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ABSTRACT

The objective of this Research Paper is to comprehensively identify and analyse all Permanent Establishment (PE) related provisions under the global minimum tax of the Organisation for Economic Co-operation and Development (OECD), which is implemented through the Global Anti Base Erosion (GloBE) Model Rules. The analysis has led to the conclusion that PEs hold a significant position and facilitate application of GloBE Rules.

The GloBE Rules have introduced certain new facets involving application of PE provisions when there is no tax treaty; no Corporate Income Tax (CIT) in the source state, and have brought in the concept of stateless PEs. These newly-introduced facets have widened the scope of PEs to enable application of the GloBE Rules in specific situations which would otherwise have remained outside the ambit of taxation.

The paper concludes with an observation that the OECD's Inclusive Framework is drafting the provisions of Amount A in a manner that results in consistency with GloBE Rules. Likewise, acceptance of "deemed PE" for GloBE rules should be extended to Amount A as well. By doing so, a tax nexus would be provided in source jurisdictions, which will allow profits attributable to Multinational Enterprises (MNEs) in a digitalized economy (without physical presence) getting taxed under domestic rules of these source (market) jurisdictions. This would have been a much simpler solution and would have eliminated the complexity of Amount A rules to a large extent, as we see today.

L'objectif de ce rapport de recherche est de recenser et d'analyser de manière exhaustive toutes les dispositions relatives à la définition de l'établissement stable dans le cadre de la mise en œuvre des règles globales anti-érosion de la base d'imposition (règles GloBE), définies par l'Organisation de coopération et de développement économiques (OCDE, qui garantissent le versement par les multinationales d'un montant minimum d'impôt à l'échelle mondiale. L'analyse a permis de conclure que cette notion revêt un caractère essentiel en ce qu'elle facilite l'application des règles GloBE.

Les règles GloBE ont introduit de nouveaux aspects concernant l'application des dispositions relatives aux établissements stables en l'absence de convention fiscale et d'imposition sur les revenus générés dans l'État de la source, qui ont donné lieu à l'émergence de la notion d'établissement stable présumé, qui permet d'élargir le champ d'application des règles GloBE à des situations particulières dans lesquelles il n'aurait pas été possible autrement d'envisager une taxation.

Le rapport conclut en observant que la formulation choisie par le Cadre inclusif de l'OCDE/G20 s'agissant des dispositions relatives au Montant A assure une cohérence avec celles contenues dans le modèle de Règles GloBE. C'est pourquoi, la notion d'établissement stable présumé, qui est utilisée dans ces règles, doit être étendue aux dispositions relatives au Montant A afin qu'un lien fiscal puisse être établi dans les juridictions de la source. Ce faisant, celles-ci auraient la possibilité d'imposer les bénéfices attribuables aux entreprises multinationales du numérique (qui n'ont pas d'établissements physiques) en vertu des dispositions fiscales en vigueur sur leur territoire national. Cette solution a l'avantage de la simplicité et permettrait, dans une large mesure, de résoudre les difficultés liées à l'application des règles relatives au montant A, qui tiennent à leur trop grande complexité.

El objetivo de este documento de investigación es identificar y analizar exhaustivamente todas las disposiciones relativas al establecimiento permanente en virtud del tipo impositivo mínimo mundial de la Organización para la Cooperación y el Desarrollo Económicos (OCDE), que se implementa a través de las reglas modelo GLoBE (acrónimo de Global Anti-Base Erosion). El análisis ha llevado a la conclusión de que los establecimientos permanentes ocupan una posición importante y facilitan la aplicación de las reglas GloBE.

Estas reglas han introducido unas facetas nuevas que conllevan la aplicación de las disposiciones relativas al establecimiento permanente cuando no exista ningún tratado fiscal ni ningún impuesto sobre la renta de sociedades (ISR) en el Estado fuente, y han incorporado el concepto de los establecimientos permanentes apátridas. Estas facetas de reciente introducción han ampliado el alcance de los establecimientos permanentes para permitir la aplicación de las reglas GloBE en situaciones específicas que, de lo contrario, habrían permanecido fuera del ámbito de la tributación.

El documento concluye observando que el Marco Inclusivo de la OCDE está redactando las disposiciones del Importe A de una manera que resulte coherente con las reglas GloBE. Del mismo modo, la aceptación del "considerado establecimiento permanente" para las reglas GloBE debería extenderse también al Importe A. Al hacerlo, se proporcionaría un nexo fiscal en las jurisdicciones de origen, que permitirá el pago de impuestos sobre los beneficios atribuibles a las empresas multinacionales en una economía digitalizada (sin presencia física) con arreglo a las normas nacionales de estas jurisdicciones (mercado) de origen. Esto habría sido una solución mucho más sencilla y habría suprimido la complejidad de las normas del Importe A en gran medida, como vemos hoy en día.

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List of Abbreviations

ADS	Automated Digital Services
ALP	Arm’s Length Principle
BEPS	Base Erosion and Profit Shifting
CE	Constituent Entity
CFB	Consumer-facing Business
CFS	Consolidated Financial Statements
CIT	Corporate Income Tax
DAPE	Dependent Agent Permanent Establishment
DTC	Double Taxation Convention
ETR	Effective Tax Rate
G20	Group of Twenty
GloBE	Global Anti-Base Erosion
IF	Inclusive Framework
IIR	Income Inclusion Rule
LTCE	Low-Taxed Constituent Entity
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
MNE	Multinational Enterprise
MTC	Model Tax Convention
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
TFDE	Task Force on Digital Economy
UN	United Nations
UPE	Ultimate Parent Entity
UTPR	Undertaxed Profits Rule

1. INTRODUCTION

1.1 Background

Article 7 of the Organisation for Economic Co-operation and Development's Model Tax Convention (OECD MTC) and United Nations Model Double Taxation Convention (UN Model DTC) provides that business profits are taxed exclusively in the State of residence of the enterprise unless there is a permanent establishment (PE) in the other State. If a PE exists, profits attributable to that PE are taxable in that other State. Hence, PE provisions enshrined in Article 5 of the OECD MTC and UN Model DTC assume significant importance, have hogged constant limelight and have undergone steady modifications from time to time.

1.2 PE Provisions as per OECD MTC 2014 and UN Model DTC 2011

Prior to introduction of PE related changes in the OECD MTC and UN Model DTC through Base Erosion and Profit Shifting (BEPS) 1.0,[2] paragraph 1 of Article 5 of the MTC broadly provided that the term PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on. In the MTC, there is no definition of 'fixed place' but some guidance is available in the Commentary[3] which provides that there must be 'a distinct situs' (geographical requirement); 'it must be established at a distinct place with a certain degree of permanence' (time requirement) and 'the business of the enterprise should be carried on through this fixed place'. The examples of a PE are provided in paragraph 2 of Article 5 through an inclusive list, but such places of business constitute PEs only if they meet the requirements[4] of paragraph 1. Paragraph 3 of Article 5 provides that a building site or construction or installation project constitutes a PE only if it lasts more than twelve[5] months. The twelve-month test[6] is applied to each individual site or project. Paragraph 4 of Article 5 provides list of activities which are preparatory or auxiliary[7] in nature, may not constitute PEs even if the activity is carried on through a fixed place of business. The policy rationale for incorporating this provision is that an enterprise should have the opportunity to develop in a new market without immediate liability to local taxation. Each case will have to be examined on its own merits.[8] A decisive criterion to hold whether an activity is preparatory or auxiliary in nature is to evaluate whether the activity of the fixed place forms an essential and significant part of the activity of the enterprise as a whole.[9] Paragraph 5 of Article 5 provides an extension of the PE concept to include a dependent agent who habitually concludes contracts[10] for the enterprise. The dependent agents may be either individuals or companies and need not be residents of, nor have a place of business in, the State in which they act for the enterprise.[11] Exceptions to dependent agent PE (DAPE) applicability would apply in respect of activities of independent nature in accordance with paragraph 6 of Article 5 (independent agents must be acting 'in the ordinary course of their business' for the exception to apply) and activities that

[2] OECD and G20 countries adopted a 15-point Action Plan to address BEPS in September 2013.
[3] Refer to paragraph 2 of the Commentary on Article 5 of OECD MTC 2014.
[4] Refer to paragraph 12 of the Commentary on Article 5 of OECD MTC 2014.
[5] Article 5(3)(a) of the UN Model DTC 2011 provides that PE provisions would apply to building site, construction, assembly or installation project or supervisory activities if such site, project or activities last more than six months.
[6] Refer to paragraph 18 of the Commentary on Article 5 of OECD MTC 2014.
[7] Provisions in OECD MTC 2014 and UN Model DTC 2011 in regard to activities which are preparatory or auxiliary are broadly similar, except that as per UN Model DTC 2011, any facility that is used for delivery (warehouse) function may create a PE, if this function is not preparatory or auxiliary in character.
[8] Refer to paragraph 24 of the Commentary on Article 5 of OECD MTC 2014.
[9] Id.
[10] Article 5(5)(b) of the UN Model DTC 2011 also provides that PE provisions will apply if an agent habitually maintains a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.
[11] Refer to paragraph 32 of the Commentary on Article 5 of OECD MTC 2014.

are preparatory or auxiliary in nature in accordance with paragraph 4. Paragraph 7 of Article 5 provides that existence of a subsidiary company cannot be construed as a PE of its parent company.

