POLICY NOTE

Tax Administrative Guidance: A Proposal for Simplifying Pillar Two

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1 Introduction

In 2016, the Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) was established as a platform for both OECD/G20 member countries and other (especially emerging and developing) countries in order to ensure effective implementation of the BEPS recommendations. At the request of the G20, the IF was furthermore tasked with addressing the tax challenges arising from the digitalization of the economy. Since 2019, the IF has discussed an international effective minimum tax regime as 'Pillar Two' of its programme of work in this context.[1] An extensive 'Blueprint' for an internationally coordinated Global Anti-Base Erosion (GloBE) proposal was released in October 2020. On this basis, a political agreement was reached by 130 IF member countries and jurisdictions[2] and a joint statement[3] was issued on 1 July 2021. It was subsequently amended, and an implementation plan was added on 8 October 2021. In conformity with the latter, IF member countries are currently developing model rules that will be published in mid-December 2021. Moreover, administrative safe-harbours will be provided for and shall be detailed by the end of 2022.

The development of simplification measures to minimize compliance costs for the affected multinational enterprises (MNEs) is indeed a key element of the still not yet agreed upon outstanding technical issues. The 2020 Blueprint mentioned various options to be explored, among them 'safe-harbour' rules based on country-by-country reporting (CbCR) data and 'de minimis' rules for countries to which only a small percentage of MNE group profits are assigned and thus have little BEPS potential.[4] However, public consultations revealed a preference of businesses for 'tax administrative guidance' to designate countries that are generally low risk or for which a full GloBE declaration may not be required. In spring 2021, the authors were invited by the OECD Secretariat to explore design options for an administrative safe-harbour based on the 'tax administrative guidance' and examine the feasibility of these options on a without prejudice basis. This work required the authors to make two separate assessments:

Is it possible to identify approaches and criteria that would allow MNEs to use existing information in order to avoid having to calculate a full GloBE effective tax rate

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1 *See* OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, OECD/G20 Base Erosion and Profit Shifting Project, Public Consultation Document, 13 Feb.–6 Mar. 2019 (OECD Publishing 2019), https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (accessed 20 Oct. 2021); OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Base Erosion and Profit Shifting Project, Inclusive Framework on BEPS (OECD Publishing 2019), https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf (accessed 20 Oct. 2021).

2 Since then, additional countries have joined, bringing the total number of countries to 136.

3 OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy*, OECD/G20 Base Erosion and Profit Shifting Project (2021), https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf (accessed 20 Oct. 2021) (hereafter: OECD, Statement on a Two-Pillar Solution).

4 For detailed justification, *see* OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint*, OECD/G20 Base Erosion and Profit Shifting Project, Inclusive Framework on BEPS (OECD Publishing 2020), https://doi.org/10.1787/abb4c3d1-en (accessed 20 Oct. 2021) (hereafter: OECD, Pillar Two Blueprint), paras 376 et seq.

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(ETR) and complete a minimum tax return for a particular jurisdiction, unless requested to do so, thereby reducing compliance costs; and can the relevant criteria be determined in a mechanical way without subjectivity or the exercise of political discretion and without undermining the GloBE policy objectives so as to ensure an objective and fair assessment of all interested jurisdictions?

To this effect, the authors have analysed possible conceptual approaches from the perspective of both interested jurisdictions and affected MNEs. After the identification of a promising high-level design, the authors furthermore produced detailed templates for the assessment procedure. The objective was to demonstrate that an approach could be developed that would indeed involve very little discretion and could be applied by taxpayers to reduce compliance costs and not undermine the GloBE policy objectives. Moreover, and in parallel to this conceptual work, the authors conducted a trial exercise of the concept and templates within the German business tax system. This was intended to be a proof of concept, and the procedural implementation of the proposed simplification approach was tabled.

This article outlines the simplification concept devised by the authors and proposes the underlying trade-offs between the efficiency and effectiveness of GloBE. The remainder is organized as follows. The second section briefly explains how key features of the agreed GloBE common approach will increase the complexity of the international tax system. The third section begins with a high-level presentation of core design elements of the authors' proposed simplification approach. Subsequently, the more detailed mechanics of the proposal are explored from the perspective of both countries developing the administrative guidance and MNEs making use of it. Section 4 provides an overview of the main findings of the German case study while the fifth and final section draws conclusions.

2 The GloBE Concept and its Inherent Complexities

Some key components of the GloBE common approach have been agreed upon on in the statements of 1 July and 8 October 2021 that were mentioned previously. They build on the October 2020 Blueprint and subsequent discussions in the IF which provide a greater degree of detail and will form the point of departure for the still outstanding work on technicalities and guidance. For the purpose of this study, it is assumed that the GloBE rules will incorporate the following relevant elements based on the rules' description as established in the Blueprint.[5]

1. It is foreseen that the international minimum tax regime shall apply to MNEs with consolidated group revenues above EUR 750 million. Countries are afforded the discretion to choose a lower threshold for MNEs headquartered in their jurisdiction.
2. The minimum tax rate used for purposes of the Income Inclusion Rule (IIR) and Undertaxed Payments Rule (UTPR) will be 15 %.
3. A top-up tax will be imposed on profits that are insufficiently taxed by the jurisdictions with primary taxing rights using an ETR test (full GloBE ETR calculation) that is calculated on a per-jurisdiction basis. For each jurisdiction, it is determined as the ratio between the tax base for the profits generated by all resident or locally established constituent entities, on the one hand, and what is known as covered taxes (essentially taxes on income) that are attributable to the relevant profits on the other. Permanent establishments (PEs) are treated as separate constituent entities of the MNE. Covered taxes will also be taken into account when they have been levied by another jurisdiction. The rules for the calculation of the tax base for GloBE purposes are standardized and, in principle, independent from national tax accounting rules. They originated in the 'acceptable' international financial accounting standards that are used by the parent in the preparation of its consolidated financial statements. Acceptable standards are the International Financial Reporting Standards (IFRS) and equivalent financial accounting standards; others may be accepted if their use does not result in material competitive distortions. On this basis, certain book-to-tax adjustments for differences between financial and tax accounting rules are foreseen. Some of them reflect typical deviations between the two accounting regimes and are therefore to be routinely applied (mandatory adjustments) whereas other, flexible adjustments are contingent upon a concrete deviation vis-à-vis the nationally applicable tax accounting rules. The GloBE ETR that results from dividing the covered taxes by the GloBE base (i.e., to the adjusted financial accounting profits) is then possibly further adjusted to mitigate the impact of volatility in the GloBE ETR from one period to the next. In particular, the 2020 Blueprint contemplates an unlimited carry-forward for past losses – as computed under the GloBE rules and independent of any eventual loss carry-forward rules applied in the national tax system.
4. If the MNE has a GloBE ETR in a particular jurisdiction below the minimum tax rate, top-up tax will be levied on the relevant under-taxed profits in another jurisdiction up to the minimum rate. The primary instrument for its collection will be an IIR that would technically operate similar to an extended

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[5] Regarding this and the following key elements, *see* OECD, Statement on a Two-Pillar Solution, *supra* n. 3, p. 3 et seq.

controlled foreign company (CFC) regime. Consequently, the IIR will be applied at the level of a parent entity of the MNE with under-taxed profits with priority for higher tier entities based on a top-down approach. Typically, the ultimate parent entity (UPE) jurisdiction will therefore collect the top-up tax for all foreign-sourced profits of the MNE if it has implemented the GloBE rules. When the UPE itself has earned under-taxed profits in a PE that is located in another jurisdiction in which a tax treaty prescribes the exemption method, the application of the IIR is to be facilitated by a switch-over rule. Under-taxed profits that are not covered by any IIR conforming to GloBE will be subject to a top-up tax in the other jurisdictions where the MNE operates. This also includes under-taxed profits of entities located in the UPE jurisdiction. An agreement has yet to be reached regarding the collection mechanism for this UTPR.

