To	International Co-operation and Tax Administration Division, Centre for Tax Policy and Administration	Date	December 4, 2019
From	KPMG International	Ref	Public Consultation Document – Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two

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Comments on the Public Consultation Document – Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two

Professionals in the member firms of KPMG International[1] (***KPMG***) welcome the opportunity to comment on the OECD’s public consultation document entitled “*Public Consultation Document – Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two*”, released on 8 November 2019 (the ***Consultation Document***).

The Consultation Document requests input on certain aspects of the Inclusive Framework on BEPS’ work in relation to the ‘Pillar Two’ programme of work for addressing the tax challenges arising from the digitalisation of the economy – specifically in relation to the design of the Global Anti-Base Erosion (***GloBE***) proposal.

We have structured our response in the following way:

- Introduction (which seeks to establish the principles and policy underlying the work of the Inclusive Framework in this space);

- Preliminary comments / questions (which sets out our thoughts on a number of fundamental design and policy elements that the Consultation Document does not itself seem to address, and which we believe the Inclusive Framework needs to consider in order to arrive at an administrable and practicable set of recommendations);

- Answers to specific questions (which sets out our input in relation to some of the points raised concerning tax base determination, blending, and carve-outs); and

[1] KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 154 countries and territories and have 200,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative, a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

- Priority issues (which considers the need for a clear ordering rule that we submit should be part of the GloBE proposal, so that the various elements work together as part of a holistic package (most notably the income inclusion rule and the undertaxed payments rule)).

1 Introduction

Our understanding is that the policy rationale in relation to the GloBE proposal is set out in paragraphs 7 and 8 of the Consultation Document, and is based on the OECD's concerns that possibilities remain for profit-shifting despite the OECD's BEPS project, and that countries are or may be using tax rates or incentives to compete to attract actual substance (and therefore tax base) in a way that the OECD considers to be harmful.

We also understand that an underlying concern in relation to the GloBE proposal is that in the absence of a coordinated approach, the OECD considers that countries will take unilateral actions to protect their respective tax bases, with detrimental consequences overall.

Put another way, it would seem therefore that the policy intent underpinning the GloBE proposal is to:

- Stop any remaining possibilities for profit-shifting;
- Put a floor under tax rate competition;
- Potentially protect developing countries from pressure to offer tax incentives; and
- Propose a coordinated and multilateral approach to the Framework.

Our response will seek to address the questions asked in the Consultation Document in the light of the above understanding of the underlying policy.

It would be helpful in our view if the final GloBE proposals could clearly confirm what the underlying policy / problem is however, as a clear statement of intent / scoping of work is in our view necessary to achieving a broader consensus – it is only where the various participating countries can be aligned on a common policy that we see broader political consensus being achievable.

We would also point out that the extremely short time frame for comments (coupled with the lack of detail in relation to the final likely shape of the proposals in the Consultation Document) has necessarily limited the input that we have been able to provide.

We have of course commented on as much of the Consultation Document as possible, but we would strongly encourage the OECD to provide further opportunities for consultation on and development of the GloBE proposals.

We think that it is critical that the compressed timeframe does not result in decisions being made without full and detailed consultation with business and other stakeholders, and would specifically encourage the OECD to consult in more detail in relation to the accounting questions set out in the Consultation Document, where there are many detailed technical issues that need to be fully worked through across multiple jurisdictions. Needless to say, we recommend that the final outcome of the work of the Inclusive Framework in this space should be consistent with the principles of design simplicity, administrability, and reduction of the risk of double taxation.

2 Preliminary comments / questions

Timing of Pillar Two

Our first preliminary observation is that there is an argument around whether or not Pillar Two should be held over, pending the outcome of broader BEPS-related reforms such as Actions 5, 6, and 8-10. We do recognise however that there is political desire to move quickly with the OECD/Inclusive

Framework's reforms, and that the policy objectives (as set out above) are wider than the original BEPS project.

