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Osler submission to OECD advocates for narrow application of Global Anti-Base Erosion Proposal

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In this Update

- Earlier in 2019, the OECD published its *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy* (Program of Work), which contained two principal measures: Pillar One, which would allocate additional taxing rights to market jurisdictions, and Pillar Two, which would introduce a global minimum tax to prevent the shifting of profits to low-tax jurisdictions.
- Together, these proposals under Pillar One and Pillar Two represent a fundamental overhaul of the entire international tax system. Osler's summary of the Unified Approach under Pillar One were set out in a prior Update.
- On November 8, 2019, the Secretariat of the OECD released its Global Anti-Base Erosion (GloBE) Proposal under Pillar Two, which would impose a minimum tax on internationally operating businesses.
- Osler made a submission to the OECD on its GloBE Proposal advocating, among other things, that the GloBE Proposal should be applied more narrowly, and should be designed in a manner that prevents double (or multiple) taxation and minimizes administrative complexity and compliance costs.
- Tax treaty-related changes in the GloBE Proposal may be introduced through the Multilateral Instrument (MLI) or a similar agreement. The MLI entered into force for Canada on December 1, 2019 – and will be effective for withholding taxes under several of Canada's bilateral tax treaties on January 1, 2020.

Osler submission to the OECD on the GloBE Proposal

Osler made a submission [PDF] to the OECD in response to the November 8, 2019 *Public Consultation Document – Global Anti-Base Erosion Proposal – Pillar Two* (the GloBE Proposal) [PDF]. Our comments on the GloBE Proposal were principally directed at a need to:

(a) carefully define the scope of the Pillar Two proposals such that they are focused on the intended policy objectives; and

(b) ensure that the GloBE Proposal is designed in a co-ordinated manner that prevents double (or multiple) taxation and minimizes administrative complexity and compliance costs.

The GloBE Proposal was released under Pillar Two of the OECD's *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy* (Program of Work) [PDF]. The Program of Work contains two principal measures: Pillar One, which would allocate additional taxing rights to user/market jurisdictions, and Pillar Two, which would introduce a global minimum tax to prevent the shifting of profits to low-tax jurisdictions. For more information on the proposed Unified Approach under Pillar One, see our previous Update, "OECD proposes significant international tax changes that will impact multinationals," and our November 11, 2019 submission to the OECD on the Unified Approach [PDF]. For a summary of the GloBE Proposal see our previous Update from November 11, 2019, "OECD releases consultation document on its Global Anti-Base Erosion Proposal."

The GloBE Proposal under Pillar Two calls for the development of:

(a) an income-inclusion rule, which would impose current taxation on the income of a foreign-controlled entity (or foreign branch) if that income was otherwise subject to an effective tax rate that is below a certain minimum rate (which is to be set at a later date);

(b) an "undertaxed payments" rule (for source countries), which would either deny a deduction or impose a possible withholding tax on base eroding payments unless that payment was subject to tax at or above a specified minimum rate in the recipient's jurisdiction;

(c) a switch-over rule, which would be introduced into tax treaties to permit a residence jurisdiction to switch from an exemption to a credit method for relieving double taxation where the profits attributable to a permanent establishment or derived from immovable property is subject to an effective tax rate below the minimum rate; and

(d) a "subject to tax" rule, which would ensure that treaty benefits (particularly with respect to interest and royalties) are granted only in circumstances where an item of income is subject to tax at a minimum rate in the recipient jurisdiction.

In our submission to the OECD, Osler pointed out that the GloBE Proposal does not include a clear ordering mechanism between these competing rules, even though these rules could apply to impose additional tax with respect to the same payment. A detailed ordering rule is necessary both to prevent double (or multiple) taxation, and to allow countries to more accurately evaluate the extent to which they will benefit from (or be harmed by) the GloBE Proposal before agreeing to any such proposal.

Another significant open issue with respect to the GloBE Proposal is its intended scope of application. While the Unified Approach under Pillar One is intended to apply to "large consumer-facing businesses," the scope of Pillar Two does not currently have any recognizable boundaries, although the GloBE Proposal does refer to the possibility of certain carveouts and thresholds.

In our submission, we note that the GloBE Proposal should focus its application on passive forms of income earned in jurisdictions which are not compliant with the standards of BEPS Action 5 – consistent with the OECD's stated policy objectives of discouraging artificial profit-shifting and harmful tax competition under Pillar Two. Application of the GloBE Proposal to active business operations in countries that are compliant with the standards of BEPS Action 5 would not advance the policy objectives of the Program of Work, and may discourage cross-border business activities and significantly increase administrative costs and tax disputes. A broader application of the GloBE Proposal would also likely compound the complexity of technical issues such as the computation of the tax base, blending of income, and the required dispute resolution mechanism – making it more difficult for countries to

reach agreement on these issues. Osler also noted that an exception to the GloBE Proposal should apply for tax-exempt entities (such as pension funds and charities).

Although the OECD has proposed to consider the applicable minimum tax rate at a later date, in our view it is important to consider the tax rate simultaneously with the applicable tax base – to determine whether a strong consensus may be reached among a clear majority of stakeholders. In our view, the OECD should not proceed with the GloBE Proposal without such a consensus.

Next steps and need for co-ordinated implementation

The OECD intends to complete its technical work on the Unified Approach under Pillar One and the GloBE Proposal under Pillar Two throughout 2020. If a consensus is reached in 2020, this could then start a years-long process of adopting new rules through domestic legislation and changes to tax treaties.

In our submission we noted the importance of Canada and other jurisdictions proceeding in a co-ordinated manner to prevent double (or multiple) taxation and to minimize administrative complexity and compliance costs. We expect that the OECD will seek to implement any tax treaty changes arising under the GloBE Proposal through either the Multilateral Instrument (MLI), which was developed to allow large numbers of tax treaties to be amended in an efficient manner, or a similar multilateral agreement.

The MLI entered into force in Canada on December 1, 2019, introducing certain tax measures contained in the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project into many of Canada's treaties. As a result, the MLI will modify a significant number of Canada's existing bilateral tax treaties (referred to as Covered Tax Agreements) (a) effective January 1, 2020, for withholding taxes, and (b) for other taxes (including capital gains taxes), effective for tax years beginning on or after June 1, 2020 (which for calendar year taxpayers would be January 1, 2021). For further background on the MLI, see our Updates "Multilateral Instrument (MLI) will enter into force for Canada on December 1, 2019," "Canada tables NWMM to ratify MLI; Updates MLI reservations," and "Canada signs multilateral tax agreement."

For further information on the GloBE Proposal, the OECD's Program of Work (including Pillar One proposals), the MLI or other tax matters, please contact any member of our National Tax Group.