The PE provisions discussed *supra* under the OECD MTC 2014 broadly apply to the UN Model DTC 2011 as well, except, the latter has introduced the concept of Service PE[12] involving furnishing of services, including consultancy services, by an enterprise through employees or other personnel for a period aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned. In addition, the UN Model DTC 2011 also provides that an insurance enterprise shall, except in regard to re-insurance, be deemed to have a PE[13] in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status.

The extant PE provisions of OECD MTC 2014 and UN Model DTC 2011 discussed above were found wanting and failed to hold good *inter alia* in regard to the following activities and situations:

i. where contracts which were substantially negotiated in a State were not concluded in that State and were finalised or authorised abroad,[14] or
ii. where the person that habitually exercised an authority to conclude contracts constituted an "independent agent" to which the exception of Article 5(6) of the OECD MTC 2014 applied even though it was closely related to the foreign enterprise on behalf of which it was acting,[15] or
iii. an interpretation was being taken that activities described in 5(4) (a) through (d) shall not be deemed to be a PE even if they were not of preparatory or auxiliary character, as proviso stating "provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character" was embedded in clause (f) of Article 5(4) of the OECD MTC and it was being interpreted that this proviso applies only to clause (f) and not to clauses (a) to (d),[16] or
iv. enterprises could fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity,[17] or
v. fragmentation of a cohesive operating business into several small operations was being done in a manner where these places of business belonged to closely related enterprises,[18] or
vi. enterprises (mainly contractors or sub-contractors working on the continental shelf or engaged in activities connected with the exploration and exploitation of the continental shelf) divided their contracts up into several parts, each covering a period less than twelve months and attributed the contracts to a different company which was, however, owned by the same group,[19] or
vii. potential abuse in PE triangular structures pursuant to which profits attributable to the PE are exempt in the residence state and bear little or no tax in the PE state,[20] or
viii. failure to tax income arising in market jurisdictions from automated digital services (ADS).

[12] Refer to Article 5(3)(b) of the UN Model DTC 2011.
[13] Refer to Article 5(6) of the UN Model DTC 2011.
[14] Refer *to MLI Made Easy* by Kuldeep Sharma, published by Wolters Kluwer (ISBN 978-94-035-3260-8), paragraph 314.
[15] Id.
[16] Id., paragraph 340.
[17] Id., paragraph 342, 348.
[18] Id. paragraph 348.
[19] Id., paragraph 370.
[20] Id., paragraph 280.

1.3 BEPS Action Reports

The deficiencies in the PE provisions identified *supra* were partially addressed by the BEPS 1.0 when OECD and the Group of Twenty (G20) countries adopted a 15-point Action Plan in September 2013. The PE related provisions were strengthened through Action 6[21] and Action 7[22] Reports on the following lines:

a) BEPS Action 7 Report implemented *inter alia* by Article 12 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) addresses the avoidance of PE status through commissionaire arrangements and similar strategies through modifying the provisions dealing with agency PEs – articles equivalent to Article 5(5) of the OECD MTC (2014) – and independent agents – articles equivalent to Article 5(6) of the OECD MTC (2014), as below:
   (i) DAPE[23] would exist if the person acts in a contracting state on behalf of an enterprise (parent), habitually concludes contracts or habitually plays the principal role to the conclusion of contracts that are routinely concluded without material modification by the (parent) enterprise and such contracts are:
      – In the name of the (parent) enterprise. The reference to contracts "in the name of" does not restrict the application of the phrase to contracts that are literally in the name of the enterprise; it may apply, for example, to certain situations where the name of the enterprise is undisclosed in a written contract;
      – For transfer of any right, property, etc. owned or under the right to use by the (parent) enterprise. Parts of the contracts that relate to the transfer of the ownership or use of property will be performed by the enterprise as opposed to the person that acts on the enterprise's behalf;
      – For provision of services by the (parent) enterprise. Parts of the contracts that relate to the provision of services will be performed by the enterprise as opposed to the person that acts on the enterprise's behalf.
   (ii) DAPE[24] provisions may apply where a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related,[25] thus, that person shall not be considered to be an independent agent with respect to any such enterprise.

b) BEPS Action 7 Report implemented *inter alia* by Article 13[26] of the MLI addresses the avoidance of PE status through specific activity exemptions on applying two different alternatives:
   (i) Option A modifies the list of auxiliary exceptions to PE status – articles equivalent to Article 5(4) of the OECD MTC (2014) – by explicitly stating that those activities or the combination of several of them, will be deemed not to create a PE only if they effectively fulfill the further condition of being of a preparatory or auxiliary nature. In order to elaborate, through Option A (para 2)

[21] Action 6: BEPS 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project <http://www.oecd.org/tax/beps-2015-final-reports.htm>
[22] Action 7: BEPS 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project <http://www.oecd.org/tax/beps-2015-final-reports.htm>
[23] Refer to *MLI Made Easy* by Kuldeep Sharma, published by Wolters Kluwer (ISBN 978-94-035-3260-8), paragraph 316.
[24] Id., paragraph 320.
[25] Definition of 'closely related' is provided in Article 15 of the MLI.
[26] Refer to *MLI Made Easy* by Kuldeep Sharma, published by Wolters Kluwer (ISBN 978-94-035-3260-8), paragraph 342.

under Article 13 of MLI, proviso at the end of Article 5(4) stating "provided that such activity or, in the case of subparagraph (c), the overall activity of the fixed place of business, is of a preparatory or auxiliary character" corresponds to all clauses, namely, (a) to (c) of para 2 of Article 13 of MLI, which means that all individual activities under these clauses, if preparatory or auxiliary in character, shall tantamount to no PE. However, if such activities listed in clauses (a) to (c) of para 2 of Article 13 of MLI are not preparatory or auxiliary in character, PE status of that entity shall be held.

(ii) Option B does not modify the list of activities but merely reaffirms that even auxiliary activities are intrinsically exceptions to the PE status.

Also, Article 13 establishes an anti-fragmentation rule, which applies by default and complements both options A and B, so as to prevent the fragmentation of a cohesive business operation into several small operations (in order to contend that each is merely engaged in preparatory or auxiliary activity), leading to abuse of the specific activity exemptions.

c) BEPS Action 7 Report implemented *inter alia* by Article 14[27] of the MLI addresses the PE issues arising through splitting up of contracts, through an anti-abuse rule that allows the aggregation of different periods of time for the purpose of determining whether or not the activities conducted in the state of source can be deemed to constitute a project or construction PE.

d) BEPS Action 6 Report implemented *inter alia* by Article 10[28] of the MLI establishes the anti-abuse rule for PEs situated in third jurisdictions where jurisdictions follow 'territorial system' of taxation. The rule tackles situations in which the income of an enterprise is attributed to a PE located in a third jurisdiction (is not taxed normally in that third State) and is treated as exempt from tax in the state of residence of the enterprise. That income, as attributable to a PE located in a third jurisdiction, if, subjected to low taxation (tax on that income is less than 60% of the tax on that income in the state of residence) or, if subjected to nil taxation in the third jurisdiction where the PE is located, then, as a consequence, by invocation of the anti-abuse rules enshrined in Article 10, such income shall be taxable in the State of source and no treaty benefit shall be granted by the State of source. Thus, State of source is able to protect its right to tax such income and situations of double non-taxation or reduced taxation are avoided. Consequently, Article 29(8) has been introduced in OECD MTC 2017 and UN Model DTC 2017[29] respectively.

The 2015 Final Report on Action 1[30]: It states that because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes. The digital economy and its business models present however some key features which are potentially relevant from a tax perspective. These features include mobility, reliance on data, network effects, the spread of multisided business models, a tendency toward monopoly or oligopoly and volatility. The types of business models include several varieties of e-commerce, app stores, online advertising, cloud computing, participative networked platforms, high speed trading, and online payment services. The digital economy has also accelerated and changed the spread of global value chains in which Multinational Enterprises (MNEs) integrate their worldwide operations. The digital economy raises broader tax challenges related in particular to nexus, data, and

[27] Id., paragraph 372.
[28] Id., paragraph 281.
[29] UN Model DTC 2021 is also available.
[30] Refer to OECD's Action 1: 2015 Final Report, Addressing the Tax Challenges of the Digital Economy at https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1667583632&id=id&accname=guest&checksum=9A2562965A3911203F7AB919C5ACF478.

characterisation for direct tax purposes, which often overlap with each other. The Task Force on the Digital Economy (TFDE) discussed and analysed a number of potential options to address these challenges, including through an analysis of their economic incidence, and *inter alia* concluded in relation to direct taxes, as below:

(i) a new nexus in the form of a significant economic presence,
(ii) a withholding tax on certain types of digital transactions, and
(iii) an equalisation levy.

None of the above options analysed by the TFDE were recommended at this stage. Countries could, however, introduce any of these three options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties. Adoption as domestic law measures would require further calibration of the options in order to provide additional clarity about the details, as well as some adaptation to ensure consistency with existing international legal commitments.

However, BEPS 1.0 failed to provide a comprehensive solution to tackle taxation of income arising in market jurisdictions from ADS. Carrying forward from the 2015 Final Report on Action 1, the Inclusive Framework (IF) member countries proceeded to undertaking a coherent and concurrent review of two key aspects of the existing tax framework, which are, nexus and profit allocation rules in order to consider the impacts of digitalisation.