Given the complexity in delivering Pillar One and Pillar Two, one possible option would be to decouple the two workstreams (noting that the OECD's thinking in relation to Pillar One seems significantly more advanced, and that finalising this workstream is in some senses more critical as it plays into the rollback of the various unilateral revenue-based taxes that are proliferating globally)[2]. Decoupling would also allow sufficient time for countries that currently have an exemption system to implement such fundamental changes to their domestic rules, recognising that addressing the unilateral revenue-based taxes cropping up in the light of Pillar One work should be a priority.

Time and space should also be given to the ongoing monitoring of the original BEPS measures (as was envisioned by BEPS Action 11) and to the preparation of a proper impact assessment of the new proposals.

Acceptable inclusion regimes

There appear to be a number of ways in which the OECD could achieve the above-stated policies.

The Pillar Two proposal involves starting from a tax base calculated by looking at the financial accounts. However, this would not be appropriate for countries such as the United States of America (the ***United States***), where the global intangible low-taxed income regime (***GILTI***[3]) currently exists, or other countries that use similar income inclusion rules that are not based on financial accounts.

Equally, imposing the obligation upon other countries to enact GILTI in their respective domestic tax regimes would be an inappropriate burden (this would be equally true for countries that have income inclusion regimes based on financial accounts).

An alternative and perhaps compromise approach therefore would be for the Inclusive Framework to propose rules that countries could adopt if they do not currently have an income inclusion rule, coupled with a 'white list' of acceptable income inclusion regimes (including GILTI) that would be treated as compliant with the GloBE proposals[4]. If all countries adopted an income inclusion rule – whether based

[2] A related point that needs to be addressed by the OECD in relation to its final proposals on GloBE is the way in which the Pillar One and Pillar Two proposals will interact. It seems to us that it would be most efficient for the Pillar One proposals to operate first, and for Pillar Two to then apply to the profits as reallocated under Pillar One, as otherwise the application of a rule like the undertaxed payments rule could result in significant disputes (for example, where the expense in relation to which the undertaxed payments rule is applied is subject to a contemporaneous adjustment under Pillar One that reduces the amount of that expense).

[3] The GILTI regime in the United States operates similarly to the proposed income inclusion rule, although it does not employ a top-up mechanism. Broadly speaking, GILTI targets specified U.S. shareholders of CFCs by requiring that such shareholders include in their U.S. gross income their shares of the excess of net CFC income (subject to certain exclusions) over a deemed return for tangible assets. Such income is offset by a 50% deduction, which effectively reduces the tax rate on GILTI income to 10.5%, although an 80% limitation on the amount of foreign tax credits that may be offset against such income raises the effective rate to 13.125% in most cases. Congress's intent with the foreign tax credit limitation was to ensure that GILTI operates as an effective minimum tax and should not apply where CFCs pay foreign taxes at a rate of at least 13.125% (in practice, the circumstances of a given case (*e.g.*, expense allocations) will sometimes result in a higher effective rate. Because the GILTI deduction is scheduled to be reduced in 2026, the generally effective rate is set to increase to 16.406% for taxable years beginning after December 31, 2025).

[4] KPMG considers that, from a policy perspective, GILTI is functionally equivalent to the proposed income inclusion rule, and that the policy aims of the Inclusive Framework's work on Pillar Two would be achieved by 'white-listing' GILTI and similar existing income inclusion regimes.

on financial accounts or a tax base calculation – it should meet the stated objectives of limiting tax rate competition and residual profit shifting.

It would also seem to us to be logical for the OECD to coordinate its recommendations in relation to 'white-listed' regimes with the previous work completed as part of the BEPS project on Action 3, such that countries with CFC regimes based on or compliant with the building blocks of Action 3 will also be regarded as having met the standard set down by Pillar Two and be treated as being in compliance with the GloBE proposals – albeit there may need to be some amendments to such regimes to make them compatible with GloBE.

