MNE Strategic Responses to the GloBE Rules

A working paper released by the
Oxford Centre for Business Taxation

WP 22/14

27 September 2022

Heydon Wardell-Burrus

MNE Strategic Responses to the GloBE Rules

Heydon Wardell-Burrus – 27 September 2022

Abstract: This paper considers the incentives created for MNEs under the Pillar 2 GloBE Rules and makes four key contributions. First, it sets out a framework for MNE strategic responses to undertaxed excess profits in the group ('pay-up', 'shift (back)', 'sell', 'blend' and 'shelter'). Second, it theorises the creation of two new valuable tax attributes which are created under the GloBE Rules (Covered Taxes and SBIE). Third, it considers how these new attributes create incentives which introduce new distortions into the system with respect to the location and ownership of investments. Finally, it questions whether the outcomes of these strategies ought to be considered problematic and asks what countermeasures could be considered by states in response to perceived integrity concerns.

Contents

1. Introduction 4

2. Five Strategic Responses to the GloBE Rules 6

2.1. Strategy 1 – Pay-up 7

2.2. Strategy 2 – Shift (back) 8

2.3. Strategy 3 – Sell 9

2.4. Strategy 4 – Blend 9

2.5. Strategy 5 – Shelter 20

2.6. Summary 27

3. New Valuable Tax Attributes 27

3.1. Covered Taxes 28

3.2. SBIE 29

3.3. Potential disadvantages to blending 30

3.4. Conclusion 30

4. New Distortions 31

4.1. Distortion in location 31

4.2. Distortion in ownership 32

5. What (if anything) should be done? 33

5.1. Specific countermeasures to blending 35

5.2. Specific countermeasures to sheltering 36

5.3. Anti-avoidance rules 37

6. Conclusion 39

MNE Strategic Responses to the GloBE Rules

Heydon Wardell-Burrus*

1. Introduction

David Schizer has argued (tongue-in-cheek) for 'Schizer's Law of Conservation of Tax Planning', akin to the Law for the Conservation of Energy, under which tax planning cannot be destroyed, but merely changes form.[1] This paper considers the application of that law to the GloBE Rules.

The GloBE Rules were publicly released on 20 December 2021 with the related Commentary released on 14 March 2022.[2] The related agreement has been described by senior officials as "a once-in-a-generation accomplishment for economic diplomacy"[3] that is necessary to stabilise the eroding "nearly century-old consensus on how to manage the international tax architecture."[4] While MNE's immediate response has been to focus on practical matters of implementation and compliance, it will not be long before we can expect MNES (and their advisers) to be turning their attention to strategic responses as a form of tax planning (to the extent they have not already).

This paper seeks to make four key contributions. First, it sets out a framework for considering MNE strategic responses to undertaxed income. The GloBE rules impose an overlay on the existing tax system which creates new tax liabilities with respect to undertaxed jurisdictions. In response to undertaxed jurisdictions, MNEs will adopt one (or more) of five responses – 'pay-up', 'shift (back)', 'sell', 'blend' and 'shelter'. The first three are non-controversial while the latter two are likely to sit on a spectrum and, depending on the strategy, be considered acceptable or unacceptable by different jurisdictions. Second, I theorise the creation of two new valuable tax attributes – taxes paid and SBIE. We should expect that

---

*The author would like to thank Michael Devereux, John Vella, Jason Yen, David Kamin, Miranda Stewart, Eduardo Traversa and the attendees of the 2022 Oxford Centre for Business Taxation Doctoral Conference and the Global Tax Symposium PhD Conference hosted by McGill University for their helpful comments.

[1] David Schizer, 'Border Adjustments and the Conservation of Tax Planning', *Tax Notes*, Vol. 155, 5 June 2017, 1451, 1452.

[2] OECD (2021), 'Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two)', 20 December 2021, OECD, Paris ('GloBE Model Rules'); OECD (2022), 'Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)', OECD, Paris ('Commentary to the GloBE Model Rules').

[3] Janet Yellen, 'Statement from Secretary of the Treasury Janet L. Yellen on the OECD Inclusive Framework Announcement', 8 October 2021 ('Secretary Yellen Statement of 8 October 2021'). Available at https://home.treasury.gov/news/press-releases/jy0394 (accessed 25 August 2022).

[4] Mindy Herzfeld, "Does the OECD Deal Reset the International Economic Order?", *Tax Notes Federal*, Vol. 173, 20 December 2021. The reported comment is by Itai Grinberg (US Treasury deputy assistant secretary for multilateral negotiations).

MNEs will seek to manage these new valuable tax attributes strategically in order to reduce their overall tax burden. Third, I describe two new distortions which will be created by the existence of these new valuable tax attributes. These distortions are likely to impact both ownership of investments and location of investment. Finally, the paper considers whether any of these outcomes ought to be considered problematic under the GloBE rules' policy objectives and what, if anything, should be done in response. The mere fact that a responding strategy is available to an MNE obviously does not mean that it ought to be disallowed under the rules.

It is important for both policymakers and MNEs to understand the incentives created under the GloBE Rules. First, understanding the presence of the valuable tax attributes will lead to clearer thinking about international tax in a post-Pillar 2 world. Second, it is likely that the rules will continue to take shape through the domestic implementation process. A deeper understanding of these issues at an earlier point in time increases the opportunity to find multilateral solutions which would limit the amount of divergence between the administration of the rules by different revenue authorities. Simply put, comprehensive and multilateral responses are likely to produce significantly better outcomes than piecemeal unilateral responses to unintended outcomes (or perceived 'abuses') over time. Clarity on these issues will be to the benefit of taxpayers, administrators and the international tax system.

One of the two key justifications for Pillar 2 has been to reduce Base Erosion and Profit Shifting (***BEPS***).[5] Pillar 2 effectively seeks to limit BEPS by reducing the incentive to shift profit into low tax jurisdictions because every jurisdiction will be taxed at a minimum of 15%. The incentives and opportunities for MNEs to strategically manage their new tax attributes will impact the extent to which Pillar 2 will be effective in achieving its goal of limiting BEPS. The fact that there may be continued opportunities for MNEs to engage in strategic planning in response to the GloBE Rules does not mean that Pillar 2 will have failed in its objective of limiting BEPS. Despite causing an evolution in tax planning, Pillar 2 should be expected to significantly reduce the extent BEPS and the extent to which tax benefits drive corporate decision-making.

[5] See OECD (2019), 'Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note', OECD, Paris ('OECD January 2019 Policy Note'), Sec. 1.2; OECD (2019), 'Addressing the Challenges of the Digitalisation of the Economy – Public Consultation Document', OECD, Paris, ('February 2019 Consultation Document'); OECD (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy,* OECD/G20 Inclusive Framework on BEPS, OECD, Paris ('OECD 2019 Programme of Work'); OECD (2019), 'Public consultation document: Global Anti-Base Erosion (GloBE) Proposal - Pillar Two', OECD, Paris, ('OECD November 2019 Consultation Document').

2. Five Strategic Responses to the GloBE Rules

The GloBE Rules operate on top of the existing tax system. They identify where an MNE has an 'undertaxed' jurisdiction and they impose a 'top-up tax' in order to raise the effective tax rate on the Excess Profit in the jurisdiction to 15%. The top-up tax may be imposed under one of three rules - a Qualified Domestic Minimum Top-up Tax (***QDMTT***), Income Inclusion Rule (***IIR***) or Undertaxed Profits Rule (***UTPR***).[6] In this article I simply refer to 'top-up tax' which is intended to include QDMTT, IIR or UTPR payments.

The effective tax rate (***ETR***) for a jurisdiction is calculated as the total 'Adjusted Covered Taxes' for the jurisdiction divided by the total 'Adjusted GloBE Income'.[7] Simplifying greatly, Adjusted GloBE Income is the income (determined under financial accounting principles with adjustments) of all 'constituent entities' in that jurisdiction. Adjusted Covered Taxes are all the profit-based taxes paid on that GloBE Income. There is significant complexity in how this calculation works and several of the key issues are outlined below as part of the analysis. Where a jurisdiction has an ETR under 15%, I will refer to it as 'undertaxed'. However, top-up tax is only applied to undertaxed *Excess Profit*. This is Adjusted GloBE Income in excess of the Substance-Based Income Exclusion (***SBIE***), a formulaic return to the 'substance' in the jurisdiction.[8]

If an MNE has a jurisdiction with undertaxed Excess Profits, a top-up tax liability will apply in the absence of further action. The MNE has five potential responses to a potential top-up tax liability. The first three should be relatively uncontroversial. First, the MNE can simply pay the top-up tax liability imposed under the GloBE Rules.[9] Second, the MNE can shift the undertaxed profit to another jurisdiction and, if the profit had been shifted into the undertaxed jurisdiction in the first place, it could be 'shifted back' to the jurisdiction from which it was originally sourced.[10] Third, the MNE could sell the undertaxed investments which are making the group's operations in the jurisdiction undertaxed and giving rise to the top-up tax liability. The final two strategies are likely to be more controversial. The fourth strategy is to 'blend' the

---

[6] For the purposes of this article, I assume that the GloBE Rules are adopted and will be applicable to all of the profits of the group. To the extent this is not true, other options will be available to the taxpayer.
[7] See GloBE Model Rules, above n 2, Art. 5.1.
[8] SBIE is a calculated as a formulaic return on the amount of payroll expenditure and the carrying value of depreciating tangible assets in the jurisdiction. See GloBE Model Rules, above n 2, Art. 5.3.
[9] This will be imposed under a QDMTT, IIR or UTPR(s).
[10] Obviously, this 'shifting' would need to occur within the proper principles of transfer pricing in order to be non-controversial. However, shifting profit back to the 'proper' jurisdiction of value creation would clearly be in line with the intent of the GloBE Rules.

undertaxed Excess Profit with high-tax profit, raising the ETR and reducing the top-up tax liability. The fifth is that the MNE could 'shelter' the undertaxed Excess Profit by increasing the amount of SBIE, this will reduce the amount of Excess Profit, reducing the top-up tax liability.

These potential responses are not mutually exclusive. An MNE could both blend and shelter the same undertaxed profit through different techniques. Each of these responses would contribute to the total reduction in top-up tax liability. It is also important to recall that tax will not be the only factor in MNE business decisions. It should not be surprising to find that the tax benefits of a particular strategy (for example, most obviously relocating SBIE) could be dominated by pre-tax disadvantages (lack of business synergies in that jurisdiction).

Each of the five potential responses are considered in turn from the perspective of an MNE which has determined that it has undertaxed excess profit within a jurisdiction. In approaching its strategic options, this paper assumes that the MNE is seeking to produce the lowest overall amount of tax for the MNE group.[11] It is important to note that I use the term 'strategy' in a neutral way. It should not be inferred that an available strategy is necessarily 'bad' and ought not to be allowed under the GloBE rules. The extent to which the rules ought to be modified defensively to 'protect' against certain strategies is addressed in Section 5.