2. RECOMMENDATIONS UNDER BEPS 2.0

2.1 Taxation of Activities related to ADS in Market Jurisdictions

With the advent of modern means of telecommunications and the spread of digitalization, enterprises have the ability to effectively engage in substantial business activities in the market country without a fixed place of business there, or to conclude contracts remotely through technological means with no involvement of individual employees or dependent agents. The existing PE provisions in the OECD MTC and UN Model DTC do not cover in their ambit any income arising in market jurisdictions from ADS.[31] The ensuing discussion provides a bird's eye-view of evolution of OECD's Two-Pillar Solution post BEPS 1.0 recommendations.

2.2 OECD's Policy Note of 2019

The Policy Note,[32] as approved by the IF on BEPS on 23 January 2019, observed as below:

> There is agreement to examine proposals involving two pillars which could form the basis for consensus. One pillar addresses the broader challenges of the digitalised economy and focuses on the allocation of taxing rights, and a second pillar addresses remaining BEPS issues. A two pillar approach would recognise that the digitalisation of the economy is pervasive, raises broader issues, and is most evident in, but not limited to, highly digitalised businesses. It raises questions of where tax should be paid and if so in what amount in a world where enterprises can effectively be heavily involved in the economic life of different jurisdictions without any significant physical presence and where new and often intangible value drivers more and more come to the fore. At the same time, the features of the digitalising economy exacerbate BEPS risks, and enable structures that shift profits to entities that escape taxation or are taxed at only very low rates. A solution would therefore require comprehensive work that covers the overall allocation of taxing rights through revised profit allocation rules and revised nexus rules, as well as anti-BEPS rules.

2.3 Unified Approach adopted by the OECD under Pillar One

In order to expedite progress towards reaching a consensus solution to Pillar One issues, the OECD Secretariat proposed a "Unified Approach".[33] The key features of the Unified Approach are outlined below:

- *Scope*: The approach covers highly digital business models but goes wider and broadly focusing on consumer-facing businesses (CFB) with further work to be carried out on scope and carve-outs. Extractive industries are assumed to be out of the scope. Further discussion to take place to consider whether other sectors (e.g., financial services) should also be carved out and consideration of size limitations, such as, the Euro 750 million revenue threshold used for country-by-country reporting requirements.
- *New Nexus*: For businesses within the scope, it creates a new nexus, not dependent on physical presence but largely based on sales. The new nexus could have thresholds

[31] Refer to South Centre's Tax Cooperation Policy Brief titled "The Tax Sovereignty Principle and Its Peaceful Coexistence with Article 12B of the UN Model Tax Convention" by Kuldeep Sharma at https://www.southcentre.int/wp-content/uploads/2021/06/Tax-PB-14.pdf, accessed on 2 November 2022.

[32] Refer to "Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note" at https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf, accessed on 2 November 2022.

[33] Refer to "Public consultation document: Secretariat Proposal for a 'Unified Approach' under Pillar One 9 October 2019 – 12 November 2019" at https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf, accessed on 2 November 2022.

including country specific sales thresholds calibrated to ensure that jurisdictions with smaller economies can also benefit. It would be designed as a new self-standing treaty provision. The simplest way of operating the new rule would be to define a revenue threshold in the market (the amount could be further adapted to the size of the market) as the primary indicator of a sustained and significant involvement in that jurisdiction. The revenue threshold would also take into account certain activities, such as online advertising services, which are directed at non-paying users in locations that are different from those in which the relevant revenues are booked. This new nexus would be introduced through a standalone rule – on top of the PE rule – to limit any unintended spill-over effect on other existing rules.

– *New Profit Allocation Rule going beyond the Arm's Length Principle (ALP)*: It creates a new profit allocation rule applicable to taxpayers within the scope, and irrespective of whether they have an in-country marketing or distribution presence (PE or separate subsidiary) or sell via unrelated distributors. At the same time, the approach largely retains the current transfer pricing rules based on the ALP but complements them with formula-based solutions in areas where tensions in the current system are the highest.
– *Increased Tax Certainty delivered via a Three Tier Mechanism*: The approach increases tax certainty for taxpayers and tax administrations and consists of a three-tier profit allocation mechanism, as follows:
  – *Amount A*: a share of deemed residual profit allocated to market jurisdictions using a formulaic approach, i.e., the new taxing right;
  – *Amount B*: a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and
  – *Amount C*: binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B and accordingly, a particular jurisdiction seeks to tax an additional profit on those extra functions in accordance with the existing transfer pricing rules.

It is to be noted that at the time of adoption of Unified Approach by the OECD, unlike Amount A, Amounts B and C did not create any new taxing rights. The taxable profits potentially allocable to market jurisdictions under Amounts B and C were based on the existing profit allocation rules (including the reliance on physical presence), and reflected efforts to improve the practical application of the ALP. The formula-based approach (with no connection to the ALP) was therefore applied only in the case of Amount A.

2.4 Pillar One Blueprint and October 2021 Statement

Thereafter, the Pillar One Blueprint[34] identified the following three foundations:

– a new taxing right for market jurisdictions over a share of residual profit (Amount A);
– a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP (Amount B); and
– processes to improve tax certainty through effective dispute prevention and resolution mechanisms.

Subsequently, vide October 2021 Statement,[35] the primary Pillar One provisions were identified as under:

[34] Refer to *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* at https://www.oecd-ilibrary.org/docserver/beba0634-en.pdf?expires=1661277373&id=id&accname=guest&checksum=3FA269D0CE30E2A2ADB05DF6B835B7DA, accessed on 4 November 2022.
[35] Refer to "OECD's Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy dated 8 October 2021" at https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf, accessed on 4 November 2022.

a) *Scope*: In-scope companies are the multinational enterprises (MNEs) with global turnover above Euro 20 billion and profitability above 10% (i.e., profit before tax/revenue) calculated using an averaging mechanism with the turnover threshold to be reduced to Euro 10 billion, contingent on successful implementation including of tax certainty on Amount A, with the relevant review beginning seven years after the agreement comes into force, and the review being completed in no more than one year. Extractives and Regulated Financial Services shall be excluded.
b) *Nexus*: There will be a new special purpose nexus rule permitting allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least Euro 1 million in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than Euro 40 billion, the nexus will be set at Euro 250,000. The special purpose nexus rule applies solely to determine whether a jurisdiction qualifies for the Amount A allocation.
c) *Quantum of allocation*: For in-scope MNEs, 25% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key.
d) *Revenue sourcing*: Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an in-scope MNE must use a reliable method based on the MNE's specific facts and circumstances.
e) *Tax base determination*: The relevant measure of profit or loss of the in-scope MNE will be determined by reference to financial accounting income, with a small number of adjustments. Losses will be carried forward.
f) *Segmentation*: Segmentation will occur only in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules.
g) *Marketing and distribution profits safe harbour*: Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction through Amount A.
h) *Elimination of double taxation*: Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method. The entity (or entities) that will bear the tax liability will be drawn from those that earn residual profit.
i) *Tax certainty*: In-scope MNEs will benefit from dispute prevention and resolution mechanisms, which will avoid double taxation for Amount A, including all issues related to Amount A (e.g., transfer pricing and business profits disputes), in a mandatory and binding manner. Disputes on whether issues may relate to Amount A will be solved in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism. An elective binding dispute resolution mechanism will be available only for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review and have no or low levels of MAP disputes. The eligibility of a jurisdiction for this elective mechanism will be reviewed regularly; jurisdictions found ineligible by a review will remain ineligible in all subsequent years.
j) Amount A will be implemented through a Multilateral Convention (MLC) which will require all parties to remove all DSTs and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted DSTs or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC.

2.5 Pillar Two Blueprint and October 2021 Statement

The blueprint[36] on Pillar Two states that Pillar Two would address remaining BEPS challenges and sets out rules that would provide jurisdictions with a right to 'tax back' where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation. These rules would ensure that all large internationally operating businesses pay at least a minimum level of tax. Jurisdictions are free to determine their own tax systems, including whether they have a corporate income tax and the level of their tax rates, but also consider the right of other jurisdictions to apply an internationally agreed Pillar Two regime where income is taxed below an agreed minimum rate. The so-called tax back is achieved via a number of interlocking rules[37] that seek to (i) ensure minimum taxation while avoiding double taxation or taxation where there is no economic profit, (ii) cope with different tax system designs by jurisdictions as well as different operating models by businesses, (iii) ensure transparency and a level playing field, and (iv) minimise administrative and compliance costs.

Subsequently, the October 2021 Statement[38] was an update on the IF discussions on the Two-Pillar Solution on the following lines:

- *IF members in agreement*: The landmark deal, agreed by 136 countries and jurisdictions representing more than 90% of global GDP, is supported by all OECD and G20 countries. Four countries, namely, Kenya, Nigeria, Pakistan and Sri Lanka have not yet joined the agreement.
- *Rule Design*: The UTPR allocates top-up tax from low-tax constituent entities including those located in the UPE jurisdiction. The GloBE rules will provide for an exclusion from the UTPR for MNEs in the initial phase of their international activity, defined as those MNEs that have a maximum of Euro 50 million tangible assets abroad and that operate in no more than 5 other jurisdictions. This exclusion is limited to a period of 5 years after the MNE comes into the scope of the GloBE rules for the first time. For MNEs that are in scope of the GloBE rules when they come into effect the period of 5 years will start at the time the UTPR rules come into effect.
- *ETR calculation*: In respect of existing distribution tax systems, there will be no top-up tax liability if earnings are distributed within 4 years and taxed at or above the minimum level.
- *Minimum rate*: The minimum tax rate used for purposes of the IIR and UTPR will be 15%.
- *Carve-outs*: The GloBE rules will provide for a formulaic substance carve-out that will exclude an amount of income that is 5% of the carrying value of tangible assets and payroll. In a transition period of 10 years, the amount of income excluded will be 8% of the carrying value of tangible assets and 10% of payroll, declining annually by 0.2 percentage points for the first five years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the last five years.
- *De minimis exclusion*: The GloBE rules will provide for a de minimis exclusion for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million.
- *STTR*: The minimum rate for the STTR will be 9%.

