OECD's BEPS Inclusive Framework: A Complete, Easy-to-Remember Summary

The central problem

Multinational enterprises often operate across many countries. Differences between national tax systems can allow them to legally structure transactions so that:

- profits appear in low-tax countries,
- expenses appear in high-tax countries,
- and the total tax paid becomes much lower than where the actual business activity occurred.

This is known as **Base Erosion and Profit Shifting, or BEPS**.

"Base erosion" means reducing the profits on which a country can impose tax. "Profit shifting" means moving those profits, at least on paper, to another jurisdiction.

The result is lost government revenue, an unfair advantage for multinational companies over domestic firms, greater complexity for businesses and tax authorities, and declining public trust in the tax system.

The simplest way to understand the framework

The OECD's BEPS framework tries to answer three questions:

1. **Where was the business activity conducted?**
2. **Where was the profit reported?**
3. **Was an adequate amount of tax paid there?**

Its broad principle is:

Profits should be taxed where meaningful economic activity and value creation take place, rather than wherever a company finds the lowest tax rate.

Part I: The BEPS Inclusive Framework

The **Inclusive Framework on BEPS** was launched in 2016 as a collaborative arrangement involving more than 140 countries and jurisdictions.

It is called “inclusive” because participating countries work together on international tax rules rather than having those rules determined only by a small group of developed economies.

The framework seeks to create a more coordinated global corporate-tax system by:

- closing gaps and mismatches between national tax rules,
- improving transparency around multinational companies,
- establishing minimum standards,
- improving transfer-pricing rules,
- monitoring implementation through peer reviews,
- and creating mechanisms for resolving tax disputes.

The broader BEPS package contains **15 Action Plans** covering different methods through which tax bases may be eroded or profits shifted.

Why countries participate

The framework is intended to produce four broad benefits:

- higher and more secure tax revenue,
- fairer competition between domestic and multinational firms,
- greater certainty for businesses,
- and more consistent international tax rules.

Countries commit to implementing agreed BEPS measures, although the pace and form of implementation can differ depending on domestic laws and levels of development.

Part II: The Two-Pillar Solution

The most important later development under the Inclusive Framework is the **Two-Pillar Solution**.

A useful memory device is:

Pillar One decides where profit can be taxed.
Pillar Two decides the minimum amount of tax that should be paid.

Pillar One: Reallocating taxing rights

The problem Pillar One addresses

Traditional international tax rules often require a company to have a physical presence—such as an office, factory or permanent establishment—before a country can tax its profits.

However, a digital company may earn substantial revenue from customers in a country without having a major physical presence there.

Pillar One attempts to give such **market jurisdictions** a right to tax part of the profits generated from their customers or users.

The central idea

Pillar One asks:

Even when a multinational has little or no physical presence in a country, is it earning significant value from that country's market?

Where the answer is yes, part of the multinational's profit may be reallocated to that market country.

Amount A

The main component explained in the document is **Amount A**.

Amount A reallocates a portion of the profits of certain large and profitable multinational enterprises to the countries where their customers or users are located.

This allocation is formula-based and may consider factors such as:

- sales in the market,
- customer participation,
- user activity,
- and the multinational's overall profitability.

The important point is that the market country may obtain taxing rights even without the company having a conventional physical presence there.

Why Pillar One matters

Pillar One is intended to:

- give market countries a share of tax revenue,

- modernize tax rules for the digital economy,
- reduce unilateral digital-service taxes,
- improve certainty for multinational businesses,
- and reduce disputes between countries.

The main challenge

Pillar One requires many countries to agree on:

- which businesses are covered,
- how much profit should be reallocated,
- how that profit should be divided among countries,
- and how double taxation should be prevented.

The document notes that the Multilateral Convention for implementing Amount A had been prepared but had not yet been fully implemented at the time covered by the notes.

Pillar Two: The Global Minimum Tax

The problem Pillar Two addresses

Even when countries agree on where profits should be taxed, multinational companies may still shift profits to jurisdictions with very low tax rates.

