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To: Centre for Tax Policy and Administration, OECD/CTPA

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EBIT comments on the OECD public consultation document: Reports on the Pillar One and Pillar Two Blueprints

Brussels, 14 December 2020

Dear Achim,

EBIT's Members[1] thank the OECD for the opportunity to provide comments on the OECD's public consultation document: Reports on the Pillar One and Pillar Two Blueprints, which is up for comments from 12 October 2020 – 14 December 2020. Below are a number of issues and open questions that EBIT believes are important for the OECD to take into account.

The Members are particularly focused on avoiding double/multiple taxation and minimising the compliance and administration burden. That includes the incorporation of advanced certainty with effective dispute prevention and resolution mechanisms. Ideally a process for achieving certainty would provide a multi-year framework in a similar manner to an advance pricing agreement. Consistency of application is also critical and implementation via a multilateral treaty seems the surest way to achieve this. Mandatory binding dispute resolution will ultimately be the only way to avoid multiple taxation.

Further public consultation on the draft rules and commentary to reflect the eventual consensus would be welcome (with more than 500 pages in the Blueprints, we expect many times more will be required to provide an implementable set of measures). A rigorous testing period before a phased-in approach would also provide an opportunity to see how the provisions will work in practice. EBIT are also keen to see how existing measures will be removed or adapted alongside the new rules, including the removal of DSTs and similar unilateral measures made unnecessary by Pillar One and removal of CFC and various BEPS provisions no longer required with the introduction of Pillar Two.

[1] EBIT Members include Airbus Group, BP, Caterpillar, C-Brands, Diageo, GSK, Huawei, International Paper, JTI, Naspers, PepsiCo, Pfizer, P&G, Raytheon Technologies Corp., RELX, Schroders and SHV Group. For more information on EBIT see: www.ebit-businesstax.com

Comments on Pillar One

Amount A

1. Scope and activity test(s)

The test for ADS is not sufficiently clearly defined and could lead to a large number of scope reviews and substantial disputes.

The test for CFB appears to have been left deliberately wide as it stands. This is perhaps because the rationale is less developed.

It is critical that the activity test can be and is applied equitably across all business models and industries, catering for both now and in the future. In this regard we have concerns that the definition is not being consistently applied across all industries. This is particularly evident with the Option 1 proposal for prescription pharmaceutical products, where the rationale for their being in-scope appears misaligned with wider policy intent and the proposed application of the rules to other industries.

In general, looking at the difficult delineation of the ADS and CFB positive / negative list, and the valid arguments why certain industries should be carved out (which could actually be extended to yet further industries with similar arguments), EBIT is curious whether a general consensus can be reached on this topic. This also because the OECD has consistently taken the position that it is not possible to "ringfence" the digital economy, which is what an ADS versus CFB scoping would effectively do.

2. Nexus factors

The establishment of the local nexus threshold should include an option for the taxpayer to choose a multi-year approach to avoid the situation in which it regularly switches from being in scope and out of scope.

It raises concerns that the rules could serve as a deterrent for MNEs in investing and establishing more of a presence in a jurisdiction on account of the additional compliance and tax burden that would be created.

The so-called deemed engagement provision that assumes that once a group's CFB sales in a market reach a certain threshold, it will no longer be necessary to establish the existence of plus factors (i.e. the group could be treated as having a nexus) seems a helpful suggestion to enhance tax certainty, while also increasing simplicity and lowering the compliance burden.

3. De minimis foreign in-scope revenue

The de minimis threshold will exclude activities that will give rise to a low amount of tax outside the 'home' market because associated (foreign) revenues are relatively small. A wide application of the de minimis threshold would help to further reduce the compliance burden as well as the number of situations where applying Amount A is likely to have a limited tax impact. If segmentation were to be applied, then the exemption should be on a segmented basis. It should be noted, however, that mandatory segmentation will likely lead to a higher compliance burden and it should therefore be left to the self-assessment and judgment of the MNE whether segmentation is appropriate.

To achieve certainty, this exception needs to be clear and simple to operate. The determination of what is 'home' and what is 'foreign' will be straightforward in many MNE

groups. Usually it will be the jurisdiction of the UPE and / or headquarters entity. In the situation where there is another country which by design generates more sales, there is an argument for opting for that to be the 'home' territory.

4. Losses

EBIT believes that taxpayers should be allowed to offset and carry forward indefinitely both pre-regime losses and those arising under Amount A. This allows businesses to recoup losses reflecting costs of their investment and development, and put those with fluctuating profits on a level playing field with those having more stable profits.

