The OECD continues its work towards overhauling the international tax system, its main areas of focus being:

- a fundamentally new approach to the allocation of taxing rights with respect to business profits in the digital age (Pillar 1)
- global minimum taxation (Pillar 2)

The Inclusive Framework released a package consisting of the Report on the Pillar One Blueprint and the Report on the Pillar Two Blueprint for public consultation. The reports reflect the convergent views on many of the key policy features, principles, and parameters of both Pillars.

The members of the G20/OECD Inclusive Framework recognised the reports as a solid foundation for building a new approach to taxing profits in the digital economy and a solid basis for a systemic solution that would address the remaining base erosion and profit shifting.

According to the conservative estimates of experts, the total global effect from the implementation of these initiatives will amount to USD 60–100 billion of additional corporate income tax revenues per year.

Many questions still remain open, but it is already clear that the changes may affect both international companies operating in Russia and foreign operations of Russian companies. Read on for a detailed review of each Pillar.

Pillar 1.

The key elements of Pillar One can be grouped into two components: a new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group level (Amount A) and a fixed return for certain baseline routine marketing and distribution activities (Amount B).

Pillar 1. Amount A

In this respect, the document came as a response to the changed business environment.

In this digital age, businesses across all sectors are able to design and build their operating models around technological capabilities to improve flexibility and efficiency and reach out to the global markets. Previously, to enter a distribution market, companies needed to register their presence in the respective country, i.e. to set up a subsidiary or a permanent establishment.

Now one can sell goods and services from anywhere in the world without paying any taxes in the country where users/consumers are located.

As a result, today’s economic environment has simply outgrown the traditional approaches to international taxation. Recognising the importance of the problem, the OECD started working on a conceptually new approach to taxation of multinational enterprise groups.

The documents published by the OECD include about 500 pages’ worth of details of the proposed tax regimes. They are not easy to take in at a glance, so we will start with the core changes and will go into more detail in the last section.

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Having started with the digital business, the concept was further extended to MNEs selling consumer products/services and having nexus in their distribution markets.

So what is Pillar 1 all about?
A portion of the MNE’s residual profit should be taxed in the jurisdiction where customer or user is located.

Such “residual” profit will be defined as the excess of an MNE’s profitability (based on consolidated financial statements with certain adjustments) over an internationally agreed threshold.

In-scope companies
The new rules will primarily apply to highly digitalised businesses (social networks, online advertising, Internet intermediaries, search engines, etc.), but will also cover MNE groups that sell consumer products and services.
Pillar 1 covers big businesses only, i.e. companies with a global revenue of at least EUR 750 million (the threshold can be even higher at early stages).

There will be another threshold for the amount of "foreign" income earned outside the location of the ultimate parent company.

When is a market jurisdiction entitled to tax a portion of the MNE’s profits?
MNEs will pay tax in a particular jurisdiction only when the amount of revenue received from users/consumers in that jurisdiction exceeds a certain threshold.

Perhaps this is where the biggest technical difficulty lies – MNEs will need to estimate their revenues received from users/consumers for each distribution market.

To enable this, the document provides for a hierarchy of revenue sourcing indicators.

Simply put, in terms of digital services, revenue will be determined with reference to the location of users (according to their profile/geolocation data or IP-address), and in terms of sale of consumer products/services – to the end customer’s location (retail store or delivery address).

How will the tax be paid?
The new rules assume that after determining the jurisdictions where tax obligations arise, MNEs will select the companies that will be responsible for paying the tax.

This choice will be based on two principles: profit generation and nexus in the jurisdiction in which the tax is to be paid.

Report filing and communicating with the tax authorities will generally remain at the parent company’s level.

What’s the deal with double taxation?
The new rules are not about creating additional tax liabilities; rather, they are aimed at distributing tax payments among market jurisdictions in a fairer way.

The new rules will inevitably lead to double taxation: taxes will be paid at the level of MNE group companies, as well as in the distribution markets (regardless of physical nexus).

The double taxation issue may be addressed using two methods:
• the exemption method, i.e. exempting a portion of profit allocated to other jurisdictions from tax in the country of residence
• the credit method: the tax paid in other jurisdictions is credited against tax liabilities in the country of residence.

The members of the Inclusive Framework stress the importance of tax certainty and the need for the improved dispute prevention and resolution tools; however, there is no political consensus on the initiative yet.

