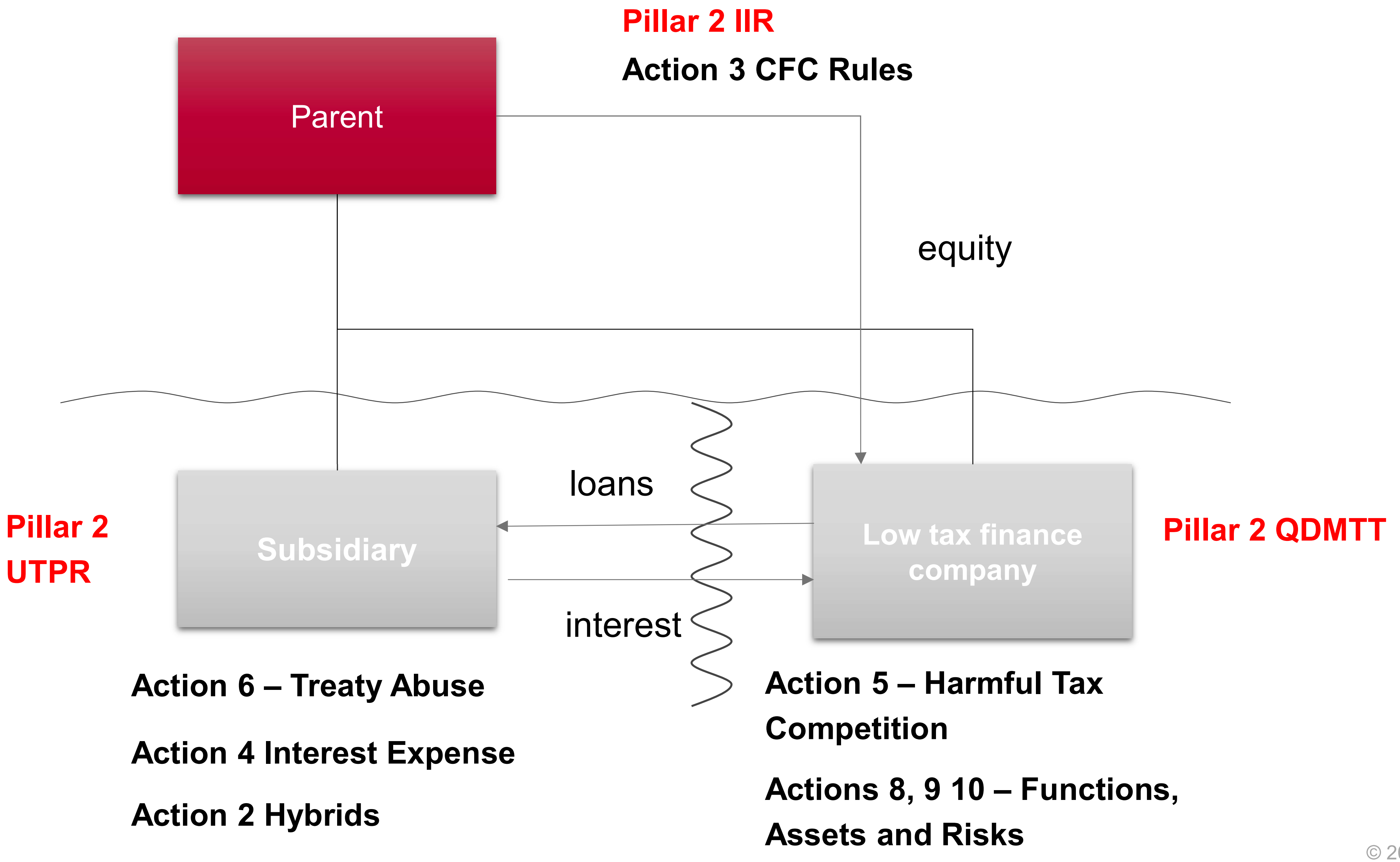
Post BEPS Financing Structures



Impact of GMT on Low-Taxed Financing Regimes

Low taxed/zero tax regimes

Finance company subject to low or zero tax will have low or zero effective tax rate under Pillar Two rules

Top-up tax applies to increase effective tax rate to 15%

Interest over equity

Deemed interest deduction applicable to reduce taxable income, resulting in low effective tax burden for Finance company

The deemed interest deduction is not recognised for financial reporting purposes, so GloBE Income will be reported at the standard amount with no associated covered tax expense, resulting in low ETR.

Top-up tax applies to increase effective tax rate to 15%

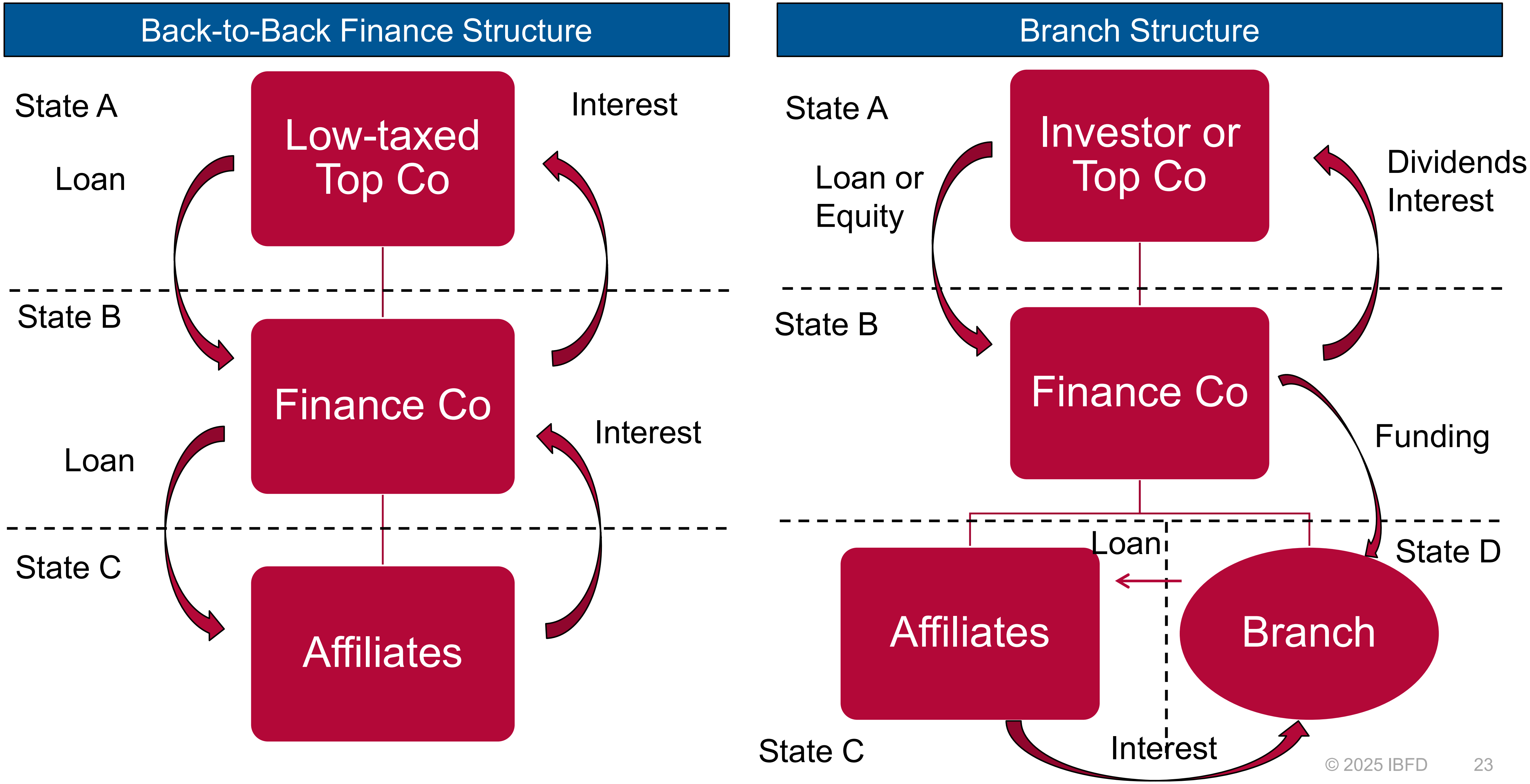
Normal taxed with imputation tax credits refunded to shareholders

Disqualified Refundable Imputation Taxes are "…taxes that are initially imposed on the income of a CE but when that income is distributed by way of dividend to the owners of the CE, the tax is refunded to the CE or the owner or creditable against a tax liability of the owner other than a tax liability arising from the dividend…"

Disqualified Refundable Imputation Taxes are excluded from the definition of Covered Taxes and are added back to the calculation of GloBE income, resulting in lower ETR.

Top-up tax applies to increase the ETR to 15%.

Finance Companies General Structures



Permanent Establishments

Permanent Establishment (PE)

- PE is treated as a separate Constituent Entity than the Main Entity
- FANIL of PE is net income/loss as per (real/fictitious) separate financial accounts.
- Taxes in books of PE and taxes in books of Main Entity related to PE income are allocated to PE.
- Where Globe Loss of PE is treated as expense of Main Entity & subsequent income allocated to Main Entity as well – Covered Taxes on that income are also allocated to Main Entity.

