# Kluwer International Tax Blog

## GloBE: Do We Need a Super-CFC? (Forthcoming: Intertax, Vol. 49, 2021, Issue 1)

Johanna Hey (University of Cologne) · Wednesday, November 4th, 2020

Since the OECD introduced its Global Anti-Base Erosion Proposal (GLoBE) in early 2019 as the second pillar of the ongoing search for a solution to the tax challenges of the Digitalisation of the economy, the goal of GloBE seems to be moving. On the one hand, already the name suggests that the proposal for a global minimum tax merely continues the BEPS package of 2015. At the same time, however, the OECD seemed to be taking a new direction with the goal of bringing the general race to the bottom of corporate tax rates to an end. From the very beginning of its work on tax competition[1], the OECD has always limited itself to harmful tax competition. Preferential tax regimes were banned, but not generally low corporate tax rates. The February 2019 consultation document[2] suddenly appeared as if the OECD had expanded the understanding of harmfulness to the effect that fierce competition in corporate tax rates harms national tax sovereignty over the composition of the tax system by forcing national tax legislators to shift the tax burden from capital to labor and consumption.

October 2020 witnessed the release of the Pillar Two Blueprint[3] with important clarifications of the scope and the character of the GloBE. Just as Country-by-Country Reporting the GloBE is supposed to apply only to MNE groups with a consolidated revenue of Euro 750m p.a. The effective tax burden will be determined on the basis of a modified financial accounting using a per-country approach. The OECD thus decided against worldwide blending as known from the U.S. GILTI regime. However, the most important decision concerns the restriction to excess profits through a formulaic substance and activity carve-out. The May 2019 work program still expressed the OECD concerns that carve-outs could undermine the initial GloBE policy intent of a comprehensive solution and its effectiveness[4]. Now the goal of curbing tax competition in general has apparently been abandoned. Instead, the GloBE, at least as far as the Income Inclusion Rule is concerned, is now hardly distinguishable from the current CFC regimes.

This raises the question of how the latest GloBE proposal relates to the 2015 final report on Action 3[5]? Did the OECD fail with its recommendations for designing effective CFC rules? Why is it not possible to refine them instead of proposing a new instrument with the GloBE? The OECD does not bother to make a connection, but only notes that the two instruments could coexist because they pursue different goals. These diverging goals, however, remain unspecified. It seems rather as if the OECD was guided by the 2017 U.S. tax reform. Instead reforming the insufficient Subpart F rules, the legislator placed GILTI at their side. This, in view of the different legal consequences of both rules, forces taxpayers to pursue complex tax planning considerations.

To which extent the GloBE income inclusion amount differs from the one of common CFC regimes cannot be estimated at the first glance, and is neither uttered by the OECD. Traditional carve-outs are based on the distinction between active and passive income instead of determining excess returns by a formulaic substance and activity requirement.

It is equally unclear whether the determination of the inclusion amount on the basis of territorially allocated wages and tangible assets reduces compliance costs compared to today's cumbersome distinction between active and passive income.

The key difference between the GloBE income inclusion rule and traditional CFC regimes is the applicable tax rate. The GloBE income is not added to the domestic tax base, thus not taxed at the domestic tax rate of the jurisdiction of the ultimate parent, but is subject to the lower minimum tax rate. With GILTI, the U.S. have taken this path in order not to endanger the foreign competitiveness of U.S. companies. This would be understandable if the entire low-taxed foreign profit were actually added back. However, if an MNE earns excess returns, this is supposedly due to low competition in the source countries.

For various reasons, it is unlikely that countries will abolish their CFC regimes in favor of GloBE. First, the EUR 750m threshold means that GloBE has only a limited scope. In any case, it would have to be clarified beforehand to what extent BEPS activities below this threshold currently are addressed by CFC regimes, but would not be taxed under GloBE. Moreover, high-tax countries such as the U.S. or Germany apply their CFC regimes even if the foreign effective tax rate is only slightly lower than the domestic tax rate. It is therefore difficult to imagine that they would settle for a lower GloBE minimum tax rate. The low tax threshold has not yet been set. However, it is evident that it must be really low, i.e. more likely to be 10%, 12.5% or at maximum 15%, because otherwise the GloBE will not meet with the necessary broad approval in the Inclusive Framework.

On the other hand, the coexistence of a GloBE income inclusion and traditional CFC income inclusion would increase the complexity of international tax law for cross-border companies and thus should be avoided. The fact that the measure should be limited to large MNEs is not a carte blanche. GloBE should only be introduced if it promises real benefit compared to the existing rules. This can only be assessed if the possibilities of an advancement of the CFC regimes recommended in 2015 are examined in parallel. Doubts are justified if the advantage of GloBE over action 3 is seen in its greater coordination. It is true that the proposals in the final report on action 3 contained much scope for different solutions. If the 137 members of the Inclusive Framework are already prepared to agree to GloBE and to implement it largely on a one-to-one basis in their national tax systems, greater standardization of the existing CFC regime, at least with regard to the central building blocks, including a bottom for the minimum tax threshold, should also be possible. As already envisaged today based on the ATAD's minimum standard concept (Art. 3), the determination of a higher threshold can be left to the states.

If the OECD abandons the plan of a generally applicable minimum tax by including a formulaic substance and activity carve-out, then GloBE should not be placed unrelated to the Action 3 recommendations.

*You can read the full version of this article in the guest editorial section of Intertax, vol. 49, 2021, issue 1.*

[1] OECD, *Harmful Tax Competition – An emerging Global Issue* (1998).

[2] See OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy, Public Consultation Document*, 13 February – 6 March 2019, 29 (para. 88, 90).

[3] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, Oct. 2020); accompanied by the Public Consultation Document, Reports on the Pillar One and Pillar Two Blueprints, 12 October – 14 December 2020 (OECD Publishing, Oct. 2020).

[4] OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy,* OECD/G20 Base Erosion and Profit Shifting Project, (OECD Publishing, May 2019), at 29.

[5] OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2015)

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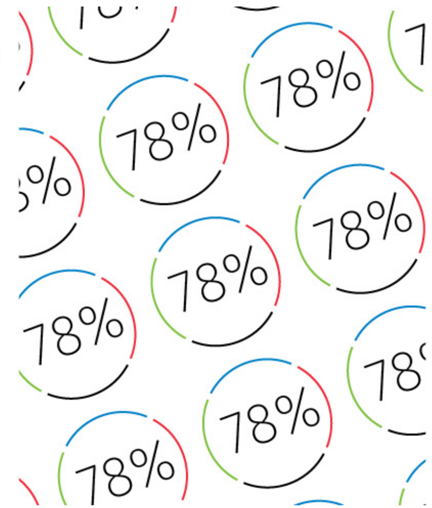

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