From the fair taxation principle perspective, the concept appears reasonable, yet hard to implement:
• the whole concept is based on fixed values, including the level of profitability for determining the residual profit, as well as the percentage of the residual profit to be allocated; however, it is quite clear that reaching agreements between the member states will be a challenge;
• it will not always be clear how in-scope and out-of-scope activities for Pillar 1 purposes will be classified
• compliance procedures are rather complex and will create additional difficulties, especially calculating the portion of profit attributable to the market jurisdiction – this may require the use of additional technical means to track the place of supply of digital services for the required data segmentation.

The international community today lacks strong confidence that Pillar 1 will be finalised and implemented, so there is Plan B – a digital tax lobbied by the European Union.

Many countries (e.g. UK, France, Spain) decided not to wait until the unified approach has been finalised and opted for the digital tax.

Despite its obvious faults (primarily – double taxation issues), the digital tax is much easier to administer and its effect on tax budgets is way more visible.

The instrument proposed as part of Pillar 1 is in many ways aimed at preventing the unilateral measures, which, as the OECD reasonably points out, may trigger trade wars.

Pillar 1. Amount B
These rules are much simpler and aim to standardise the remuneration of related party distributors that perform “baseline marketing and distribution activities.”

In particular, the proposal calls for using a fixed return to determine the remuneration of such distributors.

The rule to become mandatory for all businesses regardless of the industry and size.

Pillar 2
In the modern economy, MNEs structure their global footprint across a vast number of jurisdictions, which is not always driven solely by business goals.

Often, the establishment of subsidiaries in low-tax jurisdictions and their participation in intragroup transactions (financing, intragroup services, licensing agreements) is dictated by tax considerations.

The existing mechanisms for combating tax evasion (the concept of beneficial income ownership, taxation of CFC profits) do not always allow fully replenish such artificially created tax savings.

In this regard, the OECD offers a conceptually new instrument – Pillar 2 – which would ensure that all large internationally operating businesses pay at least a minimum level of tax.

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Pillar 2 Blueprint includes two elements:  
the Income Inclusion Rule (IIR), supplemented by the Undertaxed Payments Rule (UTPR).

The rule will trigger additional “top-up tax” payable in case the profits of group companies in any one country are taxed at an effective tax rate below an internationally agreed minimum tax rate.

Additional tax will generally be payable by the ultimate parent company.

In general, the mechanism is somewhat similar to the CFC tax rules.

Subject To Tax Rule (STTR)

This rule applies to withholding tax on selected intra-group payments.

Where interest, royalties or service payments to related parties are subject to no or low tax in the receiving jurisdiction, the source jurisdiction will apply WHT to bring the total tax up to the agreed minimum rate.

The STTR applies in priority to the IIR.

Impact on the Russian business

It would not be an overstatement to say that the OECD’s initiatives could revolutionise international taxation.

Despite the fact that the published documents have not yet been finally agreed upon, it is already safe to say that if they are adopted, the effect on the MNEs will be significant.

The Russian tax authorities have not yet commented on the blueprints published by the OECD.

At the same time, it is clear that all potential stakeholders in Russia are closely monitoring the status of the initiatives and are assessing their possible effects on the Russian economy.

Below we will try to consider in greater detail the impact that the changes may have on Russian businesses.

Subject to Tax Rule (STTR)

To reiterate, the mechanism is quite simple.

Most of Russia’s tax treaties provide for a WHT exemption for interest, royalties, and other types of passive income.

Intragroup service fees are generally treated as active income (if not reclassified into passive income) and are not subject to WHT, either.

At the same time, historically, many payments have been structured through jurisdictions where income received from a Russian company is tax-exempt or taxed at reduced rates.

In other words, no double taxation arises.

Under the new rules, in such situation the OECD would provide source jurisdiction with a right to withhold additional tax on intragroup payments in case they are taxed in a receiving jurisdiction at a rate below the agreed minimum rate.

Apparently, the implementation of the mechanism will entail the increase of tax withheld on Russian-sourced income.

The proposed changes will also affect remunerations for intra-group services.

Now the tax authorities have to go the hard way – prove that the services were not provided and reclassify the respective service fees into different types of taxable income (usually, dividends).

If the changes proposed by the OECD are adopted, charging WHT will be much easier.

It must be noted that Russia has already initiated a similar mechanism by revising tax treaties with “transit” jurisdictions (such as Cyprus, Malta, and Luxembourg).