FANIL & Taxes – normally allocated to PE

FANIL 200
Attributable to PE 150
Remainder 50

Tax in Jur I:
5% on 200 = 10
Tax in Jur PE = 0

Top-up Tax Under IIR

Jur I ETR = 2.5/50
Top-up tax = 5

Jur PE ETR = 7.5/150
Top-up tax = 15

Jur I
5% income tax rate

Main entity
50 FANIL/GIL

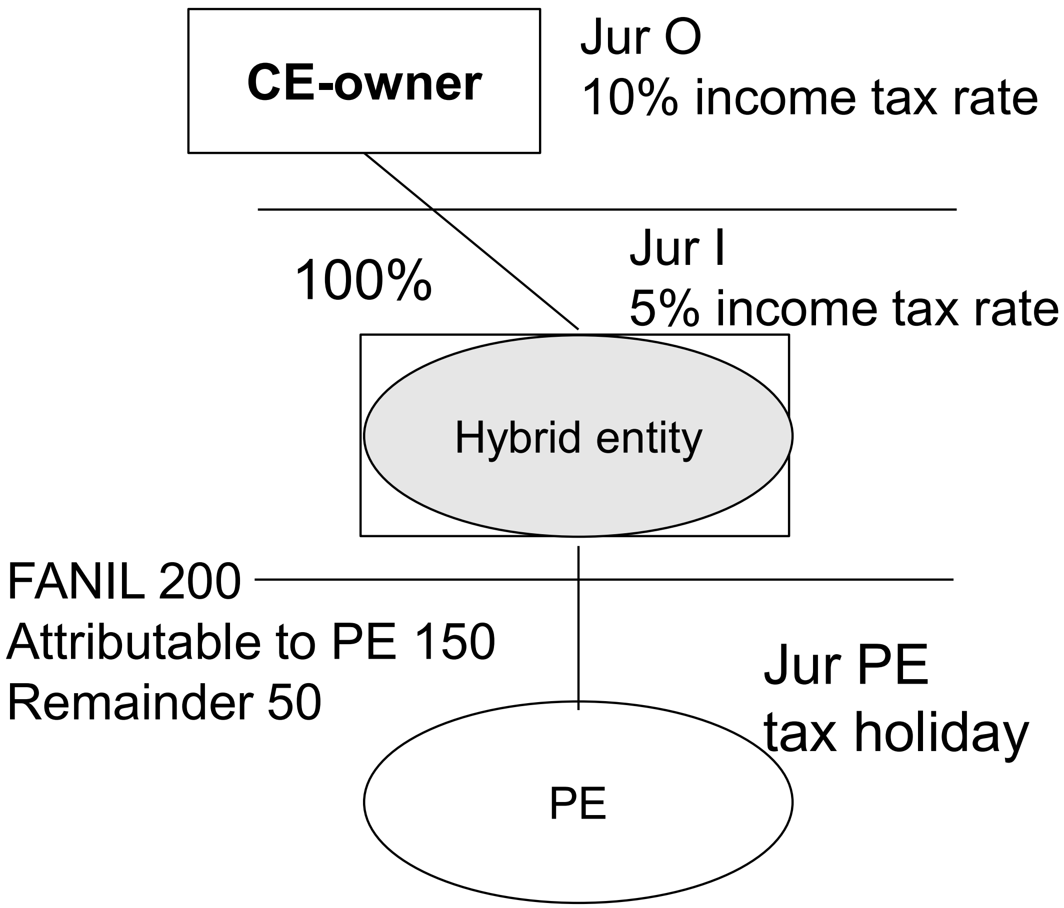
Jur PE
Tax holiday

PE
150 FANIL/GIL
tax holiday

* GIL = GloBE Income or Loss

Hybrid Entity

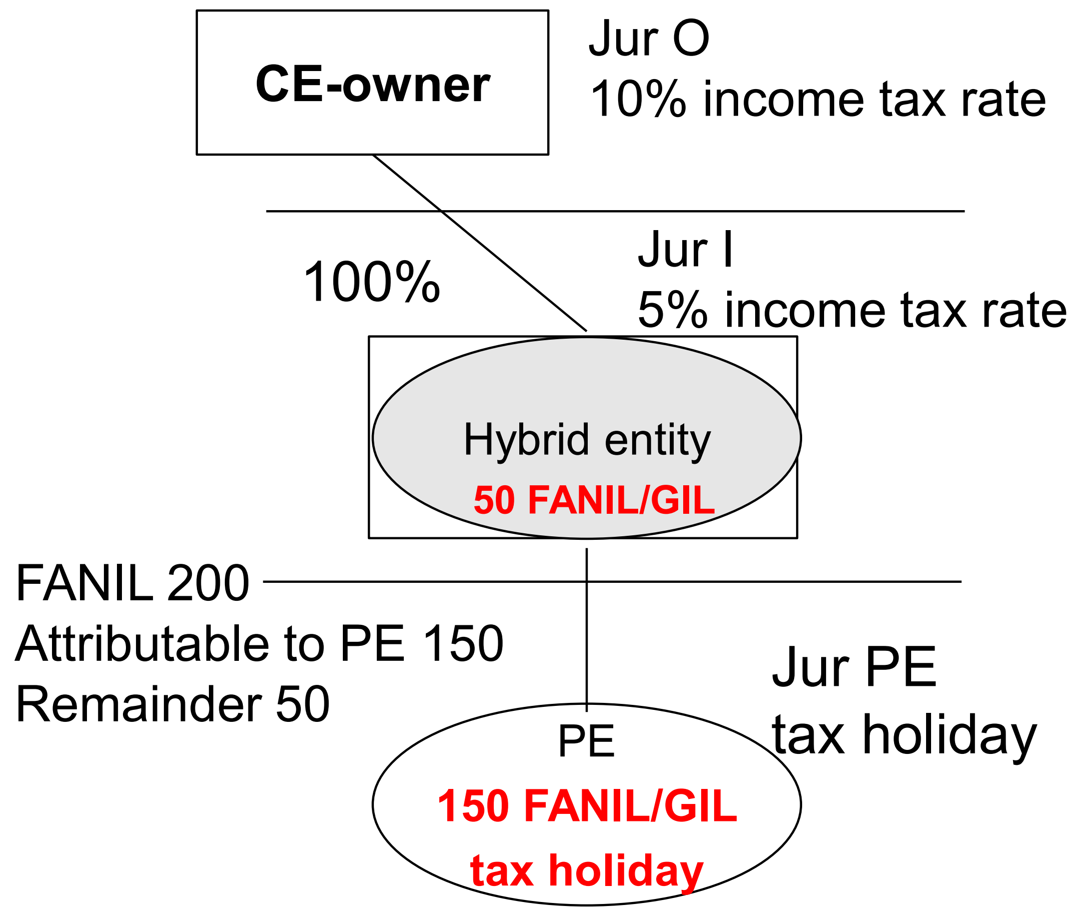
- Hybrid entity in Jur I earns 200 FANIL
  - 50 from Head office
  - 150 from PE
- Income of Hybrid entity is taxed as follows:
  - Tax holiday in jurisdiction PE: no tax
  - Worldwide taxation in jurisdiction I @5% = 10
  - Worldwide taxation in jurisdiction O @10% = 20
- Question: How is the structure dealt with under GloBE Rules?



* GIL = GloBE Income or Loss

Matching Principles – Hybrid Entity

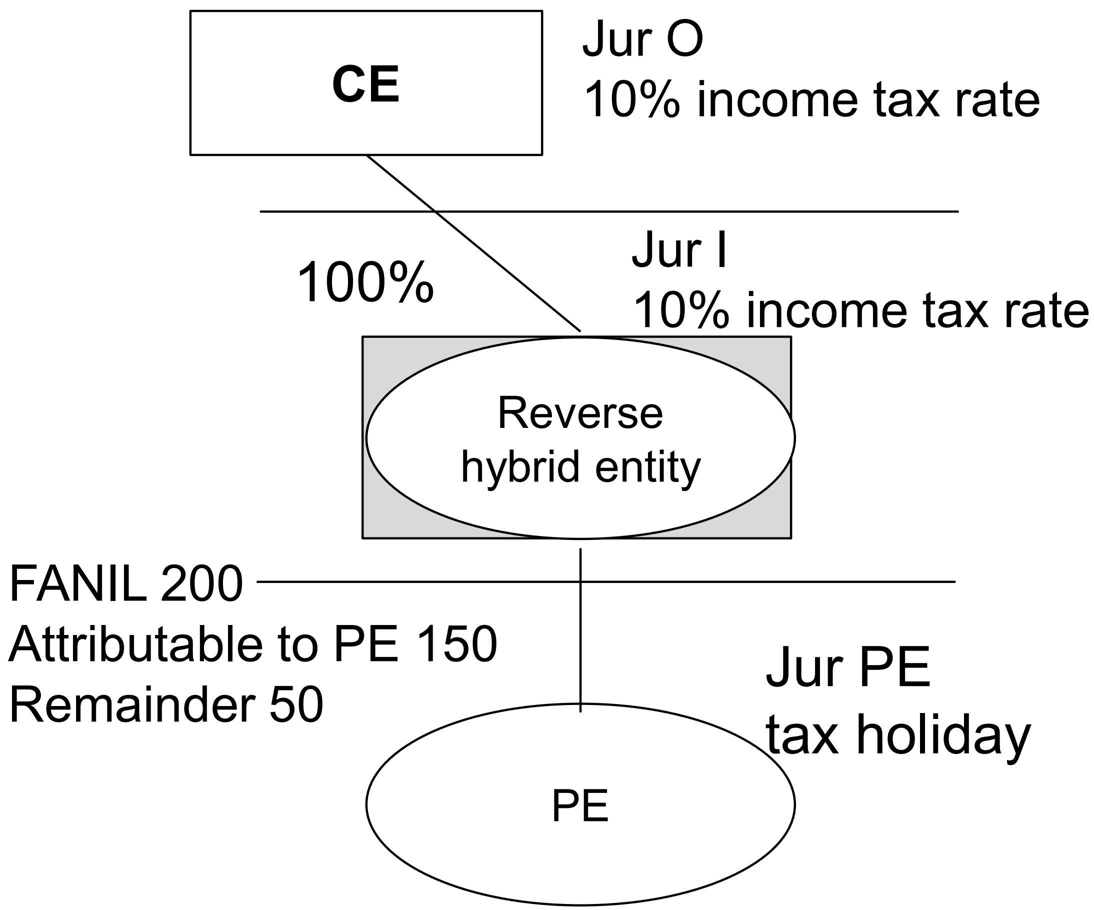
- Article 4.3.2 (d) – in the case of a Constituent Entity that is a Hybrid Entity the amount of any Covered Taxes included in the financial accounts of a Constituent Entity-owner on income of the Hybrid Entity is allocated to the Hybrid Entity
- PE income 150 allocated to the PE
  - Covered tax allocated to the PE = 7.5 + 15
  - ETR PE: (7.5+15)/150 = 15%
- Remainder income 50 allocated to the hybrid entity
  - Covered taxes allocated to hybrid entity = 2.5 + 5
  - ETR (2.5+5)/50 = 15%



* GIL = GloBE Income or Loss

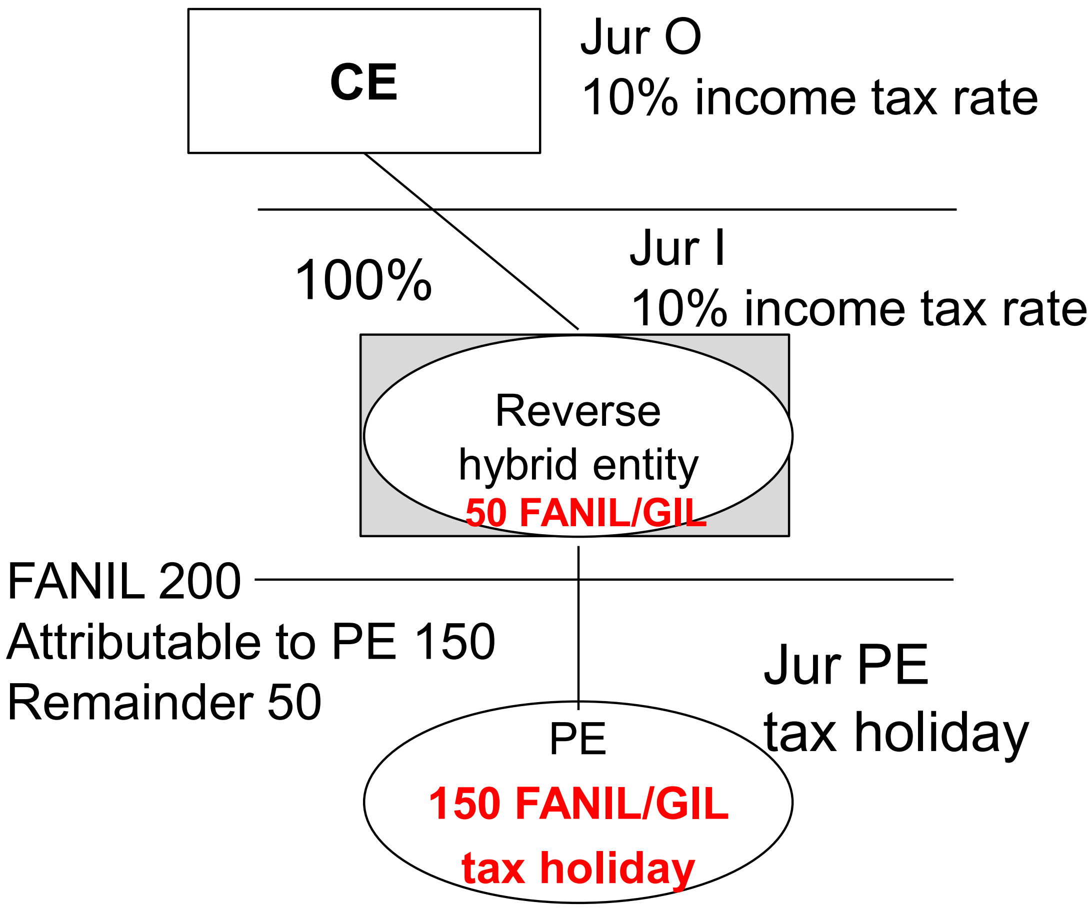
Reverse Hybrid

- Reverse Hybrid entity in Jur I earns 200 FANIL
  - 50 from Head office
  - 150 from PE
- Income not taxed anywhere:
  - Tax holiday in jurisdiction PE: no tax
  - No taxation in jurisdiction I: treats 200 as income of the CE owner
  - No taxation in jurisdiction O: treats 200 as income of the Reverse Hybrid entity
- Question: How is the structure dealt with under the GloBE Rules?



Matching Principles – Reverse Hybrid

- FANIL is allocated first to the PE in accordance with the tax treaty or the domestic law. The remainder of FANIL is allocated to the Reverse hybrid
- Covered taxes follow FANIL
- PE income 150 allocated to the PE
  - Tax holiday in jurisdiction PE: no tax
  - No taxation in jurisdiction I or jurisdiction O on PE income
  - ETR PE: 0/150 = 0%; Top-up Tax = 15%
- Remainder income 50 allocated to the Reverse hybrid entity
  - In jurisdiction PE no tax
  - No taxation in jurisdiction I or jurisdiction O on this income
  - ETR 0/50 = 0%; Top-up Tax = 15%



* GIL = GloBE Income or Loss

Intragroup Financing Arrangements: Article 3.2.7

The adjustment under Article 3.2.7 provides:

- The computation of a Low-Tax Entity's GloBE Income or Loss shall exclude any expense attributable to an Intragroup Financing Arrangement that can reasonably be anticipated, over the expected duration of the arrangement to:
  - (a) *increase the amount of expenses* taken into account in calculating the GloBE Income or Loss of the Low-Tax Entity;
  - (b) without resulting in a *commensurate increase in the taxable income* of the High-Tax Counterparty. [Emphasis added]

Relevant Definitions (defined in Article 10.1):