2.1. Strategy 1 – 'Pay up'

The first strategic response is simply to 'do nothing' from a tax planning perspective and pay the relevant amount of top-up tax. From the MNE's perspective, it is unlikely to matter whether it pays the top-up tax obligation under the QDMTT, IIR or UTPR so long as all would impose the same amount of tax.[12] In each case, the MNE is expecting the relevant profits to be taxed at the minimum rate. The MNE may reason that the relevant undertaxed amounts will not be subject to a lower level of taxation in any other jurisdiction and therefore there is no benefit to shifting the profits elsewhere. The amount of additional tax which is owed under this strategy is simply the difference between the current ETR and the minimum rate. This may produce a total tax amount on the investment(s) of less than or equal to their location in any other jurisdiction (other than if Strategies 4 or 5 can be deployed).

[11] Within this constraint, the MNE is indifferent as to which jurisdictions receive the payments of tax.

[12] There is a risk that if the source country imposed a QDMTT which did not take into account CFC taxes and the foreign CFC tax did not take into account the QDMTT, there would be an additional tax burden under a QDMTT as opposed to an IIR. This is addressed in further detail in Heydon Wardell-Burrus, 'Should CFC Regimes Grant A Tax Credit for Qualified Domestic Minimum Top-Up Taxes?', *Tax Notes International*, 27 June 2022, 1649.

This is the 'default' option and therefore may be adopted merely as a matter of inertia. While the decision on whether states will adopt a QDMTT is beyond the scope of this paper,[13] it is worth noting that if low-taxed jurisdictions do simply adopt a QDMTT they may gain significant revenue under this mechanism as the path of least resistance without any clear downside.

2.2. Strategy 2 – 'Shift (back)'

The second strategy is to shift the undertaxed profit into another jurisdiction. There is a potential distinction to be drawn between shifting income and shifting 'back' income. One of the key objectives of Pillar 2 was to provide a disincentive for MNEs to engage in profit shifting. If we assume that some amount of profit which has been shifted into low tax jurisdictions, shifting the income which is currently booked in the low tax jurisdiction may be a matter of shifting it back to the jurisdiction where it ought to be taxed under the principle of value creation as opposed to shifting it to simply another jurisdiction.[14]

The benefit to the MNE in doing so is generally to decrease their transfer pricing risk (and exposure to penalties). The expectation would be that while it was worth engaging in profit shifting when the tax benefit was an applicable tax rate below 15%, it is no longer worth the potential exposure. Accordingly, the MNE is willing to book the profits in a value-creating jurisdiction instead.

If the profits are genuinely sourced in the country where they are currently booked (the low tax jurisdiction), then there may be little benefit in shifting excess profits to another jurisdiction. Regardless of where the MNE shifts the relevant excess profit, it will still be subject to the minimum rate either in the source jurisdiction through the QDMTT or in another country through the IIR or UTPR. The key exceptions to this rule are cases where the profits can be blended (Strategy 4) or sheltered (Strategy 5).[15] Accordingly,

---

[13] See Michael Devereux, John Vella, and Heydon Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition," *Oxford University Centre for Business Taxation Policy Brief* (Mar. 11, 2022); Michael Devereux, John Vella and Heydon Wardell-Burrus, 'Pillar 2's impact on tax competition', (forthcoming, working paper available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4203395); Noam Noked, 'The Case for Domestic Minimum Taxes on Multinationals', *Tax Notes International*, 23 February 2022, 671.

[14] The term 'value creation' is contested as a useful term in this debate. See Michael Devereux and John Vella, 'Value Creation as the Fundamental Principle of the International Corporate Tax System', *European Tax Policy Forum*, 31 July 2018; Michael P. Devereux and John Vella, 'Are we heading towards a corporate tax system fit for the 21st century?' (2014) 35(4) *Fiscal Studies* 449, 463-468; and Collier, Richard, "The Value Creation Mythology" in Werner Haslehner and Marie Lamensch (eds), *Taxation and Value Creation*, IBFD, 2021.

[15] It should be noted that if the MNE shifts the entire investment including the relevant substance (as opposed to just the excess profit), it can receive a lower tax rate by shifting to a jurisdiction with the lowest possible domestic corporate tax (that is, corporate tax excluding the QDMTT). This is further explained in Devereux, Vella and Wardell-Burrus, above n **Error! Bookmark not defined.**.

shifting the profit to a third jurisdiction which does not have Excess Tax or SBIE is unlikely to be attractive. It would be better to 'pay up' under Strategy 1.

2.3. Strategy 3 – 'Sell'

The third strategy is simply to sell the underlying investment. It may be that taking into account the additional top-up tax, the after-tax profits from the investment do not justify its cost of capital. It also may be that another purchaser can operate the business without exposure to a top-up tax liability. This may be because the relevant investment is below the 750 million Euro turnover cap itself and the potential acquirer is not subject to the GloBE rules (for example, a pension fund could seek to acquire it or a private equity firm that is not required to consolidate under the rules).

Even if the purchaser is subject to the GloBE rules, they may have sufficient quantities of the new tax attributes in the jurisdiction which mean that they will not be subject to the top-up tax. This latter case is simply the inversion of the blend and shelter by acquisition strategies outlined below (that is, the same strategies from the perspective of the vendor rather than the purchaser). For these reasons, another owner may be able to operate the business at a lower after-tax cost than the current MNE. This additional value could be shared between the MNE and the new owner through the acquisition price.

2.4. Strategy 4 – Blend

The 'blend' strategy seeks to utilize jurisdictional blending to reduce or eliminate top-up taxes. In essence, if the MNE can combine 'high-tax' profit (profit taxed above 15%) with its existing 'low-tax' profit (profit taxed below 15%), it can reduce its top-up tax liability with respect to the low-tax profit. This is because by blending high-tax profit into the low-tax profit, the jurisdictional ETR can be increased which will reduce the top-up tax amount. This is not dissimilar to foreign tax credit planning strategies which have been adopted in the US which attempt to 'blend' sources of income within relevant baskets to increase the foreign tax credit limitation.[16]

The GloBE rules apply 'jurisdictional blending' which means that they determine whether a *jurisdiction* is undertaxed by blending together all of the income attributable to that jurisdiction and the taxes paid with respect to that income in calculating the effective tax rate. This means that some profit attributed to the jurisdiction can be taxed below the minimum rate and other profit taxed above the minimum rate. The

[16] See further Scholes et al, *Taxes and Business Strategy*, 2nd edition (2002), Chapter 11.1.

rules do not depend on whether specific investments or entities are undertaxed but only on whether the jurisdiction as a whole is undertaxed.

An important design component of the rules is to ensure the integrity of the jurisdictional blending. If MNEs are able to manipulate their affairs such that profits which ought to be counted towards one jurisdiction are able to be counted towards another, the GloBE rules lose the capacity to ensure that a minimum level of tax is properly paid in each jurisdiction in which the MNE operates.

If an MNE has undertaxed excess profits in a jurisdiction, then its existing investments have already been blended to produce a below-minimum rate. In other words, the ETR for the jurisdiction is below 15% with the blending of the existing income and taxes which are counted towards the jurisdiction under the GloBE Rules. Accordingly, the question is whether there are mechanisms available to the MNE which would *increase* the amount of high-tax profit which will be blended with the pre-existing low-tax profit.

In pursuing this strategy, the MNE is aiming to take profit which is already subject to high tax and to blend it with low tax profit. The strategy is not to take low tax profit and increase the amount of tax which is paid on it. While this will increase the ETR, it will increase the total amount of tax paid by the MNE. Put differently, the aim is to change the jurisdiction to which the relevant Covered Taxes are counted for the purposes of the GloBE Rules *without* substantially changing their tax treatment under the existing tax system. Of course, it is possible to do both at once in which case there will either be a double benefit or a trade-off between the benefit under the GloBE Rules and a detriment under the current corporate tax system.[17]

The MNE may seek to achieve blending through several strategies. However, it is convenient to divide these into two categories – intrajurisdictional blending and interjurisdictional blending. Intrajurisdictional blending involves cases where the high tax and low tax profits are from the same jurisdiction. Interjurisdictional blending involves cases where profits which ‘properly belong’ to another jurisdiction are capable of being blended with a low tax jurisdiction.[18]

[17] However, if there a benefit could be achieved under the existing corporate tax system, one might expect the MNE to already have taken advantage of that opportunity.

[18] Interjurisdictional blending has strong parallels to US foreign tax credit planning strategies that seek to ‘unlock’ the value of excess foreign tax credits by shifting the source of certain types income. See, for example, Scholes et al, *Taxes and Business Strategy*, 2nd edition (2002), Chapter 11.1.

2.4.1. Intrajurisdictional Blending (Strategy 4A)

Intrajurisdictional blending involves seeking to deliberately blend low-tax and high-tax investments within the same jurisdiction. It should be noted from the outset that this is clearly intended under the GloBE Rules. Strategic intrajurisdictional blending would look to acquire profitable investments that are high tax. The additional taxes from the new investment would be available to be blended with the undertaxed profits already existing in the jurisdiction. This can be demonstrated with an example.

Consider an MNE which has pre-existing undertaxed profits in a jurisdiction (column 2 below). In the absence of any further steps, it will be subject to a new top-up tax from the imposition of the GloBE Rules (here $150). However, it considers acquiring one of two businesses. The two businesses (Business A, column 3 and Business B, column 4) are identical with respect to their after-tax profit, risk profile, initial investment, disposal value, etc. The only difference is with respect to their pre-tax profits and taxes. Both businesses produce the same after-tax profit when viewed in isolation ***even under the application of the GloBE rules***. That is, both have ETRs of at least 15% and therefore would not, on their own, give rise to any top-up tax. Accordingly, one might expect the businesses to have the same value to an acquirer.

Table 1 – Businesses valued separately

	MNE	**Business A**	**Business B**
	Pre-Pillar 2		
Revenue[19]	6000	3215	3000
Expenses	5000	2000	2000
Profit	1000	1215	1000
Domestic tax rate	0%	30%	15%
Domestic tax	0	365	150
After domestic tax profit	1000	850	850
	Post-Pillar 2		
ETR	0%	30%	15%
Top-up Tax Percentage	15%	0%	0%
SBIE Exclusion[20]	-	-	-
Top-up Tax due	150	-	-
Total Tax	150	365	150
After-Tax Profit	850	850	850

*All figures are in US Dollars unless noted otherwise

[19] For simplicity, assume there are no differences in the relevant tax bases.

[20] For simplicity, assume that there is no SBIE. This is not necessary but makes the calculations easier to follow.

In the absence of an acquisition, the MNE will be subject to a new top-up tax of $150 from the introduction of the GloBE Rules. However, by acquiring a business with high-tax income (Business A), it can reduce its tax burden. There is no such benefit from acquiring Business B.