5. No top-up tax will be levied on routine profits that are deemed to have been derived from business activities with sufficient underlying substance in a jurisdiction. Therefore, a formulaic 'substance carve-out' will exclude an amount of income from the GloBE regime that is equivalent to 5 % of the carrying value of tangible assets and payroll. In a transition period of ten years, higher percentages will apply.[6]

A requirement for in-scope MNEs to periodically calculate the full GloBE ETR for each jurisdiction in which the firm has a resident parent or subsidiary or has established a PE has the potential to generate considerable compliance costs. In recognition of this fact, it is foreseen that existing entity-level financial information that has been used in preparing the parent's consolidated financial accounts may also be employed for the purpose of calculating the GloBE ETR. Even so, this additional compliance burden might be regarded as excessive with respect to jurisdictions where there is no risk or only a limited and clearly identifiable risk that the local profits of the concrete MNE are effectively taxed below the minimum rate.

3 The Tax Administrative Guidance Simplification Approach

3.1 *Conceptual Outline*

The 'tax administrative guidance' approach aims at reducing tax compliance costs for taxpayers and tax administrations. The most promising way to achieve a significant simplification of Pillar Two is to completely avoid any unnecessary full GloBE ETR calculations. An unnecessary calculation is one in which the full GloBE ETR can *ex ante* be anticipated as – at least most likely – being above 15 % (or, in general, the agreed minimum rate). Indications against an expected higher-than-15 % full GloBE ETR are low nominal tax rates or substantial deviations between a country's tax base and the financial accounting standard used for GloBE purposes. In theory, many should agree with this concept, however, in practice, it is not straightforward to implement as many details such as 'substantial deviations' and dealing with losses must be defined. The authors present a detailed approach below. On this basis, policymakers need to set up procedures that ensure an unbiased neutral assessment of a country's circumstances and allow for periodical revisions when needed.

The simplification approach developed by the authors consists of a two-level test to determine if a full GloBE ETR calculation is mandatory: a country-level test and – when necessary – an MNE-level test. As a caveat, even in the case for which a jurisdiction is considered low-risk with the country-level test, the jurisdiction that would collect any eventual top-up tax may wish to reserve the right to request a full GloBE ETR calculation in individual cases.

First, the country-level test takes place. This test assesses a country's tax system based on checklists and other materials. At this level, there is no involvement of firms as the test analyses the tax system per se and does not seek to approximate the local full GloBE ETR of a specific MNE. The objective of the two-stage country-level test is to identify whether the country is generally low-risk, high-risk, or requires a further MNE-level test (level 2). This is achieved based on a country-specific analysis of its tax rate(s) and tax base(s) as well as the base deviations between financial accounting and tax. A template could be used to assist in identifying specific low tax rates or problematic base deviations which the authors have denoted as 'red flag' deviations in the following analysis. The country-level test would only be repeated when necessary following a change of law that would impact the accuracy of the prior country analysis. The conditions for redoing the test have not yet been defined, but major tax rate or tax base reforms will likely be triggering events for initiating a reassessment.

The country-level test results in one of three possible outcomes for each country:

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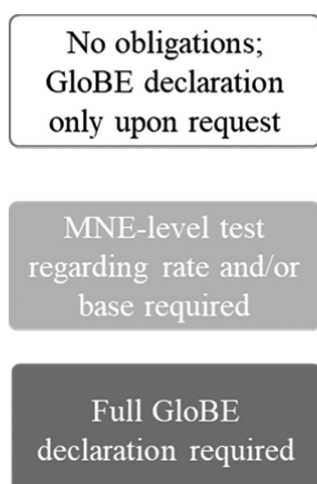
[6] *See* OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Base Erosion and Profit Shifting Project, Highlights Brochure, Oct. 2021 9 (OECD Publishing 2021), https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf (accessed 9 Dec. 2021), p. 9.



There are generally no GloBE obligations for MNEs with business activity in that country. GloBE declarations (i.e. a full GloBE ETR calculation) only occur for individual cases upon request by the respective country's tax administration, or further tests such as the computation of a simplified GloBE ETR are required on an MNE-level (level 2) for business activities in that country, or a yearly full GloBE declaration (i.e. a full GloBE ETR calculation) is required in that country for MNE's business activities that are generally encompassed within Pillar Two.

The second level, the MNE-level test, only becomes a factor if the first level – the country-level test – has identified potential 'red flags'. This can either be a specific rate below the tax rate threshold of 15 % or a relevant base deviation. The MNE-level test is a two-stage periodical test that must be performed by each MNE generally falling under Pillar Two and with a nexus in a 'red flag country'. The aim of the test is to identify whether the MNE benefits from existing 'red flags' regarding rates or base; specifically, the risk level of the individual MNE is assessed. If the MNE benefits from 'red flag' deviations and/or low tax rates, a simplified, deviation-adjusted GloBE tax base and GloBE ETR needs to be calculated. This simplified GloBE ETR is based on national tax law. The reason for that is that the national tax base is known for all of the jurisdictions. It is therefore much easier available as compared to preparing a financial accounting base that is adjusted for all OECD-proposed GloBE adjustments such as adjustments for income from other constituent entities of the MNE. Taking the national tax base as a starting point for the simplified GloBE ETR calculations, only the major deviations between tax and financial accounting – the 'red flags' – have to be taken into account. If the resulting simplified GloBE ETR is below 15 %, then a full GloBE declaration is required. In the event that it is at least 15 %, there is generally no GloBE declaration and no top-up tax payment due for that country.

In the following sections, the country-level test (section 3.2) and the MNE-level test (section 3.3) will be more comprehensively outlined.

3.2 *Country-Level Test*

3.2.1 *Two-Stage Approach*

The first part of the proposed dual simplification procedure involves a two-step approach to determine a country's GloBE risk profile.

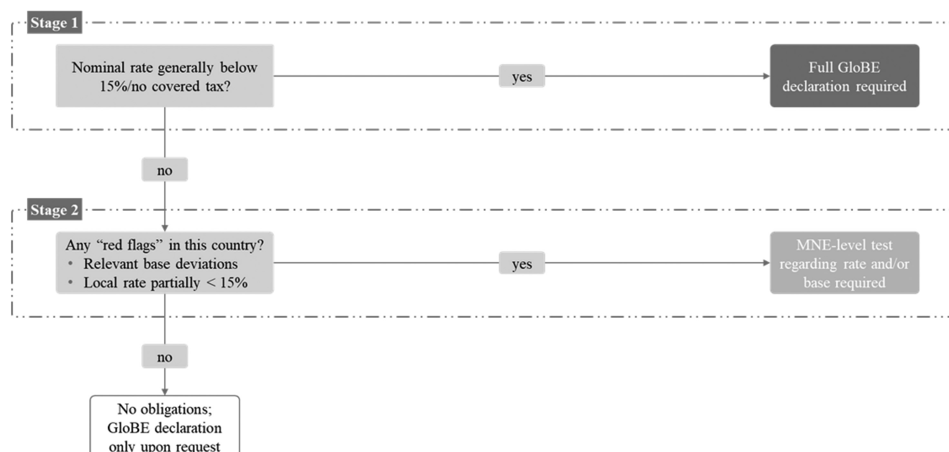
In the first stage, it needs to be examined whether the nominal tax rate in the respective country is generally below the GloBE minimum tax rate of 15 % or if any taxes covered under GloBE are levied at all in the respective country. In the case that the country's nominal tax rate is below the GloBE minimum tax rate of 15 % or the country does not levy any taxes covered under GloBE, a full GloBE declaration is required from all MNEs in that country.[7] If an explicit safety buffer in the minimum tax rate tested for is considered necessary (see 3.3.2.3), the rate could also be slightly increased for the purpose of this test.

If the nominal tax rate of the respective country exceeds 15 %, the second stage of the suggested two-step approach becomes a factor. In this stage, it is examined whether any 'red flags' are present in the respective country. A 'red flag' constitutes a deviation between the financial accounting standard(s) used for GloBE purposes in the respective country and its national tax law that is neither addressed by the adjustments provided by GloBE nor considered as immaterial or unproblematic. Section 3.2.2 describes how such a 'red flag' base deviation is identified in the simplification approach. A 'red flag' is also present if the local tax rate in a respective country is partially below the GloBE minimum tax rate of 15 %. For example, this might be the case if a country offers reduced tax rates for specific sectors or regions. If a 'red flag' is present, an MNE-level test is required for that country which is explicitly explained in section 3.3. If there is no 'red flag' present in the country under review, the model developed by the authors suggests that the country should be classified as low-risk from the Pillar Two-perspective. As such, no MNE GloBE obligations arise in this country per se and, consequently, no top-up taxes have to be paid. A full GloBE declaration is only required upon request by the tax authority in this case.

