The **BEPS** Monitoring Group

COMMENTS ON THE OECD CONSULTATION DOCUMENT ON A GLOBAL ANTI-BASE EROSION PROPOSAL ("GLOBE") - PILLAR TWO

This submission has been prepared by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This report has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It has been drafted by Sol Picciotto, Jeffery Kadet and Jim Stewart, with contributions and comments from Joy Ndubai.

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SUMMARY

The proposed anti-base erosion tax is welcome as an essential component of effective measures to ensure that multinational enterprises pay tax where they have real economic activities. Its main aim should therefore be to ensure that business profits are effectively taxed at their source. A primary goal should be to nullify the beggar-thy-neighbour preferential tax regimes offered by states competing to be residence or conduit locations for services, funds, or property provided to operating companies in source states. These are a major source of BEPS, as they reduce the taxable profits of operating companies, while the payments are often not taxable by the source state and subject to low or no taxation in the either the home country of the multinational enterprise (MNE) or the country of residence of the conduit. Such regimes have undermined the tax bases of other countries and continue to do so. Because of this, priority should be given to the tax on base eroding payments as against the income inclusion rule.

Tax incentives to attract inbound investment involve a legitimate and understandable national policy trade-off between increased local employment and real operations and lower tax receipts. However, we agree such tax incentives should be discouraged and curbed, if possible, as they contribute to the ongoing race to the bottom.

We propose a superior approach that would work to counter these two situations in an integrated way. This approach would also provide more accurate and easier to determine results than the Unified Approach of Pillar One.

Our holistic approach is based on a formulaic substance rule, which would be much easier to administer than the GloBE Proposal. It would require agreement on a method to define MNEs' global tax bases that applies necessary tax adjustments to MNEs' consolidated accounts. It would also require agreement on the principles for multi-factor allocations of profits, followed by detailed technical work to define specific allocation keys and weightings for common business models and industries/sectors. Such keys would be objective,

quantifiable, and location-specific factors that reflect where real activities take place and sales are made. Even if this approach were not also used for Pillar One, it would identify for Pillar Two when income reported by an entity is excessive in relation to its real activities and sales, whether from the perspective of the host (source) or home countries. The template for country-by-country reports could be suitably modified to provide the necessary data for easy administration of this system. The formulaic allocation would also establish a cap for application of both the denial of deductions/withholding tax and the income inclusion rules, more easily resolving the issue of priority.

A brief description of the holistic approach is included in Appendix 1.

1. General Comments

We are grateful for the opportunity to make this submission, and note that 'comments are welcome on all aspects of the Programme of Work on Pillar Two, but requested specifically on three technical design aspects of the GloBE proposal'. In our view it is essential to consider detailed technical issues in the context of the overall design of the proposal. We will therefore in this section make general comments on the proposal as a whole and on some of its key elements. The second section will respond to the questions on the specific technical issues dealt with in this consultation document ('the document').

1.1 Aims of the Proposal

We welcome the proposal for an anti-base-erosion tax, which we consider to be an essential component of a package aimed at ensuring that multinational enterprises (MNEs) pay tax where their economic activities occur, and value is created, as mandated by the G20. As the document points out (paragraph 7), such a measure would reduce the incentive for taxpayers to engage in profit shifting, establish a floor for tax competition among jurisdictions, and act as a brake on the 'harmful race to the bottom on corporate taxes, which risks shifting the burden of taxes onto less mobile bases and may pose a particular risk for developing countries with small economies'. We agree also that, if well designed, such a measure 'may shield developing countries from pressure to offer inefficient tax incentives'.

However, we stress that the primary objective must be to establish effective measures to nullify the preferential tax regimes offered by states competing to be residence or conduit countries for outbound investment, many of which are developed countries. Tax incentives to attract inward investment reduce the tax revenues of the countries offering them. A country has the right to take a policy decision to balance tax revenues against attracting inward investment for real business activities and employment. Since the competition to reduce effective tax rates on real investment is damaging to all, we agree that it would be desirable to brake this race to the bottom. However, it is the preferential regimes offered by states competing to be resident and conduit countries for outbound investments that have so undermined the international tax rules, by beggaring their neighbours. These should be the main targets of Pillar Two.

It is now over twenty years since this problem was first referred to the OECD by the G7 leaders, resulting in the first measures against harmful tax practices. The issue was again included in the BEPS Action Plan of 2013, resulting in further refinement of the criteria for evaluating harmful tax practices. Although BEPS Action 5 had some positive effects in phasing out the most egregious preferential regimes, it also had the negative result of legitimising those which were not found harmful. This has created a perverse incentive for countries to adopt such regimes, the extensive spread of which shows that the Action 5 measures must be supplemented. It would therefore be clearly inappropriate to allow a carve-

out for regimes found not harmful under Action 5. Pillar Two must be designed to supplement the standards on harmful tax practices.

