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Report No. 1465
July 21, 2022

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William M. Paul
Principal Deputy Chief Counsel
and Deputy Chief Counsel
(Technical)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report No. 1465-Report on the OECD Global Anti-Base Erosion Model Rules (Pillar Two).

Dear Ms. Batchelder and Messrs. Rettig and Paul:

I am pleased to submit Report No. 1465 of the Tax Section of the New York State Bar Association discussing certain of the U.S. federal income tax implications of the Model Rules under Pillar Two of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting.

We appreciate your consideration of our Report. If you have any questions, please feel free to contact us and we would be happy to assist.

Respectfully Submitted,

Robert Cassanos
Chair

Enclosure

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Report No. 1465

New York State Bar Association Tax Section

REPORT ON THE OECD GLOBAL ANTI-BASE EROSION MODEL RULES (PILLAR TWO)

JULY 21, 2022

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New York State Bar Association Tax Section

REPORT ON THE
OECD GLOBAL ANTI-BASE EROSION MODEL RULES (PILLAR TWO)[1]

I. Introduction

This report comments on certain U.S. federal income tax ("U.S. tax") implications of the Model Rules under Pillar Two of the OECD/G20 Inclusive Framework (the "Inclusive Framework") on Base Erosion and Profit Shifting. On October 8, 2021, the Inclusive Framework reached a general agreement on the second of two "pillars" of new international tax rules aimed at addressing tax challenges arising from the digitalization of the economy ("Pillar Two").[2] Pillar Two is a global minimum tax regime with a hierarchical system of related rules, an income inclusion rule, or IIR, and an undertaxed payments rule that eventually developed into an undertaxed profits rule, or UTPR, and that applies where the IIR does not subject profits to the minimum tax regime. On December 20, 2021, the Inclusive Framework published comprehensive model rules for the minimum tax, the *Global Anti-Base Erosion Model Rules* (the "Model Rules").[3] The Model Rules were further explained by a commentary published March 14, 2022,[4] together with a set of illustrative examples.[5]

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1 The principal author of this report is Ansgar A. Simon, with substantial contributions from Jon Endean and Joseph Tootle. This report reflects substantial comments from Andrew Braiterman, Robert Cassanos, Peter Connors, Kevin Glenn, William L. McRae, Kara Mungovan, Richard Nugent, Stuart Rosow, Michael L. Schler, David Schnabel, Stephen Shay, Joseph Toce, Shun Tosaka, Philip Wagman and Gordon Warnke. This report reflects the views solely of the Tax Section of the New York State Bar Association and not those of the New York State Bar Association Executive Committee or its House of Delegates.

2 On October 14, 2020, the OECD published a report on the status of the development of the Pillar Two rules. *See* OECD (2020), *Tax Challenges Arising from the Digitalisation of the Economy – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en (the "Blueprint Report").

3 OECD (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

4 OECD (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf (the "Commentary").

5 OECD (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples*, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf (the "Model Rules Examples").

This report addresses various questions regarding the interaction and integration of the Model Rules with and into the existing framework of U.S. tax law, in particular the current provisions of the Section 951 and Section 951A of the Internal Revenue Code of 1986, as amended (the "Code"),[6] the foreign tax credit limitation under Section 904 and related provisions, and various proposals made under the *Build Back Better Act* (the "BBBA")[7] and the Treasury Department's *General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals* (the "Greenbook")[8].

Pillar Two introduces a global minimum tax at a rate of 15% on multinational groups with annual revenue of EUR 750 million or more. The minimum tax is imposed on a country-by-country basis. If the income of members of the multinational group in a given country is subject to corporate income tax at a rate less than 15%, a top-up tax applies with respect to the country. The top-up tax is imposed at the rate differential on the amount of the country–specific income less a 5% minimum return on tangibles and employment expenses and collected from members of the multinational group that have adopted and implemented the Pillar Two rules. Generally, if the ultimate parent is located in a jurisdiction that has implemented these rules, it will be responsible for the top-up tax for each low-taxed jurisdiction in which members of the multinational group are located, and the jurisdiction of the ultimate parent will collect this tax. As a backstop to this rule, first, lower-tier intermediate parent entities will collect the top-up tax of their subsidiaries if the ultimate parent entity's jurisdiction has not adopted the Pillar Two rules. Second, if there is no such intermediate parent entity in a Pillar Two rule jurisdiction, the top-up tax is distributed among all member entities in Pillar Two jurisdictions based on an allocation fraction.

Because the corporate income taxes of member entities in high-tax countries are not blended with those of member entities in low-tax countries, each jurisdiction is separately subject to tax at the minimum rate, but for members in low-tax countries the tax is collected from members in other jurisdictions, regardless of the rate at which tax is otherwise imposed on them. For this reason, the Inclusive Framework has maintained that "Pillar Two puts a floor on tax competition on corporate income tax, . . . [as] it does set multilaterally agreed limitations on it." [9]

Pillar Two thus deviates from existing systems of international taxation by requiring no nexus, apart from membership in the same multinational group, in order to impose taxes on members with respect to offshore income. It also departs from existing standards of the taxation by using book income, with certain modifications, as its tax base. If a country wants to avoid top-up taxes being collected from other members of the multinational group, it can adopt a "domestic"

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6 References to "Sections" are to the Code and references to "Articles" are to the Model Rules, unless otherwise indicated. This reports will refer to Section 951 and related provisions as the "subpart F Regime" and to Section 951A and related provisions as the "GILTI Regime".

7 H.R. 5376, 117th Cong. (2021), https://www.congress.gov/bill/117th-congress/house-bill/5376.

8 U.S. Department of the Treasury (March 28, 2022), https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf.

9 OECD (2021), *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD, Paris, October 2021, at p. 4.

top-up tax with respect to its book income, which generally preempts the imposition of top-up taxes on other members of the group.

Part II of this report will summarize considerations and recommendations regarding the Model Rules and their interaction with U.S. tax law; Part III will outline in more detail the Model Rules, and Part IV will discuss the recommendations in more detail. For ease of use, Appendix II to this report lists the acronyms and Appendix III provides an index of defined terms.

II. Summary of Principal Considerations and Recommendations[10]

A. Considerations Regarding the Interaction of the U.S. Tax System, Including the GILTI Regime with the Model Rules

Subject to any further agreements made by the United States and the Inclusive Framework regarding the coexistence of the GILTI Regime (and related items) with the GloBE Rules, we have the following observations about the interaction between the Model Rules and the U.S. tax system:

(1) The current GILTI Regime should be treated as a Controlled Foreign Company Tax Regime under the Model Rules and should not qualify as a Top-up Tax imposed under the IIR.

(2) The modification to the current GILTI Regime proposed by the BBBA and the Greenbook do not appear to conform the GILTI Regime sufficiently to a Top-up Tax imposed under the IIR within the meaning of the Model Rules.

(3) If the GILTI Regime remains a Controlled Foreign Company Tax Regime under the Model Rules, U.S. tax could be imposed with respect to GILTI included by a U.S. corporation that is a member of the MNE Group, regardless of whether the U.S. member is the ultimate parent entity of the MNE Group. If the GILTI Regime were treated as a Top-up Tax under the IIR, the United States should be required to cede taxing jurisdiction, and not to impose tax under the GILTI Regime, in a variety of cases where, under the Model Rules, other members of the MNE Group take precedence under the IIR.

(4) It should not be possible under the Model Rules for the GILTI Regime (in its current form or as modified under the BBBA, the Greenbook or both) to be treated as both a Controlled Foreign Company Tax Regime and as a Top-up Tax under an IIR.

(5) The application of the UTPR to U.S. members of a U.S. parented MNE Group would not be clear if a modified GILTI Regime were treated as a Top-up Tax imposed under the IIR.

[10] Capitalized terms used in this Part II are defined at the location indicated in the index in Appendix II.

(6) The alternative book income minimum tax proposed in the BBBA should not qualify as a Top-up Tax imposed under an IIR or a Qualified Domestic Minimum Top-up Tax and should also not be a safe harbor Top-up Tax under the Model Rules.

(7) While generally Top-up Taxes under the Model Rules should not be creditable foreign income taxes for U.S. tax purposes, an allocable portion of Top-up Taxes, whether imposed under the IIR or the UTPR, should be creditable foreign income taxes under Section 960(d) for United States shareholders that are not members of the MNE Group.

(8) Any Qualified Domestic Minimum Top-up Tax imposed by a foreign jurisdiction on a CFC should be a creditable foreign income tax for a corporate United States shareholder for purposes of the indirect foreign tax credit of the GILTI Regime and subpart F in general under Section 960(d), and a Qualified Domestic Minimum Top-up Tax imposed on a foreign branch should likewise be a creditable foreign income tax for the U.S. owner of the branch.

(9) While the Model Rules do not analyze a Qualified Domestic Minimum Top-up Tax that provides for a credit for such taxes in years when the relevant member of the MNE Group does not generate any Top-up Taxes, such a credit is not prohibited under the Model Rules.

B. RECOMMENDATIONS REGARDING THE IMPLEMENTATION OF THE MODEL RULES

(10) U.S. tax incentives and benefits, such as certain credits, tax exempt income and certain deductions, reduce U.S. taxable income and, therefore, may result in a reduction of the effective U.S. tax rate below the Minimum Rate of the Model Rules. While various factors of the U.S. tax system counteract a reduction below the Minimum Rate, certain variances exist between the book income as measured under the Model Rules on the one hand and U.S. taxable income on the other.

(11) If the United States adopted a Qualified Domestic Minimum Top-up Tax for U.S. members of an MNE Group, it should allow for a credit for such Qualified Top-up Taxes in later years of the U.S. members when no Top-up Tax or Qualified Domestic Minimum Top-up Tax would otherwise be due.

(12) A CFC Minimum Top-up Tax styled after the Qualified Domestic Minimum Top-up Tax intended to ensure that tax imposed in respect of income inclusions from controlled foreign corporations in the aggregate does not fall below amount of tax that would be imposed on book income of the CFCs under the Minimum Rate, while not prohibited under the Model Rules, could as a technical matter not operate as an additional surtax to preclude a Top-up Tax under the Model Rules.

(13) If not repealed before the Model Rules are implemented and take effect in other jurisdictions, the base erosion and anti-abuse tax (the "BEAT") should be treated as a Tax, and as a Covered Tax, under the Model Rules.

C. OBSERVATIONS REGARDING THE MODEL RULES

(14) Further commentary should clarify the changes in the Model Rules' definitions of Controlling Interest and Consolidated Financial Statements from the Blueprint Report.

(15) Because entities are included in an MNE Group only if the MNE Group prepares a Consolidated Financial Statement, various groups can be under common control based on stock ownership without combining into a single MNE Group. It is recommended that anti-abuse rules be designed to target transactions and structures that result in a fragmentation of groups to avoid MNE Group status subject to the Model Rules.

(16) If a Flow-through Entity is the ultimate parent of an MNE Group, the attribution of taxes imposed on an owner of a Flow-through Entity back to the Flow-through Entity for purposes of determining its Top-up Tax contains an all-or-nothing cutoff without proper justification. As a result of this discontinuity, any Qualified Domestic Minimum Top-up Tax would have to be specially allocated among partners or owners of the Flow-through Entity, and it would be very complex to properly allocated Top-up Taxes imposed under the UTPR to partners or owners. Absent such tracing, and without a tax credit for Top-up Taxes, double taxation should result with respect to the income of Flow-through Entities that are ultimate parents of MNE Groups.

(17) The Model Rules governing Flow-through Entities and Hybrid Entities do not properly mesh with the treatment of disregarded entities for U.S. tax purposes. Specifically:

(a) it is not clear how the income of, and taxes imposed on, Reverse Hybrid Entities under the Model Rules are properly matched, and it should be clarified whether this is to be done as if the business activities of a Reverse Hybrid Entity in any given country, including the jurisdiction of the Reverse Hybrid Entity itself, constitutes a separate Permanent Establishment of the Reverse Hybrid Entity;

(b) the exceptions to the rule that no step-up in the carrying value of assets is obtained are too narrow to properly reflect the tax treatment of taxable sales of domestic disregarded entities by foreign sellers to foreign buyers or of foreign disregarded entities by a U.S. seller or to a U.S. buyer; and

(c) it should be considered how foreign entities are to be treated under the Controlled Foreign Company Tax Rules of the Model Rules if the foreign entities are (i) disregarded for U.S. tax purposes by the United States shareholder who indirectly owns them through a regarded foreign entity but (ii) treated as fiscally non-transparent by the foreign direct owner.

III. Outline of the Model Rules

The Model Rules would impose on a multinational enterprise group with gross revenue of at least EUR 750 million (an "MNE Group") a "Top-up Tax" with respect to the income of its constituent entities ("CEs")[11] whose income is subject to tax at an effective tax rate ("ETR") of less than the minimum rate of 15% (the "Minimum Rate"). The revenue threshold is determined by reference to the consolidated financial statements of the parent entity of the MNE Group,[12] and membership in the MNE Group is likewise determined by reference to inclusion in the Consolidated Financial Statements.[13] An MNE Group is within the scope of the Model Rules if it meets the Consolidated Financial Statement threshold in at least two of the four fiscal years preceding the fiscal year for which it is tested.[14] We will refer to the Top-up Taxes imposed under the Model Rules as "GloBE Taxes".

The Model Rules provide rules regarding the determination of the income or loss (the "GloBE Income" or "GloBE Loss")[15] of CEs as well as rules for deriving from certain specified taxes ("Adjusted Covered Taxes") that factor into a CE's ETR.[16] The Top-up Tax is determined on a jurisdictional basis, i.e., all CEs located in a jurisdiction are combined in determining their "Net GloBE Income" as the sum of the GloBE Income of each of the CEs located in a given jurisdiction reduced by the GloBE Loss of each of the CEs located in that jurisdiction.[17] The ETR for the jurisdiction then equals the sum of the Adjusted Covered Taxes of each of the CEs located in the jurisdiction divided by the aggregate Net GloBE Income of all the CEs located in the

11 A CE is any legal person (other than an individual) or "arrangement that prepares separate financial accounts," including partnerships and trusts, or a "Permanent Establishment." Arts. 1.3.1 and 10.1.1 (definitions of "Entity" and "Permanent Establishment").

12 In general, these consolidated financial statements have to be prepared in accordance with IFRS or a set of local generally accepted financial accounting principles ("Acceptable Financial Accounting Standard"), and show the assets, liabilities, income, expenses and cash flows of the parent entity and any entity in which it has a controlling interest as those of a single economic unit, unless certain exceptions apply ("Consolidated Financial Statements"). Art. 10.1.1 (definition of "Consolidated Financial Statements").

13 There is a class of entities that would be a part of an MNE Group although excluded from the Consolidated Financial Statements. These are entities that "are excluded from the Consolidated Financial Statements of the Ultimate Parent Entity solely on size or materiality grounds, or on the grounds that the Entity is held for sale." Art. 1.2.2(b).

14 The EUR 750 million threshold is adjusted proportionally for a fiscal year of less, or possibly more, than 12 months. Art. 1.1.2.

15 Art. 3.

16 Art. 4. Adjusted Covered Taxes result from certain adjustments to the "Covered Taxes" of a CE, as discussed in more detail in Part III.B below.

17 Art. 5.1.2. Where an entity is "located" depends on whether it is a Flow-through Entity (as defined in the Model Rules) or not. A non-Flow-through Entity whose tax residence is determined based on its place of management or creation, or similar criteria, is located in the jurisdiction of its tax residence. Otherwise it is located where it was "created", which presumably means the jurisdiction under the laws of which it was created (rather than the location of, e.g., the execution of the documents constitutive of the creation). Art. 10.3.1. Flow-through Entities by contrast are treated as stateless Entities, each of which is treated separately, i.e., as if located in a separate jurisdiction, with the exception of Flow-through Entity CEs that are UPEs, IPEs or POPEs (all as defined below) required to apply an IIR. In that case they are treated as located in the jurisdiction where they were created. Art. 10.3.2. Special rules apply to CEs that are, under these rules, located in more than one jurisdiction. Art 10.3.4.

jurisdiction.[18] If, in a given jurisdiction, the ETR falls below the Minimum Rate, the shortfall constitutes the "Top-up Tax Percentage" at which the Top-up Tax is imposed.[19]

The "Jurisdictional Top-up Tax" for a given jurisdiction is not simply calculated as the Top-up Tax Percentage multiplied by the jurisdictional GloBE Income, but by reference to the "Excess Profit". This is the excess of the Net GloBE Income (if any) over a "Substance-based Income Exclusion" or "SBIE", which in effect is a minimum return on certain tangible assets and local employment expenditures.[20] In addition, the Jurisdictional Top-up Tax is reduced by any "Domestic Top-up Tax" and increased by certain additional current top-up taxes.[21] We will refer to a CE that is located in a jurisdiction where its MNE Group has Net GloBE Income and an ETR of less than the 15% Minimum Rate as a "Low-Taxed CE".

The Jurisdictional Top-up Tax (or GloBE Tax) is allocated to and in some cases among CEs in another jurisdiction under an "IIR" or a "UTPR" (the "GloBE Rules").[22] At their core, the Model Rules are two ordering systems: a hierarchical system of taxes setting the order of priority under which types of taxes are to be determined to yield the amount of GloBE Tax; and a hierarchical system of allocation rules governing the imposition of GloBE Tax among CEs of an MNE Group.

How Jurisdictional Top-up Tax is allocated to CEs (the "GloBE Taxpayer") depends whether the allocation is made under the IIR or the UTPR. Under the IIR, it further depends on whether a CE is the "ultimate parent" of the MNE Group (the "UPE") or an Intermediate Parent Entity (an "IPE"), and complex structural ownership features of the MNE Group. The allocation among CEs under the UTPR applies only to GloBE Tax of Low-Taxed CEs that is not subject to allocation under the IIR.

A. TOP-UP TAXES

1. Qualified IIR

If the UPE is located in a jurisdiction that has adopted an IIR (an "IIR Jurisdiction"), the Top-up Tax is allocated to the UPE, i.e., the UPE's IIR liability, is equal to its share of Top-up Tax of each Low-Taxed CE.[23] No other CE in a jurisdiction that has adopted the Model Rules will

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18 Art. 5.1.1.

19 Art. 5.2.1.

20 Art. 5.2.2.

21 Art. 5.2.3.

22 The Blueprint Report, at pp. 8f., defines the acronyms IIR and UTPR as, respectively, "Income Inclusion Rule" and "Undertaxed Payments Rule." The Model Rules do not define either abbreviation, but "UTPR" may be best thought of as an acronym for Undertaxed Profits Rule for reasons that will become clear later.

23 Art. 2.1.1. This report will at times use the shorthand of "IIR liability" or an IIR being imposed instead of stating that Top-up Tax is allocated under the IIR to a CE, which is then liable therefor in the jurisdiction where it is located, and likewise for UTPR. The Model Rules distinguish between "IIR" (the rules of Articles

be subject to the IIR in this case, regardless of whether the CE in the same jurisdiction as the UPE or in any other jurisdiction, unless it is a POPE with respect to lower-tier CEs (see below).[24] In addition, the UTPR may apply in certain circumstances to CEs that are located in the UPE's jurisdiction, as discussed in Part III.A.2 below.

If the GloBE Taxpayer is an IPE, its GloBE Tax liability is equal to its share of the Top-up Tax that is not allocated to any higher-tier IPE (or the UPE) under the IIR and that owns a controlling interest in the lower-tier IPE.[25] This would generally be the case if the UPE is not located in an IIR Jurisdiction. The IIR, in other words, is applied in a top-down manner and applies to the MNE Group's top-most CE in any chain of CEs that is located in a jurisdiction that has adopted an IIR.

In each case, only the "Inclusion Ratio" of Top-up Tax is allocated to the UPE or IPE under the IIR, which is the fraction of the GloBE Income of the Low-Taxed CEs that is not attributable to non-MNE Group owners or other, higher-tier CEs (in the case of IPEs that do not directly or indirectly own all of the stock of the lower-tier CE). The Inclusion Ratio for directly and indirectly wholly owned subsidiaries is always 1.

> ***Example 1*** *UP* is the UPE of an MNE Group and directly owns 89% of the single class of stock of *IPE1*. *IPE1* in turn owns 89% of the single class of stock of *IPE2*, which owns all of the stock of Low-Taxed CE. The remainder of the stock of each of *IPE1* and *IPE2* is owned by unrelated persons. *UP's* Inclusion Ratio with respect to Low-Taxed CE is 0.7921.

An exception to the basic IIR applies with respect to IPEs (but not UPEs) if more than 20% of the ownership interests in such IPE is held, directly or indirectly, by persons that are not CEs of the MNE Group (a "Partially-Owned Parent Entity" or "POPE").[26] Such a POPE, if an IIR Taxpayer, is required to pay its share of the Top-up Tax with respect to any Low-Taxed CE in which it, directly or indirectly, has an ownership interest.[27] In Example 1, *IPE1* is not a POPE, but *IPE2* is a POPE because, directly and indirectly, more than 20% of its ownership interests are held

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2.1 to 2.3, discussed in this Part III.A.1) and "Qualified IIR," which are rules "equivalent" to the IIR, including any provision associated with the IIR Articles, that are included in the domestic law of a jurisdiction and that are implemented and administered in a way consistent with the Model Rules and the Commentary, and the jurisdiction does not provide any benefit related to the rules. Art. 10.1.1 (definition of "IIR" and "Qualified IIR").

24 Art. 2.1.3(a).

25 Arts. 2.1.2 and 2.1.3. A CE holds a "controlling interest" in a subsidiary CE if the first, higher-tier CE holds an "ownership interest" in the subsidiary CE and the higher-tier CE is required to consolidate with the lower-tier CE or would be required to do so if it prepared consolidated financial statements. An "ownership interest" in a CE is any equity interest in that CE that carries rights to the profits, capital or reserves of that CE. Art. 10.1. (definitions of "Controlling Interest" and "Ownership Interest").

26 Art. 10.1.1 (definition of "Partially-Owned Parent Entity"). The definition more specifically refers to ownership interests in "profits".

27 Art. 2.1.4.

by non-CEs: 11% directly and 9.079% indirectly. Low-Taxed CE is not a POPE because it does not own an ownership interest in any other CE. The POPE rule accordingly applies and allocates to *IPE2* 100% of any Top-up tax imposed in respect of Low-Taxed CE, even though the UPE owns less than 80% of the ownership interests in Low-Taxed CE.

The POPE rule also applies in a top-down manner where one POPE wholly owns (directly or indirectly) another IPE that is a POPE. Thus, if an IPE is a POPE but another POPE that is a CE wholly owns that POPE and is subject to an IIR, then the Top-up Tax is borne by the higher-tier POPE.

Lastly, if the UPE (together with other CEs in its jurisdiction) is a Low-Taxed CE, it does not apply the IIR to itself. And if an IPE or POPE (together with other CEs in its jurisdiction) is a Low-Taxed CE and not subject to an IIR of a higher-tier IPE or UPE, it is likewise not subject to IIR in its own jurisdiction. (UPEs, IPEs and POPEs together will be referred to as "Parent Entities").[28]

As a technical matter, the top-down allocation of GloBE Tax under a Qualified IIR is implemented through an exclusion rule and an "Offset Mechanism." The exclusion rule applies if a higher-tier Parent Entity owns a controlling interest in the lower-tier Parent Entity or, in the case of POPEs, the POPE is wholly owned by another POPE. In that case, the lower-tier Parent Entity is not allocated any GloBE Tax under the IIR with respect to the relevant Low-Taxed CE.[29]

The Offset Mechanism applies where the higher-tier Parent Entity does not own a controlling interest in the lower-tier Parent Entity or, in the case of POPEs, does not wholly own the lower-tier POPE.[30] It effectively operates as a GloBE Tax credit. Where it applies, the Parent Entity that holds its ownership interest in a Low-Taxed CE indirectly through an IPE or POPE reduces its share of the Top-up Tax of the Low-Taxed CE by its share of the amount of Top-up Tax allocated to the IPE or POPE. The Offset Mechanism turns the top-down approach of the exclusion rule somewhat into a bottom-up approach, i.e., the Top-up Tax of the higher-tier Parent Entity is reduced by the share of the IIR liability of the lower-tier Parent Entity .

> ***Example 2*** *UP* is the UPE of an MNE Group and is located in a jurisdiction that has not adopted a Qualified IIR. *UP* has two subsidiaries: *IPE1* and *IPE2*, both of which are located in an IIR Jurisdiction. *UP* owns all of the single class of stock of *IPE1* and 80% of the single class of stock of *IPE2*. The remaining 20% of the stock of *IPE2* is owned by *IPE1*. *IPE1* owns 10%, and *IPE2* owns 90% of the single class of stock of Low-Taxed CE, which is located in a jurisdiction that has not adopted a Qualified IIR.

28 Art. 2.1.6.

29 Art. 2.1.3 (exclusion for lower-tier IPEs if there is a higher-tier IPE or a UPE that is required to apply a Qualified IIR); Art. 2.1.5 (exclusion of lower-tier POPE wholly owned by a higher-tier POPE).

30 Art. 2.3.

Because *IPE1* does not hold a controlling interest in *IPE2,* the exclusion rule does not apply. As *UP* does not apply a Qualified IIR, both *IPE1* and *IPE2* are required to apply the IIR based on their respective share of the Top-up Tax, i.e., 90% in the case of IPE2 and 28% in the case of *IPE1* (10% directly and 20% of the 90% held indirectly through *IPE2*). In this case, the Offset Mechanism will reduce *IPE1's* share of the Top-up Tax with respect to Low-Taxed CE by the share of such Top-up Taxes allocated to *IPE2*, i.e., 20% of the Top-up Tax for which *IPE2* is liable under the IIR.[31] Thus, under an IIR, if the Top-up Tax for Low-Taxed CE were EUR 10 million, *IPE2* would be allocated, and liable for, EUR 9 million and *IPE1* would be allocated, and liable for, EUR 1 million.[32]

> ***Example 3*** *UP* is the UPE of an MNE Group and is located in an IIR Jurisdiction. *UP* has two subsidiaries: *PPCo* and Low-Taxed CE. *UP* owns 60% of the single class of stock of *PPCo*, with the remainder owned by unrelated persons. *PPCo* is located in an IIR Jurisdiction. Each of *UP* and *PPCo* owns 50% of the single class of stock of Low-Taxed CE. Low-Taxed CE gives rise to a Jurisdictional Top-up Tax of EUR 10 million.

Because *PPCo* is a POPE and there is no higher-tier POPE that wholly owns *PPCo*, *PPCo* is required to apply the IIR and will include its 50% share of the Jurisdictional Top-up Tax of Low-Taxed CE, or EUR 5 million.

Because *UP* is the UPE, its share of the Top-up Tax is, prior to applying the Offset Mechanism, 80% or EUR 8 million, 50% through its direct interest in Low-Taxed CE and 30% (i.e., 60% of 50%) through its indirect interest held through *PPCo*. This amount is reduced by its share of IIR for which *PPCo* is liable, which is 60% of *PPCo*'s EUR 5 million IIR liability, or EUR 3 million. *UP* is thus liable for EUR 5 million of IIR in respect of Low-Taxed CE, and *UP* and *PPCo* together will be liable for the entire EUR 10 million of Top-up Tax of Low-Taxed CE.

2. Qualified UTPR

If for any Low-Taxed CEs there is Top-up Tax that is not allocated to a Parent Entity under the IIR, this Top-up Tax is allocated to all CEs (and not just Parent Entities) in jurisdictions that have adopted a Qualified UTPR ("<u>UTPR Jurisdiction</u>").[33] Unlike the Qualified IIR, it is not allocated in a top-down manner subject to the Offset Mechanism, but according to formulary apportionment amongst all such CEs, regardless of whether they have any economic, ownership

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31 *See* Model Rule Examples, Example 2.1.3-2.

