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**Programme of Work to Develop a Consensus Solution to the Tax Challenges
Arising from the Digitalisation of the Economy**

This note is the final version of the Programme of Work as approved by the Inclusive Framework at its plenary meeting on the 28th May, 2019.

Grace PEREZ-NAVARRO, Deputy Director, OECD Centre for Tax Policy and Administration
Grace.perez-navarro@oecd.org; +(33-1) 45 24 18 80 80.

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*PROGRAMME OF WORK TO DEVELOP A CONSENSUS
SOLUTION TO THE TAX CHALLENGES ARISING FROM
THE DIGITALISATION OF THE ECONOMY*

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Chapter I - Introduction

1. The digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time the breadth and speed of this change introduces challenges in many policy areas, including taxation.

2. The tax challenges of the digitalisation of the economy were identified as one of the main areas of focus of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, leading to the 2015 BEPS Action 1 Report (the Action 1 Report).¹ The Action 1 Report found that the whole economy was digitalising and, as a result, it would be difficult, if not impossible, to ring-fence the digital economy.

3. For indirect taxes, the Action 1 Report recognised new challenges related to the collection of Value Added Taxes (VAT)/Goods and Services Taxes (GST) on the continuously growing volumes of goods and services that consumers purchase online from foreign suppliers. It recommended implementing the destination principle contained in the 2017 OECD International VAT/GST Guidelines,² together with the mechanisms for effective collection of VAT/GST on cross-border supplies of services and intangibles presented in those Guidelines.

4. For direct taxes, the Action 1 Report observed that while digitalisation could exacerbate BEPS issues, it also raises a series of broader tax challenges, which it identified as “nexus, data and characterisation”. The latter challenges, however, were acknowledged as going beyond BEPS, and were described as chiefly relating to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions. A number of potential options to address these concerns were discussed, but none were ultimately recommended. Instead, the Action 1 Report called for continued work in this area, notably by monitoring developments in respect of digitalisation, with a further report to be delivered by 2020.

5. Notwithstanding the progress made in tackling double non-taxation as part of the BEPS package, and the widespread implementation of the OECD International VAT/GST Guidelines, ongoing concerns around the tax implications of a rapidly digitalising economy led the G20 Finance Ministers, at their meeting in Baden Baden in March 2017, to advance the timeline and request the Inclusive Framework to deliver an interim report by early 2018. In March 2018, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE), issued *Tax Challenges Arising from Digitalisation – Interim Report 2018* (the Interim Report).³ The Interim Report provided an in-depth analysis of new and changing business models that enabled the identification of three characteristics frequently observed in certain highly digitalised business models, namely *scale without mass*, *heavy reliance on intangible assets*, and the *importance of data, user participation and their*

¹ OECD (2015), *Addressing the Tax Challenges of the Digital Economy*, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

² OECD (2017), *The International VAT/GST Guidelines*, OECD Publishing, Paris.

³ OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

synergies with intangible assets. The ensuing potential tax challenges were discussed, including remaining BEPS risks and the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions.

6. While members of the Inclusive Framework did not converge on the conclusions to be drawn from this analysis, they committed to continue working together to deliver a final report in 2020 aimed at providing a consensus-based long-term solution, with an update in 2019.

7. Conscious of the challenging time frame and the importance of the issues, the Inclusive Framework further intensified its work after the delivery of the Interim Report. Consistent with the analysis included in the Action 1 Report as well as the Interim Report, some members made suggestions on how the work could be taken forward to achieve progress towards a consensus-based solution. Some proposals focused on the allocation of taxing rights by suggesting modifications to the rules on profit allocation and nexus, other proposals focused more on unresolved BEPS issues. In the Policy Note *Addressing the Tax Challenges of the Digitalisation of the Economy*,⁴ approved on 23 January 2019, the Inclusive Framework agreed to examine and develop these proposals on a “without prejudice” basis. These proposals were grouped into two pillars which could form the basis for consensus:

- Pillar One focuses on the allocation of taxing rights, and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules;
- Pillar Two focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to “tax back” where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation.

8. While the two issues of the ongoing work on remaining BEPS challenges and a concurrent review of the profit allocation and nexus rules are distinct, they intersect and a solution that seeks to address them both could have a mutually reinforcing effect. Therefore the Inclusive Framework agreed that both issues should be discussed and explored in parallel.

9. Since January 2019, and consistent with the Policy Note, the Inclusive Framework has continued to examine the proposals, including by considering how the gaps between the different positions of jurisdictions could be bridged, taking into consideration the overlaps that exist between the BEPS issues exacerbated by digitalisation and the broader tax challenges. As part of this work, a public consultation document was released on 13 February 2019, which sought input from external stakeholders on the specific proposals examined under Pillar One and Pillar Two.⁵ The response from stakeholders was robust with more than 200 written submissions running to over 2,000 pages of written comments.⁶ Stakeholders had the opportunity to express their views at the public consultation meeting that was held at the OECD Conference Centre in Paris on 13 and 14 March 2019 and that

⁴ *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019, accessible through this [link](#).

⁵ Public Consultation Document, *Addressing the Tax Challenges of the Digitalisation of the Economy*, 13 February – 6 March 2019, accessible through this [link](#).

⁶ All written submissions made to the Public Consultation Document are available at this [link](#).

was attended by over 400 representatives from governments, business, civil society and academia.

10. This ongoing work, including the public consultation process and inputs received from various stakeholders, has highlighted important areas that need to be discussed among the members of the Inclusive Framework. One area is the effect of the three characteristics noted in the Interim Report, which are more pronounced in certain highly digitalised business models, reinforced by globalisation, and the broader challenges this may pose in relation to existing tax rules, including by exacerbating some BEPS risks.⁷ For some commentators and members of the Inclusive Framework the work on the tax challenges of digitalisation has revealed some more fundamental issues of the existing international tax framework, which have remained after the delivery of the BEPS package.

11. A further issue is the recognition that if the Inclusive Framework does not deliver a comprehensive consensus-based solution within the agreed G20 time frame, there is a risk that more jurisdictions will adopt uncoordinated unilateral tax measures. A growing number of jurisdictions are not content with the taxation outcomes produced by the current international tax system, and have or are seeking to impose various measures or interpretations of the current rules that risk significantly increasing compliance burdens, double taxation and uncertainty. One of the focal points of dissatisfaction relates to how the existing profit allocation and nexus rules take into account the increasing ability of businesses, in certain situations, to participate in the economic life of a jurisdiction without an associated or meaningful physical presence. An unparalleled reliance on intangibles and the rising share of services in cross border trade are among the causes typically identified. This dissatisfaction has created a political imperative to act in a significant number of jurisdictions. Cognisant that predictability and stability are fundamental building blocks of global economic growth, the Inclusive Framework is therefore concerned that a proliferation of uncoordinated and unilateral actions would not only undermine the relevance and sustainability of the international framework for the taxation of cross-border business activities, but will also more broadly adversely impact global investments and growth.

12. This economic and political context is at the foundation of the programme of work for each Pillar outlined in this paper, which has been developed by the Inclusive Framework with a view to reporting progress to the G20 Finance Ministers in June 2019 and delivering a long-term and consensus-based solution in 2020. This timeline is extremely ambitious given the need to revisit fundamental aspects of the international tax system, but is reflective of the political imperative that all members of the Inclusive Framework attach to finding a timely resolution of the issues at stake.

