

OECD releases new guidance and consultation drafts on Pillar Two of BEPS 2.0

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Issue 1

In brief

On 20 December 2022, the Organisation for Economic Co-operation and Development (OECD) released the following guidance and public consultation documents¹ on Pillar Two of Base Erosion and Profit Shifting (BEPS) 2.0:

- (1) guidance on safe harbours and penalty relief (not subject to public consultation);
- (2) public consultation document on the Global Anti-Base Erosion (GloBE) information return (GIR) (comments due by 3 February 2023); and
- (3) public consultation document on the tax certainty for the GloBE rules (comments due by 3 February 2023).

The guidance on safe harbours and penalty relief was approved by the OECD/G20 Inclusive Framework on BEPS (IF) on 15 December 2022. The two public consultation documents represent the work of the OECD Secretariat and do not reflect the final views of the IF.

This News Flash provides an overview of these documents². For a detailed discussion, please refer to the *PwC Global Tax Policy Alerts*³.

In detail

Safe harbours and penalty relief

In response to stakeholders' calls for safe harbours and simplifications under Pillar Two (particularly in the early years of implementation and for low-risk jurisdictions), the IF has designed the following measures:

Transitional country-by-country reporting (CbCR) safe harbour

This safe harbour is a temporary measure and would effectively exclude from the scope of the GloBE rules a multinational enterprise's (MNE) operations in lower-risk jurisdictions in the initial years. It applies to fiscal years beginning on/before 31 December 2026 and ending on/before 30 June 2028.

Subject to certain exclusions and special rules, the top-up tax in a jurisdiction will be deemed to be zero for a fiscal year if the MNE group meets at least one of the following three tests in that jurisdiction:

- (1) **de minimis test:** the MNE group has (i) total CbCR revenue of less than EUR10 million and (ii) CbCR profit before income tax of less than EUR1 million (or a CbCR loss before income tax) in that jurisdiction;
- (2) **simplified effective tax rate (ETR) test:** the 'simplified ETR' (as defined) in that jurisdiction is equal to or greater than the 'transition rate'. The transition rate ranges from 15% to 17%, depending on the fiscal year concerned; or
- (3) **routine profits test:** the CbCR profit before income tax in that jurisdiction does not exceed the substance-based income exclusion⁴ (SBIE) for constituent entities resident in that jurisdiction under both the CbCR and the GloBE rules. If the MNE group has zero CbCR profit or a CbCR loss before income tax in that jurisdiction, it will always meet this test and it will not be necessary to calculate the jurisdiction's SBIE.

Our observations:

- To access a safe harbour (be it a temporary or a permanent safe harbour, the latter of which is discussed below), an MNE group would need to comply with the relevant specific filing requirements. Furthermore, qualifying for a safe harbour does not exempt an MNE group from complying with the group-wide GloBE requirements, such as the requirement to prepare and file a GIR.
- It remains to be seen whether this safe harbour will incentivise systematic scrutiny by authorities of an MNE's CbC report. Although at various points IF members tried to reassure stakeholders, it is expected that CbC reports will receive much more attention going forward.

Simplified calculations (permanent) safe harbour

The guidance sets out a framework for the development of a permanent safe harbour. This safe harbour allows MNE groups to avoid making certain complex GloBE calculations in situations where the calculation could be simplified without affecting the GloBE outcomes or otherwise undermining the GloBE rules. Essentially, this safe harbour makes use of simplified income, revenue and tax calculations as alternatives to the GloBE income or loss, GloBE revenue and adjusted covered taxes calculations under the GloBE rules.

Based on the framework, the top-up tax (other than additional current top-up tax) for a jurisdiction will be deemed to be zero for a fiscal year if the MNE group meets at least one of the following three tests (which mirror those in the GloBE rules) in that jurisdiction using 'simplified calculations':

- (1) **routine profits test:** the MNE group has (i) a GloBE income not exceeding the jurisdiction's SBIE or (ii) a GloBE loss in that jurisdiction;
- (2) **de minimis test:** the MNE group has (i) an average GloBE revenue of less than EUR10 million, and (ii) an average GloBE income of less than EUR1 million or an average GloBE loss in that jurisdiction; or
- (3) **ETR test:** the ETR in that jurisdiction is at least 15%.