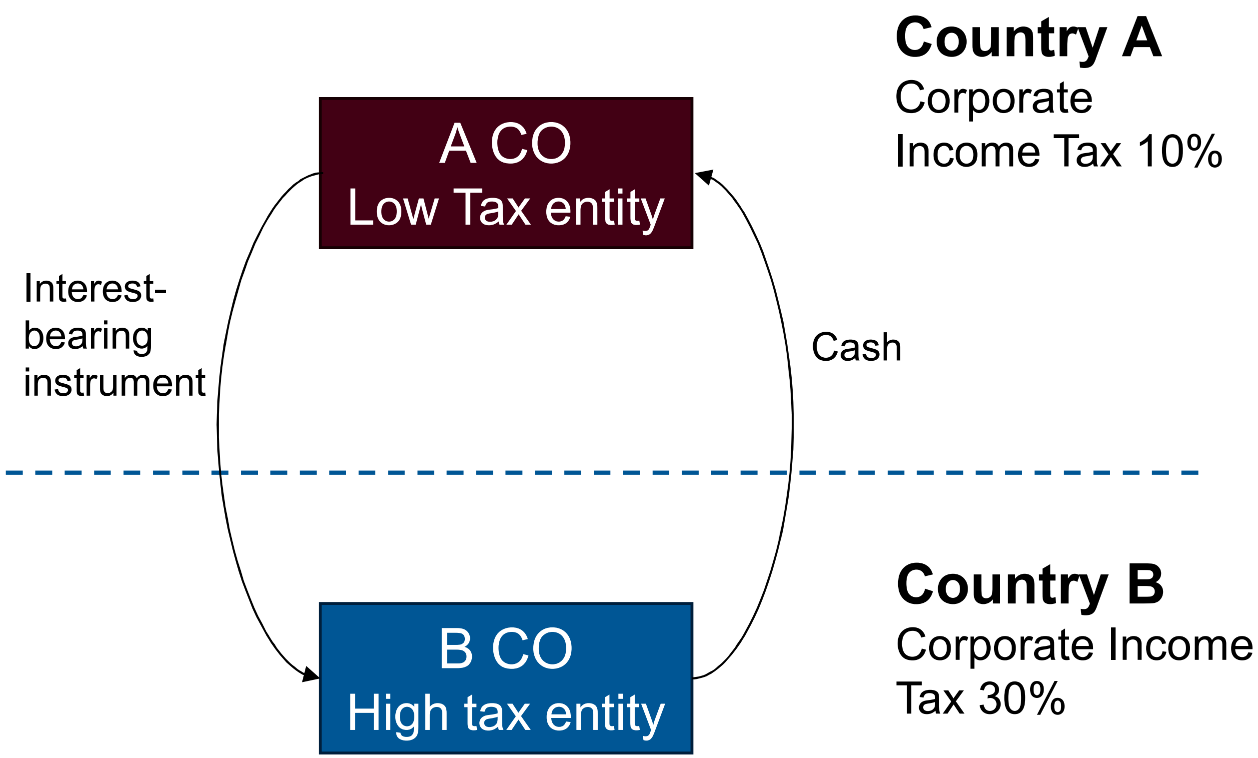
- Intragroup Financing Arrangement
- High-Tax Counterparty
- Low-Tax Jurisdiction
- Low-Tax Entity
- Low-Taxed Constituent Entity

Intragroup Financing Arrangements: Key Points

- Two prong test:
  - Increase of the amount of expenses taken into account in calculating the GloBE income of the Low-Tax Entity and
  - No commensurate increase in the taxable income of the High-Tax Counterparty

- Unlike other adjustments, this is considered to be an anti-avoidance provision and only applies to cross-border situations, one exception
- An “objective assessment” is made. Intermediary Treasury (if finance Co with back-to-back arrangements) may or may not fall under this article
- Debt releases under prescribed circumstances
- Care should also be taken when the counterparty to the intra-group financing arrangement is a Flow-Through Entity

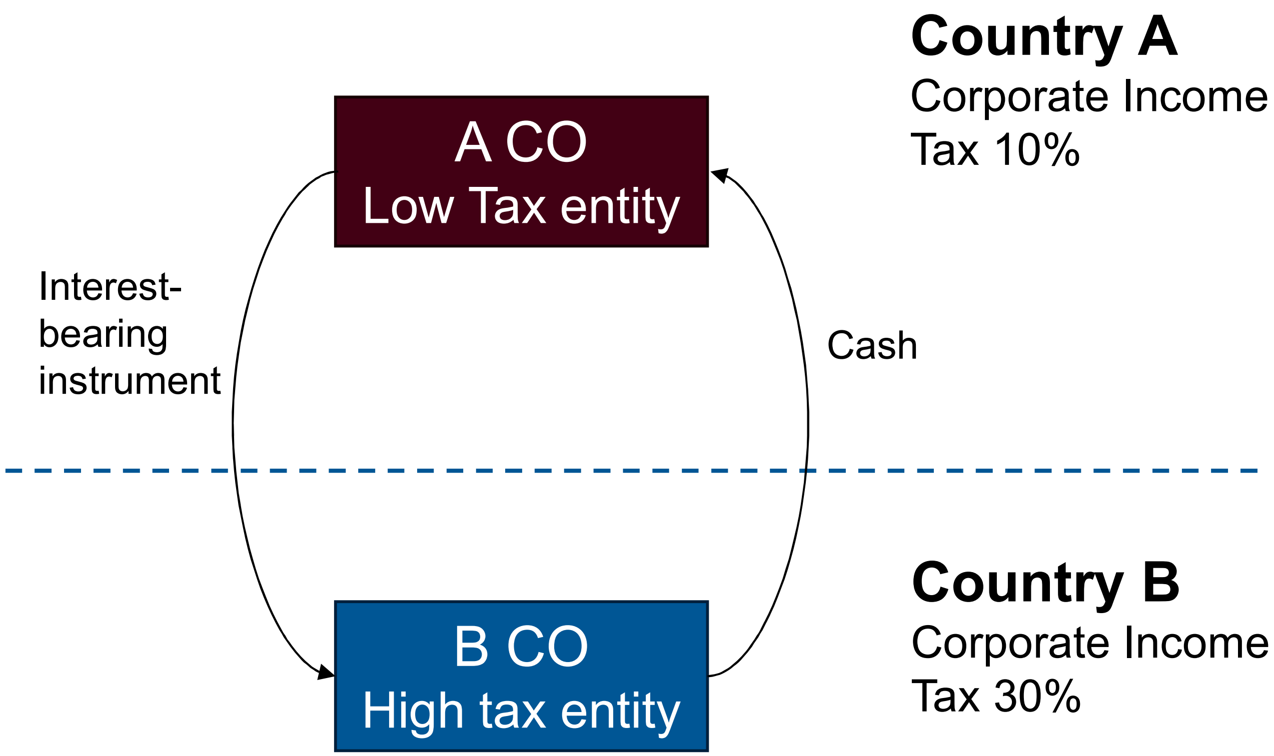
Special Rule for Intra-Group Financing Arrangements: Example 1* - Facts



*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.7- 1

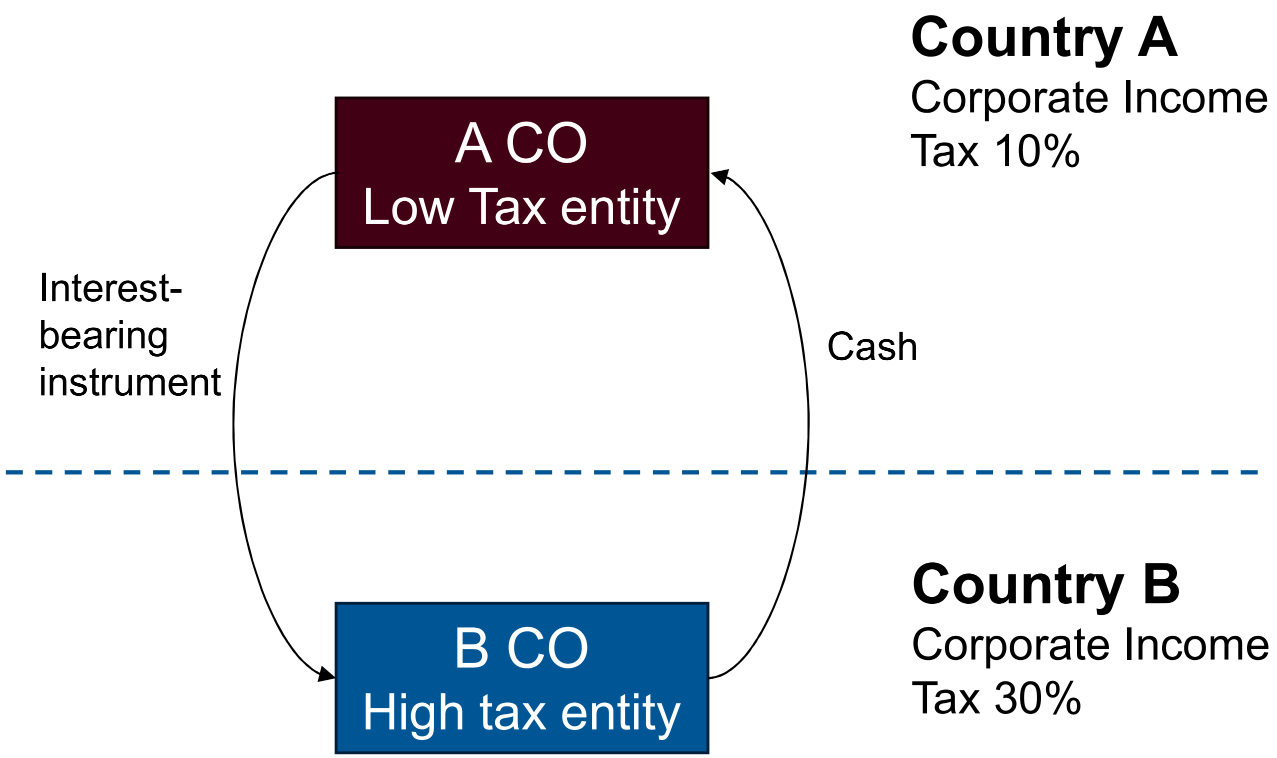
- A Co is located in Country A with a 10% CIT rate, and B Co is in Country B with a 30% CIT rate.
- A Co issues an interest-bearing instrument to B Co in exchange for cash, **treated as equity for tax purposes** in both countries.
- The payments reduce A Co's GloBE Income but don't affect its Country A tax liability, and they increase B Co's GloBE Income without affecting its Country B tax liability.
- As a result,
  - A Co's GloBE ETR increases, and
  - B Co's GloBE ETR decreases.
- Under Article 3.2.7, the transaction is reviewed to determine if it's an Intragroup Financing Arrangement.

Special Rule for Intra-Group Financing Arrangements: Example 1 - Answer



- The first test of Article 3.2.7 is met since the arrangement increases expenses in A Co's GloBE Income calculation.
- The second test is met as B Co’s taxable income doesn't increase due to the equity treatment in Country B.
- Therefore, the interest expense from the instrument issued between B Co and A Co should be excluded from A Co’s GloBE Income or Loss computation.

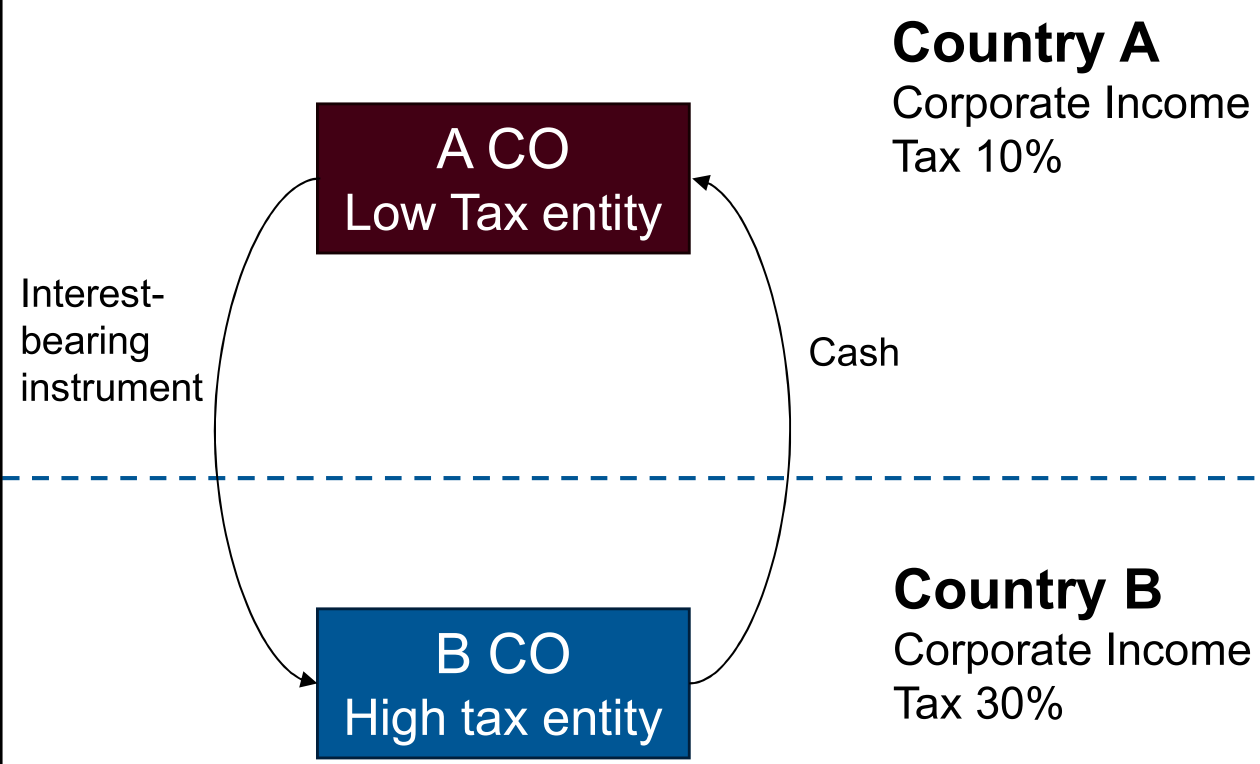
Special Rule for Intra-Group Financing Arrangements: Example 2* - Facts



- Facts are the same as Example 1 except that:
- The instrument issued between B Co and A Co is **treated as debt** for tax purposes in both Country A and Country B.
- A Co is highly-leveraged and cannot deduct additional interest expense for Country A tax purposes.
- B Co is also highly-leveraged and has carried forward previously denied interest expense deductions.
- These carried-forward deductions are sufficient to offset the interest income B Co receives from the instrument issued between B Co and A Co.