13. A consensus based solution to be agreed among the 129 members of the Inclusive Framework will, in addition to the important technical work that must be carried out, require political engagement and endorsement as the interests at stake for members go beyond technical issues and will have an impact on revenues and the overall balance of taxing rights. For a solution to be delivered in 2020, the outlines of the architecture will need to be agreed by January 2020. This outline will have to include a determination of the

⁷ This matter was recently addressed in a Policy Paper released by the International Monetary Fund (IMF), stressing that the challenges raised by digitalisation are emblematic of wider vulnerabilities in the international tax system that cannot be addressed by small scale reforms but rather ask for a more fundamental reconsideration (International Monetary Fund (2019), *Corporate Taxation in the Global Economy*, Policy Paper No 19/007, Washington D.C., accessible through this [link](#)).

nature of, and the interaction between, both Pillars, and will have to reduce the number of options to be pursued under Pillar One. The solution should reflect the right balance between precision and administrability for jurisdictions at different levels of development, underpinned by sound economic principles and conceptual basis. Furthermore, it would be important to ensure a level playing field between all jurisdictions; large or small, developed or developing. The G20 process can provide important momentum in this regard. As indicated in the Policy Note,⁸ the rules agreed should not result in taxation where there is no economic profit nor should they result in double taxation.

14. The work programme contained in this paper provides a path to finding such a solution but will require an early political steer informed by an economic analysis and impact assessment of the possible designs of a solution, as described in Chapter IV.

15. Given the interlinked nature of these different elements the Steering Group of the Inclusive Framework will play a key role in advancing this work and developing proposals for the consideration of the Inclusive Framework.

16. To support this process and enable the Steering Group to fulfil its mandate, technical work, including on the economic analysis, at the subsidiary body level will start immediately on all current proposals as needed to support the Steering Group. Once there is an agreed architecture proposed by the Steering Group and agreed by the Inclusive Framework, the subsidiary bodies will revert to their more traditional role of working towards the implementation of an agreed policy direction.

17. The programme of work for the future technical work contained in this document needs to be seen in this context. It remains dynamic throughout, recognising that new technical issues may emerge as the work progresses. It has a preparatory focus initially and then turns more definitive once an overall architecture has been agreed. It recognises that there are cross-cutting issues that affect both Pillars requiring close coordination. Finally, it recognises the need for the Steering Group to play a central and ongoing role in managing the work and provide direction as and when needed to achieve a successful outcome.

18. Chapter II of the document focuses on the allocation of taxing rights (Pillar One), and describes the different technical issues that need to be resolved to undertake a coherent and concurrent revision of the profit allocation and nexus rules.

19. Chapter III focuses on remaining BEPS issues (Pillar Two), and describes the work to be undertaken in the development of a global anti-base erosion (GloBE) proposal that would, through changes to domestic law and tax treaties, provide jurisdictions with a right to “tax back” where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation.

20. Chapter IV discusses work to be undertaken in connection with an impact assessment and economic analysis of the proposals.

21. Chapter V explains how the work under both Pillars is organised and articulates the role of the Steering Group in steering, monitoring and co-ordinating the Programme of Work and related outputs in order to ensure that the Inclusive Framework can deliver on its commitment to arrive at a consensus solution and produce a final report by the end of 2020. The schedule of meetings of the Inclusive Framework will be adapted accordingly.

⁸ See above footnote 4.

Chapter II – Revised Nexus and Profit Allocation Rules (Pillar One)

22. Under Pillar One, three proposals have been articulated to develop a consensus-based solution on how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries – namely, the “user participation” proposal,⁹ the “marketing intangibles” proposal¹⁰ and the “significant economic presence” proposal.¹¹

23. These proposals have important differences, including the objective and scope of the reallocation of taxing rights – hereafter, the “new taxing right”. At the same time, they all allocate more taxing rights to the jurisdiction of the customer and/or user – hereafter, the “market jurisdictions”¹² – in situations where value is created by a business activity through (possibly remote) participation in that jurisdiction that is not recognised in the current framework for allocating profits. Further, they have important common policy features, as they all contemplate the existence of a nexus in the absence of physical presence, contemplate using the total profit of a business, contemplate the use of simplifying conventions (including those that diverge from the arm’s length principle) to reduce compliance costs and disputes – a feature supported by many commentators at the public consultation, who expressed concerns about approaches that would add complexity to existing tax rules –, and would operate alongside the current profit allocation rules.

24. Hence, although further work will be conducted in parallel to reach a political agreement on the objective and scope of a unified approach, the existing commonalities suggest that there is sufficient scope to establish a programme of work considering together some key design features of a consensus-based solution under Pillar One. The technical issues that need to be resolved under the programme of work may be grouped into three building blocks, namely:

- different approaches to determine the amount of profits subject to the new taxing right and the allocation of those profits among the jurisdictions;
- the design of a new nexus rule that would capture a novel concept of business presence in a market jurisdiction reflecting the transformation of the economy, and not constrained by physical presence requirement; and

⁹ See paragraphs 17-28 of the Public Consultation Document.

¹⁰ See paragraphs 29-49 of the Public Consultation Document.

¹¹ See paragraphs 50-54 of the Public Consultation Document.

¹² In the context of the programme of work, the term “market jurisdiction” refers to the jurisdiction where the customers of the business are located or, in the case of businesses that supply services to other businesses, the jurisdiction where those services are used. In the context of many digitalised business models, this definition would cover the jurisdiction where the user is located either because the user acquires goods or services directly from the on-line provider or because the on-line provider provides services to another business (such as advertising) targeting such users.

- different instruments to ensure full implementation and efficient administration of the new taxing right, including the effective elimination of double taxation and resolution of tax disputes.

25. The programme of work will invite subsidiary bodies to explore these issues and assess their implications, with a view to assisting the Steering Group to reach a unified approach on Pillar One which will facilitate a political agreement.

1. New profit allocation rules

1.1. Overview

26. The new taxing right requires a method to quantify the amount of profit reallocated to market jurisdictions, and a method to determine how that profit should be allocated among the market jurisdictions entitled to tax under the new taxing right. The different methods suggested so far to determine the profit subject to the new taxing right will be further explored, including the possible use of more simplifications to minimise compliance costs and disputes.

27. Due consideration will be given to concerns about the complexity and uncertainty of the methods articulated so far, and the possible advantages of using other simplified approaches. Additionally, this work will consider the feasibility of business line or regional segmentations, different mechanisms to allocate the profit to the relevant market jurisdictions, the design of various scoping limitations and alternative treatments of losses. It is recognised that, due to the nature and the variety of possible approaches that are to be considered in this work, the scope of the work may need to be adapted as the work progresses.

1.1. New profit allocation rules

The programme of work would explore issues and options in connection with new profit allocation rules. These issues and options are expected to include:

- 1) The development of conceptually underpinned methods for determining the amount of profit and loss subject to the new taxing right, consistent with the principle of avoiding double taxation;
- 2) The use of simplification measures where appropriate to limit the burden of the new rules on tax administrations and taxpayers alike; and
- 3) An assessment of the administrability of the features of any proposal, taking into consideration capacity and resource constraints.

1.2. Modified residual profit split method

28. The MRPS method would allocate to market jurisdictions a portion of an MNE group's non-routine profit that reflects the value created in markets that is not recognised under the existing profit allocation rules. It involves four steps: (i) determine total profit to be split; (ii) remove routine profit, using either current transfer pricing rules or simplified conventions; (iii) determine the portion of the non-routine profit that is within the scope of the new taxing right, using either current transfer pricing rules or simplified conventions; and (iv) allocate such in-scope non-routine profit to the relevant market jurisdictions, using an allocation key.

29. The programme of work will explore the issues and alternative options associated with each of these steps, including possible simplifications. Further, given that the scope of the new taxing right is not intended to cover all profit, the MRPS method will coexist with the existing transfer pricing rules and rules for coordinating these two sets of rules will be necessary to provide certainty and minimise disputes.