Table 2 – Blending MNE with Business A and Business B

	MNE	**MNE + Business A**	**MNE + Business B**
	Pre-Pillar 2		
Revenue	6000	9215 (6000 + 3215)	9000 (6000 + 3000)
Expenses	5000	7000 (5000 + 2000)	7000 (5000 + 2000)
Profit	1000	2215 (1000 + 1215)	2000
Domestic tax rate	0%	0% on 1000 & 30% on 1215	0% on 1000 & 15% on 1000
Domestic tax	0	365 (0 + 365)	150
After domestic tax profit	1000	1850 (1000 + 850)	1700
	Post-Pillar 2		
ETR	0%	16.47% (365 / 2215)	8.82% (150 / 1700)
Top-up Tax Percentage	15%	0%	6.18%
SBIE Exclusion	-	-	-
Top-up Tax due	150	-	123.6
Total Tax	150	365	273.6
After-Tax Profit	850	**1850**	**1726.4**

*All figures are in US Dollars unless noted otherwise

By acquiring Business A, the MNE has avoided the application of top-up tax of $150 on its pre-existing operations. The tax above the minimum rate which has been paid by Business A can be counted towards the undertaxed profits of the MNE's pre-existing operations. Business A has paid $365 of tax on $1215 of profit. The GloBE rules only 'required' $182.25 of taxes to be paid (15% of the pre-tax profit of $1215). However, the investment included $365 of Covered Taxes which is enough to raise the ETR of the jurisdiction (including both investments) to 16.47%. Accordingly, by acquiring Business A, the MNE has successfully blended its low tax profits with high tax profits to avoid the application of top-up tax. It should be noted that if the MNE acquires Business B, the blended rate ETR would also increase. However, there is not enough Covered Tax to raise the blended ETR above 15%.

Under this approach, an MNE is acquiring an entity at least *in part* because of its valuable tax attribute (Covered Taxes). There is a reasonable question as to whether this should be considered problematic from the perspective of states. Many states attempt to stop the acquisition of particular tax characteristics which are of value in offsetting other tax obligations. The most obvious example is the common restriction on the use of acquired losses under domestic Corporation Tax systems. However, there is an important

difference between acquiring under the GloBE Rules and acquiring tax losses. Tax losses are generally a stock which can be carried forward under the domestic tax system while Excess Tax must be incurred by the investment going forward each year.[21]

The simplest answer is that there has been no agreement under the GloBE Rules to restrict this type of strategic acquisition. MNEs are entitled to manage their new tax attributes, including by making strategic acquisitions to attain Covered Taxes, in order to minimize their overall tax burden. It is important to note that the value of this strategy is highly dependent upon the relevant state having substantially different tax rates for different types of investment. Whether or not states may be able to adopt strategic countermeasures in such situations is addressed in Section 5.

In the example above, intrajurisdictional blending has been achieved by blending investments with different tax profiles. This could have been caused by differences in available deductions, tax credits or special regimes for different types of income. Another mechanism for achieving intrajurisdictional blending would be the strategic timing of particular events which trigger tax liabilities. For instance, an MNE could seek to trigger a capital gain liability in an undertaxed year so that the capital gains tax would effectively 'soak up' some of the top-up tax which would otherwise be applied.[22] Strategically timing a capital gains tax liability would effectively blend the regular tax with the corporate income tax. Strategically timing liabilities could apply in a variety of other circumstances but most importantly, could include timing the repatriation of dividends which will trigger dividend withholding tax in a year which would otherwise be undertaxed.[23] While strategically managing the timing of tax liabilities may be important for the MNE, it is unlikely to be viewed as problematic from the perspective of the GloBE Rules.

2.4.2. Interjurisdictional Blending (Strategy 4B)

Interjurisdictional blending occurs where an MNE can effectively subvert what may be considered the intended jurisdictional blending requirement under the GloBE Rules. 'Interjurisdictional blending' does not cover cases where taxes paid to a particular state are simply counted towards the ETR calculation of a different jurisdiction. The rules are designed to produce this outcome and explicitly allocate cross-jurisdictional taxes under Article 4.3. The general principle adopted by the GloBE Rules (subject to

[21] If the GloBE Rules had adopted the carry-forward approach as outlined in the Blueprint, there would be a more difficult question regarding the use of acquired Covered Taxes.

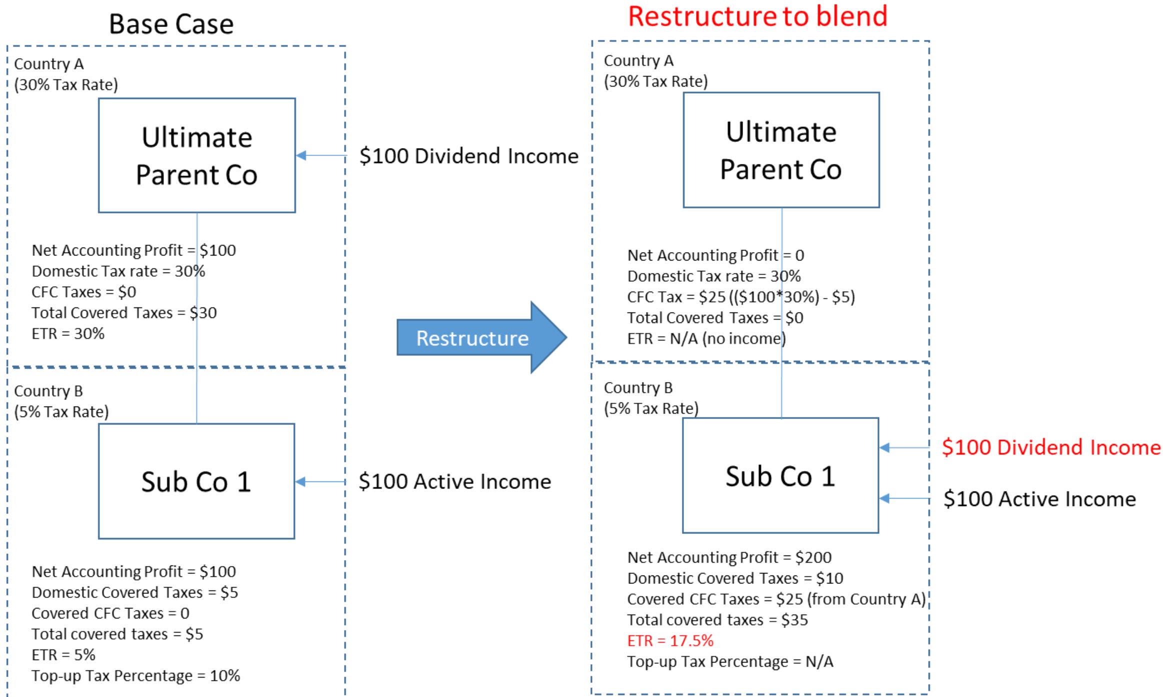
[22] Note that while there is a mechanism for smoothening the recognition of capital gains taxes in Art. 3.2.6 (along with its taxes), this is elective.

[23] GloBE Model Rules, above n 2, Art. 4.3.2(e). See further Commentary to the GloBE Model Rules, above n 2, Art. 4, paragraph [11].

limitations and exceptions) is that taxes ought to count towards the jurisdiction where the profits have been assigned under the GloBE Rules *even if they are paid to another jurisdiction.* The simplest example is withholding taxes which are paid to the jurisdiction in which the payment is withheld but count towards the jurisdiction of the recipient.[24]

The GloBE Rules have clearly been designed to prevent interjurisdictional blending. The Commentary directly refers to 'the integrity of the jurisdictional blending rules'.[25] The rules explicitly adopt provisions which are designed to prevent interjurisdictional blending – most importantly, the limitation in Art. 4.3.3 which is designed to stop MNEs from blending high tax, mobile, Passive Income with low tax income. The relevant strategy of concern, along with the limitation as a response to it, are best demonstrated by an example.

Diagram 1: CFC Pushdown Strategy



In this case, the MNE has passive income in Country A which is subject to a tax rate of 30%. It also has undertaxed active income in Country B (which is not subject to CFC taxation). By restructuring to shift the

[24] Commentary to the GloBE Model Rules, above n 2, Art. 4, paragraph [42].
[25] Commentary to the GloBE Model Rules, above n 2, Art. 4, paragraph [62].

relevant shares (and therefore dividend income) to Sub-Co 1, the MNE could effectively achieve interjurisdictional blending.

Under Country A's CFC regime, Ultimate Parent Co is taxed immediately on the dividend income received by Sub Co 1 after a tax credit has been given for taxes paid in Country B. As $5 of taxes have been paid on the dividend income in Country B, an additional $25 of taxes are owed in Country A. The result is that after the restructure, $30 of taxes are still being paid with respect to the $100 of dividend income. Accordingly, no benefit has been gained with respect to this passive income. However, as the GloBE rules would now allocate the dividend income to Country B and not Country A, the cross-jurisdictional allocation of taxes would count the $25 of CFC taxes towards Country B. These CFC taxes would then be blended with the undertaxed active income (at only 5%) in order to achieve a jurisdictional ETR of 17.5% - above the minimum. Accordingly, this strategy would give rise to interjurisdictional blending. The passive income (which 'ought' to be located in the parent jurisdiction) has been relocated down to a different jurisdiction. The MNE has not saved any regular corporate income tax (because the CFC rule effectively tops up the tax to the parent's domestic rate) but it has avoided GloBE top-up tax by blending high and low tax income.

In order to prevent this simple planning strategy, the GloBE Rules included the Article 4.3.3 limitation. The limitation operates by restricting the amount of Covered Taxes which can be allocated to the low-tax jurisdiction to ensure that there is no blending benefit.[26] However, this limitation only applies to the cross-jurisdictional allocation of CFC taxes and taxes on hybrid entities with respect to 'Passive Income' as defined by the rules.[27] The Commentary states "This rule is designed to maintain the integrity of the jurisdictional blending rules in relation to mobile income".[28]

This limitation is effective in addressing the most important aspects of the problem – MNEs seeking to achieve interjurisdictional blending through the use of purely passive assets under a CFC or hybrid regime. However, several opportunities appear to remain which could allow for MNEs to achieve interjurisdictional blending, albeit not as simply as shifting passive assets to a foreign subsidiary subject to CFC Rules.

---

[26] Technically, this rule operates by limiting the allocated Adjusted Covered Taxes to the lesser of (a) the Covered Taxes allocated in respect of the relevant Passive Income and (b) the Top-up Tax Percentage for the Constituent Entity's jurisdiction, determined without regard to the Covered Taxes incurred with respect to such Passive Income by the Constituent Entity-owner, multiplied by the amount of the Constituent Entity's Passive Income includible under any Controlled Foreign Company Tax Regime or fiscal transparency rule. See GloBE Model Rules, above n 2, Art. 4.3.3.
[27] See GloBE Model Rules, above n 2, Arts. 4.3.2(c)-(d), 4.3.3.
[28] Commentary to the GloBE Model Rules, above n 2, Art. 4, paragraph [62].

Discrepancies between the CFC pushdown limitation and domestic CFC rules

First, MNEs may seek to exploit the 'gap' between the income covered by the pushdown limitation in Art. 4.3.3 and the income covered by passive income CFC rules within the corporate income tax of the parent entity. Art. 4.3.3. only applies to a specified list of passive income types: dividends (and equivalents), interest (and equivalents), rent, royalties, annuities, or net gains from property of these types.[29] However, in adopting their CFC rules, states realized that income could be highly mobile without falling into these defined categories of income. This is why many CFC rules on passive income apply to a broader set of income types than those covered by the GloBE rule limitation. For example, some rules consider 'tainted' sales income or services income where the profit is made from transactions within a controlled group.[30] For example, this type of income would be included under the US Subpart F Rules[31] and the Australian CFC rules.[32]

Art. 4.3.3. is a deliberate attempt at producing a 'bright line test that focuses on mobile payments with a readily identifiable character'.[33] The Commentary makes clear that the definition 'does not include any test of whether an item of income is earned as part of an active business'.[34] The GloBE rules clearly opted for the benefits of certainty and simplicity over an attempt to match the lines drawn under other CFC rules (a potentially impossible task). However, this produces a 'gap' – there can be income which is covered by CFC regimes and not covered by the Art. 4.3.3. limitation. For this income, MNEs can achieve interjurisdictional blending as demonstrated in the above example. That is, the CFC tax paid on the income covered by the parent entity's CFC rule is counted towards the low tax jurisdiction. It is therefore available to be blended with low-taxed active income in order to raise the ETR for the low-tax jurisdiction, reducing the top-up tax.