*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.7- 2

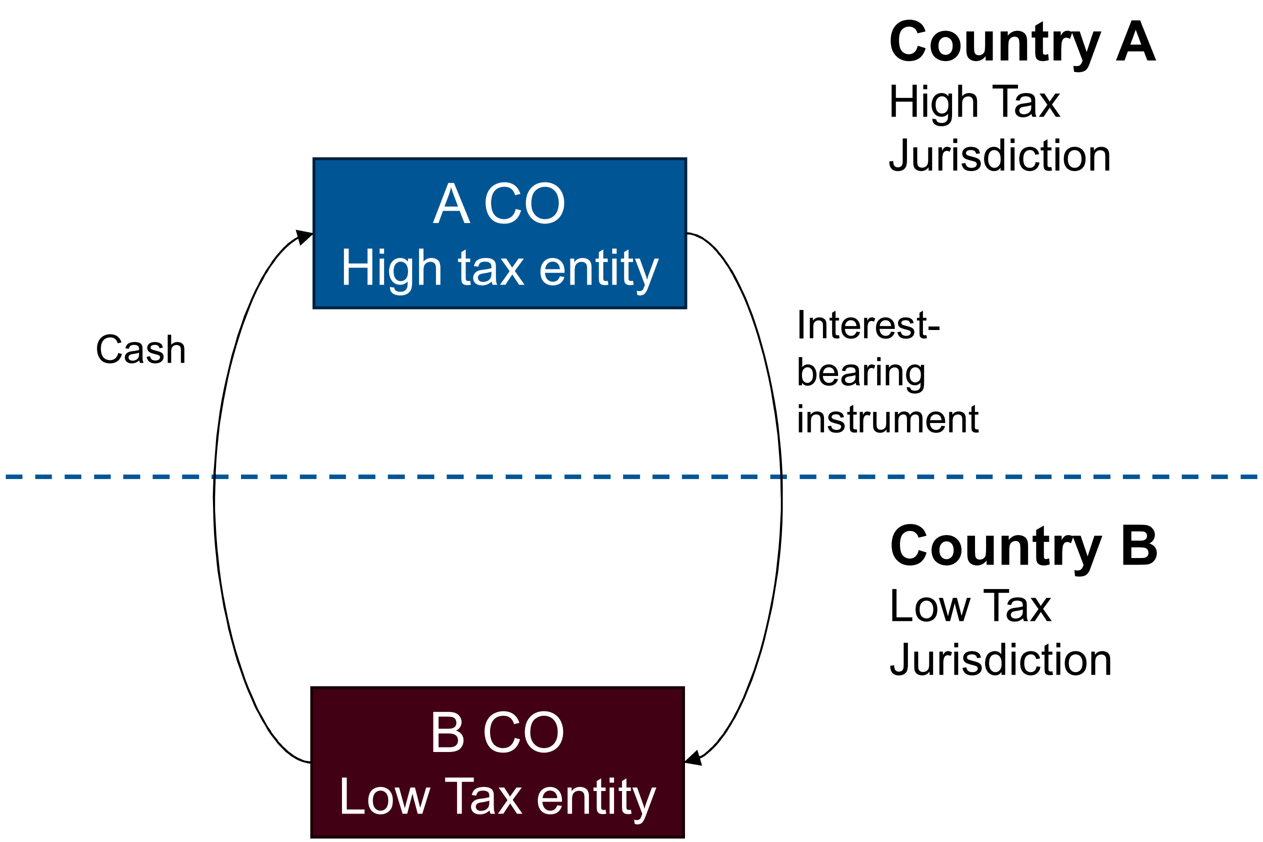
Special Rule for Intra-Group Financing Arrangements: Example 2 - Answer



*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.7- 2

- A Co's interest expense meets the first prong of the Article 3.2.7 test as it increases A Co's expenses considered in GloBE Income or Loss.
- The second prong of Article 3.2.7 is satisfied because B Co does not see a commensurate increase in its taxable income due to its excess interest expense carry-forward.
- Since both prongs of Article 3.2.7 are met, the interest expense related to the instrument between B Co and A Co should be excluded from A Co's GloBE Income or Loss computation.

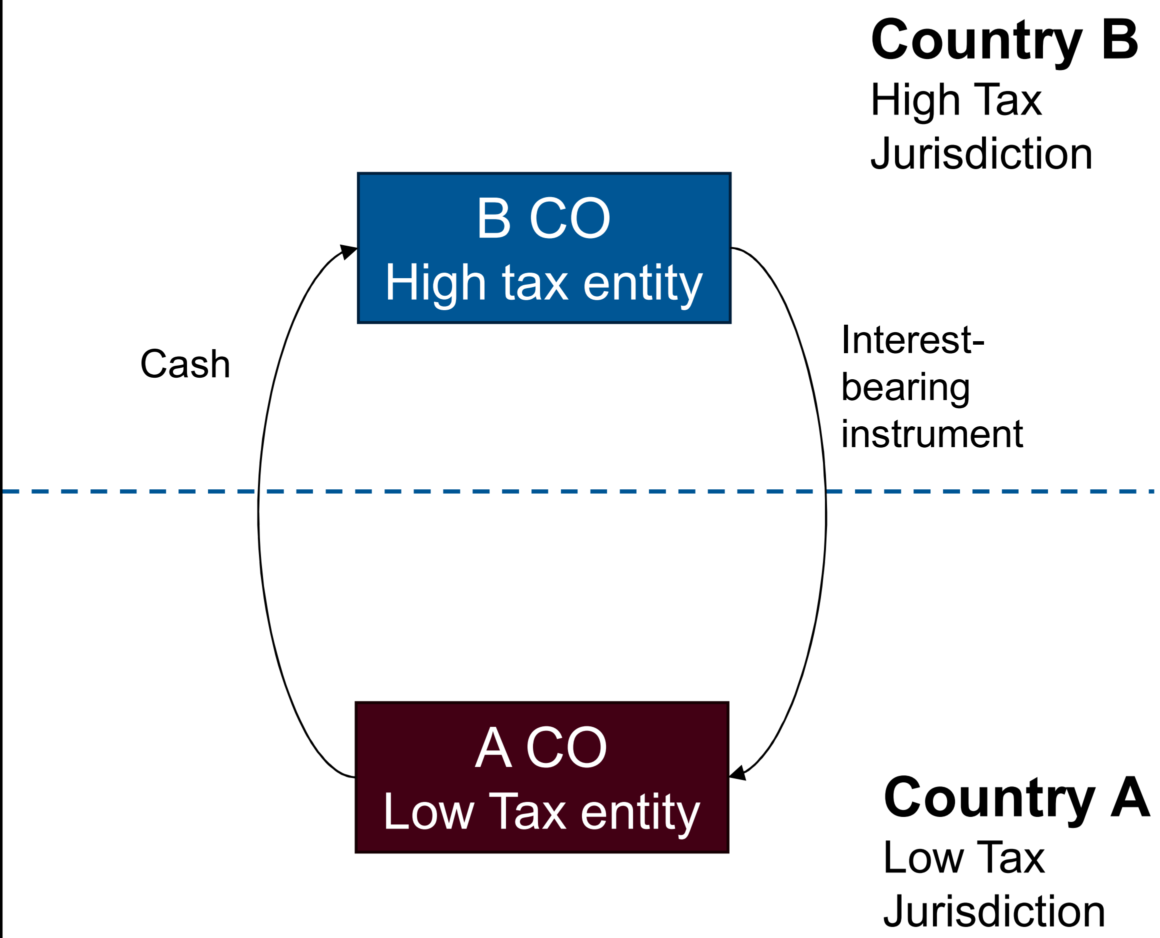
Special Rule for Intra-Group Financing Arrangements: Example 3 – Facts*



- **Before** issuing the hybrid instrument
  - ACo has Globe Income of EUR 1.000, Globe tax of EUR 200 and ETR of **20%**.
  - BCo has Globe Income of EUR 200 Globe tax of EUR 20 and ETR of **10%**.
- ACo grants a hybrid financial instrument to BCo (interest amounting to EUR 100).
- The interest-bearing instrument is treated as **equity for tax** purposes and **debt for accounting** purposes in **both** jurisdictions.

*M.Schul & S.Klein, Hybrid Financing arrangements under the GloBe Rules, TNI, July 2024.

Special Rule for Intra-Group Financing Arrangements: Example 3 - Answer



- Result **after** issuing the hybrid instrument:
  - ACo has Globe Income of EUR 1.100 (1.000+100), Globe tax of EUR 200 and ETR of **18,8% (-1,92%)**.
  - BCo has Globe Income of EUR 100 (200-100), Globe tax of EUR 20 and ETR of **20% (+10%)**.
- Both ACo and BCo ETR is above 15%
- The first prong of Article 3.2.7 is met since the arrangement increases expenses in A Co's GloBE Income calculation.
- The second prong is met as B Co's taxable income doesn't increase due to the equity treatment in Country B.
- If Article 3.2.7 applies, then BCo ETR is **10%**

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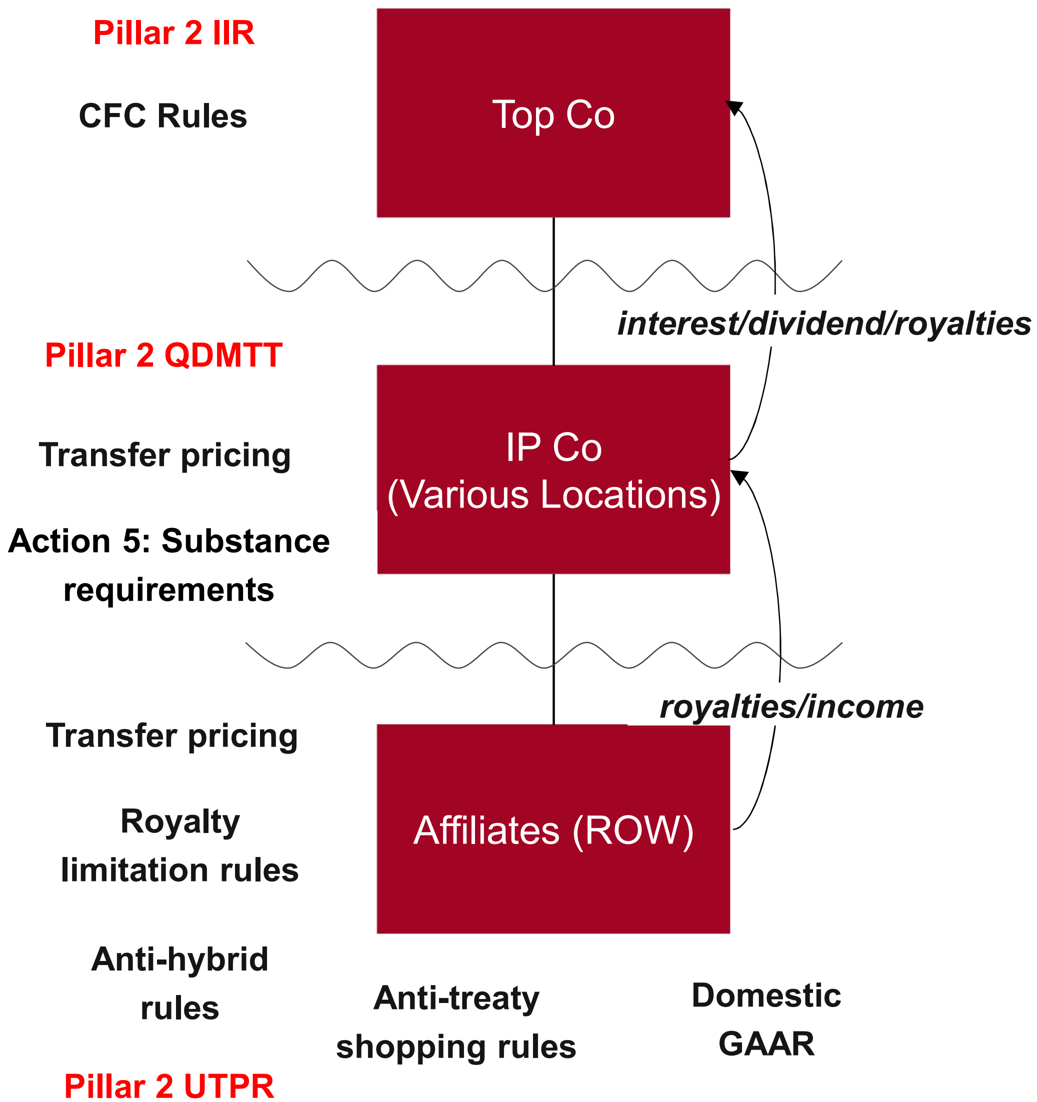
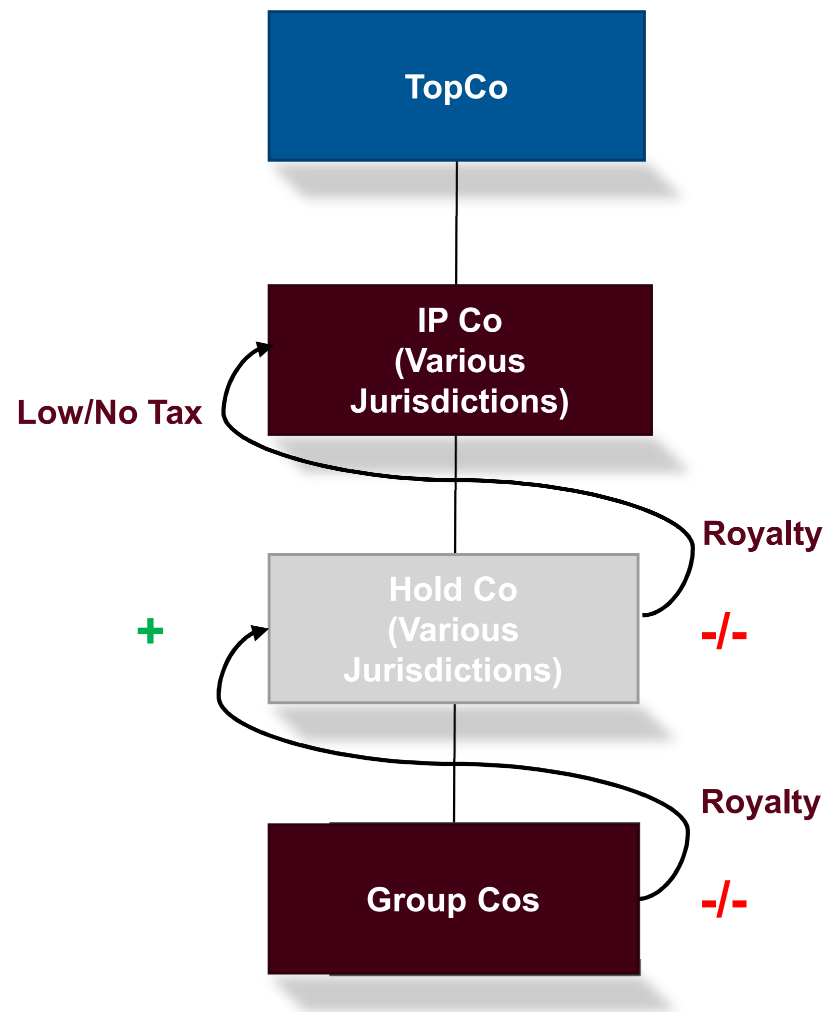
Post BEPS IP Structures