1.2. Modified Residual Profit Split

The programme of work would explore options and issues relating to a modified residual profit split method. These issues and options are expected to include:

- 1) The development of rules that govern how total profits should be computed for purposes of applying the Modified Residual Profit Split ("MRPS") method.
 - a) This requires consideration of the suitability of using accounting rules for the computation of total profits, the relevant measure of profit to be used (such as pre-tax profit etc.), and what adjustments (if any) would be appropriate.
 - b) It also requires an evaluation of the relative merits of determining total profits:
 - i) on a group-wide basis, including how this approach could be integrated with the existing international tax system to ensure that a group could identify which entity's or entities' profit is subject to the new taxing right exercised by a particular jurisdiction; or
 - ii) on an entity or aggregated entity basis, including how the entity or entities in scope could be identified and, where multiple entities are identified, how the combined profits of these entities would be reallocated under the new taxing right.
- 2) The development of rules to bifurcate total profit into routine and non-routine components. This would require an evaluation of the relative merits of using current transfer pricing rules and simplified approaches. In particular,
 - a. The evaluation of using current transfer pricing rules would include consideration of the following:
 - i. the impact of future transfer pricing disputes (which can take a number of years to conclude) on routine and non-routine profit computations; and

- ii. the mechanisms that local tax administrations would require to confirm the amount of non-routine profits.
 - b. The evaluation of using simplified approaches would include consideration of possible proxies for the determination of non-routine profit.
- 3) The development of rules to quantify the portion of non-routine profit subject to the new taxing right. This would include an evaluation of the relative merits of using the approaches set forth below.
 - a. The adaptation of the current transfer pricing rules, taking into account the issues raised above.
 - b. The use of a proxy based on capitalised expenditures. This would include consideration of:
 - i. how costs relating to the activities and assets in and out of scope of the new taxing right should be identified;
 - ii. how the “useful lives” of different categories of expenditure and investment should be determined and applied; and
 - iii. how concerns that cost may not always be an appropriate indicator of value could be addressed.
 - c. The use of a proxy based on projections of future income.
 - d. The use of a proxy based on fixed percentages of total non-routine income, including the possibility of using different fixed percentages for different lines of business.
 - e. Such other proxies as may be developed by the detailed work in this area.
- 4) The development of rules to allocate the identified profit subject to the new taxing rights among the relevant market jurisdictions. This requires the evaluation of possible allocation keys, such as revenues.
- 5) The integration of the MRPS method with the existing transfer pricing rules without giving rise to double taxation or double non-taxation.
- 6) Other technical issues that arise from the exploration of the above topics, recognising that the detailed points discussed above may need to be adapted as the work progresses.

* *A fundamental issue associated with the MRPS method is whether it would be applied to an MNE group as a whole, or whether it would separately take into account different business lines and geographical regions. That topic is addressed below.*

1.3. Fractional apportionment method

30. The fractional apportionment method involves the determination of the amount of profits subject to the new taxing rights without making any distinction between routine and non-routine profit. One possible approach to assessing the profit derived by a non-resident enterprise is to take into account the overall profitability of the relevant group (or business line). This method would involve three steps: (i) determine the profit to be divided, (ii)

select an allocation key, and (iii) apply this formula to allocate a fraction of the profit to the market jurisdiction(s).

31. In exploring the development of a fractional apportionment method, the programme of work will explore a number of issues, including:

- Determining options for the starting point of the computation of the relevant profits subject to the fractional apportionment mechanism. Such options may include the profit of the selling entity as determined by the current transfer pricing rules, or by applying a global profit margin to local sales, or by any other measures as may be considered appropriate.
- Explore different allocation keys that could be taken into account in constructing the formula that would be used to apportion the relevant profit.
- Addressing the interaction between the current profit allocation framework with the fractional apportionment approach, especially if a decision is made to adjust the amount of profit allocated to the market jurisdiction based on the overall profitability of the relevant group or business line.

1.3. Fractional apportionment

The programme of work would explore issues and options relating to a fractional apportionment method. These issues and options are expected to include:

- 1) The development and evaluation of a method to determine the profits of a non-resident entity or group that would be subject to the fractional apportionment mechanism, including the possibility of taking into account overall profitability.
- 2) The financial accounting regime and measure upon which the profit determination would be based for this purpose.
- 3) The factors, including employees, assets, sales, and users, that could be taken into account in constructing the formula that would be used to apportion the relevant profit.
- 4) The design of rules to coordinate the effect of the fractional apportionment method and the current transfer pricing system, without giving rise to double taxation or double non-taxation. This would include, for example, rules related to how the burden of the new taxing right might be shared with other entities in the MNE group where the profits of a non-resident entity take into account the overall profitability of the group.

1.4. Distribution-based approaches

32. Consistent with the strong demand for simplicity and administrability, the programme of work will also explore other possible simplified methods. This includes consideration of a simplified approach grounded in the twin considerations of the interest in allocating more profit to market jurisdictions and reducing the ongoing controversies associated with the proper pricing of marketing and distribution activities. In contrast to the MRPS method, this approach might address, in addition to non-routine profit, profit arising from routine activities associated with marketing and distribution.

33. One possibility would be to specify a baseline profit in the market jurisdiction for marketing, distribution and user-related activities. Other options might also be considered, for example, the baseline profit could increase based on the MNE group's overall profitability. Through this mechanism, some of the MNE group's non-routine profit would be reallocated to market jurisdictions. The baseline profit could also be modified by additional variables to accommodate, for instance, industry and market differences.

34. The design of such an approach would require consideration of whether it would envisage allocating to market jurisdictions a profit which would be a final allocation – i.e. an allocation which taxpayers or tax authorities would not be able to re-evaluate under the current transfer pricing rules. Alternatively, such a simplified approach could be designed to allow the allocation of a higher return under traditional transfer pricing principles to market jurisdictions, such as in those cases where a local distribution company owns and controls all the risks for highly profitable marketing intangibles.

35. In scenarios involving a remote activity, an issue that will need to be explored is whether the amount of profit (including any baseline profit) taxable by that market jurisdiction would be the same as for locally-based marketing and distribution activities, or whether that amount should be reduced in some formulaic manner.

1.4. Distribution-based approaches

The programme of work would explore issues and options related to distribution-based approaches. These issues and options are expected to include:

- 1) The development of rules providing a baseline amount of profit attributable to marketing, distribution, and user-related activities.
- 2) The assessment of whether and how a baseline amount could be adjusted based on a group's overall profitability and other relevant factors to effectively allocate a proportion of routine and non-routine profits to market jurisdictions. This could include consideration of how concerns that cost may not always be an appropriate indicator of value could be addressed.
- 3) The assessment of whether the baseline could function as a minimum or maximum return.
- 4) The assessment of whether and how any such adjusted profits or returns could be applied where the relevant group has no established tax presence in the market jurisdiction.
- 5) How the approach could be coordinated with the current transfer pricing system without giving rise to double taxation or double non-taxation.

1.5. Explore the use of business line and regional segmentation

36. The profitability of a MNE group can vary substantially across different business lines and regions. To avoid unintended outcomes and distortions, and ensure a proper balance between simplicity and precision, the programme of work will explore the possibility of determining the profits subject to the new taxing right on a business line and/or regional basis.

1.5. Business line and regional segmentation

The programme of work would explore issues and options for business line and regional segmentation. These issues and options are expected to include:

- 1) The design of rules to define and delineate among different business lines for the purposes of applying the approaches described above, and an evaluation of the administrability associated with such rules. As elsewhere, these rules would need to be administrable for taxpayers and tax administrations with different capability and resource constraints. In developing these rules consideration would be given to (i) the information MNE groups already prepare (e.g. for accounting, securities law, or regulatory purposes); (ii) the extent to which this information could be used reliably to segment MNE groups by business line; and (iii) any other required information.
- 2) The design of rules or principles to allow the regional segmentation of an MNE group's activities for the purposes of applying the approaches described above. These rules or principles could need to consider many of the same issues identified for business line segmentation.

1.6. Design scoping limitations

37. To the extent that the activities and assets within the scope of the new taxing right would not be undertaken or exploited by all businesses, scope limitations may be appropriate. The programme of work will explore different limitations that could operate either by reference to the nature (e.g. through negative exclusions, safe harbours, and/or other screening criteria) or the size (e.g. thresholds based on revenue or other relevant factors) of a given business. In this task, due consideration will be given to the feasibility of business line segmentations and any legal constraint arising from other international obligations. Due consideration will also be given to whether or to what extent any new taxing right would apply to certain items such as commodities and other primary products, and financial instruments.