Passive Income of Foreign Branches

Second, the MNE could seek to rely upon Passive Income earned through foreign branches (that is, permanent establishments) rather than CFCs. At least some jurisdictions attempt to create equivalent

---

[29] GloBE Model Rules, above n 2, Art. 10.1.
[30] See OECD, 'Designing Effective Controlled Foreign Company Rules', above n **Error! Bookmark not defined.**, paragraph [79].
[31] See 26 U.S. Code § 954(a)(2)(d).
[32] See *Income Tax Assessment Act 1936* (Australia), s. 384.
[33] Commentary to the GloBE Model Rules, above n 2, Art. 10, paragraph [87].
[34] Commentary to the GloBE Model Rules, above n 2, Art. 10, paragraph [87].

outcomes for CFC rules and permanent establishments in terms of the exclusion from the parent's/head office's tax base of active income but not passive income.[35]

While the GloBE Rules contain a limitation on the pushdown of CFC taxes with respect to Passive Income (as discussed above), there is not an equivalent 'limitation' for permanent establishments (that is, the limitation contained in Art. 4.3.3. only applies to CFC regimes and hybrid entity regimes – it does not apply to permanent establishments).[36] If the limitation does not apply to permanent establishments, an MNE could achieve interjurisdictional blending by pushing passive assets down into the foreign permanent establishment. In other words, as long as the Passive Income was properly attributable to the permanent establishment under transfer pricing rules, taxes paid in the head office on these amounts could be pushed down and blended against other income in that jurisdiction. This is the exact same integrity concern as raised under the CFC case above but using a permanent establishment instead of a foreign subsidiary.

There is arguably ambiguity as to whether a general inclusion of income of foreign permanent establishments combined with an exclusion for active foreign income would amount to a CFC Tax within the definition provided under the rules. The definition of CFC Tax in Art. 10.1.1. does not support such an interpretation. It clearly refers to a regime applicable to 'a direct or indirect shareholder of foreign entity'. The relationship between a Head Office and a foreign permanent establishment involves neither a shareholder nor a foreign entity. However, additional language added to the Commentary may throw this interpretation into doubt. It states:

> *A jurisdiction that provides an exemption regime to PEs may apply its CFC Tax Regime to a PE located in another the [sic] jurisdiction in the same manner as if that PE was a foreign subsidiary.*[37]

This language appears to attempt to expand the definition contained in Art. 10.1.1. of the Model Rules to include a limitation for income included in a Head Office's tax base which is not exempt foreign income for a foreign permanent establishment. This would align the outcomes for permanent establishments and CFC regimes. To the extent that the Inclusive Framework is able to agree to align these outcomes through

[35] See, for example, s 23AH *Income Tax Assessment Act 1936* (Australia). See also Commentary to the GloBE Model Rules, above n 2, Art. 10, paragraph [5].
[36] This outcome arises because Art. 4.3.3. refers only to Covered Taxes allocated under Art. 4.3.2(c) and (d) and not Art. 4.3.2(a).
[37] Commentary to the GloBE Model Rules, above n 2, Art. 10, paragraph [5].

Administrative Guidance, it would be an improvement to the integrity of the GloBE Rules. If not, there is a real risk that MNEs would be able to engage in interjurisdictional blending.

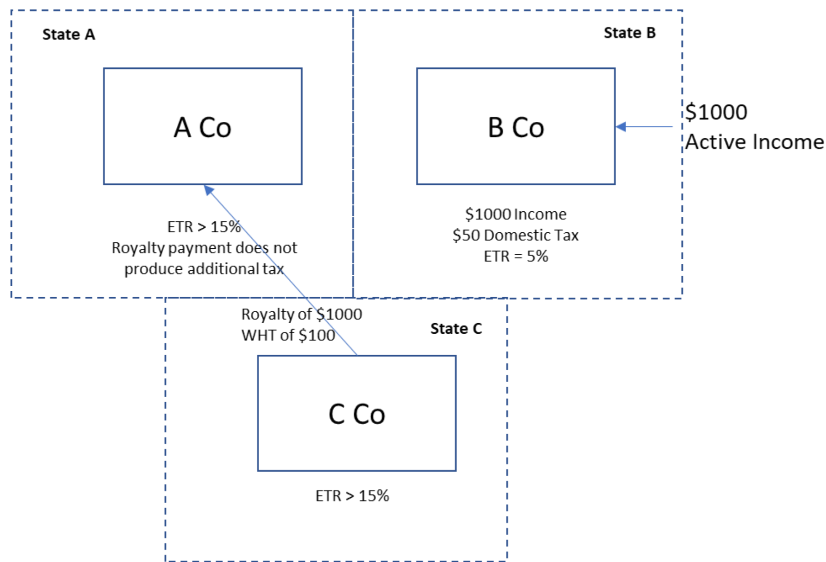
Use of Withholding Taxes

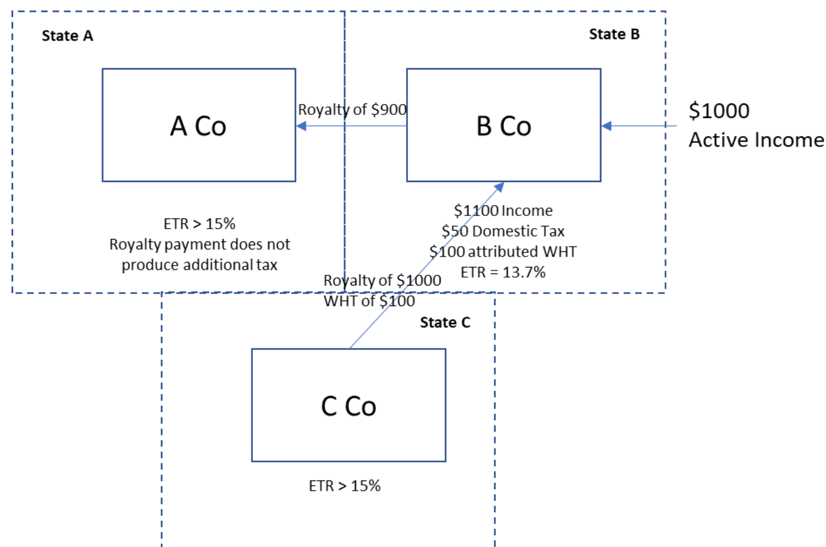
Another mechanism of achieving interjurisdictional blending may be the redirection of royalty or interest payments through a low tax jurisdiction to raise its ETR. The basic concept is that a withholding tax is paid in the place of the original payment and may be imposed regardless of the country to which the payment is made.[38] Under the GloBE Rules, the withholding tax will be included in the Covered Taxes of the recipient of the payment – even if the relevant underlying ***profit*** is not booked in that jurisdiction. Accordingly, by using a back-to-back arrangement, an MNE may be able to shift Covered Taxes from a jurisdiction which does not benefit from them (for instance, the ETR will be above 15% even without adding the withholding tax).

Consider the following example. A $1000 royalty is being paid from C Co (Country C) to A Co (in Country A). The payment is subject to a gross withholding tax of 10% ($100). This tax payment is currently counted towards the ETR of Country A but Country A would have an ETR of above 15% even without the additional $100 in Covered Taxes. Furthermore, A Co does not pay additional taxation on the received payment because either (a) the amount is not taxable or (b) the MNE is in an excess foreign tax credit position. The MNE also has operations in Country B (B Co) which make a profit of $1000 but they are only subject to domestic tax of $50 (5%).

The MNE restructures by granting a head license for the relevant IP from Country B to Country C for a region which includes Country A. The MNE's entity in Country C then sub-licenses the intellectual property to the MNE's entity in Country A. The MNE has not migrated DEMPE functions to B Co and accordingly, B Co cannot make a profit from the licensing arrangement (as required under the transfer pricing rules). The structure is represented in the diagram below.

[38] Of course, tax treaties may impact the amount of withholding tax imposed. This strategy is only likely to be attractive where the withholding tax payments are the same for both jurisdictions.





The aim of the restructure is not to impact the domestic corporate tax position in State A, B or C. The purpose is to shift the jurisdiction to which the royalty withholding tax imposed by State C will be counted under the GloBE Rules. In this case, it has been shifted from State A (where it is not needed because the ETR is already above 15%) to State B where it is valuable and raises the ETR. It is important that this kind of structure is not prevented (or at least not obviously prevented) by the requirement that the relevant transactions meet the requirements of transfer pricing. B Co is not making an unjustified profit from the relevant royalty payment. Nevertheless, the GloBE Rules will now allocate the royalty withholding tax

(which needed to be paid in any event) to State B rather than State A. This can now be blended against independent low-tax income to reduce the amount of top-up tax. It should be noted that these structures are not simple and may require very particular tax treatment under relevant domestic tax systems. The full complexity of such a structure is beyond the scope of this article. However, the example is designed to illustrate how a redirected payment can be used to achieve blending.

2.5. Strategy 5 - Shelter

The fifth strategy to address an undertaxed jurisdiction seeks to utilise the shelter provided by the substance-based income exclusion (SBIE). The GloBE rules operate to prevent the application of top-up tax to amounts of SBIE, which is a formulaic return on the amounts of 'substance' in the jurisdiction.[39] As there is no attempt under the GloBE rules to trace amounts of profit and taxation to the relevant amounts of 'substance', the SBIE operates as a simple 'shelter' which covers any profits in the jurisdiction – regardless of their connection to the substance itself. In other words, the amount of substance exclusion is also effectively 'blended' across the jurisdiction.

The theory behind the SBIE is not entirely clear.[40] Its origin is clearly the concept of 'Net Deemed Tangible Income Return' (NDTIR) under the US GILTI rules which effectively excludes from 'top-up tax' a standard return on tangible assets in a jurisdiction.[41] One defense of the SBIE is that there are limited concerns with respect to BEPS activity which merely equals a formulaic return on substantial activity. Accordingly, Pillar 2 ought not apply with respect to these amounts. Another argument would be that States still want to be able to engage in tax competition with respect to a standard return on substance.[42]

The top-up tax percentage (which is 15% less the jurisdictional ETR[43]) is only applied to the excess profit of the jurisdiction (total profit less SBIE). Accordingly, top-up tax is only paid with respect to excess profits

[39] In the final state of the rules, the SBIE will exclude 5% of the eligible payroll expense for the jurisdiction and 5% of the carrying value of eligible tangible assets in the jurisdiction. However, there is a generous 'transition period' for these mark-ups. In the first year (2023), there will be a 10% mark-up on the payroll expense and an 8% mark-up on the carrying value of eligible tangible assets. See GloBE Model Rules, above n 2, Art. 9.2.

