Substance-Based Income Exclusion from GloBE/Pillar Two Minimum Tax

December 8, 2023

On behalf of the undersigned organizations and individual taxpayers, representing globally engaged businesses across various sectors, we are writing to request guidance regarding the application of the Substance-Based Income Exclusion ("SBIE") from the GloBE/Pillar Two minimum tax with respect to mobile (or "interjurisdictional") assets and employees. The OECD should immediately--and in any case before December 31, 2023--provide guidance to taxpayers confirming that the SBIE applies in full to mobile assets and employees to avoid exposing taxpayers in a wide range of industries that deploy mobile assets and employees to undue and discriminatory taxation. The July 2023 Administrative Guidance would put taxpayers with mobile assets and employees at a material competitive disadvantage relative to taxpayers that deploy assets and employees primarily in one jurisdiction. Such competitive disadvantage would be exacerbated by the fact that taxpayers in industries with mobile assets (and employees) have significant capital invested in such mobile assets given the capital-intensive nature of the affected businesses.

Background

The SBIE excludes from the GloBE tax base a certain amount of income calculated by reference to a fixed return on assets and payroll expenses in each jurisdiction for an applicable Constituent Entity. The amount of the SBIE is equal to the sum of (1) 5% of the carrying value of tangible assets located in the jurisdiction, and (2) 5% of the payroll costs for employees that perform activities in that jurisdiction. There is a 10-year transition period pursuant to which the SBIE for payroll costs is 10% and for assets is 8%, both of which decline to 5% during the transition period. The Commentary to the GloBE Model Rules explains that: "The policy rationale behind a formulaic, substance-based carve-out, based on payroll and tangible assets is to exclude a fixed return for substantive activities within a jurisdiction from the application of the GloBE Rules. The use of Payroll and Tangible Assets as indicators of substantive activities is justified because these factors are generally expected to be less mobile and less likely to lead to tax-induced distortions. Conceptually, excluding a fixed return from substantive activities focuses GloBE on 'excess income', such as intangible-related income, which is most susceptible to BEPS risks." Moreover, the Commentary adds that, "including a broad range of tangible assets in the carve-out base recognises that ***all such assets are indicative of substantive activities***. Furthermore, it helps to ***level the playing field across industries that use varying types of tangible assets in their business***."

Because the GloBE Model Rules focus on the physical location of employees and assets in a particular jurisdiction, they do not appropriately take into account that in many very capital-intensive industries, given the nature of the business, assets and employees may spend very little or no time in the jurisdiction of the relevant Constituent Entity that owns the assets or employs the employees. Such use of assets and employees outside the jurisdiction of the relevant Constituent Entity has nothing to do with "tax-induced distortions." Indeed, in the July 2023 administrative guidance, the OECD recognized that taxpayers in various industries, including airlines, shipping (both cargo and cruise lines), those that use satellites, and submarine cables used in international waters, all deploy assets that are mobile. Oil and gas drillers are another example, given that drilling rigs and vessels are used on the high-seas and/or in certain offshore locations.

Discriminatory July 2023 Administrative Guidance

Recognizing that taxpayers in certain industries do not use assets or employees exclusively or even mostly in the jurisdiction of the relevant Constituent Entity, the Commentary to the GloBE Model Rules notes that "consideration will be given to the development of Agreed Administrative Guidance as part of the GloBE Implementation Framework to address those cases." As noted above, the OECD released Administrative Guidance in July 2023 that addressed the application of the SBIE. Unfortunately, the guidance provides no relief whatsoever for mobile assets and employees that spend 50% or more of their time outside the jurisdiction of the Constituent Entity that owns the asset or employs the employees. Rather, the guidance provides that if an asset and/or employee spends more than 50% of their time within the jurisdiction of the relevant Constituent Entity, then that asset and/or employee will be allocated 100% to such jurisdiction. However, if an asset and/or employee spends 50% or less of its time within the jurisdiction of the relevant Constituent Entity, then that Constituent Entity will be allocated only a proportionate amount of the asset or employee for purposes of the SBIE. For example, if a mobile asset or mobile employee spends 1% of its/their time in the jurisdiction of the Constituent Entity, then that Constituent Entity will be allocated only 1% of the carrying value of the asset and 1% of the payroll costs of the employee for purposes of the SBIE. Such a rule places taxpayers in industries with assets and employees that spend a large majority of their time outside the jurisdiction of the Constituent Entity—only by reason of the nature of the taxpayer's relevant business—at a significant disadvantage compared with taxpayers whose assets and employees spend most or all of their time in a single jurisdiction.

The July 2023 administrative guidance acknowledges that it fails to adequately address assets and employees that spend the majority of their time outside the jurisdiction of the Constituent Entity: "The Inclusive Framework will give further consideration to a simplified allocation mechanism with respect to industries with a substantial portion of their employees and assets located outside the jurisdiction for a substantial portion of the Fiscal Year." We understand that the OECD intends to revisit the issue in the near term. However, time is of essence for the additional guidance, as many countries will begin to apply the GloBE/Pillar Two rules starting in 2024.

Request for Immediate Additional Guidance

The OECD should provide clear guidance on the application of the SBIE rules to mobile assets and employees. We recommend that such guidance provides that mobile tangible assets are, at the annual election of the Filing Constituent Entity, deemed to be located in the jurisdiction where the Constituent Entity that legally owns the asset is considered to be located, provided that such Constituent Entity carries on from within the jurisdiction of the Constituent Entity key people functions and key entrepreneurial risk-taking activities involved in the management of the relevant mobile tangible assets. Similarly, we also recommend that payroll costs in respect of mobile employees of a Constituent Entity be treated as located in the jurisdiction where the Constituted Entity that employs the employees is considered to be located, provided that such Constituent Entity carries on from within the jurisdiction of the Constituent Entity key people functions and key entrepreneurial risk-taking activities involved in the management of the relevant employees.

Our recommendations provide a simple methodology that deals with the unique nature of mobile assets and employees used in different industries, while also aligning with the policy rationale to provide a fixed return for substantive activities measured by investments in assets and employees.

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We would appreciate the opportunity to meet with you to discuss these points at a mutually convenient time in the near future.

Sincerely,

Cruise Lines International Association	DEME NV
National Foreign Trade Council	Jan De Nul Group
United States Chamber of Commerce	SES S.A
United States Council for International Business	

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