We therefore strongly recommend that carve-outs under Pillar Two include a white list of specifically identified regimes, and that taxpayers subject to those regimes be treated as fully compliant with the income inclusion rule in the final GloBE proposals. Furthermore, Pillar Two should not set out a mandatory tax base for countries which do not already have income inclusion rules. Rather, it should be a framework with a potential approach (based on financial accounts) containing guardrails that permit the adoption of alternative approaches within the parameters that they create.

For completeness, we also note consideration will need to be given to taxes other than federal level taxes (*e.g.*, municipal, provincial, state, *etc*). In some countries, the domestic policy is that there is a fairly low central or federal tax rate but corporations pay high local income taxes. We recommend that these should be considered by the OECD as part of its continuing work on Pillar Two to ensure that there is a level playing field in comparable situations.

European dimension

The potential interaction of the final GloBE proposals with existing principles of European Union (***EU***) law is alluded to in the Consultation Document, but is not developed.

From the outset, it seems that the GloBE proposals might come into conflict with non-discrimination principles laid down in Article 49 of the TFEU (freedom of establishment) or Article 63 of the TFEU (free movement of capital) if any GloBE feature discriminates against cross-border situations versus domestic ones. Furthermore, if certain carve-outs are introduced for certain sectors or types of entities, Article 107 of the TFEU (State aid) will need to be assessed.

We appreciate that the assessment of EU compatibility will depend on the more detailed GloBE design features. However, we would already at this stage recommend a detailed analysis to be carried out to ensure that any proposals can be made EU-compliant in order to avoid the uncertainty and administrative cost of rules being introduce only to be found to be unlawful under EU law in a few years' time.

If no global consensus is achieved, the consequences of fragmented, unilateral implementation of GloBE-types laws would increase complexity generally and, to the extent that such laws are introduced within the EU, increase the chance that they would be non-compliant with EU law.

By contrast, if the EU Member States decided to commit to any GloBE recommendations, it seems that an EU legal instrument (*i.e.*, a Directive) would provide more tax certainty for taxpayers, mitigating the EU law compatibility risk mentioned above.

Dispute resolution

Because the details of the four rules contemplated under Pillar Two, and in particular those concerning their ordering and interaction, remain to be determined, it is difficult to provide specific comments regarding the need for and implementation of dispute prevention and resolution mechanisms.

We note that the Consultation Document, unlike its counterpart under Pillar One, does not make reference to the need for effective dispute resolution mechanisms. We assume this is because detailed consideration of these issues would be premature pending agreement on the GloBE architecture. Nevertheless we think it is useful to set out a few areas of potential tension that should be considered as work on Pillar Two moves forward. In particular, if these can be addressed in the architecture of the rules it will mean that resort to dispute resolution mechanisms will be far less likely.

Undertaxed Payments Rule

The undertaxed payments rule resembles the U.S. base erosion and anti-abuse tax (***BEAT***). The U.S. Treasury Department has raised concern as to the interaction of BEAT and tax treaties, and is reportedly seeking reservation language that would prevent bilateral tax treaties awaiting U.S. ratification from interfering with the application of BEAT.

While any Pillar Two solution that incorporates a deduction denial regime such as the undertaxed payments rule would certainly need to include treaty language supporting the operation of the regime, the Inclusive Framework should also give careful consideration to how such a regime impacts existing treaty principles, and to what mechanisms would function best to prevent and resolve disputes in this area.

Coordination between Pillar One, Pillar Two, and Existing Systems

If implemented, Pillar One and Pillar Two will both cause significant disruption to existing international tax and transfer pricing regimes. It will be necessary to devise cohesive coordination rules to address the order in which these rules are applied.

For instance, Pillar One should apply before Pillar Two, as application of Pillar One will affect the amount of taxes paid in each jurisdiction. However, it will be equally important to craft mechanisms whereby subsequent adjustments made under each of these systems are carried out through all of them.