EBIT also believes this principle should be extended so that taxpayers can carry forward net profit shortfalls against residual profits in future years.

5. Elimination of double counting and double taxation

Amount A may overlap with distributor returns and with withholding taxes. Fundamentally, EBIT wants to ensure residual profits are not taxed twice by the same country or in certain cases by more than one country.

The marketing and distribution profits safe harbour is designed so that where market jurisdictions already have taxing rights that reflect an allocation of residual [non-routine] profits under ALP rules, those amounts should be omitted from the Amount A determination. This avoids unnecessary compliance and the need to consider and effect relief from double counting/double taxation. It's important to keep the safe harbour fairly simple and consider in-scope local profits against a straightforward benchmark, such as a return on sales plus an additional mark-up. This could be a cap on Amount A + B as a percentage of overall MNE profit to ensure that the re-allocation amount remains modest.

It is in theory simpler and a more targeted mechanism to address the issue of double counting than a domestic business exemption and needs to remain so. The Blueprint should more clearly state that the safe harbour is to be compared against the total in-scope profits recognised in a market jurisdiction that relate to goods or services sold to customers in that jurisdiction, as the Blueprint at times seems to inconsistently suggest that only a portion of such profits may be compared against the safe harbour.

The 'market connection priority test' is more complex in theory than mere 'pro-rata allocation' because all paying entities would need to make adjustments rather than just the affected paying entity if using the 'market connection priority test'. However, the pro-rata allocation might require adjustments to ensure consistent calculation of profits and the elimination of things like dividends.

One would need to consider how to adjust paying entities' profits should there be a subsequent transfer pricing adjustment in order to reallocate double taxation relief across all paying entities. There should be an adjustment to the paying entities in the event of an adjustment in a later period. Adjustments are more complicated under the 'pro-rata' allocation.

6. Segmentation

Concerns arise for taxpayers (but also for tax administrations) on segmentation, both by business line and geography. Segmentation puts a significant burden on companies.

Therefore, segmentation should only be required in very limited and clearly articulated cases that would otherwise result in distortive impacts. Segmentation may lead to similarly situated MNEs (e.g. with similar sales revenue and profits) that segment their financial statements in different ways for entirely non-tax-related purposes, realizing very different Amount A allocations. Financial statement disclosure, including segmentation, if any, should be driven by the intention to inform investors without the influence of potential tax outcomes. Tax administration concerns about the offsetting of potentially higher and lower allocation activities can probably be limited to extreme cases.

However, in certain cases segmentation is warranted in case of significant differences between the segments. Companies should therefore have the option to segment either by business line or by geographic region, in order to avoid unjustified allocations of profit to other business lines or regions in such cases.

7. Tax certainty

EBIT's Members reiterate that tax certainty will need to be sure that the review processes will happen on a timely basis and without creating significant costs.

The operation of a mandatory binding dispute resolution process agreed to by all IF countries is vital. EBIT areas of concern regarding the complexity of the system include:

1) self-assessment
2) acceptance (or not) by lead administration
3) review panel
4) determination panel
5) multilateral by nature
6) unclear relationship with MAP.

Another suggestion would be to adopt a "fast track" or similar simplified process for MNEs that clearly stay below the relevant PBT profit threshold for Amount A.

Amount B

Amount B should be as consistent as possible with results determined under the arm's length principle. In this regard, the most straightforward, and probably most widely accepted, profit level indicator would be a return on sales (ROS). EBIT thinks the additional burden of coping with multiple rates would not be justified by the need to reflect the different standards across industries and regions. The marginal benefit from having different rates is outweighed by the complexity and the risk of achieving inconsistent outcomes.

It should set the boundary between benchmarkable (routine) activities and those which attract residual profits. The definition of distribution and marketing activities covered by Amount B, as well as the associated transactions such as but not limited to payments for royalty and services relevant to distribution, will therefore be very important but should be driven by whether benchmarks are realistically available. In practice, this will need to be translated into clear definitions and positive and negative lists.

EBIT considers that the intention that Amount B will reduce the number of disputes is likely to be met only if there is a change in the cultural approach of some tax authorities. As the amount is said to be "within the ALP', taxpayers should be able to determine another (benchmarked) figure; in other words, Amount B would act as a kind of super safe harbour. If this were the case (super safe harbour), it should become elective for the taxpayer; not elective for the tax authority.