- Low tax IP regimes have been amended to conform with Action 5 of the OECD BEPS Action Plan
- Tax advantages can be supported only if there are qualifying R&D expenditures
- Tax advantages can be negated by home country CFC rules
- Other countries where DEMPE activities are carried out may want a share of the IP income
- Post-BEPS changes in affiliate countries need to be monitored
  - Various limitations can apply to deny deductions
  - Withholding tax costs may increase

Example: IP Box Regimes



- Many European countries offer preferential tax rates for certain IP income. Examples include: Ireland (6.25%), Luxembourg (5.2%), UK (10%), Cyprus (2.5%).
- GloBE Rules would impose Top-up taxes on IP Co, taking into account SBIE.
- SBIE is not the same as Qualifying Expenditure under the ‘nexus approach’, but both are related to substance:

$$\frac{\text{Qualifying expenditure to develop IP}}{\text{Overall expenditure to develop IP}} \times \text{Overall IP income} = \text{Income receiving tax benefits}$$

Incentives for R&D Activities

Special capital allowances

Accelerated depreciation: some capital assets can be depreciated immediately or over a shorter period of time compared with their economic useful life

Super deduction: Czech Republic - a company performing R&D projects may deduct from its tax base an additional 110% of qualifying R&D costs

Reduced tax rates

Example: China - High-new technology enterprises- reduced tax rate 15%

Tax credits

Non-refundable credits: R&D costs and capital investments may generate tax credits to offset tax liability. The credits can not be refunded, but may be carried forward.

Refundable credits: Australia - a tax offset between 30% and 45% of the eligible R&D expenditure depending on the turnover. The credits can be refunded as cash in case there is no tax liability to be offset.

GloBE Rules would claw back these incentives

Tax incentives that are unaffected by the GloBE Rules

Table 1. Mapping the impact of tax incentive instrument design in the GloBE ETR calculation

The intensity of the colour reflects the likelihood with which the benefit of the tax incentives may be affected by the GloBE ETR calculation

Nature of relief	Type of instrument		Tax benefits affected by the GloBE ETR calculation (intensity of the colour indicates intensity of effect)	Effect on GloBE ETR: Numerator	Effect on GloBE ETR: Denominator
Income-based incentives		Full exemption	More likely	↓	
		Partial exemption	More likely	↓	
		Reduced rates	More likely	↓	
Expenditure-based incentives	Tax deductions[1]	Tax allowances[3]	More likely	↓	
		Immediate expensing and accelerated depreciation	Less likely	Adjusted for timing differences	
		For tangible assets: machinery, equipment, buildings	Unaffected	No recapturing applies	
		For short-lived intangibles	Less likely	Recapturing may apply	
		Other assets	More likely	Recapturing may apply	
	Tax credits	Qualifying refundable tax credits	Less likely	2	↑
		Other tax credits	More likely	↓	

- GloBE adjusts Covered Taxes to account for tax incentives that are based on timing differences by including the deferred tax asset
- By doing so, the GloBE ETR will be unaffected (Art. 4.4)
- Where these differences are maintained over a period of more than five years a recapturing mechanism may apply (Art. 4.4.4)
- The recapture mechanism does not apply to a Recapture Exception Accrual (Art. 4.4.5)
  - e.g. research and development expenses

Tax incentives regarding R&D expenses are unaffected by the GloBE Rules

4.4.5. Recapture Exception Accrual means the tax expense accrued attributable to changes in associated deferred tax liabilities, in respect of:

(a) Cost recovery allowances on tangible assets

(b) The cost of a licence or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets;

(c) Research and development expenses;

(d) De-commissioning and remediation expenses;

(e) Fair value accounting on unrealised net gains;

(f) Foreign currency exchange net gains;

(g) Insurance reserves and insurance policy deferred acquisition costs;

(h) Gains from the sale of tangible property located in the same jurisdiction as the Constituent Entity that are reinvested in tangible property in the same jurisdiction; and

(i) Additional amounts accrued as a result of accounting principle changes with respect to categories (a) through (h).

- Paragraph (a): Tangible assets that reflect the principle of accelerated depreciation and immediate expensing regimes
- Paragraph (c): jurisdictions generally permit the deduction of research and development costs, whereas some of such costs may be capitalised for financial accounting purposes.

Qualified Refundable Tax Credits and Marketable Transferable Tax Credits: A.3.2.4

The adjustment under Article 3.2.4 provides:

- Qualified Refundable Tax Credits **shall be treated as income** in the computation of GloBE Income or Loss of a Constituent Entity. Non-Qualified Refundable Tax Credits **shall not be treated as income** in the computation of GloBE Income or Loss of a Constituent Entity.

Five categories of Tax Credits (defined in Article 10.1 and Commentary)

- Qualified Refundable Tax Credits (refundable as cash or equivalent withing 4 years);
- Non-Qualified Refundable Tax Credits (not a Qualified Refundable Tax Credit);
- Marketable Transferable Tax Credits;
- Non-Marketable Transferable Tax Credits (not a Marketable Transferable Tax Credit); and
- All Other Tax Credits (residual category).

Impact of Tax Credits: There are Five Categories of Tax Credits with Two Different Treatments

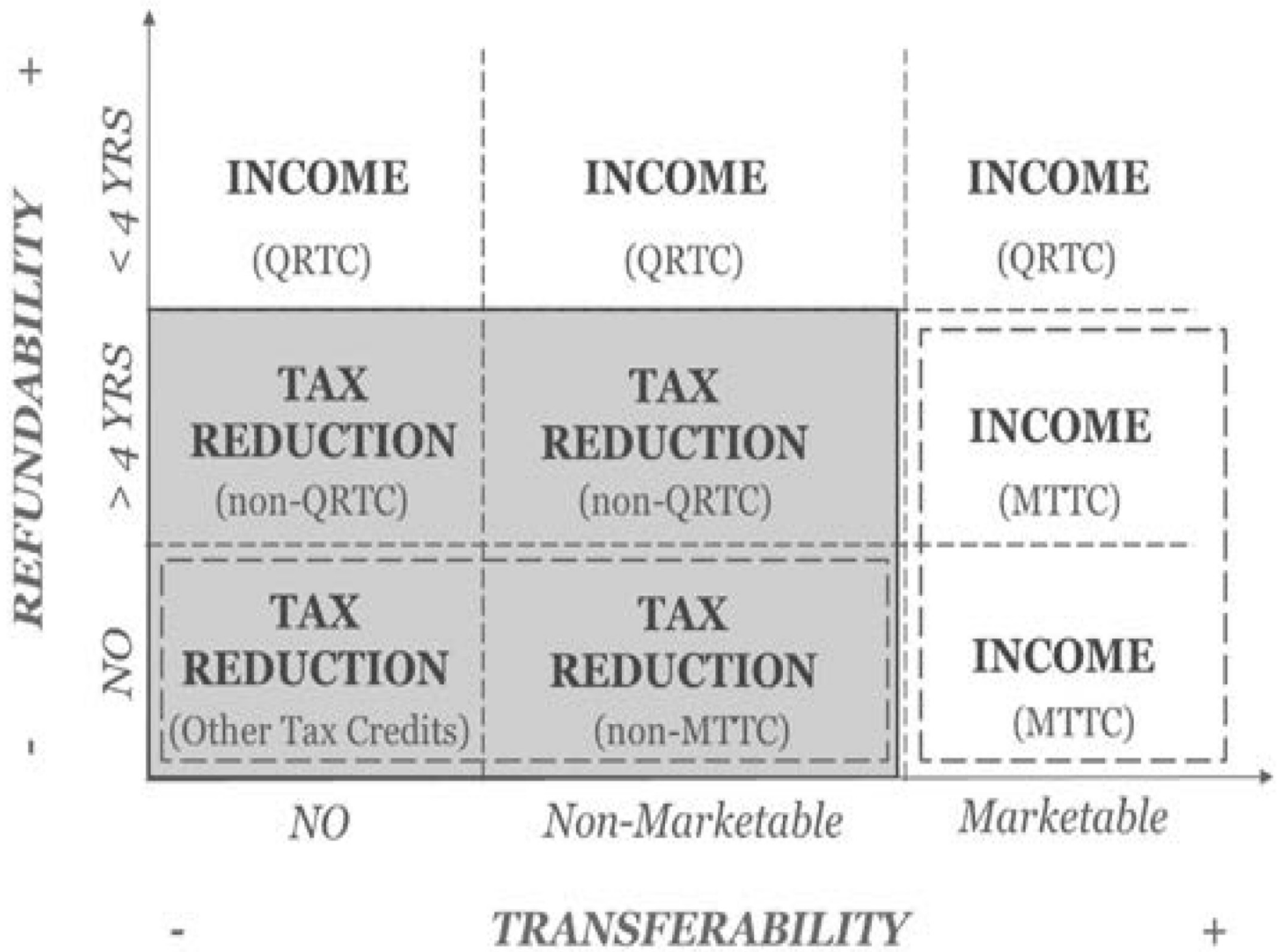
Income treatment, that is, inclusion of the tax credit in the computation of GloBE Income or Loss, which applies to:

- (i) Qualified Refundable Tax Credits and
- (ii) Marketable Transferable Tax Credits; and

Tax reduction treatment, that is, reduction to Covered Taxes, which applies to:

- (i) Non-Qualified Refundable Tax Credits,
- (ii) Non-Marketable Transferable Tax Credits and
- (iii) all Other Tax Credits.

Qualified Refundable Tax Credits and Marketable Transferable Tax Credits: Overview



- Five categories of Tax Credits:
  - Qualified Refundable Tax Credits;
  - Non-Qualified Refundable Tax Credits;
  - Marketable Transferable Tax Credits;
  - Non-Marketable Transferable Tax Credits; and
  - All Other Tax Credits.