The core problem here is the provision of low tax rates for entities engaged in activities that lack commensurate substance, and which take advantage of the principle of separate accounting or independent entity in international tax. It is this combination that encourages MNEs to design group structures that fragment their activities, and assign supposedly high-margin functions to entities in jurisdictions offering low taxation for those activities. These include

- group service functions such as corporate headquarters, treasury and finance;
- holding companies for the ownership and management of intellectual property and other assets such as aircraft;
- management of franchised business in sectors such as fast-food and hotels;
- consultancy, professional, engineering and other technical services; and
- activities such as design, logistics, procurement, and commodity trading.

Entities to which such functions are assigned can easily be located in convenient jurisdictions that provide low or zero tax rates on income earned from providing these services, especially to clients outside that jurisdiction. Digitalisation has greatly facilitated the ability of their employees to provide these services with a minimal physical presence in the countries where they are delivered. In addition, payments for such services reduce the taxable income of their clients, whether those clients are related entities or not. These are classic BEPS devices. Pillar Two should be aimed primarily at these regimes, and not at the incentives offered for inbound investment, especially those offered by developing countries.

The measures on harmful tax practices developed in Action 5 of the BEPS project have been ineffective in relation to these structures, because those measures lack a suitable substance test. To determine whether affiliates carrying out these functions have been attributed an appropriate level of income, tax authorities must continue to rely on transfer pricing rules, which are still largely based on the independent entity principle. The revisions agreed in the BEPS project targeted simple ‘cash box’ entities. In response, however, countries have introduced minimal substance requirements, such as a physical base and a low level of operating expenses. For example the Netherlands, which has long been a favoured location for conduit companies, introduced substance requirements in 2014 and 2018, which however are largely formal, e.g. having local directors. The only substantive test is that the entity must have office space and annual salary expenses of 100,000 euros.[1] The current transfer pricing rules are ineffective against such arrangements, since they are subjective, hard to apply, and create conflicts.

In principle, these problems should be dealt with under Pillar One, which aims to devise more appropriate rules for the allocation of MNE income. However, the current proposals under Pillar One are far from comprehensive, and would not resolve these problems. First, they are limited to ‘consumer-facing’ business, which would not cover any of these business-to-business services. Furthermore, they would allocate only a part, likely to be small, of the so-called ‘non-routine’ profits of MNEs to the ‘market’ jurisdiction. They envisage that the remaining non-routine profits would be allocated using current transfer pricing rules. As we

[1] Aidha, C. N., A. Maftuchan, M. Hietland and J. v. Teeffele (2019). *How the Indonesia-Netherlands tax treaty enables tax avoidance*, Prakarsa & SOMO, p. 35. These measures have been found not harmful by the Forum, so other jurisdictions have followed suit, e.g. Mauritius.

have pointed out in our submission to the consultation on Pillar One, the claim that these rules work well in most cases is far from the truth.

It is just as important to protect the tax base of source countries from base-eroding payments as to preserve the tax base of home countries by ensuring that foreign income has been correctly attributed. Indeed, as we argued in our submission on the OECD Secretariat draft on Pillar One, a strong case can be made that it is source countries where economic activities take place, due to the increasingly close interaction between suppliers and consumers of services. Yet, the design proposals for Pillar Two seem to prioritise income inclusion rather than restriction of base eroding payments. This would be a fundamental design flaw of Pillar Two. The income inclusion rule would be in effect a full-inclusion rule for CFC income, which we advocated for Action 3 of the BEPS project, but which was not adopted at that time. Such a rule should of its nature give priority to taxation of business profits at source, in the country where they are earned. If it does not do so, the proposals would also fail to meet the test that they should be appropriate for developing countries.

A better approach would be to design Pillar Two to integrate its two elements. What is needed for both Pillar One and Pillar Two is a clear and easy-to-apply methodology for aligning the income and tax payable of MNEs with their real activities in each country. Our submission on Pillar One outlined our proposals for reform of the current rules to achieve this outcome, based on a combination of principles and pragmatism. At the same time, it is important that the design of Pillar Two should complement that of Pillar One, so that it can act as a backstop.