Other countries, including the Netherlands and Cyprus, have also shown interest in the issue and are now contemplating the imposition of WHT on income payable to EU-blacklisted jurisdictions.

Income Inclusion Rule (IIR)

As discussed above, the rule would subject foreign income and controlled entities to the agreed minimum tax in the parent jurisdiction.

The purpose is quite clear: to ensure that MNEs pay at least a minimum tax.

IIR is harder to administer and implement in practice than STTR.

In respect of Russia, IIR may primarily influence Russian groups that use their foreign operations to minimise tax.

Firstly, there will likely be additional tax liabilities at the ultimate parent company’s level.

Secondly, companies will have to implement compliance procedures to calculate the effective tax rate and discharge their tax liabilities.

Pillar 1. Amount A

The new rules will require reallocation of residual profit among all jurisdictions MNEs have nexus in.

The changes will apply to digital businesses and the MNEs selling consumer products/services.

Perhaps, of all the OECD’s initiatives, this one is the most difficult in terms of execution and will require significant internal compliance expenses.

Which Russian taxpayers may fall under the new rules?

For purely Russian holdings, the impact may not be that tangible.

Naturally, the new rules will apply to Russian digital companies – given the revenue threshold of EUR 750 million, to the largest ones.

They will certainly have to put in place internal controls to determine the countries in which users are located as well as compliance procedures to calculate tax liabilities under the new rules.

Russian companies from the consumer products segment with no foreign shareholding will hardly be affected, since most of them are domestically focused.
Domestic companies from the minerals and energy sector (Russia’s biggest exporters) are out of scope of the new rules, although not without exceptions, since some of their products can also be intended for individual consumption.

For example, mineral fertilisers are generally out of scope; at the same time, if fertilisers are packed up in individual packages and are intended for household use, their producers/sellers may be covered by Pillar 1.

The effect on Russian subsidiaries of MNE groups will most likely be limited to the preparation of reports for the parent company, since most of compliance procedures will be carried out abroad.

**Pillar 1. Amount B**

The rules provide for fixed remuneration for “baseline” routine marketing and distribution activities.

If introduced, they will undoubtedly impact Russian groups that sell their products to foreign markets through traders, as well as routine distributors being subsidiaries of international holdings operating in Russia.

Thus, all prominent transfer pricing cases revolved around transactions via traders (RIF Trade House, Togliattiazot, Uralkali, Dulisma Oil Company).

In this respect, agreeing upon fixed remuneration will significantly narrow down the potential dispute areas.

For MNE group companies, the effect may be ambiguous. Using a fixed distributor remuneration will prevent them from reporting operating losses for their subsidiaries.

This, in turn, may require adjustment of transfer prices in controlled transactions via available dispute resolution mechanisms.

**Further steps**

The OECD released the documents for public consultation. Comments were accepted until 14 December 2020 (with the total submissions exceeding 3,000 pages); public hearings will take place in January 2021.

The OECD hopes to finalise the concept by mid-2021.

Even if approved, the concept will require the development of a large number of documents (a model convention, multilateral instruments, etc.).

Realistically, unless there are any additional delays, the new provisions will not enter into force until 2024.

We will keep you posted on further developments.

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We hope that you will find this issue interesting and informative. If you have any questions or comments on its subject, please do not hesitate to contact us.

Deloitte CIS Partners
Appendix: technical details

As we noted above, the OECD’s documents include about 500 pages of technical descriptions of how the new rules work. We described the key details of each rule for you below.

Pillar 1. Amount A: the new approach to determining tax nexus in market jurisdictions

To understand whether Amount A, taxable under the new rules, will arise, we suggest using the following algorithm:

**Step 1. In scope or not?**

The new rules will apply to the MNEs that “participate in an active and sustained manner” in the economic life of a market jurisdiction (regardless of physical presence), that is, primarily, to digital and customer-facing businesses.

Let us take a look at some definitions.

