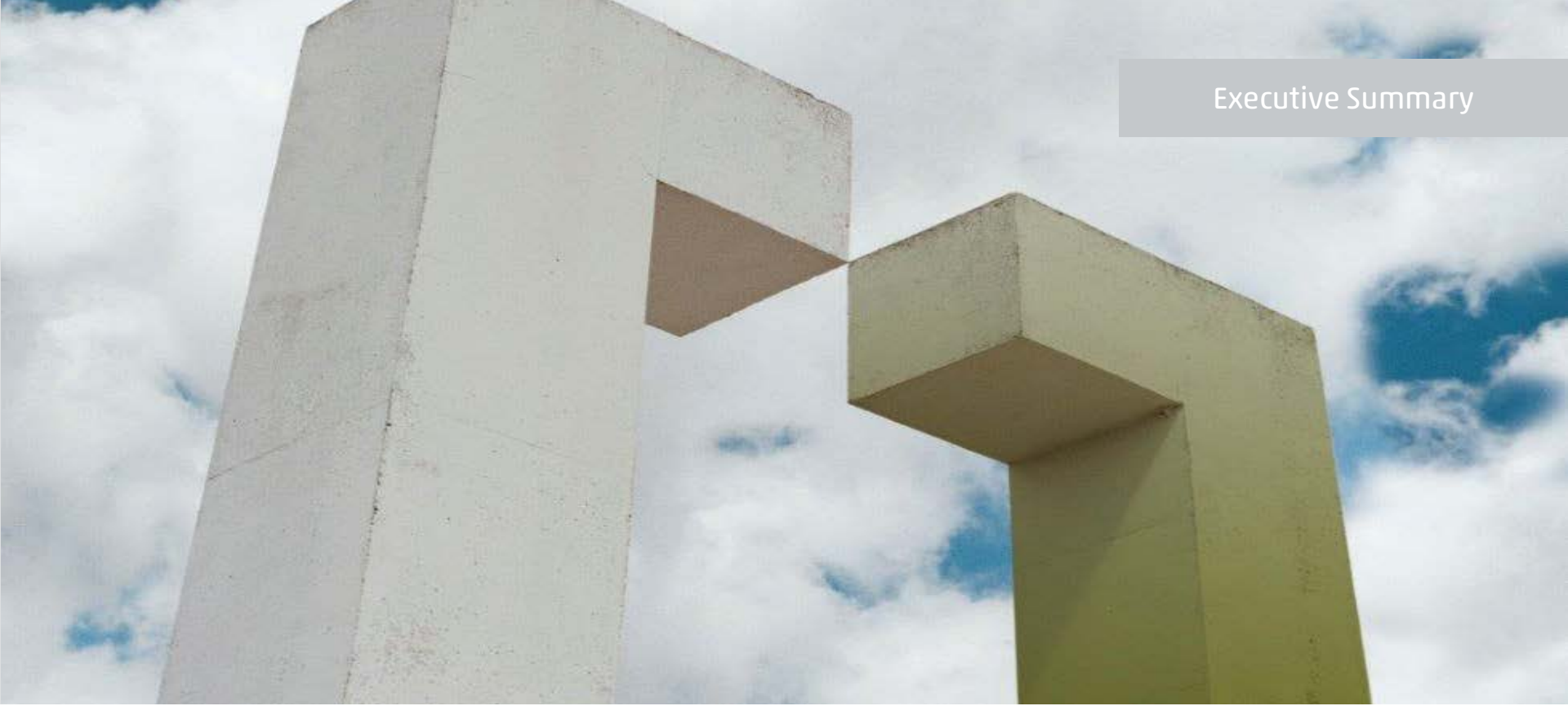

Executive Summary

Pillar Two: Global Anti-Base Erosion

February 2020

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Main features

What	» Proposal that focuses on the remaining BEPS issues exacerbated by digitalization and the broader tax challenges, and seeks to develop rules that are based on a minimum effective tax requirement
Why	» To address the remaining BEPS challenges, such as profit shifting planning structures
Who	» The scope of the Proposal includes all internationally operating businesses, and is not limited to highly digitalized businesses.
How	» Development of a coordinated set of rules comprised of four component parts: the income inclusion rule, the undertaxed payments rule, the switch over rule and the subject-to-tax rule.
When	» Final version of the proposal is expected to be delivered by the end of 2020

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What

» The Pillar Two Proposal (also referred to as the "GloBE" proposal) aims to develop a coordinated set of rules that jurisdictions have the right to apply where income is taxed at an effective rate below a minimum rate, and which seek to address remaining BEPS risk of profit shifting to entities subject to no or very low taxation.