Comments on Pillar Two

Sustainability and fairness

For Pillar Two to serve as a robust and sustainable measure in the long-term, and to avoid a patchwork of unilateral measures, it is critical that there is consistency in implementation and interpretation by adopting jurisdictions. This underlines the need for any final framework to clearly articulate key parameters and the extent to which any deviations would be allowed. Any departures should be principle-based.

It is also critical that there is equity of treatment for all taxpayers, across all jurisdictions and industries. At present it is not clear that this will be the case – as there are a number of areas where, without further work, the rules could discriminate against certain taxpayers or simply lead to an incremental compliance burden for all MNEs. Further work is for instance needed to look into:

- The interaction of Pillar Two with domestic rules; and
- The carryforward of pre-regime losses and timing differences, where without unlimited carryforward, certain taxpayers be will rendered subject to taxation on profits in excess of the economic position, simply by virtue of where they are in their investment cycle.

Complexity

EBIT thinks that in its current form, Pillar Two would impose heavy burdens on taxpayers (and tax authorities) and would lead to disputes and double taxation, made worse by inconsistent implementation.

There also seem to be areas where complexity is being created unnecessarily – such as with the introduction of a requirement for a refundable investment tax credit to be refundable within 4 years. It is unclear as to the need for this requirement given such investment credits, by their nature, are low risk, and the threshold for accounting for them as income arguably sets a higher bar.

Equivalent regimes

Compliance will be incredibly difficult if a business is subject to similar but different minimum tax regimes in different territories and they are not considered equivalent in a manner that removes one set of obligations. Most clearly this is an issue with the US GILTI regime. For all practical reasons, US GILTI (and potentially other similar regimes) should be considered as equivalent to GloBE or at least to the IIR, though further work is required to address potential double counting that would arise where non-US headquartered groups have US subsidiaries that are subject to GILTI (so-called “sandwich structures”).

If the US GILTI regime is allowed to co-exist, clarity will be needed around the implications (e.g. application of the UTPR/STTR to US UPEs). Any exclusions applied to GILTI (e.g. regarding the application of the UTPR to US UPEs) should be broadly available to any Inclusive Framework jurisdiction on the same basis for other similarly consistent regimes.

The operation of the US BEAT and any other existing UTPRs should be limited in respect of payments to entities that are subject to an IIR.

Carve-outs

If recognition is not going to be given for all substance regimes that are cleared of being harmful, consideration could be given to a carveout for certain approved objectives (e.g. manufacturing investment or R&D incentives). If not for all R&D incentives, then at least for expenditure-based R&D incentives given the limited BEPS risk associated with those. Countries should remain free to choose if and how they incentivise R&D activities (i.e. whether through direct government grants, tax incentives, or a combination of both) within the limits of BEPS Action 5 and MNE groups should not be treated differently for GloBE purposes depending on the choice made by individual governments. The proposed GloBE rules effectively put a limitation on the use of R&D tax incentives, in favour of expenditure-based tax incentives that provide relief to payroll taxes or social security contributions; government grants; and qualified refundable R&D tax credits. Apart from the different accounting treatment, it is unclear what the rationale for this is, both from an economic and a BEPS perspective, particularly for expenditure-based R&D incentives (e.g., an R&D super deduction). [EBIT members] support making a permanent difference adjustment to the tax line for R&D super deductions or non-refundable R&D credits. Adding in an R&D super deduction to the GloBE tax base for the taxpayers that are otherwise claiming an R&D super deduction or non-refundable R&D tax credit could also be an alternative.

Even on the basis suggested under the formulaic substance-based carve-out, the return for payroll and tangible assets should be high enough to reflect the MNE group's underlying substantive activities. It may be appropriate to consider providing a higher percentage mark-up for different categories of payroll costs, including for example R&D payroll costs. For the carve-out to properly recognise those activities, an MNE group that claims the benefit of the carve-out should not be required to make a corresponding and proportional adjustment to the covered taxes.

Where a carve out arises and is unutilized, it should be carried forward and be available in future years at the point a return on that investment is generated. This will ensure that a routine return on all substantive investment is protected, even in industries with long investment lifecycles.

IIR

EBIT Members still believe that global rather than jurisdictional blending would be more appropriate and would fit with other approaches, like US GILTI. In particular, it would avoid the need to calculate certain elements at country level, e.g.

- ETRs based on financial statement data (most will prepare on an entity basis but not per country);
- loss and credit carryforwards.