<table>
<thead>
<tr>
<th>Automated digital services (ADS)</th>
<th>Consumer-facing businesses (CFB)</th>
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<tbody>
<tr>
<td><strong>In-scope ADS activities (positive list):</strong></td>
<td></td>
</tr>
<tr>
<td>• online advertising services</td>
<td></td>
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<tr>
<td>• sale or other alienation of user data</td>
<td></td>
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<tr>
<td>• online search engines</td>
<td></td>
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<tr>
<td>• social media platforms</td>
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<tr>
<td>• online intermediation platforms</td>
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<tr>
<td>• online gaming</td>
<td></td>
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<tr>
<td>• standardised online teaching services</td>
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<tr>
<td>• digital content services</td>
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<tr>
<td>• cloud computing services.</td>
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<tr>
<td><strong>Non-ADS services (negative list):</strong></td>
<td></td>
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<tr>
<td>• customised professional services (legal, medical, etc.)</td>
<td></td>
</tr>
<tr>
<td>• customised online teaching services</td>
<td></td>
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<tr>
<td>• revenue from sale of physical goods requiring network connectivity (Internet of Things)</td>
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<tr>
<td>• services providing access to the Internet or another electronic network.</td>
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</tbody>
</table>

If an activity is not on either list, is it necessary to consider if the service to a particular user requires minimal human involvement on the part of the service provider.

Includes the sale of goods/services generally intended for personal purposes, including sales via intermediaries, franchising, and licensing.

If the goods/services could be characterised as intended both for consumers and businesses (the “dual category”), i.e. personal computers, passenger cars, the entire revenue from the sale of such products is recorded toward the Amount A liability.

The sale of raw materials and commodities will not be within the consumer-facing business definition.

**Exemptions:**

• extractive industries (except those packed up in individual packages and intended for personal use)
• financial services
• general construction business
• international air and shipping businesses.

Rules for the pharmaceutical businesses are still under discussion.

Stand-alone operations, although formally in scope of Pillar 1, must not trigger allocation of residual profit as, according to Pillar 1, taxing rights arise only in the event of “significant/active and sustained way of participating in the economic life of a market jurisdiction”.

In case of doubts regarding the classification of activities, the MNE may request a tax ruling to avoid future tax disputes.
Step 2. Are revenue thresholds exceeded?

Excess profits will arise with an MNE subject to the following conditions:

- **consolidated revenue of over EUR 750 million** (initially, higher thresholds may be applied to reduce the number of MNEs administered under the new rules)
- **aggregated foreign source revenue from in-scope activities** exceeds an agreed fixed threshold.

Foreign income will mean income received outside home jurisdiction.
Domestic income will mean income from the jurisdiction of the ultimate parent’s company.

Step 3. Does right to tax income arise in a particular jurisdiction?

A jurisdiction where consumers/users are located will have a right to tax a portion of an MNE’s excessive profit, if

<table>
<thead>
<tr>
<th>Criteria</th>
<th>ADS</th>
<th>CFB</th>
</tr>
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<tbody>
<tr>
<td>revenues from sales to consumers/users in this jurisdiction are above the established value *</td>
<td>V</td>
<td>V</td>
</tr>
<tr>
<td>plus factor (under discussion): physical presence (through a permanent establishment or a subsidiary) or marketing activities</td>
<td>X</td>
<td>V</td>
</tr>
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</table>

*to be determined, will most likely depend on the market size (for CFB, a higher threshold may be established than for ADS).

The biggest question is how to determine the income of an MNE sourced from a particular jurisdiction.
This is proposed to be achieved through the articulation of sourcing principles, supported by a range of specific indicators, subject to a defined hierarchy.

Here are some examples:

### Goods /service

#### Online advertising services
1. **User profile information**
   - information on residence obtained from recurring data on geolocation or IP address of the viewer’s device
   - billing address
   - mobile country code of the phone number of the viewer
   - information on residence inputted by the viewer
   - other available information that can be used to determine the jurisdiction of the ordinary residence of the viewer
2. **The jurisdiction of the geolocation of the device of the viewer at the time of display**
3. **The jurisdiction of the IP address of the device of the viewer at the time of display**

#### Goods
1. **The jurisdiction of the retail storefront directly selling to consumers.**
2. **The jurisdiction of the delivery address of the purchaser.**
3. **Other available information on the purchaser’s location.**

The functioning of the MNE’s internal control framework related to revenue sourcing must be described in respective documents.
It may be necessary to introduce additional technologies to determine the location of the user.
With respect to sales via independent distributors, the MNE is expected to take reasonable steps to seek a change in the contractual arrangement with the distributor, which would require the distributor to report the information on the aggregate number and type of products sold to each jurisdiction.

Step 4. How to calculate the MNE’s profit?