[36] Refer to "Cover Statement by the OECD/G20 IF on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two" as contained on pages 10-12 of the Report on Pillar Two Blueprint.
[37] Refer to Executive Summary (para 8) of the Report on Pillar Two Blueprint.
[38] Refer to "OECD's Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy dated 8 October 2021" at https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf, accessed on 4 November 2022.

2.6 GloBE Rules under Pillar Two

OECD's statement dated 8 October 2021 was followed by release of Pillar Two Model Rules[39] on 20 December 2021 which define the scope and set out the mechanism for Global Anti-Base Erosion (GloBE) rules under Pillar Two. Taxpayers that either have no foreign presence or that have less than EUR 750 million in consolidated revenues are not in scope of the Model Rules. The Pillar Two Model Rules *inter alia* contemplate the possibility that jurisdictions may introduce their own domestic minimum top-up tax based on the GloBE mechanics, which is then fully creditable against any liability under GloBE, thereby preserving a jurisdiction's primary right of taxation over its own income.

2.7 Objective of Pillar One

The primary purpose of the OECD/G20 project on digitalisation addresses how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries.[40] It involves development of a solution to various mechanisms (and proposals) so as to bridge the requirements of capital/technology exporting countries vis-à-vis capital/technology importing countries and in the process, *inter alia,* shore up tax revenues of market jurisdictions to account for the contribution made by users in the market jurisdictions and compensate such jurisdictions for the revenue generated by them for the MNEs. This is being achieved through the Two-Pillar Solution, wherein, *inter alia*, Pillar One intends to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest and most profitable MNEs. It will re-allocate some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence there. The rules provide under Amount A that MNEs with global sales above Euro 20 billion and profitability above 10% will be covered, with 25% of profit above the 10% threshold to be reallocated to market jurisdictions.[41] In this respect, treaties must be amended so as to allow market jurisdictions to exercise their new taxation rights on their share of the Amount A profit of the foreign MNE. Since only the estimated one hundred[42] MNEs are expected to be within the scope of Amount A, the rules of the OECD Model need particular revision. For all the other remaining companies around the world, the current legal and treaty landscape will remain unchanged under Pillar One.[43]

2.8 Objective of Pillar Two

The secondary purpose of the OECD/G20 project is to address remaining BEPS issues related to low-tax jurisdictions.[44] This is being addressed by Pillar Two which *inter alia* deals with:

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[39] Refer to "OECD's Global Anti-Base Erosion Model Rules (Pillar Two)" at https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

[40] Refer to "BEPS Project Public Consultation Document on Addressing the Tax Challenges of the Digitalisation of the Economy" at https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf, accessed on 4 November 2022.

[41] Refer to OECD's Press Release dated 8 October 2021 titled "International community strikes a ground-breaking tax deal for the digital age" at https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm, accessed on 4 November 2022.

[42] Refer to OECD's brochure (July 2021) "Addressing the tax challenges arising from the digitalisation of the economy" FAQ 1 on page 14, at https://www.oecd.org/tax/beps/brochure-addressing-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf, accessed on 4 November 2022.

[43] Refer to "Have the OECD and UN Models Served Their Purpose?" by Helmut Loukota at https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2021_11_o2_6.html. accessed on 4 November 2022.

[44] Refer to South Centre Tax Cooperation Policy Brief 22, 12 January 2022 by Kuldeep Sharma titled "Global Minimum Corporate Tax: Interaction of Income Inclusion Rule with Controlled Foreign Corporation and Tax-sparing Provisions" at https://www.southcentre.int/tax-cooperation-policy-brief-22-12-january-2022/, accessed on 4 November 2022.

- global minimum tax rate of 15 % in all countries with an intent to curb shifting of profits from higher tax jurisdiction to lower tax jurisdiction or tax havens;
- to discourage 'race to the bottom' i.e., competition among countries to charge lower corporate taxes to attract foreign investment; and
- to place a floor on tax competition between jurisdictions, ensuring the sustainability of corporate income tax (CIT) as a major source of government revenues, while leaving appropriate flexibility for countries to use CIT as a policy lever for supporting business investment and innovation.

2.9 Impact of Pillar One and Pillar Two

Pillar One will apply only to about one hundred multinational groups, making its scope relatively narrow. In contrast, Pillar Two which is based on common approach, will have far reaching consequences for virtually all countries, whether or not they decide to implement Pillar Two.[45]

[45] Refer to "The Ordering of Residence and Source Country Taxes and the OECD Pillar Two Global Minimum Tax" by Brian J. Arnold at https://research.ibfd.org/#/doc?url=/collections/bit/html/bit_2022_05_o2_1.html, accessed on 4 November 2022.

3. PE PROVISIONS UNDER GLOBE RULES

3.1 GloBE Rules – An Overview

Countries that choose to introduce the GloBE rules have agreed to do so in a consistent and coordinated way. The inter-locking nature of the GloBE Rules means that their adoption by a critical mass of jurisdictions will be sufficient to ensure that MNEs are required to pay the minimum level of tax on their profits arising in each jurisdiction where they operate. The GloBE Rules incorporate an agreed rule order together with backstop or secondary rules that apply if a country where an MNE is based does not apply the primary rule. For instance, if the country where the MNE is headquartered does not subject the ultimate parent entity (UPE) of the MNE group to the primary income inclusion rule (IIR), another parent entity in the group, further down in the ownership chain, must apply the IIR under the agreed rule order. If even this does not result in the income of the MNE Group being subject to tax at the 15% minimum tax rate, the further back stop of the undertaxed profits rule (UTPR) kicks in, which ensures the payment of the minimum tax through a denial of deduction or similar mechanism in all the countries where the MNE has a presence. The interlocking nature of these rules therefore ensures that top-up tax will be collected in jurisdictions that have introduced the GloBE rules even where the MNE operates in or through other jurisdictions that have not implemented the rules. While countries are not required to adopt the GloBE rules, jurisdictions that adopt the GloBE rules will apply an effective tax rate test using a common tax base and a common definition of covered taxes to determine whether an MNE is subject to an effective tax rate below the agreed minimum rate of 15% in any jurisdiction where it operates. Thus, the objective of Pillar Two is to help in creating a level playing field for all developed and developing countries and put a floor under tax competition.[46]

3.2 Definition of a PE under GloBE Rules

Definition of PE is provided in Article 10.1 of GloBE Rules[47] as below:

> Permanent Establishment means:
>
> (a) a place of business (including a deemed place of business) situated in a jurisdiction and treated as a permanent establishment in accordance with an applicable Tax Treaty in force provided that such jurisdiction taxes the income attributable to it in accordance with a provision similar to Article 7 of the OECD Model Tax Convention on Income and on Capital;
> (b) if there is no applicable Tax Treaty in force, a place of business (including a deemed place of business) in respect of which a jurisdiction taxes under its domestic law the income attributable to such place of business on a net basis similar to the manner in which it taxes its own tax residents;
> (c) if a jurisdiction has no corporate income tax system, a place of business (including a deemed place of business) situated in that jurisdiction that would be treated as a permanent establishment in accordance with the OECD Model Tax Convention on Income and on Capital provided that such jurisdiction would have had the right to tax the income attributable to it in accordance with Article 7 of that model; or
> (d) a place of business (or a deemed place of business) that is not already described in paragraphs (a) to (c) through which operations are conducted outside the

[46] Refer to FAQ No. 1 on "OECD's Model GloBE Rules" dated 20 December 2021" at https://www.oecd.org/tax/beps/pillar-two-model-GloBE-rules-faqs.pdf, accessed on 4 November 2022.
[47] Refer to "Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two)" at https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

jurisdiction where the Entity is located provided that such jurisdiction exempts the income attributable to such operations.