Agenda

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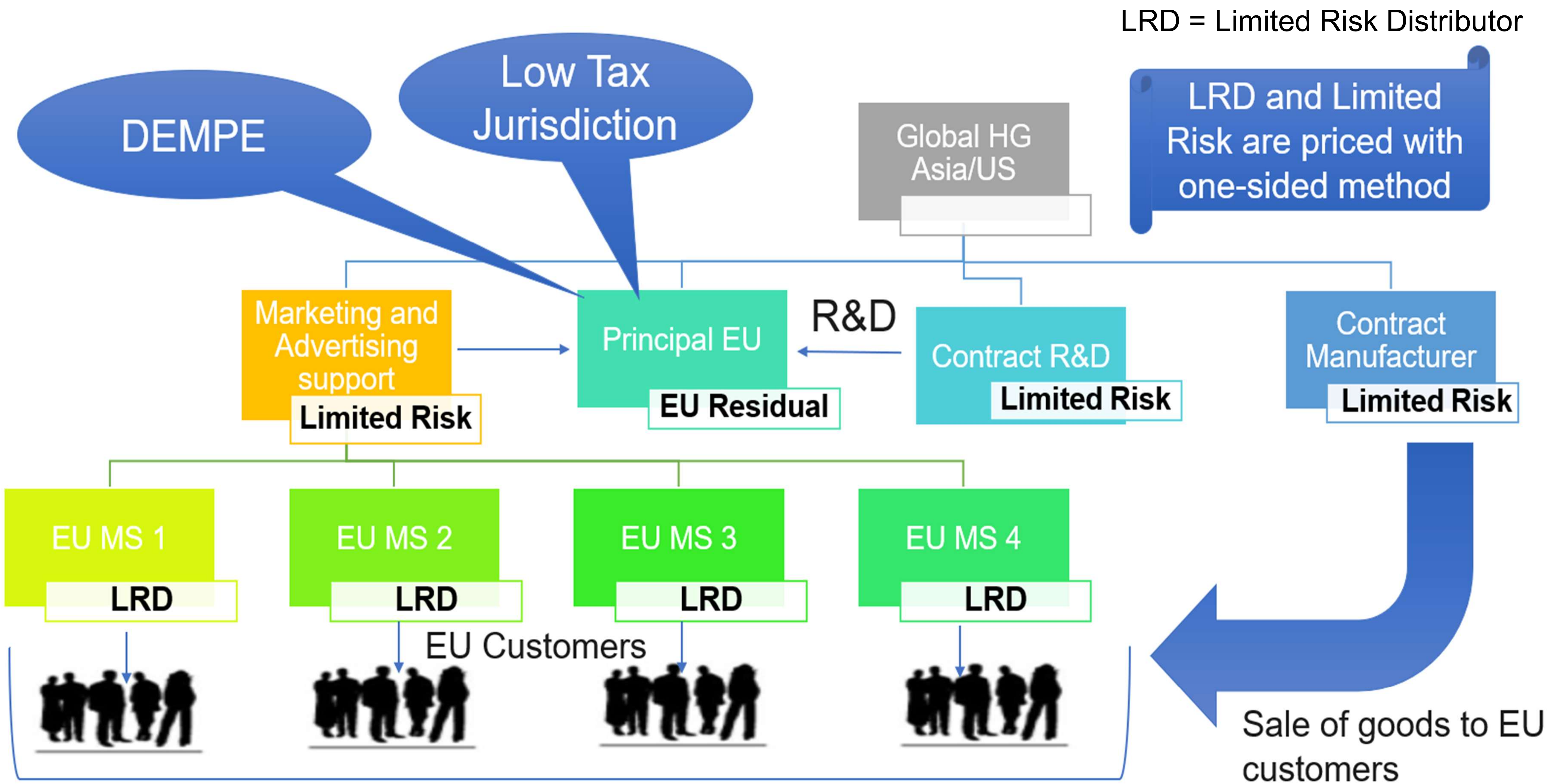
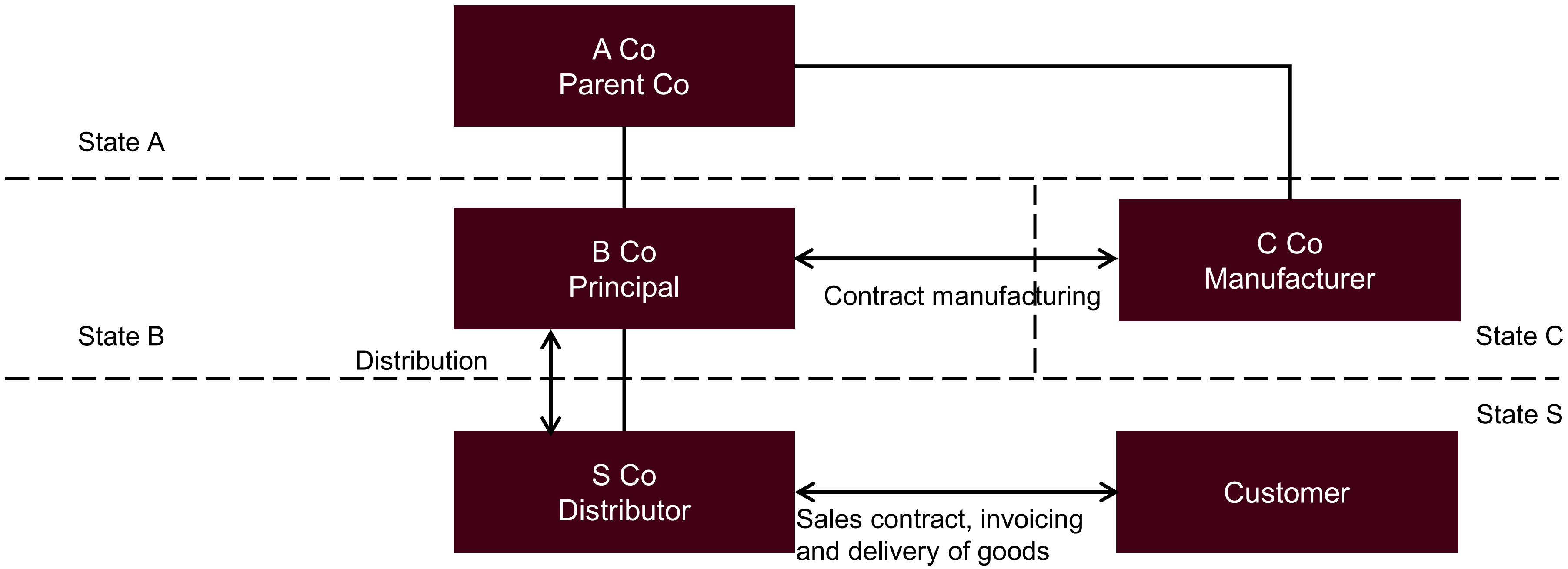
1	GMT and International Tax Structures
2	Application of GMT to holding structures
3	Financing structures under GMT
4	IP structures under GMT
5	**Supply chain structures under GMT**
6	Immovable Property
7	References

Entrepreneur or Principal Structure



Global Supply Chain Structure

Routine profits from “substantive activities” in a jurisdiction are not subject to the top-up tax



Are the Transitional CbCR Safe Harbours applicable to the limited risk entities?

Arm's length requirement for cross-border transactions: A.3.2.3

- Article 3.2.3 provides for the adjustment of amounts arising from intragroup arrangements that are inconsistent between the financial accounts of the related counterparties or not under the arm's length principle. Distinction between:
  - **Cross-border** (first sentence of article 3.2.3) and
  - **Domestic** intragroup transactions (second sentence of article 3.2.3).
- Anti-profit shifting purpose adjustment
- Cases where the transfer price used in the financial accounts of the counterparties may differ from the transfer price used to compute the taxable income of one counterparty but not another:
  - A unilateral advance pricing agreement has been agreed;
  - Where a CE files a tax return under a self-assessment system that includes book-to-tax adjustments to comply with local transfer pricing rules; or
  - The tax authorities adjust the transfer price used in the local tax return of a CE.

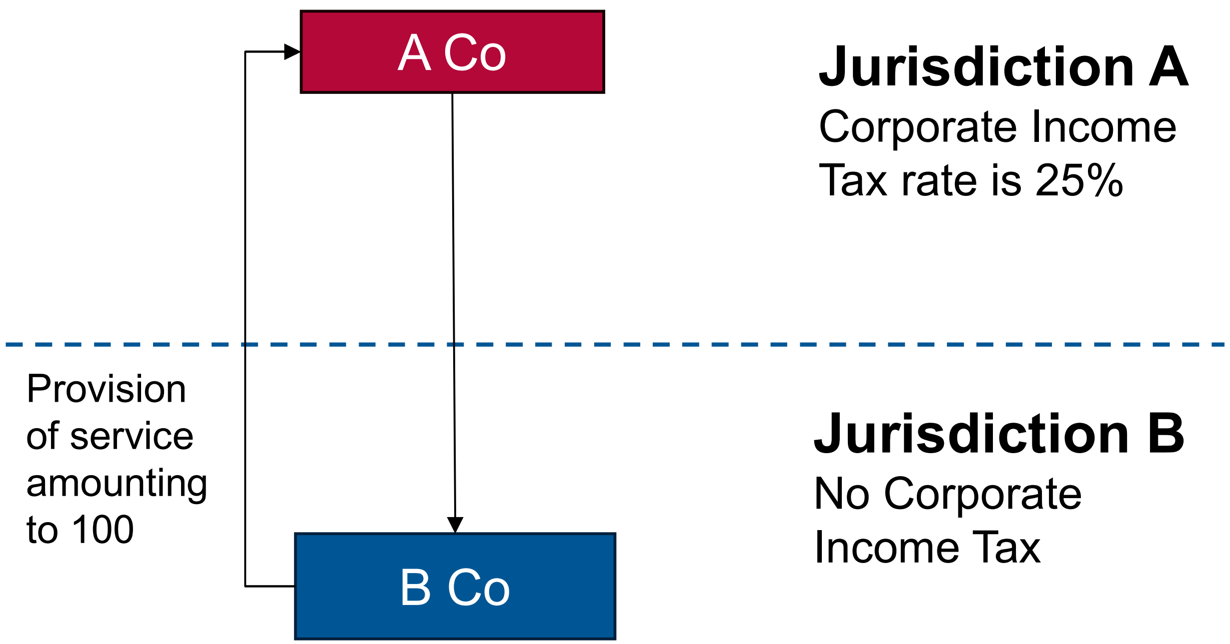
Arm's length requirement principles can be summarized as follows:

- The general principle is that the transfer price applied for determining taxable income is assumed to align with the arm's length principle.
- In the event of a unilateral transfer pricing adjustment (such as a unilateral tax audit), a corresponding adjustment to the GloBE income or loss of all involved parties is necessary, except when the TP adjustment results in an increase or decrease in the MNE group's taxable income within a Low-Taxed jurisdiction.
- Simply put, an adjustment is only mandated if a unilateral adjustment affects the taxable income in a high-tax jurisdiction.
- In a bilateral transfer pricing agreement, where the relevant tax authorities agree on a uniform transfer price (or adjustment to it), the adjustment for each party is factored into the calculation of their GloBE income or loss, in accordance with Article 4.6.1, if applicable.

Arm’s length requirement for cross-border transactions: Key Points

- No adjustment should be made to the GloBE Income or Loss if the prices reflected in the financial statements used in computing local taxes are consistent with the Arm’s Length Principle and no transfer pricing adjustment has been made by tax authorities
- Adjustments must be made to prevent double taxation or double non-taxation
- No adjustments are required to be made when the adjustments would give rise to double taxation or double non-taxation under the GloBE Rules
- CEs in different MNE Groups are still related parties for transfer pricing due to regulatory differences and vice versa entities of the same MNE group deemed not to be related parties. This article still applies.
- Price setting exercise is preferred over price testing to ensure consistency between financial statements and the Arm’s Length Principle

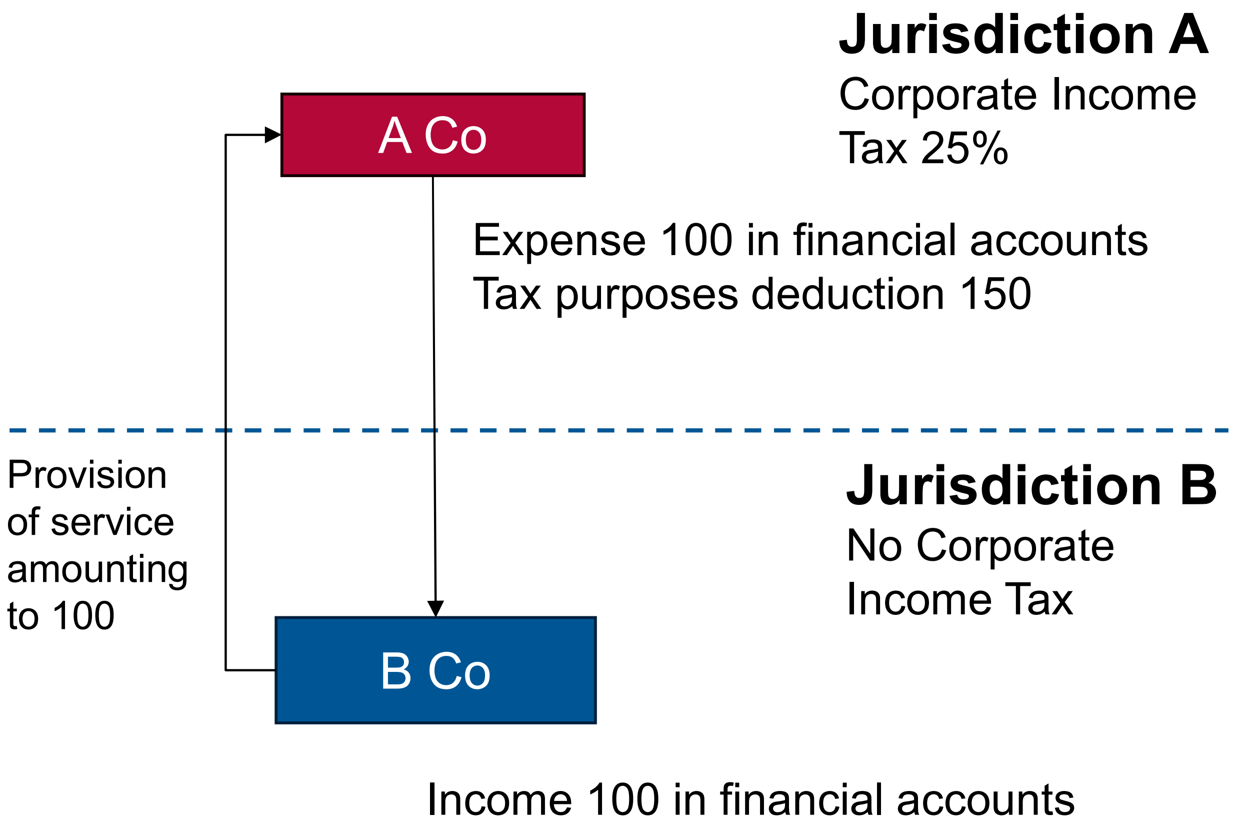
Arm’s Length Requirement for Cross-border Transactions: Example 1* - Facts