1.6. Design scope limitations

The programme of work would explore issues and options in connection with design scoping limitations. These issues and options are expected to include:

- 1) Potential limitations on the scope of the new taxing right. This work would include the development of rules to limit the scope of the new taxing right based on the size of a MNE group or business line. It would also include an evaluation of rules that could focus the scope of the rules on businesses that are of a type to which the rules should apply.
- 2) Consideration would also be given to whether any scope limitations are legally constrained by other international obligations, e.g. trade regulations.

1.7. Develop rules on the treatment of losses

38. It is important that the new profit allocation rules have effective application to both profits and losses. The programme of work will explore the different options available for the treatment of losses under the new taxing right.

1.7. Treatment of losses

The programme of work would explore issues and options in connection with the design of rules for the treatment of losses. These issues and options are expected to include:

- 1) The development of profit allocation rules that apply symmetrically to profits and losses. This should include consideration of the practical consequences of this approach, such as when and how a loss-making MNE group would be required to file a tax return in market jurisdictions.
- 2) The development of an “earn out” approach to losses, wherein an MNE group would maintain a notional cumulative loss account, and profits would be subject to the new taxing right only once that cumulative loss account had been reduced to zero by subsequent profits.
- 3) The development of a hybrid system incorporating elements of the symmetric treatment of losses and “earn out” approach could also be considered.
- 4) The determination of whether all or a defined subset of the losses of an MNE group (such as carry-forward losses, losses in relation to a particular business line, or losses in a particular region/jurisdiction) should be taken into account under the approaches described above.

2. New nexus rules

39. The work programme will explore the development of a concept of remote taxable presence (i.e. a taxable presence without traditional physical presence) and a new set of standards for identifying when such a remote taxable presence exists. The work programme will also consider a new concept of taxable income sourced in (i.e. derived from) a jurisdiction. This taxing right would generally not be constrained by physical presence requirements.

40. Developing a new non-physical presence nexus rule to allow market jurisdictions to tax the measure of profits allocated to them under the new profit allocation rules would require an evaluation of the relative merits of alternative approaches, including:

- amendments to the definition of a “permanent establishment” (PE) in Article 5 of the OECD Model Convention,¹³ and potential ensuing changes to Article 7 of the OECD Model Convention;
- development of a standalone rule establishing a new and separate nexus, either through a new taxable presence or a concept of source.

2.1. New nexus rules rule and other treaty related issues

The programme of work would explore options and issues related to a new nexus rule. These options and issues are expected to include:

1. The development of a new nexus rule that would capture a novel concept of a business presence in a market jurisdiction reflecting the transformation of the economy and not constrained by physical presence requirements, and which would allow market jurisdictions to exercise taxing rights over the measure of profits allocated to them under the new profit allocation rules. This would require an evaluation of the relative merits of alternative approaches, including the making of recommendations on:
 - a. Amending Articles 5 and 7 of the OECD Model Convention to deem a PE to exist where an MNE exhibits a remote yet sustained and significant involvement in the economy of a jurisdiction and to accommodate the new profit allocation rules. This would also require a consideration of any impact of such an amendment on other provisions that use the PE concept (Articles 10-13, 15, 21, 22, and 24) and other issues (such as VAT and social security contributions).
 - b. Alternatively, introducing a new standalone provision giving market jurisdictions a taxing right over the measure of profits allocated to them under the new profit allocation rules, which would require:
 - identifying and defining a new non-physical taxable presence separate from the PE concept;
 - identifying and defining a new concept of income taxable in the source jurisdiction (i.e. income derived from a particular source in a jurisdiction); and
 - the interaction between the new taxable presence or source income and existing provisions (including especially provisions governing non-discrimination).
2. The evaluation and development of indicators of an MNE group’s remote but sustained and significant involvement in the economy of a market jurisdiction. This would require:

¹³ What matters, of course, is what is in existing bilateral or multilateral tax treaties – whether these are based on the OECD Model Convention or not. But for clarity and convenience this note talks about the OECD Model Convention.

- a. a sustained local revenue threshold (both monetary and temporal); and
 - b. a range of additional indicators which, in combination with sustained local revenues, would be taken to demonstrate a link beyond mere selling between those revenues and the MNE's interaction with the economy of a jurisdiction.
3. The necessity to change any other treaty provision, such as Article 9, to allow market jurisdictions to exercise taxing rights over the measure of profits allocated to them under the new nexus and profit allocation rules.
 4. The considerations to ensure tax certainty, administrability, and effective dispute prevention and resolution.

3. Implementation of the new taxing right

3.1. Elimination of double taxation

41. The proposals under this Pillar may, depending on the design options eventually chosen, envisage reallocating taxing rights over a proportion of an MNE group's profit (however defined), rather than over the profit from specific transactions or activities undertaken by particular separate entities. It may therefore not be immediately clear which member(s) of an MNE group should be considered to derive the relevant income. This leads to questions about how, in practice, source jurisdictions would exercise the reallocated taxing rights, and how residence jurisdictions would provide relief from double taxation of the relevant income. It is also recognised that the new taxing right may raise new questions relating to the sufficiency of existing double tax relief mechanisms.

42. The work programme will consider those questions and, in particular, explore the effectiveness of the existing treaty (and domestic law) provisions and the need to develop new or enhanced provisions. Consideration would also be given to a multilateral competent authority mutual agreement or framework that would provide additional guidance.

43. The programme of work will also examine the current dispute prevention and resolution procedures in the context of the new nexus and profit allocation rules and, where necessary, make recommendations for changes or enhancements to these procedures, including arbitration procedures, multilateral competent authority agreements, etc.

44. Where appropriate, the work could also consider whether multilaterally co-ordinated risk assessment could be helpful in applying the new nexus and profit allocation rules and make recommendations accordingly. This work could be informed by the ongoing work within the Forum on Tax Administration, including the International Compliance Assurance Programme.

3.1. Elimination of double taxation and dispute resolution

The programme of work would explore options and issues related to the elimination of double taxation and the avoidance and resolution of disputes in relation to the new nexus and profit allocation rules. These options and issues are expected to include:

- 1) The effectiveness of the existing treaty provisions and the need to develop new or enhanced, treaty provisions for the effective elimination of double taxation in relation to the new nexus and profit allocation rules. This work should examine, in particular:
 - a) The extent to which, under the new profit allocation rules, the clear identification of the relevant taxpayer in respect of the income that is reallocated would allow the existing treaty and domestic law mechanisms for eliminating double taxation to continue to operate as intended.
 - b) The effectiveness of the existing mechanism for addressing economic double taxation by way of appropriate adjustments under Article 9(2) of the OECD Model Convention and the need for this mechanism to be updated or supplemented in relation to the new profit allocation rules.
 - c) The effectiveness of the existing mechanisms for eliminating juridical double taxation by using the exemption or credit method and the need for those mechanisms to be updated or supplemented in relation to the new profit allocation rules.
- 2) The interaction between the new taxing right and existing taxing rights – in particular those permitting the imposition of withholding taxes on payments (such as royalty payments or payments for services) forming part of the reallocated income. Appropriate recommendations for the development of rules or guidance designed to coordinate the application of these taxing rights in the market jurisdiction would also be explored.
- 3) The current dispute prevention and resolution procedures, in the context of the new nexus and profit allocation rules. Where necessary, appropriate recommendations for changes or enhancements to these rules would be made. In particular, given that, under some design options, the new approaches will have a more multilateral focus, the work would examine the extent to which these existing procedures need updating because they have focused largely on solving bilateral disputes. This will require, in particular, the evaluation of the need for multilateral approaches to dispute avoidance and resolution.
- 4) The consideration for multilaterally co-ordinated risk assessment in applying the new nexus and profit allocation rules. This work should be informed by the ongoing work within the Forum on Tax Administration.