1.2 A Holistic Approach based on a Formulaic Substance Rule

The current proposals for Pillar Two aim to provide a coordinated set of rules constructed around four component parts, illustrated in the graphic on p.6 of the document. However, the approach adopted seems to be to design the component parts without considering the coherence of the overall design, which creates problems for their coordination. Furthermore, the issue is being viewed from the perspective of the MNE's home country. The present consultation focuses on issues primarily relevant to taxation by the residence country (the income inclusion and switchover rules): the suitability of defining the tax base starting from the financial accounts of the 'shareholder jurisdiction', the interaction with CFC rules, and how to deal with blending and carve-outs in determining the effective tax rate. Although no decision has apparently been taken yet, the implication is that when it comes to coordination, priority would be given to income inclusion by the residence country.

We suggest that a holistic approach should be adopted, which would combine the elements in Pillar Two, while also ensuring that it complements Pillar One. Both the elements of Pillar Two are premised on participating states including in their own tax base MNE income that is not effectively taxed in another jurisdiction. The income inclusion rule would do so by including low-taxed income of a foreign branch or subsidiary in the tax base of its parent, while the tax on base eroding payments would deny deductions or treaty relief to achieve the same objective. At the same time, the aim of Pillar One should be to devise rules to allocate the income of MNEs, and the tax they pay, according to a measure of their real activities in each country.

What is needed is a common measure for this test of substance, by using a multi-factor allocation of profits. For Pillar Two, it would identify when the income that has been attributed to an entity is excessive in relation to its real activities, whether from the perspective of the host (source) or home countries. As outlined in our submission on Pillar One, we propose that this should be based on quantifiable and location-specific factors that

reflect where real activities take place. As put forward in the fractional apportionment method proposed by the G24 for Pillar One, this should balance supply-side factors (labour, capital, and users where relevant) with demand-side factors (sales). Appendix 1 summarises our proposal, showing also how it could be introduced with the least disruption to existing international tax rules.

This would have many advantages also for Pillar Two. Not least, it would ensure that the measures are non-discriminatory and hence valid under investment treaties and EU rules. The same test of substance would be applied to local MNE parent companies and subsidiaries of foreign-based MNEs, and its aim would clearly be to ensure that they are taxed similarly to domestic firms. Such a combined approach would also ensure proper coordination between the two elements greatly reducing the need for complex linking and priority rules, and hence make the tax simpler and easier to apply.

The substance test should therefore be based on applying the generic allocation principles of labour, capital and sales (and users where appropriate), with more detailed quantifications and weighting to be developed by agreement for common business models and industries or sectors. Countries that adopt such an apportionment approach to determine the income in their own tax base, could apply the same principles in determining whether income attributed to other countries is adequately aligned with substantial economic activities. Once some detailed technical work has been done to define and quantify the application of these principles to common business models, as outlined in Appendix 1, appropriate formulas could be applied in a simple way.

However, to allow for some genuine disagreements on details, there could also be an allowance (e.g. of 20%) to act as a safe harbour. In other words, income declared in a jurisdiction with an effective tax rate below the minimum that exceeds 120% of the amount indicated by the substance test would fall within the scope of the tax. This would also help to deal with year-to-year variations in the tax paid in a jurisdiction, without the need for a complicated system of carry-forward. The following is an example of how such a system could work.

Example

Country	RUP	FOM	OTB	CSB	FMM	Totals
declared taxable profit	100	300	500	4	96	1000
applicable tax rate	20	12.5	0	25	30	
cash tax paid	20	37.5	0	1	28.8	87.3
profit indicated by allocation factors	460	300	5	5	230	1000
apportioned profit +/- 20%	419.7	360	6	4.6	209.7	1000
tax chargeable on apportioned profit	85.8	45	0	1.5	59.7	192

RUP = residence of ultimate parent
FOM = foreign operations + some marketing
OTB = offshore tax base
CSB = conduit services base
FMM foreign mainly marketing

The example assumes that the effective tax rate is set at 15%. FOM and CSB are countries where the MNE has some operations, but which allow it to reduce its global ETR by attributing profits to OTB, due to preferential regimes. FOM and OTB both apply a tax rate below the target ETR, while CSB's is higher. The profit apportioned to FOM and OTB is increased by 20% above the amount indicated by applying the allocation factors. For FOM, if it taxed the apportioned profit, the increase brings the ETR to 15%. The 61 of profits added to the profits indicated for FOM and OTB by the 20% allowance are deducted from the profit indicated for RUP, CSB and FMM, in proportion to their allocation. The caps on both the deductions that CSB and FMM can deny and the income that RUP can include ensure that there is no overlap, without the need for a priority rule.