Notes

[7] Under the OECD, Pillar Two Blueprint, *supra* n. 4, para. 128 'any tax on an entity's income or profits (including a tax on distributed profits), and [...] any taxes imposed in lieu of a generally applicable income tax' are defined as covered taxes.

Figure 1 Two-Stage Approach of the Proposed Country-Level Test



3.2.2 *Identifying 'Red Flag' Base Deviations Through an Exclusion Process*

3.2.2.1 Objectives and Trade-Offs

Identifying 'red flag' deviations between the GloBE base and the local tax base requires a trade-off. Not every deviation should rule out the designation as a low-risk jurisdiction at a country-level or at least at the level of the individual MNE. Otherwise, no meaningful simplification could be achieved because there will be certain base deviations in almost every jurisdiction that would also affect a broad range of business activities. It is therefore necessary to establish and apply criteria that permit a classification of each deviation as either immaterial and thus negligible for a preliminary and approximate ETR test or as material and thereby requiring a 'red flag' test at the MNE-level.

The criteria to be agreed upon must be sufficiently broad so as to provide uniformly applicable guidance for the assessment of a very heterogeneous set of national tax accounting rules. Furthermore, they should provide all countries that have implemented the GloBE regime with a 'confidence interval' of high probability in which the simplification approach does not undermine the effectiveness of the minimum tax regime when applied at the level of individual MNEs. Accordingly, the relevant criteria must be conceived so as to eliminate only deviations from the preliminary approximate ETR calculation that can *a priori* be expected to be only *de minimis* or that do not raise significant concerns with respect to the objectives underlying the GloBE common approach. However, some degree of generalization with regards to a lack of problematic effects should be accepted when designing and applying the relevant criteria in order to take into account their tax simplification and efficiency objective.

Finally, when balancing the conflicting objectives, it is also important to specify the relevant criteria in a manner that allows a mechanical assessment of national tax accounting rules with no or only little political discretion, thus ensuring their impartial application.

3.2.2.2 Process and Criteria for Excluding Immaterial Deviations

The starting point for the calculation of the GloBE base is the profit (or loss) of a firm that is determined in accordance with the financial accounting standard used by the parent entity of the group to prepare its consolidated financial statements.[8] The process of identifying any eventual 'red flag' tax base deviations for a parent jurisdiction therefore starts by first identifying all potential deviations between the countries' national tax law and the relevant accounting standard used by an MNE's parent in the respective country. In this regard, the OECD outlines that the IFRS and equivalent standards will be the primary standard; however, other accounting standards are also acceptable as long as they are 'recognised by an appropriate authority'[9].[10] For reasons of feasibility, the IFRS will be the only general accounting standard used as a basis for the following analysis.[11]

Notes

8 *See* OECD, Pillar Two Blueprint, *supra* n. 4, para. 164.

9 *Ibid.*, para. 173.

10 *See ibid.*, paras 166 et seq.

11 Major differences between the IFRS and other financial accounting standards can be considered when appropriate.

Identifying all of the deviations between the accounting standard used for consolidated financial statements in a country and the national tax law not only requires comparing rules with respect to within-balance sheet items (intra-balance sheet deviations) such as different depreciation schedules regarding assets included in both financial and tax accounts. It also requires documenting all tax-specific deviations beyond the scope of financial accounts such as deductions that are only allowed for tax purposes (denoted as extra-balance sheet deviations in the following). All of these deviations between national tax law and the financial accounting standards are listed in a list of potential 'red flags'.

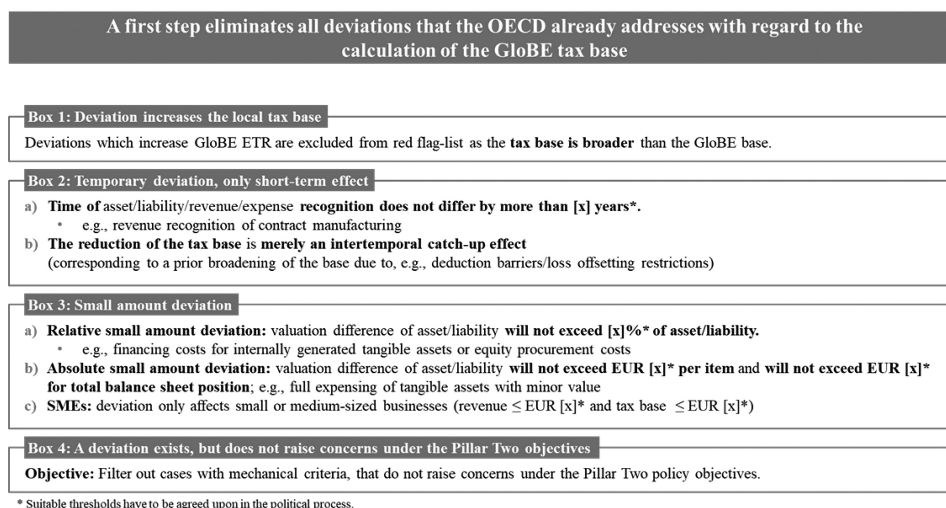
Having identified and listed all of the deviations between the relevant accounting standards and national tax law, the process of determining country-specific 'red flags' is initiated by subsequently filtering out immaterial or unproblematic deviations. This procedure leads to a reduced number of 'red flags' per country and thus the desired simplification of the MNE-level test.

A first step eliminates all deviations that the future GloBE model rules will already address with regard to the calculation of the GloBE tax base. In general, items held in consolidation should only be taken into account in the GloBE tax base if they can be reliably and consistently attributed to an MNE's constituent entity. If not, these items are excluded from the GloBE tax base. Furthermore, income derived from shareholdings in other constituent entities is also excluded from the GloBE tax base. This includes intra-group dividends, portfolio dividends,[12] gains (or losses) from the disposition of stock, and gains (or losses) from equity interest that is accounted for using the fair value method. In addition to the previously mentioned adjustments, a deduction of bribes as well as fines and penalties exceeding EUR 50,000 from the GloBE tax base is not allowed; therefore, they must be added back to the GloBE tax base. Investment returns that incur only to the benefit of the life insurance policy holders are also excluded from the GloBE tax base. Lastly, as Pillar One applies before Pillar Two, adjustments to the GloBE tax base might be necessary to reflect the outcome of Pillar One depending on its final design.[13]

The upcoming model rules for Pillar Two will demonstrate whether further proposals, such as adjustments stemming from deviations from gains and losses on restructuring or immediate expensing and accelerated depreciation of assets, will be also included as adjustments in the final two-pillar approach.

In a second step, further base deviations are eliminated from the potential 'red flag' list based on four different types of criteria: the deviation increases the local tax base compared to the GloBE base (Box 1 criterion), the deviation is only temporary and will reverse in the short term (Box 2 criterion), the relative or absolute amount of the deviation is small (Box 3 criterion), and the deviation does not raise concerns under the Pillar Two policy objectives (Box 4 criterion). Figure 2 provides an overview of these criteria.

Figure 2 Criteria for Excluding Immaterial or Unproblematic Deviations Between the Relevant Accounting Standard and National Tax Law from the 'Red Flag' List



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[12] According to the OECD Pillar Two Blueprint, *supra* n. 4, paras 181 et seq., the dividend exclusion rule will include an exemption for dividends received from a firm when the MNE only owns a low percentage of equity. The exact threshold has not yet been decided.

[13] *See* OECD, Pillar Two Blueprint, *supra* n. 4, paras 175–219.