3.2. Administration

45. The implementation of any of the approaches would first require identifying the taxpayer who bears the tax liability and the filing obligations. Where the tax liability is assigned to an entity that is not a resident of the taxing jurisdiction, it would be necessary to address the required enforcement and collection arrangements. The work programme will need to examine, and develop recommendations to address, these enforcement and collection issues.

46. One option could be to design simplified registration-based collection mechanisms. A simplified registration-based collection mechanism, together with enhanced exchange of information and cooperation mechanisms may be sufficient for compliance and collection purposes. However, as a complementary measure, a withholding tax mechanism will also be explored in the work programme, where it does not lead to double taxation.

47. The effective application of any of the approaches would likely require a number of data points (e.g. total profit, total profit per business line, sales, users etc.) to be available not only to the tax administrations, but also to the MNE group and the taxpayer itself. In all events, the implementation of any of the approaches would likely result in the need for new data, documentation and reporting obligations. The work programme will develop recommendations for a system to report and disseminate information needed to administer the new taxing right. One option for such a system could be based on the existing framework and technology used for the exchange of country-by-country reports under BEPS Action 13. The data points could be included on a separate report, as the CbC reports are limited to assist with risk assessment.

48. The work programme will furthermore need to examine the challenges that may arise in determining and reporting the location of sales.

3.2. Administration

The programme of work would explore options and issues in connection with the administration of the new taxing right. These options and issues are expected to include:

- 1) The development of measures needed for the effective administration of the new taxing right. This work will explore collection mechanisms including a withholding tax, reporting obligations and mechanisms to disseminate that information to the tax authorities.
- 2) The technical and practical issues that may arise in determining and reporting the location of sales, including:
 - a. establishing the final destination of remote sales, sales to a market through third party intermediaries located in a third country, sales in multi-sided business models where the users/consumers are located in different jurisdictions, sales of intermediate goods, and destination of services;
 - b. the need for new reporting obligations; and
 - c. the need for new and/or revised protocols for the exchange of information between jurisdictions.

3.3. Changing existing tax treaties

49. Any proposal seeking an allocation of taxing rights over a portion of a non-resident enterprise's business profits in the absence of physical presence and computed other than in accordance with the arm's length principle would require changes to existing tax treaties if they are to be successfully implemented. Different approaches could be envisaged to

streamline the implementation of these changes and these options would need to be further assessed in the work programme in light of the precise nature of the changes to be made.

3.3. Modifying Tax Treaties

The programme of work would explore options and issues related to modifying existing tax treaties, with the aim of ensuring that all parties committing to the changes can implement them at substantially the same time. These options and issues are expected to include:

1. Ways to coordinate the effective implementation of the tax treaty changes required to introduce the new nexus and profit allocation rules and address the challenges that arise in relation to the elimination of double taxation and the resolution of associated disputes.
2. The relative merits of implementing these treaty changes by amending or supplementing the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (MLI) to further modify existing treaties, or by establishing a new multilateral convention.

Chapter III – Global anti-base erosion proposal (Pillar Two)

50. Under Pillar Two, the Members of the Inclusive Framework have agreed to explore an approach that leaves jurisdictions free to determine their own tax system, including whether they have a corporate income tax and where they set their tax rates¹⁴, but considers the right of other jurisdictions to apply the rules explored further below where income is taxed at an effective rate below a minimum rate. Within this context, and on a without prejudice basis, the members of the Inclusive Framework have agreed a programme of work that contains exploration of an inclusion rule, a switch over rule, an undertaxed payment rule, and a subject to tax rule. They have further agreed to explore, as part of this programme of work, issues related to rule co-ordination, simplification, thresholds, compatibility with international obligations and any other issues that may emerge in the course of the work.

51. Consistent with the Policy Note *Addressing the Tax Challenges of the Digitalising Economy*, approved on 23 January 2019, Members of the Inclusive Framework agree that any rules developed under this Pillar should not result in taxation where there is no economic profit nor should they result in double taxation.

52. This part sets out the global anti-base erosion (GloBE) proposal which seeks to address remaining BEPS risk of profit shifting to entities subject to no or very low taxation. It first provides background including the proposed rationale for the proposal and then summarises the mechanics of the proposed rules together with a summary of the issues that will be explored as part of the programme of work.

53. While the measures set out in the BEPS package have further aligned taxation with value creation and closed gaps in the international tax architecture that allowed for double non-taxation, certain members of the Inclusive Framework consider that these measures do not yet provide a comprehensive solution to the risk that continues to arise from structures that shift profit to entities subject to no or very low taxation. These members are of the view that profit shifting is particularly acute in connection with profits relating to intangibles, prevalent in the digital economy, but also in a broader context; for instance group entities that are financed with equity capital and generate profits, from intra-group financing or similar activities, that are subject to no or low taxes in the jurisdictions where those entities are established.¹⁵

54. The global anti-base erosion proposal is made against this background. It is based on the premise that in the absence of multilateral action, there is a risk of uncoordinated, unilateral action, both to attract more tax base and to protect existing tax base, with adverse

¹⁴ Previous OECD studies, including OECD (2008) “Taxation and Economic Growth”, Working Paper No. 620, have suggested that there may be efficiency benefits in improving the design of the corporate income tax and reducing its relative weight in a country’s tax system. However, these studies, which were issued before the BEPS Project was launched, did not consider the proposals currently under discussion under Pillar Two. Current proposals should be designed in a way that preserves the ability of jurisdictions to determine their own tax systems.

¹⁵ Other members are of the view that the rules explored within this pillar may affect the sovereignty of jurisdictions that for a variety of reasons have no or low corporate taxes in particular where they target income arising from substantive activities.

consequences for all countries, large and small, developed and developing as well as taxpayers. It posits that global action is needed to stop a harmful race to the bottom, which otherwise risks shifting taxes to fund public goods onto less mobile bases including labour and consumption, effectively undermining the tax sovereignty of nations and their elected legislators. It maintains that developing countries, in particular those with smaller markets, may also lose in such a race. Over recent decades, tax incentives have become more widespread in developing countries as they seek to compete to attract and retain foreign direct investment.¹⁶ Some studies have found that, in developing countries, tax incentives may be redundant in attracting investment.¹⁷ Revenue forgone from tax incentives can also reduce opportunities for much-needed public spending on infrastructure, public services or social support, and may hamper developing country efforts to mobilise domestic resources. There is evidence that tax incentives are frequently provided in developing countries in circumstances where governments are confronted with pressures from businesses to grant them.¹⁸ Depending on its ultimate design, the GloBE proposal could effectively shield developing countries from the pressure to offer inefficient incentives and in doing so help them in better mobilising domestic resources by ensuring that they will be able to effectively tax returns on investment made in their countries. The proposal therefore seeks to advance a multilateral framework to achieve a balanced outcome which limits the distortive impact of direct taxes on investment and business location decisions. The proposal is also intended as a backstop to Pillar One for situations where the relevant profit is booked in a tax rate environment below the minimum rate.

55. Recognising, as stated in the Action 1 Report, that it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes, the scope of the anti-base erosion proposal is not limited to highly digitalised businesses. By focusing on the remaining BEPS challenges, it proposes a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax. In so doing, it helps to address the remaining BEPS challenges linked to the digitalising economy, where the relative importance of intangible assets as profit drivers makes highly digitalised business often ideally placed to avail themselves of profit shifting planning structures.

1. GloBE proposal

56. The proposal seeks to address the remaining BEPS challenges through the development of two inter-related rules:

- 1) an ***income inclusion rule*** that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate; and

¹⁶ See, for example, IMF, OECD, UN, and World Bank (2015), “Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment”, A Report to the G-20 Development Working Group, pp. 8-9.

¹⁷ Ibid., pp. 11-12.

¹⁸ Ibid., pp. 35-36.

- 2) a *tax on base eroding payments* that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless that payment was subject to tax at or above a minimum rate.

57. These rules would be implemented by way of changes to domestic law and double tax treaties and would incorporate a co-ordination or ordering rule to avoid the risk of economic double taxation that might otherwise arise where more than one jurisdiction sought to apply these rules to the same structure or arrangements.