32 I.e., EUR 2.8 million directly or indirectly, minus an offset of 20% of EUR 9 million.

33 Arts. 2.4, 2.5 and 2.6. The Model Rules distinguish between UTPR, as a set of rules, and a Qualified UTPR, as a Model Rule-conforming implementation, in the same matter as they distinguish between IIR as a rule set and Qualified IIR as a Model Rule-conforming implementation. Art. 10.1.1. The report will refer to a jurisdiction that has adopted both a Qualified IIR and a Qualified UTPR as a "<u>GloBE Tax Jurisdiction</u>".

or other nexus, apart from being members in the same MNE Group as the relevant Low-Taxed CEs.

A UTPR can arise in two circumstances. First, if the UPE is not a GloBE Taxpayer, there may be CEs that are not, directly or indirectly, wholly owned by a Parent Entity subject to the IIR. This would be the case, for example, if a Low-Taxed CE is directly wholly owned by the UPE, or if a Low-Taxed CE is 80% directly owned by an IPE located in a jurisdiction that imposes an IIR and 20% by the UPE. If all of the ownership interests in a Low-Taxed CE are held, directly or indirectly, through or by Parent Entities located in an IIR Jurisdiction, no UTPR applies.[34]

Second, a UTPR can arise if the UPE is located in an IIR Jurisdiction, but the ETR of the UPE and all other CEs located in the same jurisdiction is less than the Minimum Rate and there is Jurisdictional Top-up Tax with respect to that jurisdiction. In that case, the IIR of the UPE jurisdiction does not pick up its own Jurisdictional Top-up Tax.

Accordingly, for any MNE Group, the amount of Top-up Tax allocated under the UTPR among CEs in UTPR Jurisdictions equals the aggregate amount of Top-up Tax of each Low-Taxed CE reduced (for each Low-Taxed CE) by the amount of Qualified IIR for which any Parent Entity is liable.[35] More precisely, the UTPR liability is allocated on a UTPR Jurisdictional basis by pro-rating based on the average of two ratios: (1) the portion of all employees in all UTPR Jurisdictions of the MNE Group that are located in the relevant UTPR Jurisdiction and (2) the portion of all tangible assets in all UTPR Jurisdictions of the MNE Group that are located in the relevant UTPR Jurisdiction.[36]

For each CE located in a UTPR Jurisdiction, its share of the Top-up Tax is in effect imposed under the UTPR through the disallowance of deductions in an amount so that the resulting increase in cash tax equals this share of Top-up Tax. Instead of reducing deductions, a CE may also make "an equivalent adjustment under domestic law."[37] Thus, a loss-making CE whose expenses exceed its gross income may in effect become liable for Top-up Tax allocated to it by the UTPR.

If there are insufficient deductions available for any Fiscal Year for a CE to which the UTPR allocates Top-up Tax,[38] the excess of the allocated Top-up Tax over the increase in the CE's cash tax expense is carried forward to future years and not re-allocated for the current Fiscal Year

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34 Art. 2.5.2.

35 Art. 2.5.3.

36 Art. 2.6.1.

37 Art. 2.4.1. While the Model Rules do not prescribe how this will work, the Commentary also suggests an additional tax imposed on the CE or an additional amount of deemed income. Commentary to Art. 2, ¶46-47, pp. 32f. Another potential "equivalent adjustment" might be the denial of tax credits.

38 A "Fiscal Year" is the accounting period with respect to which the UPE prepares its Consolidated Financial Statements. Art. 10.1.1 (definition of "Fiscal Year").

to other CEs in UTPR Jurisdictions.[39] This is so regardless of whether these other CEs have additional capacity to increase cash taxes by further disallowance of their respective deductions. The carryforward is likewise to the same CE and is not added to, or does not create, Top-up Tax in the subsequent year allocable under the UTPR to all CEs of the MNE Group in UTPR Jurisdictions.[40]

The IIR under Model Rules differs from the UTPR in an important aspect. If a UPE (or any IPE) is located in a low-tax jurisdiction, it will not apply the IIR with respect to its own Jurisdictional Top-up Tax.[41] The UTPR of a given UTPR Jurisdiction, by contrast, applies to its own Jurisdictional Top-up Tax. Thus, if a UPE is a Low-Taxed CE and located in a GloBE Tax Jurisdiction, the UPE will include its share of Top-up Tax (if any) with respect to itself and all of its co-jurisdictional CEs in its UTPR.

> ***Example 4*** *UP* is the UPE of an MNE Group and is a tax resident in country X. *UP* has two wholly owned subsidiary CEs, *CE-Y*, which is tax resident in country Y, and *CE-Z*, which is tax resident in country Z. Country X and country Z are GloBE Tax Jurisdictions; country Y does not impose any GloBE Tax. Assume that the Top-up Tax allocation under the UTPR between *UP* and *CE-Z* is 10% to *UP* and 90% to *CE-Z*; *CE-Y* is a Low-Taxed CE and gives rise to a Jurisdictional Top-up Tax of EUR 4 million with respect to country Y; *UP* is likewise a Low-Taxed CE and gives rise to a Jurisdictional Top-up Tax of EUR 10 million for country X on Excess Profits of EUR 500 million; and *CE-Z* has a GloBE Loss of EUR 20 million.

Accordingly, *UP* is liable under country X's IIR for the Jurisdictional Top-up Tax of *CE-Y* in an amount of EUR 4 million. The EUR 10 million of Jurisdictional Top-up Tax of *UP*, by contrast, is allocated between *UP* and *CE-Z* under the UTPR in the ratio of 10%:90%, i.e., EUR 1 million to *UP* and EUR 9 million to *CE-Z*. Thus, *UP*, which has Excess Profits of EUR 500 million, is liable for EUR 5 million of Top-up Tax while *CE-Z*, which has a GloBE Loss of EUR 20 million, is liable for EUR 9 million of Top-up Tax.[42]

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39 Art. 2.4.2.

40 As a liability of the CE, it should remain with it if the CE leaves the MNE Group.

41 Art. 2.1.6. The Commentary, however, suggests that an IIR can also be applied by a parent entity with respect to the CEs located in the same jurisdiction (to the extent of the parent's Ownership Interest in these CEs), but only if no Top-up Tax is allocated to the UPE or another IPE under the Model Rules. The EU Proposal for a Council Directive 2021/0433 (CNS). COM(2021) 823 (December 21, 2022) (the "EU Proposed Directive") appears to propose such a rule. *See* EU Proposed Directive, Art. 6(2).

42 Article 5.5 provides for a *de minimis* exclusion, which, at the election of the CE that files the GloBE return, allows the Top-up Tax with respect to all CEs located in a given country to be reduced to EUR 0 if their revenue is less than EUR 10 million in the current and two preceding Fiscal Years and GloBE Income is less than EUR 1 million or there is a GloBE Loss during the same period. There is no such *de minimis* exception to allocations of Top-up Taxes to CEs under either the IIR or the UTPR. This election is not available for

Second, under a the IIR, only the Inclusion Ratio of the Top-up Tax is allocated to the top-most parent entity. Under the UTPR, by contrast, the entire amount of Top-up Tax is allocated to other CEs, regardless of the group's Inclusion Ratio.[43] The UTPR Top-up Tax is reduced to zero when the IIR applies to allocate Top-up Tax to the UPE.[44] The UTPR applies *only if* the IIR does not apply to all of the ownership interests of a Low-Taxed CE owned, directly or indirectly, by the UPE. But the UTPR applies *to the extent* the IIR does not allocate Top-up Tax to an IPE if not all of the interests held, directly or indirectly, by the UPE are subject to the IIR.[45] Thus, if a UPE is not subject to the IIR, and an IPE is subject to the IIR with respect to less than the entire amount of Top-up Tax that otherwise would be included by the UPE, then the entire remaining Top-up Tax is allocated under the UTPR.

> ***Example 5*** *UP* is the UPE of an MNE Group, located in country *X*. *UP* owns 50% of the stock of Low-Taxed CE, 85% of the stock of *IPE1* and 95% of the stock of *IPE2*. *IPE1* owns the remaining 50% of the stock of Low-Taxed CE. Country X is neither an IIR nor a UTPR Jurisdiction; *IPE1* and *IPE2* are located in different GloBE Tax Jurisdictions. *UP's* inclusion ratio is 0.925, and *IPE1's* Inclusion Ratio is 0.5. If Low-Taxed CE gives rise to EUR 100 of Top-up Tax, then EUR 50 is allocated to *IPE1* under the IIR, and the remaining EUR 50 of Top-up Tax is allocated between *IPE1* and *IPE2* under the UTPR. If *UP* instead were located in a GloBE Tax Jurisdiction, EUR 92.5 of Top-up Tax would be allocated to *UP*, and no remaining Top-up Tax would be allocated under the IIR or the UTPR to *UP*, *IPE1* or *IPE2*.

3. Domestic Minimum Top-up Tax

The Jurisdictional Top-up Tax for any jurisdiction and Fiscal Year, whether allocated under the IIR or the UTPR, is offset by any Qualified Domestic Minimum Top-up Tax ("QDMTT") that is imposed by the jurisdiction for the relevant Fiscal Year.[46] A QDMTT is a minimum tax imposed under the domestic law of a jurisdiction that meets three requirements:

1. The tax determines Excess Profits of CEs located in the jurisdiction in a manner equivalent to Model Rules;

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stateless CEs (see footnote 17, above). Article 2.6.3 provides for an exception to the UTPR allocation (which is not elective) by reducing the allocation percentage to zero if Top-up Taxes allocated in a prior Fiscal Year have not resulted in a cash tax payments (i.e., because the CE lacked sufficient deductions or equivalent adjustable items to increase its domestic tax liability.

43 Art. 2.5.

44 Art. 2.5.2.

45 Art. 2.5.3.

46 Art. 5.2.3.

2. The tax "operates" to increase the tax liability in such jurisdiction with respect to the Excess Profits to the Minimum Rate (in the jurisdiction, for the Fiscal Year), and

3. The tax is implemented and administrated in a way consistent with the Model Rules.[47]

The QDMTT thus serves to reduce the Jurisdictional Top-up Tax that would otherwise be allocated under the IIR or the UTPR to CEs of an MNE Group located in other jurisdictions. Because the UTPR (mostly) and the IIR (entirely) impose Top-up Tax on CEs in jurisdictions other than the home jurisdiction of the CEs that generate the Jurisdictional Top-up Tax, a jurisdiction enacting a QDMTT can, in effect, domesticate and localize its own potential Jurisdictional Top-up Tax.

Unlike Top-up Tax allocated under the IIR or UTPR, a QDMTT is not required to be calculated with respect to Excess Profits as determined under the UPE's Consolidated Financial Statement. Instead, its tax base may be Excess Profits as determined under any Acceptable Financial Accounting Standard permitted under the Model Rules, provided the standard is permitted by an authority that has the legal authority in that local jurisdiction to prescribe, establish or accept accounting standards for financial reporting purposes.[48] Alternatively, the accounting standard could be any such standard adjusted to prevent material competitive distortions, which is specifically defined under the Model Rules.[49]

Like Top-up Taxes allocated under the IIR or UTPR, a QDMTT is imposed on all CEs located in the same jurisdiction, i.e., it combines the incomes and losses, as well as the SBIE, of all of the entities and permanent establishments in the jurisdiction. A domestic top-up tax imposed on a CE-by-CE basis that increases the total tax imposed on each CE with Excess Profits to the Minimum Rate but does not offset underlying GloBE Income by GloBE Losses of loss CEs should not be a QDMTT for failure to determine Excess Profits "equivalent" to the Model Rules. If this is in fact a condition for a domestic Top-up Tax to be considered a QDMTT by other jurisdictions, it has a counterintuitive consequence: a domestic Top-up Tax could fail as a QDMTT merely because it does not allow for an offset even though, as a result, it imposes more tax than a QDMTT and, possibly, even the Top-up Tax. (However, such a domestic Top-up Tax should still qualify as a Covered Tax, see Part III.B.1 below.)

If the QDMTT is not based on the UPE's Consolidated Financial Statement, the underlying measure of excess profits may differ from Excess Profits under the IIR and UTPR Top-up Tax calculations in two ways: how the net income is determined and how the SBIE is determined under

47 Art. 10.1.1 (definition of "Qualified Domestic Minimum Top-up Tax").

48 Art. 10.1.1 (definitions of "Qualified Domestic Minimum Top-up Tax" flush language, "Acceptable Financial Accounting Standard" and "Authorised Accounting Body").

49 *See* Art. 10.1.1 (definition of "Material Competitive Distortion").

the local accounting rules. A QDMTT therefore can in principle be more or less than the Jurisdictional Top-up Tax that arises with respect to the CEs in a given jurisdiction absent the QDMTT. In any event, unlike a Qualified IIR or a Qualified UTPR, a QDMTT is not a final Top-up Tax. If it falls short of imposing the full amount of Top-up Tax imposed on GloBE Income (as determined under the UPE's Consolidated Financial Statements), it offsets, but does not replace, the Jurisdictional Top-up Tax imposed absent the QDMTT. [50]

A domestic Top-up Tax that is imposed at a top-up percentage that results in less than the Minimum Rate may not qualify as a QDMTT. The definition cited above required that the increase is "to the Minimum Rate." The EU Proposed Directive likewise requires that a "qualified domestic top-up tax" apply the "minimum tax rate" (which is the same as the 15% Minimum Rate) to Excess Profits as determined under the rules of the EU Proposed Directive.[51] This suggests that a QDMTT is in effect imposed a rate of either 0% (no QDMTT) or 15%.

If this is the correct interpretation, it has a curious consequence. If a jurisdiction decided to impose a domestic top-up tax of less than the Top-up Tax Percentage of Excess Profits (determined under either the UPEs or the local accounting principles), it would not offset the Top-up Tax imposed under the IIR or the UTPR dollar-for-dollar. Instead, if it qualified as a Covered Tax (which it should do, as explained immediately below) a fraction equal to the portion of Net GloBE Income that represents SBIE would not be creditable against the Top-up Tax.

> ***Example 6*** An MNE Group has several CEs in jurisdiction *J* ("CEs_J") and several other CEs in jurisdiction *K* ("CEs_K"). Each CEs_J and CEs_K have the same amount of Net GloBE Income (EUR 1,000), SBIE (EUR 150) and Covered Taxes before any domestic minimum tax (EUR 100). As a result, each has a Top-up Tax Percentage of 5% and Excess Profits of EUR 850. Assume that *J* imposes a QDMTT, as a result of which CEs_J are subject to additional tax in *J* in the amount of EUR 42.50. Assume further that *K* imposes a domestic top-up tax of 80% of the Top-up Tax Percentage, resulting in a domestic top-up tax percentage of 4% and domestic top-up tax in *K* of EUR 34.

No additional Top-up Tax is imposed under the IIR or the UTPR with respect to CEs_J. By contrast, if the domestic top-up tax in *K* in respect of CEs_K does not constitute a QDMTT because its rate is not equal to the Top-up Tax Percentage, this top-up tax would increase Adjusted Covered Taxes to EUR 134, the ETR of CEs_K would be 13.4%, the Top-up Tax Percentage would be 1.6% (and not 1%, i.e., not the remaining 20% of the 5% Top-up Tax Percentage that is the basis of the domestic top-up tax in *K*), and additional Top-up Tax of EUR 13.60 would be allocated to other

[50] Art. 5.2.3(d).

[51] EU Proposed Directive, Art. 3, definition (23).

members of the MNE Group under the IIR or UTPR. The total tax in respect of CEs_J would equal EUR 142.50, while the total tax in respect of CEs_K would equal EUR 147.60.[52]

B. COVERED TAXES

1. In General

Covered Taxes, as adjusted under the GloBE Rules, factor in the determination of the jurisdictional ETR for the Fiscal Year.[53] The GloBE Rules list out four types of taxes that qualify as Covered Taxes of a CE:

1. Taxes that are recorded in the financial accounts of the CE with respect to either (a) the income or profits of the CE itself or (b) the share of the income or profits of an entity in which the CE owns an ownership interest;

2. Taxes that are imposed (a) on distributed profits, deemed profit distributions or non-business expenses and (b) under an eligible distribution tax system, which is, in general, a corporate tax that is imposed only on distributed profits, is imposed at a rate not less than the Minimum Rate and was in force on or before July 1, 2021;[54]

3. Taxes imposed in lieu of a generally applicable corporate tax; or

4. Taxes imposed by reference to retained earnings and corporate equity.[55]

The concept of Covered Taxes excludes Top-up Taxes allocated and imposed under a Qualified IIR, a QDMTT or a Qualified UTPR ("Qualified Top-up Tax").[56]

2. Push-Down of Covered Taxes to Controlled Foreign Corporations

The Model Rules set forth a series of rules that allocate Covered Taxes between CEs.[57] One of these rules allocates Covered Taxes back from a CE (the "CFC Shareholder CE") that is a shareholder in a lower-tier CE that is a CFC with respect to the first CE (a "CFC-CE") if the Covered Taxes are included in the financial accounts of the CFC Shareholder CE in respect of its share of income of the CFC-CE under a Controlled Foreign Company Tax Regime (as discussed

52 The difference of EUR 5.10 is equal to the fraction (15%) of the domestic top-up tax of EUR 34 equal to the fraction of Net GloBE Income (EUR 1000) representing SBIE (EUR 150). *See also* Appendix I.

53 Art. 5.1.1.

54 These Covered Taxes are outside the scope of this report.

55 Art. 4.2.1.

56 Art. 4.2.2. It also excludes any so-called Disqualified Refundable Imputation Credit and taxes paid by insurance companies in respect of returns to policy holders, both of which are beyond the scope of this report.

57 Art. 4.3.2.

in more detail in Part IV.A below).[58] In this manner, Covered Taxes are allocated to and associated with the income in respect of which they are imposed. For the CFC Shareholder CE, however, this requires a separation of Covered Taxes related to the CFC income inclusions for each CFC-CE from other Covered Taxes.

Moreover, CFC-related Covered Taxes would have to be further separated into a passive and a non-passive "basket," which in effect disallows any blending of Covered Taxes with respect to passive income and Covered Taxes for non-passive income, similar to the foreign tax credit limitation under Section 904. Covered Taxes that are allocable under the above CFC rule to passive income of a CFC-CE are allocated only to the extent they do not exceed the Top-up Tax Percentage for the CFC-CE's jurisdiction multiplied by the CFC-CE's passive income.[59] For this purpose, the Top-up Tax Percentage is determined without the Covered Taxes incurred by the CFC Shareholder CE with respect to the CFC-CE's passive income.[60] Taxes related to passive income that are not pushed down to the CFC-CE under this limitation are treated as Covered Taxes of the CFC Shareholder CE, even though they are not related to the GloBE Income of the CFC Shareholder CE, as clarified by the Commentary.[61]

3. *Matching Covered Taxes and GloBE Income for Permanent Establishments and Partnerships*

CEs are the units for which GloBE Income or Loss is determined and then aggregated on a jurisdictional basis to obtain the jurisdictional Net GloBE Income or Loss. A CE is either an "Entity" that is a member of the MNE Group or a "Permanent Establishment."[62] CEs do not include

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58 Art. 4.3.2(c). "CFC" or "controlled foreign corporation/company" is not defined under the Model Rules. *See* Art. 10.1.1 (definition of "Controlled Foreign Company Tax Regime"). *Cf*. EU Proposed Directive, Art. 3 definition (14). For purposes of the U.S. tax analysis, this report will use the definitions of Chapter 1, Subchapter N, Part III, Subpart F of the Code (Sections 951–965).

59 Art. 4.3.3. "Passive income" is defined under the Model Rules as (a) dividends and dividend equivalents; (b) interest and interest equivalents; (c) rents; (d) royalties; (e) annuities; and (f) net gain from property of a type that produces income described clauses (a) through (e), to the extent that the CFC Shareholder is subject to tax on such income under a CFC Regime. Art. 10.1.1 (definition of "Passive Income").

60 Art. 4.3.3(b).

61 *See* Commentary to Art. 4, ¶62-63, at p. 99. *See also* discussion below in Part IV.A.1 below.

62 Arts. 1.3.1 and 1.3.3. Article 1.2 defines "MNE Group" from the base elements of Entity, Permanent Establishment, Consolidated Financial Statements and ownership/control. A "Group" is (1) a collection of Entities related through ownership or control whose financial items are included in the Consolidated Financial Statement of the UPE or excluded solely on grounds of size or materiality, or because they are held for sale, as well as (2) any Entity (not a member of a clause (1) Group) that has one or more Permanent Establishments located in a jurisdiction outside its own jurisdiction. Arts. 1.2.2 and 1.2.3. An MNE Group is then a Group with at least one Entity not located in the same jurisdiction as the UPE and any Group described in clause (2) above. Art. 1.2.1. Note that a "jurisdiction" seems to be a country, but not a subdivision of a country or a state, in the case of the United States. "Tax" is defined not by reference to the imposition by a jurisdiction, but as a "compulsory unrequited payment to General Government," with the latter defined as "the central administration, agencies whose operations are under its effective control, state and local governments, and their administrators." Art. 10.1.1 (definitions of "Tax" and "General Government"). Thus,

any Excluded Entities, which are discussed in Part IV.E below. An "Entity" is any legal person (other than an individual) and any "arrangement that prepares separate financial accounts," which expressly includes partnerships and trusts.[63] Partnerships and Permanent Establishments are thus CEs, regardless of the fact that their income, loss, and taxes are or may be included in the income, loss, and taxes of their owner or owners.

In order to properly match GloBE Income, GloBE Loss, and Covered Taxes, the Model Rules contain rules for allocating these items from or to the relevant CEs. Under the Model Rules, partnerships for U.S. tax purposes are classified as "Tax Transparent Entities," "Reverse Hybrid Entities," or "Hybrid Entities." They are Tax Transparent Entities *to the extent* fiscally transparent in the jurisdiction of any owner, and Reverse Hybrid Entities *to the extent* not fiscally transparent in the jurisdiction where the owner is located.[64] Thus, a domestic limited liability company ("LLC") treated as a partnership and owned entirely by U.S. persons is a Tax Transparent Entity. However, if an interest in the LLC is owned by a foreign person located in a jurisdiction that treats the LLC as not fiscally transparent, the LLC is considered a Reverse Hybrid Entity *to the extent* of the foreign owner's interest. A foreign entity that is treated as a partnership for U.S. tax purposes but is not fiscally transparent for local law purposes is not considered a Tax Transparent Entity (to the extent of any U.S. person's ownership interest), but is treated separately as a Hybrid Entity under the Model Rules. Lastly, a foreign entity treated as a partnership under its local laws but classified as an association for U.S. tax purposes should be a Reverse Hybrid Entity *to the extent* of any U.S. owner's interest.

GloBE Income, GloBE Loss and Covered Taxes of Flow-through Entities are allocated as follows under the Model Rules:

- In the case of a Permanent Establishment,[65] GloBE Income or Loss, and Covered Taxes

income taxes imposed by states and localities in the United States are included in Covered Taxes, although states and localities are not "jurisdictions" as the term is used in the Model Rules.

63 Art. 10.1.1 (definition of "Entity").

64 Art. 10.2.1. For this rule to apply, the relevant entity has to be a "Flow-through Entity". An entity is a Flow-through Entity *to the extent* that it is fiscally transparent with respect to its income, expenses, and losses in the jurisdiction "where" it was created (which will require clarification) "unless it is tax resident and subject to a Covered Tax on its income or profit in another jurisdiction." It appears that the second prong does not apply *to the extent* of an ownership interest, i.e., an entity cannot be a Flow-through Entity with respect to some owners and a non-Flow-through Entity with respect to other owners. This appears to necessitate the definition of "Hybrid Entity" in Article 10.2.5. The definition of Reverse Hybrid Entity is the opposite of the definition for U.S. tax purposes in Treas. Reg. § 1.894-1(d)(2), which defines it, in the case of a U.S. entity, as an entity not treated as fiscally transparent in the United States and as fiscally transparent in the foreign owner's jurisdiction.

65 Art. 10.1.1 defines "Permanent Establishment" in effect as a permanent establishment under an applicable income tax treaty, a branch where income attributable to it is taxed on a net income bases in the location of the branch or, if no income tax is imposed, that would be a treated as a permanent establishment under the 2017 OECD Model Tax Convention on Income and on Capital (https://doi.org/10.1787/mtc_cond-2017-en).

are pushed down to the Permanent Establishment,[66] and they are not again included in the GloBE Income or Loss, and Covered Taxes of its owner.[67] Each Permanent Establishment is for this purpose treated as a separate CE from other Permanent Establishments as well as its owner.[68]

- Likewise, in the case of a Reverse Hybrid Entity, GloBE Income and Loss remain allocated to the Entity.[69] Generally, no push down of Covered Taxes from the owner in respect of the Reverse Hybrid's income is expressly contemplated.[70] The Model Rules do not expressly address the push down under a CFC Regime to a Reverse Hybrid, but there appears to be no rule that would preempt such an allocation to a Reverse Hybrid if the owner's (or any indirect owner's) jurisdiction imposes tax in respect of earnings of a Reverse Hybrid under a CFC Regime. The Model Rules also do not address the push down of Covered Taxes that may be imposed by the Reverse Hybrid Entity's jurisdiction on the owner. A Permanent Establishment of a Reverse Hybrid Entity is treated separately from the Reverse Hybrid Entity, i.e., the Reverse Hybrid Entity is the Main Entity with respect to any of its Permanent Establishments.

- Similarly, in the case of a Hybrid Entity, Covered Taxes of a CE-owner of a Hybrid Entity imposed on the owner's share of the Hybrid Entity's income are pushed down to the Hybrid Entity.[71] However, there is no allocation of GloBE Income or Loss to a Hybrid Entity, as its Financial Accounting Net Income or Loss remain with it.[72] A Permanent Establishment of a Hybrid Entity is treated separately, i.e., the Hybrid Entity is the Main Entity with respect to any of its Permanent Establishments. Covered Taxes of the CE-owner that relate to the Permanent Establishment should, accordingly, be pushed down to the Permanent Establishment and not the Hybrid Entity, but this is not expressly stated in the Model Rules.

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66 Arts. 3.4.1 and 3.5.1(a) (allocation of Financial Accounting Net Income or Loss to Permanent Establishment); Art. 4.3.2(a) (allocation of Covered Taxes to Permanent Establishment). The Model Rules refer to the owner of a Permanent Establishment as the "Main Entity", which as a technical matter is defined as the Entity that includes the Financial Accounting Net Income or Loss of the Permanent Establishment in its financial statements. Art. 10.1.1 (definition of "Main Entity").

67 Arts. 3.4.4 and 4.3.1. An exception to the exclusion from Main Entity GloBE Income is made if a loss of the Permanent Establishment offsets the Main Entity's domestic taxable income and not later reversed, in effect providing for a loss recapture rule. Arts. 3.4.5 and 4.3.4 (related reallocation of Covered Taxes); *cf.* Section 904(f).

68 Art. 1.3.2.

69 Art. 3.5.1(c).

70 *See* also Commentary to Art. 4, ¶57, at p. 98 (no allocation rules from Reverse Hybrid Entities, as the Covered Taxes of the Entity remain allocated to it).

71 Art. 4.3.2(d); Commentary to Art. 4, ¶59, at pp. 98f.

72 *See* Arts. 4.3.1 and 4.3.2.

- By contrast, in the case of (or to the extent an entity is) a Tax Transparent Entity, GloBE Income or Loss, and Covered Taxes, are pushed up to the CE owners, in accordance with their interest in the Tax Transparent Entity.[73] This rule does not apply if the Tax Transparent Entity is itself the UPE of an MNE Group.[74] GloBE Income, GloBE Loss and Covered Taxes that are subject to this push up exclude income, loss, and taxes allocated to a Permanent Establishment of the Tax Transparent Entity.