[40] Joachim Englisch refers to it as the 'original sin' of the GloBE Rules. See Joachim Englisch, 'GloBE Rules and Tax Competition', (forthcoming, draft available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4199543), 6.

[41] 26 U.S. Code § 951A(b)(2).

[42] On the role of the SBIE and its interaction with the policy objectives of Pillar 2 see Michael Devereux, John Vella and Heydon Wardell-Burrus, 'Pillar 2's impact on tax competition', (forthcoming, working paper available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4203395).

[43] The SBIE plays no role in determining the ETR for the jurisdiction. That is, the ETR is determined as a percentage of Total Profit (Adjusted GloBE Income) and not as a percentage of Excess Profit. For consideration of alternative designs see Michael Devereux, Martin Simmler, John Vella and Heydon Wardell-Burrus, 'What is the Substance-Based Carve-Out under Pillar 2? And how will it affect tax competition?', EconPol Policy Brief 39,

and not to profits which are sheltered by the SBIE. It can generally be expected that there will be at least some SBIE in each jurisdiction in which the MNE operates because there is likely to be at least some payroll expense or tangible assets owned related to its taxable presence. Accordingly, some portion of the profits in the jurisdiction is likely to already be 'sheltered' without any further action on behalf of the MNE.

Before becoming too concerned by the strategic use of SBIE, it is important to recognize that MNEs are unlikely to be able to simply relocate SBIE without impacting their pre-tax profit. The SBIE in a jurisdiction is a function of the payroll expenditure and carrying value of the tangible assets in that jurisdiction. These are real expenses and cannot generally be reallocated to another jurisdiction without impacting the operation of the business itself. To the extent that these impacts on operating on the business make it less efficient and decrease its before tax profit, it is only in narrow circumstances that the damage to pre-tax profit could be outweighed by the increased tax benefit. Accordingly, while this section considers the strategic location of SBIE it must always be subject to the caveat that this is only likely to make a difference at the margin.[44]

I set to one side the issue of whether an MNE is capable of artificially shifting its SBIE. That is, of booking either payroll expenses or tangible assets to a jurisdiction without the employees or contractors actually doing the work in that jurisdiction or without actually locating the tangible assets in that jurisdiction. To the extent that this can be achieved by an MNE, then SBIE would be more capable of being used as a strategic asset because it would not require relocating the real activity. However, for the purposes of this paper I put that issue to the side but note that it is very important that the rules have sufficient integrity to ensure that SBIE cannot be artificially shifted to a different jurisdiction.

Subject to the above caveat, I set out two ways in which MNEs could think strategically about using SBIE. These are by attempting to shift profit towards jurisdictions in which the MNE has Excess SBIE (Strategy 5A) and by making investments to acquire Excess SBIE (Strategy 5B). However, before doing so it is worth

---

https://www.econpol.eu/sites/default/files/2021-11/EconPol_Policy_Brief_39_Pillar2.pdf (accessed 25 August 2022).

[44] Note that similar incentives have been taken seriously by a large number of academic commentators in the context of the GILTI regime. Kamin and 12 co-authors outlined the equivalent incentive in the context of the GILTI regime. In short, NDTIR (GILTI's equivalent of SBIE) creates an incentive to locate tangible assets in overseas locations.See Kamin et al, 'The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation', 2019 *Minnesota Law Review* 1439, 1493-1494. The relevant authors are David Kamin, David Gamage, Ari Glogower, Rebecca Kysar, Darien Shanske, Reuven Avi-Yonah, Lily Batchelder, J. Clifton Fleming, Daniel Hemel, Mitchell Kane, David Miller, Daniel Shaviro, and Manoj Viswanathan.

noting why, despite a technical tax incentive for doing so, an MNE is unlikely to deliberately shift SBIE into an undertaxed jurisdiction.

2.5.1. Shifting deductions to shelter undertaxed profits with SBIE

Consider an MNE with operations in two jurisdictions (A and B) with tax rates of 15% and 0% respectively. In the base case, we shall assume that these is $100 of SBIE in Jurisdiction A (10% on $1000 of payroll expense[45]) and no SBIE in Jurisdictions B.

Base Case

	Jurisdiction A (15%)	**Jurisdiction B (0%)**
Gross Income	3000	3000
Gross Deductions	2000	2000
GloBE Income	1000	1000
Domestic Tax	150	0
ETR	15%	0%
Top-up Tax Percentage	0%	15%
SBIE	100	0
Excess Profit	900	1000
Top-up Tax	0	150
Total Tax	150	150
Total Tax for MNE (A and B)	300	

*Figures are in US Dollars unless otherwise noted.

We then consider the impact on the total tax paid by the MNE if it shifts $500 of payroll expense from Jurisdiction A to Jurisdiction B. This has two effects. First, it shifts the amount of profit in each jurisdiction – increasing the profit of Jurisdiction A and decreasing the profit of Jurisdiction B. Second, it shifts $50 of the SBIE from Jurisdiction A to Jurisdiction B.

SBIE is shifted from Jurisdiction A to Jurisdiction B

	Jurisdiction A (15%)	**Jurisdiction B (0%)**
Gross Income	3000	3000
Gross Deductions	1500 (2000 - 500)	2500 (2000 + 500)
GloBE Income	1500	500
Domestic Tax	225	0
ETR	15%	0%
Top-up Tax Percentage	0%	15%
SBIE	50 (100 - $50)	50 (0 + 50)
Excess Profit	1450 (1500 - $50)	450 (500 - $50)

[45] This example considers the first year of the rules where the SBIE is equal to 10% of the payroll expense.

Top-up Tax	0 (1450 * 0%)	67.50 (450 * 15%)
Total Tax	225 (225 + $0)	67.50 (0 + 67.50)
Total Tax for MNE (A and B)	**442.50**	

*Figures are in US Dollars unless otherwise noted.

This example shows that something highly counter-intuitive has happened. By shifting deductions to a lower tax jurisdiction, the MNE has actually reduced its total tax burden. The taxpayer has improved its total tax position by moving a *deduction* from a country with a 15% rate to a 0% rate (Jurisdiction B). The effect is caused by the Excess SBIE which provides an additional benefit in 'sheltering' undertaxed income.

The value of the payroll expense deduction can be divided into two components. First, the payroll expense reduces the amount of total profit in the jurisdiction. As the maximum top-up tax percentage is 15%, this effect can reduce total top-up tax by 15% of the amount of the payroll expense (which occurs if the ETR is zero). Second, the payroll expense increases the amount of SBIE in the jurisdiction. This reduces the amount of excess profit by 10% of the amount of the payroll expense. The tax savings from this effect are (up to) 15% of the 10% - which equals 1.5%. Combining these effects together, the full value of the payroll expense in a zero corporate tax rate jurisdiction with excess profits can be up to 16.5%. Of course, to gain this full value there must be sufficient Excess Profit in the jurisdiction which can be sheltered by the additional SBIE.

While this example demonstrates the value of SBIE as a tax attribute, it is important not to overstate the likelihood of it being used as a strategy. This example has shown the maximum value possible from shifting a $500 payroll expense. The total tax benefit to the MNE is $7.50 – or 1.5% of the value of the shifted deduction. It is highly unlikely that a total 1.5% tax benefit would be an influential factor in where an MNE would locate its staff. Furthermore, the 1.5% tax benefit is only available in the first year, the transition rules will lower the SBIE value from 10% to 5% over 10 years.[46] In the final state of the rules, this tax benefit would be a maximum of 0.75%. This example has focused on shifting an expense but the same principles apply in making a new investment in at the margin. The additional SBIE tax benefit is too modest to credibly drive location decisions of new payroll or tangible asset investment.

2.5.2. Strategy 5A – Shifting profit to Excess SBIE shelters

While the above section has outlined why shifting SBIE related expenditure is unlikely, this does not mean that MNEs have no opportunity to manage SBIE as a new tax attribute. The value of SBIE is unlocked by

[46] GloBE Model Rules, above n 2, Art. 9.2.1.

matching it to undertaxed profits. If the SBIE cannot be moved to undertaxed profits, then perhaps profits can be moved to the SBIE.

The most obvious opportunity would be a low-tax jurisdiction which has SBIE but does not have Excess Profits (that is, its GloBE Income is less than the SBIE for the jurisdiction).[47] In such a case, the SBIE is underutilized to the extent that there is SBIE exceeding the GloBE income in the jurisdiction. SBIE is effectively a 'use it or lose it' tax attribute. It does not carry forward to future years but is simply lost. Shifting profit into a low-tax jurisdiction with excess SBIE is valuable to the MNE.

The simplest example would be the case where an MNE has made an investment into an undertaxed jurisdiction which is not yet profitable. Shifting profit to that jurisdiction can save the MNE tax by two effects. The first is the pre-existing benefit, of matching taxable profits and losses.[48] However, *in addition* to this benefit, is the ability to use the Excess SBIE in the jurisdiction under the GloBE rules.

Consider the example below:

Base Case

	Jurisdiction A (5% CIT)	**Jurisdiction B (5% CIT)**
	Company A	**Company B**
Gross Income	22,000	2,000
Gross Deductions	2,000	12,000
GloBE Income	20,000	(10,000)
Domestic Tax	1000	0
ETR	5%	0%
Top-up Tax Percentage	10%	15%
SBIE	0	1000
Excess Profit	20,000	0
Top-up Tax	2000 (20,000 * 10%)	0 (0 * 10%)
Total Tax	2100	0
Total Tax for MNE (Jurisdictions A and B)	**2100**	

*Figures are in US Dollars unless otherwise noted

In the base case we have two jurisdictions, Jurisdiction A is highly profitable and has significant excess profits. It has no SBIE and so there is no shelter in effect in Jurisdiction A. Jurisdiction B is making losses

[47] On a jurisdictional basis, an MNE can have Excess Profits or Excess SBIE. The former arises in any case where SBIE < Adjusted GloBE Income and the latter where SBIE > Adjusted GloBE Income.
[48] This does assume that the existing losses in the jurisdiction can be used to offset the profits. This can be achieved in a variety of ways across jurisdictions. For example, through loss transfer regimes or through group tax consolidated group regimes.

but has significant SBIE (which is therefore unutilized). Both jurisdictions have the same corporate tax rate and are subject to the Pillar 2 rules. The MNE can utilize the Excess SBIE by shifting profit into Jurisdiction B *even beyond the point of offsetting all the existing losses.*

Shifting $10,000 in Profit

	Jurisdiction A (5% CIT)	**Jurisdiction B (5% CIT)**
	Company A	**Company B**
Gross Income	12,000 (22,000 - 10,000)	12,000 (2,000 + 10,000)
Gross Deductions	2,000	12,000
GloBE Income	10,000	0
Domestic Tax	500	0
ETR	5%	N/A
Top-up Tax Percentage	10%	N/A
SBIE	0	1000
Excess Profit	10,000	0
Top-up Tax	1000 (10,000 * 10%)	0
Total Tax	1500	0
Total Tax for MNE (Jurisdictions A and B)	**1500**	

*Figures are in US Dollars unless otherwise noted

By shifting $10,000 of profit from Jurisdiction A to Jurisdiction B, the MNE has matched the profit to the loss, reducing its total taxes from $2100 to $1500. This is to be expected and exists under the current system. However, this has fully utilized the benefit of matching the loss to the profit (that is, there are no further unutilized losses in Company B). The Excess SBIE means that the MNE can save taxes by shifting *further profit* to Company B because it will be sheltered from top-up tax in Jurisdiction B.