Pillar Two attempts to reduce the benefit of doing this.

Its basic rule is:

Large multinational enterprises should pay at least a minimum effective tax rate on profits earned in each jurisdiction.

The document describes the minimum rate as **15%**.

The central logic

Suppose a multinational earns profit in Country B and pays only 5% tax there.

If the minimum rate is 15%, there is a tax shortfall of 10 percentage points.

Pillar Two allows this shortfall to be collected through a set of interconnected rules.

The most important rules covered in the document are:

- Income Inclusion Rule,
- Undertaxed Profits Rule,
- and Subject-to-Tax Rule.

1. Income Inclusion Rule: IIR

What it does

The **Income Inclusion Rule** allows the country of the multinational's parent company to collect additional tax when a subsidiary's profits have been taxed below the minimum rate.

It is therefore commonly described as a **top-up tax**.

Simple example

Assume:

- a subsidiary earns $100,
- it pays 5% tax, or $5,
- the minimum required rate is 15%.

The tax shortfall is:

15% − 5% = 10%

The parent company's country may impose an additional tax of:

10% × $100 = $10

The total tax on the subsidiary's profit therefore becomes $15, equivalent to the 15% minimum.

How to remember IIR

IIR looks upward to the parent.

The parent company's jurisdiction collects the top-up tax on the low-taxed income of the subsidiary.

2. Undertaxed Profits Rule: UTPR

What it does

The **Undertaxed Profits Rule** acts as a back-up where the low-taxed profit has not been sufficiently taxed under the Income Inclusion Rule.

For example, the parent company's country may not have implemented the IIR, or the IIR may not apply in a particular case.

Other countries in which the multinational operates may then impose adjustments or additional tax so that the low-taxed income does not escape the minimum tax.

Why it exists

Without the UTPR, a multinational could avoid the top-up tax simply because its parent country had not adopted the IIR.

The UTPR therefore ensures that:

Low-taxed profit should be taxed somewhere, even when the parent jurisdiction does not collect the top-up.

How to remember UTPR

UTPR is the back-up rule.

IIR gets the first opportunity. UTPR applies when the minimum tax has still not been collected.

IIR versus UTPR

The distinction can be remembered through three questions.

Who applies the rule?

- **IIR:** Normally the parent company's jurisdiction.
- **UTPR:** Other jurisdictions in which the multinational operates.

When does it apply?

- **IIR:** When a parent owns a subsidiary whose profits are taxed below the minimum rate.
- **UTPR:** When the IIR has not resulted in the required top-up tax.

What role does it play?

- **IIR:** Primary top-up mechanism.
- **UTPR:** Backstop mechanism.

The document summarizes the relationship by presenting the IIR as the rule that collects the minimum tax in the parent company's jurisdiction, while the UTPR ensures that the tax is collected somewhere if the parent jurisdiction does not apply the IIR.

3. Subject-to-Tax Rule: STTR

What it targets

The **Subject-to-Tax Rule** focuses on particular cross-border payments between related companies.

Examples may include:

- interest,
- royalties,
- management fees,
- and certain other related-party payments.

A company in one country may deduct such a payment as an expense, while the related company receiving it may face little or no tax in another country.

This reduces the taxable profit in the source country and moves income to a low-tax jurisdiction.

How STTR responds

The STTR allows the country from which the payment originates—the **source country**—to impose additional tax where the payment is taxed below an agreed minimum level in the recipient country.

Unlike the IIR and UTPR, the STTR is primarily a **treaty-based rule**.

That means countries generally need to incorporate it into their bilateral tax treaties or implement it through an agreed multilateral treaty mechanism.

Why STTR matters to developing countries

Developing countries are often more dependent on taxing income generated within their borders.

They may also have fewer multinational parent companies headquartered within their jurisdiction, meaning the IIR may provide them with limited revenue.

STTR gives the source country a more direct right to tax certain low-taxed payments leaving its economy.