58. The combined rules are intended to affect behaviour of taxpayers and jurisdictions alike which is expected to limit the revenue impact of rule order for jurisdictions. Rather, rule order will need to be determined by reference to principles of good rule design including effectiveness, simplicity and transparency.

2. Income inclusion rule

59. The income inclusion rule would operate as a minimum tax by requiring a shareholder in a corporation to bring into account a proportionate share of the income of that corporation if that income was not subject to an effective rate of tax above a minimum rate. This rule could supplement a jurisdiction's CFC rules.

60. The income inclusion rule would ensure that the income of the MNE group is subject to tax at a minimum rate thereby reducing the incentive to allocate returns for tax reasons to low taxed entities. The income inclusion rule would have the effect of protecting the tax base of the parent jurisdiction as well as other jurisdictions where the group operates by reducing the incentive to put in place intra-group financing, such as thick capitalisation, or other planning structures that shift profit to those group entities that are taxed at an effective rate of tax below the minimum rate.

2.1. Top up to a minimum rate

61. The work programme would explore an inclusion rule that would impose a minimum tax rate. This approach is consistent with a policy of establishing a floor on tax rates by ensuring that a multinational enterprise (MNE) would be subject to tax on its global income at the minimum rate regardless of where it was headquartered. Consideration could be given to an exception to this principle in the case of income taxed below the minimum rate and benefiting from a harmful preferential regime, which would then be taxed at the higher of the minimum rate or the full domestic rate.

62. In general terms, it is contemplated that this rule would apply where the income is not taxed at least at the minimum level – that is, it would operate as a top up to achieve the minimum rate of tax.¹⁹ A top-up to a minimum rate increases the likelihood of the proposal resulting in a transparent and simple global standard that sets a floor for tax competition and makes it easier to develop consistent and co-ordinated rules. It would further increase the likelihood of achieving a level playing field for both jurisdictions and MNEs and

¹⁹ Countries would, of course, remain free to tax a subsidiary's income (or particular categories of income) at a rate higher than the minimum rate as they already do under their CFC rules.

reduces the incentive for inversions and other restructuring transactions designed to take advantage of low effective rates of taxation below the threshold.

63. A minimum tax tied to each country's corporate income tax (CIT) rate would result in a more complex and opaque international framework given the significant variance in CIT rates across Inclusive Framework members. For jurisdictions with high domestic CIT rates, such a design would create a cliff-edge effect for income that was subject to tax at around the minimum tax rate threshold.

2.2. Use of a fixed percentage

64. The work programme would explore an approach using a fixed percentage rather than a percentage of the parent jurisdiction's CIT rate or a range or corridor of CIT rates.

65. While there is precedent in the CFC context for using a percentage of the parent jurisdiction's CIT rate, this approach would give rise to significant variations in the rates used under the inclusion rule, which would result in a rule that is not in line with the intended policy of the GloBE proposal in addressing the risks associated with low-taxation. It would not result in a level playing field and make it difficult to co-ordinate such a rule with the undertaxed payments rule, significantly increasing the risk of double taxation.

66. Another possible approach would be to use a range or corridor of minimum rates depending on other design elements of the inclusion rule that impact on the effective rate of tax. However, it would be difficult for jurisdictions to quantify the impact of different design features and determine how that translates to an appropriate rate thereby resulting in potentially arbitrary and less transparent outcomes, making it harder for jurisdictions to co-ordinate their rules, thereby increasing compliance and administration costs and leading to a greater risk of double taxation.

67. An approach based on a fixed percentage tax rate is the simplest option from a design perspective. It provides greater transparency and facilitates rule co-ordination, thereby reducing administration and compliance costs. It also helps maintain a level playing field for jurisdictions and taxpayers and reduces the incentives for tax driven inversions and other restructuring transactions.

2.3. Exploration of simplifications

68. The programme of work starts from the proposition that in principle the tax base would be determined by reference to the rules that jurisdictions already use for calculating the income of a foreign subsidiary under their CFC rules, or in the absence of CFC rules, for domestic CIT purposes. Such an approach means, however, that each subsidiary of an MNE would need to recalculate its income in accordance with the tax base calculations in the parent jurisdiction. This may result in significant compliance costs and lead to situations where technical and structural differences between the calculation of the tax base in the parent and subsidiary jurisdiction could result in an otherwise highly taxed subsidiary being treated as having a low effective rate of tax for reasons unrelated to the policy drivers underlying the GloBE proposal.

69. For example, differences between countries in the treatment of carry forward losses and the timing of recognition of income and expenses could impact on the calculation of the effective rate of tax in different jurisdictions. Structural differences in the design of different jurisdictions' tax bases could result in the application of the rule in cases that

might not give rise to the policy concerns that are intended to be addressed by the inclusion rule.

70. In order to improve compliance and administrability for both taxpayers and tax administrations and to neutralise the impact of structural differences in the calculation of the tax base, the programme of work will explore simplifications. Simplifications could also serve to make the rules more transparent and help with co-ordination in the operation of the rules.

71. One simplification could be to start with relevant financial accounting rules subject to any agreed adjustments as necessary. The starting point for such an approach could be the financial accounts as prepared under the laws and relevant accounting standards of the jurisdiction of incorporation or establishment, which would be subject to agreed upon adjustments to reflect timing and permanent differences between tax and financial accounting rules. Other simplification measures could also be explored as part of the programme of work.

2.1. Inclusion Rule

The programme of work would explore options and issues in connection with the design of the income inclusion rule. These options and issues are expected to include:

- 1) A design that operates as a top up to a minimum rate but with an inclusion at the full rate for income taxed at below the minimum rate and benefitting from a harmful preferential regime;
- 2) A test for determining when income has been subject to tax at a minimum effective rate whereby:
 - a. the tax rate would be based on a fixed percentage;
 - b. the tax base would in principle be determined by reference to the rules applicable in the shareholder jurisdiction, but
 - c. the design would consider simplifications with a view to reduce compliance costs and avoid unintended outcomes including exploring the possible use of financial accounting rules as a basis for determining net income (with appropriate adjustments including for losses and the timing of recognition of income and expenses).
- 3) The possible use and effect of carve-outs, including for:
 - a. Regimes compliant with the standards of BEPS Action 5 on harmful tax practices, and other substance based carve-outs, noting however such carve-outs would undermine the policy intent and effectiveness of the proposal.
 - b. A return on tangible assets.
 - c. Controlled corporations with related party transactions below a certain threshold.
- 4) Different options of blending,⁽¹⁾ ranging from blending at the entity level to blending at global group level with a particular focus on blending at the jurisdictional versus global level; and

- 5) All other relevant design and technical issues, including:
- a. co-ordination with other international tax rules, such as withholding tax rules and other source based taxation rules, transfer pricing rules and adjustments, CFC and other inclusion rules;
 - b. co-ordination between inclusion rules where, for instance, in a tiered ownership structure several jurisdictions may apply the rule;
 - c. ownership thresholds;
 - d. rules for the attribution of income and calculation of tax paid on that income; and
 - e. rules for calculating the investor's tax liability.

⁽¹⁾ *Blending refers to the ability of taxpayers to mix high-tax and low-tax income to arrive at a blended rate of tax on income that is above the minimum rate.*

72. There is a need to ensure that the income inclusion rule applies to foreign branches as well as foreign subsidiaries. For example, in the case of profits attributable to exempt foreign branches, or that are derived from exempt foreign immovable property, the income inclusion rule could be achieved through a switch-over rule that would turn off the benefit of an exemption for income of a branch, or income derived from foreign immovable property, otherwise provided by a tax treaty and replace it with the credit method where that income was subject to a low effective rate of tax in the foreign jurisdiction.

2.2. Switch-over rule

The programme of work would explore options and issues in connection with the design of the switch-over rule. These options and issues are expected to include:

- 1) The design of a switch-over rule for tax treaties that would allow the state of residence to apply the credit method instead of the exemption method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to tax at an effective rate below the minimum rate; and
- 2) A design that, as much as possible, is simple to implement and to administer.