In this manner, Covered Taxes and GloBE Income/Loss are allocated on a separate jurisdictional basis for each CE that is a Permanent Establishment, Reverse Hybrid Entity or Hybrid Entity, and combined into the CE-owners' jurisdictional GloBE Income/Loss and Covered Taxes for Tax-Transparent Entities. However, the allocation rules apply only to such entities that are CEs, i.e., their assets, liabilities, income, expense and cash flow are included in the UPEs Consolidated Financial Statements.

Ownership interests in Transparent Entities, Hybrid Entities and Reverse Hybrid Entities that do not rise to the level of CE are subject to special rules, and their treatment depends also on whether such interests are "Portfolio Shareholdings" or "Short-Term Portfolio Holdings."[75] Discussion of these rules is beyond the scope of this report.

IV. Discussion

A. The Model Rules and Subpart F/GILTI

The Model Rules define "Controlled Foreign Company Tax Regime" ("<u>CFC Regime</u>") as "a set of tax rules (other than an IIR) under which a direct or indirect shareholder of a foreign entity (the . . . CFC) is subject to current taxation on its share of part or all of the income earned by the CFC, irrespective of whether that income is distributed currently to the shareholder."[76]

The definition entails that CFC Regimes and the IIR are mutually exclusive. If the GILTI Regime is a CFC Regime, then it cannot be a Qualified IIR under the Model Rules, and if it were a Qualified IIR (after any required changes) it could not be a CFC Regime under the Model Rules.

73 Arts. 3.5.1(b) and 4.3.2(b).

74 Art. 3.5.1(c).

75 Commentary to Art. 3, ¶¶34-57, pp. 50-54. Art. 3.2.1, Art. 10.1.1 (definitions of "Excluded Dividends" and "Excluded Equity Gain or Loss"). "<u>Portfolio Shareholdings</u>" are equity interest of less than 10% in profits, capital, reserves or voting rights, and they are "Short-term Portfolio Shareholdings" if held by a CE for less than one year at the date of distribution. Because the characterization of a Portfolio Shareholding as short term or not short term is measured by the holding period of the CE, intragroup transfers may be used to obtain short term classification. Art. 10.1.1 (definitions of "Portfolio Shareholdings" and "Short-term Portfolio Shareholdings").

76 Art. 10.1.1 (definition of "Controlled Foreign Company Tax Regime").

1. *Qualification of the GILTI Regime as a "CFC Regime" under the Model Rules*

In at least two instances, foreign taxing authorities concluded that the GILTI Regime is not a CFC regime, albeit for their specific purposes and under their local definitions of what constitutes a CFC regime and not in the context of Pillar Two.

The draft determination TD 2019/D12 by the Australian Taxation Office (ATO) states that the GILTI Regime fails to be a CFC regime under the relevant Australian definition because the GILTI Regime does not apply on a CFC-by-CFC basis, as the GILTI Regime nets tested income and tested losses of all CFCs.[77] The ATO has recently issued a final Taxation Determination that follows the holding of the prior draft determination.[78] The Taxation Determination further elaborates the reasons why, for purposes of the Australian anti-hybrid rules, a GILTI inclusion by the U.S. parent corporation of a deductible payment by an Australian resident corporation to a reverse hybrid foreign sister limited partnership, both of which are wholly owned by that U.S. parent corporation, is not "subject to foreign income tax […] under a provision of a law of a foreign country that corresponds to section 456 or 457 of the" applicable Australian tax act.[79] The ATO explains in Appendix 1 to the Taxation Determination that the purpose of the GILTI Regime is to impose a minimum tax while the purpose of the Australian CFC regime under section 456 and 457 of the Australian tax code is "to deter tainted income from being shifted offshore for the aim of avoiding or deferring Australian tax."[80]

Similarly, a Summary of Responses by the UK HM Revenue & Customs (Hybrid and Other Mismatches, Summary of Responses, Nov. 12, 2020), in addressing their local hybrid mismatch rules, concluded at ¶5.21 that the GILTI Regime is not "similar to the UK CFC charge . . . [because] [t]he nature of the profits subject to each charge, and the mechanisms for computing and imposing the charges, are materially different."

If the GILTI Regime failed to be a CFC Regime (and also failed to be an IIR Top-up Tax, see Part IV.A.2 below), non-U.S. income of CFC-CEs that are Low-Taxed CEs ("<u>Low-Taxed CFC-CEs</u>") would be exposed to potentially substantial double taxation.

While the CFC Shareholder CE, a U.S. CE, would be taxed in the United States under the GILTI Regime on the tested income of the Low-Taxed CFC-CEs, the Covered Taxes of the Low-Taxed CFC-CE would not take account of the share of the U.S. parent's federal income tax

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77 ATO, TD 2019/D12 (November 21, 2019).

78 ATO, TD 2022/9 (June 29, 2022). This Taxation Determination is legally binding for Australian tax law purposes, while the legend to the explanation in appendix 1 to the determination is marked as being not legally binding.

79 ATO, TD 2022/9 at ¶1; see also ¶¶15-17 (Explanation).

80 ATO, TD 2022/9 at ¶41 (Explanation).

imposed in respect of GILTI.[81] It is not entirely clear, however, whether in this case Covered Taxes of the domestic CFC Shareholder CE would include any U.S. tax imposed in respect of GILTI. Covered Taxes includes "Taxes recorded in the financial accounts of a Constituent Entity with respect to . . . its share of the income or profits of a Constituent Entity in which it owns an Ownership Interest."[82] On the face of it, U.S. taxes imposed under the GILTI Regime would thus be Covered Taxes if (a) they are recorded in the financial accounts of the U.S. CFC Shareholder CE and (b) the U.S. CFC Shareholder CE is treated as owning the Ownership Interest in the CFC-CE. This should generally be the case, as GILTI taxes are an expense of the U.S. CFC Shareholder CE. Regarding the second requirement, we believe that ownership does not require direct ownership only, and there is no indication in the Model Rules themselves or the Commentary that that be the case.

Even if GILTI taxes are treated as Covered Taxes, it is conceivable that they are disqualified as Adjusted Covered Taxes of the U.S. CFC Shareholder CE. Adjusted Covered Taxes exclude the amount of "current tax expense with respect to income excluded from the computation of GloBE Income or Loss."[83] This rule does not state whether it is the GloBE Income (or Loss) of the relevant CE whose Adjusted Covered Taxes are determined, or the GloBE Income (or Loss) of any CE in the MNE Group. If it is the first, then GILTI taxes would be excluded from a U.S. CFC Shareholder CE's Adjusted Covered Taxes, as the GloBE Income of a CFC Shareholder CE is its Financial Accounting Net Income or Loss of the CE for the Fiscal Year, and there is no adjustment for its share of income from CFC-CEs.[84] The Commentary regarding excess Covered Taxes under a CFC Regime with respect to passive income, however, clearly suggests that these Covered Taxes would be included in the Adjusted Covered Taxes of the CFC Shareholder CE.[85]

The Commentary in fact confirms that "Taxes imposed under a CFC Tax Regime . . . are treated as Covered Taxes" under Article 4.2.1(a). Thus, the relevant elements (a) and (b) are present in any CFC Regime (within the meaning of the Model Rules). This suggests that they should likewise be present for the GILTI Regime. But it may still be doubted that taxes under the GILTI Regime are imposed on the share of income or profit of the CE for the reasons advanced by the ATO: the GILTI Regime does not apply on a CFC-by-CFC basis, but rather it allows for the netting of tested income and tested losses of all CFCs. The Commentary thus does not clearly settle whether U.S. taxes imposed on GILTI are Covered Taxes. It also does not clarify whether

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81 The Commentary to Art. 4.3 clarifies that a Covered Tax at the parent level is a Covered Tax when allocated to a CFC. *See* Commentary to Art. 4, ¶43-44 (p. 96). Even if GILTI were not treated as a CFC Regime, GILTI tax would be a Covered Tax of the U.S. parent under Article 4.2.1(a) as a "Tax recorded in the financial accounts of a Constituent Entity with respect to . . . its share of the income or profits of *a* Constituent Entity in which it owns an Ownership Interest." (Emphasis added.)

82 Art. 4.2.1(a).

83 Art. 4.1.3(a).

84 Arts. 3.1.1 and 3.2.1.

85 *See* footnote 61, above.

GILTI taxes would or would not be included in Adjusted Covered Taxes of the U.S. CFC Shareholder CEs.

If GILTI taxes are not Covered Taxes, double taxation of a CFC-CE's income may result, because GILTI taxes (if any) would be imposed with respect to a CFC-CE in addition to Top-up Taxes (if any).

> ***Example 7*** *FP* is a foreign corporation that is the UPE of an MNE Group and located in a GloBE Tax Jurisdiction. *FP* owns all of the stock of *USCo*, a domestic corporation, which in turns owns all of the stock of two foreign corporations located in in different jurisdictions, *CFCA*, located in country *A*, and *CFCB*, located in country *B*. *CFCA* has $200 of tested income and pays $20 of country *A* income tax; *CFCB* also has $200 of tested income but pays only $10 of country *B* income taxes. *USCo* has, without regard to GILTI inclusions, $400 of U.S. taxable income. Assume *USCo's* GILTI inclusion is $400 and its Section 250 deduction amounts to $200. It has $24 of foreign tax credits with respect to its GILTI inclusions and pays $102 of residual U.S. tax on $600 of taxable income ($400 of U.S. income plus $400 of GILTI minus $200 of section 250 deduction, for a tax liability for $126 (21% of $600), reduced by foreign tax credits of $24. Assume that U.S. taxable income is the same as GloBE Income and that there is no SBIE.[86]

If GILTI were not treated as a CFC Regime but GILTI Taxes were included in *USCo's* Adjusted Covered Taxes, *USCo* would have an ETR of 25.5% ($102 of Adjusted Covered Taxes divided by GloBE Income of $400), *CFCA* would have an ETR of 10% (for a Top-up Tax Rate of 5%) and *CFCB* would have an ETR of 5% (for a Top-up Tax Rate of 10%). Country *A* Top-up Tax would therefore equal $10 and country *B* Top-up Tax $20, which would be allocated to *FP* under the IIR. Without regard to *FP* itself, the MNE Group pays total taxes of $162 ($30 Top-up Tax, $102 U.S. tax and $30 tax in countries *A* and *B*). But of the $102 U.S. tax, $18 relates to GILTI, i.e., income of *CFCA* and *CFCB*, and the total tax to which the income is subject ($78) therefore exceeds the Minimum Rate by 4.5% (the excess of $78 of total taxes divided by $400 of GloBE Income, over the 15% Minimum Rate).[87]

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86 Where not expressly stated, it is assumed that the net deemed taxable income return as defined below is $0.

87 Generally, there appear to be three ways in which double taxation of some or all of the income of a Low-Taxes CFC-CE can arise if GILTI tax are not pushed down to the Low-Taxed CFC-CE. First, if the U.S. parent is not the UPE but is itself a subsidiary CE of a foreign UPE, and if that foreign UPE is tax resident in a GloBE Jurisdiction, then the foreign UPE would be subject to the IIR with respect to the Excess Profits of the Low-Taxed CFC-CE. This is illustrated in Example 7. Second, if the U.S. parent is the UPE and the United States is not an IIR Jurisdiction, then other CEs, if they are tax resident in UTPR Jurisdictions, will be allocated any Top-up Tax in respect of the Low-Taxed CFC-CE under the UTPR. As discussed below, this UTPR imposed on one CFC-CE in respect of another CFC-CE should not be a creditable foreign tax for U.S. tax purposes, specifically Section 960(d). Third, if the U.S. parent is the UPE and the United States is an IIR Jurisdiction but also retains the GILTI Regime, then the IIR would apply without a push-down of

Because under the above assumptions U.S. taxable income matches GloBE Income and the U.S. tax rate of 21% exceeds the Minimum Rate, the qualification or disqualification of GILTI taxes for or from Adjusted Covered Taxes has no effect on the question of whether Top-up Tax is due with respect to the United States. It is $0 in either case.

If the GILTI Regime is a CFC Regime, then the $18 of U.S. taxes imposed in respect of the GILTI inclusion would be pushed down, possibly with $5 to *CFCA* and $13 to *CFCB*.[88] *CFCA* thus would have $25 of Adjusted Covered Taxes, an ETR of 12.5%, a Top-up Tax Percentage of 2.5% and Top-up Taxes of $5. *CFCB* by contrast would have $23 of Adjusted Covered Taxes, an ETR of 11.5%, a Top-up Tax Percentage of 3.5% and Top-up Taxes of $7. Apart from any corporate income taxes imposed on *FP*, the MNE Group pays total tax of $144 ($102 of U.S. tax, $30 of country *A* and *B* income tax, and $12 of Top-up Tax). With Jurisdictional Top-up Tax, each of *CFCA* and *CFCB* is subject to $30 of total tax, for a rate of 15%.

We believe that, in the context of both the language and the purpose of the Model Rules, this is the right result. Even assuming that there will be no agreement to treat GILTI as a Top-up Tax, the GILTI Regime should qualify as a CFC Regime and U.S. tax imposed under the GILTI

GILTI taxes to Low-Taxed CFC-CE, although in this case it would be within the control of the United States to avoid the double taxation through properly modifying the GILTI Regime.

88 How GILTI taxes are to be allocated among CFCs with multi-jurisdictional blending is complex. A simplified approach, used for this example, may be as follows. Because the Model Rules make determination on a jurisdictional basis, GILTI tax push-down by country should be sufficiently granular. Because some CFCs may have tested losses, net tested income would be determined by country, and residual U.S. taxes then allocated to each country based on the ratio that such tested income bears to total GILTI. If the CFCs of a given country in the aggregate have a net tested loss, this amount would be added back to GILTI for allocation purposes (or, looked at differently, the denominator is not GILTI but the sum of aggregate net tested income of each country that does not have a net tested loss in the aggregate). *Cf.* Section 960(d)(2)(B).

Because different countries have different corporate income tax rates and, accordingly, different associated foreign tax credits, the allocation should be made by reference to the total residual U.S. taxes plus the total amount of indirect foreign tax credits (not including foreign tax credits of countries with excess foreign tax credits). This amount of taxes is then allocated to each jurisdiction in the proportion described above. The residual U.S. tax allocated to a jurisdiction with aggregate net tested income would then be pushed down to the jurisdiction. This residual U.S. tax would be the excess of total tax allocated under the formula over the foreign tax credits (i.e., the country specific residual U.S. tax). No residual U.S. tax would be allocated to a country with aggregate net tested loss, and excess foreign tax credits would be excluded from the taxes re-allocated to jurisdictions.

In Example 7, there are no net tested loss countries and no excess foreign tax credit countries. Accordingly, under the above formula, the allocation of $18 of residual tax is made as follows: total tax of $42 ($18 plus $24 of credits) is allocated $200/$400 (i.e., 50%) to each of *CFCA* and *CFCB*. Of the $21 so allocated to *CFCA*, $5 represents U.S. residual tax, i.e., $21 minus 80% of $20. Of the $21 allocated to *CFCB*, $13 represents residual U.S. tax, i.e., $21 minus 80% of $10. After the push-down, *CFCA*'s Adjusted Covered Taxes amount to $25 and *CFCB*'s Adjusted Covered Taxes amount to $23. The difference reflects the "loss" of foreign tax credits because of the 20% foreign tax credit haircut under Section 960(d)(1). *CFCA*'s haircut is $4, resulting in total Adjusted Covered Taxes of $21 of pre-credit U.S. tax liability, as determined under Section 951A and Section 250, plus $4 of foreign taxes that are not creditable, while *CFCB*'s haircut is only $2, resulting in $21 plus $2 of Adjusted Covered Taxes.

Regime should qualify as a Covered Tax that is allocated to the relevant CFC-CEs, because it properly reflects the total income tax to which the income of the CFC-CE is subject.

The definition of a CFC Regime in the Model Rules contains no requirement along the lines of the UK Summary of Responses or the ATO Taxation Determination. Rather, the definition requires that the parent be subject to current tax on "part or all of the income" of the CFC-CE. There is no requirement that the CFC-CE's income be subject to tax by the parent entity on an item-by-item basis, CFC-by-CFC basis, or jurisdiction-by-jurisdiction basis. The definition by its terms should therefore include the GILTI Regime. In fact, the ATO Taxation Determination disqualified the GILTI Regime because it is a minimum tax regime, and therefore does not correspond to an Australian anti-abuse rules intended to prohibit income shifting that avoids or defers Australian taxation. The purpose of the GloBE Rules, however, is to impose a minimum tax regime, so by its own analysis, the GILTI Regime should be a good CFC Regime under the Model Rules precisely because the GILTI Regime has a purpose similar to that of Pillar Two.

We therefore do not see a policy reason for disqualifying GILTI from being a CFC Regime for Pillar Two purposes. The sole purpose of the definition is to delimit the scope of parent-level taxes on income of a CFC-CE that count as taxes of the CFC-CE in determining the CFC-CE's Adjusted Covered Taxes, its ETR and the resulting Jurisdictional Top-up Tax (if any). If losses of a second CFC-CE cause the U.S. parent not to be taxed on all of the income of the first CFC-CE, the sole consequence is that there is less CFC Regime tax of the parent that is allocable to the relevant CFC-CEs. In other words, offsetting income of one CFC-CE by losses of another CFC-CE only reduces the amount of taxes pushed down, and in effect results in less Adjusted Covered Taxes, a lower ETR and potentially greater Jurisdictional Top-up Tax. But any taxes pushed down to the CFC-CE are in fact paid by the parent and in respect of the income of the CFC-CE. We therefore do not see a reason to exclude the GILTI Regime from being a CFC Regime under the Model Rules.

In the following discussion, we are assuming that the current GILTI Regime qualifies as a CFC Regime under the Model Rules. We assume the same for the subpart F regime, of course, for which the status as a CFC Regime under the Model Rules should not be doubtful at all.

2. The Differences between GILTI and a Qualified IIR

The GILTI Regime, in its current form, is not a Qualified IIR under the Model Rules. A Qualified IIR is

> a set of rules equivalent to Article 2.1 to Article 2.3 [the articles defining what an IIR is and its top-down application] of the GloBE Rules (including any provisions of the GloBE Rules associated with those articles) that are included in the domestic law of a jurisdiction and that are implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the

Commentary provided that such jurisdiction does not provide any benefits that are related to such rules.[89]

The GloBE Rules are in effect the Model Rules.[90] While it is not clear what "equivalence" would mean here other than an implementation of the Model Rules in the relevant jurisdiction, its mathematical roots suggest more than a general similarity. The GILTI Regime deviates from the GloBE Rules in several aspects, some of which are fundamental.

The following discussion is designed to serve solely as a technical comparison of the GILTI Regime with the Model Rules. This discussion is not designed to express a view on policy considerations, or on the advisability or consequences of any potential agreement that may ultimately be reached within the Inclusive Framework as to the interaction between the GILTI Regime and the Model Rules, including whether the GILTI Regime (in its current form, or with certain possible modifications discussed below) will be treated as a Qualified IIR under Pillar Two.[91].

The Blueprint expressly addressed the place of the (existing) GILTI Regime in, and its coordination with, the GloBE Rules. After stating that "the GILTI and GloBE rules […] have similar purpose and overlapping scope," the Blueprint Report observed that "the design of GILTI differs from the GloBE in a number of important respects."[92] It suggests that the critical element in the analysis is not whether the rules of the GILTI Regime are, as much as possible, congruent with the GloBE Rules, nor whether the GILTI Regime, on its own, has similar results as the GloBE Rules, but whether their "*coexistence* achieves reasonably equivalent *effects*."[93] While this report

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89 Art. 10.1.1 (definition of "Qualified IIR").

90 Art. 10.1.1 (definition of "GloBE Rules", which are defined to be "this set of rules as developed by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting").

91 *See, e.g.*, Stephanie Soong Johnston and Sarah Paez, "Reformed GILTI Would Comply With GLOBE Rules, OECD Official Says", 106 *Tax Notes Int'l* 1313 (June 6, 2022) (citing an OECD official to the effect that "it is clear that a reformed GILTI at 15 percent that operates on a country-by-country basis will be accepted as … being equivalent to a" Qualified IIR and the tax attaché of the German Embassy to the United States to the opposite effect that even if proposed changes to the GILTI Regime were enacted there is doubt that the GILTI Regime can be a Qualified IIR because, "we are still stuck with different tax bases [as] the qualifying income that is used in order to calculate and compute the pillar 2 top-up tax is different from what the GILTI [Regime] provides, and there are no changes."); Sarah Paez, "Inclusive Framework Drafting Proposal to Delay Tax Plan Timeline", 107 *Tax Notes Int'l* 80 (July 4, 2022) (citing an industry representative as stating that it "really doesn't make any sense . . . to raise [. . .] GILTI taxes once other countries have adopted and implemented pillar 2," and that "the United States needs to modify GILTI so that it aligns with pillar 2 in every significant respect [. . .] not just in being a per-country application, but [. . .] the rate should be identical, the treatment of historic losses and other attributes should be the same," and the "substance-based carveout should be the same" while citing a U.S. government official with the opposite conclusion that it is "extraordinarily clear" that country-by-country GILTI is a Qualified IIR. A discussion of what modifications of U.S. tax law are required to conform to any such agreement are beyond the scope of this report.

92 Blueprint Report ¶25, p. 19.

93 Blueprint Report ¶27, p. 19.

at various places will address potential challenges in coordinating between the GILTI Regime and the Model Rules, it agrees that "an agreement of the co-existence of the GILTI [Regime] and the GloBE [Rules] would need to be part of the political agreement on Pillar Two,"[94] but it should not be construed to take any position as to what such an agreement should look like.

a. GILTI is not based on financial statement income determined under U.S. GAAP

The existing GILTI Regime differs from the GloBE Rules in the principal defining characteristic of a tax system, namely the tax base. While GloBE Income or Loss is determined based on book income under the UPE's Acceptable Financial Account Standard, GILTI is determined under the U.S. tax accounting principles. Under the GloBE Rules, both the IIR and the UTPR measure the ETR, Excess Profits and the Top-up Tax based on the UPE's Consolidated Financial Statements, which in the case of a U.S. domestic UPE generally is U.S. GAAP.

If GILTI qualified as a Top-up Tax under an IIR, then it appears that U.S. taxable income is the tax base on which ETR, Excess Profits and Top-up Tax are based. Do other jurisdictions have to use this measure of income for determining whether Top-up Tax is due in respect of the domestic CEs of a U.S. domestic parented MNE Group, which is then allocated among the CEs under the UTPR?

It is also not clear how this could affect the determination of any QDMTT by non-U.S. subsidiaries of a U.S. domestic UPE. Could the tax base for a local QDMTT imposed by any CFC-CE's jurisdiction likewise be the CFC-CE's income as determined for U.S. tax purposes?[95] And could U.S. taxable income be the tax base for a QDMTT in the United States if the UPE is a domestic corporation, so that the U.S. QDMTT imposed on the U.S. CEs of the MNE Group preempts that any Top-up Tax is allocated under the UTPR to non-U.S. CEs?

b. The implied tax rate under GILTI is not the 15% GloBE Minimum Rate

Current U.S. tax law has a statutory corporate income tax rate of 21%, allows a deduction of 50% of GILTI under Section 250 of the Code, and allows for an indirect foreign tax credit of 80% of a CFC with tested income. Ignoring any expense allocations, the implied GILTI minimum tax rate is between 10.5% (if no foreign tax is imposed on the relevant portion of GILTI) and 13.125%, which is the rate of foreign tax at which no residual U.S. tax applies after an 80% indirect foreign tax credit.[96] This is less than the Minimum Rate.

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94 Blueprint Report ¶27, p. 19.

95 The determination of the QDMTT is relevant principally if QDMTT should be treated as a creditable foreign tax for purposes of determining residual U.S. tax in respect of GILTI. See the discussion in Part IV.C.2 below.

96 A non-U.S. jurisdiction may, of course, impose tax at a higher rate and no residual U.S. tax would be imposed, leaving aside the effects of allocation of expenses to foreign income.

The BBBA proposed various modifications to the GILTI Regime, including an increase of the implied GILTI rate to approximately 15% by reducing the Section 250 deduction to 28.5% for GILTI.[97]

The Greenbook proposed to raise the U.S. corporate tax rate to 28%, and if this increase were enacted, the implied minimum rate under GILTI would be 14% to 17.5% if the Section 250 deduction is not reduced as proposed by the BBBA. For jurisdictions without an income tax, this would still result in a GILTI tax rate of less than the Minimum Rate. However, if the Section 250 deduction is reduced in accordance with the BBBA, the implied GILTI rate is approximately 20%. If the corporate income rate increased to 28% but the Section 250 deduction remained unchanged from current law and were 37.5%, as provided under current law for post-2024 taxable years, the effective GILTI Rate would be 17.5%. This would also exceed the Minimum Rate.

There is, in other words, no reason to reduce the Section 250 deduction as compared to current law, if the rate increase takes effect and the aim is to reach the Minimum Rate for GILTI. In fact, as the GILTI Regime is currently designed, the GILTI rate would change with any change in the domestic corporate income tax rate. A tax rate of 24% would in effect be the "cut-off" rate for a Section 250 deduction of 37.5% that yields a 15% effective GILTI rate.

The Minimum Rate could be specifically targeted by making the Section 250 deduction variable depending on the corporate income tax rate.[98] For a U.S. corporate income tax rate of 28%, a Section 250 deduction of 13/28 or approximately 46.4% would yield the Minimum Rate.

A set of rules that is genuinely equivalent to the Model Rules would arguably have to impose tax at a rate of no more and no less than the Minimum Rate. Some jurisdictions agreed to the GloBE Regime expressly under the condition that the minimum tax rate under Pillar Two is 15% as a floor as well as a ceiling.[99] If members of the Inclusive Framework would not accept GILTI as a Qualified IIR because it imposes a Top-up Tax equivalent at a rate above the agreed upon 15%, non-U.S. members of the Inclusive Framework may in fact be able to reserve their ability to impose a UTPR with respect to Low-Taxed CFC-CEs for any Fiscal Year for which the ETR under the Model Rules falls below the Minimum Rate. This may be the case because the tax base for GILTI purposes differs from GloBE Income. Such an ETR shortfall under the Model Rules is less likely, of course, if the GILTI rate is substantially above the Minimum Rate.

However, this issue should not arise and the GILTI Regime, accordingly, may more easily be accepted as an IIR if the Section 250 deduction is set to deliver an effective GILTI rate exactly equal to the Minimum Rate.

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97 BBBA Section 138121(a). Proposed changes to the foreign tax credit are discussed in Part IV.C, below.

98 The deduction, as a fraction, would equal $\left(1 - {}^{0.15}/_{\tau_{Corp}}\right)$, with τ_{Corp} the corporate income tax rate.

99 *See* Johnston, S. S., and Paez, S., "Ireland, Estonia to Join OECD Global Tax Reform Deal", 2021 *Tax Notes Today Int'l* 194-1.

c. Country-by-country determination of a Top-up Tax

GILTI and the related tax liability is not determined on a country-by-country basis. Like the IIR, it allows for netting of income and losses of CFCs, but the netting is not limited to CFCs in the same jurisdiction.

The BBBA proposed to determine GILTI on a country-by-country basis.[100] A country-by-country foreign tax credit determination under the Model Rules is essential to the GloBE Rules. The Model Rules are predicated on determining Top-up Tax, GloBE Income and any derived concepts on a jurisdictional basis for CEs in the jurisdiction. The blending of higher-taxed income with lower-taxed income and losses from other jurisdictions, as it is done under the current GILTI Regime, is not compatible with the purpose of the GloBE Rules "to ensure large multinational enterprises (MNEs) pay a minimum level of tax *on the income arising in each jurisdiction* where they operate."[101]

The current GILTI Regime therefore is not akin to a Jurisdictional Top-up Tax for each Fiscal Year in this regard. Adoption of the BBBA proposal, however, would address this concern.

d. Income tax or Top-up Tax

If GILTI is not determined on a jurisdictional basis, the allocation of GILTI taxes from a U.S. CFC Shareholder CE to the relevant CFC-CEs is complex. A possible approach is outlined above,[102] and any such approach is complicated by the GILTI Regime's (1) cross-jurisdictional blending of income of CFC-CEs subject to different tax rates in different jurisdictions,[103] and (2) offsetting of tested income with tested losses (if any).[104] Another deviation in determining GILTI tax is the fact that other U.S. losses of a U.S. CFC Shareholder CE can offset GILTI. The current GILTI Regime therefore is not akin to a Top-up Tax for each Fiscal Year in this regard.