Shifting 12,000 in Profit

	Jurisdiction A (5% CIT)	**Jurisdiction B (5% CIT)**
	Company A	**Company B**
Gross Income	10,000 (22,000 - 12,000)	14,000 (2,000 + 12,000)
Gross Deductions	2,000	12,000
GloBE Income	8,000	2,000
Domestic Tax	400	100
ETR	5%	5%
Top-up Tax Percentage	10%	10%
SBIE	0	1000

Excess Profit	8,000	1000 (2000 - 1000)
Top-up Tax	800 (8,000 * 10%)	100 (1000 * 10%)
Total Tax	1200	200
Total Tax for MNE (Jurisdictions A and B)	**1400**	

*Figures are in US Dollars unless otherwise noted

The MNE has reduced its taxes by shifting a further $2000 to Jurisdiction B. The additional $100 tax benefit comes from the shelter provided by the SBIE in Jurisdiction B which is now being utilized. The MNE has created a tax benefit by shifting income between two jurisdictions with identical tax bases and rates.

2.5.3. Strategy 5B – Acquiring SBIE

If the MNE does not already have excess SBIE in a low tax jurisdiction, it could seek to acquire it. If an MNE has Excess Profit in a jurisdiction, it could obtain additional value by acquiring a business which has excess SBIE. This would operate in much the same way as acquiring an entity to achieving a blending outcome (as outlined above in Strategy 4A). The outcomes are not reproduced here.

It may be thought that because the formulaic return on the relevant amounts of 'substance' is relatively low (10% and 8% falling to 5%), there is unlikely to be much excess SBIE. However, emerging empirical work by Michael Devereux and Martin Simmler has suggested that that there may be significant pools of excess SBIE, including in low-tax jurisdictions for MNEs.[49] To the extent this excess SBIE is in jurisdictions with below minimum tax, MNEs could seek to acquire businesses with these tax assets.

It is important not to overstate the extent to which this is likely to happen. It is unlikely that many MNEs would seek commercial acquisitions of large enterprises with significant expenses merely in order to gain access to their SBIE. However, there may be certain MNEs and industries for which this matching could take place. The most attractive options could be enterprises with significant SBIE and relatively stable incomes. Furthermore, MNEs which considered taking advantage of this strategy could seek to enter into arrangements with existing asset owners that transferred the asset to the MNE which could use the benefit without transferring the real risk.[50] To the extent that this could be achieved, there would be greater opportunity for MNEs to attempt to strategically acquire SBIE.

[49] Martin Simmler, 'Some Empirical Observations Related to Pillar 2', presentation given at the Oxford Centre for Business Taxation Conference, 4 April 2022 (slides on file with author).
[50] In this context it is important to recall that the included SBIE is only that of Constituent Entities. A Constituent Entity must be included in the MNE Group (see Art. 1.3.1) which requires a relationship of 'ownership or control

2.6. Summary

The above section has set out a framework for thinking about MNE strategic responses to the imposition of the GloBE rules. In comparing the available strategies, MNEs will need to take into account a variety of factors. The most obvious and direct of these are the tax consequences. However, they are not necessarily the most significant considerations. The MNE will also need to take into account its business requirements in terms of locating substance, its reputational exposure, its litigation exposure in terms of anti-avoidance rules, transfer pricing risk and its exposure to penalties. It will also need to consider its flexibility in terms of restructuring and the risk that relevant jurisdictions will amend their tax systems in response to the rules (for example, adoption of QDMTTs or raising of corporate income tax rates). Any strategic change is likely to involve additional transaction costs.

While the GloBE Rules can be expected to have a significant impact on profit shifting, it is worth emphasizing that they cannot be relied upon to ensure that profit is shifted back to the 'correct' jurisdiction. Where an MNE has shifted profit into a low tax jurisdiction, the GloBE rules are unlikely to create a strong incentive to shift that profit back to a high-tax jurisdiction. In most cases, the MNE is likely to be better off adopting simply paying the top-up tax in the low tax jurisdiction (strategy 1) rather than shifting the profit back to a higher-tax country. The GloBE Rules limit the benefit of engaging in profit shifting but they generally do not remove that benefit where the 'correct' source country has a tax rate above the minimum.

3. New valuable tax attributes

Strategies 4 and 5 above both rely upon the MNE taking advantage of the two new valuable tax attributes created under the GloBE Rules – Covered Taxes and SBIE. Blending (strategy 4) relies upon mixing investments with different amounts of Covered Taxes, while sheltering (strategy 5) relies upon mixing investments with different proportions of SBIE. These new tax attributes are valuable but their value is very complicated and cannot be identified in isolation of one another.

---

such that the assets, liabilities, income, expenses and cash flows' of the entity are included in the consolidated financial statements of the ultimate parent entity (see Art. 1.2.2).

3.1. Covered Taxes

The simplest way to see Covered Taxes as a valuable tax attribute is to conceptualise the GloBE Rules as an alternative minimum tax for the full amount but against which tax credit is granted for Covered Taxes.[51] From this perspective, Covered Taxes are the equivalent of foreign tax credits, which can be used to offset a tax liability which would otherwise arise under the alternative minimum tax. As the GloBE Rules rely upon jurisdictional blending, the Covered Taxes are allocated to a different 'basket' for each jurisdiction.

The difficulty in thinking about Covered Taxes as a valuable tax attribute is that Covered Taxes cannot be added to a jurisdiction without also adding the associated GloBE income. Accordingly, in seeking to 'blend' income by managing Covered Taxes as a valuable new tax attribute, an MNE will need to take into account the benefit of increased Covered Taxes against the 'detriment' of increasing the GloBE Income for the jurisdiction. The impact on the ETR can be analysed relatively simply. If the ETR of the additional investment (that is, the additional Covered Taxes divided by the additional GloBE Income) is above the ETR of the jurisdiction without the investment, the ETR will increase. All else equal, the ETR increasing will reduce the amount of top-up tax. However, by adding additional investment, all else is not held equal. There will be an increase in Adjusted GloBE Income and, potentially, in Excess Profit. Accordingly, the impact will be dependent upon the second valuable tax attribute – SBIE.

It might initially be thought that in order for the additional investment to be a benefit, it must have an ETR above 15%. This is not the case. As long as the new investment has an ETR above the current ETR for the jurisdiction, it *could* provide a blending benefit. Having a higher ETR means that it will raise the total ETR for the jurisdiction. However, whether or not it will produce an overall benefit will depend upon the impact of the SBIE as well. In the below example, the new investment (B) does not change the amount of Excess Profit in the jurisdiction (that is, its SBIE is equal to its GlobE Income). Despite being taxed below 15%, and not reducing the amount of Excess Profit, mixing Investment B with Investment A still reduces the top-up tax for jurisdiction.

	A	**B**	**A + B**
A. Covered Taxes	0	14	14
B. GloBE Income	100	100	200
C. ETR (A/B)	0%	14%	7%

[51] Daniel Shaviro notes that alternate minimum taxes can be conceptualized this way. See Daniel Shaviro, 'What Are Minimum Taxes, and Why Might One Favor or Disfavor Them?', 40 *Virginia Tax Review* 395, 405.

D. SBIE	0	100	100
E. Excess Profit (B – D)	100	0	100
F. Top-up Tax Percentage (15% – C)	15%	1%	8%
G. Top-up Tax (F*E)	15	0	8

*All figures are in US Dollars unless noted otherwise

3.2. SBIE

The second valuable tax attribute is SBIE – which, all else equal, reduces the amount of Excess Profit in the jurisdiction. However, SBIE is very unlikely to change without (a) changing the amount of profit in the jurisdiction and (b) changing the amount of Covered Taxes in the jurisdiction.[52] Therefore, while SBIE has value in isolation as a tax attribute, it is difficult to analyse its impact in isolation.

SBIE 'shelters' profit whether or not that profit is undertaxed. This means that $1000 of SBIE will shelter $1000 of GloBE income regardless of whether it is taxed at 0% or 15%. From the MNE's perspective, SBIE as a tax asset provides no additional value to the group in a high-tax jurisdiction as no top-up tax would arise in that jurisdiction regardless of the SBIE. Strategically managing SBIE would be to consider, at the margin, whether SBIE can be matched with undertaxed income. From a purely tax perspective, the most valuable place to locate SBIE will be with the lowest taxed income because in that location it will shelter the group from the largest amount of top-up tax.

An investment which increases the SBIE for the jurisdiction by more than it increases the GloBE Income, will overall decrease the amount of Excess Profit. If the new investment does not alter the ETR for the jurisdiction (that is, its ETR is equal to the existing ETR for the jurisdiction), this will provide an overall benefit and reduce the top-up tax for the jurisdiction. If the ETR for the new investment is higher than the existing ETR, there will be a double benefit (that is, both a blending and a sheltering benefit). If the ETR for the new investment is below that of the jurisdiction, then there will be a trade-off between the sheltering benefit and the blending benefit.

[52] This is because SBIE is a formulaic return to payroll expenditure and the carrying value of tangible assets, the presence of which will generally reduce the GloBE Income of the jurisdiction.

3.3. Potential disadvantages of blending

It should be noted that the GloBE rules can create circumstances where two investments in the same jurisdiction are subject to greater top-up tax if blended together than if they were both subject to the GloBE Rules separately. This is best demonstrated by an example.

	A	B	A + B
A. Covered Taxes	0	15	15
B. GloBE Income	100	100	200
C. ETR (A/B)	0%	15%	7.5%
D. SBIE	100	0	100
E. Excess Profit (B – D)	0	100	100
F. Top-up Tax Percentage (15% – C)	15%	0%	7.5%
G. Top-up Tax (F*E)	0	0	7.5

*All figures are in US Dollars unless noted otherwise

In this case, Investment A and Investment B have the two valuable tax attributes. Viewed in isolation, neither is undertaxed from the perspective of the GloBE Rules. Investment A is not subject to a top-up tax because there is no Excess Profit – all of the profit is within the formulaic return. Investment B is not subject to a top-up tax because, despite the fact that all of the profit is Excess Profit, the MNE has paid a sufficient level of tax (15%). When the two investments are mixed together, the 'protection' each investment relied upon to prevent the application of top-up tax (the valuable tax attributes, Covered Taxes and SBIE) are diluted across the two investments. The result is that top-up tax is applicable.

In Sections 2.4 and 2.5, the paper outlined the ways in which blending and sheltering income can be used to produce a tax benefit for undertaxed income. This example shows how mixing together the various attributes can leave the MNE worse off overall. Accordingly, these tax attributes cannot be viewed as always providing 'upside' to the MNE. If mismanaged, they can also produce a detriment.