The definition of a PE stated above applies[48] for the purposes of GloBE Rules only and refers to cases where:

(a) a PE exists in accordance with a Tax Treaty. The phrase "deemed place of business" was included for situations in which the non-resident does not have a place of business but its activities in the source jurisdiction are deemed to be a PE under the terms of the Treaty, for example a dependent agent PE.[49] Determinations by domestic courts and competent authorities are taken into account while holding existence of a PE for purposes of the Tax Treaty;[50]
(b) a PE exists in accordance with domestic law in cases where there is no Tax Treaty in force between the residence and source jurisdictions.[51] Paragraph (b) requires that the source jurisdiction taxes the income attributable to a 'domestic PE' on a net basis similar to the manner in which it taxes its own tax residents. It does not require that the 'domestic PE' is taxed exactly the same as a tax resident, as long as it is taxed in a similar manner. For instance, a 'domestic PE' would be taxed in a similar manner as a tax resident in the source jurisdiction regardless that the deductibility of its expenses is subject to further limitations not applicable to resident taxpayers. Furthermore, the taxable income has to be attributable to the 'domestic PE', which means that activities have to be carried out through it in the source jurisdiction. Finally, this condition excludes from paragraph (b) any source taxation based on a gross basis (e.g., a withholding tax);[52]
(c) in cases where it would have existed if a jurisdiction without a CIT had a Tax Treaty with the jurisdiction of the Main Entity. This Paragraph requires a hypothetical analysis of whether a PE would have existed in the jurisdiction with no CIT system (referred in this paragraph as the 'source country'). The analysis proceeds as if the residence and source country had a treaty that replicates the last version of the OECD MTC. This means that it takes into account the version of the OECD MTC of the year in which this analysis is made;[53]
(d) paragraph (d) includes cases that are not covered in (a) to (c) above and creates a PE for purposes of the GloBE Rules in situations where the jurisdiction in which a Constituent Entity (CE) is located exempts the income attributable to the operations conducted outside such jurisdiction.[54] By excluding PEs already described in paragraphs (a) to (c), the definition avoids any overlap between PEs falling under this paragraph and the other types of PE listed in the paragraph above. Drawing a clear dividing line between 'stateless PEs' under paragraph (d) and those under paragraphs (a) – (c) is important for determining the location of the PE in accordance with Article 10.2. For example, A Co is located in jurisdiction A and conducts activities in jurisdiction B through a person that habitually concludes contracts in the name of A

[48] Refer to "Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)" at https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf, Chapter 10 (Definitions), paragraph 96.
[49] Refer to paragraph 98 of the Commentary on Definition of PE (paragraph (a)) provided in Article 10.1 of the GloBE Rules.
[50] Refer to paragraph 99 of the Commentary on Definition of PE (paragraph (a)) provided in Article 10.1 of the GloBE Rules.
[51] Refer to paragraph 103 of the Commentary on Definition of PE (paragraph (b)) provided in Article 10.1 of the GloBE Rules.
[52] Refer to paragraph 107 of the Commentary on Definition of PE (paragraph (b)) provided in Article 10.1 of the GloBE Rules.
[53] Refer to paragraph 110 of the Commentary on Definition of PE (paragraph (c)) provided in Article 10.1 of the GloBE Rules.
[54] Refer to paragraph 111 of the Commentary on Definition of PE (paragraph (d)) provided in Article 10.1 of the GloBE Rules.

Co. Jurisdiction B has adopted the definition of a PE of Article 5 of the OECD MTC into its domestic law and taxes the income attributable to it. Jurisdiction A exempts the income earned by A Co through a PE. Jurisdictions A and B do not have a Tax Treaty. In this case, paragraph (b) is triggered because jurisdiction B taxes the income attributable to a PE in accordance with its domestic law. Paragraph (d) is also triggered because jurisdiction A exempts the income attributable to the operations carried out through the PE. In this case, a PE exists in jurisdiction B for purposes of the GloBE Rules. If, however, jurisdiction B does not treat an agent that habitually concludes contracts in the name of its principal as giving rise to a PE under local law then paragraph (d) would apply, but the PE would be 'stateless' for the purposes of the GloBE Rules, meaning that the income of the PE would be subject to the GloBE Rules on a standalone basis without the ability to blend its income with other CEs located in jurisdiction B.[55]

3.3 PEs facilitate application of GloBE Rules

The GloBE Rules apply to CEs that are members of an MNE Group that has annual revenue of Euro 750 million or more in the Consolidated Financial Statements (CFS) of the UPE in at least two of the four Fiscal Years immediately preceding the tested Fiscal Year.[56] Formation of an MNE Group is, therefore, an essential requirement for GloBE Rules to apply. As per GloBE Rules, an MNE Group means any Group that includes at least one Entity or PE that is not located in the jurisdiction of the UPE.[57] A Group also means an Entity that is located in one jurisdiction and has one or more PEs located in other jurisdictions provided that the Entity is not a part of another Group.[58] Since, an entity and its foreign PE meet the definition of Group and MNE Group, it can be construed that PEs hold a significant position and facilitate application of GloBE Rules. However, a stateless[59] PE is excluded in determination[60] of a Group because such a PE is not recognised under the laws of any other jurisdiction. This narrow situation only occurs where a standalone entity has a PE as defined by paragraph (d) of the definition of PE in Article 10.1.

The significance of a PE in application of GloBE Rules is also evident in cases of demergers. As a general rule, the disposal of a single CE is not a demerger because after the disposal it would become a standalone Entity and not a Group. However, where the disposed of CE has a PE in another jurisdiction, then the standalone Entity and its PE are considered a Group in accordance with Article 1.2.3 and therefore, a new Group would exist for the purposes of Article 6.1.3.[61]

3.4 PE can be a CE and is independent of the Main Entity

Under the GloBE Rules, a CE is any PE of a Main Entity that is included in the Group. A PE that is a CE shall be treated as separate from the Main Entity and any other PE of that Main Entity.[62] This means, a company with two PEs would be treated as three separate CEs for the

[55] Refer to paragraph 112 of the Commentary on Definition of PE (paragraph (d)) provided in Article 10.1 of the GloBE Rules.
[56] Refer to Article 1.1.1 of GloBE Rules.
[57] Refer to Article 1.2.1 of GloBE Rules.
[58] Refer to Article 1.2.3 of GloBE Rules.
[59] A PE that is stateless for the purposes of GloBE Rules, means that the income of the PE would be subject to the GloBE Rules on a standalone basis without the ability to blend its income with other CEs located in that particular jurisdiction.
[60] Refer to paragraph 26 of the Commentary on Article 1.2.3 of GloBE Rules.
[61] Refer to paragraph 43 of the Commentary on Article 6.1.3 of GloBE Rules.
[62] Refer to Article 1.3 of GloBE Rules.

purposes of the GloBE rules.[63] In cases where the Group is a single entity with one or more foreign PEs, then the Main Entity is the UPE. This extended definition of UPE is necessary to ensure that a domestic entity that engages in cross-border operations through PEs is subject to the GloBE Rules.[64]

Requirement for independence[65] of foreign PE: The need to distinguish the separate business operations undertaken in the foreign PE is essential for the jurisdictional blending calculations under Chapter 5. It ensures that the income earned through PEs in another jurisdiction and the tax imposed on that income is not blended with the tax and income of the Main Entity or another PE in a different jurisdiction. Accordingly, it ensures parity in the treatment of foreign subsidiaries and PEs of the MNE Group.

PEs not treated as Parent Entities under the GloBE Rules: In order to avoid difficult factual determinations and disputes as to whether the Ownership Interests in Low-Taxed Constituent Entities (LTCEs) are held by the PE or the Main Entity, PEs are not treated as Parent Entities under the GloBE Rules. In this context, Ownership Interests in an LTCE that are held through a PE are treated, instead, as held by the Main Entity.[66]

Since a PE is treated as independent of the Main Entity, Number of Employees[67] for the purposes of the UTPR percentage that are attributed to the tax jurisdiction of a PE shall not be taken into account for the Number of Employees of the tax jurisdiction of the Main Entity. Similarly, Tangible Assets[68] for the purposes of the UTPR percentage and for Article 9.3 that are allocated to the tax jurisdiction of a PE shall not be taken into account for the Tangible Assets of the tax jurisdiction of the Main Entity.

Also, the PE is treated separately from the UPE (when the UPE happens to be a Flow-through entity) under Article 7.1.4. The GloBE Income or Loss of the PE is not included in the GloBE Income of the UPE for purposes of applying 7.1.1[69] to the UPE. The PE is treated separately from the UPE under Article 7.1.4 because it is a separate CE and its income does not flow-through to the UPE under Chapter 3 as does the income of a Tax Transparent Entity. However, to the extent that the conditions of Article 7.1.1 are met by a holder of an Ownership Interest in the UPE with respect to the income of the PE, the PE's GloBE Income is reduced pursuant to Article 7.1.4.[70]

3.5 Transactions between the Main Entity and a PE to be at arm's length[71]

Any transaction between CEs located in different jurisdictions that is not recorded in the same amount in the financial accounts of both CEs or that is not consistent with the ALP must be adjusted so as to be in the same amount and consistent with the ALP. Rules for allocating income or loss between a Main Entity and its PEs are found in Article 3.4. Thus, Article 3.2.3 requires transactions between Group Entities to be priced consistently with the ALP and recorded at the same price for GloBE purposes for all CEs that are parties to the transaction.

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[63] Refer to "The HMRC's OECD Pillar 2 Consultation on implementation" at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1045663/11Jan_2022_Pillar_2_Consultation_.pdf, accessed on 5 November 2022.
[64] Refer to paragraph 36 of the Commentary on Article 1.4.1 of GloBE Rules.
[65] Refer to paragraph 30 of the Commentary on Article 1.3.2 of GloBE Rules.
[66] Refer to paragraph 14 of the Commentary on Article 2.1.2 of GloBE Rules.
[67] Refer to definition of Number of Employees in Article 10.1 of the GloBE Rules.
[68] Refer to definition of Tangible Assets in Article 10.1 of the GloBE Rules.
[69] Article 7.1.1 permits the UPE to reduce its GloBE Income for a Fiscal Year in three situations.
[70] Refer to paragraph 33 of the Commentary on Article 7.1.4 of GloBE Rules.
[71] Refer to Article 3.2.3 of GloBE Rules.

3.6 Allocation of Income or Loss between a Main Entity and a PE

Allocation of income or loss between a Main Entity and a PE is governed by Article 3.4 of the GloBE Rules.