Covered taxes

The Pillar Two Blueprint states that entity level PBT should be calculated using the accounting standard of the parent [paras 256 and 258] and covered taxes should align with PBT [para 129]. While group accounting systems may allow to calculate PBT based on the parent's accounting standard, it won't necessarily be possible to ensure that tax calculations align with the group accounting standards, as tax is calculated based on the local GAAP financial statements.

While the Pillar Two Blueprint suggests that the local GAAP accounts can be used under certain circumstances, it is not clear that this is an option generally available to avoid a mismatch between covered tax and the PBT calculation.

We therefore suggest that where local GAAP accounts have been prepared and where that local GAAP is an approved GAAP, these can be used for determining both PBT and covered tax for the ETR calculation. Whilst this approach may generate inconsistencies with other members of the MNE group, it will eliminate other inconsistencies. In addition to the calculation of covered taxes point above, paras 251-253 highlight some of the issues.

UTPR

There is a need to simplify the design for UTPR. A statutory rate approach may be sufficient given the objectives of the rule. It should also be phased in since payee countries may take time to be able to implement their IIR or equivalent regimes. Given the significant administrative burden associated with the GloBE rules, careful consideration should be given to whether imposing such a burden could be justified where no “critical mass” of adopting jurisdictions is reached.

Subject to tax rule (STTR)

The purpose of Pillar Two is to ensure a minimum level of taxation, not to reallocate taxing rights. This suggests that there is no place for STTR or, if considered absolutely necessary, it should be ordered to apply subsequently to IIR. The scope should be very narrowly targeted (i.e. not apply to service income) and the rate of withholding tax very modest to avoid double / over-taxation. It might perhaps even be part of a single rule with UTPR based on the statutory tax rate.

Timing differences

Timing differences should be allowed to reverse over time. Relying on a deferred tax approach across the board would be more straightforward but, in absence of that, we need unlimited carryforwards.

The Blueprint largely proposes a tax accounting approach for accelerated depreciation, so a number of other book-tax timing differences that are material in a particular case could also be dealt with more straightforwardly in the same way. There is a particularly strong argument for those differences that may not reverse for an extended period of time, e.g. due to continuous growth of a business.

To address temporary book-tax differences, an excess tax carryforward mechanism, like that applicable for purposes of the IIR, should be allowed for purposes of the UTPR.

It is also critical that there is an unlimited look-back period for the carry forward of pre-regime losses and timing differences. Without an unlimited look back period, certain taxpayers be will rendered subject to taxation on profits in excess of the economic position, simply by virtue of where they are in their investment cycle.

The GloBE rules should permit inclusion of brought forward losses at a jurisdictional level to the extent that those losses are available for local tax purposes.

Retirement Benefits Schemes

Many groups operate a retirement benefits scheme to provide retirement benefits to their staff and dependents. The schemes would generally meet the definition of "Pension Fund" on page 32 of the report if established and operated exclusively to administer and provide retirement benefits to individuals and regulated as such. However, as a group retirement benefits scheme is not an entity that would otherwise be an ultimate parent entity, it would not meet the definition of Excluded Entity as defined on page 31 of the report.

Para 71 states that, "Further consideration will be given for cases where the exclusion should still apply in respect of a Constituent Entity that is not otherwise the UPE, such as certain life insurance and pension structures that are consolidated within an MNE Group and whose income is not beneficially owned by the MNE Group."

Not all groups consider their group retirement benefits schemes as constituent entities and consolidate into the group's consolidated financial statements. To remove any doubt and potential inconsistencies in relation to the treatment of employer-provided retirement benefits schemes, we would suggest full exemption from the GloBE rules for all employer-provided retirement benefits schemes that meet the definition of "recognised pension fund" in the OECD Model Tax Convention (para 1 of Article 3 of the OECD Model Tax Convention).

Further, local tax rules can delay or spread the timing of tax deductions for employer contributions to retirement benefits schemes which will lead to inconsistencies between the local tax base and the GloBE ETR calculation. For example, when UK employing entities make contributions to an employer pension scheme, the timing of the tax deductions can be spread over a number of years in the case of large, one-off contributions, e.g. to eliminate a defined benefit pension scheme deficit. Given that any such amounts will by definition be material, we would suggest the GloBE ETR calculation aligns with local rules where these require spreading of deductions for pension contributions.