More specifically, under the U.S. tax rules, the GILTI inclusion, together with any other items of gross income, are reduced by deductions and loss carryforwards (if any). If, without GILTI inclusion, there is a loss, only a portion of GILTI, and possibly none of it, is subject to U.S. tax in the current Fiscal Year. The last feature highlights an important difference between a Top-up Tax allocated to a CE under the IIR or the UTPR and GILTI tax. Because GILTI is in effect one item of overall gross income, the amount of GILTI subject to U.S. tax depends on other available deductions. GILTI is part of the general corporate income tax system of the United States. GloBE Tax is not a form of corporate income tax. It is a separate, *sui generis*, tax that is imposed on the

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100 BBBA Section 138126(a).

101 Commentary, Introduction ¶1, p. 8.

102 *See* footnote 88, above.

103 Sections 904(d)(1)(A) and 960(d).

104 Sections 951A(b)(1)(A) and (c)(1).

CE to which it is allocated under the IIR or UTPR, regardless of whether the relevant CE otherwise has income or loss for the Fiscal Year.

e. Stock ownership under the GILTI Regime

Regardless of whether GILTI and the related tax liability is determined by netting on a worldwide or country-by-country basis, the GILTI Regime also differs from the IIR because it allows for netting with CFCs that are not CEs. More specifically, a CFC for U.S. tax purposes is generally any foreign corporation if more than 50% of its stock (by vote or value) is owned (directly, indirectly, actually and constructively) by one or more "United States shareholders" within the meaning of Section 951(b), i.e., United States persons that own (directly, indirectly, actually and constructively) 10% or more of such stock (by vote or value).[105]

It is therefore possible for an MNE Group to have a domestic CE that is a United States shareholder of a CFC that not a CE of the MNE Group. If this domestic CE is also a United States shareholder of CFC-CEs of the MNE Group, it will blend tested income (and tested loss) and foreign taxes of any such CFC that is not a CE with tested income and foreign taxes of CFC-CEs.

The non-CE CFCs may affect the ETR (or its surrogate measure under the GILTI Regime) and the determination of other factors flowing into the calculation of GILTI as a Top-up Tax. The GloBE Rules, by contrast, determine both the ETR and any Top-up Tax solely by reference to CEs. When applied to MNE Groups, GILTI may thus have to operate separately for CFC-CEs and for non-CE CFCs in order to satisfy the requirements of a Qualified IIR.

The BBBA proposal does not address the netting between CFC-CEs and CFCs that are not CEs. The Model Rules, however, operate strictly within an MNE Group. Leaving GILTI inclusions from non-MNE Group members in jurisdictional GILTI baskets therefore deviates from the Model Rules.

f. The indirect foreign tax credit with respect to GILTI inclusions

Under Section 960(d), a U.S. CFC Shareholder CE is allowed an indirect foreign tax credit equal to 80% of the foreign income tax paid or accrued by any CFC-CE, but only if the CFC-CE has tested income. The foreign tax credit is further limited to the so-called inclusion percentage, which has the effect of including in the foreign tax credit only an amount of foreign income taxes in proportion to the excess return as determined under GILTI. This is discussed in more detail in Part IV.A.2.g immediately below.[106]

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105 Sections 957(a) and 951(b).

106 The limitation of the inclusion percentage itself is also embedded in the determination of Jurisdictional Top-up Tax and will be not be addressed in the following discussion. See Appendix I for a summary of the credit mechanism under the Model Rules.

The BBBA proposed changes to the indirect foreign tax credit rules under Section 960(d), increasing the indirect foreign tax credit to 95% of the CFC's foreign income taxes and making foreign income taxes of a CFC creditable regardless of whether it has tested income or a tested loss (section 138127). This is moving closer to the Model Rules in two ways.

First, by increasing the indirect foreign tax credit to 95%, it is closer to the full "credit" that is afforded under the Model Rules. Under the Model Rules, the Top-up Tax Percentage is the excess (if any) of the Minimum Rate over the full ETR, without any haircut.[107] This in effect tests for whether the relevant jurisdiction imposes tax at a rate at least equal to the Minimum Rate on the CE's (or CEs') income. By allowing only a 95% credit, an amended Section 960 tests whether a foreign jurisdiction imposed income tax at a rate of approximately 15.7895%.

The Model Rules do not allow for a jurisdiction to employ a Top-up Tax Percentage that is different from the Minimum Rate, which is consistent with the overall objective that the GloBE Rules ensure that each jurisdiction imposes income tax at a rate of no less than the Minimum Rate, i.e., a rate agreed on by the members of the Inclusive Framework. It is therefore not clear how to reconcile a Section 960(d) credit of less than 100%, which "tops up" to more than the Minimum Rate, with the purpose of the GloBE Rules and the implementation through the Model Rules.

Second, Section 960(d) as currently in effect allows for a foreign tax credit only with respect to "tested foreign income taxes," i.e., foreign income taxes paid or accrued that are attributable to tested income. Creditable foreign taxes for the GILTI basket do not include foreign income taxes paid by a CFC with a tested loss.[108] The Model Rules do not have such a restriction. Rather they net GloBE Income and GloBE Loss of all CEs in a given jurisdiction,[109] arrive at the ETR by aggregating the Adjusted Covered Taxes of all the CEs in the jurisdiction,[110] and deduct that ETR from the Minimum Rate to determine whether and how much Jurisdictional Top-up Tax is to be imposed.[111] The proposed amendment of Section 960(d)(3) would therefore further conform the GILTI Regime to the Model Rules.

However, the BBBA proposal does not address the issue noted above that foreign income taxes of CFCs that are not CEs are included in the GILTI basket. As previously noted, the Model Rules operate strictly within an MNE Group, which is not compatible with this aspect of the GILTI Regime.

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107 Art. 5.2.1.

108 Section 960(d)(3).

109 Art. 5.1.2.

110 Art. 5.1.1.

111 Arts. 5.2.1–5.2.3.

g. The GILTI Regime determines Excess Profit differently from the Model Rules

Both the GILTI Regime and the GloBE Rules are designed as "excess" profit tax regimes. Under the GILTI Regime, the net tested income is subject to U.S. tax only to the extent it exceeds net deemed tangible income return ("NDTIR").[112] NDTIR is 10% of qualified business asset investment reduced by interest expense deducted from tested income,[113] where the qualified business asset investment represents the aggregate amount of the average of quarterly adjusted bases of tangible personal property used in the production of tested income.

The Model Rules by contrast apply the Top-up Tax to the excess of Net GloBE Income over the SBIE. The SBIE is determined not only by reference to tangible assets, but also to Eligible Payroll Costs of Eligible Employees.[114] The amount of the SBIE is 5% of the Eligible Payroll Costs plus 5% of the carrying value (and not adjusted tax bases) of Eligible Tangible Assets.[115] Both carve-outs from Net GloBE Income are subject to a 10-year incremental phase in from an initial percentage of 10% in the case of Eligible Payroll Cost and 8% for Eligible Tangible Assets.[116]

A further difference between NDTIR and the SBIE is that the adjusted bases or carrying values are determined on a quarterly basis for NDTIR and as the average of the carrying value as of the beginning and the end of the fiscal year for the SBIE. In addition, NDTIR, under current law, allows for cross-jurisdictional blending, while the SBIE is calculated separately for each jurisdiction.

This is another instance where the BBBA, if enacted, would move the GILTI Regime closer to the Model Rules, but would stop short of adopting them fully. Specifically, the rate for NDTIR

112 Section 951A(b)(1).

113 Section 951A(b)(2)

114 Art. 5.3. "Eligible Payroll Costs" include wages, salaries, other expenses, fringe benefits, pension contributions, payroll and employment taxes, and employer social security contributions. "Eligible Employee" includes independent contractors. Art. 10.1.1. Thus, classification questions with respect to service providers should not generally impact the calculation of SBIE. The payroll carve-out applies only to Eligible Payroll Costs for Eligible Employees who perform activities for the MNE Group in the jurisdiction of the relevant CE. Art. 5.3.3.

115 Arts. 5.3.2-4. "Eligible Tangible Assets" are property, plant, and equipment located in the relevant CE's jurisdiction, natural resources located in the jurisdiction, the right to use tangible assets located in the jurisdiction if the CE is the lessee of such assets, and any license or similar arrangement from the government for the use of real property or for the exploitation of natural resources that entails significant investment in tangible assets, provided such assets are not held for sale, lease, or investment. Art. 5.3.4. An overlap rule applies to eligible payroll costs that are capitalized and included in the carrying value of eligible tangible assets.

116 Art. 9.2.

would be scaled back to 5% of qualified business asset investment,[117] but there would be no 5% tax-free return on employee and independent contractor expenses.

This in effect favors businesses that give more weight to the use of tangible assets over more service-dependent and (tangible) asset-light businesses. In the extreme case of a business without any tangible assets, all profit would be treated as excess profit, rather than allowing for a routine return on labor as well. It is not clear why, if a minimum tax is imposed on "excess profits," the excess is not measured by both factors. It is also clearly different from the approach of the Model Rules. A lower SBIE-equivalent amount is another factor by which the modified GILTI Regime produces a higher minimum tax than the Minimum Tax envisaged by the Inclusive Framework.

h. GILTI does not cover the entire income of the CFC-CE

GloBE Income (or Loss) is the entire financial accounting net income of a CE, with certain adjustments, and excludes "International Shipping Income."[118] GILTI is tested income, which excludes subpart F income, high-taxed income, and foreign oil and gas extraction income, but does not exclude international shipping income. Subpart F income, of course, is subject to current inclusion as well, but subject to U.S. tax at a higher rate than GILTI as the Section 250 deduction does not apply to subpart F income. The Model Rules have a separate "basket" for Passive Income, but this is both narrower and broader than both foreign personal holding company income under Section 954(c) and subpart F income more generally.[119] For any CFC-CE with subpart F income, the separate treatment of subpart F income that is not Passive Income within the meaning of the Model Rules may further increase the overall U.S. tax rate over the Minimum Rate. However, this makes it less likely, in general, that CFC-CEs of a U.S. CFC Shareholder CE give rise to a Jurisdictional Top-up Tax if the GILTI Regime is not a Qualified IIR because U.S. tax imposed in respect of active subpart F income should count as a Covered Tax without the limitation that applies to Passive Income.

i. CFCs for U.S. tax purposes are both less and more inclusive than CFC-CEs

GILTI also excludes U.S. source income that is effectively connected with the CFC-CE's conduct of a U.S. trade or business. This in effect corresponds to the Model Rules, which treat a Permanent Establishment as a separate CE ("PE-CEs").[120] By excluding effectively connected income, GILTI treats the U.S. trade or business similar to a separate CE. However, by excluding

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[117] BBBA Section 138126(d).

[118] Arts. 3.1.1, 3.3 (International Shipping Income exclusion).

[119] *See* part III.B.2, above.

[120] Art. 1.3.1(b). A Permanent Establishment should include both a permanent establishment under U.S. income tax treaties and any "place of business . . . in respect of which [the United States] taxes under its domestic law the income attributable to such place of business on a net bases similar to the manner in which it taxes its own tax resident."

only U.S. source income, the implied PE-CE under the GILTI Regime is delineated more narrowly than PE-CEs under the Model Rules.

Another difference between the current foreign tax credit regime and the Model Rules arises from the treatment of foreign branches. A PE-CE is treated no different from any other CE under the Model Rules, and its GloBE Income or Loss is netted with that of any other CEs in the same jurisdiction, not only PE-CEs. Its Adjusted Covered Taxes are likewise included in the aggregate Adjusted Covered Taxes when determining the ETR for the jurisdiction, and so are its Eligible Tangible Assets and Eligible Payroll Costs for determining the SBIE. The Adjusted Covered Taxes of PE-CEs and CFC-CEs, in other words, fall into the same foreign tax credit basket for purposes of obtaining the Top-up Tax Percentage and the Excess Profits subject to any Top-up Tax.

Currently, a permanent establishment or branch of a CFC in a foreign country is not treated as a separate CFC for purposes of the GILTI Regime. Its income is included in tested income, except for items excluded from tested income, such as subpart F income, and the related income and taxes are assigned to the GILTI basket, unless they fall into the passive or general basket for non-GILTI/tested income items.

Income of a foreign branch of a U.S. CE, by contrast, is subject to a separate foreign branch income basket except for income that is passive category income, and not combined with the GILTI basket.[121] The BBBA has proposed, in addition to foreign tax credit limitations on a country-by-country basis, to eliminate the separate foreign tax credit limitation basket for foreign branch income.[122] As a result, the non-passive category income of the foreign branch and the related foreign income taxes would be allocated to the general category income basket. Only non-passive subpart F income of a CFC, however, would be allocated to this basket. Thus, the PE-CEs of a U.S. CFC Shareholder CE or other U.S. CEs would be aggregated on a country-by-country basis, but not with PE-CEs of any CFC-CE or the CFC-CEs themselves. In other words, the foreign tax credit system proposed by the BBBA creates two types of CEs for determining whether a minimum tax (as measured by U.S. tax law) was paid or accrued by the CEs. This two-class CE system is inconsistent with the Model Rules.[123]

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121 Section 904(d)(2)(J).

122 BBBA Section 138124(b). The BBBA would apply the country-by-country limitation to "taxable units," which are (1) the U.S. taxpayer itself (to the extent not described in the following categories of taxable unit), (2) CFCs of the U.S. taxpayer, (3) an interest in a pass-through entity owned by a U.S. taxpayer or a CFC, if the pass-through entity is a tax resident in a foreign country other than that of its owner, and (4) a direct or indirect branch of the U.S. taxpayer or a CFC that has a taxable presence in a foreign country other than the country of residence of its owner. BBBA Section 138124(a).

123 The Model Rules apply special rules to allocating Covered Taxes in respect of "Passive Income" (as defined in the Model Rules) of a CFC-CE imposed on the owner of the CFC-CE back to the CFC-CE, in effect limiting the Adjusted Covered Taxes with respect to the CFC-CE's Passive Income to tax imposed at the Minimum Rate. Taxes imposed under a CFC Regime on Passive Income can thus not be cross-credited with non-Passive Income of the CFC-CE in determining the Top-up Percentage. *See* Part III.B.2, above.

3. The GILTI Regime and the Hierarchy of Top-up Taxes

As described in Part III.A above, the Model Rules lay out a hierarchical systems of Top-up Taxes that apply after all Covered Taxes of each CE of an MNE Group are determined. Covered Taxes, as adjusted under the rules of Article 4.1, are aggregated on a jurisdictional basis to obtain the ETR for a given jurisdiction *J* as

$$\text{ETR}_J = \frac{\text{Aggregate Adjusted Covered Taxes of all CEs in } J}{\text{Net GloBE Income of all CEs in } J}$$

and the Top-up Tax Percentage is dependent on the ETR_J as

$$\text{Top-up Percentage in } J \ = \ \text{Minimum Rate} - \ \text{ETR}_J.$$

However, the actual amount of Jurisdictional Top-up Tax is also dependent on the amount of QDMTT imposed by jurisdiction *J*, i.e.,

$$\text{Top-up Tax in } J = [\text{Top-up Pcercentage in } J \ \times \text{Excess Profit in } J] - \text{QDMTT}_J.$$ [124]

This hierarchy of taxes would have far reaching consequences if the existing GILTI Regime were modified in a manner that it would be treated as a Qualified IIR by the Inclusive Framework (an "IIR-GILTI").[125]

a. Subordination of IIR-GILTI under Other Qualified IIRs

An IIR-GILTI would be subordinated to other countries' CFC regimes and also would have to permit a credit to any other country's QDMTT (see also below discussion in Part IV.C.2). But most importantly, an IIR-GILTI would be subordinated to any other country's IIR under the top-down approach applicable to IIRs. Specifically, IIR-GILTI would be switched off for any U.S. corporation that is a CE of an MNE Group with a UPE that is tax resident in a foreign jurisdiction that has adopted a Qualified IIR. An IIR-GILTI will in effect have to cede taxing jurisdiction over any Low-Taxed CFC-CE of any U.S. domestic corporation that is an IPE. Alternatively, if an IIR-GILTI were imposed regardless of whether a UPE is located in a GloBE jurisdiction, it should not be considered a Covered Tax (as it is a Qualified IIR) nor reduce the allocation of Top-up Tax to the UPE (because the Offset Mechanism does not apply).

An IIR-GILTI also would be subordinated to any IIR adopted in a country of a subsidiary POPE.

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[124] We note that this simplifies the calculation of Article 5.2.3 by leaving out the added Additional Current Top-up Tax.

[125] This may be the case if the changes to the existing GILTI Regime proposed in the BBBA were enacted.

> ***Example 8*** *USP* is a domestic corporation that is the UPE of an MNE Group. *USP* has two subsidiaries: *FSubP*, which is located in country *P*, an IIR Jurisdiction, and *FSubL*, a Low-Taxed CE located in country *L*, which has not adopted a Qualified IIR, Qualified UTPR or QDMTT. *USP* owns 79% of the single class of stock of *FSubP*, with the remainder owned by unrelated persons, so that *FSubP* is a POPE. *USP* owns 30%, and *FSubP* owns 70%, of the single class of stock of *FSubL*. *FSubL* has undertaxed Excess Profit that gives rise to a Top-up Tax of $10 million.

If the United States does not adopt an IIR-GILTI, then *USP* includes approximately 85% of *FSubL's* tested income, which is included in *USP's* GILTI and subject to U.S. tax. If the GILTI Regime had the same effect as a Top-up Tax, *USP* would pay $8.5 million in U.S. tax in respect of the inclusion. As a Covered Tax, this amount is allocated back to *FSubL* and the country *L* Top-up Tax is reduced accordingly to $1.5 million. *FSubP* is liable for $1.05 million of Top-up Tax, i.e., the Inclusion Ratio of 0.7 of $1.5 million, which is collected by country *P* under its Qualified IIR.[126]

Under an IIR-GILTI, the liability for the $10 million of Top-up Tax with respect to country *L* would be allocated between *USP* and *FSubP* under the IIR and UTPR, and the Offset Mechanism. Accordingly, *FSubP* would pay $7 million of Top-up Tax to country *P* and *USP* would pay $3 million to the United States government. While in this example the total Top-up Tax plus GILTI tax burden for the MNE Group is increased by a small amount, the revenue collected by the United States is significantly reduced by moving from GILTI to IIR-GILTI.[127]

> ***Example 9*** *USP* and *FSubP* change roles from Example 8: Instead of *USP*, there is a foreign parent *FP* that is the UPE of an MNE Group located in country *P*, which is an IIR Jurisdiction. *FP* owns 30% of the stock of *FSubL*. Instead of *FSubP*, there is a domestic subsidiary *USSub*, which owns 70% of the stock of *FSubL*, and *FP* owns 79% of the stock of *USSub*. Otherwise the facts are the same.

If the IIR-GILTI exactly matched the Top-up Tax under the Model Rules, 70% of the $10 million of Top-up Tax with respect to *FSubL*, or $7 million, would be imposed on *USSub*. The remainder would be imposed on *FP* under the IIR in connection with its direct 30% interest in *FSubL*. If GILTI remained as a CFC Regime, *USSub* would be liable for U.S. tax with respect to its GILTI inclusion with respect to *FSubL*. This amount of tax in turn would be allocated to *FSubL* as a Covered Tax and would reduce the Top-up Tax. Because *FP's* Inclusion Ratio is only 85.3% (30% direct interest in *FSubL* and 79% of 70% held through *USSub*), *FP's* share of the remaining Top-up Tax with respect to FSub-L is also 85.3%. If the GILTI inclusion resulted in the same $7

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126 Because the Inclusion Ratio of *FSubP* is less than *USP*'s ownership interest in *FSubL*, the difference ($0.45 million) of the Top-up Tax is allocated under the UTPR to other CEs or *FSubP*. The total Top-up Tax imposed on the MNE Group is in that case $1.5 million. *See* Art. 2.5.

127 See Part III.A.1, above regarding the IIR offset calculations.

million of tax as the IIR-GILTI inclusion, *FP* would be allocated $2.56 million of Top-up Tax. The MNE Group as a whole would pay less total taxes in respect of *FSubL,* but the United States would collect the same amount of taxes under GILTI and IIR-GILTI, because no Top-up Tax is imposed on an intermediate IPE or POPE.

If in Example 9 *USSub* were wholly owned by *FP*, *USSub* would be an IPE and no Top-up Tax in respect of *FSubL* would be allocated to it. The difference from Example 9 is that *USSub* is no longer a POPE, for which Article 2.1.4 trumps the UPE and IPE rules of Articles 2.1.1 through 2.1.3. It is an IPE, to which Article 2.1.2 applies but which has to step back before the UPE to which the IIR allocates the entire Top-up Tax under Article 2.1.1. As in Example 8, the United States collects in this scenario less tax under IIR-GILTI (namely $0) than under GILTI as a CFC Regime, which permits the United States to collect revenue in an amount equal to, or possibly greater than, the Top-up Tax.

In order to maximize revenue, could the United States adopt a modified GILTI Regime with a dual role: employ it as a traditional CFC Regime in the case of a U.S. entity that is the UPE in an MNE Group with intermediate subsidiary POPEs or a U.S. entity that is an IPE, but as an IIR-GILTI otherwise?

The Model Rules do not seem to allow for such a switch-over regime. For a system of taxation to be a CFC Regime under the Model Rules, it has to be a set of rules "other than an IIR."[128] The Commentary to Article 10.1 likewise states that the two are different:

> An IIR is not included in the definition of a CFC Tax Regime. . . . [T]he Top-up Tax under the IIR is initially computed on a jurisdictional basis so as to bring the tax paid on excess profits in that jurisdiction up to an agreed minimum tax rate. Those taxes are then allocated to each [Low-Taxed CE] in proportion to that Entity's GloBE Income before being brought into charge by a Parent Entity. Given the policy and mechanical differences between the two, a jurisdiction is not required to replace an existing CFC Tax Regime by introducing an IIR . . . .[129]

The Model Rules, in other words, and in particular the top-down approach of Article 2.1, do not seem to allow for the GILTI Regime to simultaneously function as both a CFC Regime and an IIR for in-scope MNE Groups.

Arguably, this assumes that a modified GILTI constitutes a *single* tax regime. For any United States shareholder (within the meaning of Section 951(b)) that is not a CE of an MNE Group, it does in any event not matter how GILTI is characterized under any implementation of the Model Rules. For a CE that is a member of an MNE Group, by contrast, the characterization would toggle depending on structural features of the MNE Group in a manner that would maximize

128 Art. 10.1.1 (definition of "Controlled Foreign Company Tax Regime").

129 Commentary to Art. 10.1 ¶8, at p. 194.

U.S. tax revenue. Apart from the question of whether tax regimes can be individuated by reference to the scope of subjects to which they apply,[130] it would appear difficult to argue that the same set of U.S. tax rules can invariably take precedence over other jurisdictions' GloBE rules.

In any event, the examples above show that the benefits of an IIR-GILTI to the United States revenue may not be as material as they first appear, at least assuming enactment of the BBBA proposals discussed above. This may not necessarily be the case under current law, however, because it allows for netting of tested income and tested losses of CEs in different jurisdictions, potentially resulting in no GILTI taxes where Jurisdictional Top-up Tax would otherwise be imposed on a CE with tested income, regardless of the existence and amount of tested losses in other jurisdictions. This would not be possible under country-by-country basketing and GILTI tax determinations as proposed under the BBBA. In that case, because taxes imposed under a CFC Regime are Covered Taxes and are applied in priority to a Top-up Tax, there appear to be few situations in which GILTI as a CFC Regime gives rise to less U.S. tax revenue than IIR-GILTI.[131]

b. CFC Regimes with a CFC Minimum Top-up Tax

A jurisdiction with a tax regime similar to the GILTI Regime (or the subpart F regime) could maximize tax revenue for any group (or subgroup) that is parented by a CE in that jurisdiction by adding a tax with respect to CFCs that "soaks up" potential Top-up Tax otherwise imposed by other GloBE Tax Jurisdictions. Such a "CFC surtax" would be applied to a CFC Shareholder CE that is a member of the relevant MNE Group, would apply to the extent that after application of the general CFC rules the Low-Taxed CFC-CE's ETR is less than the Minimum Rate of 15%, and would apply to GloBE Income as determined by the UPE. Such a CFC surtax operates in effect similar to a QDMTT, but with respect to CFC-CEs, and the report shall refer to it as a "CFC Minimum Top-up Tax" or "CFC-MTT".

A CFC-MTT would be effective in eliminating Jurisdictional Top-up Taxes only if it satisfied two conditions: (1) it is a Covered Tax and (2) it reduces Top-up Tax to zero.

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130 Under current U.S. tax law, whether a foreign tax is a (foreign) income tax or an in lieu of tax depends on its substantive character, not the class of persons on which it is imposed. *See* Treas. Reg. § 1.901-2(a)(1)(i) ("A foreign tax either is or is not a foreign income tax, in its entirety, for all persons subject to the foreign tax.") and Treas. Reg. § 1.903-1(b)(1) ("A foreign tax either is or is not a tax in lieu of an income tax in its entirety for all persons subject to the tax.").

131 Top-up Tax allocated under the IIR applies, but not GILTI tax, if the Low-Taxed CE is not a CFC, but this should generally not be the case after the repeal of former Section 958(b)(4). If, in Example 9, *FP* owned 95% of the stock of *FSubL* and *USSub* only 5%, *FSubL* would still be a CFC as *FP's* ownership would be attributed to *USSub* for determining *FSubL's* CFC status. Section 958(b) and Section 318(a)(3)(C). Another scenario where Top-up Tax under the IIR, but no or little GILTI tax, applies would arise where GloBE Income is sufficiently greater than GILTI.

A CFC-MTT could technically qualify as a tax imposed under a CFC Regime as defined under the Model Rules and in that case could be re-attributed to the Low-Taxed CFC-CE in the same manner as any other taxes imposed under a CFC Regime. It would be a Covered Tax under Articles 4.2.1 and 4.2.2 if it is "included in the financial accounts of" the CFC shareholder(s) "under a Controlled Foreign Company Tax Regime on its share of the [. . .] income" of the Low-Taxed CFC-CE under Article 4.3.2(c) and it is not a Top-up Tax accrued (1) by a Parent Entity under a Qualified IIR or (2) by a Constituent Entity under a QDMTT.[132] Moreover, to be a tax imposed under a CFC Regime, the CFC-MTT cannot be an IIR.

One technical reason a CFC-MTT is not an IIR is that it does not respect the ordering rules of Articles 2.1 through 2.3,[133] and it is therefore also not a Qualified IIR. Nor is it a QDMTT, because it is not imposed on the CFC Shareholder CE's Excess Profits in its own jurisdiction.[134] Because it is not an IIR Top-up Tax, a CFC-MTT can be treated as part of the CFC Regime, which excludes not Top-up Taxes as such, but only Top-up Taxes accrued under an IIR.