Box 1 filters out all of the deviations that lead to a broader tax base compared to the GloBE base. By not adjusting for such deviations, the denominator of the simplified ETR calculation is inflated compared to a full ETR calculation with the GloBE base as a denominator. This implies ceteris paribus a lower simplified ETR compared to the actual full GloBE ETR. Such an outcome is never problematic from the perspective of the simplification mechanism because it will not result in a failure of the simplified ETR to properly identify a risk of undertaxation. Therefore, this type of deviation between the national tax base and the GloBE base can be deleted from a potential 'red flags' list. After applying the Box 1 criterion, only deviations for which the direction is unclear and those that cause a lower tax base compared to the GloBE tax base are considered. An example for this category is higher provisions that can be created under financial accounting standards compared to tax accounting laws in many jurisdictions. Due to the application of the Box 1 criterion, these different provisions are not taken into account in the simplified ETR calculation.

The criteria from Box 2 aim at filtering out any short-term, temporary deviations between the GloBE base and national tax law as their effect reverses within a few years. The objective of Criterion 2a) is therefore to eliminate all deviations in which the recognition of assets, liabilities, revenues, or expenses does not differ by more than a few years between the financial accounting standard and national tax law. Examples include an earlier recognition of a prepayment in the tax income compared to financial income or an earlier expensing of guarantee and warranty cost estimates in financial accounting compared to tax accounting. In the vast majority of cases, these differences will reverse after a relatively short period of time. Nevertheless, the authors acknowledge that this criterion involves some judgment of whether the temporary deviation is material due to a lack of formal rules mandating the reversal of these book-tax differences after a certain time. Criterion 2b) complements the exclusion of temporary deviations by further excluding any intertemporal catch-up effects that correspond to a prior broadening of the tax base due to, for instance, deduction limitations or loss offset restrictions.

Box 3 filters out all of the deviations between the GloBE base and national law that concern only a small amount. These deviations can either be small deviations in a relative sense (Criterion 3a)) or in an absolute sense (Criterion 3b)). Criterion 3a) aims at eliminating all deviations for which the difference of an asset or liability's valuation does not differ by more than a certain percentage of that asset or liability. Such a relatively small amount deviation can occur if, for example, the financial accounting standard allows for the capitalization of certain parts of an asset whereas national tax law does not. Absolute small amount deviations are also eliminated when determining a country's 'red flags', which is reflected in Criterion 3b). This criterion treats all deviations as immaterial when the valuation difference of an asset or liability does not exceed a certain fixed amount of the item or the total balance sheet position. For example, some countries' national tax law allows for the immediate full expensing of assets with minor value below a certain threshold whereas the financial accounting standard requires the assets to be depreciated over their useful life. In contrast to Criterion 3a), the identification of absolute small amount deviations does not require any judgment. Box 3 also includes Criterion 3c) that eliminates deviations between the GloBE base and national tax law that only apply to small or medium-sized businesses. This criterion reflects the low risk that constituent entities of an MNE that exceeds the high GloBE consolidated revenue threshold will significantly benefit from small and medium-sized enterprise (SME) tax concessions. Nevertheless, Criterion 3c) is only applied to standalone SMEs in contrast to SMEs as part of an MNE group. Otherwise, multiple SMEs that are constituent entities of an MNE could claim benefits of which the combined amount could incite BEPS concerns. Aiming only at deviations that benefit standalone SMEs, the authors assume that the GloBE rules do not become applicable in the vast majority of cases when Criterion 3c) is applied. As for the Criteria 3a) and 3b), suitable thresholds for defining small and medium-sized businesses as well as concrete numbers for defining relative and absolute small amount deviations have to be agreed upon by the IF.

Finally, Box 4 filters out deviations between the relevant accounting standard and national tax law that do not raise concerns under the Pillar Two policy objectives. Concretely, this step could be used to eliminate deviations that do not match one of the criteria of Boxes 1–3 but, in the authors' view, are not susceptible to be used for international tax planning by MNEs or are otherwise acceptable considering the GloBE objectives and design. In this context, it would seem appropriate to take into account the political compromise to introduce a formulaic carve-out for routine profits derived from 'substantive' activities.[14] This implies that the agreed GloBE common approach does not seek to address international tax competition for real investment. Consequently, corresponding tax incentives that are likely to provide benefits not exceeding the amount of shelter to that recognized under the substance carve-out could be classified as immaterial base deviations; at least when they specifically target investments in tangible assets. Furthermore, deviations that would not arise if a different and theoretically equally

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[14] *See ibid.*, paras 332 et seq.

eligible financial accounting standard was selected as the starting point for the GloBE base should also not raise concerns. As a caveat, the application of the Box 4 criterion may cover very heterogeneous categories of national tax rules and would require a thorough and continuous monitoring by the assessing authority. Examples for this category are the carry-forward of a previously denied interest expense, the roll-over of capital gains from the disposal of certain assets, and even a deduction for donations to charitable non-profit entities.

Pursuant to a draft of the GloBE model rules to be published in December, the IF plans to take deferred taxes into account in the calculation of the GloBE ETR. If this will be the case, the number of deviations between national tax law and the relevant financial accounting standard that would have to be checked to determine whether they constitute material 'red flag' deviations will be significantly reduced. With deferred taxes added to actual tax payments in the ETR numerator, only permanent deviations will have to be considered as potentially material or problematic deviations. Box 2, which aims only at temporal deviations, will generally no longer need to be applied.

3.3 *MNE-Level Test*

An MNE should check the administrative guidance, where available,[15] for each jurisdiction in which it has at least one constituent entity. If the respective country is considered to be either generally high – or low-risk according to the guidance, there is no need for estimating the jurisdictional ETR. In these cases, a full GloBE calculation and declaration is either always required (if deemed high-risk) or it is unnecessary by default unless explicitly requested by the tax authorities of an IIR or UTPR jurisdiction (if deemed low-risk). However, when a country has been classified with a case-specific risk of under-taxation – depending on the applicability and use of tax accounting rules or tax regimes designated as 'red flags' (in the form of a tax base deviation or a low preferential tax rate) by the local constituent entities of a particular MNE – a provisional ETR could be estimated using a simplified approach. This simplified ETR then determines whether a full GloBE declaration must routinely be submitted for this jurisdiction or only upon explicit request.

3.3.1 *Two-Stage Approach*

The MNE-level test in a jurisdiction with case-specific risk involves up to two stages depending on the categories of 'red flags' that have been identified for this jurisdiction.

In a first stage, it needs to be determined whether any of the profits that are attributable to a local constituent entity benefit from a preferential nominal tax rate below the minimum rate of 15 % or – if an explicit safety buffer is considered necessary (see 3.3.2.3) – it is a percentage slightly above the minimum rate. If a beneficial rate applied at least to a portion of relevant profits, an approximate GloBE ETR needs to be calculated. To this effect, the relevant covered taxes will be divided by the relevant local tax base (adjusted for loss carry-overs, if applicable; see 3.3.3). The latter, specifically, the denominator, would be the local tax base by default; the concepts of relevant covered taxes and relevant local tax base are further explained in 3.3.2. If this operation results in an approximate GloBE ETR below 15 %, a full GloBE declaration is required.