For instance, this will be necessary in a situation where a jurisdiction asserts entitlement to a certain quantum of Amount C under Pillar One for a prior year, which increases or decreases the amount by which the multinational group falls below the minimum tax threshold under Pillar Two[5] and thus affects its income inclusion rule liability. Where a subsequent adjustment under any of these regimes is subject to dispute, it will be critical to ensure that dispute resolution mechanisms be available to carry such adjustment through each regime, or otherwise to provide relief from the imposition of double taxation.

Similarly, because Pillar Two involves four distinct rules and depends on their coordination, subsequent adjustment under one of the rules may result in double taxation if adjustments are not carried out through the remaining Pillar Two regimes (as well as any other affected regimes). The Inclusive Framework should consider whether it would better serve the purposes of the GloBE project to implement dispute resolution mechanisms to address such adjustments, or to prohibit subsequent adjustments under Pillar Two.

Dispute Resolution Mechanisms

KPMG strongly supports investment in multilateral dispute prevention and advance agreement programs such as ICAP 2.0 and multilateral APAs, and recommends that the Inclusive Framework act to ensure that both ICAP and APAs are available to address issues arising under Pillar One and Pillar Two, as well as conventional transfer pricing issues.

Because Pillars One and Two are layered on top of the existing tax system, dispute prevention and resolution systems that can address conventional international tax and transfer pricing disputes but not

[5] The Pillar One adjustment may also have ramifications under existing tax rules.

Pillar One and Pillar Two issues (or vice versa) will have limited utility for taxpayers and may frustrate the efforts of both taxpayers and tax authorities to gain advance certainty and conserve resources.

While dispute prevention mechanisms are critical, and while we believe that all stakeholders will benefit from a means to ensure timely and efficient advance resolution of issues, it is nonetheless vital that efficient dispute resolution mechanisms be made available to address those disputes that do arise. As remarked above, such mechanisms must be able to address issues, and impose resolutions, with respect to Pillars One and Two as well as current tax regimes. Because any given adjustment may affect the results under all of these systems, the number of stakeholders in a given dispute maybe very large, making a multilateral dispute resolution system necessary. Other disputes that are specific to Pillar Two (*e.g.*, a dispute as to the application of one country's undertaxed payments rule) may only involve two parties, highlighting the need to strengthen existing bilateral dispute resolution mechanisms as well.

As we remarked in our comments on the proposed unified approach under Pillar One, binding dispute resolution will be critical to successful implementation. KPMG believes that mandatory binding arbitration would be an effective dispute resolution tool. In multilateral cases, existing arbitration procedures, including the use of standard 'baseball' arbitration and procedures for selecting arbitrators, may not function well, as they are designed for bilateral systems and rely on the incentives inherent in a controversy between two opposing sides. The Inclusive Framework should therefore consider modifications to existing arbitration procedures for multilateral cases, including the use of an iterative approach to baseball arbitration,[6] as suggested in our comments under Pillar One.

We are aware that some developing countries have expressed reservations concerning the use of binding arbitration, and that the OECD is working to address such concerns. Some of these reservations relate to a perceived infringement on a country's sovereignty as a result of the arbitration process, which is sometimes thought to involve the creation of law for a jurisdiction by a third party.

We believe these concerns may be addressed through the use of the iterative approach to baseball arbitration as outlined above. Arbitral decisions are not precedential and thus do not create law, but rather are limited to resolving the dispute at hand. In particular, in baseball arbitration, the arbitration panel does not reach an independent decision, but simply selects one of the proposals put forth by the participating jurisdictions.[7] The panel does not issue a statement of its reasoning or any form of quasi-judicial opinion, which prevents the development of an informal body of precedent. Moreover, countries can protect their sovereignty by actively engaging in the mutual agreement procedure process and endeavoring to resolve cases before they reach arbitration.

As noted in our Pillar One comments, we believe that the creation of an impartial OECD body to provide optional assistance to developing countries in arbitration matters could also help to assuage sovereignty concerns. However, to the extent that the OECD and Inclusive Framework prefer to explore other binding dispute resolution tools, KPMG recommends careful consideration of the incentives inherent in each option,[8] and of the time required to successfully resolve disputes that may span several complicated tax regimes and involve several interested parties.