The Amount A tax base will be quantified using an adjusted PBT measure, which will be derived from the consolidated financial accounts of in-scope MNE groups.
In practice, consolidated financial accounts prepared under local GAAP that produce equivalent or comparable outcomes to consolidated financial accounts under IFRS will mainly be used

Limited number of book-to-tax adjustments
No specific book-to-book harmonisation adjustments (to account for variances between different local GAAPs) are considered necessary at this stage

In some cases (a considerable gap between profitability earned from different activities) it may be necessary to compute the Amount A tax base on a segmented basis to ensure that Amount A applies only to the profits derived from in-scope activities

Any losses arising from a taxable period will be preserved and carried forward to subsequent years.
A transitional regime is being considered, which would allow certain net pre-regime losses to be preserved and deducted against Amount A.
Possibility to account “profit shortfalls” is also under discussion.
To determine residual profit of the MNE
Profit in excess of the agreed revenue threshold*

Example: a MNE’s profitability (profit/revenue) is 17%, the agreed threshold for residual profit is 10%. 7% will constitute the residual profit for Amount A purposes.

To determine residual profit subject to allocation
Agreed reallocation percentage of residual profit

Example: reallocation percentage amounts to 20%. Allocable base will then amount to 1.4% (7% x 20%).

To determine profit allocated to a particular market jurisdiction
Based on the revenue sourced from the respective jurisdiction

Example: revenue from an in-scope activity in a jurisdiction amounts to EUR 100 million. Residual profit taxable in the jurisdiction will amount to EUR 1.4 million (100 x 1.4%)

* Residual profit can be determined as an absolute amount, but in such a case relevant exchange differences should be considered.

For MNEs with taxable presence in an eligible market jurisdiction, an option under consideration is to adjust the quantum of Amount A to avoid any duplicative allocation of residual profit to that jurisdiction.

A domestic business exemption will be envisaged for the jurisdictions that can be seen as autonomous from the rest of the group, i.e. sale of goods or services that are developed, manufactured, and sold in a single jurisdiction.

Lower margin thresholds for Amount A purposes and higher reallocation percentage might be established for ADS.

Step 6. Identifying paying entities

Pillar 1 establishes special rules for determining the MNE groups that will be recognised as taxpayers, as well as a mechanism for eliminating double taxation.

Identify the MNEs that are material and sustained contributors to residual profit based on their function and risk profile (largely will be based on the existing transfer pricing functional analyses and country-by-country reports).

From among them, select those MNEs that really generate residual profits by analysing their financial statements.

Establish connection of the selected MNEs with the market jurisdictions (user/consumer location) based on their engagement in such jurisdiction.

If the MNE identified as the paying entity lacks the capacity to pay the tax, then Amount A liabilities will be apportioned among other entities on a formulaic pro-rata basis.

Imposing tax obligations on individual MNE entities in market jurisdictions will inevitably lead to double taxation – profits will be taxed both in the home jurisdiction and in such market jurisdiction.

The blueprint suggests two methods for eliminating double taxation:

- exempting the paying entity from taxation of the portion of its profits that had been allocated to market jurisdictions under Amount A
- making tax applied to Amount A in the market jurisdictions available as a tax credit to the paying entity or entities.
Pillar 1. Amount B: a new approach to determining remuneration of related-party distributors that perform baseline marketing and distribution activities

Amount B is intended to simplify the administration of transfer pricing rules for tax administrations and reduce compliance costs for taxpayers, to enhance tax certainty and reduce controversy between tax administrations and taxpayers regarding the computation of low risk distributors’ remuneration.

The proposal calls for using an internationally agreed fixed return for determining compensation for routine marketing and distribution activities.

Naturally, no specific figures have been named yet, but it is assumed that Amount B would approximate the results determined in accordance with the arm’s length principle and, therefore, would be based on comparable company benchmarking analyses under the Transactional Net Margin Method (TNMM) with the quantum potentially varying by industry, as well as by region.

Its use will be mandatory for all MNEs, regardless of their industry, revenue, etc.

The only chance to avoid the use of fixed return is to prove that another transfer pricing method (for example, the Comparable Uncontrolled Price method) is more appropriate.