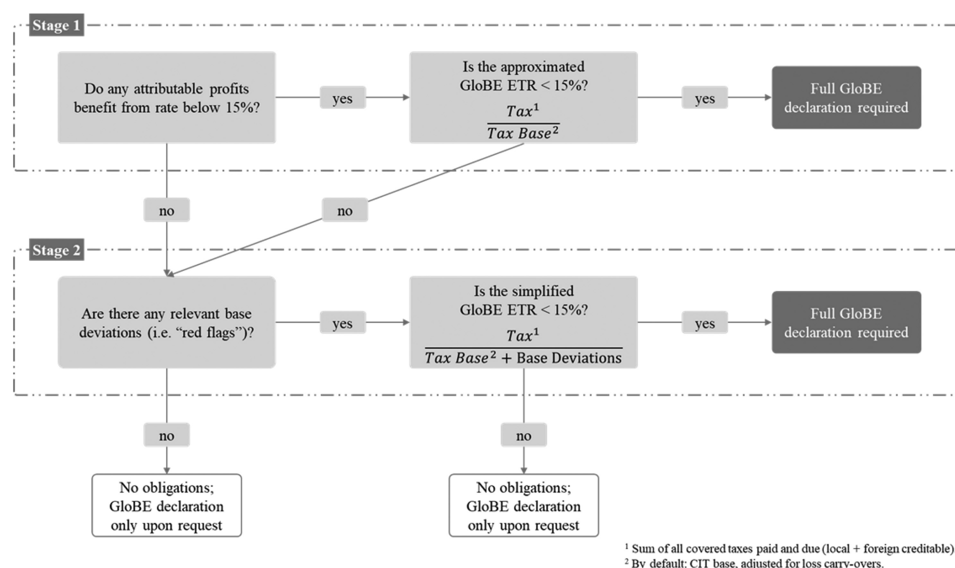
If preferential nominal tax rates below 15 % ('red flag' rate deviations) either do not exist in the tested jurisdiction or have not been applied to any of the MNE's profits there, the assessment proceeds to a second stage in which it is necessary to test whether any eventual relevant tax base deviations ('red flag' base deviations) applied when calculating the relevant local tax base. When this is not the case, there is no significant risk of a full GloBE ETR below 15 %. Based on the first stage, it has then already been affirmed that the amount of covered tax is sufficient to lift the ETR above this rate under the premise that the GloBE base was equivalent to the relevant local tax base. The second stage subsequently provides the reassurance that this local base is indeed not substantially smaller than the GloBE base. Consequently, the MNE would not be obligated to submit a full GloBE declaration for this jurisdiction unless explicitly requested to do so.

By contrast, if the determination of the local tax base of any of the MNEs' constituent entities involved significant material deviations from the GloBE base as designated in the administrative guidance derived from the country-level test, the calculation of a simplified ETR becomes necessary at the second stage of the MNE-level test. Then, the relevant covered taxes are divided by the sum of the relevant local tax base plus the problematic base deviations. Since only deviations that are either immaterial or do not raise concerns are disregarded in this base adjustment exercise (see above at 3.2.2.2), the adjusted local tax base as a denominator should not be considerably smaller than the actual GloBE base. Therefore, this formula should result in an approximation of the ETR that does not exceed the actual, full GloBE ETR in any relevant way. This means that the MNE should not have to submit an unsolicited full GloBE declaration for the respective jurisdiction if the outcome of this test is that the simplified ETR exceeds the threshold of 15 %. On the other hand, if it is below the relevant percentage of the minimum tax rate and an eventual safety buffer, the MNE must carry out a full ETR calculation and file a GloBE declaration.

Notes

[15] Since the 'tax administrative guidance' can be expected to be designed as a voluntary process, guidance might not be available for each jurisdiction.

Figure 3 Two-Stage Approach of the Proposed MNE-Level Test for One Jurisdiction



3.3.2 *Estimation of the MNE's Jurisdictional ETR*

The two formulas for estimating the MNE's jurisdictional ETR under the simplified approach described above imply design choices and trade-offs that will now be analysed more in depth.

3.3.2.1 The Numerator: Covered Taxes

The taxes taken into account in the numerator of the ETR formulas in both stages of the MNE-level test could either comprise all covered taxes considered in the full GloBE calculation, or they could be limited to covered taxes that are easy to identify and assign to individual jurisdictions.

Under the first option, the relevant covered taxes would comprise the totality of covered taxes, as defined in the October 2020 Blueprint, that correspond to the profits attributable to the tested jurisdiction. This would reflect the approach taken under a full GloBE ETR calculation and would thus render the estimate of the GloBE ETR more accurate. However, this could then also involve relatively complex operations with respect to certain categories of 'cross-jurisdictional' covered taxes that have not been levied by the jurisdiction under scrutiny.[16] For example, it would then be necessary to determine the exact amount and allocation of eventual CFC taxes in order to allocate them to the tested jurisdiction where the subsidiary is domiciled. This can be complicated due to the existence of foreign tax credits in the CFC legislation. Similar challenges would arise with respect to foreign taxes on intra-firm dividends paid by constituent entities with a tax residence in the tested jurisdiction and taxes imposed by the foreign head office jurisdiction on the income of local PEs or hybrid entities because those taxes also have to be allocated to the tested jurisdiction.

Alternatively, if a further reduction in complexity and compliance costs was desired and if somewhat less accurate results were deemed acceptable, the concept of relevant covered taxes could be limited to taxes that can be directly attributed to the relevant profits of which the amount can be determined without complex calculations. Quintessentially, this would then tend to include source country taxes on items of income comprised in the tested profits, especially foreign withholding taxes, in addition to the domestic covered taxes levied on the profits that are attributable to the tested jurisdiction.

3.3.2.2 The Denominator: An Approximation of the GloBE Base

Regarding the local tax base that serves as a denominator in the ETR formulas in both stages of the MNE-level test, a design issue arises with respect to jurisdictions where business profits are subject to more than one type of covered tax. Clearly, all categories of local covered taxes would be taken into consideration for the numerator when determining the amount of covered taxes. However, if the different local covered taxes have potentially divergent tax bases, a decision must be made regarding which tax base should serve as the denominator.

Notes

16 *See* OECD, Pillar Two Blueprint, *supra* n. 4, paras 129 et seq.

In order to ensure that the ETRs in both stages of the MNE-level test are closely aligned with the results that would be obtained under a full GloBE ETR calculation, their denominator should ideally be chosen to reflect the actual GloBE base as closely as possible. If one of the different local tax bases *generally* deviates from the rules on establishing the GloBE base to a lesser extent than the other local tax base(s), it should accordingly be prioritized and used for the calculation of the ETRs in both stages of the MNE-level test. If no such general superiority of one of the local tax bases can be ascertained, it might nevertheless be possible to establish a clear preference for one of them. Deviations between a local tax base and the GloBE base that have been designated as material ('red flag' base deviations) are eventually adjusted at the second stage of the MNE-level test. Therefore, they can be ignored in a second step when deciding whether one of the local tax bases *generally* aligns better with the rules on the GloBE base, i.e., with the IFRS or equivalent financial accounting standards and the mandatory and flexible book-to-tax adjustments. If a general conclusion still cannot be drawn as neither of the divergent local tax bases is consistently better aligned with the GloBE base already in the abstract, independent of the circumstances of an individual case, the authors' recommendation is to select the corporate income tax (CIT) base by default. On the one hand, the CIT will typically be the most relevant covered tax in a particular jurisdiction in terms of revenue and tax burdens. On the other, it is not possible to determine the better aligned base ad hoc in each individual case, because this might require complex assessments that would undermine the simplification objective of the administrative guidance or lead to tax planning opportunities by choosing the more advantageous base. This solution furthermore implies that all of the aforementioned steps in identifying the proper local tax base to be used in the denominator should form part of the procedure that creates the administrative guidance. It also suggests that the relevant base should thus be determined at country-level rather than by individual MNEs.

Choosing a single uniform local tax base as the denominator for the ETR formula under the simplified approach for all types of covered taxes, even when some of them have a different tax base, has two distinct advantages. First, it somewhat reduces the complexity of the ETR estimation because adjustments for material deviations from the GloBE base at the second stage of the MNE-level test are then necessary for only one local tax base. Second, it also permits inclusion in the numerator of the so-called 'in lieu of taxes' that qualify as covered taxes[17] such as, for instance, a municipal tax on a business that uses rough estimates or an approximate basis for profitability like the surface of commercial or industrial area that is used. These bases of assessment for these categories of taxes deviate so fundamentally from the GloBE base that adjustments for material differences would be unfeasible. Therefore, the approximate contribution of such taxes to the GloBE ETR could not reasonably be estimated in isolation. However, if all covered taxes are simply related to a uniform local tax base, there is no need to exclude them from the equation.

Finally, it is necessary to increase the relevant local tax base in the amount of any eventual local loss carry-overs that has reduced it under national taxation rules. This reflects the fact that domestic loss carry-over rules are generally disregarded when determining the actual GloBE base since the latter has its origin in financial accounting rules. Instead, a GloBE-specific loss carry-over regime is applied under a full GloBE calculation that will also be mirrored under the simplified approach proposed here (see section 3.3.3 below).