3 Answers to specific questions

[6] Such an approach could proceed as follows: the parties would submit initial proposals for the panel to review; the panel would identify reasonable or valuable aspects of the proposals to be retained, while sending the proposals back for further work; and the parties would submit revised proposals, until the panel ultimately selected one of the proposals submitted.

[7] This would also be the case under the modified iterative approach we have suggested for multilateral disputes.

[8] To the extent possible, the Inclusive Framework should avoid solutions that incentivise countries from making larger initial adjustments than are warranted with the aim of strengthening their position in dispute resolution. KPMG believes that baseball arbitration is generally successful in avoiding such harmful incentives.

Tax base determination

Reply to question 1(a)

Consistent with our recommendations elsewhere, KPMG notes that GILTI and other existing income inclusion regimes do not rely on financial accounts, and thus the use of financial accounts should not be required in cases where there is a white-listed equivalent regime.

For taxpayers that are not subject to a white-listed regime, KPMG agrees that the use of a multinational enterprise's ultimate parent's consolidated financial accounts as a starting point for the application of the income inclusion rule could be a practical approach, assuming such accounts are prepared in accordance with acceptable accounting standards.

In this regard, there could be a white list based on standards that are acceptable to independent third party regulators, such as securities regulators – for example, US, UK & Chinese GAAP and IFRS should be treated as acceptable standards in any final Pillar Two recommendations.

One advantage of using financial statements is that where they have been audited it should help reduce disputes.

The challenge in our view is most likely to come in relation to aligning the financial accounts numbers with the tax return numbers, and in addressing any divergence between permanent versus temporary timing differences in the accounts. These divergences will vary from jurisdiction to jurisdiction, and no definitive comments can therefore be made at this stage about permanent versus temporary timing differences that must be addressed in all scenarios (until the reference system has been definitively set).

Given the time frame for responding to this Consultation Document, it is not possible to go into detail about what adjustments may be required – a detailed study on this matter should clearly be carried out.

We do however strongly caution against the creation of new standalone accounting rules in order to operate the income inclusion rule the OECD's final recommendations should focus on utilising existing accounting standards, creating a white list, and make any necessary adjustments to iron out significant differences between accounting standards (recognising that it will never be possible fully to align two different accounting standards, and that reaching an acceptable position that achieves the OECD's aims and is acceptable to taxpayers should be prioritised over the pursuit of perfection).

Reply to question 1(b)

We believe that the consequences of using the accounting standards applicable to the ultimate parent entity would be relatively limited. This is on the basis that in practice, most subsidiaries of multinational enterprises prepare numbers based on the accounting standard applied in the jurisdiction of their ultimate parent entity (*i.e.*, whilst local accounts would likely be prepared in line with a given subsidiary's local GAAP requirements, that subsidiary would likely also prepare numbers under its parent's accounting standards). Those numbers would in practice usually be audited, and would be available to the ultimate parent of the group for reporting and consolidation purposes (this indicates that global aggregation is more practicable and less burdensome than a jurisdictional approach, as auditors could more easily sign-off on the total amount of profits outside a parent jurisdiction – if a jurisdictional approach was required in comparison, there may be materiality thresholds that mean more audit work is required in relation to local figures).

Reply to question 1(c)

In practical terms, we think it would be necessary to identify several accounting standards that are regarded as acceptable standards (based on acceptance by securities regulators or other third party bodies for example). It will be highly impracticable to attempt to align any two given accounting standards or to align how they map to the relevant tax base in question.

Reply to question 1(d)

Yes, this could create a competitive advantage, given the standards are set and monitored by different organisations, although this could depend ultimately on whether or not adjustments can be identified, and whether the comparison is between the financial results and the tax base or between different forms of acceptable accounting standards.

Reply to question 1(e)

Assuming the OECD recommends a threshold for the application of Pillar Two that dovetails with the proposed EUR750m in relation to Pillar One, we would expect the fact that some multinational groups do not prepare consolidated accounts would be of limited relevance.