However, a CFC-MTT is inefficient as a Top-up Tax substitute because it either results in total tax in excess of that imposed under the Model Rules (absent a CFC-MTT) or, if it is calculated in the same manner as the Article 5.2 Top-up Tax, it does not increase the ETR to 15%. If the CFC-MTT were determined like a Top-up Tax under the Model Rules, it would be imposed only on Excess Profits, not the entire Net GloBE Income. Thus, if allocated back to the relevant CFCs in the various CFC-CEs jurisdictions, no CFC-MTT is imposed on the SBIE, and the Adjusted Covered Tax in the relevant jurisdiction would not be sufficient to increase the ETR to the full 15%. By contrast, if the CFC-MTT were imposed on Net GloBE Income with respect to the CFC-CEs in a given jurisdiction, and not only Excess Profits, a quasi-Top-up Tax is imposed not only on Excess Profits in the jurisdiction, but also on the SBIE portion of Net GloBE Income. This would increase the ETR to 15%, but result in a higher overall tax burden for the MNE Group equal to the SBIE multiplied by the excess of the Top-up Tax Percentage. Yet however inefficient, a CFC-MTT would still be effective in preempting a Top-up Tax imposed under the IIR or UTPR.

Further commentary on the Model Rules, or their implementation framework, should clarify whether a CFC-MTT could be respected as a tax imposed under a CFC Regime. They could revisit the definition of CFC Regime and exclude not only an IIR but any Top-up Tax from qualifying as tax imposed under a CFC Regime. If this is the intention of the Model Rules, a more robust explanation of what constitutes a Top-up Tax should be developed and possibly a broader class of exclusions from the definition of Covered Taxes.

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132 Art. 4.2.2(a) and (b).

133 Art. 10.1.1 (definition of "IIR").

134 *See* Art. 10.1.1 (clause (a) of the definition of "Qualified Domestic Minimum Top-up Tax").

4. IIR-GILTI and UTPR

Under an IIR-GILTI Regime, the GILTI Regime would take precedence over the UTPR. Countries that have adopted the UTPR would have no jurisdiction to collect GloBE Tax of Low-Taxed CFC-CEs.

However, allocation of Top-up Taxes under the UTPR could still apply to the domestic member CEs (including the domestic UPE) of any MNE Group with the domestic UPE. Such member CEs include U.S. branches or permanent establishments in the United States that are maintained by any foreign CE of the MNE Group. In that case, the question arises what measure of income would be used by countries with a UTPR in order to determinate whether the U.S. Jurisdictional ETR is below the Minimum Rate.

The principal candidates are (1) financial accounting income, i.e., the Consolidated Financial Statements of the U.S. domestic UPE (and other U.S. CEs, including U.S. branches and permanent establishments, together the "MNE US Subgroup") and (2) taxable income as determined under U.S. tax laws. In addition, (3) the corporate alternative minimum tax proposed in the BBBA (the "BBBA AMT"),[135] if adopted, might be used to determine that no UTPR is required. In fact, (4) the BBBA AMT might be used as a "GloBE Safe Harbor," with the Jurisdictional Top-up Tax for the MNE US Subgroup deemed to be zero.[136]

(1) The Model Rules suggest that other jurisdictions would determine whether the MNE US Subgroup are Low-Taxed CEs based on Consolidated Financial Statements, with the adjustments required under the GloBE Rules. The U.S. UPE or other entities in the MNE US Subgroup would then have to engage in all of the financial accounting-based calculations and determinations required under the Model Rules. The existence of the UTPR, in this case, would limit the benefit that an IIR-GILTI does not have to rely on GloBE Income. While GloBE Income would not play a role for the Top-up Tax applicable to CFC-CEs (i.e., IIR-GILTI), it would be relevant for determining Top-up Taxes under the UTPR for the MNE US Subgroup.

(2) Using U.S. taxable income as the starting point for the determination of the UTPR runs counter to the purpose of the GloBE Rules, which aim at a measure of income that disregards the various tax benefits that may be provided under a local income tax system, such as categories of tax-exempt income, the foreign-derived intangible income ("FDII") provisions[137] or certain tax credits. We are not aware of a policy reason for advancing this measure of income for UTPR purposes, then.

(3) The BBBA AMT, if enacted, would impose a tax of 15% on the "adjusted financial statement income," less certain tax credits, of (a) any C corporation with a 3-year average adjusted

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135 BBBA Section 138101.

136 Art. 8.2.1.

137 Section 250(b).

financial statement income in excess of $1 billion or,[138] if the corporation is a member of a group with a foreign common parent that has at least one U.S. corporate member or a U.S. branch, $100 million. The BBBA AMT applies to financial statement income, but with a different income threshold. It is higher than the revenue threshold for MNE Groups under the Model Rules if the UPE is a U.S. corporation and much less if the UPE is a foreign corporation. It includes the pro rata share of the income of CFCs in which a U.S. CE is United States shareholder (within the meaning of Section 951(b)) that is includible under Sections 951 or 951A, with respect to any CFC, not only CFC-CEs. In addition, it includes the income of any non-U.S. branches and disregarded entities subject to foreign tax on a net income basis and allows for a foreign tax credit against the BBBA AMT amount, with a carryforward for excess foreign tax credits. It is therefore possible that foreign losses of foreign branches offset U.S. income subject to the 15% tax. No losses of CFCs are available to offset other income of the U.S. corporation.

(4) The BBBA AMT arguably comes close to ensuring a minimum tax of 15%. By limiting foreign tax credits to foreign source income at the minimum tax rate, these credits do not shelter U.S. source income. The GloBE Rules expressly consider a "GloBE Safe Harbor" under which no Jurisdictional Top-up Tax is deemed be due.[139] The conditions for any GloBE Safe Harbor will be "developed and released under the GloBE Implementation Framework," which will be a set of administrative procedures and guidance yet to be developed by the Inclusive Framework.[140]

Whether the BBA AMT could make the United States a GloBE Safe Harbor jurisdiction for purposes of the GloBE Rules is uncertain. It applies to U.S. parented MNE Groups with an income threshold rather than the revenue threshold of the GloBE Rules, and it does not apply on a jurisdictional basis. The Commentary states:

> These conditions would be designed to limit compliance costs for MNE Groups as well as administrative burden for tax authorities and incorporate thresholds that ensure only those parts of the MNE Group's operations that are nearly certain to have jurisdictional ETRs above the Minimum Rate would be eligible for the GloBE Safe Harbor.[141]

The failure of the BBBA AMT to apply on a jurisdictional basis may prevent it from qualifying as a GloBE Safe Harbor. If a GloBE Safe Harbor is not available, adoption of an IIR-GILTI (or another IIR) would be necessary in order for the United States to become a GloBE Rule country, but that would not simplify the multiplicity of taxable base determinations that a U.S. parented MNE Group would have to calculate:

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138 For purposes of determining adjusted financial statement income all persons treated as a single employer under section 52(a) and (b) are treated as one person, with some exceptions.

139 Article 8.2.

140 Commentary Art. 8, ¶32, at p. 184.

141 Commentary Art. 8, ¶32, at p. 185.

1. the mainstream U.S. federal income tax determination;

2. the determination of GILTI (and subpart F income) to determine IIR-GILTI;[142]

3. the determination of "modified taxable income" for purposes of the base-erosion minimum tax under Section 59A or, if it is replaced by a QDMTT, the QDMTT;

4. the determination of adjusted financial statement income under the BBBA AMT; and

5. the determination of GloBE Income for purposes of determining UTPR with respect to any MNE US Subgroup.

There is no discernible policy reason for this abundance, in particular for a separate role of the BBBA AMT in the context of the Model Rules. There will be three other minimum tax regimes apart from the mainstream U.S. corporate income tax, specifically geared towards ensuring imposition of a minimum tax at the Minimum Rate worldwide. Further discussion of the BBBA AMT is beyond the scope of this report.

There is a comparatively simpler structure of the U.S. tax system in a world with GloBE Rules, which may in fact not be so different from the existing system:

1. Determine taxable income under the mainstream U.S. federal income tax;

2. Determine GILTI (and subpart F income) as a CFC Regime on a jurisdictional basis, not as an IIR-GILTI;

3. Determine GloBE Income (under U.S. GAAP or possibly the UPE's Consolidated Financial Statement if the U.S. entity is not the UPE) and

   a. determine QDMTT for U.S. CEs (and possibly obtain GloBE Safe Harbor status for U.S. QDMTT) and

   b. determine CFC-MTT for non-U.S. entities on a jurisdictional basis.

B. THE QUALIFIED DOMESTIC MINIMUM TOP-UP TAX

1. Is the QDMTT a Top-up Tax?

There is a definitional question as to whether a QDMTT is a Top-up Tax within the meaning of the Model Rules. "Top-up Tax" is defined as "the top-up tax computed for the jurisdiction or Constituent Entity pursuant to Article 5.2." Article 5.2 provides computational rules for the Jurisdictional Top-up Tax (the dependent variable of Article 5.2.3), but not the QDMTT

142 This determination, of course, also would have to be made if GILTI were not treated as an IIR by the Inclusive Framework.

(which is one of the independent variables of the equation). Top-up Tax in this sense is then allocated to one or more CEs under the GloBE Rules, i.e., an IIR or UTPR.

Similarly, the definition of "QDMTT" itself does not refer to this tax as a Top-up Tax but instead as a "minimum tax."[143] This would of course ignore that "Top-up Tax" is contained in the label QDMTT. Moreover, in the definition of "Covered Taxes" in Article 4.2, Article 4.2.2 expressly states that "Covered Taxes does not include any amount of: . . . (b) Top-up Tax accrued by a Constituent Entity under a Qualified Domestic Minimum Top-up Tax."

Yet, references to Top-up Taxes in Article 2 should not include references to QDMTT, or else the QDMTT paid or accrued by a CE becomes itself part of the Top-up Tax that is allocated to a Parent Entity, if the CE subject to the QDMTT remains a Low-Taxed CE (see Example 10 below).[144] It thus seems that the distinction should be between (1) Jurisdictional Top-up Tax or GloBE Tax, as defined in Article 5.2; (2) Qualified Domestic Minimum Top-up Tax, as defined in the Model Rules; and (3) Top-up Tax in general, which is a Jurisdictional Top-up Tax or a QDMTT.

Another distinction results from the allocation rules, namely whether or not the (Jurisdictional) Top-up Tax is a Qualified IIR. A Qualified IIR is "a set of rules equivalent to Article 2.1 to Article 2.3 of the GloBE Rules (including any provisions of the GloBE Rules associated with those articles), . . . provided that [the] jurisdiction [imposing the Qualified IIR] does not provide any benefits that are related to such rules."[145] Would it be possible to have a Jurisdictional Top-up Tax that fails to be a Qualified IIR?

> ***Example 10*** *UPE* is a country *A* parent of an MNE Group. *UPE* directly owns all of the stock of *FSub-B*, which is located in country *B*, which in turn wholly owns *FSub-C*, located in country *C*. There are no other CEs in the MNE Group. Country *C* imposes a QDMTT, based on Country *C* generally accepted accounting standards, which are different from the acceptable financial accounting standard employed by *UPE*. Under that standard, *FSub-C* has accounting based income of 1000u, SBIE of 200u and Adjusted Covered Taxes of 80u. Based on this, country *C* imposes on *FSub-C* QDMTT in the amount of 56u.[146] Under *UPE*'s accounting standard, *FSub-C*'s Net GloBE Income is 1067u, and its SBIE is 227u. Country *B* imposes on *FSub-B* with respect to the Net GloBE Income of *FSub-C* a Top-up Tax

143 Art. 10.1.1 (definition of "Qualified Domestic Minimum Top-up Tax").

144 *See* Art. 2.2.1.

145 Art. 10.1.1 (definition of "Qualified IIR"). The definition of "Qualified UTPR" is analogous to that of "Qualified IIR". *Id.*

146 The Top-up Tax Percentage of FSub-C is 7% (15% less 8%, i.e., 80u/1000u). The Top-up Tax therefore should be 7% of excess profits of 1000u – 200u, i.e., 56u. FSub-C's total domestic tax is thus 136u (and not 150u), consisting of 120u with respect to excess profits (i.e., 15% of the excess profits of 800u) and 16u on the SBIE portion of financial accounting income (i.e., 8% of SBIE of 200u).

> of 7u, reflecting the fact that the Jurisdictional Top-up Tax under Article 5.2 of the Model Rules is 7u.[147]

In this case, the imposition of a QDMTT by country *C* is insufficient to fully offset the Top-up Tax imposed by country *A* or country *B*. The tax imposed in country *B* on *FSub-C*'s country *C* income is a Top-up Tax because it follows the determination of a Top-up Tax under Article 5.2. However, it is not a Qualified Top-up Tax because it allocates the Top-up Tax to itself and does not cede taxing jurisdiction with respect to the Top-up Tax to the *UPE*'s jurisdiction *A*. Country *A* can allocate 7u of Top-up Tax with respect to the Excess Profits of *FSub-C* under its own Qualified IIR (in the same amount as determined by FSub-B) under Articles 2.1.1 and 2.1.3. Under its Qualified IIR, it does not have to offset it by the Top-up Tax allocated by country *B* to *FSub-B* under its non-Qualified IIR.

However, as a non-Qualified Top-up Tax, country *B*'s Top-up Tax may qualify as a Covered Tax. In that case, if is part of a CFC Regime, country *B*'s Top-up Tax should be pushed down to *FSub-C* for the reasons explained above in Part IV.A.3.b in connection with the concept of a CFC-MTT. If that is not the case, the non-IRR Top-up Tax should be treated as an Adjusted Covered Tax of the *FSub-B* for the reasons described in Part III.B.2 in connection with excess Covered Taxes relating to passive income of a CFC-CE.

2. Considerations for a U.S. QDMTT

The Greenbook proposes to replace the BEAT with a Qualified UTPR, but also announces the intent to introduce a QDMTT:

> When another jurisdiction adopts a UTPR, the proposal also includes a domestic minimum top-up tax that would protect U.S. revenues from the imposition of UTPR by other countries.[148]

As Example 10 above showed, a QDMTT's function is not only to reduce Top-up Tax to be allocated under a UTPR, but equally to reduce Top-up Tax allocated under any IIR. The only scenario where IIR cannot apply is where the entity that is subject to the QDMTT is the UPE itself or another CE in the same jurisdiction as the UPE. A QDMTT offsets GloBE Tax, however allocated among CEs. It does not reduce the tax burden of an MNE Group as such, but ensures that a Top-up Tax otherwise collected by member CEs of the MNE Group located in other jurisdictions is domesticated. A U.S. QDMTT, in other words, increases U.S. tax revenue if U.S. corporate income tax results in an ETR below the Minimum Rate.

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147 The Top-up Tax Percentage is 7.5% (15% minus 7.5%, i.e., 80u/1067u). The Top-up Tax with respect to FSub-C is therefore 7u, i.e. 63u (7.5% of 1067u – 227u) reduced by FSub-C's QDMTT amount of 56u.

148 Greenbook at p. 6.

However, a QDMTT applies only to domestic income. More specifically, to qualify as a QDMTT, a domestic minimum Top-up Tax must satisfy two conditions. First, it must be imposed on the combined Excess Profit of all CEs in the jurisdiction imposing the QDMTT.[149] Thus, all U.S. members of the MNE Group would need to net their respective domestic financial accounting income and losses and reduce it by the domestic SBIE of all U.S. CEs in order to obtain U.S. Excess Profits. Importantly, Excess Profits would have to include the financial accounting income and SBIE of U.S. branches and permanent establishments of a foreign member of the MNE Group[150] as well the income of certain Flow-Through Entities and Hybrid Entities that are CEs.[151]

Second, a QDMTT must apply with respect to each Fiscal Year. The question thus arises whether a credit can be given for QDMTT paid in another year if the ETR in the United States for any subsequent (or preceding) Fiscal Year exceeds the Minimum Rate. The Model Rules do not expressly contemplate carryforwards (or carrybacks) of QDMTT to years where the ETR, based on the U.S. corporate income tax, exceeds the Minimum Tax. For example, if in year 1 a QDMTT of $10 were imposed because the U.S. corporate income tax liability produces an ETR below the Minimum Rate and there is Excess Profit, but in year 2 the U.S. corporate income tax produces an ETR above the Minimum Rate, could, under the Model Rules, the prior-year QDMTT be credited against the U.S. corporate income tax liability in excess of the amount reflected in U.S. tax liability at the Minimum Rate? This is not clear under the Model Rules.

Like a Qualified IIR or a Qualified UTPR, a Qualified Domestic Minimum Top-up Tax requires that the jurisdiction imposing it "does not provide any benefits related to such rules."[152] This is conceivably broad enough to cover the benefit of a carryforward or carryback, but it is not clear that, as a policy matter, this is the kind of benefit that is contrary to a minimum tax regime. In addition, the requirement that a QDMTT must apply with respect to "each Fiscal Year" may be understood to preclude averaging across accounting periods.

There are arguments to allow for carryforwards of "excess" QDMTT to future Fiscal Years. One reason is that corporate income taxes generally are not imposed with respect to book income of an ultimate parent and therefore may result in bunching of credits or losses relative to book income in a manner that may lead to unfair results. Alternatively, a lack of smoothing may compel MNE Groups to time business decisions, such as investments that generate nonrefundable tax credits, in order to avoid such bunching. We do not see a policy reason to disallow some form of smoothing to address these situations.

Carryforwards of, and credits for, excess QDMTT also level the playing field between jurisdictions that impose corporate income tax at a higher rate and those that impose such a tax at

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149 *See* Part III.A.3, above.

150 "Member" would include any CE, i.e., any other branch or permanent establishment. The Model Rules refer to a "Main Entity" to determine the owner. A Main Entity is the entity that includes the net income or loss of the permanent establishment in its financial statement.

151 *See* Part III.B.3, above.

152 Art. 10.1.1 (definition of "Qualified Domestic Minimum Top-up Tax", clause (c)).

a low or zero rate. In the limit case of a no-income-tax jurisdiction, QDMTT averaging occurs by default and no credit is necessary unless SBIE were to exceed GloBE Income, or there are GloBE Loss years. For jurisdictions that impose income tax at a low rate, the ETR should generally not exceed the Minimum Rate, unless there are very substantial distortions between the income tax base and GloBE Income (or, as with no-tax jurisdictions, SBIE exceeds GloBE Income or there is a GloBE Loss). For jurisdictions with a corporate income tax rate close to or above the Minimum Rate, by contrast, a CE's QDMTT position is more likely to oscillate over time on account of relatively minor distortions resulting from, e.g., nonrefundable tax credits or differences in determining taxable income on the one hand and GloBE Income on the other.

Example 11 *USCo* is the sole U.S. CE of an MNE Group, and the United States has adopted a QDMTT. The following table describes *USCo's* relevant U.S. and GloBE Tax items, and it is assumed that *USCo* reduces its U.S. tax liability through the use of tax credits.

USCo	***FY 1***	***FY 2***	***Combined***
Taxable Income	$ 1,000.00	1,000.00	$ 2,000.00
U.S. Tax Liability	$ 180.00	$200.00	$ 380.00
Net GloBE Income	$ 1,400.00	$ 1,250.00	$ 2,650.00
SBIE	$ 200.00	$ 250.00	$ 450.00

The resulting ETR, Top-up Tax Percentage, QDMTT and Top-up Tax without a QDMTT carryforward are as follows:

ETR	12.86%	16.00%	14.34%
Top-up Tax Percentage	2.14%	n/a	0.66%
Excess Profits	$ 1,200.00	$ 1,000.00	$ 2,200.00
QDMTT	$ 25.71	$ 0.00	$ 14.52
Top-up Tax	$ 0.00	$ 0.00	n/a

If smoothing over Fiscal Years were permitted through QDMTT carryforwards, various approaches are conceivable. The four obvious ones are:

(1) *Excess from Multi-Period Aggregating*: Adjusted Covered Taxes, GloBE Income (Loss) and SBIE are aggregated over several Fiscal Years (two years in Example 11, but longer periods are probably more sensible), and ETR, Top-up Tax Percentage and QDMTT are determined based on the aggregated figures. To the extent that the carryforward of previously paid,

and not previously refunded, QDMTT exceeds the QDMTT determined based on the aggregate amounts, it is refunded. In the above example, $11.19 would be refunded. Note that in this approach the ETR and the Top-up Percentage are weighted by the Net GloBE Income of each Fiscal Year and not simply averaged.

(2) *Excess Over ETR*: Adjusted Covered Taxes in the subsequent Fiscal Year are reduced to the extent that, after the reduction, the U.S. tax liability does not result in the ETR below the Minimum Rate. In the above example, a U.S. tax liability (i.e., Adjusted Covered Taxes) of $187.50 results in an ETR of 15%. The excess of the mainstream corporate income tax liability of $200 over this floor amount, i.e., $12.50, would be refunded to *USCo* as excess QDMTT.

(3) *Excess Over Top-up Tax Percentage*: In this case, the refund is determined by the excess of the ETR over the Minimum Rate multiplied by the Excess Profit. In Fiscal Year 2, the ETR exceeds the Minimum Rate by 1%, so after taking into account the SBIE the Adjusted Covered Taxes of *USCo* could be reduced by $10.00 without giving rise to Top-up Taxes. Note that for this approach, the haircut in the tax credit on account of the SBIE remains $40, i.e., it is based on the U.S. tax liability without regard to the refund of QDMTT.[153] We believe that this is the correct approach because it refunds QDMTT only to the extent that Top-up Tax is overpaid, not to the extent that the income tax may be reduced, as the Excess over ETR approach.

(4) *Crediting Against QDMTT Only*. Excess QDMTT is determined under one of the three methods above. Excess QDMTT is credited to an Excess QDMTT Account, but it is never refunded against corporate income tax. Instead, if in a future Fiscal Year USCo is liable for QDMTT, the amount of QDMTT that would be payable based solely on that Fiscal Year is reduced (but not below zero) to the extent of the Excess QDMTT Account. The Excess QDMTT Account is then reduced by the amount of the reduction in the QDMTT that *USCo* is liable to pay. We believe that such an approach may be punitive where QDMTT is the result of timing differences, such as the one discussed at the end of part IV.D below.

A QDMTT carryforward is easily administrable. So long as credits are allowed only against income taxes or QDMTT imposed by the same jurisdiction as the one that imposes the QDMTT, and only subject to one of the limitations described above, it is certain that the minimum tax at the Minimum Rate is paid. Credit carryforwards, in other words, even out the administratively necessary determination of the QDMTT based on the arbitrary temporal cut-offs that demarcate Fiscal Years. Future commentary by the International Framework or implementation rules for the QDMTT should expressly allow for this.

3. The QDMTT and the Substance-Based Income Exclusion

Whether a Jurisdictional Top-up Tax applies is not determined solely by reference to the Minimum Rate, but also by reference to the SBIE, i.e., the Jurisdictional Top-up Tax is calculated

153 *See* Appendix I below regarding the reduction in tax credits on account of the SBIE.

as the Top-up Tax Percentage, multiplied by the jurisdictional Excess Profit, i.e., is the excess of the Net GloBE Income (if any) over the SBIE. The SBIE equals 5% of certain eligible payroll expenses plus 5% of the carrying value of certain eligible tangible assets. Payroll expenses are eligible only if they are incurred for Eligible Employees that perform activities for the MNE Group in the jurisdiction of the CE, and tangible assets are likewise eligible if they are located in the jurisdiction of the CE.[154]

> ***Example 12*** *CE*, the only member of an MNE Group located in country *A*, has GloBE Income of $1,000 and pays Adjusted Covered Taxes of $60. Accordingly, its Top-up Tax Percentage in *A* is 9% (0.15 minus $60/$1,000 (0.06)). Assume that *CE*'s eligible tangible assets located in country *A* have a carrying value of $8,000 and *CE's* eligible payroll expenses with respect to country *A* are $4,000. *CE*'s SBIE is accordingly $400 (5% of $8,000) plus $200 (5% of 4,000), or $600. Assuming no Additional Current Top-up Tax and no Domestic Minimum Top-up Tax, the country *A* Jurisdictional Top-up Tax with respect to *CE* is $36 (9% of the excess of $1000 of GloBE Income over $600 of SBIE). Assuming this tax is collected through a GloBE Tax, *CE*'s $1,000 of GloBE Income is subject to tax at a blended rate of 9.6% for a total tax of $96.[155]

As a result of the exclusion of the SBIE from the tax base for the Top-up Tax, it is only the Excess Profit that is required to be subject to the Minimum Tax of 15%. *CE*'s $96 of tax is in effect composed of Excess Profits of $400 subject to the Minimum Rate (ETR of 6% plus Jurisdictional Top up Tax of 9%) for $60 of total tax, while the SBIE amount of $600 is subject to tax only at the ETR of 6% (i.e., $36).

> ***Example 13*** The facts are the same as in Example 12, except that *CE* is located in country *B*, which is a no-tax jurisdiction, and *CE*'s ETR is 0%. In this case, the country *B* Jurisdictional Top-up Tax Percentage is 15% and the country *B* Jurisdictional Top-up Tax is $60 (15% of $400). *CE*'s GloBE Income is subject to combined local Covered Tax and Jurisdictional Top up Tax of $60.

Pillar Two in other words is not a Minimum Tax on GloBE Income, but a Minimum Tax on GloBE Excess Profits. If this is the case, however, it is questionable whether the Top-up Tax Rate should be determined by reference to Net GloBE Income in the first place, rather than the excess of Net GloBE Income over the SBIE. In Example 12, if the ETR were determined as the amount of Adjusted Covered Taxes divided by the excess of the Net GloBE Income over SBIE, it would equal 15% ($60/$400). The ETR equals the Minimum Rate, and no Top up Tax would be imposed. The MNE Group would not be disadvantaged, in other words, by locating the CE in a higher tax jurisdiction.

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[154] Art. 5.3.3 and 5.3.4.

[155] This example and the next example ignore the phase-in. *See* Art. 9.2.

The calculation has consequences for a QDMTT as well. If in Example 12 country *A* imposed a QDMTT to avoid the possibility that another jurisdiction collected taxes in respect of *CE*'s GloBE Income, it would have to be imposed at the country *A* Jurisdictional Top-up Tax Percentage with respect to the Excess Profits of CE. Country *A* would have to collect an additional $36 of QDMTT for a total of $96 of taxes to avoid having Jurisdictional Top-up Tax allocated to the UPE in another jurisdiction. Country *B*, by contrast, would have to impose more QDMTT to achieve the same objective, but its total tax collection with respect to *CE* would be $60, not $96. All else being equal, then, the MNE Group would be incentivized to locate subsidiary CEs or permanent establishment CEs that will generate any SBIE in low tax jurisdictions, as this would minimize the total taxes paid with respect to *CE*'s GloBE Income within the MNE Group. The same would apply for the UPE itself.

Conversely, countries that consider the imposition of a QDMTT may at the same time reduce the rate at which they impose corporate income tax. As the Pillar Two project arose to counter a perceived "race to the bottom" it may instead replace mainstream corporate income tax with a QDMTT imposed on Excess Profits at the Minimum Rate.[156]

C. Foreign Tax Credit Issues

1. Top-up Tax and Creditable Foreign Taxes

This Part IV.C addresses whether and to what extent a Top-up Tax allocated under an IIR or UTPR, or (non-U.S.) QDMTT should be included among creditable foreign taxes for purposes of Sections 901 and 960.

a. Qualified IIR imposed by another jurisdiction

Where a U.S. domestic corporation is a CE of an MNE Group, the issue whether an IIR is a creditable foreign tax arises only where the U.S. CFC Shareholder CE is an upper-tier CE and the IIR is imposed on a foreign IPE or POPE that is a CFC-CE. Otherwise, an IIR would not be imposed on a CFC-CE of a U.S. CFC Shareholder CE (including a domestic UPE).

If the GILTI Regime (with modifications) is accepted as a Qualified IIR by the Inclusive Framework, then U.S. taxes under IIR-GILTI would have to be reduced by any Top-up Taxes allocated to CEs in another jurisdiction. This arises principally in two situations: (a) where the U.S. CE is a member of a foreign-parented MNE Group and the U.S. CE is a subsidiary of at least one foreign CE in a jurisdiction that imposes a Qualified IIR; and (b) where the U.S. CE is the UPE (or other top-most IPE that is subject to a Qualified IIR) and at least one foreign subsidiary that is a CFC-CE is a POPE.

