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**EBIT comments on the OECD Public Consultation Document titled Global Anti-Base Erosion Proposal ("GloBE") - Pillar 2**

To: Tax Policy and Statistics Division, Centre for Tax Policy and Administration

Sent via upload to: taxpublicconsultation@oecd.org

Brussels, 2 December 2019

Dear Achim,

EBIT's Members[1] are grateful for the opportunity to provide comments and input on the OECD's public consultation running from 8 November – 2 December 2019 with regard to the OECD's public consultation document (hereinafter: 'the consultation document') titled "*Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two*."

**Comments**

Given time constraints EBIT has focused its input on the key areas identified in the consultation document, while taking the opportunity to highlight other design / policy issues in the final section of the document. At this stage, we are able to provide a range of comments on the three key areas of the income inclusion rule on which the consultation document is focused. We look forward to further development of these points in later consultation on the income inclusion rule and in relation to the numerous other issues raised in the May 2019 Work Programme to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy.

EBIT recognises the work done by the Secretariat in working through the issues and the challenges and we are looking forward to seeing more specific proposals on Pillar 2 as a whole soon. At the same time, we are concerned about the amount of time left in the early part of 2020 for discussion of the technical details on Pillar 2 (and indeed the combined approach of Pillar 1 and Pillar 2). We urge the OECD to put forward more concrete and substantial proposals for proper consideration as soon as possible We will welcome the opportunity to provide further comments then.

In EBIT's view, the proposals will need to be practicable and proportionate to implement and to narrowly target those situations in which BEPS could still arise. There is a risk of a significant and complex administrative and compliance burden being created across the board in a disproportionate manner, especially in light of the existing BEPS measures that countries are still in the process of rolling out globally. In this regard, we would advocate that the interaction with Action 3 (Controlled Foreign Company regimes) be leveraged so as to build on the work already done, avoid duplication and ensure any additional compliance burden created is targeted and proportionate.

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[1] EBIT membership information is available on: www.ebit-businesstax.com; EBIT Member companies include: AIRBUS GROUP, BP, CATERPILLAR, C-BRANDS, DEUTSCHE LUFTHANSA, DIAGEO, GSK, HUAWEI, INTERNATIONAL PAPER, JTI, NASPERS, PEPSICO, PFIZER, P&G, RELX GROUP, SCHRODERS, SHV GROUP, TUPPERWARE, UTC.

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## 1. Tax/ accounting basis

For simplicity and administrability reasons, Pillar 2 should be based on worldwide consolidated financial statements prepared under the GAAP of the parent entity. The use of consolidated financial accounts in calculating the tax base under Pillar 2 has the advantage of providing the most readily available and partially validated figures (an audit currently provides a view rather than the kind of precision expected for tax purposes), noting, however that significant system changes would be needed to be able to geographically separate/break down income and taxes in the way described in the consultation document.

In this case, it seems highly appropriate in order to avoid unwanted distortions to exclude the impact of certain things that are concepts in tax but not in the accounts or vice versa (permanent differences) or that are recognised in both but in different time periods (timing differences). The range of adjustments that ought to be made depends on the tax system in point – that will determine what permanent and temporary differences arise – so that principles should be described unless a lengthy list is envisaged.

Some complicated considerations apply to the possible ways of dealing with timing differences. Not all groups use deferred tax accounting or, if they do, they sometimes use it only at a global level (so, if anything other than global blending is used additional complex accounting would be necessary). A change of tax regime (or just tax rate) can result in a severe impact on the calculation of the tax arising from timing differences - a restatement of a deferred tax asset/liability could result in a significant adjustment to a specific year's accounts tax charge/ provision, a carryforward might not reflect the nature of the change (and a carryback would not be easily administered or well received by a tax authority) and a long averaging period may be required to smooth out the figures sufficiently. Global blending, by contrast, could be effective at smoothing over volatility issues arising from temporary differences, but without giving rise to many of the challenges which the consultation document rightly identifies as needing to be addressed when adopting any of the other proposed approaches. Addressing those challenges (e.g. dealing with trading tax attributes under a carry-forward mechanism) would introduce additional layers of complexity into rules which will already be complex enough to administer / comply with.

In view of these inevitable challenges, we would strongly recommend that the application of any new regime and any adjustments required to the financial accounts should be agreed between the taxpayer and its parent country tax authority, rather than having to reach agreement with multiple tax authorities, with all of the administrative burden and risk of inconsistencies that that would entail.

If an existing minimal effective tax regime already exists in a jurisdiction, its tax basis should be used – whether or not that used the consolidated financial accounts – or the regime should be accepted as a 'white-listed' regime so no further or intermediary charges are applied (see further below).

## 2. Blending of rates

If consolidated financial accounts are used as a starting point, a worldwide blending approach will be the most likely way to make Pillar 2 work, for simplicity and administrability reasons (the wider the scope of the blending, the easier/simpler the application of the rules). As mentioned, global blending could smooth over timing differences and subsequent changes in tax paid (e.g. due to audit or transfer pricing adjustments). It could also reduce (although not fully eliminate) the need for carve-outs because the aim would be to ensure an MNE pays a minimum tax globally. In addition, Pillar 2 is stated to leave countries the freedom to determine their own tax systems. Of the three approaches proposed, worldwide blending would infringe the least on countries' tax sovereignty.