Blending

Jurisdictional blending seems to fulfil the stated policy objective more fully; with worldwide blending, there could still be an incentive for a country to attract tax base with a very low rate in the belief that this would be blended up by investments a MNE makes in high tax jurisdictions. However, even if worldwide blending is less precise from a purist perspective, there are sound administrative reasons why it should be preferred (worldwide blending provides the easiest way to implement from an administrative perspective, and minimises cost and complexity to taxpayers and to tax administrations, and noting our comments above in relation to GILTI (which uses a worldwide approach), we also consider that it would in practical terms be impossible to follow anything other than a worldwide blending approach).

Worldwide blending also appears to us to reduce some of the risks around disputes, as it allows for blending of high and low-tax income. We recommend that the OECD should consider whether this is an acceptable trade-off, balancing the desire for perfection / precision against the need for ease of administration and for certainty.

Carve-outs

Firstly, we note that the Consultation Document indicates that the Inclusive Framework is considering a carve-out for a return on tangible assets. GILTI provides a similar carve-out, as it imposes tax only on the excess (if any) of net CFC tested income over a deemed tangible asset return. Generally speaking, this deemed return is calculated as 10% of the CFC's adjusted tax basis in depreciable property employed in its trade or business.

GILTI provides a carve-out for a return on tangible assets because it is intended to target intangible income (which may be shifted between jurisdictions relatively easily), rather than income associated with tangible property (which generally cannot easily be moved from a given jurisdiction).

The same rationale underlies most CFC regimes more generally. From a policy perspective, a carve-out for returns on tangible assets is therefore consistent with income inclusion and CFC regimes currently in force. Accordingly, on the basis that GloBE should be a framework to enable countries to introduce measures to achieve the stated objectives in a coordinated fashion, we recommend that it permit a similar carve-out from the income inclusion regime. This could likewise be based on simplifying assumptions designed to approximate a return for tangible business property.

We also see the logic in thresholds based on turnover or group size, noting that these would appear to be consistent with the underlying policy concern in relation to profit-shifting by large multinationals.

In relation to thresholds, and noting in particular the hoped for coordination between Pillar One and Pillar Two, we would recommend that the same threshold be applied for both Pillars. In both cases, the threshold must be set at a level that balances the additional complexity and administrative burden against the goals that the OECD is attempting to achieve through the introduction of the GloBE proposals.

We would note also that it would appear appropriate for the OECD to provide carve-outs for specific sectors, noting that the advent of Pillar Two must not result in policy conflict with tax incentives or low-tax regimes which are currently generally accepted as being legitimate. In broad terms, it is possible to split these into two categories: (i) general policy exceptions (*e.g.*, in relation to tonnage taxes etc); and (ii) acceptable incentives (*e.g.*, for extractives).

In many cases, these will have been introduced for sound policy reasons, and will be applicable only to groups operating in highly-regulated areas in a ring-fenced manner with strict regulatory and licensing requirements. These can often involve cross-overs into government-related contracts. Beyond shipping and extractives, examples might include regimes applicable to highly-regulated industries such as pharmaceuticals, financial services, and insurance. Similarly, a case may justifiably be made for collective investment vehicles to be carved out of the Pillar Two proposals on the basis that they are simply vehicles for the pooling of assets, with tax being paid ultimately at the investor level. Similar arguments apply in relation to the clean energy / climate change incentives; it would be paradoxical to incentivise a subsidiary to switch to clean energy through a tax incentive, only for that incentive to be taken away at the parent level.

The charity and not-for-profit sector could also be impacted by the Pillar Two proposals. For example, this sector increasingly draws upon the global market place in order to fulfil its charitable objectives, particularly with regard to higher education and university sectors, where international collaboration, recruitment and research are core to the majority of institutions. To the extent that these activities are charitable in nature, they are typically "within the charge" to tax, however they are not "subject to tax" by virtue of the charitable exemptions often afforded to them by governments around the world.