3. Tax on base eroding payments

73. The second key element of the proposal is a tax on base eroding payments that complements the income inclusion rule by allowing a source jurisdiction to protect itself from the risk of base eroding payments. More specifically, this element of the proposal would explore:

- an *undertaxed payments rule* that would deny a deduction or impose source-based taxation (including withholding tax)²⁰ for a payment to a related party if that payment was not subject to tax at a minimum rate; and
- a *subject to tax rule* in tax treaties that would only grant certain treaty benefits if the item of income was subject to tax at a minimum rate.

74. The undertaxed payments rule denies a deduction or a proportionate amount of any deduction for certain payments made to a related party unless those payments were subject to a minimum effective rate of tax.

3.1. Undertaxed payments rule

The programme of work would explore options and issues in connection with the design of the undertaxed payments rule. These options and issues are expected to include:

- 1) A rule that would achieve a balance between a number of design principles including effectiveness to achieve its stated objectives, design compatibility and co-ordination with other rules, avoidance of double taxation and taxation in excess of economic profit, and minimising compliance and administration costs; and
- 2) A range of different design options including a consideration of:
 - a. the types of related party payments covered by the rule (including measures to address conduit and indirect payments);
 - b. the test for determining whether a payment is “undertaxed”, which will include dealing with loss situations;
 - c. the nature, extent and operation of the adjustment to be made under the rule (including whether it should be on the gross amount of the payment or limited to net income); and
 - d. the possible use and effect of carve-outs including those referred to in Box 2.1 above.

75. The proposal also includes a subject to tax rule which could complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and denying treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate. This rule contemplates possible modifications to the scope or operations of the following treaty benefits, with priority given to interest and royalties:

- a. The limitation on the taxation of business profits of a non-resident, unless those profits are attributable to a permanent establishment. (Article 7 of the OECD Model Convention)
- b. The requirement to make a corresponding adjustment where a transfer pricing adjustment is made by the other Contracting State (Article 9 of the OECD Model Convention)

²⁰ For treaty-related aspects see the subject to tax rule.

- c. The limitation on taxation of dividends in the source state (Article 10 of the OECD Model Convention)
- d. The limitations on taxation of interest, royalties and capital gains in the source state (Articles 11-13 of the OECD Model Convention)
- e. The allocation of exclusive taxing rights of other income to the state of residence (Article 21 of the OECD Model Convention)

76. There are a number of broad issues to be explored in connection with the subject to tax rule, including the benefits of a withholding tax over a deduction denial approach, the degree of overlap with the undertaxed payments rule, and timing issues also considering the overall principle that any rule should include measures to avoid double taxation.

77. The proposal also contemplates the exploration of the application of a subject to tax rule to unrelated parties as regards Articles 11 and 12 of the OECD Model Convention. The programme of work would explore risk areas that may justify an extension to unrelated parties or to other treaty benefits beyond interest and royalties. For instance, whether there are certain arrangements, using structured, but otherwise unrelated arrangements that could achieve tax outcomes inconsistent with what is intended by the GloBE proposal.

3.2. Subject to tax rule

The programme of work would explore options and issues in connection with the design of the subject to tax rule. These options and issues are expected to include:

- 1) Broad issues including:
 - a) the need to amend bilateral tax treaties and other cost benefit considerations of a subject to tax rule next to an undertaxed payments rule;
 - b) the design of a subject to tax test and the degree of overlap with the test for low taxation under an undertaxed payments rule;
 - c) the operation of any withholding tax particularly where the effective rate of tax on the payment may not be known at the time the payment is made and including the need to address issues of possible double taxation;
 - d) the identification of risks that would merit the extension of the subject to tax rules to payments between unrelated parties; and
- 2) Different rule designs, taking into account the specificities of the particular treaty benefit, the learnings from work on the undertaxed payments rule limited to interest and royalties, but also identifying risks that would merit the extension of the scope to other types of payments.

4. Rule co-ordination, simplification, thresholds and compatibility with international obligations

78. Further work will also be required on rule co-ordination, simplification measures, thresholds and carve-outs to ensure the proposal avoids the risk of double taxation, minimises compliance and administration costs and that the rules are targeted and proportionate. This work will address the priority in which the rules would be applied and how they interact with other rules in the broader international framework. In this context it is important to analyse the interaction between this proposal and other BEPS Actions. It will also explore compatibility with international obligations (such as non-discrimination) including, for EU members, the EU fundamental freedoms and how that compatibility could depend on the rule's detailed design.

4.1. Co-ordination, simplification, thresholds and compatibility with international obligations

The programme of work would explore options and issues in connection with the design of co-ordination, simplification and threshold measures including interaction with BEPS Actions. These options and issues are expected to include:

1. Co-ordination between the undertaxed payments rule, subject to tax rule and income inclusion rule to minimise the risk of double taxation, including simplification measures that could further reduce compliance costs; and
2. Thresholds and carve-outs to restrict the application of the rules under the GLOBE proposal, including:
 - a. Thresholds based on the turnover or other indications of the size of the group;
 - b. *De minimis* thresholds to exclude transactions or entities with small amounts of profit or related party transactions; and
 - c. The appropriateness of carve-outs for specific sectors or industries.
3. Compatibility with international obligations (and, where appropriate, the EU fundamental freedoms).

Chapter IV – Economic analysis and impact assessment

79. In agreeing to explore the various proposals under the two Pillars, the Policy Note *Addressing the Tax Challenges of the Digitalising Economy*, approved on 23 January 2019, highlighted the desire of Members of the Inclusive Framework to carry out more in-depth analysis of each proposal and their interlinkages with a particular focus on the importance of assessing the revenue, economic and behavioural implications of the proposals in order to inform the Inclusive Framework in its decision making.

80. Assessing the impact of the proposals will involve an in-depth consideration of how they would be expected to affect the incentives faced by taxpayers and governments, their impact on the levels and distribution of tax revenues and their overall economic effects, including their effects on investment, innovation and growth. The impact assessment will also need to consider how these effects vary across different kinds of MNEs, sectors and economies.

81. The analysis of the economic impacts of the proposals will need to draw upon the existing public finance literature and will also require new empirical research to be undertaken. Such research will need to rely upon the full range of available data sources, including macro-level data (e.g., National Accounts and FDI statistics) and micro-level data (e.g., company financial statements). To the extent that available data permits, the analysis will need to consider the impact of the proposals on particular sectors, industries and business models.

82. The Secretariat has already undertaken some preliminary economic analysis to address these questions. An update of this work was presented to the Inclusive Framework meeting in May 2019. The preliminary analysis has considered available evidence on the size, location, composition and potential allocation of profits under the various Pillar One proposals. Under Pillar Two, proxies for the extent of profits that may be subject to a minimum tax have been considered. The preliminary analysis has also considered the broader incentive effects of the proposals, principally by drawing on the economic literature. So far, the preliminary analysis has drawn on macro-level and micro-level data sources, including National Accounts data, Balance of Payments data, anonymised and aggregated Country-by-Country-Report data and ORBIS.

83. While the economic analysis will be carried out throughout the course of the entire period of the programme of work, the timing of this work will need to be phased in such a way as to deliver members of the Inclusive Framework with the information required to take decisions at key milestones. Building upon the preliminary economic analysis already undertaken, the programme of work will require further Secretariat-led analysis to be provided to members of the Inclusive Framework by the end of 2019. This analysis will be designed to support members of the Inclusive Framework to take decisions in relation to the future direction of the overall programme of work. Continued work will be carried out during 2020, to ensure that the Inclusive Framework can be kept fully informed of the impact of key technical decisions relating to the design of the proposals.

84. Noting that the various proposals are evolving as discussions continue, the Secretariat will need to carry out a range of economic analyses in order to support the ongoing discussions around design questions associated with the proposals.