While it is theoretically possible to see an argument that income could be manipulated to take advantage of a low tax rate in a particular jurisdiction, it is probably not a proportionate response to deal with an amount which would be by definition relatively small for the group (if it didn't sufficiently affect the group effective tax rate). There might be sourcing issues in relation to certain types of taxes that would add to both the complexity here and the risk of double taxation.

Consolidated financial statements have the advantage over entity/local country accounts that – for listed companies at least – they not only need to be audited but there will be a commercial pressure to maximise rather than minimise income recorded in those accounts (i.e. delivering positive results for investors and analysts trumps any pressure to reduce taxable profits).

EBIT considers that irrespective of the level of blending, intercompany dividends should be excluded.

## 3. Carve-outs

The proposals for an income inclusion regime largely take existing controlled foreign company (CFC) type regimes and apply a much stricter set of criteria. The arguments that have arisen about the effectiveness of many of these CFC regimes have centred about the extent of carve-outs and 'incentivised' rates.

While there are cases for including carve-outs, we risk duplicating the issues faced previously with CFC regimes. However, some may not be carve-outs but rather proper descriptions of the scoping of the intended targets. Much clearer objectives are required before we can consider this. If the target were harmful tax regimes (or some category of preferential regimes), anything which didn't scope out those regimes which have addressed BEPS Action 5 recommendations or other substance requirements would risk undermining those measures. Further, it is critical that the proposals do not adversely impact international trade and investment by affecting existing investment incentives regimes, particularly those that are compliant with the standards of BEPS Action 5 on harmful tax practices. If this were to happen, there is a risk it could encourage the provision of incentives outside the tax system, reducing transparency and potentially undermining the output of the BEPS Actions to date. Insofar as R&D tax incentives are concerned, both front end incentives - such as R&D super deductions and R&D tax credits, and back end incentives - such as patent boxes – should be carved out given such regimes are generally substance-based, and so there is a minimal likelihood of BEPS, and acknowledging the critical role R&D plays in stimulating innovation and economic growth.

A tax aimed at passive and highly moveable income begins to sound like a CFC regime anyway, but could by definition exclude or allow for a fixed return on immoveable assets.

Some countries have already addressed minimum taxation. It seems to make sense to 'white-list' any such regimes which can be considered to be as effective (e.g. the U.S. GILTI regime), and to prevent another country from imposing a similar charge where they act as intermediary between an investee and the ultimate parent entity.

In a European context, any new regime that imposed 'blanket' income inclusion without a carve-out for entities with sufficient economic substance, would likely be illegal under EU law (as per the CJEU judgment in *Cadbury Schweppes*) and if then there necessarily must be a substance carve-out, wouldn't the new regime start to look more like an ATAD/BEPS-compliant CFC regime in any case? Hence, Pillar 2 might be better focused on adapting existing CFC regimes – or at the very least replacing rather than duplicating them.

## 4. Other

As noted above, there are a number of additional matters that EBIT Members consider to be key to the future deliberation of Pillar 2. The consultation document does not call for comments on them now and the time available does not allow for a full and detailed explanation but it may help to identify the following:

- The rate to be used as the benchmark (rate should be kept low, while recognising that a worldwide blending approach may warrant a higher rate as compared to a jurisdictional/entity approach);
- Application of the income inclusion rule only at the ultimate e parent entity level;
- Interaction of Pillar 1 and Pillar 2 (with Pillar 1 first);
- Ordering rules within Pillar 2 (income inclusion rule first, undertaxed payment rule only a backstop);
- Design of undertaxed payments rule:
    - targeted scope (interest and royalties)
    - adjustment by way of partial denial of deduction under undertaxed payments rule
    - no withholding tax mechanism for administrative/practical/cash flow reasons;
- Elimination of, and standstill commitment with respect to, unilateral minimum tax rules that have not been "white-listed" for pillar 2 purposes; if the design of pillar 2 is more holistic, the same goes for other overlapping rules, such as CFC rules (and need for constant review by OECD or FTA or a smaller subset of countries);
- Need for dispute prevention and resolution mechanisms (expect more disputes, amongst others, because of limited or no tax administration capability in area of tax accounting);
- Change of ownership (less of an issue if global blending);
- Taxes to be taken into account (definition of "income" tax for accounting purposes can be volatile/inconsistent between jurisdictions and companies) e.g.:
    - joint venture accounting
    - treatment of withholding taxes and final taxes on revenue
    - treatment of tax penalties and interest, and
    - treatment of taxes on gross margins e.g. in France there is "CVAE" which is sort of a tax applied on gross margin and is considered income tax for US GAAP purposes)
- EU law related aspects (already partly and briefly alluded in the previous section); and
- Draft legislation to include the rules in domestic law - cf CbCR draft legislation.

EBIT Members trust that the above comments are helpful and are taken into account and look forward to providing additional assistance with the further consultations on Pillar 2 to come.

Yours sincerely,

**European Business Initiative on Taxation – December 2019**

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).