The document pays special attention to in-scope “routine” activities, involving the performance of minimal functions and bearing minimal risks.

| Functions | Routine: importation of products, purchase of goods for resale within the market; determination or negotiation of pricing and other contract terms with third-party customers within the MNE group’s pricing guidelines, processing of orders and contracts with customers; management of logistics, warehousing, and marketing activities
|           | Non-routine: activities related to the development, enhancement, maintenance or protection of marketing intangibles (e.g., improving the technology, supporting on-line sales and interaction with customers, development of strategic marketing policies), development and negotiation of pricing |
| Assets    | Routine: ownership/lease of offices, warehouses, product display premises
|           | Non-routine: ownership of valuable marketing intangibles, such as local trademarks, brands, trade names |
| Risks     | Routine: limited market risks, limited credit risk, limited foreign exchange risk and inventory risks
|           | Non-routine: risks that are economically significant for the MNE group as a whole |

These qualitative indicators may be supplemented by additional quantitative indicators (significant advertising and marketing costs, R&D costs, etc.), which may be used as proxies to identify entities and transactions out of scope of Amount B.

This mechanism is planned to be implemented through amendments to local legislation (appropriate instructions are likely to be developed at the international level), as well as through the creation of a new dispute resolution instrument.

Importantly, Amount B would not supersede advanced pricing agreements (APAs) executed before the implementation of Amount B.
The document proposes two fundamentally new dispute resolution frameworks: one for Amount A, the other—beyond Amount A.

**Pillar 1. New framework for dispute resolution**

The new frameworks are distinguished by two main characteristics: focus on tax certainty and utmost simplification of all procedures.

<table>
<thead>
<tr>
<th>Dispute resolution for Amount A</th>
<th>Dispute resolution beyond Amount A</th>
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<tbody>
<tr>
<td>An MNE may request validation of a self-assessment return by the lead tax administration to confirm the accuracy of information provided, in particular, whether Amount A and its allocation between market jurisdictions have been correctly determined and paying entities correctly identified.</td>
<td>For MNE groups with global revenue and foreign in-scope revenue above the relevant Amount A thresholds, the approach contemplates a new binding resolution process for all disputes related to transfer pricing and permanent establishment adjustments to any of their constituent entities.</td>
</tr>
<tr>
<td>The tax administration may perform the validation self-assessment return independently or initiate a panel review.</td>
<td>Any disputes related to the application of Amount B (for example, whether a taxpayer falls within the definition of “baseline marketing and distribution activities”) that create risks of double taxation would also be subject to binding dispute resolution.</td>
</tr>
<tr>
<td>If needed, a review panel will be formed of affected tax administrations. The panel review will take from three to 12 months. The panel may approve the filed documents or propose adjustments.</td>
<td>Improvements and enhancements of mutual agreement procedures, including the development of the International Compliance Assurance Programme (ICAP, a co-ordinated risk assessment of potentially all of an MNE group’s transfer pricing and permanent establishment risks), greater use of joint audits by tax administrations, use of standardised benchmarks in common transfer pricing situations, improved processes for bilateral and multilateral APAs, etc.</td>
</tr>
<tr>
<td>The issues that the competent authorities were unable to resolve by mutual agreement would be submitted to a panel of experts (a determination panel) who would reach a decision. The decision of the panel would generally be binding on the competent authorities.</td>
<td>Possibility of creating the infrastructure for binding dispute resolution in developing economies with no or low levels of MAP disputes.</td>
</tr>
<tr>
<td>If an MNE group did not request an early validation and does not agree with the recommendations of the review panel (including any adjustments agreed by the panel based on objections raised by other tax administrations) or the conclusions of the determination panel, it may then rely on general MAP procedures.</td>
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The document calls for the development of a co-ordinated set of rules to address tax avoidance, the core objective being the payment of de-minimis tax by MNE groups. The GloBE proposal is based on two building blocks:

### The Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR)

The rule will trigger a “top-up tax” payable in a group's parent company country where the profits of group companies in any one country are taxed at an effective tax rate below an agreed threshold.

In general, the mechanism is somewhat similar to the CFC tax rules.

### The Subject to Tax Rule (STTR)

The mechanism applies to certain intragroup service fees. Where interest, royalties or service payments to related parties are subject to no or low tax in the receiving jurisdiction, the source jurisdiction will apply additional WHT to bring the total tax up to the agreed minimum rate.

This mechanism is prioritised over the IIR.

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#### Subject to Tax Rule (STTR)

**When will the rule apply?**

The rule will have priority over the IIR, i.e. the IIR can be applied only after the STTR.