Investment company taxation

Para 191 confirms that gains and losses on the disposition of stock where a minimum ownership threshold is not met (portfolio investments) will be included in the GloBE tax base. Jurisdictions may tax such gains on a realisation basis or on a fair value basis during the life of the investment. Certain jurisdictions, e.g. the UK, may apply both approaches depending on the nature of the investment and the company making the investment.

To avoid inconsistencies between the GloBE ETR and the actual tax base, we suggest gains on such investments are recognised for GloBE purposes in the same way as the investments are taxed at a local level.

Life insurance companies

At para 218 the report discusses life insurance companies where investment returns on policy holders' assets are recorded in the company's P&L account and the equity section of the balance sheet includes an adjustment reflecting the fact that the investment earnings do not belong to the company. The proposed approach is to strip out investment earnings from the GloBE tax base to the extent that they are exclusively for the benefit of policyholders.

Some groups account for life insurance company policy holders' returns in a different way, by including both policy holders' investment returns and an offsetting movement in the liability due to policy holders in the P&L accounts. Positive investment returns for the benefit of policyholders (a P&L credit) are matched by an increase in the liability due to policy holders

(a P&L debit). The net impact is that the profit before tax of the company only relates to the company's own profits.

For consistency, the GloBE tax base should strip out both elements (the investment returns due to policyholders and the P&L movement in the change in liability due to policy holders).

General simplification options

If global blending is not stipulated or permitted, a major simplification would involve Pillar Two being applied in a safe harbour kind of way instead of automatically requiring the calculation of ETRs for each country. For example, if the ETR based on global blending indicates that the ETR is above the determined threshold, tax authorities should abstain from analysing on the basis of Pillar Two, unless there is good reason why to proceed to an analysis based on jurisdictional blending. Tax authorities would need to evidence why the analysis based on jurisdictional blending is required. Further, a clear and subjective anti-abuse rule could be included to address extreme cases as to when this might be inappropriate.

- At the very least, a substitute for legal entity accounts based on the GAAP of the parent, with transactions recognised on an ALP basis, should be considered for those businesses that do not prepare or need them.
- Statutory tax rates could be used rather than ETRs, perhaps at the option of the business.
- Guidance (for taxpayers and tax authorities) on identifying 'high risk' that would allow a large number of entities to be excluded from the detailed ETR calculations.
- Excluding MNE groups with sufficiently high ETRs, again at the taxpayer's option and without the need to produce large amounts of ETR calculation information.

De minimis profit exclusion

In order to promote simplicity and reduce the administrative burden for both taxpayers and tax authorities we welcome the application of a practical approach to establish a threshold above which the rules should apply. The Pillar two Blueprint details a possible approach at 5.3. where it is proposed that jurisdictions be excluded from the ETR calculation, and therefore the rules on GloBE, where they have an accounting PBT below a certain threshold. The Blueprint mentions 2.5% of group PBT and although this is just an example, this level of threshold would remove a significant compliance burden for many MNE Group's.

As an alternative to having a percentage of group PBT as a threshold, the report also suggests a fixed quantum of PBT. This approach could also provide a practical solution and such a test is already applied by tax authorities in certain CFC regimes to remove immaterial entities from analysis. However, as noted by the OECD, we agree that in contrast to the application of a relative limit based on a set % of accounting profit, a fixed amount does not account for the significant differences in scale of MNE businesses that these rules will apply to.

If consensus cannot be reached on the value of the PBT threshold, an alternative approach could be a threshold limit, for instance the 2.5% mentioned in the report, and tax authorities could then be allowed to use their discretion to decide on either a limit between zero and this upper boundary, or alternatively whether or not to apply the rule at all, i.e. opt in or opt out.

We acknowledge that reaching consensus on simplification options will be difficult, however, we do feel that it is important to have proportionality between the administration and compliance burden being imposed on taxpayers and the tax impact of the rules and their objectives. Furthermore, in the event that jurisdictions are excluded from the rules due to the

application of a de minimis threshold, they will still have to comply with existing BEPS rules under Actions 8-10 and report CBCR data for risk assessment.

Next steps

EBIT Members trust that the above comments are helpful and are taken into account. We are keen to continue to engage in discussions which will help drive this project forward and in the further consultations that will be required if matters are to be implemented successfully.

Yours sincerely,

European Business Initiative on Taxation – December 2020

For further information on EBIT, please contact EBIT's Secretariat via Bob van der Made, Telephone: + 31 6 130 96 296; Email: bob.vandermade@pwc.com).

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