156 *See* Michael Devereux *et al.*, *Pillar 2: Rule Order, Incentives, and Tax Competition*, Oxford University Centre for Business Taxation Policy Brief (Jan. 14, 2022) (arguing that the QDMTT "moves 'source' countries to the head of the queue to collect the top-up tax generated by Pillar [Two]").

Example 14 *FP* is a foreign UPE of an MNE Group, *USCo* is a wholly owned U.S. subsidiary of *FP* and *FSub* is a wholly owned subsidiary of *USCo*. *FP* is tax resident in country *A*, which is an IIR Jurisdiction, and *FSub* is tax resident in country *B*, which has not adopted a QDMTT. *FSub* has $100 of GloBE Income and pays $10 of Adjusted Covered Taxes, and its SBIE is $10. *FSub* has tested income of $90 and NDTIR of $3.

In this case, IIR-GILTI should not apply, as country *A*'s IIR takes precedence. The Top-up Tax with respect to *FSub* is $4.5, i.e., the Top-up Tax Percentage of 5% (15% minus $10/$100) of the Excess Profits of $90 ($100 of Net GloBE Income less $10 of SBIE). Residual U.S. tax imposed in respect of the GILTI inclusion (assuming no other subsidiaries) under the modification to GILTI proposed by the BBBA and the Greenbook would amount to approximately $8.2 (approximately $17.4 of tax on GILTI of $87 ($90 less $3 of NDTIR) less 28.5% of Section 250 deduction, subject to a U.S. tax rate of 28%, and reduced by a foreign tax credit of $9.2 (95% of $10 times an inclusion percentage of 87/90)). Under the hierarchy of taxes, IIR-GILTI may not be imposed with respect to *FSub*, the Low-Taxed CFC-CE. Country *A* does not give a credit for IIR-GILTI against country *A* Top-up Tax allocated to *FP* under the IIR, but preempts the imposition of IIR-GILTI tax. In other words, the additional $3.7 of tax by which IIR-GILTI exceeds the country *A* Qualified IIR would fall away in its entirety.

By contrast, if GILTI (however modified) remained as a CFC Regime, then $8.2 of residual U.S. tax would be imposed on *USCo* in respect of the *FSub* GILTI inclusion. Because the GILTI tax is allocated back to *FSub*, it reduces the Top-up Tax. A tax credit for the IIR would be circular,[157] and in any event not consistent with the IIR being a Top-up Tax applied after the sum of all other taxes falls short of the Minimum Rate.[158] Within an MNE Group, taxes imposed under a Qualified IIR should not give rise to a creditable foreign tax.[159]

However, not allowing a foreign tax credit for an IIR Top-up Tax may in some cases lead to double taxation, for example, where a minority owner outside of the MNE Group owns an interest in a CFC subject to an IIR with respect to the minority owner's share of the CFC's income. Consider the following example:

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157 The term "circular" is not used in its strict logical or mathematical sense. It is beyond our scope to determine whether there is a computable solution for each case of this mutual dependence of IIR and GILTI tax. In any event, it would be highly unusual to have to engage in such a calculation to determine tax liability in a multi-jurisdictional setting.

158 Or at best it would require a complex set of simultaneous equations that would have to be applied in the same manner by each of the foreign jurisdictions and the United States, and for that matter by the foreign jurisdictions imposing an IIR and the jurisdictions with a CFC regime. There is no indication in the Model Rules that would implicate this level of coordination between tax systems.

159 This is confirmed by Commentary to Art. 4, ¶45 (p. 96).

Example 15 *F-POPE* is a country *A* POPE of a foreign UPE (*F-UPE*), which owns 79% of the stock of *F-POPE* by vote and value. A domestic corporation (*USCo*) owns the remaining stock of *F-POPE*. *F-POPE* has a country *B* foreign subsidiary (*FSub*) and a domestic subsidiary (*USSub*). *FSub* thus is a CFC, and *USCo* will be required to include *FSub*'s subpart F income and tested income, and will be allowed to claim a credit under Section 960(d) for foreign income taxes paid by *FSub*, subject to applicable limitations. *FSub* is not subject to any income tax under country *B*'s tax system, and country *B* does not impose a QDMTT. Country *A* imposes a Qualified IIR so that *F-POPE* is liable for Top-up Tax under the IIR with respect to *FSub*.[160]

USCo's pro rata share of the tested income as well as subpart F income of *FSub* is subject to the IIR imposed on *F-POPE*, as *F-POPE* is required to include the entire Top-up Tax of *FSub* (except for differences in the tax base between subpart F and GloBE Income).[161] If *USCo* is not able to claim a tax credit for the Top-up Tax paid by *F-POPE* in respect of *FSub's* income, *USCo*'s share of *FSub*'s income is subject to double taxation. Any U.S. taxes imposed on *USCo* in respect of its share of *FSub's* income will not be allocated to *FSub* as the allocation rule applies only as between CEs, and *USCo* is not included as a member in the MNE Group that includes *F-POPE*, *FSub* and *USSub*.[162] This strongly supports the conclusion that the pro rata share of any Top-up Tax imposed on an MNE Group should be a creditable foreign tax for United States shareholders that are not CE's and that include, under subpart F of the Code, income of the CE with respect to whose GloBE Income the Top-up Tax is imposed.

A complicating feature is that the entity liable for the Top-up Tax under the IIR, *F-POPE*, is not itself a CFC as to which *USCo* is a United States shareholder. If GILTI is imposed on a country-by-country basis, a reallocation of an IIR is generally necessary to ensure that the Top-up Tax is properly associated with the income on which is was imposed. Rules for the reattribution of Top-up Tax to the entities with respect to which they were imposed are therefore necessary for such an IIR tax credit to work. An allocation may, for example, be made by allocating the total Jurisdictional Top-up Tax in proportion to GloBE Income, along the lines of Article 5.2.4.[163]

It is not necessary for the owner to be a minority owner of a POPE. Taxes imposed with respect to a CFC-CE under a CFC Regime are allocated to the CFC-CE under Article 4.3.2(c) only if the taxes are imposed on another CE of the same MNE Group. If a non-CE owner of the CFC-CE is subject to a CFC Regime with respect to the CFC-CE, however, taxes imposed under the CFC Regime applicable to the non-CE owner will not be pushed down to the CFC-CE. This could

160 *See* also Example 2.3.2-1, Examples pp. 13f.

161 *See* Art. 2.2 (Allocation of Top-up Tax under the IIR).

162 *See* Art. 4.3.2(c).

163 Article 5.2.4 does not itself provide that such a reallocation could be made, i.e., it only allocates the total liability for a Top-up Tax among entities in the jurisdiction that imposes the Top-up Tax.

result in double taxation in the following situation, where all relevant entities are treated as corporations for U.S. tax purposes.

> ***Example 16*** Each of *USP1* and *USP2* owns 49% of the single class of stock of *FSub*, and individual A owns the remaining stock. *USP1*, *USP2* and *A* are unrelated, i.e., *USP1* and *USP2* are not included in the same Consolidated Financial Statement. In addition, neither *USP1* nor *USP2* is included in the same Consolidated Financial Statement as *FSub*; rather *FSub* is the *UPE* of a separate MNE Group. *FSub* is tax resident in a jurisdiction with a Qualified IIR and has one or more wholly owned subsidiaries that are Low-Taxed CEs and that are also CFCs with respect to *USP1* and *USP2*.

Each of *USP1* and *USP2* is required to include in income its proportionate share of the tested income and subpart F income of *FSub* and its subsidiaries. However, the U.S. tax imposed in respect of these inclusions would not be allocated back to *FSub* or its subsidiaries. Any Top-up Tax allocated to *FSub* in respect of its Low-Taxed CEs under a Qualified IIR would therefore in effect result in double taxation to the extent that *USP1* and *USP2* pay tax under the Section 951 of Section 951A in respect of the income of Low-Taxed CEs.

Whether Top-up Tax under a Qualified IIR is creditable against inclusions under Section 951 or Section 951A should therefore depend on whether the United States shareholder is a member of the MNE Group or not. If the United States shareholder is a member of the MNE Group, its U.S. tax in respect of these inclusions is allocated to the CE in respect of which it is imposed. The Top-up Tax is then determined, and under the IIR allocated to a POPE, IPE or UPE, only after this reallocation. Thus, no credit should, and without circularity could, be allowed for Top-up Tax under the IIR. By contrast, if the United States shareholder is not a member of the MNE Group, its U.S. tax in respect of its inclusions of income of Low-Taxed CFC-CEs is not allocated back to the Low-Taxed CFC-CEs in respect of which it is imposed, and the Top-up Tax under the IIR is imposed regardless of whether and how much the United States shareholder is taxed on its pro rata share of the Low-Taxed CFC-CEs income under the GILTI or subpart F Regimes. We believe that there is a strong argument that, in order to avoid double taxation of all or part of the Low-Taxed CFC-CE's income, a non-CE United States shareholder should be allowed a foreign tax credit for any properly allocated IIR Top-up Tax. [164]

The same result could be achieved by expanding an allocation of taxes imposed under a CFC Regime from a non-CE shareholder back to the relevant Low-Taxed CFC-CE under the Model Rules. This may be administratively more difficult, however, and requires changes to the Model Rules by the Inclusive Framework.

[164] Here, too, the Top-up Tax could be allocated to a CE based on the formula provided in Article 5.2.4, which pro-rates the Jurisdictional Top-up Tax in proportion to the CEs' GloBE Income.

b. Qualified UTPR imposed in respect of a Low-Taxed CFC-CE

UTPR is likewise imposed only if a CE's ETR is less than the GloBE Minimum Rate (and it has Excess Profits). The Jurisdictional ETR of any CE reflects the allocation of the U.S. tax liability relating to each foreign CFC-CE's GILTI or subpart F income from each of its U.S. CFC Shareholder CEs. For a U.S. CFC Shareholder CE of the MNE Group, Top-up Tax allocated to a CFC-CE under the UTPR should therefore likewise not be creditable as the creditability would otherwise be "circular", i.e., to the extent the UTPR Top-up Tax increases foreign tax credits it reduces the U.S. tax liability, thereby in effect increasing the UTPR, etc. For the reasons explained above, crediting UTPR Top-up Tax is also contrary to its role as a final Top-up Tax.[165]

As under the IIR, however, under the UTPR there could be double taxation if the MNE Group has a minority shareholder that is a United States shareholder.

> ***Example 17*** Each of *USP1* and *USP2* owns 49% of the single class of stock of *F-UPE*, and individual A owns the remaining stock. *USP1*, *USP2* and *A* are unrelated, i.e., *USP1* and *USP2* are not included in the same Consolidated Financial Statement. In addition, neither *USP1* nor *USP2* is included in the same Consolidated Financial Statement as *F-UPE*; rather *F-UPE* is the *UPE* of a separate MNE Group. *F-UPE* is tax resident in a jurisdiction without a Qualified IIR, UTPR, and QDMTT, and has three directly wholly owned subsidiaries *FSub1*, *FSub2* (both foreign) and *USSub* (domestic). *FSub1* is resident in a jurisdiction that imposes a UTPR. *FSub2*, like *F-UPE*, is resident in jurisdiction that that has not adopted GloBE Rules or a QDMTT. Each of *F-UPE* and *FSub2* is Low-Taxed CEs and CFCs with respect to *USP1* and *USP2*.

Any U.S. tax imposed on *USP1* or *USP2* with respect to inclusions from *F-UPE* and *FSub2* under Section 951 or Section 951A is not allocated back to *F-UPE* or *FSub2*. Thus, *FSub1* will be liable for UTPR in its country of tax residence, and so would *USSub* if the United States adopted a UTPR. So long as there are sufficient deductible items or other equivalent adjustments available for them, the Excess Profits of each of *F-UPE* and *FSub2* will be subject to tax at the Minimum Rate, albeit at least in part in the hands of other members of the MNE Group through the UTPR.

The Top-up Tax payments by *FSub1* under its UTPR, however, are not creditable foreign taxes if Top-up Taxes are not creditable as such, with the result that the same income will be subject to tax (at least in part) both under the GILTI Regime or the subpart F Regime and under the UTPR. If the United States adopted a UTPR, then for at least a portion of the Excess Profits of *F-UPE* and *FSub2*, the United States itself would collect taxes twice, once under the UTPR from a member of the MNE Group (*USSub*) and a second time from the non-member United States shareholders (*USP1* and *USP2*).

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165 *See also* footnote 159, above.

The burden of double taxation would be greatest if the low-tax jurisdiction imposed no income tax at all. In that case, the full amount of the income in the low-tax jurisdiction is subject to both Top-up Tax under the UTPR Top-up Tax and U.S. tax under the U.S. CFC Regime, subject only to differences in the tax base, i.e., between Excess Profits on the one hand and GILTI and subpart F income on the other.

There is no discernible policy reason under the GloBE Rules or under the GILTI Regime and subpart F Regime for double taxation in this fact pattern. Accordingly, Top-up Tax allocated under the UTPR should be creditable to the extent that a non-MNE Group member entity is required to include in its income the income of any MNE Group member that has been subject to a Top-up Tax within the MNE Group, even though such Top-up Tax is not creditable within the MNE Group itself.

2. QDMTT as a Creditable Foreign Income Tax

While also a Top-up Tax, the QDMTT rules operate differently from the IIR and the UTPR. Unlike the Jurisdictional Top-up Tax, a QDMTT in respect of a CE is not calculated after first determining *all* Covered Taxes to be allocated to it. Rather, any taxes imposed on a shareholder of a CFC-CE under a CFC Regime with respect to its share of the income of the CFC-CE is not allocated down to the CFC-CE before determining the QDMTT imposed on that CFC-CE.

As defined in Article 10.1 of the Model Rules, a QDMTT "operates to increase *domestic* tax liability with respect to *domestic* Excess Profits to the Minimum Rate *for the jurisdiction* and Constituent Entities" (emphasis added). Thus, as a technical matter under the Model Rules, because it is designed to increase the domestic tax liability and not the overall tax liability, a foreign tax liability like that imposed under a CFC Regime does not factor into calculating the QDMTT.[166]

A foreign jurisdiction's imposition of a QDMTT therefore functions in a similar manner to an additional foreign income tax, i.e., it is a domestic minimum tax and not a final Top-up Tax calculated post-Adjusted Covered Taxes. The Model Rules, however, treat a QDMTT at least nominally as a type of Top-up Tax and not as an income tax (i.e., a Covered Tax). But unlike a Jurisdictional Top-up Tax, it is not a genuine Top-up Tax under the Model Rules because its imposition is not in lieu of Jurisdictional Top-up Tax subject to the IIR or the UTPR. A QDMTT does not *ipso facto* preclude their imposition. QDMTT is subtracted from the Jurisdictional Top-up Tax amount, i.e., credited against it, in the same manner in which the Top-up Tax Rate is determined after crediting the Adjusted Covered Taxes against the amount of taxes that would be

166 While we believe that the Model Rules are clear, we are aware of ongoing policy discussions. *See* Stephanie Soong Johnston, "Pillar 2 and CFC Tax Credit Issue Needs Work, U.K. Official Says", 106 *Tax Notes Int'l* 947 (May 16, 2022) (Quoting a U.K. official as addressing the question of QDMTT creditability and a U.S. official as stating that "the ordering priority between a CFC tax regime and a QDMTT is still being debated, with no clear answer yet"). For a detailed discussion of the interrelationship between QDMTT and CFC taxes, see Heydon Wardell-Burrus, "Should CFC Regimes Grant a Tax Credit For Qualified Domestic Minimum Top-up Taxes?", 106 *Tax Notes Int'l* 1649 (June 27, 2022).

imposed if the Minimum Rate applied to the Excess Profits. The difference is that the Top-up Tax Percentage is determined without the SBIE, which in effect amounts to a "haircut" with respect to Adjusted Covered Taxes equal to the portion of the Net GloBE Income that constitutes SBIE,[167] while the QDMTT is not subject to a haircut. But that is so because the QDMTT is in the first place determined only with respect to Excess Profits in any event.[168]

This is not merely a difference in mechanism, i.e., preemption in the case of IIRs (between various Entities of an MNE Group) and UTPR, and an actual reduction of Top-up Taxes to zero if QDMTT is credited. Imposition of a jurisdictional QDMTT does not necessarily do that. Rather "a Parent Entity with an Ownership Interest in what would otherwise be a [Low-Taxed CE] *generally* will not have any liability under the IIR if that Constituent Entity is subject to a [QDMTT] *that imposes the same amount of tax that would otherwise arise under the IIR*."[169]

Whether, and to what extent, a QDMTT reduces an IIR (or UTPR for that matter) is a factual question that depends on the amount of QDMTT imposed, and not the fact that any QDMTT is imposed. The principal reason is that the QDMTT may be determined by local accounting standards and is not required to be determined using the accounting standard under which the Consolidated Financial Statements of the UPE are prepared.[170] This may, conversely, also result in a QDMTT in excess of the Top-up Tax that would be imposed under the relevant IIR absent the QDMTT.[171] Another reason is that local accounting standards may calculate the SBIE differently.

Not allowing a foreign tax credit for QDMTT would in this case result in a substantial risk of double taxation of foreign income of a CFC.[172] The QDMTT is a tax that is determined before any push-down allocation of Covered Taxes imposed on an owner of a CE under a CFC Regime. Within the architecture of the Model Rules, a CFC Regime is in effect subordinate to a QDMTT.

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167 *See* Appendix I.

168 The Commentary reflects that the QDMTT is a credit against Top-up Tax, not a substitute. *See* Commentary to Art. 5, ¶20 p. 118 (QDMTT taken into account "so as to give full credit in the GloBE Top-up Tax computation").

169 Commentary to Art. 10, ¶115 p. 212. (emphasis added).

170 Art. 10.1.1 provides in the flush language to the definition of "Qualified Domestic Minimum Top-up Tax" that a QDMTT "may compute domestic Excess Profits based on an Acceptable Financial Accounting Standard permitted by the Authorised Accounting Body or an Authorised Financial Accounting Standard adjusted to prevent any Material Competitive Distortions, rather than the financial accounting standard used in the Consolidated Financial Statements."

171 The Pillar Two Model Rules do not currently envisage a carryforward of such overpayments.

172 Whether a domestic tax qualifies as a QDMTT will not raise classification issues, as the GloBE Implementation Framework will determine whether a minimum tax is considered a QDMTT and publicly release this information. *See* Commentary to Art. 10, ¶118 p. 212. The scope of taxes for which a foreign tax credit is allowed could therefore be easily expanded by expressly referencing the future list to be published by the OECD/GloBE Implementation Framework.

D. GloBE Income and U.S. Tax Incentives

If the United States provides tax incentives to a taxpayer, the benefit to domestic CEs may be (partially) reversed if the benefits reduce the ETR of the domestic CEs of an MNE Group below the Minimum Tax. If the benefit comes in the form of a tax credit, the incentives generally should reduce Adjusted Covered Taxes, dollar-for-dollar, without reducing GloBE Income. This generally creates the risk that U.S. domestic CEs could turn into Low-Taxed CEs by reducing the numerator of the ETR. Similarly, if the benefit comes in the form of a deduction for tax but not book purposes, e.g., for FDII under Section 250(a)(1)(A), Adjusted Covered Taxes are reduced but not the GloBE Income. If the benefit comes in the form of tax-exempt income, by contrast, the risk of turning the domestic CE's into Low-Taxed CEs results from an increased denominator of the ETR, i.e., the fact that GloBE Income is increased without a corresponding increase in Adjusted Covered Taxes.

Generally, any resulting jurisdictional Top-up Tax would accrue to non-U.S. jurisdictions. For an MNE Group as a whole, this may neutralize the benefits of the tax incentives, but generally only in part, unless the U.S. ETR absent the tax incentives is exactly at the Minimum Rate. It thus blunts the benefits, or would in general limit the extent to which domestic groups that are part of an MNE Group within the scope of the GloBE Rules may be able to participate in such benefits. Domestic entities that are not members in such an MNE Group, by contrast, will not face such a limit.

There are two factors, however, that counteract the loss of benefits as an economic matter: first, the headline U.S. corporate income tax rate is currently at 140% of the Minimum Rate, which leaves room for tax benefit items. The extent of this is impossible to calculate in general, however, because U.S. taxable income on the one hand and GloBE Income on the other are not congruent. If the headline U.S. corporate tax rate were to be increased to 28% as proposed by the Greenbook, or approximately 187% of the Minimum Rate, the effect would be even larger. Second, U.S. Top-up Tax is imposed not on GloBE Income but on Excess Profits, i.e., GloBE Income reduced by SBIE. This in effect allows for Top-up Tax-free GloBE Income in an amount equal to 5% of Eligible Payroll Costs and Eligible Tangible Assets for U.S. employees and independent contractors and U.S. assets.

Tax incentives in the Code in the form of tax credits, such as the investment tax credit or production credits, should not be Qualified Refundable Tax Credits. A "<u>Qualified Refundable Credit</u>" is a refundable tax credit required to be paid by the government in cash or cash equivalents within four years from the time when the CE satisfies the conditions for the credit. It is added back to Adjusted Covered Taxes,[173] but is treated as an item of income in determining GloBE Income or Loss.[174] In other words, instead of reducing dollar-for-dollar the numerator of the ETR

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[173] Art. 4.1.2(d).

[174] Art. 3.2.4.

calculation, it increases the denominator and is thus in effect treated as tax-exempt income. This reduces the ETR proportionally less.

Some tax credits granted under the Code result in a corresponding reduction in tax basis.[175] In this case, the amount of the credit indirectly gives rise to income by reducing deductions for depreciation and increasing gains on any future disposition. This future gain, however, is speculative and may never crystallize and any increased income (or reduced loss) is not bound to be realized within the five-year period during which deferred tax liabilities are otherwise required to be recaptured in order to be reflected as an item of Covered Tax in determining Adjusted Covered Taxes.[176] Nonetheless, this is an immediate item of loss. Instead of reducing Adjusted Covered Taxes, the reduction in tax basis could be treated along the lines of an asset sale and give rise to a loss equal to the reduced basis. It would then reduce GloBE Income and mitigate the effect of the immediate reduction of Covered Taxes on account of the tax credit.

A third type of tax incentive, by contrast, accelerated depreciation such as, e.g., bonus depreciation, should in general not affect the ETR calculation.

The Model Rules require that Adjusted Covered Taxes be increased for a Fiscal Year by the "Total Deferred Tax Adjustment Amount." This is intended to adjust for timing differences that result from such accelerated deductions, as a result of which the current U.S. federal taxable income (and, therefore, U.S. tax liability) is reduced without a corresponding reduction of book income and, therefore, GloBE Income. As a timing difference, this creates a deferred tax liability and should increase Adjusted Covered Taxes (and thus the Effective Tax Rate) as part of the Total Deferred Tax Adjustment Amount.[177] Importantly, this amount should not be subject to a recapture rule to which accelerated deductions with respect to long-lived assets are otherwise subject.[178] Rather, accelerated depreciation such as bonus depreciation should constitute an item of "Recapture Exception Accrual," which in accordance with its label comprises items excepted from the recapture rule. Recapture Exception Accrual includes any "cost recovery allowance on tangible assets."[179] Deductions for research and experimental expenditures under Section 174 should

175 *See* Section 50(c).

176 Art. 4.4.4.

177 Arts. 4.1.1(b) and 4.4.1. If the applicable tax rate is above the 15% Minimum Rate (as would be the case for bonus depreciation), however, the deferred tax liability is recast at the Minimum Rate.

178 Art. 4.4.4 (deferred tax liability not paid within the five subsequent Fiscal Years to be recaptured). Resulting deferred tax liabilities, to the extent that they are not paid within the five subsequent Fiscal Years, are "recaptured" as follows: Covered Taxes for the original Fiscal Year when the deferred tax liability arose are reduced by the unpaid amount, and the ETR and Top-Up Tax for the original Fiscal Year are recalculated. Any incremental Top-Up Tax otherwise payable in the original Fiscal Year is paid in that fifth subsequent year. Arts. 4.4.1, 4.4.4 and 5.4.1. To the extent any of these recaptured amounts are subsequently paid, Adjusted Covered Taxes in the year of payment are increased. Art. 4.4.2(b).

179 Art. 4.4.5(a).

likewise give rise to a Recapture Exception Accrual, as it includes "research and development expenses."[180]

The Recapture Exception Accrual thus is a mechanism built into the Model Rules that restores, or retains, flexibility for each taxing jurisdiction with respect to certain widespread tax incentives.

Some depreciation or amortization with respect to other assets may not fall under the Recapture Exception Accrual. In light of the Recapture Exception Accrual, the overall effect of timing differences may thus be small.

In some cases, however, the timing differences may be substantial. Consider, for example, an applicable asset acquisition where $1.5 billion of the purchase price is allocated to goodwill and going concern value.[181] The buyer may in this case amortize this intangible on a straight line basis over a 15-year period, i.e., deduct $100 million annually.[182] If goodwill is not similarly amortized for GAAP purposes because the MNE Group is publicly traded or has not made an accounting policy election to amortize goodwill, there may be an immediate excess of GloBE Income over taxable income of $100 million annually for the years in which the goodwill is amortized for tax, but not GAAP, purposes, and a potentially very large excess of taxable income over GloBE Income when goodwill is amortized because of impairment under GAAP.[183] Such a large difference may result in the imposition of some Top-up Tax in the early years of tax amortization and an ETR in the year of impairment that substantially exceeds the Minimum Rate. We cannot discern a policy reason for imposing a Top-up Tax in such case.[184]

E. Excluded Entities and MNE Groups

The GloBE Rules apply only to MNE Groups that have annual revenue of at least EUR 750 million, determined based on the "Consolidated Financial Statements" of the UPE in two of the four Fiscal Years preceding the Fiscal Year for which its ETR is tested.[185] Leaving aside MNE Groups consisting of a single parent entity and one or more Permanent Establishments, the UPE is an entity that owns a Controlling Interest in at least one other entity and is not so owned by any other entity.[186] Entities are part of the MNE Group by reason of being included in the Consolidated

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180 Art. 4.4.5(c).

181 Section 1060, Treas. Reg. §1.1060-1(c)(2).

182 Section 197(a) and (d)(1).

183 *See* Accounting Standards Codification No. 350, *Intangible-Goodwill and Other* (ASC 350) and ASC Subtopic 350-20-35-1 (after adoption of ASU 2017-04).

184 A jurisdiction that adopts a QDMTT may use a QDMTT carryforward and credit mechanism to smooth such deviations between tax and financial accounting that are not otherwise addressed by the GloBE Rules. *See* Part IV.B.2, above.

185 Art. 1.1.1.

186 Art. 1.4.1.

Financial Statements of the UPE.[187] And an entity is a CE (of an MNE Group) if it is included in the MNE Group.

The Model Rules remove certain Excluded Entities from the reach of the GloBE Rules by not treating them as CEs.[188] Excluded Entities are Governmental Entities (described below), international organizations, non-profit organizations, and pension funds, as well as Investment Funds (also described below) and real estate investment vehicles, but only if they are the UPE ("Primary Excluded Entities").[189] In addition, Excluded Entities also comprise (a) entities that are at least 95% owned (by value) by one or more Primary Excluded Entities and hold assets or invest funds for the benefit of Primary Excluded Entities or engage in ancillary activities, and (b) entities that are at least 85% owned (by value) by one or more Primary Excluded Entities and substantially all of their income is from dividends or gains that are excluded from GloBE Income or Loss (together, "Secondary Excluded Entities").[190] Ownership in this case may be indirect, provided that all intermediate entities are Primary or Secondary Excluded Entities.[191] The CE of an MNE Group responsible for filing the GloBE information return may elect not to treat Secondary Excluded Entities as Excluded Entities. This election is not available with respect to Primary Excluded Entities.[192]

The various Primary Excluded Entities are specifically defined under the Model Rules. An entity is an "Investment Fund" if it satisfies the following seven criteria: (1) it is designed to pool financial and/or non-financial assets of at least some unrelated persons; (2) it does so in accordance with an investment policy; (3) it allows investors to reduce investment-related costs or to spread risk; (4) it is primarily designed to produce investment income or gain, or to protect against a particular or general event or outcome; (5) investors have a right to the earnings and/or gains from the fund assets based on their investment in the fund; (6) the entity or its management are subject

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187 Art. 1.2.2.