Why

» The purpose of the Proposal is to tackle the tax challenges of the digitalisation of the economy by:

- Providing jurisdictions with the ability to "tax back" group profits that are subject to a low effective rate.
- Ensuring that all internationally operating businesses pay a minimum level of tax
- Addressing remaining BEPS issues
- Present a multilateral solution to avoid uncoordinated rules, increased complexity and risk of over-taxation
- Reduce pressure on developing countries to grant tax incentives
- Address profit shifting risk from intangibles but not restricted to digital economy

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How (I)

The Proposal is aimed at strengthening the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits through the creation of new rules that apply whenever the minimum effective tax rate is not met:

Parent country measures

Income inclusion rule

» It would incorporate the income of a foreign branch or subsidiary (where taxed below a minimum rate) in the taxable base of the parent entity.

Switch-over rule

» It would be inserted into double tax treaties to allow residence states to switch from an exemption to a credit method of double tax relief, in cases where profits of PE or immovable property had been taxed below a minimum rate.

Income not subject to tax at a minimum rate

Source country measures

Undertaxed payment rule

» It would deny a deduction (or impose source-based taxation, such as a withholding tax) on a payment to a related party, where the payment is taxed below a minimum rate.

Subject-to-tax rule

» It would be inserted into double tax treaties to deny certain treaty benefits, in cases where the item of income is not subject to tax at a minimum rate.

» Possible extension to unrelated parties.

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How (II)

A. Tax base determination

- Use of consolidated group financial accounts as the starting point for the determination of the taxable income.
- The entity's accounting profit would be subject to adjustments to take into account permanent and temporary differences between accounting income and income under tax rules.
- To be determined which financial accounting standard is more appropriate, so as to avoid distortions that could arise from the different accounting standards applied to the subsidiaries.
- Important interaction between the existing domestic CFC rules and the GloBE proposal, although the OECD seems reluctant to introduce any carve-outs in the GloBE proposal.
- Three approaches are proposed for addressing the problem of temporary differences: (i) carry-forward of excess taxes and tax attributes; (ii) deferred tax accounting; and (iii) a multi-year average effective tax rate.
- Compliance, administration and tax policy issues should be considered.

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How (III)

B. Blending

- Blending is defined as the "mixing of income from different sources"
- Different blending options, which represent different policy choices:
  - Worldwide
  - Jurisdictional
  - Entity level
- All the blending approaches present challenges in their implementation which would need to be addressed, inter alia:
  - Interaction with the local tax consolidation or grouping rules.
  - Allocation of income between branch and head offices
  - Allocation of income from a tax transparent entity
  - Crediting of taxes that arise in another jurisdiction
  - Treatment of dividends and other distributions
  - Compliance costs implications

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How (IV)

» The GloBE Proposal calls for the design of appropriate carve-outs and thresholds, in line with the OECD's Programme of Work from May 2019 ("**PoW**").

Carve-outs

- Regimes compliant with the BEPS Action 5 to preserve the existing special regimes (i.e. R&D and IP regimes) and other substance based carve-outs.
  - However, under the PoW, the OECD explicitly states that the introduction of such carve outs could "undermine the policy intent and effectiveness of the proposal".
- A return on tangible assets
- Controlled corporations with related party transactions below a certain threshold.
- The appropriateness of carve-outs for specific sectors or industries should be explored.

Thresholds

- Thresholds based on the turnover or other indications of the size of the group (e.g. the CbCR threshold of €750 million).
- De minimis thresholds to exclude transactions or entities with small amounts of profit or related party transactions.

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Key outstanding issues

- Design of coordination and simplification measures, as well as thresholds and carve-outs, including interaction with BEPS Actions.
- Compatibility with international obligations (in particular, with existing tax treaties or EU rules).
- Potential technical, compliance and administrative implications.
- PoW calls to explore the possible extension of the subject-to-tax rule to unrelated parties or to other treaty benefits beyond interest and royalties.
- Need of consensus on the determination of the rate of the minimum tax and the use of financial accounts as a starting point for determining the tax base.

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WTS Global Comments on Pillar Two

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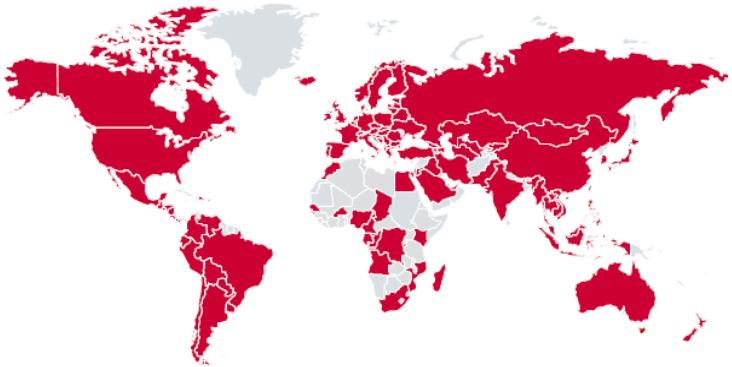

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