3.4. Conclusion

It follows from the above that the value of the two tax attributes cannot generally be identified independently. There will always be a benefit if the new investment is subject to an ETR of above 15% and which has SBIE greater than its GloBE Income. In this case, the ETR will be increased and the Excess Profit for the jurisdiction will be reduced. Both of these reduce top-up taxes and are good from the perspective of the MNE. However, in other cases it is not obvious whether a new investment will increase or decrease

top-up taxes for the jurisdiction. An investment may lower the ETR but increase the amount of Excess Profit. Alternately it may increase the ETR but also lower the amount of Excess Profit. These effects pull in opposite directions and it is not clear which will be larger.

The value of the new tax attributes cannot be identified in isolation. They will always be a function of the other tax attribute in the jurisdiction. Nevertheless, Covered Taxes and SBIE are valuable tax attributes which we should expect to be managed by sophisticated MNEs engaged in tax planning activities.

4. New Distortions

The existence of the new tax attributes has the capacity to introduce new economic distortions to the ownership of investments as well as to the location of those investments. The distortions arise because of the value to the MNE which can be unlocked from matching the new valuable tax attributes (Covered Taxes and SBIE) to a common owner (distorting ownership) in a single jurisdiction (distorting location). At least theoretically, due to the incentives for matching, we should expect that both the ownership and location of investments would be different from those which would arise in the absence of the taxes.[53]

4.1. Distortion in location

The matching of both Covered Taxes and SBIE to undertaxed Excess Profits must be within the same jurisdiction. The capacity of this feature to distort investment decisions can be seen in a simple example. Consider an MNE which is going to make a new investment in one of two jurisdictions – Jurisdiction A and Jurisdiction B. Both Jurisdiction A and B will apply the same, low (below minimum) tax rate to the investment. The MNE already has significant Covered Taxes and excess SBIE (SBIE in addition to its GloBE Income) in Jurisdiction A. It has no operations in Jurisdiction B. The presence of these valuable tax attributes in Jurisdiction A may distort the MNE's decision in favour of Jurisdiction A at the margin.

It is important to note that this distortion is against the current after-tax result, which is likely to itself be a distortion on pre-tax income. Accordingly, it is not clear whether this new source of tax distortion would make the outcome more or less efficient overall (that is, it is not clear whether the new valuable tax attributes would increase any economic inefficiency from distortion compared to the current system). This example shows a distortion in the location of investment. A key impact is that MNEs may have an

[53] Daniel Shaviro notes these potential distortions in the context of US excess Foreign Tax Credit positions citing Harry Grubert. See Daniel Shaviro, 'What Are Minimum Taxes, and Why Might One Favor or Disfavor Them?', 40 *Virginia Tax Review* 395, 409; Harry Grubert, 'Tax Planning by Companies and Tax Competition by Governments: Is There Evidence of Changes in Behavior?', in *International Taxation and Multinational Activity* (James R. Hines Jr. ed., 2000) 113.

additional incentive to invest where they already have pre-existing investments as opposed to in a new jurisdiction where they do not have the new tax assets available to cross-subsidize the new investment. This may be particularly true with respect to jurisdictions which are mature and currently have investments subject to higher taxes.[54]

4.2. Distortion in ownership

The second distortion is a distortion in the ownership of relevant investments. Consider an investment which produces Covered Taxes above 15% of the associated GloBE Income or which has SBIE in excess of its GloBE Income. Such an investment would not be subject to top-up tax on its own. There are two potential acquirers which are bidding to purchase this investment – MNE A and MNE B. MNE A has better group synergies with the investment and by acquiring it will produce the larger amount of pre-tax income. However, MNE A has no pre-existing presence in the jurisdiction. On the other hand, MNE B has fewer valuable synergies with the investment and therefore will produce less pre-tax income post-acquisition. However, MNE B has pre-existing undertaxed Excess Profit in the jurisdiction from an unrelated investment. Acquiring the investment will prevent the application of top-up tax to the unrelated investment (either through the blending or sheltering effect).

On a pre-tax basis, MNE A should place greater value on the investment and therefore could be willing to offer a higher purchase price. However, the introduction of the GloBE Rules may increase the value of the investment to MNE B, which is now also acquiring the relevant new tax assets. Accordingly, MNE B may acquire the investment and the ownership of the investment has been distorted.[55]

The ownership distortion could give rise to two broader systemic effects. First, an advantage for incumbents within the jurisdiction. Blending may allow for incumbents effectively to cross-subsidize the new investment with the new tax asset from pre-existing high-tax investments. An MNE with no pre-existing presence in the jurisdiction may face a higher effective marginal tax rate on the new investment than the MNE with a prior presence in the jurisdiction. Second, no such disadvantage exists for investors that do not fall within the GloBE rules. Accordingly, there is likely to be an advantage for low-tax investments to be owned by investors which are not subject to the GloBE rules. For example, private

[54] However, the treatment of timing differences reduces the benefit of having mature investments within a jurisdiction.

[55] Michael Devereux is acknowledged as having coined the term ‘capital ownership neutrality’ in a 1990 working paper ‘Michael Devereux, Capital Export Neutrality, Capital Import Neutrality, Capital Ownership Neutrality and All That 2 (Inst. for Fiscal Stud., Working Paper, 1990). See Michael Knoll, ‘The connection between competitiveness and international taxation’, 65(3) *Tax Law Review* 349, 365.

equity investors which are not required to consolidate (and do not fall within the GloBE Rules) may place a higher value on low-tax investments than an MNE which is not able to fully cross-subsidize the undertaxed amounts using the new tax attributes from pre-existing assets. A corollary of this point is that investments which produce the valuable tax attributes can be more valuable to an MNE within the scope of the GloBE rules than an owner which does not fall within the rules.

The examples above have relied upon a *benefit* which is attained by matching different investments under a common owner in the same location. However, as shown in Section 3.3, two investments in the same jurisdiction can be worse off under a common owner subject to the GloBE Rules than if they were subject to the GloBE Rules separately. That is, there can be a *detriment* from common ownership in the same jurisdiction. Accordingly, there could also theoretically be 'push factors' against the same MNE holding two different types of investments in the same jurisdiction. These incentives could also distort ownership and the location of investment. However, these circumstances are much narrower and are significantly less likely to pose a major concern.

5. What (if anything) should be done?

This paper has set out a framework for how MNEs may think about strategically responding to the imposition of the GloBE Rules (Section 2), the new valuable tax attributes created under the regime (Section 3) and what impacts those strategies may have on distorting the ownership and location of investments (Section 4). In this section, I consider the extent to which these outcomes ought to be considered problematic and what, if anything, should be done in response. In doing so, I put to one side the possibility that the GloBE Rules and Commentary could be updated or otherwise effectively changed through Administrative Guidance with respect to specific design elements. This avenue remains a possibility for the Inclusive Framework.

The starting point should be to recognize that there is a real risk of disagreement between states as to the boundaries of appropriateness with respect to strategically responding to the agreed GloBE Rules. A significant portion of this difference is likely to arise due to different legal norms as to whether formal compliance with a set of rules is sufficient or whether there is an overlay which prevents 'tax avoidance' where unintended outcomes would be achieved under a strict approach to the formal rules. We should not underestimate the extent to which anti-avoidance rules or doctrines on economic substance play a crucial role in different jurisdictions' tax systems. Differences between these norms run the risk of producing discrepancies in application of the GloBE Rules. The GloBE Rules are designed to apply

consistently regardless of which jurisdiction is applying the rules. Deviations run the risk of spiraling compliance and administration costs. It is important to consider the extent to which the 'common approach' adopted by the GloBE Rules can tolerate such differences.[56]

At one end of the spectrum, there would be a view that there should be no flexibility in applying the GloBE Rules. Any outcomes achievable under the regime (including subversion of the interjurisdictional blending limitations outlined in Section 2.4) ought to be accepted under the rules. Supporters of this position are likely to argue that the capacity for states to adopt different avoidance rules or apply economic substance doctrines will produce an intolerable scope for variation in the application of the rules. Accordingly, they would argue that any top-up tax liability under the GloBE rules should not be subject to any such rules. They would note that the GloBE Rules operate on top of the existing tax system and, to the extent that the underlying tax system recognizes such rules, they will already be taken into account in determining current taxes. In other words, while anti-avoidance rules or economic substance doctrines can be applicable to the underlying tax liabilities (Covered Taxes), they should not be applied to the avoidance of a GloBE top-up tax liability under the IIR or UTPR.[57] Proponents of this view are also likely to argue that allowing for such variations, particularly under an anti-avoidance type rule, would make compliance with the rules impossible as they would need to take into account another jurisdiction's (or multiple jurisdictions') variations of the rules into account.

The counterargument to this position is likely to be that the agreed bargain involved achieving certain outcomes. Most importantly, MNEs are supposed to pay a minimum level of tax for every jurisdiction in which they operate. The GloBE Rules clearly demonstrate the intention to ensure this boundary has integrity. The rules have a CFC pushdown limitation[58] and the Commentary further makes the intention clear by referring to the 'integrity of jurisdictional blending'.[59] States may argue that there is no compelling reason why they ought to accept avoidance behaviour by MNEs which subverts the intended outcomes of the GloBE Rules. States which adopt this view may very well seek to implement the rules so as to allow

[56] Under the 'common approach', Inclusive Framework members are not required to adopt the GlobE Rules but, if they do so, they must 'implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two…'. See OECD (2021), 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy', 8 October 2021, OECD, Paris.
[57] It seems plausible that supporters of this view would be willing for anti-avoidance rules to be applied to increase the amount of QDMTT.
[58] GloBE Model Rules, above n 2, Art. 4.3.3.
[59] See Commentary to the GloBE Model Rules, above n 2, Art. 4, paragraph [62].

the limitation of 'abusive' cases as well as adapt existing regimes such as anti-avoidance rules to ensure that the outcomes are acceptable.

Whether or not one thinks that jurisdictions ought to be able to take countermeasures to strategies available under the rules, it is worth considering what kind of measures might be considered in imposing the GloBE Rules. In this context, strategies 1-3 as outlined above are unlikely to be considered at all problematic. The focus will be on MNEs that have managed to blend income (strategy 4) or shelter income (strategy 5). States considering countermeasures could adopt specific, targeted variations to the rules to address a perceived problem. Alternately, they could seek to rely upon a more general avoidance rule to capture 'problematic' strategic responses. These are addressed in turn below.

5.1. Specific countermeasures to blending

States may seek to apply countermeasures to both interjurisdictional blending and intrajurisdictional blending. The focus with the respect to interjurisdictional blending will likely be on the actions of MNEs to subvert the rules. With respect to intrajurisdictional blending, the focus is likely to be on actions which have been taken by foreign states rather than MNEs themselves. These are addressed in turn below.