188 Art. 1.3.3 (not CEs) and Art. 1.1.3 (not subject to GloBE Rules).

189 Art. 1.5.1.

190 Art. 1.5.2(a) and (b). The Primary Excluded Entity for this purpose does not include so-called Pension Services Entities, as defined in the Model Rules. *See* Commentary to Article 1 ¶44, p. 21 for an explanation for this limitation.

191 It is not clear from the definition in Article 1.5.2 and the related Commentary, whether an intermediate entity could be a Pension Services Entity.

192 Art. 1.5.3. For the filing of the GloBE information return, see Art. 8.1.

to a regulatory regime where the entity is established or managed;[193] and (7) the entity is managed by professional investment managers on behalf of the investors.[194]

A "Governmental Entity" is an entity wholly owned by a government and accountable to it (including by way of providing annual information reporting) that has as its principal purpose either (1) fulfilling a government function or (2) managing or investing assets of the government or the jurisdiction through the making and holding of investments, provided it does not "carry on a trade or business."[195] A typical sovereign wealth fund should under this definition be a "Governmental Entity." The Commentary clarified that "holding assets" is intended to limit the activities, i.e., that such assets may not be operated or used in an active trade or business by the entity.[196] Thus, a portfolio company that is majority or wholly owned by an investment vehicle that is wholly owned by a government is not a Governmental Entity.

1. The Consolidation Requirement for MNE Groups

A UPE is not required to be a CE. Any Entity can function as a UPE, provided it has a Controlling Interest in another Entity and no other Entity has a Controlling Interest in it.[197] As a consequence, at least as a technical matter, an Excluded Entity could be a UPE, even if it is not included among the CEs potentially subject to Top-up Tax.[198]

The Blueprint Report, by contrast, defined a UPE as a CE of an MNE Group which "owns directly or indirectly a sufficient interest in one or more other Constituent Entities of such MNE Group such that it is required to prepare Consolidated Financial Statements under accounting principles generally applied in its jurisdiction of tax residence, or would be so required if its equity interests were traded on a public securities exchange in its jurisdiction of tax residence."[199]

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193 The intended regulations are "prudential regulation." Commentary to Art. 10.1, ¶44 at p. 201. Such regulations include "appropriate money laundering and investor protection regulation." It is not clear whether one of, or both, money laundering and investor protection regulations are a necessary condition for being subject to a regulatory regime, or each is a type of prudential regulation that is separately sufficient to meet this criterion. Investment Funds owned by governments (and that are not otherwise governmental entities as defined in the Model Rules) are subject to a less strict requirement, where "regulation may take any form endorsed by the General Government, for example provisions for accountability and review contained in the Investment Fund's constituting legislation," and naturally would not require anti-money laundering regulations. *Id*.

194 Art. 10.1.1 (definition of "Investment Fund").

195 Art. 10.1.1 (definition of "Governmental Entity").

196 Commentary to Art. 1 ¶53, at p. 22.

197 *See* Art. 1.4.1(a) (requiring that UPE is an Entity, but not requiring it to be a CE). See also Art. 1.5.1(e) and (f) which state that an Investment Fund or real estate investment vehicle that is the UPE is an Excluded Entity.

198 Art. 1.1.1. and 1.2.1. The exclusion from the GloBE Rules of Excluded Entities is expressly stated in Article 1.1.3, but also follows from the fact that under Article 1.1.1 the GloBE Rules apply to "Constituent Entities," which under Article 1.3.3 do not include Excluded Entities.

199 Blueprint Report, section 2.2 (definitions box), at p. 24.

Because an Excluded Entity is not a CE, it cannot be a UPE under the Blueprint Report. Accordingly, the Blueprint Report concluded that if an investment entity is an Excluded Entity that does not consolidate the accounts of its investee companies, and such Excluded Entity has separate investments in two subgroups each consisting of a holding company (directly wholly owned by the investment entity) and a wholly owned subsidiary of the holding company, then each subgroup is a separate MNE Group and separately subject to the GloBE revenue threshold for purposes of the GloBE Rules.[200] While the example in the Blueprint Report does not expressly state this, if either of those MNE Groups exceeded the GloBE Threshold, it should be separately treated as subject to the GloBE Rules with the relevant holding company (rather than the investment entity which owns such holding company) as the MNE Group's UPE. In addition, even if the investment entity were required to consolidate each of the holding companies (and their subsidiaries), there would be no single MNE Group with the investment fund as its UPE because it is an Excluded Entity.[201]

The Model Rules, by contrast, require only that a UPE have a Controlling Interest in a subsidiary. This in turn requires an equity or similar interest in the subsidiary such that the UPE either is required to consolidate on a line-by-line basis the assets, liabilities, income, expenses, and cash flows of the subsidiary in accordance with an Acceptable Financial Accounting Standard or *would have been required* to consolidate these items if the UPE had prepared Consolidated Financial Statements.

The counterfactual standard here is not entirely clear. We believe, however, that the intention is that an investment entity that is not required to prepare Consolidated Financial Statements will not have a Controlling Interest in its subsidiary companies. This is so because even if it had prepared financial statements, those would not have been Consolidated Financial Statements within the meaning of the Model Rules. Under the Model Rules, Consolidated Financial Statements mean any of the following:

(a) Financial statements prepared in accordance with an Acceptable Financial Accounting Standard with line-by-line consolidation;

(b) If the MNE Group consists solely of an Entity and one or more Permanent Establishments, the financial statements of that Entity prepared in accordance with an Acceptable Financial Accounting Standard;

(c) Financial statements described in (a) or (b) that are not prepared in accordance with an Acceptable Financial Accounting Standard, where the financial statements are

200 *See* Blueprint Report, Example 2.4.3. The Blueprint Report sets out definitions for identifying MNE Groups and CEs that do not substantively differ from the ones in the Model Rules, but the definition of UPE in the Model Rules has been changed from the Blueprint Report, without an explanation in the Commentary. *See* Blueprint Report, section 2.2 (definitions box), pp. 23f.

201 Blueprint Report, Example 2.4.3, ¶5.

prepared with adjustments to prevent material competitive distortions (as further defined in the Model Rules); or

(d) Financial statements that the UPE would have prepared if it were required to prepare financial statements in accordance with an Acceptable Financial Accounting Standard (or another standard adjusted to prevent material competitive distortions).

If an investment entity prepares financial statements, those financial statements generally are not of a type described in prongs (a) through (c). In particular, with respect to prong (a), the financial statements prepared by an investment entity under an Acceptable Financial Accounting Standard generally do not consolidate the investment entity's subsidiaries on a line-by-line basis. In addition, it appears prong (d) generally would not apply to an investment entity, because if the investment entity were required by an applicable legal or regulatory authority to prepare financial statements, the applicable financial standards would generally not provide for the investment entity to consolidate its subsidiaries..

Under IFRS 10, for example, an investment entity is expressly not required to prepare consolidated financial statements (except for subsidiaries that provide services related to the investment activities themselves) that consolidate the assets, liabilities, income, expenses, and cash flows of subsidiaries (i.e., portfolio companies) on a line-by-line basis. An investment entity instead measures its investments at fair value through profit or loss.[202] An investment entity is defined under IFRS 10 as an entity that satisfies three criteria: (1) it obtains funds from one or more investors for the purpose of providing those investors with investment management services; (2) it commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (3) it measures and evaluates the performance of substantially all of its investments on a fair value basis.[203]

Where IFRS 10 applies, Excluded Entities should generally not be UPEs if they are “investment entities”. However, the list of Excluded Entities is not identical with the IFRS 10 definition (including the definition of Investment Fund under the Model Rules),[204] and other Accepted Financial Accounting Standards may have slightly differing concepts. It is therefore possible that Excluded Entities would be required to file Consolidated Financial Statements, requiring line-by-line consolidation, in some cases.[205]

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202 IFRS 10 *Consolidated Financial Statements*, ¶¶4B, 31 and 32.

203 IFRS 10, ¶27.

204 Compare IFRS 10, ¶¶B85A to B85W (*Determining whether an entity is an investment entity*) with Art. 10.1.1 (definition of “Investment Fund”).

205 The Model Rules do not expressly address what result is intended if a parent entity is not an Excluded Entity but qualifies as an "investment entity" under IFRS 10 and, thus, does not prepare consolidated financial statements that include its portfolio companies on a line-by-line basis. In such a case, it appears the Model Rules can be read as providing that there are no Consolidated Financial Statements and that, as a result, the parent entity does not have a Controlling Interest in its portfolio companies and is not a UPE.

The Model Rules have evolved from the Blueprint Report in this respect. Whereas the Blueprint Report by definition precluded Excluded Entities from functioning as UPEs, the Model Rules do so only for Excluded Entities that are not required, or would not be required, to consolidate the subsidiaries on a line-by-line basis. The reasons for, and import of, the change have not been addressed in the Commentary but should be explained in future commentary.

2. *Potential Role for a Targeted Anti-Avoidance Rule*

In contrast to investment entities, privately held companies that are not investment entities generally should be UPEs even if they are not required to prepare Consolidated Financial Statements. The reason for this is that, if they were required to do so, under Accepted Financial Accounting Standards the statements would have to consolidate subsidiaries on a line-by-line basis. This is the correct result and consistent with the Blueprint Report. However, as grouping into an MNE Group principally turns on line-by-line consolidation for accounting purposes, two groups of companies owned by the same group of individuals would not be combined into a single MNE Group under the Model Rules. As a result, such groups may, in certain circumstances, avail themselves of opportunities for avoiding the GloBE Rules.

> ***Example 18*** Individuals *A* and *B*, both U.S. tax residents, each own 50% of *HoldCo*, a partnership that is not an investment entity. *HoldCo* has two parallel groups, one headed by *USCo*, a domestic corporation, and the other by *FCo*, a foreign corporation, and the two groups are engaged in related businesses and enter into many intercompany transactions. Each of the *USCo* group and the *FCo* group has gross revenue of EUR 400 million in all relevant Fiscal Years. *HoldCo* has no revenue apart from dividends from its subsidiaries. *A* and *B* then liquidate *HoldCo*, and each of them holds 50% of the equity interests in each of *USCo* and *FCo*, but their business model has not changed. *Holdco* does not prepare financial statements. It would be subject to line by line consolidation of its subsidiaries under IFRS if it did prepare financial statements.

Before its liquidation, *Holdco* appears to be a UPE of an MNE Group that includes *HoldCo*, *USCo* and *FCo*, and their respective subsidiaries. This MNE Group has aggregate revenue of EUR 800 million. Accordingly, it is subject to the GloBE Rules because the financial statements that *HoldCo* would have to prepare if it were required to do so would consolidate *USCo's* and *FCo's* assets, liabilities, income, expenses, and cash flows on a line-by-line basis in accordance with IFRS.[206]

After the liquidation, *A* and *B* are generally in the same economic position, but the *USCo* group and the *FCo* group are no longer combined into a single MNE Group for lack of a UPE. *A*

[206] Art. 10.1.1 (definition of "Consolidated Financial Statements," paragraph (d)).

and *B* thus enjoy various advantages over the *Holdco* structure subject to the GloBE Rules. For example:

- No member of the *USCo* group or *FCo* group will be subject to a QDMTT (assuming that a QDMTT is tailored solely to reach entities within the scope of the GloBE Rules);

- Tax credits and tax-exempt income can be enjoyed without any limitation even if Adjusted Covered Taxes are reduced to a level at which the ETR of a group falls below the Minimum Rate;

- Apart from monitoring that they do not exceed the EUR 750 million threshold for the GloBE Rules, the two separate groups no longer have to comply with the administrative burdens of the GloBE Rules;

- No CE of either group will be subject to any Jurisdictional Top-up Tax.

These benefits would apply to all entities that are tax resident in jurisdictions that have adopted GloBE Rules. Such structures that do not have to file Consolidated Financial Statements also could specifically structure future acquisitions to avoid having the GloBE Rules apply, e.g., by creating various parallel chains of corporations with the aim to stay below the GloBE revenue threshold or by fragmenting groups on a country-country basis and thereby avoiding the GloBE Rules not on the basis of size of revenue, but by never being MNE groups in the first place. The same results would apply if A and/or B were Excluded Entities (such as Governmental Entities or Investment Funds), even if one of such entities owned 100% of Holdco.

We believe that generally there is a difference between structures such as Example 18 which may be designed to avoid the result that commonly controlled holdings of entities or entire groups that conducted integrated business activities normally fall within the scope of the GloBE Rules, on the one hand, and groups of portfolio companies commonly owned by investment entities such as a private equity, venture capital, sovereign wealth or pension funds, on the other hand. Different chains of portfolio companies held by such funds generally lack common management and control and are not managed in an integrated fashion, they may have different investors (e.g., as a result of different co-investors), they generally are acquired separately and subject to separate exits, and they are held as investments for a limited period of time. Investment entities may be different in these respects from conglomerates, which are treated as single MNE Groups, regardless of whether they are privately held or publicly traded. For these reasons, generally permitting Excluded Entities (within the definition of the Model Rules) not to be UPEs is an understandable choice in the design of the Model Rules.

There is, however, a potential for intentional avoidance of the GloBE Rules where the preparation of Consolidated Financial Statements is not, or would not be, required. An investment entity could, for example, acquire one or more additional groups or separate entities as separate portfolio companies that absent the GloBE Rules would be added to existing portfolio companies as bolt-on acquisitions. Purportedly separate groups could thus de facto be managed in an integrated manner in order to avoid the GloBE Rules. A corporate group held by individuals, by a family office, or by an investment entity that does not, and would not be required to, file Consolidated Financial Statements also could restructure to remain outside the application of the GloBE Rules if revenue were to approach the GloBE threshold.[207] Further, the MNE Group threshold could be manipulated by intercompany sales, services, licenses or similar transactions, or through the shifting of risks or functions among the subgroups.

While in the latter case traditional transfer pricing rules can function as a backstop against potential manipulations through intergroup payments, they would not be a tool for addressing the various techniques of artificial fragmentation into separate subgroups as such. The Blueprint Report provides that "[f]urther work could be undertaken to consider whether the consolidation threshold should be supplemented with a targeted anti-avoidance rule to avoid the fragmentation of a single MNE Group into different subgroups in order to avoid the EUR 750 M threshold. This work would need to take into account the on-going work on the 2020 Country-by-Country (BEPS Action 13 Minimum Standard) review process and the outcomes from this work would be incorporated into the development of model rules, ..."[208]

We recommend that the Inclusive Framework give further attention to the circumstances in which a targeted anti-avoidance rule may be appropriate to avoid the fragmentation of a single, integrated MNE Group into different subgroups either in order to avoid the EUR 750 million threshold or to avoid the application of the GloBE rules through country-by-country fragmentation or otherwise. Such a rule would appear to be potentially appropriate in the case of a privately owned MNE Group (for example, one that is owned by an investment fund, a sovereign wealth fund, a family office, a small group of individuals or even a single individual) in the circumstances outlined above or other comparable circumstances.

F. FLOW-THROUGH ENTITIES AND DISREGARDED ENTITIES

1. Flow-through UPEs with an All-or-Nothing Cutoff in Determining GloBE Income

If a partnership or other Flow-through Entity is the UPE of an MNE Group, its GloBE Income is reduced by the portion of its GloBE Income included by the following partners or members that have an equity or similar interest in the pass-through UPE:

1. Any partner or member that (a) includes its share of GloBE Income within 12 months of the MNE Group's Fiscal Year; and (b) either (i) is subject to tax on the full amount of the GloBE Income at a nominal rate of at least the Minimum Rate

[207] Parties considering such planning presumably would evaluate, in addition to potential advantages under the GloBE Rules, other considerations such as potential loss of tax consolidation between the separate groups, and potential commercial or economic inefficiencies in obtaining third party debt financing.

[208] Blueprint Report, ¶126, at p. 126.

of 15% or (ii) is subject to Taxes that, together with the Adjusted Covered Taxes of the UPE, are reasonably expected to be at least as high as the Minimum Rate ("Rule 1");

2. Any partner or member that is a natural person, a governmental entity, an international organization, a non-profit organization or a pension fund (all as defined in the Model Rules) that is, in each case, tax resident in the UPE's jurisdiction and in the aggregate owns no more than 5% of the rights to "profits and assets" of the UPE ("Rule 2").[209]

For Rule 2, the 5% ownership threshold is an all-or-nothing test. In that case, however, the rules seem to allow that a more-than-5% owner is tested for meeting the Minimum Rate under Rule 1. Likewise, any partner or member that is tax resident outside the UPE's jurisdiction should be tested under Rule 1.

Rule 1 has a cliff effect: if the partner or member is subject to tax on the full amount of its share of the flow-through UPE's GloBE Income at the Minimum Rate or higher (separately or aggregated with the UPE's entity-level taxes), then the UPE can reduce its own GloBE Income by the amount attributed to the partner or member. If, however, the partner or member falls even negligibly short of that threshold, the flow-through UPE cannot reduce its GloBE Income. But it and also cannot include the partner's/member's taxes in its own Adjusted Covered Taxes, even though it is treated similarly to a Hybrid Entity for purposes of determining Top-up Taxes.[210]

To the extent that a Flow-through Entity UPE is a Low-Taxed CE, its Top-up Tax would be allocated under the UTPR and imposed on CEs in other jurisdictions, unless the UPE is subject to a QDMTT. If the Top-up Tax is a QDMTT, it can be specially allocated to specific partners in respect of which it is imposed if for other partners there was an exclusion of their share of the UPE's GloBE income under one of the rules above. But if this Top-up Tax is allocated under the UTPR, the cost would presumably be shared by all partners or members of the Pass-through Entity UPE. Otherwise, UTPR-allocated Top-up Tax would have to be traced through distributions by the relevant CEs that bear the UTPR Top-up Tax allocated from the UPE. Absent such tracing, the cliff effect creates an economic double burden for partners who are subject to tax in respect of their distributive shares at a rate at or above the Minimum Rate and are exempt under Rule 1 or who are exempt under Rule 2. This partly shifts the burden from the partners who are subject to tax at a rate below the Minimum Rate. In response to this, pass-through UPEs may in the future

209 *See* Art. 7.1.1. Covered Taxes are reduced proportionately. Art. 7.1.3. GloBE Loss by contrast is reduced by any portion attributable to any owner that is allowed to use the loss in computing separate taxable income. It is not clear how this would apply in the context of the at-risk limitation or to passive activity losses under Sections 465 and 469.

210 *Cf.* Art. 4.3.2(d) (allowing push-down to a Hybrid Entity of taxes imposed on a partner from such partner if the partner is a CE of the MNE Group).

require information, if not assurances, from their partners or members regarding the partners' or members' taxation of their shares of GloBE Income in their home jurisdictions.[211]

2. *Disregarded Entities*

a. *Treatment of disregarded entities under the Model Rules*

Under the Model Rules, disregarded entities within the meaning of Treasury Regulation Section 301.7701-2(a) ("DREs") are "Entities," as they are legal persons.[212] In addition, they are not in all cases Tax Transparent Entities.

A Tax Transparent Entity is defined as a Flow-through Entity that is fiscally transparent in the jurisdiction in which its owner is located, and a Flow-through Entity is one that is fiscally transparent in the jurisdiction where it was created. Domestic DREs owned by U.S. persons (which as defined appears to include owners that are partnerships) are Tax Transparent Entities under this definition.

A domestic DRE owned by a foreign person is not a Tax Transparent Entity, but a Reverse Hybrid Entity if, as often would be the case, the foreign jurisdiction of the owner does not disregard it and does not treat it as fiscally transparent.[213] A foreign DRE owned by a U.S. person, by contrast, is a Hybrid Entity under the Model Rules if the foreign jurisdiction does not treat the DRE as fiscally transparent. A Hybrid Entity is one that is "a separate taxable person for income tax purposes in the jurisdiction where it is located . . . to the extent that it is fiscally transparent in the jurisdiction in which its owner is located."[214] Where a domestic owner owns a domestic DRE, i.e., the DRE is considered a Tax Transparent Entity, the GloBE Income of the DRE is allocated to the domestic owner.[215] U.S. tax is an expense of the owner, and therefore does not need to be reallocated away from the owner and is a Covered Tax of the owner.[216]

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211 The problem that the higher-taxed partner bears a disproportionate economic burden of UTPR imposed in respect of the pass-through UPE's low taxed profits would remain, albeit to a lesser extent, if the taxes imposed on the lower-taxed partner are allocated back to the UPE. The higher-taxed partner would still bear the burden for its share of the UTPR even though it was triggered by the low-taxed partner's below-Minimum Rate tax. Imposing a QDMTT on the pass-through UPE that is allocated to the partner that causes the need for its imposition would avoid this outcome.

212 Art. 10.1.1 (definition of "Entity"). A partnership that is disregarded for U.S. tax purposes because it is owned by, e.g., a corporation on the one hand and a disregarded subsidiary of that corporation on the other should likewise be an Entity because it is an "arrangement that prepares separate financial accounts." *Id*. The Permanent Establishment rules should therefore not apply to disregarded entities. *See* Part III.B.3, above.

213 *See* Art. 10.2.1(b); *see also* Art. 10.2.4.

214 Art. 10.2.5.

215 Art. 3.5.1(b).

216 Art. 4.2.1(a).

Where a domestic owner owns a foreign DRE that is not fiscally transparent in the foreign jurisdiction, i.e., the foreign DRE is considered a Hybrid Entity, the U.S. tax imposed on the U.S. owner is allocated to the Hybrid Entity.[217] The foreign DRE is, under the laws of its jurisdiction, an "Entity." Consequently, GloBE Income and Loss is determined for the foreign DRE and does not need to be re-allocated away from it.

Where a foreign CE owns a domestic DRE, and the domestic DRE is engaged in the conduct of a U.S. trade or business, the foreign CE is subject to U.S. tax on the income effectively connected with the U.S. trade or business.[218] This U.S. tax should be a Covered Tax as it is a tax "recorded in the financial accounts of a [CE] with respect to . . . its share of the income or profits of a [CE] in which it owns an Ownership Interest."[219] There is no rule that would reallocate this Covered Tax to the DRE. There is also no rule that would allocate the GloBE Income of the domestic DRE (which is an Entity and a CE) to its foreign CE owner, as the foreign CE is a Reverse Hybrid Entity.[220] These results are summarized in the following table.

<table>
<tr><td colspan="2" rowspan="2"></td><th colspan="2">Tax Treatment in Owner Jurisdiction</th></tr>
<tr><th>Fiscally Transparent</th><th>Fiscally Opaque</th></tr>
<tr><th rowspan="2">Tax Treatment in DRE Jurisdiction</th><td>Fiscally Trans-parent</td><td>Tax Transparent Entity
<u>Example</u>: Domestic DRE owned by domestic corporation
<u>Allocations</u>
• Income: allocated from DRE to owner
• Tax: stays with owner</td><td>Reverse Hybrid Entity
<u>Example</u>: Domestic DRE owned by foreign corporation
<u>Allocations</u>
• Income: stays with DRE unless the U.S. activities are treated as a PE
• Tax: stays with owner unless the U.S. activities are treated as a PE</td></tr>
<tr><td>Fiscally Opaque</td><td>Hybrid Entity
<u>Example</u>: Foreign company electing to be disregarded, owned by domestic corporation
<u>Allocations</u>
• Income: stays with DRE
• Tax: allocated from owner to DRE</td><td>Entity/CE
<u>Example</u>: Foreign company electing to be disregarded, owned by foreign corporation
<u>Allocations</u>
• Income: stays with DRE
• Tax: stays with DRE</td></tr>
</table>

The allocation rules yield the correct result for entities that are treated as fiscally transparent in the owner's jurisdiction and unite GloBE Income and Covered Taxes in the same CE. As the domestic DRE owned by a domestic owner is treated as a stateless Entity under the Model Rules,[221] the allocation up to its domestic owner includes income and taxes in the jurisdictional

217 Art. 4.3.2(d).

218 Sections 871(b) and 882.

219 Art. 4.2.1(a).

220 Art. 3.5.1(c), *see* Part III.B.3, above.

221 Art. 10.3.2(b).

determinations for the United States. That is likewise the correct result, because it does not leave U.S. income and U.S. tax stranded in a separate Entity and avoids complex questions as to whether transactions between the DRE and its owner, which are disregarded for U.S. tax purposes, would have to be reflected in determining GloBE Income and Adjusted Covered Taxes of the DRE on a stand-alone basis. By contrast, a Hybrid Entity is treated much like a CFC and the approach of the Model Rule follows the tax treatment of the jurisdiction where the Hybrid Entity is treated as located under the Model Rules,[222] which we believe is the correct result.

But in the case of Reverse Hybrid Entities, there are no reallocation rules, which seems to yield the wrong result. For a domestic DRE owned by a foreign corporation, the foreign corporation is subject to U.S. tax on its effectively connected income earned through the DRE. Not reallocating U.S. taxes to the DRE would unfairly reduce the Adjusted Covered Taxes of the DRE CE located in the United States. A domestic DRE owned by a foreign CE rather resembles a Permanent Establishment with respect to its U.S. taxation. Similar to a PE-CE, if the income of a Reverse Hybrid Entity is subject to income tax in the hands of the Reverse Hybrid Entity's owner in the jurisdiction where the Reverse Hybrid Entity is located,[223] such income tax should be allocated back to the Reverse Hybrid Entity.

It is conceivable that, under the current Model Rules, the domestic DRE that is owned by a foreign CE and that conducts a U.S. trade or business is classified as a Permanent Establishment of the foreign owner with respect to that trade or business. The Model Rules currently suggest, but do not expressly state, that Entity and Permanent Establishment are exclusive classifications.[224] However, as a technical matter, under the definition of Permanent Establishment in the Model Rules, the U.S. trade or business conducted through the Reverse Hybrid qualifies as a Permanent Establishment as it is "a place of business (including a deemed place of business) in respect of which a jurisdiction taxes under its domestic law the income attributable to such place of business on a net basis similar to the manner in which it taxes its own residents."[225] The income (or loss) of a Flow-Through Entity (i.e., the Reverse Hybrid Entity) is in that case allocated to the Permanent Establishment,[226] and the U.S. taxes imposed on the foreign owner in respect of the income of the PE is likewise allocated to the Permanent Establishment.[227] In addition, the income (or loss) of the

222 Art. 10.3.1 (location based on tax residence, which in turn is based on place of management, place of creation or similar criteria).

223 Location in this case should also be determined in the same manner as for PEs. Under the Model Rules, however, a Reverse Hybrid Entity is a stateless entity and not considered located under the general rule based on where it is tax resident, because it is a Flow-through Entity. Art. 10.3.2(a). As a Permanent Establishment, by contrast, the domestic DRE with a U.S. trade or business and that is a Reverse Hybrid Entity would be located in the United States. Art. 10.3.3(b).

224 *See* Art. 1.3.1.

225 Art. 10.1.1(b) (definition of "Permanent Establishment").

226 Art. 3.5.1(a), the amount to be so allocated is determined under Article 3.4.2(a).

227 Art. 4.3.2(a). The Covered Taxes have to be included in the financial account of *a* CE in order for the push-down to be available. This CE does not have to be the Main Entity of the Permanent Establishment.