- A Co (in Jurisdiction A, 25% tax rate) and B Co (in Jurisdiction B, no income tax) are part of the same MNE Group.
- B Co provides services to A Co during Year 1.
- A Co's financial accounts reflect a 100 expense for these services, and B Co's accounts show 100 income.
- For tax purposes, A Co claims a 150 deduction for the same services.
- Article 3.2.3 of the GloBE Rules requires intercompany transactions to follow the Arm’s Length Principle.
- Adjustments are needed under GloBE Rules if the amount in tax returns differs from the financial accounts to prevent double taxation or non-taxation.

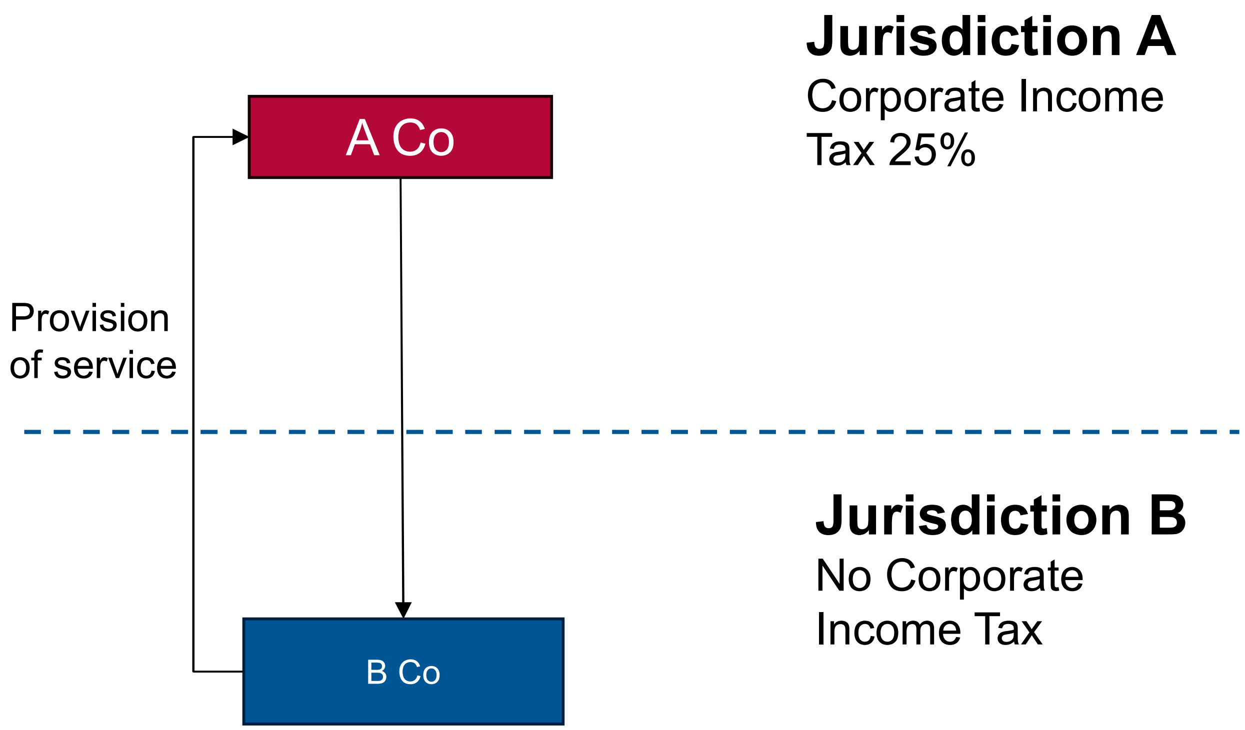
*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.3- 1

Arm's Length Requirement for Cross-border Transactions: Example 1 - Answer



- A Co reported 150 of expense in its Jurisdiction A tax return but only 100 in its financial accounts for Year 1.
- B Co reported 100 of income in its financial accounts for Year 1.
- The 50 difference between the tax deduction and financial expense results in **50 of income not taxed in Jurisdiction A or subject to Top-up Tax in Jurisdiction B.**
- To **prevent double non-taxation**, Article 3.2.3 of the GloBE Rules **requires**:
  - A Co to add the 50 of additional expense to its GloBE Income or Loss computation.
  - B Co to add 50 of additional income to its GloBE Income or Loss computation.

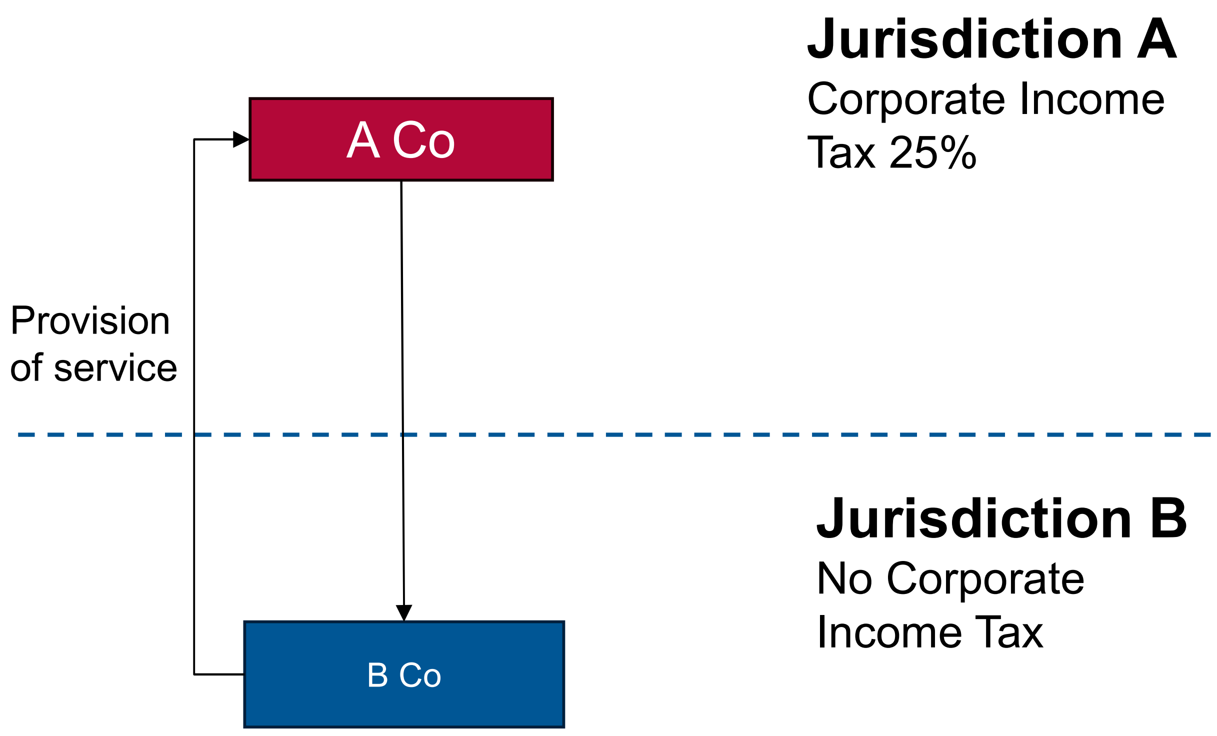
Arm's Length Requirement for Cross-border Transactions: Example 2* - Facts



- Facts are the same as Example 1, except that:
- A Co reported 80 expense from the transaction with B Co in its Jurisdiction A tax return in accordance with a unilateral Advance Pricing Agreement concluded with Jurisdiction A.
- B Co reported 100 of income in its financial accounts for Year 1.

*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.3- 2

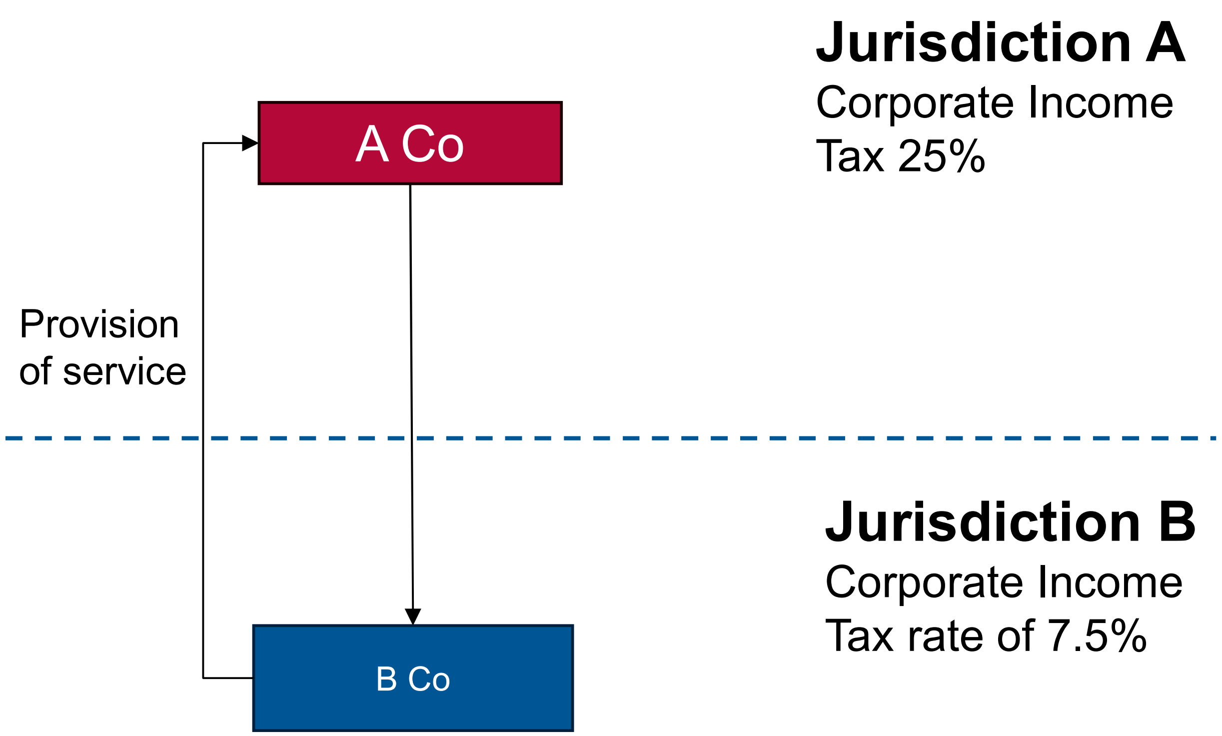
Arm's Length Requirement for Cross-border Transactions: Example 2 - Answer



Conclusion:

- A Co reported 80 of expense in its Jurisdiction A tax return but 100 in its financial accounts for Year 1.
- B Co reported 100 of income in its financial accounts for Year 1.
- As a result, **A Co is taxed in Jurisdiction A on 20 of income that is also subject to Top-up Tax in Jurisdiction B.**
- To avoid **double taxation** under the GloBE Rules, Article 3.2.3 requires:
  - **A Co to reduce the expense by 20** in its GloBE Income or Loss computation.
  - **B Co to reduce the reported income by 20** in its GloBE Income or Loss computation.