The simplified calculations will be provided as part of an administrative guidance at a later date.

The guidance also specifically sets out the simplified calculations safe harbour for non-material constituent entities (NMCEs). An NMCE is a member of an MNE group that is not consolidated on a line-by-line basis in the MNE group's consolidated financial statements solely by reason of its size or on materiality grounds, and includes any permanent establishments of such NMCE. Under the safe harbour, the revenue, income (i.e. profit) and adjusted covered taxes of an NMCE will be determined by reference to the relevant CbC regulations.

Our observations:

- The simplification provided by the framework is not yet completely clear. As businesses get to grips with the full impact of the GloBE rules in 2023, we encourage continued engagement with the IF to identify and address additional issues that may need simplification.
- Under the safe harbour for NMCEs, the 'simplified adjusted covered taxes' is the income tax accrued in accordance with the relevant CbC regulations, which excludes deferred tax expenses, other non-current items and provisions for uncertain tax liabilities. This simplification should be welcome for NMCEs since the adjustments for such tax attributes to adjusted covered taxes are typically some of the most difficult adjustments under the GloBE rules.

Transitional penalty relief regime

This regime reflects a common understanding among implementing jurisdictions to provide MNEs with a 'soft landing' during the initial years of the introduction of the GloBE rules. Under the regime, where a tax administration considers that an MNE has taken reasonable measures to ensure the correct application of the GloBE rules, no penalties or sanctions should apply in respect of the filing of a GIR. An MNE may be considered as having taken reasonable measures if it can demonstrate that it has acted in good faith to understand and comply with the GloBE rules.

Our observations:

- The requirement that an MNE takes reasonable measures effectively means that the relief will not apply to situations involving avoidance, fraud or abuse. Additionally, these provisions would not relieve the MNE from any liability to correct errors and pay any unpaid / underpaid top-up tax in accordance with the domestic legislation.
- Subject to the tax certainty provisions (which will be discussed below), the relief is at the discretion of individual governments and is not subject to any type of multilateral procedure or review. That may cause concerns in some jurisdictions.

GloBE information return

The IF has begun to develop a standardised GIR that will facilitate compliance with and administration of the GloBE rules. The GIR centres around groups of data points which are presented in Annex A of the consultation document. These include:

- (1) identification of the constituent entities and their location;
- (2) the overall corporate legal entity structure of the MNE group;
- (3) information necessary to compute the ETR for each jurisdiction (including data at jurisdictional and legal entity levels);
- (4) the top-up tax for each constituent entity and members of a JV group;
- (5) allocation of the top-up tax to the Income Inclusion Rule (IIR) and Undertaxed Payment / Profits Rule (UTPR); and
- (6) record of any elections made.

Annex A represents the best efforts of the IF to identify all the data points that an MNE group may need to collect in order to calculate its GloBE tax liability. It should not be viewed as the final GIR. While all of the data points will require further analysis by stakeholders, we would like to highlight two particular aspects:

1. Corporate legal entity structure

An MNE group is required to disclose the entire corporate legal entity structure. This extends to constituent entity-level information with respect to any ownership changes within the year (e.g. share transfers, acquisitions, divestitures, legal entity formations, etc.).

2. Information necessary to compute the ETR for each jurisdiction

An MNE group is required to disclose, on a constituent entity basis, all positive and negative adjustments to the GloBE income or loss and the adjusted covered taxes (including the current and deferred taxes). The information is then aggregated on a per-jurisdiction basis.

The model GloBE rules provide that the GIR must be filed within 15 months of the end of the GloBE reporting year (extended to 18 months for the first fiscal year that an MNE group is within scope).