The approach of adopting specific countermeasures would rely upon identifying individual perceived weaknesses in the GloBE Rules and addressing them through a targeted rule which did not rely on an avoidance purpose. For example, states could seek to ensure that the passive income limitation on pushing down CFC taxes cannot be subverted through the use of permanent establishments. The relevant strategy was outlined in Section 2.4.2 above. The specific countermeasure would be to domestically implement the GloBE Rules to apply the CFC limitation in Art. 4.3.3. to apply to foreign permanent establishments.[60]

For states which have an equivalent to a CFC Tax which applies to foreign permanent establishments, there could be an important financial incentive to adopt such a rule. If interjurisdictional blending can be achieved through the use of foreign permanent establishments, MNEs can gain a benefit by earning their passive income through a permanent establishment in a low tax state. While additional tax would be paid in the (higher tax) parent country on this income in order for the scheme to work, the parent state would still lose primary taxing rights with respect to the income. Accordingly, the low tax state would have

[60] As outlined in Section 2.1.2, there is a reasonable argument that such a response should not be considered as a deviation from the GloBE Rules and Commentary. On this view, such an implementation would not be a countermeasure which should be considered as a deviation from the common approach.

primary taxing rights and its corporation tax would apply ahead of the parent country applying the CFC rule. This would reduce the regular corporation tax received by the higher tax state. States which adopt such a strategic countermeasure are likely to argue that it is available under the current GloBE Rules and Commentary and ought not to be considered as a deviation from the common approach.[61]

The concern with respect to intrajurisdictional blending is likely to be focused on what is considered inappropriate actions of states, rather than MNEs. The most obvious example is a state which has adopted a special economic zone subject to an entirely different taxation regime to the rest of the jurisdiction. Other states may consider this to allow inappropriate blending between the special economic zone and the remainder of the state. Accordingly, a state could foreseeably seek to treat the special economic zone as a separate jurisdiction for the purposes of applying the rules. Similar questions may be raised with respect to patent box regimes. This article is focused on strategic responses of MNEs to the rules rather than states. However, it is worth noting that (a) allowing such blending may be considered a design flaw as states seek to strategically respond to the rules by adopting bifurcated tax systems which capitalize on the Covered Taxes as a valuable tax attribute[62] and (b) to the extent they are allowed, countermeasures to state actions are likely to have important flow-on effects for MNEs which are adopting strategies intrajurisdictional blending strategies.

5.2. Specific countermeasures to sheltering

Sheltering is far less likely to be considered a problematic strategy from the perspective of states than strategies which achieve blending. Section 2.5 outlined the mechanisms by which an MNE could seek to achieve sheltering. The strategic relocation of SBIE to a low-tax jurisdiction is unlikely to be considered problematic from an integrity perspective. Artificially shifting profits to a jurisdiction which already has significant excess SBIE is likely to be considered problematic but ought to be addressed under existing anti-BEPS regimes (that is, the problem would be profit shifting and not the GloBE Rules). Accordingly, it is unlikely to induce specific GloBE countermeasures.

Strategically acquiring SBIE is also unlikely to be considered problematic subject to the proviso that the acquiring MNE is genuinely owning and operating the asset. States are most likely to be concerned by an MNE that is able to acquire SBIE as a valuable tax attribute to shelter undertaxed income, if the MNE is

[61] Of course, such questions could be resolved through further guidance which made clear that such an approach was permissible or impermissible.
[62] See Heydon Wardell-Burrus, State Strategic Responses to the GloBE Rules, (forthcoming).

not taking the real economic risk with respect to the underlying 'substance' which is giving rise to the SBIE. The GloBE Rules operate by relying upon the financial accounting standards for what can be consolidated and therefore counted towards the MNE's SBIE. If MNEs are able to bring additional SBIE into their consolidated group despite fundamentally avoiding exposure for the economic risk of the relevant asset (or payroll expense), states could foreseeably want a greater restriction in the application of the GloBE Rules. For instance, a state adopting the GloBE Rules may attempt to adopt a restriction on consolidating an entity (or counting its SBIE) if there is insufficient control or exposure to the economic risk of the investment. In other words, the state may seek to replace sole reliance upon the relevant accounting rules and rely upon a more stringent test where the relevant acquisition gave the MNE access to valuable SBIE.[63] However, as with all such specific rules, it runs the risk of creating divergence with the GloBE Rules and being considered as a breach of the common approach.

5.3. Anti-avoidance rules

Despite the possibility of specific countermeasures, the biggest question is with respect to adopting a general anti-avoidance rule which would apply to GloBE tax liabilities. Such measures are likely to be attractive due to their flexibility and the fact that they avoid the need to play 'whack-a-mole' with individual 'loopholes' in the rules.

When considering how anti-avoidance rules could apply to the GloBE Rules, it is important to recognize that the novel structure of the rules and its aims may render existing general anti-avoidance rules (GAARs) unsuitable. For instance, many GAARs are likely to require that the relevant activity (or set of transactions) results in the avoidance of a tax liability of that state. In the context of the GloBE Rules, this condition may be not be satisfied if there is an applicable QDMTT in the undertaxed jurisdiction. The design of the GloBE Rules is such that if a source country has adopted a QDMTT, it will claim the top-up tax which would otherwise have been paid to the IIR jurisdiction. This structure can present a problem for GAARs in the IIR jurisdiction which require the avoidance of tax in the IIR jurisdiction.

Consider an example where the MNE has engaged in a series of artificial transactions to achieve interjurisdictional blending. This leads to a low tax jurisdiction having an artificially high ETR, which reduces the top-up tax due with respect to that jurisdiction. However, the low tax jurisdiction has a

[63] A similar approach could be adopted if there was access to additional Covered Taxes which reduced the top-up tax liability for the group. Note that this countermeasure is different to a general rule which attempted to replace the consolidation test under the relevant accounting rules with a stricter measure regardless of the circumstances (which is very likely to be considered inconsistent with the common approach under the GloBE Rules).

QDMTT. The IIR jurisdiction forms the view that the MNE has engaged in avoidance activity resulting in lower top-up tax payable. However, the IIR jurisdiction cannot establish that the MNE has avoided IIR jurisdiction tax. It is open for the MNE to argue that, under the GAAR counterfactual, it would have needed to pay additional QDMTT to the source jurisdiction and not any additional IIR. Accordingly, its tax liability to the IIR jurisdiction would have been exactly the same (that is, nil). This may be enough to prevent the GAAR from applying. Of course, the source jurisdiction may be able to assert that without the artificial transactions, there would have been a higher QDMTT. However, the source jurisdiction (a) might not have general anti-avoidance rules, (b) may not have the capacity to run such anti-avoidance cases or (c) may deliberately hold itself out as a low tax jurisdiction and therefore not wish to pursue such cases.

If IIR jurisdictions are to have the capacity to enforce the minimum tax in such cases, they are likely to need to adapt their GAARs (or adopt a separate anti-avoidance rule for the GloBE regime). If this is to be allowed, we may have the emergence of a 'GloBE GAAR' which could be adopted by implementing States. A GloBE GAAR could take different forms. A narrow form would be simply to limit the extent to which MNEs could argue that an increased QDMTT is enough to prevent a GAAR applying to increase IIR payments. An alternative would be to create a broader 'GloBE GAAR' which took into account all of the relevant taxes to see whether the MNE received a tax benefit overall.

Both of these models run into similar problems regarding which state ought to receive the revenue. On the one hand, we may think that the source/QDMTT jurisdiction should get the additional revenue – after all, it is the source state of the profit. On the other hand, if it is the source state that will receive the revenue, then IIR jurisdictions have very limited incentive to pursue expensive GAAR litigation only to see the revenue go to another state. All revenue authorities have resource limitations and are unlikely to prioritise cases where there is no revenue benefit to that state. There is an inherent tension between these two positions which would need to be negotiated by the Inclusive Framework. However, it strikes the author that the better approach will likely be to give the revenue to the IIR jurisdiction. While in the individual case this may seem unfair to the source jurisdiction (which may be resource constrained and unable to pursue the case itself), overall, it is likely to be beneficial to maintain the integrity of the system as a whole. Ensuring the correct incentives are present to enforce jurisdictional blending will protect source states (including low-capacity source states) in the long run.

So far the analysis has focused on cases with an IIR and a QDMTT. The incentives to pursue such cases are significantly diluted in the case of a UTPR. While a UTPR state could pursue such a case, its financial benefit would be diluted to the extent that the relevant jurisdiction was only entitled to a fraction of the top-up

tax (that is, its proportionate share of the substance of jurisdictions that have adopted the rules). Depending on the number of jurisdictions and the location of the MNE's substance, this may be too weak an incentive to pursue cases using a GAAR. However, this may be a good thing.

In considering how anti-avoidance rules should apply to the GloBE Rules, it is very important to consider the complexity for MNEs attempting to comply with the rules. It is one thing for the MNE to need to take into account the anti-avoidance rules of the source jurisdiction and the IIR jurisdiction (both of these jurisdictions' anti avoidance rules may already need to be taken into account with respect to CFC regimes). However, it would be a very large increase in complexity if all UTPR jurisdictions were able to apply their own anti-avoidance rules to a relevant transaction. It would be unreasonable for the GloBE regime to expect MNEs to consider the GAARs of twenty other jurisdictions which would be able to apply the UTPR when considering a restructure relating to one or two jurisdictions.

Accordingly, there are two questions. Should states be able to apply a GAAR to the GloBE Rules and, if so, should they be restricted to doing so under the IIR (and not be allowed to do so under the UTPR). In the author's view, there are reasonable ground for applying a GAAR to the GloBE Rules under the IIR (at least at the UPE level). However, the burden of needing to take into account divergent GAARs applied by different jurisdictions under the UTPR is likely to be too significant to justify the additional integrity benefit. Accordingly, in order to adopt a GAAR under a UTPR there would need to be an Inclusive Framework agreement on a GloBE GAAR. It must be acknowledged that a significant shortcoming of this approach is that there may be an advantage to MNE headquarter jurisdictions which do not adopt the IIR. Such states would not be subject to an integrity regime which would apply to other MNEs. On the other hand, there are very limited incentives for a UTPR state to pursue a GAAR case where its share of the top-up tax amount is limited to its share of the undertaxed amount. Accordingly, there may not be a large benefit to such MNEs in practice when compared to the alternative.

6. Conclusion

If the GloBE Rules are adopted by a critical mass of countries, many in-scope MNEs are likely to have undertaxed jurisdictions which are subject to a top-up tax. There are five strategic responses to this 'problem' – 'pay-up', 'shift (back)', 'sell', 'blend' and 'shelter'. The incentives with respect to these strategies arise primarily due to the creation of two new valuable tax attributes – Covered Taxes and SBIE. MNEs acting strategically would seek to maximise the value of these tax attributes where possible within their groups. Of course, optimizing the use of valuable tax attributes will only be one of a set of competing

objectives in making business decisions. In many cases, commercial realities which affect pre-tax profit are likely to dominate strategies based on maximizing the value of tax assets. Accordingly, it is important not to overemphasise the extent to which strategies available under the GloBE Rules are likely to influence business and structuring decisions.

Nevertheless, these planning strategies ought to be taken seriously. The value of the new tax attributes will introduce new distortions with respect to both ownership and location of investment. These have the potential to advantage incumbents within a given jurisdiction. Tax policymakers will also need to consider the extent to which these planning strategies ought to be considered acceptable under both the GloBE rules. Ideally there would be multilateral agreement as to a common approach to important outstanding questions – including the applicability of anti-avoidance rules. Clarity for both taxpayers and administrators should be highly valued.