3.6.1 Concept[72] of a PE

A PE is a tax rather than an accounting concept. This means that financial accounting information may not always be separately maintained in respect of the PE. In many cases, however, separate accounts may be maintained either for management purposes or to comply with local tax rules. Given that the GloBE Rules primarily rely on accounting information rather than management accounts or local tax information, Article 3.4 ensures that the right amount of Financial Accounting Net Income or Loss is allocated between the PE and Main Entity. In making this allocation, the accounting treatment is followed as far as possible. This is subject, however, to the income and expense allocation rules under a Tax Treaty or domestic tax law.

3.6.2 Prominent features[73] of Article 3.4

The prominent features of Article 3.4 of the GloBE Rules governing allocation of income or loss between a Main Entity and a PE are as below:

a) Article 3.4 ensures that the right amount of Financial Accounting Net Income or Loss is allocated between the PE and Main Entity. In making this allocation, the accounting treatment is followed as far as possible. This is subject, however, to the income and expense allocation rules under a Tax Treaty or domestic tax law.
b) Provides that the Financial Accounting Net Income or Loss of a CE that is a PE in accordance with paragraphs (a), (b) and (c) of its definition in Article 10.1 is the net income or loss reflected in the separate financial accounts of the PE.
c) Where a PE maintains separate financial accounts, CEs that are PEs and subsidiaries are treated in the same way for the purposes of computing the Effective Tax Rate (ETR).
d) Provides that if the PE does not have separate financial accounts, then the Financial Accounting Net Income or Loss is the amount that would have been reflected in its separate financial accounts if prepared on a standalone basis and in accordance with the accounting standard used in the preparation of the CFS of the UPE.
e) Provides for adjustments in the amount and items of income and expenses that can be attributed to the PE for the purposes of determining its Financial Accounting Net Income or Loss under Article 3.4.1.
f) Provides that in the case of a PE as defined by paragraphs (a) and (b) of the definition in Article 10.1, to reflect only those amounts and items of income and expense that are attributable to the PE in accordance with the applicable Tax Treaty or domestic law of the jurisdiction where it is located regardless of the amount of income subject to tax and the amount of deductible expenses in that jurisdiction;
g) Provides that where a PE exists in accordance with paragraph (c) of its definition in Article 10.1, then the income or expenses for determining the Financial Accounting Net Income or Loss of the PE would be the amounts and items that would have been attributed in accordance with Article 7 of the OECD MTC, 2017.
h) Article 3.4.3 provides for attribution of income to a PE that arises under paragraph (d) of the PE definition in Article 10.1, when the Main Entity jurisdiction exempts such income from tax, which is attributable to activities occurring outside the

[72] Refer to paragraphs 186, 187 of the Commentary on Article 3.4 of GloBE Rules.
[73] Refer to *GloBE Rules Made Easy* by Kuldeep Sharma, published by Wolters Kluwer (ISBN 978-94-035-1156-6), Box 4.15.

jurisdiction. Article 3.4.3 attributes to the PE the income that the Main Entity jurisdiction exempts from tax and that is attributable to activities occurring outside the jurisdiction. Similarly, Article 3.4.3 allocates to the PE any expenses that are not taken into account in the jurisdiction of the Main Entity because they are attributable to activities occurring outside the jurisdiction.

i) The Financial Accounting Net Income or Loss of a PE is not taken into account in determining the GloBE Income or Loss of the Main Entity, except as provided in Article 3.4.5. Article 3.4.4 provides that the Financial Accounting Net Income or Loss of a PE as adjusted by Articles 3.4.2 and 3.4.3 should not be taken into account in determining the GloBE Income or Loss of the Main Entity. Thus, if the Financial Accounting Net Income or Loss of a PE is reflected in the financial accounts of a Main Entity, it must be subtracted from the Financial Accounting Net Income or Loss of the Main Entity. This Article is intended to prevent double counting or omission of Financial Accounting Net Income or Loss in the computation of the GloBE Income or Loss of the Main Entity and the PE.

j) Article 3.4.5 provides a rule relating to the allocation of losses of a PE to the Main Entity under certain conditions. Some jurisdictions include the income or loss of a PE in the computation of the domestic taxable income of its Main Entity (e.g., jurisdictions with a worldwide tax system with a foreign tax credit system). However, GloBE Rules calculate the ETR of the Main Entity without taking into account the GloBE Income or Loss of the PE. Absent a special rule, the ETR of the Main Entity may be understated in a Fiscal Year when a PE loss is taken into account for domestic tax purposes but not for GloBE Income or Loss purposes. Under Article 3.4.5 this domestic treatment can be preserved, with the necessary corresponding adjustments.

3.6.3 Income of a Flow-through Entity is first allocated to a PE under Article 3.5.1(a)

Paragraph (a) of Article 3.5.1 provides that if the business of the Flow-through Entity is partially or totally carried out through a PE, the Financial Accounting Net Income or Loss of the Flow-through Entity is attributed to that PE in accordance with Article 3.4. This rule ensures that the Financial Accounting Net Income or Loss of the PE is removed from the Financial Accounting Net Income or Loss of the Flow-through Entity where it is included. This is necessary to avoid double-counting under the GloBE Rules.

3.7 Allocation of Covered Taxes from Main Entity or another CE to a PE

The Tax allocation provisions follow the same pattern as the Income allocation provisions between a CE or a Tax Transparent Entity and a PE.

Paragraph (a) of Article 4.3.2 allocates Covered Taxes from a CE to a PE. The rule applies to Covered Taxes incurred by a Main Entity or another CE in respect of the income of a PE. The Covered Taxes are excluded from the Adjusted Covered Taxes of the CE that incurred them and are included in the Adjusted Covered Taxes of the PE. The Covered Taxes arising in the Main Entity in respect of the PE income can be computed using a three-step[74] process.

Paragraph (b) of Article 4.3.2 provides that Tax borne by a Tax Transparent Entity that is attributable to a PE, is first allocated to the PE, whereas, Tax borne by a Tax Transparent Entity that is not attributable to a PE, is then allocated to Constituent Entity-owners.

Article 4.3.4 ensures that in cases where the GloBE Income of a PE is treated as GloBE Income of the Main Entity pursuant to Article 3.4.5, any Adjusted Covered Taxes associated

[74] Refer to paragraphs 47-49 of the commentary on Article 4.3.2(a) of GloBE Rules.

with such income are treated as Adjusted Covered Taxes of the Main Entity, in an amount not exceeding such income multiplied by the highest corporate tax rate[75] on ordinary income in the jurisdiction. The situation to apply Article 4.3.4 arises after a loss of a PE has been treated as a loss of a Main Entity under Article 3.4.5. In most cases, there will not be taxes in the location of the PE, either because the jurisdiction allows the PE to carry-forward its loss or, more rarely, because the PE is not subject to tax in the jurisdiction. It may, however, be noted[76] that when a GloBE Loss of a PE is treated as an expense of a Main Entity under Article 3.4.5, any deferred tax asset established with respect to a tax loss of the PE jurisdiction shall not reduce the Adjusted Covered Taxes of the PE jurisdiction or the Main Entity jurisdiction. Conversely, when the deferred tax asset established by the PE reverses in the PE jurisdiction, the Adjusted Covered Taxes of the PE jurisdiction or Main Entity jurisdiction shall not be increased. Deferred tax attributes generated or used in the Main Entity jurisdiction with respect to a loss of the PE are available for use and remain subject to the other provisions of Chapter 4.

3.8 Location of a PE

Location of an Entity and a PE[77] is an important criterion in the determination of ETR, which is important for jurisdictional blending and for determining where the Top-up Tax has to be paid. The location of a PE is determined as follows:

(a) if it is described in paragraph (a) of the definition in Article 10.1, the PE is located in the jurisdiction where it is treated as a PE and is taxed under the applicable Tax Treaty in force. This paragraph of the PE definition refers to a PE that is subject to tax on its net income in the source jurisdiction in accordance with a Tax Treaty in force between the source and residence jurisdiction. In this case, the GloBE Rules apply the outcome provided for under the Tax Treaty and the PE is treated as located in the source jurisdiction.[78]

(b) if it is described in paragraph (b) of the definition in Article 10.1, the PE is located in the jurisdiction where it is subject to net basis taxation based on its business presence. This paragraph of the PE definition refers to a PE that is subject to tax on its net income in the source jurisdiction but there is no Tax Treaty in force between the source and residence jurisdiction. In this situation, the PE is located in the source jurisdiction.[79]

(c) if it is described in paragraph (c) of the definition in Article 10.1, the PE is located in the jurisdiction where it is situated. This paragraph of the PE definition refers to a PE that is not subject to tax on its net income in the source jurisdiction because the jurisdiction has no CIT system. In such cases, Article 10.1 provides that a PE is deemed to exist for purposes of the GloBE Rules if the source jurisdiction would have treated it as a PE in accordance with the OECD MTC and had the right to tax the income attributable to it in accordance with Article 7. In this case, it would be located in the jurisdiction that does not have a CIT.[80]

(d) if it is described in paragraph (d) of the definition in Article 10.1, the PE is considered as a stateless PE. Paragraph (d) of the PE definition deems a PE to be established for purposes of the GloBE Rules where the law of the residence jurisdiction exempts the income from a resident's operations (or a portion of its

[75] The highest corporate tax rate on ordinary income means the full marginal rate which a jurisdiction generally applies to categories of income which do not benefit from any exemption, exclusion, credit or other tax relief applicable to particular types of payments.
[76] Refer to paragraph 66 of the Commentary on Article 4.3.4 of GloBE Rules.
[77] Refer to Article 10.3.3 of the GloBE Rules.
[78] Refer to paragraph 191 of the Commentary on Article 10.3.3 of GloBE Rules.
[79] Refer to paragraph 192 of the Commentary on Article 10.3.3 of GloBE Rules.
[80] Refer to paragraph 193 of the Commentary on Article 10.3.3 of GloBE Rules.