The GloBE proposals would appear to deny access to double tax treaties for the charity and not-for-profit sector, where deductions may be denied for certain defined categories of payments where the recipient of the payment (*e.g.*, a charitable university) is not subject to a minimum effective tax rate in its home jurisdiction. We believe that (by reference to our understanding of the stated policy underpinning GloBE as set out above) this would be an unintentional consequence of the GloBE proposals, and so would suggest that such organisations are carved out or specifically exempted from the OECD's final Pillar Two proposals. We also recommend that the potential impact of this kind of issue be properly explored by the OECD in an impact assessment.

4 Priority issues

The Consultation Document lists 4 anti-avoidance measures, but critically it does not outline the proposed priority between each of them.

In our view, coordination of the various elements of the GloBE proposals is critical to securing political consensus and to ensuring that they can be administered successfully in practice (although we fully acknowledge that some countries will oppose Pillar Two, whilst others will support it).

We acknowledge that the ultimate choice between the priority of these elements of the GloBE proposals will ultimately be for the Inclusive Framework to decide upon. We also acknowledge the concerns of developing countries that deductible payments should come first, given their ease of collection in particular[9].

However, we consider there to be a number of technical and practical reasons why the income inclusion rule (which operates as a 'top-up' tax to secure the application of an agreed minimum tax rate) should be given precedence over the other 3 elements of the GloBE proposal. Furthermore, if the policy rationale is to address concerns about a 'race to the bottom' and any residual profit shifting, the income inclusion rule should achieve this.

Dozens of countries currently have CFC rules that could be adapted for income inclusion purposes, while deduction denial regimes are far less prevalent. Moreover, the undertaxed payments rule would require that tax authorities proceed on a transactional basis, which could prove unworkable. In contrast, the income inclusion rule would be comparatively easy to apply at the level of the enterprise's parent, especially if global blending were applied.

Moreover, it seems to us that the ultimate parent jurisdiction applying the income inclusion rule is best-placed to ensure that the income in question is being taxed on a net basis (*i.e.*, not a gross basis) at the rate required under the globally-agreed minimum, and is also best-placed to ensure that matters such as loss utilisation are handled appropriately[10].

According priority to the income inclusion rule over the undertaxed payments rule would also appear to be consistent in some ways with the broader drive under Pillar One to reallocate some profits away from headquarter jurisdictions to other jurisdictions where consumers¸ *etc* are based (*i.e.*, rather than inverting those taxing rights).

It is also clear to us that multiple layers of taxation could arise if the income inclusion and undertaxed payments rule were to be applied to the same item of income. Moreover, the administrative burden involved in applying the undertaxed payments rule as the default rule would be significant – it would amount to having to adopt a transaction-by-transaction approach, which both for taxpayers and tax administrations would appear to be impracticable to administer efficiently.

A related point in this context is the interaction of the income inclusion rule in the ultimate parent jurisdiction with similar rules in the jurisdictions where subsidiaries are located within a multinational group.

Consistent with an 'imported mismatch' approach, it would seem to us to make most sense to disregard intermediate holding company regimes and look to the income inclusion regime of the ultimate parent. The practical application of this aspect of the rule would find its expression by the final GloBE proposals providing that payments made to subsidiaries of a multinational enterprise parented in a 'white-listed' jurisdiction country would not be impacted by the other three elements of the GloBE proposals.

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[9] Noting however the counter to this argument, which is that the priority between the various elements of the GloBE proposals may not in practice matter, as developing countries could potentially benefit if the GloBE proposals are effective once implemented (*i.e.*, on the basis that developing countries will benefit in the way outlined by the OECD).

[10] As with Pillar One, we recommend that the Pillar Two proposals should apply only to profits (*i.e.*, not to revenues). In a related way, we also recommend that the Pillar Two proposals should, as noted elsewhere, include a firm commitment from participating countries to abolish unilateral revenue-based measures in conjunction with implementing the GloBE proposals.

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