Reverse Hybrid Entity is reduced by the income (or loss) allocated to the Permanent Establishment.[228] The Reverse Hybrid Entity would in this case apparently be the Main Entity, i.e., the Entity of which the Permanent Establishment is a Permanent Establishment and that includes the income or loss of the Permanent Establishment in its financial statement. This approach would leave the Reverse Hybrid Entity as a stateless shell with no GloBE Income or Loss, while the GloBE Income or Loss is shifted to a U.S. Permanent Establishment. If this is the intended treatment, it seems oblique, and the Commentary does not elaborate on this. It is also unusual to have a Permanent Establishment of an Entity located in the same country as its Main Entity.

We believe that this treatment of the U.S. trade or business as a Permanent Establishment is the correct treatment. However, we believe that it could be achieved in a simpler way by expressly treating a DRE that is a Reverse Hybrid Entity in the same manner as a Permanent Establishment.

Last, the Model Rules do not directly address the case where a foreign DRE that is not fiscally transparent in its home jurisdiction is owned by a CFC-CE and a U.S. person is a U.S. CFC Shareholder CE of such CFC-CE. While such a DRE is not a Hybrid Entity under the Model Rules, it is a CE and Covered Taxes imposed on a U.S. CFC Shareholder CE under the GILTI Regime or subpart F Regime in respect of its shares of the DRE's income should therefore be allocated to the foreign DRE CE under the rules applicable to CFC Regimes.[229]

b. DREs joining and leaving an MNE Group

DREs also do not fit well into the current rules regarding transfers of CEs and transfers of asset and liabilities.

The general rule for the transfer of equity interests in a CE is that "in the acquisition year and each succeeding year, the target shall determine its GloBE Income or Loss and Adjusted Covered Taxes using its historical carrying value of the assets and liabilities."[230] However, this rule is superseded (the "<u>Asset Acquisition Exception</u>") if either (1) the "acquisition or disposal" of the equity interests in the CE is treated as an "acquisition or disposition" of assets and liabilities in the jurisdiction where the target CE is located or (2) if the CE is a Tax Transparent Entity, the jurisdiction where the assets are located treats the "acquisition or disposal" of the equity interests in the CE in the same or similar manner as an "acquisition or disposition" of the assets and liabilities and imposes a Covered Tax on the seller based on the gain recognized.[231] In that case, the carrying value of the acquired assets and liabilities is determined under the accounting standard used by the transferred CE.[232]

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228 Art. 3.5.5.

229 *See* part III.B.2, above.

230 Art. 6.2.1(c).

231 Art. 6.2.2.

232 Art. 6.3.1.

For U.S. tax purposes, the sale of all of the equity interests in a domestic DRE by its domestic owner to a (single) domestic buyer is treated as a sale of the DRE's assets by the DRE's owner to the buyer, and an assumption of the DRE's liabilities by the buyer. Because the DRE is in this case a Tax Transparent Entity for both the acquisition and disposal/disposition characterization, the GloBE Rules coincide with the U.S. tax rules, i.e., the domestic seller is treated as selling assets and the domestic buyer as purchasing assets (and a corresponding relief from and assumption of liabilities), and the initial carrying value of the assets of the DRE after the sale appears to be their fair market value.

But this is the only case where the clause (2) of Article 6.3.2 unambiguously applies in the context of a sale of a DRE. The following table summarizes the characterizations of the disposals and acquisitions under the Model Rules.

Seller	**Buyer**	**DRE**	**Seller DRE Classification (Location of DRE)**	**Buyer DRE Classification (Location of DRE)**
Domestic	Domestic	Domestic	Tax Transparent Entity (Stateless)	Tax Transparent Entity (Stateless)
Domestic	Foreign	Domestic	Tax Transparent Entity (Stateless)	Reverse Hybrid Entity (Stateless)
Foreign	Domestic	Domestic	Reverse Hybrid Entity (Stateless)	Tax Transparent Entity (Stateless)
Foreign	Foreign	Domestic	Reverse Hybrid Entity (Stateless)	Reverse Hybrid Entity (Stateless)
Domestic	Domestic	Foreign	Hybrid Entity (where tax resident)	Hybrid Entity (where tax resident)
Domestic	Foreign	Foreign	Hybrid Entity (where tax resident)	Non-Transparent (where tax resident)
Foreign	Domestic	Foreign	Non-Transparent (where tax resident)	Hybrid Entity (where tax resident)
Foreign	Foreign	Foreign	Non-Transparent (where tax resident)	Non-Transparent (where tax resident)

For a domestic DRE sold by a U.S. seller to a foreign buyer, the second prong of the Asset Acquisition Exception also seems to yield the correct result even if the exception applies only to the disposal/disposition, not the acquisition, as the Asset Acquisition Exception is a disjunctive rule. The DRE is a Tax Transparent Entity and the United States treats the sale of the interests as an asset sale, so the buyer obtains a carrying value corresponding to the stepped-up or stepped-down tax basis of the assets.

For a domestic DRE sold by a foreign seller to a U.S. buyer, this rule also results in the buyer obtaining a carrying value corresponding to the stepped-up or stepped down tax basis of the assets, as the rule required that the acquisition or disposal be treated as an asset acquisition or disposition. Thus, as long as the transfer is treated as an asset transfer with respect to a Tax Transparent Entity for the seller or for the buyer, the carrying value would not be the historic carrying value of the seller.

No step-up is available under the second prong of the Asset Acquisition Exception, however, in any of the other scenarios because the DRE is not a Tax Transparent Entity with respect to either the seller or the buyer. Under the first prong of the Asset Acquisition Exception, a step-up or down is available if the acquisition or disposal of the interest in the DRE is treated as acquisition or disposal of the assets and liabilities of the DRE, if the jurisdiction in which the DRE is located treats the acquisition or the disposal as such. This will not be the case for any of the remaining five cases. If a domestic DRE that is engaged in the conduct of a U.S. trade or business is sold by a foreign seller (located in a jurisdiction that treats the DRE as fiscally non-transparent) to a foreign buyer (that likewise treats the DRE as fiscally non-transparent), the DRE is treated as a Reverse Hybrid Entity, which is treated as a stateless entity, and not as located in the United States.[233] This result seems incorrect, as the foreign owner recognizes gain (or loss) for U.S. tax purposes on the deemed sale of the DRE's assets, which triggers U.S. tax. In addition, the buyer of the domestic DRE will be subject to U.S. tax on the U.S. taxable income of the DRE, and the taxable income reflects depreciation calculated by reference to a purchase price tax basis and a freshly starting recovery period. Thus, the carrying value for purposes of determining GloBE Income and Loss should likewise be reset to the purchase price. It is not clear why the historic carrying value of the seller has any relevance for determining whether the buyer is not subject to a minimum tax in the United States, if the seller has paid U.S. tax on its entire gain with respect to the assets of the DRE. Reverse Hybrid Entities face the same issue in an acquisition/disposition as the issue described for the determination of their (or their owners) GloBE Income and related Adjusted Covered Taxes, i.e., the Model Rules do not properly reflect that domestic DREs engaged in the conduct of a U.S. trade or business are fully flow-through entities for U.S. tax purposes and behave like Permanent Establishments.

If a foreign DRE is sold by a U.S. seller to a U.S. buyer, the first prong of the Asset Acquisition Exception likewise cannot be invoked: the foreign jurisdiction does not treat the DRE as disposing of assets and liabilities, and the foreign DRE is not a Tax Transparent Entity, but a Hybrid Entity. This, too, would distort the GloBE minimum tax analysis and could yield an unfair result if the buyer is a U.S. person. This is so because the U.S. seller recognizes U.S. taxable gain or loss and the U.S. buyer will be fully taxable in the United States on the income of the foreign

[233] Art. 10.3.2 (a Flow-through Entity is a stateless Entity unless it is the UPE or required to apply an IIR in accordance with Article 2.1.1).

DRE, using the stepped-up or stepped-down tax basis and a freshly starting recovery period with respect to the DRE's assets. GloBE Income based on historic carrying values may in that case be overstated or understated.

Where a foreign DRE is acquired by a domestic buyer from a foreign seller, the carrying value of the DRE's asset should likewise be stepped up to the purchase price, to avoid distortions of the GloBE minimum tax analysis. If the reason for using the historic carrying value is that the foreign seller may not have recognized any gain on the sale of its interest in the foreign DRE, e.g., because of a participation exemption regime, the relevance is questionable. Whether the U.S. ETR for the domestic CEs that include the domestic buyer exceeds the Minimum Rate on Book Income should reflect that fact that the domestic buyer will not only determine its U.S. taxable income by reference to the stepped up or stepped down tax basis of the assets of the foreign DRE, but also later gain on the disposition of the assets (including a sale of interests in the foreign DRE). Using for these purposes the historic carrying value divorces GloBE Income from U.S. taxation and will lead to distortions that seem hard to justify.

This would treat a foreign DRE in the same manner as a domestic DRE for a sale by a foreign seller to a domestic buyer. If the foreign seller's jurisdiction excludes gain from a sale of a subsidiary from taxation under, e.g., a participation exemption, the foreign DRE sale is different from a domestic DRE sale, however, because the foreign seller does not recognize any gain either in its home jurisdiction or on a pass-through basis in the foreign jurisdiction of the foreign DRE (if the DRE's jurisdiction is different from the seller's home jurisdiction). Similarly, the gain in respect of the stock of the foreign DRE is not treated as an item of GloBE Income and thus in effect not subject to GloBE Tax.[234] The treatment of the seller, however, should be irrelevant. The critical question for purposes of the GloBE Rules is whether the buyer's MNE Group is subject to tax at the Minimum Rate on a jurisdictional basis. The question is not whether a seller was subject to tax (or subject to tax at a specified minimum rate). Accordingly, there are strong arguments for treating a domestic DRE and a foreign DRE in the same manner.

Where a foreign DRE owned by a domestic owner-seller is sold to, and acquired by, a foreign buyer, however, we believe that there are reasons for using the historic carrying value. The foreign buyer's jurisdiction will not treat the foreign DRE as transparent and step asset bases up or down to fair market value, nor will the foreign DRE's jurisdiction. The fact that the U.S. seller was subject to tax on the deemed disposition of the assets should, by itself, not be relevant to this analysis for the same reason as in the inverse case of a sale of a foreign DRE by a foreign seller to a domestic buyer. Rather, following the foreign tax treatment of the acquisition of the DRE as a stock or assets sale appears appropriate, regardless of the treatment of the U.S. seller as recognizing gain or loss on a deemed asset sale for U.S. tax purposes, because it is the determination that is

[234] Art 3.2.1(c), excluding Excluded Equity Gain or Loss from a CE's Financial Accounting Net Income or Loss, and Art. 10.1.1 (clause (c) of the definition of "Excluded Equity Gain or Loss").

relevant for the imposition of foreign tax (in the DRE's jurisdiction), including in connection with a sale of the DRE's assets.

We therefore recommend that the Asset Acquisition Exception in Article 6.2.2 be expanded to allow for a step up or down of the carrying values of assets to fair market value with respect to (1) any taxable acquisition of a DRE that is treated as a taxable asset acquisition in the jurisdiction where the buyer is subject to tax as a tax resident provided that the jurisdiction treats the DRE as a Hybrid Entity and (2) any taxable disposition of a DRE that is treated as a taxable asset sale and taxable asset acquisition in the jurisdiction where the activities of the DRE are subject to tax on a net income basis. The first proposal could be implemented by the Model Rules by extending the first prong of the Assets Acquisition Exception from the target CE to the buyer of the target CE if the buyer CE is located in a jurisdiction that treats the buyer CE as a Hybrid Entity. The second proposal could be implemented by the Model Rules by extending the scope of the second prong of the Asset Acquisition Exception from Tax-Transparent Entities to all Flow-through Entities.

G. GLOBE TAX AND THE BEAT

In general, and as described in more detail below, the BEAT essentially imposes a minimum tax on certain Applicable Taxpayers, as defined below, which is based on the Applicable Taxpayer's taxable income determined without regard to (i) payments to related foreign persons and (ii) certain net operating loss ("NOL") carryovers.[235]

1. Calculating the BEAT

The BEAT generally applies to corporations, other than regulated investment companies, real estate investment trusts and S corporations, that have (1) a Base Erosion Percentage, as defined below, of at least 3 percent[236] (the "De Minimis Threshold") and (2) average annual gross receipts for the previous three taxable years of at least $500,000,000 (such corporations, "Applicable Taxpayers").[237]

In general, an Applicable Taxpayer calculates any BEAT liability first by determining the tax deductions allowed for certain payments to foreign related parties during the relevant taxable period (such deductions, "Base Erosion Tax Benefits").[238] Next, and generally, it divides such Base Erosion Tax Benefits by the total deductions allowable to it for such period (the quotient, its "Base

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235 *See generally* Section 59A. *See also* New York State Bar Association Tax Section, Report No. 1397, *Report on Base Erosion and Anti-Abuse Tax* (July 16, 2018).

236 The De Minimis Threshold is 2 percent for banks and registered securities dealers.

237 Section 59A(e)(1). A taxpayer that is a member of an "aggregate group" determines its gross receipts and its Base Erosion Percentage on the basis of the aggregate group. Treas. Reg. § 1.59A-2(c)(1).

238 Section 59A(d), Section 59A(c)(2).

Erosion Percentage").[239] The Applicable Taxpayer then determines its "Modified Taxable Income" for purposes of the BEAT, which generally is what the Applicable Taxpayer's taxable income would be if it were determined without regard to (i) the Base Erosion Tax Benefits and (ii) its NOLs multiplied by its Base Erosion Percentage.[240] The BEAT generally is equal to a minimum tax rate[241] multiplied by the Applicable Taxpayer's Modified Taxable Income, less the Applicable Taxpayer's regular tax liability[242] and certain tax credits, including foreign tax credits.[243]

2. *The Model Rules' Definition of Taxes and the BEAT*

Only "compulsory, unrequited payments" to a general government are Taxes under the Model Rules.[244] The Model Rules and the Commentary do not address what constitutes compulsion for such purposes. This raises two questions with respect to the BEAT.

The first question is whether a non-U.S. jurisdiction that implements the Model Rules could claim that the BEAT is not a compulsory payment, and is therefore not a Tax. A domestic CE may choose not to deduct Base Erosion Tax Benefits on its U.S. tax return and through this waiver avoid or reduce any BEAT that would otherwise be imposed.

Taxpayers are not permitted to reduce their BEAT liability by failing to deduct Base Erosion Tax Benefits except in a single, limited circumstance: they are permitted to permanently waive such deductions to the extent doing so would cause their Base Erosion Percentage to fall below the De Minimis Threshold in order to "elect out" of the BEAT.[245] This election out comes at a cost. Due to the fact that the minimum tax rate imposed under the BEAT is less than the corporate income tax rate, a permanently waived deduction of $1 could cost a taxpayer up to $0.21 cents and save the taxpayer as little as $0.10 cents with respect to the waived deduction.[246] As a result, a taxpayer generally can be expected to waive such deductions to elect out of the BEAT only if its income tax liability, determined without the BEAT and by excluding the waived deductions, would be less than the income tax liability it would have had, determined with the BEAT and by including the deductions that the taxpayer would otherwise waive. Therefore,

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239 Section 59A(c)(4)(A). Certain deductions allowed are not taken into account for such purposes. *See* Section 59A(c)(4)(B).

240 Section 59A(c)(1).

241 The minimum tax rate is 10 percent for taxable years beginning after calendar year 2018 and increases to 12.5% for taxable years beginning after calendar year 2025. Section 59A(b)(1), Section 59A(c)(1).

242 The "regular tax liability" is the tax imposed by Chapter 1 of the Code for the relevant taxable year, excluding certain other taxes, like the BEAT. Section 26(b). Corporations are subject to income tax in an amount equal to 21% of their taxable income. Section 11(b). With respect to a corporation, the term "taxable income" means the corporation's gross income minus the deductions allowed by Chapter 1 of the Code. Section 63(a).

243 Section 59A(b)(1).

244 Art. 10.1.1. *See also* Commentary to Art. 4, ¶24 at p. 91.

245 Treas. Reg. § 1.59A-3(c)(6)(i).

246 *See* footnotes 241 and 242, above.

taxpayers generally are economically compelled to pay the BEAT, except in certain borderline cases where a taxpayer's Base Erosion Percentage approaches the De Minimis Threshold.

The second question is whether a non-U.S. jurisdiction could claim that the incremental U.S. tax payable (determined without the BEAT) that results from such an "election out" of the BEAT is not a Tax on the grounds such taxes are not compulsorily paid. While the Model Rules and the Commentary are silent, the foreign tax credit regulations address a similar question.

Like the Model Rules, the foreign tax credit regulations provide that a foreign levy is a tax only if it is compulsory.[247] An amount paid to a foreign country is not a compulsory payment, and is therefore not a tax, to the extent that such payment exceeds the amount of liability for foreign income tax under the foreign tax law.[248] Such a payment does not exceed the amount of such liability if, among other requirements, the taxpayer exhausts all effective and practical remedies to reduce, over time, the taxpayer's liability for foreign income tax (*i.e.*, the foreign taxpayer must take steps to minimize its foreign income taxes payable for such amounts to be "compulsory"). However, a taxpayer generally is not required to minimize its foreign income taxes to the extent the reasonably expected, arm's length costs (including, for such purposes, the costs of paying a different foreign non-income tax) of reducing the liability would exceed the amount by which such income taxes could be reduced (the "Net Tax Minimization Exception").

The Net Tax Minimization Exception is illustrated by two examples, both of which involve a foreign taxpayer that is subject to a "Base Erosion Tax" imposed on certain deductible payments above a threshold made to related parties outside of such taxpayer's jurisdiction and is specified not to qualify as an income tax for purposes of Section 901.[249] The first example shows that, where the foreign taxpayer does not claim deductions and avoids an amount of Base Erosion Tax that exceeds the corresponding increase to its foreign income taxes, the foreign taxpayer has satisfied the Net Tax Minimization Exception, and such foreign income taxes paid are compulsorily paid. Conversely, the second example shows that, where the foreign taxpayer does not claim deductions and the corresponding increase to its foreign income taxes exceeds the Base Erosion Tax avoided thereby, the foreign taxpayer has not satisfied the Net Tax Minimization Exception, and such excess foreign income taxes are not compulsorily paid.

Under the principles of the Net Tax Minimization Exception, where a taxpayer is economically compelled to increase an income tax by avoiding a second tax, and the taxpayer's overall tax burden in respect of such taxes is reduced, then the income tax is treated as a compulsory payment in full. Under this rationale, the incremental U.S. tax payable (determined

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247 Treas. Reg. § 1.901-2(a)(2)(i).

248 Treas. Reg. § 1.901-2(e)(5)(i).

249 Treas. Reg. § 1.901-2(e)(5)(vi)(G), *Example (7)* and (H), *Example (8)*. While the Base Erosion Tax of the examples is not an income tax, as it is imposed on *deductible payments*, we believe that the BEAT is an income tax for purposes of the Model Rules, as it is imposed on *modified taxable income*. *See* Part IV.G.3, below. Unlike the BEAT, a tax imposed on deductible payments could arise in the absence of any income at all, similar to a sales or excise tax.

without the BEAT) that results from such an "election out" of the BEAT generally would be a compulsory payment, and therefore would be a Tax under the Model Rules.

We believe it is sensible to treat both the BEAT and any such incremental U.S. taxes that result from not deducting Base Erosion Tax Benefits as Taxes under Pillar Two, and the remainder of this report assumes the BEAT is a Tax. We again note, however, that the Model Rules and the Commentary do not provide any, much less clear, guidance as to what payments are compulsory. In the absence of such guidance, it is conceivable that a non-U.S. jurisdiction implementing Pillar Two could reach a different conclusion.

3. The Beat as a Covered Tax

While the BEAT is a minimum tax, it is clearly not a Top-up Tax imposed under a Qualified IIR, a Tax attributable to an adjustment as a result of the application of a Qualified UTPR, or a QDMTT. The question therefore arises whether the BEAT is a Covered Tax, which is included in the numerator in calculating a CE's ETR and would reduce any potential Top-up Taxes or UTPR adjustments imposed in respect of such a CE. On the one hand, the Model Rules and the Commentary thereto would not seem to explicitly preclude the BEAT from being treated as a Covered Tax (as they would preclude, for example, sales or excise taxes from being so treated).[250] On the other hand, corporate minimum taxes are not explicitly included in the scope of Covered Taxes.[251] As a result, to fall within the scope of Covered Taxes, the BEAT would need to be treated as a Tax "recorded in the financial accounts of a CE with respect to its income or profits" for purposes of the Model Rules.[252]

The Commentary provides that income taxes "are generally levied on a flow of money or money's worth that accrues to a taxpayer during a period of time," and "take into account related expenses of producing the flow of money to measure the taxpayer's net increase in wealth for the period."[253] Moreover, the Commentary provides that, while a Tax on gross income or revenue would not be considered an income tax, a Tax that allows deductions for some but not all expenses related to the relevant income would be considered an income tax, provided the deductible expenses can reasonably be considered to have been incurred in connection with deriving that income.[254]

The determination of whether the BEAT would qualify as a Covered Tax, therefore, depends on whether the BEAT is determined with respect to income, net of at least some deductible expenses that could reasonably be considered to have been incurred in connection with deriving

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250 *See* Ar. 4.2.2. *See also* Commentary to Art. 4, ¶36 at p. 94.

251 *See* Art. 4.2.1.

252 Art. 4.2.1(a).

253 Commentary to Art. 4.2.1, ¶25 p. 92.

254 Commentary to Art. 4.2.1, ¶27 p. 92.

such income. Reduced to its essence, the BEAT is a tax imposed on the net income of the Applicable Taxpayer, determined by including all of the deductible expenses of such Applicable Taxpayer generally, other than deductible expenses incurred in respect of payments to related foreign parties. Based on the Commentary, the BEAT should be a Covered Tax. Moreover, treating the BEAT as a Covered Tax is consistent with the purpose of the GloBE Rules generally: to ensure that large MNE Groups pay a minimum level of tax on the income arising in each jurisdiction where they operate.[255]

Treating the BEAT as a Covered Tax is also consistent with the treatment of similar foreign taxes as net income taxes for purposes of the foreign tax credit rules under Section 901. The Treasury Regulations issued thereunder generally define net income taxes as taxes that are, among other requirements, imposed based on gross receipts, as reduced to permit recovery of the significant costs and expenses attributable to such gross receipts.[256] For such purposes, "[foreign] tax law is considered to permit recovery of significant costs and expenses even if recovery of all or a portion of certain costs or expenses is disallowed, if such disallowance is consistent with the principles underlying the disallowances required under the Code, including disallowances intended to limit base erosion or profit shifting."[257] Therefore, a foreign tax that is similar to the BEAT, and is imposed based on the foreign taxpayer's net income, less deductions allowed generally, other than deductions allowed in respect of payments to related parties in other jurisdictions, generally would be treated as a net income tax for U.S. tax purposes.

4. The Future of the BEAT

Given that the complexity of the BEAT and the questions discussed above, repealing and replacing the BEAT with a UTPR and a QDMTT, as proposed in the Greenbook, would seem to provide MNE Groups with additional certainty regarding the application of the Model Rules to their U.S. operations, without subverting the BEAT's purpose of imposing a minimum tax rate on the U.S. operations of large multinational groups that are engaged in profit shifting from the U.S. to foreign jurisdictions.

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255 Introduction to Commentary, ¶1 p. 94.

256 Treas. Reg. § 1.901-2(a)(1)(ii)(B)(2), (a)(3) and (b). Certain surtaxes may also qualify as net income taxes, but such surtaxes generally are not relevant for purposes of the analysis herein. *Id*.

257 Treas. Reg. § 1.901-2(b)(4)(i)(C)(1). In addition, whether a cost or expense is significant is determined based on whether, for all taxpayers in the aggregate to which the foreign tax applies, the item of cost or expense constitutes a significant portion of the taxpayers' total costs and expenses. *Id*. Such a determination ultimately is a factual one that would require information with respect to all corporate taxpayers meeting the relevant gross receipts requirements the foreign jurisdiction's rules that are similar to the BEAT. For purposes of this discussion, it is assumed that costs and expenses incurred by such corporate taxpayers with respect to unrelated persons or related persons in such jurisdiction are significant compared to all costs and expenses of such taxpayers.

Appendix I: Top-up Tax and its Tax Credits

Let r_T be the Top-up Tax Percentage, r_M be the Minimum Rate and r_E the Effective Tax Rate; further let I_G be the Net GloBE Income, T_{AC} be Adjusted Covered Taxes, T_{TUp} the jurisdictional Top-up Tax, and S be the Substance based Income Exclusion. All calculations are on a jurisdictional basis for all CEs that are located in the jurisdiction. Under the Model Rules, if $r_M \geq r_E$:[258]

$$(1)\ r_E = \frac{T_{AC}}{I_G}\ \text{(Art. 5.1.1);}$$

$$(2)\ r_T = r_M - r_E\ \text{(Art 5.2.1).}$$

Because Excess Profit is defined as Net GloBE Income reduced by the Substance based Income Exclusion, it follows that

$$(3)\ T_{TUp} = r_T \times (I_G - S) - QDMTT\ \text{(see Art. 5.2.2).}$$

Replacing r_T with equation (2) and r_E with equation (1) and rearranging expressions yields:

$$(4)\ T_{TUp} = \boxed{r_M \times (I_G - S)} - \boxed{T_{AC} \times \frac{I_G - S}{I_G}} - \boxed{QDMTT}.$$

Note that the haircut with respect to the Adjusted Covered Taxes is in effect the fraction of the GloBE Income that is Excess Profits, i.e., the creditable Adjusted Covered Taxes are reduced in proportion to the GloBE Income that constitutes the Substance based Income Exclusion. This factor is equivalent to the "inclusion percentage" under current Section 960(d)(2).

Equation (4) shows more clearly than Article 5.2.3 that the Jurisdictional Top-up Tax equals tax at the Minimum Rate r_M imposed on Excess Profits (I_G – S), minus a credit for the portion of Adjusted Covered Taxes (T_{AC}) that is attributable to Excess Profits, minus a credit for QDMTT.

[258] The following equation does not include Additional Current Top-up Tax, which is not relevant to the analysis here.

Appendix II: List of Acronyms

BBBA	Build Back Better Act	H.R. 5376, 117th Cong. (2021)
BBBA AMT	alternative minimum tax proposed under the BBBA based on financial accounting income	
BEAT	base erosion and anti-abuse tax	§59A
CE	Constituent Entity of an MNE Group	Art. 1.3
CFC	controlled foreign corporation	§957
CFC-CE	Constituent Entity that is a CFC	
CFC-MTT	CFC Minimum Top-up Tax	
ETR	Effective Tax Rate	Art. 5.1.1
GILTI	global intangible low-taxed income	§951A(b)(1)
GloBE	Global Anti-Base Erosion	
IIR	undefined, "Income Inclusion Rule"	Art. 2.1
IIR-GILTI	GILTI Regime that is accepted as a Qualified IIR	
IPE	Intermediate Parent Entity	Art. 2.1.2
MNE Group	Multinational entity group satisfying the Consolidated Financial Statement income requirement of the Model Rules	Ar. 1.2
NDTIR	net deemed tangible income return	§951A(b)(2)
NOL	net operating less	
PE-CE	Permanent Establishment that constitutes a Constituent Entity	
POPE	Partially-Owned Parent Entity	Art. 2.1.4
QDMTT	Qualified Domestic Minimum Top-up Tax	Art. 10.1
SBIE	Substance-based Income Exclusion	Ar. 5.3
UPE	Ultimate Parent Entity	Art. 1.4
UTPR	undefined, may abbreviate "Undertaxed Profits Rule", formerly "Undertaxed Payment Rules"	Art. 2.4

Appendix III: Defined Terms