3.3.2.3 The Minimum Rate Benchmark

It is important to note that the calculation of the simplified GloBE ETR treats positive and negative deviations asymmetrically: Deviations that are liable to increase the simplified GloBE ETR compared to the full GloBE ETR are treated as potential 'red flag' material deviations and could be adjusted. By contrast, deviations that inherently broaden the local tax base compared to the full GloBE base and therefore decrease the simplified GloBE ETR compared to the full GloBE ETR are eliminated from the list based on the 'Box 1' criteria (see above at 3.2.2.2) and are not adjusted. Thus, MNEs will only have to adjust the tax base for deviations that would increase the simplified ETR under the simplified approach. As a consequence, the rules on determining the simplified GloBE ETR *systematically* underestimates the actual, accounting-based GloBE ETR of the company.

Two conclusions can be drawn from that. First, it is important to notice that the proposed 'tax administrative guidance' simplification approach can bring out false positive results when the simplified GloBE ETR is below 15 %. However, a subsequent full GloBE ETR calculation reveals that the MNE's jurisdictional full GloBE ETR is actually above the minimum rate. Second, this systematic underestimation of the full accounting-based GloBE ETR can be interpreted as an implicit buffer in the simplification approach. This buffer might be large enough and can be

Notes

17 *See ibid.*, para. 140.

considered as an argument for not adding an additional (explicit) buffer to the minimum rate for the purpose of evaluating the outcome of the simplified ETR approximation.

3.3.3 *Integrating Loss Carry-Overs*

The simplified GloBE ETR is calculated on a jurisdictional basis and allows for offsetting current losses and profits within one jurisdiction. However, in the event that the MNE has incurred losses in previous periods that have not yet been (fully) offset, the simplified GloBE ETR calculation outlined above requires additional adjustments. Since the regular, full GloBE ETR calculation features an unlimited carry-over of past losses (computed in conformity with GloBE rules), a loss carry-over also needs to be taken into account for the purpose of the simplified GloBE ETR calculation. Otherwise, the simplified ETR denominator would be distorted, and the simplified approach would systematically underestimate firms' actual full GloBE ETRs. The authors therefore propose maintaining a memorandum account for each jurisdiction of eventual prior losses. Those approximate past losses can then be carried forward to future periods for the calculation of the simplified GloBE ETR.

The proposed loss memorandum account for the purpose of calculating the simplified GloBE ETR works in principle as follows: When the calculation of the simplified GloBE base results in a loss for a particular year and jurisdiction, this loss is accounted for in a jurisdiction-specific memorandum account for the purpose of a loss carry-forward for future simplified GloBE ETR calculations. The memorandum account thus accumulates all periodical GloBE losses on a jurisdictional-level until they can be offset against positive simplified GloBE bases calculated for this same jurisdiction ('accumulated loss carry-forward' in Table 1 below).

Table 1 Example for a Simplified GloBE ETR Calculation with a 'Red Flag' Deviation in t = 1, a Loss in t = 1 and Profits in t = 2 and 3 (Required Firm Inputs are Highlighted in Grey)

Assumptions	CIT rate:		17.50%	
	GloBE minimum rate:		15.00%	
Year	*0*	*1*	*2*	*3*
			National Tax Law	
local tax base (before lcf & lcb)		-5.00	2.00	5.00
used loss carry-back		0.00	0.00	0.00
accumulated loss carry-forward	0.00	-5.00	-3.00	0.00
local tax base (after lcf & lcb)		0.00	0.00	2.00
covered taxes		0.00	0.00	0.35
			GloBE	
"red flag" deviations		2.00	0.00	0.00
GloBE base (before lcf)		-3.00	2.00	5.00
used loss carry-forward		0.00	2.00	1.00
accumulated loss carry-forward	0.00	-3.00	-1.00	0.00
GloBE base (after lcf)		0.00	0.00	4.00
simplified GloBE ETR (before lcf)		N/A	0.00%	7.00%
loss carry-forward test applicable?		No	Yes	Yes
simplified GloBE ETR (after lcf)			N/A	8.75%
Conclusion		**No obligations; GloBE declaration only upon request**	**No obligations; GloBE declaration only upon request**	**Full GloBE declaration required**

In years with a negative simplified GloBE base, no further full GloBE ETR calculation is necessary. In subsequent years with a positive simplified GloBE base, the integration of the loss memorandum account in the calculation of the simplified GloBE ETR implies a two-step approach. First, a simplified GloBE ETR is calculated by dividing the covered taxes due and payable by the simplified GloBE base before the deduction of a loss carry-forward. If the simplified GloBE ETR already exceeds the minimum rate at this step, the MNE does not need to use its loss carry-forward from the memorandum account, and it is exempt from its obligation to submit a full GloBE declaration. In the case that the simplified GloBE ETR is below the minimum rate, a second step now takes into account the previously incurred losses; the covered taxes due and payable in the jurisdiction are divided by the simplified GloBE base after the deduction of a loss carry-forward. In this regard, the authors propose that the accumulated loss carry-forward only needs to be deducted from the simplified GloBE base up to the point when the minimum tax rate is reached. Nevertheless, the authors also propose that the deduction of the loss carry-forward from the simplified GloBE base is not limited by any absolute or relative amount in conformity with the regular calculation of the actual GloBE ETR as envisaged in the 2020 Blueprint.

Table 1 applies the authors' proposed simplified GloBE ETR calculation in a three-period example with profits/losses of – 5, 2, and 5 in years 1, 2 and 3.[18] In the first period the MNE has an aggregated negative tax base in the jurisdiction. While the negative tax base creates a national loss carry-forward position, the loss carry-forward for the simplified GloBE ETR calculation purposes is diminished due to a positive 'red flag' deviation. In the second period, the loss carry-forward for both national tax purposes and those of the simplified GloBE ETR calculation is then partially used. Notably, for simplified GloBE ETR calculation purposes, the two-step approach for using loss carry-forwards that was mentioned previously is applied. In the third period, the firm incurs a higher profit and uses the remaining loss carry-forward for both national tax purposes and the simplified GloBE ETR calculation. As the initial loss carry-forward that was accumulated in the first period was lower for simplified GloBE ETR purposes than for national tax purposes due to a 'red flag' base deviation, the firm cannot sufficiently decrease its simplified GloBE base and, therefore, its simplified ETR fails to satisfy the minimum tax rate. This makes an actual GloBE ETR calculation, and hence a full GloBE declaration, necessary in the third period.

A special case occurs if a jurisdiction allows for tax loss carry-backs. Similar to the calculation of the actual full GloBE ETR, the authors' model transforms loss carry-backs for national tax purposes into loss carry-forwards for the purpose of calculating the simplified GloBE ETR.[19] Since tax loss carry-backs lead to a reimbursement of past taxes paid for national tax purposes, loss carry-backs have no use when applied to the simplified GloBE ETR calculation. Therefore, in the event that an MNE incurs a negative tax base before loss carry-overs in one period and uses this as a loss carry-back for national tax purposes, the corresponding memorandum account for calculating the simplified GloBE ETR will accumulate a loss carry-forward of the same amount. Hence, the accumulated loss carry-forward for simplified GloBE ETR purposes is greater than the accumulated loss carry-forward for national tax purposes in the respective jurisdiction. Table 2 illustrates an example of this mechanism. While the firm uses half of the loss incurred in the second period as a loss carry-back for national tax purposes, which leads to a reimbursement of taxes, the entire loss accumulates to a loss carry-forward for purposes of the simplified GloBE ETR calculation and reduces the simplified GloBE base in future years.

3.3.4 *Follow-Up Issues*

Two follow-up issues to the authors' proposed simplification approach are noteworthy.

The first issue points to the question of how to deal with past losses in the new system of GloBE-specific carry-over. This, in fact, is also an issue in the full GloBE ETR calculation and any simplification approaches mentioned in the OECD's 2020 Blueprint. The most straightforward approach is that simplification approaches will accord with the manner in which the full GloBE ETR calculation treats these past losses. As such, no separate method will be proposed here.