operations) on the grounds that they are conducted outside of the residence jurisdiction. Where a PE arises under paragraph (d) of the PE definition Article 10.3.3(d) provides that such deemed PEs are stateless.[81] Each stateless CE shall be treated as a single CE located in a separate jurisdiction.[82]

3.9 Substance-based Income Exclusion in respect of a PE[83]

Article 5.3.6 provides rules applicable to the computation of the amount of Eligible Payroll Costs and Eligible Tangible Assets of a PE that is a CE. This provision states that the Eligible Payroll Costs and the Eligible Tangible Assets of the PE are those included in its separate financial accounts.[84] This provision follows the same mechanics as Articles 3.4.1 and 3.4.2. The Eligible Payroll Costs and Eligible Tangible Assets are those included in the financial accounts of the PE provided that such accounts are prepared in accordance with an Acceptable Financial Accounting Standard. If the PE does not have separate financial accounts or they are not prepared in accordance with an Acceptable Financial Accounting Standard, the amount of such Eligible Payroll Costs and Eligible Tangible Assets shall be computed as if a PE had separate financial accounts prepared in accordance with the accounting standard used in preparation of the CFS of the UPE.[85] Where the employees and assets attributed to the PE are not located in the jurisdiction in which it is located, the costs of such employees and assets are excluded from the computation of the Substance-based Income Exclusion.[86] No attribution of Eligible Payroll Costs and Eligible Tangible Assets is done to stateless PEs.[87]

3.10 Applicability of rules when PEs meet the definition of a Minority-Owned CE[88]

The computation of the ETR and Top-up Tax for a jurisdiction in accordance with Chapters 3 to 7, and Article 8.2 with respect to members of a Minority-Owned Subgroup[89] shall apply as if they were a separate MNE Group. The Adjusted Covered Taxes and GloBE Income or Loss of members of a Minority-Owned Subgroup are excluded from the determination of the remainder of the MNE Group's ETR in Article 5.1.1 and Net GloBE Income in Article 5.1.2.

Special rules in Article 5.6 are needed for Minority–Owned CEs because a UPE may have several Minority-Owned CEs with operations in the same jurisdiction but with different groups of owners that are not Group Entities. If the income and taxes of these different CEs were blended in the jurisdictional ETR computations, low-tax outcomes in one Entity could result in a Top-up Tax for the jurisdiction, some of which would be borne by non-Group Entity owners of a different CE. While this can occur to some extent under the normal jurisdictional blending rules, the magnitude of the effect in the context of Minority-Owned CEs and the potential detrimental impact on these investment structures justifies a different rule.[90]

The special rules in Article 5.6 can also apply to PEs if the Main Entity and the PE meet the definition of a Minority-Owned CE.[91]

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[81] Refer to paragraph 194 of the Commentary on Article 10.3.3 of GloBE Rules.
[82] Refer to Article 5.1.1 of the GloBE Rules.
[83] Refer to Article 5.3.6 of the GloBE Rules.
[84] Refer to paragraph 53 of the Commentary on Article 5.3.6 of GloBE Rules.
[85] Refer to paragraph 54 of the Commentary on Article 5.3.6 of GloBE Rules.
[86] Refer to paragraph 56 of the Commentary on Article 5.3.6 of GloBE Rules.
[87] Refer to paragraph 57 of the Commentary on Article 5.3.6 of GloBE Rules.
[88] Minority-Owned CE means a CE where the UPE has a direct or indirect Ownership Interest in that Entity of 30% or less.
[89] Minority-Owned Subgroup means a Minority-Owned Parent Entity and its Minority-Owned Subsidiaries.
[90] Refer to paragraph 97 of the Commentary on Article 5.6 of GloBE Rules.
[91] Refer to paragraph 98 of the Commentary on Article 5.6 of GloBE Rules.

3.11 Filing of GloBE Information Return by PEs

Providing information to tax administrations on the tax calculations made by the MNE Group under the GloBE rules is a significant part of compliance procedure. This is achieved through filing of a GloBE Information Return which shall enable tax administrations to analyse the return information, assess risk areas, audit taxpayers and collect Top-up Tax that is brought into charge under the GloBE Rules in their jurisdiction.

PEs are CEs, therefore, are required to file a GloBE Information Return in the jurisdiction where they are located.[92]

[92] Refer to paragraph 6 of the Commentary on Article 8.1.1 of GloBE Rules.

4. NEW FACETS IN RELATION TO PES INTRODUCED BY GLOBE RULES

4.1 Scope of PEs widened

The extant provisions in the MTC applicable to PEs which are present and duly incorporated in the GloBE Rules are as below:

i. a place of business (including a deemed place of business) situated in a jurisdiction in accordance with an applicable tax treaty in force shall be treated as a PE;[93]

In addition, a striking and differentiating feature in the GloBE Rules is that it is expressly stated that PE provisions shall apply even if:

a) *there is no treaty*: Those provisions shall apply which the source state has incorporated for a PE in its domestic law.[94]
b) *there is no CIT in the source state*: Despite no CIT in the source state, if there is a place of business or a deemed place of business in such jurisdiction, it would be treated as a PE in accordance with the OECD MTC.[95]
   - It implies that while applying this provision, UN Model DTC cannot be invoked.
   - It is seen that out of the 141[96] IF member jurisdictions, at present, there is no CIT[97] regime in eight[98] jurisdictions, namely, Anguilla, Bahamas, Bahrain,[99] Bermuda, British Virgin Islands, Cayman Islands, Turks and Caicos Islands and the United Arab Emirates.[100]
c) *the PE is treated as stateless:* This means that where the jurisdiction of residence exempts the income generated by the PE through foreign operations (applies to jurisdictions that follow territorial system of taxation), the income of the PE would be subject to the GloBE Rules on a standalone basis without the ability to blend its income with other CEs located in that jurisdiction.[101]
   - The above provision brought in by the GloBE Rules applies to 'business' income arising from operations in the other jurisdiction and may be viewed as an extension of Article 10 of the MLI which addresses BEPS arising from operations that are 'other than business' in nature. It may be recalled[102] that Article 10 of the MLI was brought in to address potential abuses that, firstly, result from the transfer of shares, debt-claims, rights or property to PEs set up solely for that purpose in countries that offer preferential treatment to the income from such assets and secondly, from an artificial transfer of residence by an entity to a State that has a favourable tax treaty in force with the source State, but, retains a PE in the third State to which the income generating assets

[93] Refer to paragraphs 97, 98 of the Commentary on definition of PE under Chapter 10 of GloBE Rules.
[94] Refer to paragraph 103 of the Commentary on definition of PE under Chapter 10 of GloBE Rules.
[95] Refer to paragraph 110 of the Commentary on definition of PE under Chapter 10 of GloBE Rules.
[96] Refer to "Members of the OECD/G20 Inclusive Framework on BEPS", Updated: November 2021 at https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf, accessed on 8 November 2022.
[97] Refer to "IBFD" at https://research.ibfd.org/#/search?N=3+10+4293744764&Ne=7487&Nu=global_rollup_key&Np=2&Ns=sort_country_one|0||subcategory|0||sort_jurisdiction|0||sort_state_province|0, accessed on 8 November 2022.
[98] Information not available in respect of Côte d'Ivoire, Faroe Islands.
[99] In Bahrain, only income tax is levied on oil companies and is governed by Amiri Decree 22/1979.
[100] On 26 July 2021, the Ministry of Finance of the UAE issued an official statement confirming the UAE's support of the global minimum effective tax rate as proposed under "Pillar Two" and has proposed a headline corporate tax rate of 9% for taxable income exceeding AED 375,000 effective for financial years starting on or after 1 June 2023.
[101] Refer to paragraph 112 of the Commentary on definition of PE under Chapter 10 of GloBE Rules.
[102] Refer to *MLI Made Easy* by Kuldeep Sharma, published by Wolters Kluwer (ISBN 978-94-035-3260-8), paragraph 280.

> are attributable. Thus, in such cases where the State of residence exempts, or taxes at low rates, profits of such PEs situated in third states, the State of source as per Article 10 of the MLI, shall not grant treaty benefits with respect to that income.

The widening of the scope of PEs under the GloBE Rules allows taxation in the state of residence if such income is not taxed in the source state. These newly-introduced facets enable application of the GloBE Rules in specific situations which would otherwise have remained outside the ambit of taxation. Also, since GloBE Rules apply common approach, the above differentiating PE features are essential so as to allow application of GloBE Rules when there is no tax treaty or a source state does not have CIT regime or the ETR attributable to a so-called PE function in that state is less than the minimum tax rate of 15%.