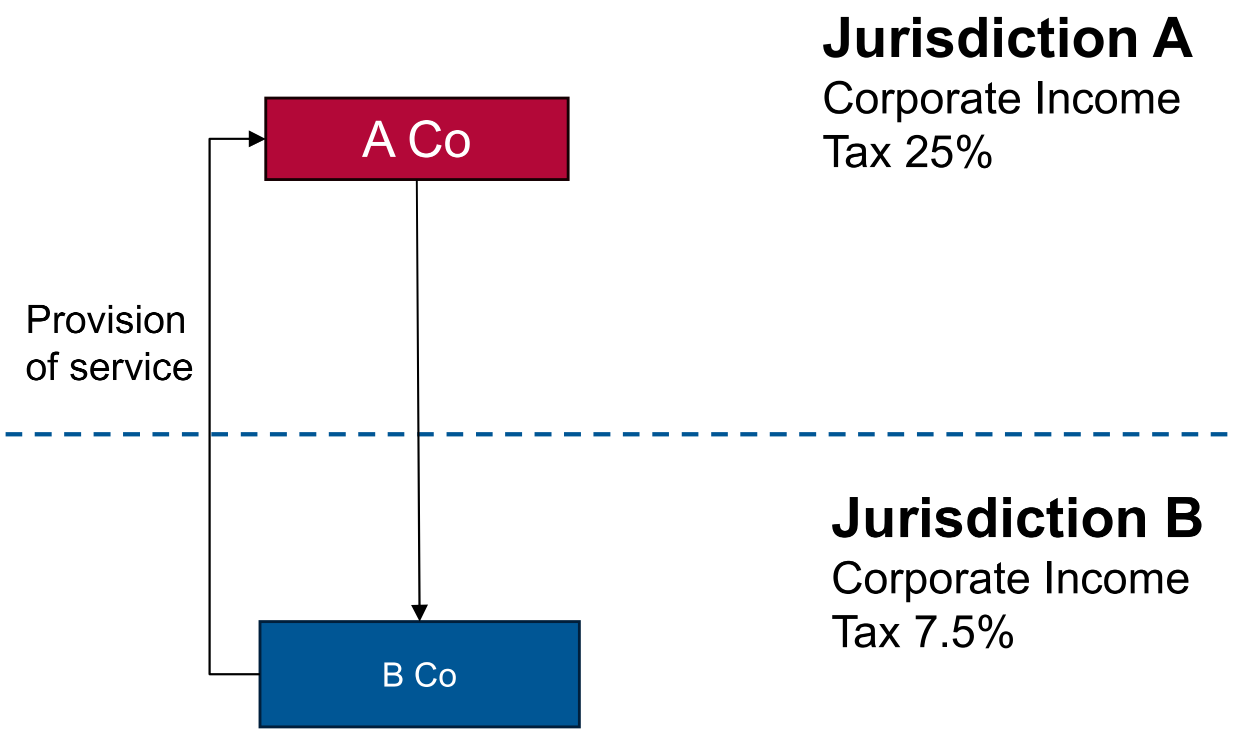
Arm's Length Requirement for Cross-border Transactions: Example 3* - Facts



- Facts are the same as Example 1, except that:
- Jurisdiction B has a corporate income tax that has a nominal rate of 7.5% and B Co reported 50 of income from the transaction with A Co in Jurisdiction B in accordance with a unilateral Advance Pricing Agreement concluded with Jurisdiction B.
- B Co reported 50 of income in its tax return and 100 in its financial accounts for Year 1.
- A Co reported 100 of expense in both its tax return and financial accounts.

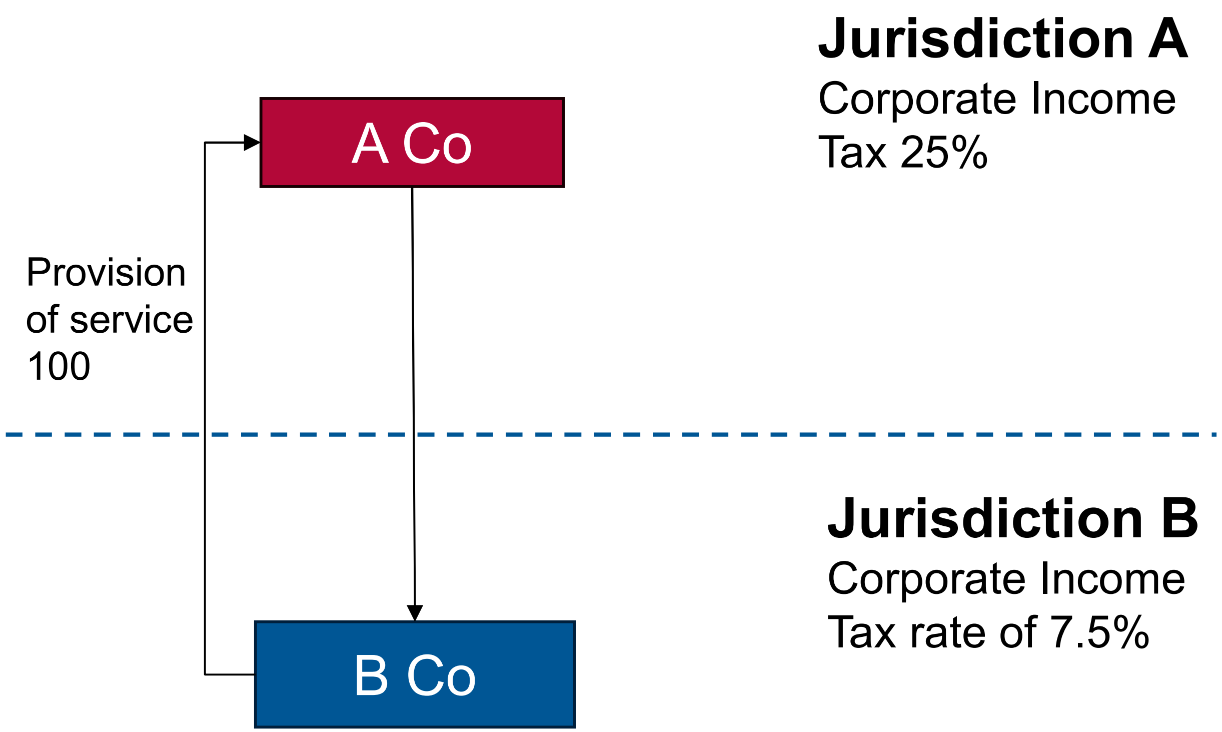
*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.3- 3

Arm's Length Requirement for Cross-border Transactions: Example 3 - Answer



- B Co reported 50 of income in its tax return and 100 in its financial accounts for Year 1.
- A Co reported 100 of expense in both its tax return and financial accounts.
- 50 of income is deducted by A Co but excluded from B Co's taxable income.
- This 50 is subject to Top-up Tax under GloBE Rules in Jurisdiction B.
- **No adjustment is required** under Article 3.2.3 to avoid double non-taxation.

Arm's Length Requirement for Cross-border Transactions: Example 4



- Both ACo and BCo reported 100 of expense in both its tax return and financial accounts.
- Tax authorities in jurisdiction B perform an upwards primary transfer pricing adjustment amounting to 50
- For Pillar 2 purposes, should the corresponding adjustment be performed, this will lead to double taxation of 50 as jurisdiction A is highly taxed
- Therefore, the unilateral TP adjustment made by the tax authorities in Jurisdiction B **is ignored** for Pillar 2 purposes **to avoid double taxation**.

Agenda

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Election to Spread Capital Gains over Five Years: Article 3.2.6

- Article 3.2.6 provides for an Annual Election made by the Filing CE in a jurisdiction, which adjusts the GloBE Income or Loss by allowing for the spreading of gains and losses from the sale of Local Tangible Assets over a five-year period.

- A Local Tangible Asset is defined in Article 10.1 of the Model Rules as immovable property located in the same jurisdiction as the CE.

- Purpose to spread the gains over a period up to five years (that is, the period in which the asset increased in value) to mitigate the effect of recognising the entire effect in one year and matching it with losses (incurred in creating that asset) provides a better measure of the level of minimum taxation in the specific jurisdiction
- The term “immovable property” not defined: interpretation issues
- Only gains and losses arising from transactions with third parties are covered

Election to Spread Capital Gains Over Five Years: Example * Facts

Year 3

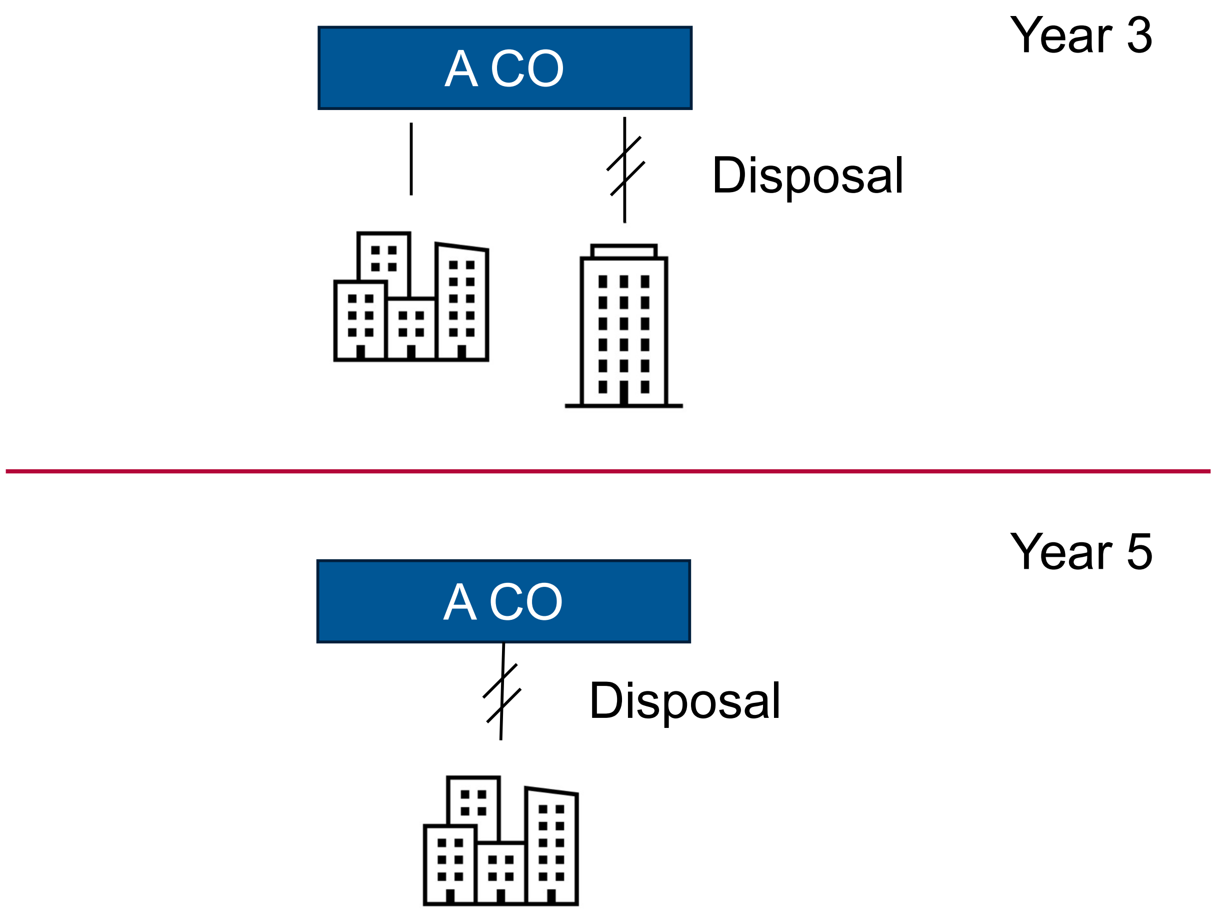
- A Co, part of an MNE Group, is incorporated and tax resident in Country A and holds Local Tangible Assets.
- **Year 3**, A Co disposed of a Local Tangible Asset and incurred a Net Asset Loss of EUR 25.

Year 5

- **Year 5**, A Co disposed of its remaining Local Tangible Assets for EUR 300 (carrying value of EUR 100), resulting in a Net Asset Gain of EUR 200.
- A Co made an **Annual Election** under Article 3.2.6 with respect to the Net Asset Gain in Year 5.

*OECD (2024) Global Anti-Base Erosion Model Rules (Pillar Two) Examples: Example 3.2.6- 1

Election to Spread Capital Gains Over Five Years: Example 8 Answer



- As per Article 3.2.6(b), the EUR 25 Net Asset Loss from Year 3 must be deducted from the Aggregate Asset Gain of EUR 200 in Year 5, leaving EUR 175.
- The remaining EUR 175 is allocated evenly across the five years of the Look-back Period, i.e., EUR 35 per year. Article 3.2.6 is an ETR Adjustment Article.
- Under Article 5.4.1, A Co must recalculate its GloBE Income, ETR, and Top-up Tax for each year in the Look-back Period to reflect the reallocated Aggregate Asset Gain.

Aggregate Asset Gain	Year 1	Year 2	Year 3	Year 4	Year 5 / Election year
EUR 200	EUR 35	EUR 35	EUR 60	EUR 35	EUR 35

Agenda

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References

Pillar 2 Model GloBE Rules published on 14 December 2021 click here

Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2025) published on 09 May 2025 click here

Illustrative examples published on 09 May 2025 click here

OECD (2022), Tax Incentives and the Global Minimum Corporate Tax: Reconsidering Tax Incentives after the GloBE Rules published on 6 October 2022 click here

OECD website for Pillar 2 updates click here

Thank you!!

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