The second issue that could also arise under the GloBE approach and under any simplification measure is the question of how to take into account an eventual GloBE-specific carry-over of past losses in the calculation of the actual GloBE ETR. This can occur when the MNE has benefitted from a simplification measure in the past that is now no longer applicable or when it comes to occasional reporting obligations because a minimum threshold is sometimes reached or sometimes not, such as if an MNE's sales revenue fluctuates around EUR 750 million. Reporting obligations would then exist in some years but not in others. If the simplified GloBE ETR is not calculated in one year, a potential carry-over does not

Notes

[18] The template for the simplified GloBE ETR calculation is available at https://www.steuern.bwl.uni-muenchen.de/accountingtransparency/tax-admin-guidance_template/index.html. Please note that the calculation of the approximate GloBE ETR (Stage 1 of the MNE-level test) differs only with regard to the inclusion of 'red flag' base deviations in the denominator of the formula.

[19] *See* OECD, Pillar Two Blueprint, *supra* n. 4, paras 302–304.

Table 2 Example of a Simplified GloBE ETR Calculation with a Loss in t = 2, Partially Used as a Loss Carry-Back (Required Firm Inputs are Highlighted in Grey)

Assumptions	CIT rate:			17.50%
	GloBE minimum rate:			15.00%
	maximum loss carry-back assumption: max. period of lcb = 1 year			5.00

Year	***0***	***1***	***2***	***3***
		National Tax Law		
local tax base (before lcf & lcb)		5.00	-10.00	5.00
used loss carry-back		0.00	5.00	0.00
used loss carry-forward		0.00	0.00	5.00
accumulated loss carry-forward	0.00	0.00	-5.00	0.00
local tax base (after lcf & lcb)		5.00	-5.00	0.00
covered taxes		0.88	-0.88	0.00
		GloBE		
"red flag" deviations		0.00	0.00	0.00
GloBE base (before lcf)		5.00	-10.00	5.00
used loss carry-forward		0.00	0.00	5.00
accumulated loss carry-forward	0.00	0.00	-10.00	-5.00
GloBE base (after lcf)		5.00	0.00	0.00
simplified GloBE ETR (before lcf)		17.50%	N/A	0.00%
loss carry-forward test applicable?		No	No	Yes
simplified GloBE ETR (after lcf)				N/A
Conclusion		**No obligations; GloBE declaration only upon request**	**No obligations; GloBE declaration only upon request**	**No obligations; GloBE declaration only upon request**

exist which may subsequently lead to a false positive below – 15 % ETR in the following year(s).

In such a case of occasional reporting obligations, the information on those past losses will typically not be readily available because the MNE will then not have calculated profits and losses in conformity with the rules on establishing the GloBE base in the past and will thus lack the relevant data.

Without the use of loss carry-overs, the simplified GloBE ETR would be too low. If the simplified GloBE ETR is below 15 %, a full GloBE declaration would have to be made, and the detailed calculations would result in a full GloBE ETR above 15%. Therefore, the carry-overs help to avoid unnecessary compliance costs.

There are two possible solutions to effectively address this problem. On the one hand, voluntary simplified GloBE ETR calculations could be made for years without Pillar Two obligations. This guarantees a continuous sequence of carry-overs and correct simplified GloBE ETRs. This advantage comes at the cost of voluntary higher compliance effort. On the other hand, no simplified GloBE ETR calculation could be made in a year without the obligation to do so. Lower compliance costs in this year result in higher compliance effort in the next year(s) because the simplified GloBE ETR without integration of carry-overs might then be too low and therefore a full GloBE ETR calculation could be necessary. Both solutions for dealing with occasional reporting obligations are feasible and, in the authors' opinion, a good option is to allow the taxpayers select which method they would like to apply. A similar problem exists regarding the full GloBE ETR calculation, and a future solution should be coordinated for both the 'tax administrative guidance' simplification approach and the full GloBE ETR calculation.

4 Case Study Germany

The objective of the simplification approach, in its first step, is to assess the general risk profile of a jurisdiction. In the following, this country-level test will be illustrated using Germany as an example. This is based on a case

study conducted by the authors with a particular focus on the reasons for eliminating deviations from the list of potential 'red flags'. Nevertheless, not all deviations can be discussed due to space constraints.

As a first step, in accordance with the concept outlined above, it was checked whether a full GloBE declaration would generally be required for Germany. This would be the case if the combined rates of covered taxes in Germany did not result in a tax rate of at least 15 % for the potentially included entities.[20] Corporations are subject to the CIT in Germany at a rate of 15 % according to section 23 paragraph 1 of the German Corporation Tax Act (GCTA). Furthermore, Germany additionally levies a trade tax on the net income of commercial enterprises. Even though its tax base is partly modified in comparison to the CIT, the tax is to be considered as a tax based on income according to GloBE.[21] The trade tax varies among municipalities but averages to approximately 14 %, and it must never be below 7 %.[22] Considering that the combined tax rates of the German taxes on business profits thus significantly exceed 15 %, Germany would not be designated as a high-risk jurisdiction. Therefore, a full GloBE declaration is not necessary in every case.

Consequently, the second stage of the country-level test was carried out by the authors and aimed at the identification of deviations of the national tax base from the GloBE base and of partially reduced tax rates. Comparing the IFRS accounting standard as the GloBE base with the German national tax law, the authors ascertained more than 100 deviations between the national tax law and the IFRS base.[23] They were compiled in a list of potential 'red flags' and subsequently checked with the criteria for excluding immaterial deviations.[24] Relying on the criteria outlined above in section 3.2.2.2, it has thus been examined which potential deviations from the IFRS base can have a substantial and long-term effect on the actual GloBE ETR of an MNE.

In a preliminary step, all deviations for which the GloBE base already provides an adjustment to the IFRS accounting that corresponds to the deviation of national tax accounting were eliminated. Furthermore, deviations from the IFRS for which the scope is limited to entities that are not covered by the GloBE MNE concept are also of no significance and were thus also removed from the list. It is assumed by the authors that a majority of the deviations between German tax rules and the IFRS are either already reflected in GloBE book-to-tax adjustments, highly likely to be covered by adjustments currently under discussion in the IF, or have no effect at all on the ETR. Moreover, the authors consider some of the deviations addressed by book-to-tax adjustments to be immaterial based on the list of criteria for eliminating immaterial deviations.[25]

In German tax law, for example, capital gains arising from the disposition of stock held in other corporations is mostly exempt from the CIT; according to section 8b paragraphs 2 and 3 GCTA, only 5 % of such gains are subject to tax. This off-balance sheet adjustment to the tax base for the national CIT constitutes a deviation from the IFRS accounting. However, this deviation from the IFRS is already taken into account in the OECD's GloBE Blueprint which is why the authors eliminated it from the list of potential 'red flags'. The GloBE concept recognizes that many jurisdictions have an exemption similar to that in Germany.[26] The underlying rationale is considered legitimate by GloBE standards provided that a minimum threshold of shareholding is met.[27]

Furthermore, some corporations that are personally exempt from the German CIT will generally not be encompassed within the personal scope of GloBE, such as those for which a tax exemption is set out in section 5 GCTA. This provision covers, inter alia, certain smaller insurance companies under section 5 paragraph 1 number 4 GCTA and certain housing cooperatives under section 5 paragraph 1 number 10 GCTA. Since these categories of companies will never exceed the consolidated group revenue threshold of EUR 750 million, this exemption is not a 'red flag' for the purposes of GloBE.

After filtering out all deviations between the IFRS and German tax rules that are either already addressed by OECD book-to-tax adjustments or will not be relevant for in-scope MNEs, the authors applied the criteria for excluding immaterial deviations (Boxes 1–4 of the proposed approach) to the remaining potential 'red flags' in Germany.

Notes

[20] Under GloBE, covered taxes are defined as taxes that are levied on the income or profits of an entity. Furthermore, taxes levied in a national tax system in lieu of those taxes are also covered. *See* OECD, Pillar Two Blueprint, *supra* n. 4, paras 129 et seq.

[21] OECD, Pillar Two Blueprint, *supra* n. 4, para. 137.