The STTR will adjust the WHT on certain intragroup payments:

- interest
- royalties
- franchise and licensing fees
- paid claims
- payments under guarantees, brokerage and financial services fees
- rent of movable property
- intragroup services (marketing, agency, procurement and other intermediary services).

If the effective tax rate in the recipient's jurisdiction adjusted for the possible tax exemption of such income is below the minimum, top up tax will be charged to compensate for this difference.

The minimum tax rate must be agreed internationally (there is no understanding yet at what level it will be set).

However, it is likely that the minimum tax rate for STTR purposes will differ from that for IIR purposes.

The rules will not apply to payments to investment and pension funds, government agencies, and non-profit organisations. Other exclusions are also being discussed, including payment amounts, the ratio of payments to the amount of expenses, etc.

**How will it work?**

Let us illustrate:

Let us assume that the internationally agreed minimum tax rate is 10%.

The recipient’s state has a statutory rate of 12% but under a special regime applying to certain royalty income excludes 50% of income from tax.

An adjusted nominal rate in the residence state will than be 6%.

Therefore, there will be additional top-up withholding tax of 4% (10% - 6%) to be paid in country B.

**Administration options**

The annual payment or payment at the time of income distribution are being considered.

**When will the rules be introduced?**

The STTR will require changes to DTTPs by clarifying the provisions of the already adopted MLI or a new multilateral convention.
The Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR)

When will the rules apply?
The IIR will apply in the event that the effective tax rate (ETR) in any jurisdiction is less than the minimum tax.
The minimum tax rate must be agreed internationally (there is no understanding yet at what level it will be set).
In general, the difference between the minimum tax rate and the ETR will be paid in the jurisdiction of the ultimate parent company.

Important ETR calculation aspects:
• ETR will be determined not at the company, but at the jurisdiction level – that is, the calculation will take into account taxes, income, losses of all constituent entities located in the relevant jurisdiction
• taxes paid domestically and internationally (on CFCs’ profit and WHT) will be taken into account
• VAT, GST, digital, property, environmental, and payroll taxes will be out of scope
• tax base for ETR purposes will be determined as profit/loss before tax according to the book data (in the amount reported in consolidated financial statements)
• certain book-to-tax adjustments will apply
• prior year losses can be carried forward.

What if the ETR is higher than minimum tax?
There might be two approaches:
• if the top-up tax had already been paid in relation to this jurisdiction in prior periods, the excess amount can be credited against the MNE group’s obligations to pay the minimum tax in this and subsequent periods
• if the top-up tax has not been paid, the excess can be credited for ETR calculation purposes within upcoming seven years.

How will the rules be introduced?
It is planned to develop a model document for the IIR, based on which changes will be made to the local legislation of each jurisdiction.

In-scope companies
The rules will apply to the MNE groups whose past year’s revenue under consolidated financial statements exceeded EUR 750 million.
Exclusions are provided for investment and pension funds, government agencies, international and non-profit organisations.
Potential options for simplifying the IIR are discussed, including a “safe harbour” for the effective rate, direct exclusions for certain jurisdictions, etc.

How will they work?
Let us illustrate.

A, ETR = 20%
B, ETR = 8%
C, ETR = 15%
D, ETR = 13%
E, ETR = 5%

Let us assume, that the agreed minimum tax rate is 12.5%.
The ETR will be below the minimum for companies B and E.
Company A as the ultimate parent company will have to pay in its jurisdiction the additional tax of:
• 4.5% (12.5% - 8%) on Company B’s profit
• 7.5% (12.5% - 5%) on Company E’s profit.

Importantly, the amount of fixed profit from the underlying activity calculated as a certain percentage of payroll costs and depreciation allowances will be deducted from the amount of profit subject to the additional tax.
If the IIR does not apply in the jurisdiction in which Company A is located, the tax liability then passes on to the next subholding company in the chain of ownership (in our example, Company C), but it pays tax only in relation to its subsidiaries (in our example – only company E).

What rule, if not the IIR?
If the IIR is inapplicable at the level of jurisdictions/subholding companies, the Undertaxed Payments Rule (UTPR) will apply.
The liability to pay the top-up tax is apportioned among the MNE group companies in which the ETR is higher than the minimum tax.
The allocation is made pro rata to the amount of tax-deductible payments to companies with a low ETR.
In this case, the amount of the top-up tax should not exceed a certain threshold.
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