85. In carrying out this work, the Secretariat will need to assemble a multidisciplinary team across a number of the OECD's directorates. The Secretariat will carry out its work in consultation with member jurisdictions, bilaterally, and Working Party No.2, other

international organisations (e.g., the IMF), the academic community and other stakeholders.

4.2. Economic analysis and impact assessment

The programme of work would require that an economic analysis and impact assessment be carried out. This analysis would explore the following key questions:

- 1) What are the pros and cons of the proposals with respect to the international tax system?
- 2) How would the proposals affect the incentives for:
 - a. Taxpayers (e.g., profit shifting, investment and location of economic activity)?
 - b. Governments (e.g., tax competition)?
- 3) What is the expected economic incidence / impact of the proposals?
- 4) What are the expected effects of the proposals on the level and distribution of tax revenues across jurisdictions?
- 5) What economic impact will the various proposals have for different types of MNEs, sectors and economies (e.g., developing countries; resource-rich countries; R&D intensive economies, etc.)?
- 6) What data sources and methodologies could jurisdictions use to assess the proposals?
- 7) What are the expected regulatory costs of the proposals?
- 8) What would be the impact of the proposals on investment, innovation and growth?

Chapter V - Organisation of the work to deliver the programme of work and next steps

1. Overall Approach

86. As described in the Introduction, the work towards a consensus-based solution will proceed along the following separate (but related) tracks:

- first, the Steering Group will continue the process aimed at reaching an agreement on a unified approach to addressing the issues of profit allocation and nexus under Pillar One and agreement on the key design elements of the GloBE proposal under Pillar Two (this work will draw on the expertise of delegates from various working parties);
- second, the subsidiary bodies will provide technical input on certain issues that may arise in the course of developing a consensus-based solution as well as the preparation of final reports that will set out the details of the agreement reached by the Inclusive Framework; and
- third, the Secretariat will provide an economic analysis and impact assessment of the proposals under the two pillars.

87. Although certain parts of the work can be advanced in parallel, there will be many interactions between them. The work to be done under one track will both depend on and drive the progress made under another. For example, the technical work to be undertaken by the various working parties is not only expected to inform and facilitate agreement under Pillars One and Two, but also to evolve and adapt as progress is made on the development of a consensus-based long-term solution.

88. Given the interlinked nature of the work and the challenging time frame for completing it, the Steering Group of the Inclusive Framework will:

- continue its work on the development of a unified approach under Pillar One and the key design elements of the GloBE proposal under Pillar Two so that the outputs from this work can be submitted to the wider Inclusive Framework for agreement; and
- steer, monitor and co-ordinate the work programme and related outputs produced by different subsidiary bodies so as to ensure that a solution can be agreed and delivered in a timely manner.

89. Finally, new technical issues may emerge as the work advances. The programme of work includes the exploration of all relevant issues and options in connection with the Pillars and a subsidiary body should not disregard an option that would address a particular issue on the basis that it has not been raised in the programme of work. To the extent necessary, transition rules would be considered.

2. Organisation of the work

90. The technical expertise needed to deliver the measures envisaged in the programme of work is largely found within the Inclusive Framework's architecture, namely the Committee on Fiscal Affairs subsidiary bodies:

- Working Party 1, which generally has responsibility for treaty developments and may be called upon to make recommendations under Pillar One regarding the design of a new nexus rule, the effectiveness of the existing, or the need to develop new, provisions for the elimination of double taxation and dispute resolution, ways to effectively implement tax treaty changes, and under Pillar Two regarding switch-over and subject to tax rules;
- Working Party 2, which generally has responsibility for data collection and economic and statistical analysis and will be consulted on the economic analysis and impact assessment of both Pillars;
- Working Party 6, which generally has responsibility for the development of transfer pricing guidance and may be expected to make recommendations regarding the design of a new profit allocation rule under Pillar One;
- Working Party 11, which generally has responsibility for the development of co-ordinated measures to address aggressive tax planning and may be called upon to advance the work on Pillar Two liaising with other working parties as necessary;
- The Task Force on the Digital Economy will continue to play its role in supporting the Steering Group in its coordination role. In particular, it will facilitate any further public consultation in relation to the proposals as required; and
- Other subsidiary bodies such as the FTA MAP Forum which has responsibility for the implementation of BEPS Action 14, as well as other bodies that deal with country-by-country related questions including the CBC Reporting Group.

91. The Chairs of the relevant subsidiary bodies, working with the Secretariat, should consider ways to streamline working methods to achieve this goal. In particular, given existing resource constraints, it will not be possible for the Working Parties to meet continuously to accomplish the work on the action items. Therefore, work will also need to be done remotely between the meetings. This work could be co-ordinated through the Bureau of the relevant Working Parties to examine particular issues. Further, Working Parties should evaluate the use of focus groups, ad hoc committees, and other organisational approaches that would facilitate the generation of timely work product.

92. Additionally, the programme of work covers a broad range of issues which involve different expertise and subsidiary bodies, and a critical aspect of this programme will be to ensure an effective coordination of the work. Therefore, the subsidiary bodies would work closely together as they advance their technical work, including working in different joint session formats if necessary.

93. The table below assigns responsibilities to different subsidiary bodies for each of the work streams identified in the programme of work. The work will start immediately on all current proposals, as well as on the economic analysis, with initially a focus on supporting the work of the Steering Group. Once there is an agreed architecture proposed

by the Steering Group and agreed by the Inclusive Framework, the Working Parties will revert to their more traditional role of working towards the implementation of an agreed policy direction which, given the dynamic nature of the work programme, may evolve and also require the involvement of other working parties. A Report on the progress on work is expected in December 2019.

Assignment of technical work to subsidiary bodies

	Working Party responsible	Working Party consulted
OVERALL		
1. Support the Steering Group and organise Public Consultation	TFDE	
PILLAR 1		
1. Modified Residual Profit Split	WP6	WP1
2. Fractional apportionment	WP6	WP1
3. Distribution-based approaches	WP6	WP1
4. Business line and regional segmentation	WP6	WP1
5. Design scope limitations	WP1/WP6	
6. Treatment of losses	WP6	WP1
7. New nexus rules	WP1	WP6
8. Elimination of double taxation	WP1/WP6	FTA MAP Forum
9. Dispute resolution	WP1	WP6 FTA MAP Forum
10. Dispute prevention	WP1/FTA MAP Forum	FTA
11. Administration	WP6/WP10	WP1/FTA
12. Modifying Tax Treaties	WP1	WP6/WP11/FTA MAP Forum
PILLAR 2		
1. Inclusion Rule	WP11	WP1
2. Switch-over rule	WP1/WP11	
3. Undertaxed payment rule	WP11	WP1
4. Subject to tax rule	WP1/WP11	
5. Rule co-ordination, simplification and thresholds and compatibility with international obligations	WP11/WP1	FTA
6. Other issues arising in connection with Pillar 2	WP11	
ECONOMIC ANALYSIS		
1. Economic analysis and impact assessment		WP2

3. Next Steps

94. In accordance with the overall approach described in this Chapter, the Working Parties will meet in June and July and subsequently throughout the remainder of this year to consider relevant technical issues arising in connection with the Programme of Work. These meetings will take place under the leadership and co-ordination of the Steering Group and will focus on those aspects of the Programme of Work that are most pertinent

to the development of a unified approach under Pillar One and the key design elements of the GloBE proposal under Pillar Two.

95. The Steering Group will continue to work on the development of a unified approach under Pillar One and the key design elements of the GloBE proposal under Pillar Two so that a recommendation on the core elements of long-term solution can be submitted to the Inclusive Framework for agreement at the beginning of 2020.

96. Throughout 2020 the Inclusive Framework, Steering Group and Working Parties will work on agreeing the policy and technical details of a consensus-based, long-term solution to the challenges of the digitalisation of the economy and will deliver a final report by the end of 2020. Consideration will be given to the holding of public consultations as necessary in order to obtain stakeholder feedback as the various proposals are refined.