[22] Statistisches Bundesamt (Destatis), *Grund- und Gewerbesteueraufkommen im Jahr 2019 um 0,3 % gegenüber dem Jahr 2018 gesunken* (2019), https://www.destatis.de/DE/Themen/Staat/Steuern/Steuereinnahmen/realsteuervergleich.html (accessed 20 Oct. 2021).

[23] The authors examine the deviations between German tax law and the IFRS as latter is the accounting standard used for consolidated financial statements in Germany. Additionally, potential deviations from the German statutory tax rate were also examined.

[24] *See* s. 3.2.2.2.

[25] Therefore, when discussing reasons why some of the deviations from the IFRS and the general tax rate are immaterial, multiple explanations may apply in some cases in the following.

[26] OECD, Pillar Two Blueprint, *supra* n. 4, para. 190.

[27] *Ibid.,* para. 191.

Box 1 excludes those deviations that only broaden the national tax base compared to GloBE. For example, donations made by a German corporation are only partially deductible from the tax base under section 9 paragraph 1 number 2 GCTA. By contrast, they would be fully taken into account under the IFRS.

Box 2 contains two criteria concerning temporal deviations. On the one hand, it filters out deviations that concern the timing of the recognition of an asset or liability or that of the recognition of income and expenses. Such a deviation exists, for example, regarding the revenue recognition for long-term contract manufacturing. In German tax law, the completed contract method that recognizes the entire income in the year in which the revenue actually occurs is prevailing. In contrast, according to IFRS 15.73 et seq., the percentage of completion method is used in a case of a performance obligation over time. This different treatment of the timing of recognition leads to a temporal deviation that was mentioned previously between the IFRS and German tax law. On the other hand, Box 2 filters out what is known as intertemporal catch-up effects which are the reversal of prior deviations between the IFRS and German tax law that led to a broader national tax base in the past. For example, according to section 2a German Income Tax Act (GITA), certain negative income (losses) from foreign countries can only be deducted from the tax base to a limited extent. However, if profits are later generated in the foreign country, these can then be offset against the losses which results in a reversal of the prior deviation between the IFRS and German tax law.

Box 3 includes three criteria that all aim at eliminating deviations that do not exceed certain minimum thresholds from the proposed list of potential 'red flags'. First, Criterion 3a) eliminates deviations that affect only a small percentage of a specific asset. For example, the IFRS provides the option to capitalize financing costs with regard to the acquisition of an asset whereas German tax law prohibits this. As financing costs typically only amount to a very small percentage of the value of the asset acquired, the authors assess this deviation to be immaterial. Criterion 3b) excludes deviations that can be linked to an entity or a specific asset and do not exceed an absolute small amount from being 'red flags'. A simple example are low-value assets of up to EUR 800 that do not need to be depreciated and can be fully deducted immediately according to section 6 paragraph 2 GITA. Further, the authors have not identified a deviation under Criterion 3c) that only affects SMEs in German tax law. This is because the German tax rules on SMEs also apply if that entity is part of an MNE. In this respect, it would be possible for several entities of a group in Germany to claim SME benefits, which could give rise to BEPS concerns.

The vast majority of the remaining deviations may, in the authors' view, be found to be compatible with the policy objectives of GloBE after further consideration. At this point in the analysis of German tax law, the criteria from Box 4 became a factor that required an individual judgment on the deviation. In light of the policy objectives of GloBE, the authors considered that these deviations raise no concerns and therefore do not need to be adjusted in the simplified ETR formula. One example of such a deviation between German tax law and the OECD's GloBE Blueprint is the tax exemption of charitable non-profit entities. The German provisions on the non-profit status in sections 52 et seq. of the Fiscal Code of Germany are broader in scope than the corresponding provisions in the Blueprint. However, non-profit organizations are not susceptible to be used for BEPS which is why it is not necessary to have an MNE-level test carried out for this reason. Another example are deviations with regard to the transfer of pension plans. If a corporation sells a pension plan that cannot be fully recognized in the tax balance sheet (e.g., due to provisions for onerous losses), the resulting loss from the sale is to be distributed over fifteen years according to section 4f GITA. Simultaneously, the purchaser of such a liability can recognize a provision that has to be reversed with effect on profit or loss over fifteen years. In comparison, the IFRS does not provide for such a special rule. The authors do not regard these examples as being susceptible to be used for BEPS and thus do not categorize them as 'red flags' in Germany.

In this manner, numerous deviations were excluded as 'red flags', and only the remaining situations were considered to give rise to clear 'red flags' which would make it necessary to undertake an MNE-level test in Germany. For example, one such material deviation is the investment tax credit (ITC) grant according to the German Research Grant Act that is aimed at stimulating investment in research and development. Such an investment will also determine where subsequent intellectual property profits will be taxed. It is therefore an element of international tax competition that goes beyond the competition for real investment (i.e., investment in 'substance' considered not to be objectionable according to the GloBE carve-out). Moreover, the maximum benefit of EUR 1 million per entity is not de minimis (Box 3). Altogether, the authors ascertained only a small number of 'red flag' indicators for Germany – a finding that would also likely apply to a number of other jurisdictions.

5 Conclusion

In recent years, almost 140 countries have worked as part of the Inclusive Framework on BEPS to reform the international tax system and address the challenges of the digitalized economy. In October 2020, they released the Global Anti-Base Erosion (GloBE) proposal which seeks to establish a global effective minimum tax on profits of large MNEs. In this 2020 GloBE Blueprint, the OECD announced several simplification options for the global minimum tax. One of those is the 'tax administrative guidance' approach that relies on filtering out unnecessary reporting obligations for MNEs in cases when no top-up tax payment is expected to be needed

in order to lift the jurisdictional effective tax rate (ETR) to the agreed minimum rate.

The authors were invited by the OECD Secretariat to explore design options for an administrative safe-harbour based on the 'tax administrative guidance'. The result is a two-level simplification approach to determine if a full GloBE ETR calculation is mandatory: a country-level test and – when necessary – an MNE-level test.

The two-stage country-level test relies on an analysis of a country's tax rate(s) and tax base(s) to determine whether the country is generally a low-risk jurisdiction, usually a high-risk jurisdiction, or requires a further MNE-level test because (only) limited but material risks of under-taxed profits exist (level 2). In the latter case, the problematic preferential tax rates or material base deviations are designated as country-specific 'red flags'.

The second level, the two-stage MNE-level test, becomes a factor if the 'tax administrative guidance' identifies a particular jurisdiction where the MNE has constituent entities as a limited risk jurisdiction with 'red flags'. The objective of the test is to identify whether the MNE benefits from existing 'red flag' deviations regarding rates or base, specifically, the risk level of the individual MNE is assessed. If the MNE benefits from 'red flag' deviations and/or low tax rates, a simplified GloBE ETR must be calculated. The denominator of the simplified GloBE ETR formula is based on the local tax base instead of a full GloBE base because the MNE's tax data is normally much easier available. Taking the national tax base as a starting point for the simplified GloBE ETR calculations, only material deviations between tax and financial accounting have to be adjusted in the denominator. If the resulting simplified GloBE ETR is below the minimum rate (or a slightly higher rate if a buffer was deemed necessary), a full GloBE declaration is required. In the event that the simplified GloBE ETR is at least equal to the minimum rate, there is generally no GloBE declaration or top-up tax payment due for that country.

The authors have tested the feasibility of developing tax administrative guidance based on this concept by scrutinizing potential deviations between the IFRS and German tax law. This trial exercise was based on a developed set of elimination criteria with over 100 potential base deviations being identified, however, only a very few of these were definitively identified as 'red flag' deviations. If this was the final list of deviations, an MNE in Germany would be able to calculate a simplified GloBE ETR by taking only existing tax data and these few 'red flag' adjustments into account. A prerequisite for the proposed approach is that policy-makers set up procedures that ensure an unbiased, neutral assessment of a country's circumstances and allow for periodical revisions when required.

Overall, the 'tax administrative guidance' simplification approach offers the opportunity for MNEs to tremendously reduce reporting obligations and compliance costs.