How to remember STTR

STTR follows the payment.

When a related-party payment leaves the source country and is taxed too lightly in the destination country, the source country may recover part of the tax.

IIR, UTPR and STTR in one picture

Imagine a multinational group with:

- a parent company in Country A,
- a subsidiary in low-tax Country B,
- and business operations in Country C.

The subsidiary in Country B earns $100 but pays only 5% tax.

First: IIR

Country A, where the parent company is located, may collect the 10% top-up needed to reach the 15% minimum.

Second: UTPR

If Country A does not apply the IIR, Country C or other operating countries may impose an adjustment under the UTPR.

Separately: STTR

If a company in Country C makes a royalty, interest or management-fee payment to the related company in Country B, and the payment is taxed too lightly in Country B, Country C may impose additional source taxation under the STTR.

Therefore:

IIR taxes through ownership.
UTPR taxes as a back-up through the group's other jurisdictions.
STTR taxes specific low-taxed cross-border payments.

How profit shifting works through transfer pricing

Transfer pricing refers to the prices charged for transactions between companies belonging to the same multinational group.

These transactions may involve:

- goods,
- services,
- loans,
- intellectual property,
- royalties,
- or management support.

Because the companies are related, the group may have some ability to influence where profits are reported.

Simplified example

A shirt is sold to a customer for $100.

Its real production cost is $40.

Normal arrangement

The low-tax subsidiary sells the shirt to the operating company for $60.

The operating company earns:

$100 – $60 = $40 profit

If its tax rate is 25%, it pays:

25% × $40 = $10 tax

Inflated transfer price

The low-tax subsidiary charges $80 instead.

The operating company's reported profit falls to:

$100 – $80 = $20

Its tax falls to:

25% × $20 = $5

The remaining profit is effectively shifted to the low-tax subsidiary.

Pillar Two attempts to reduce the attractiveness of this arrangement by ensuring that the profit reported in the low-tax country is still subject to a minimum level of tax.

The role of Pillar One and Pillar Two together

The two pillars solve different parts of the same problem.

Pillar One asks:

Which country should have the right to tax the profit?

It gives greater taxing rights to countries where customers and markets are located.

Pillar Two asks:

Has the profit been taxed at a sufficiently high rate?

It introduces a minimum effective tax and top-up mechanisms.

Combined effect

A multinational should find it more difficult to:

- earn substantial revenue in a country without paying tax there,
- shift profit to a low-tax jurisdiction,
- route income through related-party payments,
- or take advantage of mismatches between national tax systems.

A complete memory framework

The entire framework can be remembered as a four-stage sequence.

Stage 1: Identify the problem

Multinationals can exploit differences between tax systems to shift profits and erode national tax bases.

Stage 2: Coordinate countries

The Inclusive Framework brings countries together around shared rules, minimum standards, transparency and peer review.

Stage 3: Decide where profit belongs

Pillar One reallocates part of the profit to market countries, including countries where a company has customers but limited physical presence.

Stage 4: Ensure minimum taxation

Pillar Two ensures that low-taxed profit faces a minimum tax through:

- **IIR:** Parent country collects the top-up.
- **UTPR:** Other countries collect it if IIR does not.
- **STTR:** Source country taxes certain low-taxed related-party payments.

Final takeaway

The OECD's BEPS Inclusive Framework represents a shift away from a tax system based mainly on legal entities and physical presence toward one based more closely on:

- economic activity,
- market participation,
- actual profit allocation,
- and minimum effective taxation.

Its essential objective is not to force every country to adopt the same corporate tax rate.

Rather, it seeks to make it harder for multinational companies to obtain very low tax outcomes merely by moving profits, payments or legal ownership across borders.

The framework can therefore be reduced to one sentence:

Tax profits where business value is created, and ensure that profits shifted elsewhere do not escape a minimum level of taxation.

Memory line:
Pillar One = where to tax. Pillar Two = how little tax is too little. IIR = parent, UTPR = back-up, STTR = payment.