The widening of the scope of PEs under the GloBE Rules is tantamount to exceeding the extant provisions in domestic law in relation to PEs. Generally, provisions of tax treaty or domestic law shall apply to the extent they are more beneficial to a taxpayer. Accordingly, to enable applicability of the broader scope of PE rules under the GloBE, tax administrations would need to amend their domestic laws and align them with the GloBE Rules as far as PE provisions are concerned. Also, when domestic law in relation to scope of PEs shall stand widened, on case-by-case basis, for the purposes of invoking clause (c) of definition of PE in Article 10.1 of GloBE Rules (i.e., when there is no CIT in the source state), the treaty provisions would also need to be suitably modified, otherwise taxation in state of residence may not arise since provisions of tax treaty or domestic law to the extent they are more beneficial to a taxpayer are to apply. For implementation of clause (c), even though it is only assumed[103] that there is a treaty between the residence and source country that replicates the OECD MTC, however, due consideration for treaty modification may be required if a tax treaty actually exists. As an illustration, let us consider a case where an MNE resident of Austria has a place of business in Bahrain. Since, Bahrain does not have CIT, for clause (c) of definition of PE in Article 10.1 of GloBE Rules to apply in Austria as per domestic law (assuming the broader scope of PE is incorporated in domestic law of Austria), similar provision must be incorporated in the extant Austria-Bahrain tax treaty as well.

4.2 Applicability of Article 7 of OECD MTC, 2017 or UN Model DTC 2017 essential

In accordance with the extant provisions of the MTC, Article 7 would apply in the source state and enable taxation of business profits only when such profits are attributable to a PE in that state.[104] As per definition of PE provided in Article 10.1 of GloBE Rules, paragraph (a) requires that the source jurisdiction taxes the income attributable to the PE in accordance with a provision similar to Article 7 of the OECD MTC. In case, Article 7 does not apply, a PE does not exist for purposes of the GloBE Rules in accordance with paragraph (a) regardless that it meets the definition of a PE of the treaty.[105]

The phrase “a provision similar to Article 7 of the OECD Model Tax Convention” as per paragraph (a) of definition of PE provided in Article 10.1 of GloBE Rules, ensures that the source country taxes the income as income attributable to a PE without requiring the relevant provisions of the Tax Treaty to replicate the language or outcomes under Article 7 of the OECD MTC 2017. This implies that source country will be able to tax the income attributable to a PE even if Article 7 in the Tax Treaty is as per the UN Model DTC 2017.[106]

[103] Refer to paragraph 110 of the Commentary on definition of PE under Chapter 10 of GloBE Rules.
[104] Refer to “The Ordering of Residence and Source Country Taxes and the OECD Pillar Two Global Minimum Tax” by Brian J. Arnold at https://research.ibfd.org/ - /doc?url=/collections/bit/html/bit_2022_05_o2_1.html, accessed on 8 November 2022.
[105] Refer to paragraph 101 of the Commentary on definition of PE under Chapter 10 of GloBE Rules.
[106] Refer to paragraph 102 of the Commentary on definition of PE under Chapter 10 of GloBE Rules.

In view of the foregoing discussions, it is observed that in applying the definition of a PE provided in paragraph (a) of Article 10.1 of GloBE Rules, a tax treaty that is based on either OECD MTC, 2017 or UN Model DTC 2017 may apply, whereas, in applying definition of a PE provided in paragraph (c) of Article 10.1 of GloBE Rules, tax treaty based on the last version of the OECD MTC only shall apply and the one based on UN Model DTC may not apply, as discussed and inferred *supra*. This disparity may result in unintended outcomes during the implementation process, as evident from Illustration # 1 below.

Illustration # 1: Explains incongruent outcomes while applying PE's definition provided in Article 10.1 (paragraphs (a) and (c) thereof)

Let us assume that a Company A, UPE of an MNE Group, is located in Jurisdiction A and provides consultancy services worldwide through employees or other personnel engaged by it. These services are provided in Jurisdiction B, which is a low-tax jurisdiction where CIT is Nil, for a period aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned. It is also assumed that the tax treaty between Jurisdictions A and B is based on the UN Model DTC 2017 and has Service PE provisions. Accordingly, Company A will have a PE in Jurisdiction B as per paragraph (a) of Article 10.1 of GloBE Rules and therefore, IIR can be levied in Jurisdiction A, as ETR of Company A's PE in Jurisdiction B is below 15%.

Also, assume that Company A provides consultancy services in Jurisdiction C, which does not have CIT regime, for a period aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned. However, while applying the definition of a PE in Jurisdiction C as provided in paragraph (c) of Article 10.1 of GloBE Rules, PE provisions may not apply as there are no Service PE provisions as per the OECD MTC 2017. Hence, no IIR can be levied in Jurisdiction A in respect of consultancy services provided by Company A in Jurisdiction C.

The illustration demonstrates that for identical set of activities rendered by Company A in Jurisdiction B and C respectively, IIR on the UPE may or may not be levied in Jurisdiction A, i.e., GloBE Rules are not consistently applicable.

4.3 Remedial Provision Recommended

In view of the disparate results, highlighted in illustration # 1 above, it is essential that a remedial provision be introduced while applying the definition of a PE as provided in paragraph (c) of Article 10.1 of GloBE Rules, specifying that, a place of business would be treated as a permanent establishment in accordance with "a provision similar to" Article 7 of the OECD Model Taxation. With the insertion of phrase "a provision similar to" in the definition of a PE as provided in paragraph (c) of Article 10.1 of GloBE Rules, there will be parity with the phrase "a provision similar to Article 7 of the OECD Model Tax Convention" as per paragraph (a) of definition of PE provided in Article 10.1 of GloBE Rules, thereby ensuring that the source country will be able to tax the income attributable to a PE even if Article 7 in the Tax Treaty is as per the UN Model DTC 2017. With this remedial provision, there would be consistency in applicability of GloBE Rules.

It may be noted that the OECD MTC allocates taxing rights but does not actually impose any taxation, therefore, there could be scenarios where a PE in the general sense may not meet the definition of a PE for GloBE purposes. This could create complexity when considering where the profits and taxes are allocated which, in turn, has the potential of impacting ETRs.[107]

[107] Refer to "International - Pillar Two – What Actions Should Banks Be Taking Now? 18 August 2022" by Aamer Rafiq, Graham Robinson, Shezad Aleem and Jeremy Talbot at https://research.ibfd.org/#/doc?url=/collections/dfi/html/dfi_2022_02_int_1.html, accessed on 8 November 2022.

5. Conclusion

Formation of an MNE Group is an essential requirement for GloBE Rules to apply. Since an entity and its foreign PE meet the definition of Group and MNE Group, it can be construed that PEs hold a significant position and facilitate application of GloBE Rules. The significance of a PE in application of GloBE Rules is also evident in cases of demergers.

A PE that is a CE shall be treated as separate from the Main Entity and any other PE of that Main Entity. In cases where the Group is a single entity with one or more foreign PEs, then the Main Entity is the UPE. This extended definition of UPE is necessary to ensure that a domestic entity that engages in cross-border operations through PEs is subject to the GloBE Rules. The need to distinguish the separate business operations undertaken in the foreign PE is essential for the jurisdictional blending calculations under Chapter 5. It ensures that the income earned through PEs in another jurisdiction and the tax imposed on that income is not blended with the tax and income of the Main Entity or another PE in a different jurisdiction. In order to avoid difficult factual determinations and disputes as to whether the Ownership Interests in LTCEs are held by the PE or the Main Entity, PEs are not treated as Parent Entities under the GloBE Rules. In this context, Ownership Interests in an LTCE that are held through a PE are treated, instead, as held by the Main Entity.

A PE is a tax rather than an accounting concept. This means that financial accounting information may not always be separately maintained in respect of the PE. In many cases, separate accounts may be maintained either for management purposes or to comply with local tax rules. Given that the GloBE Rules primarily rely on accounting information rather than management accounts or local tax information, Article 3.4 ensures that the right amount of Financial Accounting Net Income or Loss is allocated between the PE and Main Entity.

The widening of the scope of PEs under the GloBE Rules allows taxation in the resident state if such income is not taxed in the source state. Also, since GloBE Rules apply common approach, the differentiating PE features introduced by the GloBE are essential to allow application of GloBE Rules when there is no tax treaty or a source state does not have CIT regime or the ETR attributable to a so-called PE function in that state is less than the minimum tax rate of 15%. In order to enable applicability of the broader scope of PE rules under the GloBE, tax administrations would need to amend their domestic laws and align them with the GloBE Rules.

The OECD's IF is drafting the provisions of Amount A in a manner that results in consistency with GloBE Rules.[108] Likewise, acceptance of "deemed PE" for GloBE rules should be extended to Amount A as well. By doing so, a tax nexus would be provided in source jurisdictions, which will allow profits attributable to MNEs in a digitalized economy (without physical presence) getting taxed under domestic rules of these source (market) jurisdictions. This would have been a much simpler solution and would have eliminated the complexity of Amount A rules to a large extent, as we see today.

As part of the GloBE Implementation Framework, the OECD is expected to undertake certain steps, *inter alia,* involving rendering Administrative Guidance (under Article 8.3), which will be released and made publicly available, to facilitate transparent, consistent, coordinated, uniform and efficacious implementation of the GloBE Rules by tax administrations and MNE Groups respectively. Recognizing that there is significant variation in how countries impose tax on PEs (including variation in the treatment of losses and foreign tax credits), the GloBE Implementation Framework is expected to work on the development of a common

[108] Refer to Footnotes 15, 16 of *Progress Report on Amount A of Pillar One, Public consultation, 11 July – 19 August 2022" at https://www.oecd.org/tax/beps/progress-report-on-amount-a-of-pillar-one-july-2022.pdf.

methodology to determine the amount of Covered Taxes allocated from a CE to a PE in connection with specific country regimes.[109]

[109] Refer to paragraph 54 of the Commentary on Article 4.3.2(a) of GloBE Rules.

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