Our observations:

- The volume of required data raises significant questions with respect to the compliance burden on taxpayers and the extent to which tax authorities will be able to analyse the data in a meaningful way during the examination process. The approach by which tax administrations will request supporting information that ties to and generates the data reported in the GIR will be a key issue to be resolved in the medium term.
- It is expected that implementing jurisdictions will in many cases amend the local corporate income tax return (such as Hong Kong's profits tax return) to request additional GloBE information pertinent to that jurisdiction. MNE groups will need to comply separately with these requirements.

Tax certainty for the GloBE rules

Given the complexity of the GloBE rules and the differences that could arise in the interpretation or application of the rules among jurisdictions, the OECD has been exploring mechanisms to provide further tax certainty with respect to the GloBE rules. The consultation document describes various mechanisms for achieving tax certainty before and after a taxation action has been taken (i.e. dispute prevention and resolution mechanisms).

Dispute prevention mechanisms

Dispute prevention mechanisms aim at ensuring a common interpretation or application of the rules among tax administrations and taxpayers at an early stage in the compliance or assessment process in order to avoid potential disputes. The following mechanisms are considered:

- reliance on the model GloBE rules, commentary and administrative guidance, including (i) the identification of qualified IIRs, UTPRs and domestic minimum top-up taxes, and (ii) referral of the issues to the IF for clarification;
- common risk assessment and coordinated compliance, such as developing a programme similar to the OECD International Compliance Assurance Programme⁵ (ICAP) for GloBE purposes; and
- binding certainty mechanisms similar to advance pricing arrangements.

Dispute resolution mechanisms

The mutual agreement procedure (MAP) provision in Article 25 of the OECD Model Tax Convention⁶ can serve as a basis for developing a separate GloBE dispute resolution mechanism. Such mechanism could be implemented through different legal instruments, such as a new multilateral convention, the existing Convention on Mutual Administrative Assistance in Tax Matters, existing tax treaties or a new dispute resolution mechanism under the domestic law.

Our observations: This document contains some welcome ideas, but the practicality and viability of these ideas are still quite unclear. For the moment, this document serves as a stock taking of the potential avenues to prevent and resolve disputes, with consensus on the solutions yet to be reached.

Endnotes

1. The documents can be accessed via these links:
<https://www.oecd.org/tax/beps/safe-harbours-and-penalty-relief-global-anti-base-erosion-rules-pillar-two.pdf>
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-two-globe-information-return.pdf>
<https://www.oecd.org/tax/beps/public-consultation-document-pillar-two-tax-certainty-for-the-globe-rules.pdf>
2. For a discussion of the previous documents released by the OECD on Pillar One and Pillar Two, please refer to our dedicated website which can be accessed via this link:
<https://www.pwccn.com/en/services/tax/international-tax/oecd-beps.html>
3. The *PwC Global Tax Policy Alerts* can be accessed via these links:
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-releases-p2-guidance-on-safe-harbours-and-penalty-relief.pdf>
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-announces-pillar-two-globe-information-return-consultation.pdf>
<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-announces-pillar-two-tax-certainty-framework-consultation.pdf>
4. Under Article 5.3 of the model GloBE rules, the net GloBE income shall be reduced by the SBIE to determine the excess profit for purposes of computing the top-up tax in a jurisdiction. The SBIE is the sum of the payroll carve-out and the tangible asset carve-out for each constituent entity (except for investment entities) in that jurisdiction. The model GloBE rules can be accessed via this link:
<https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf>
5. The ICAP is a voluntary risk assessment and assurance programme involving active engagement between tax administrations and MNEs. An ICAP risk assessment may cover various cross-border tax risks, such as transfer pricing risks and permanent establishment risks. For details, please refer to the OECD's website which can be accessed via this link:
<https://www.oecd.org/tax/administration/international-compliance-assurance-programme.htm>

6. The *Model Tax Convention on Income and on Capital 2017* (Full Version) can be accessed via this link:
<https://www.oecd.org/ctp/model-tax-convention-on-income-and-on-capital-full-version-9a5b369e-en.htm>

Let's talk

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