1.3 Calculation of the Effective Tax Rate and CbCRs

The key question of how to calculate the effective tax rate is not directly discussed in the document. Since it would be a ratio of tax to profits (T/P), both these concepts would need to be carefully defined. They also need to be aligned with the definitions developed for the purposes of country-by-country reports (CbCRs), to facilitate administration. The CbCR template should therefore be revised, to enable those reports to be used for the purposes of this tax.

As regards the numerator (T), the CbCR template requires data by each tax jurisdiction for income tax paid (on a cash basis), and income tax accrued (current year). The current discussion document is not clear on which measure would be used for the numerator of T/P. It states in para. 16 that: 'the numerator of the effective tax rate fraction could be based on the actual tax liability or the tax expense accrued for accounting purposes, which may need to be further adjusted to remove accruals of tax related to a different period'. This seems to refer to the tax charge shown in the P & L account or income statement, rather than cash tax paid, which is shown in the flow of funds statement. Over time there is often a considerable difference between the tax charge as reported in financial accounts and cash tax payments. Section 2.3.2 of the document discusses methods for dealing with such differences, and (ii) discusses deferred tax accounting under financial reporting standards.

In our view, financial reporting standards are absolutely unsuitable for these purposes. In particular, many MNEs indicate in footnotes to their financial statements substantial 'uncertain tax benefits', often running into billions.[2] These disclosures demonstrate that such MNEs take positions in filed tax returns that they do not believe would be sustained on audit or in an eventual judicial decision. It would be wrong to give credit for taxes claimed as accrued but which will not be paid unless the tax authority is able to put sufficient resources into an audit which would be upheld by a court. The figure for T should be cash tax paid, and the differences over time should be dealt with by using multi-year averages, as explained in paragraph 44. Alternatively, the approach we put forward (see previous section) would adequately deal with such variations.

For the denominator (P), the CbCR template does not specify how profits should be calculated, either for consolidated profits or by jurisdiction. The assumption is that what will be reported are financial profits, and consolidated accounts may use a different standard from those for local jurisdictions. The calculation of T/P for the GloBE must be done on the basis of profits defined for tax purposes. Hence, the work on Pillar Two should involve a revision of the CbCR template. However, under the approach that we propose (see section 1.2 above), this would be necessary only for consolidated profits, as profits would be allocated to

[2] For some calculations see https://www.tax-whistleblower.com/ferraro500/ .

jurisdictions by an appropriate formula. This would greatly ease the compliance burden for MNEs.

It is important that the definition of profits for the purposes of calculating the effective tax rate, which form the tax base, should be broad. In particular, it should reflect the depreciation and amortisation reported in financial statements. Deductions such as accelerated depreciation, R&D allowances, and write-offs of capital expenditure artificially reduce profits and hence should not be allowed in defining the tax base.[3] The denominator must be carefully defined to ensure that countries do not avoid application of the minimum rate by introducing such generous allowances.

Care should also be taken in specifying how losses should be treated. First, it should be noted that tax reduction strategies can involve the transfer of losses within a group as well as profits. That is why we recommend the use of a formulaic substance rule in attributing profits by jurisdiction (see previous section). Trading losses (and tax losses) also represent a valuable asset. If a subsidiary with tax losses is sold or merges with another entity, would full losses be recognised in computing effective tax rates? Because artificial manipulation of losses could artifially lower the tax base and tax receipts, there are often restrictions on the ability to use losses to reduce current tax payments. We therefore support the proposal for 'a limitation on the time period that excess taxes or losses could be carried forward' (para. 47).

2. Comments on Specific Questions

We note first that these questions are primarily directed at issues of implementation, and often at practical aspects of compliance, especially the costs. We agree that minimising compliance burdens is important. However, we believe that the heaviest compliance burdens will fall on those MNEs that have aggressively shifted profits through dozens or even hundreds of group members, many of which were established primarily as part of a tax minimisation structure. Such groups have reaped what they have sown. We should not be concerned with increased compliance burdens falling on such groups. The burden will simply be one more encouragement for such groups to simplify their structures and to unwind their profit shifting arrangements.

1. Defining the Tax Base and Use of Financial Accounts

a) Do you agree that the use of financial accounts as a starting point can provide an appropriate income base (for the computation of an effective tax rate) and would simplify and reduce the compliance costs of the GloBE proposal?

As argued in the first section above, we suggest that the design of Pillar Two should coordinate with that of Pillar One. The proposals for Pillar One rightly aim to develop a methodology for allocating the MNE's global taxable profits. The Secretariat's Unified Approach for Pillar One proposes that, although the starting point would be the consolidated financial accounts of the MNE group, work would be done to identify an appropriate measure of profits. Hence, the same methodology should be applied in Pillar Two.

Data in published financial accounts is useful in estimating the tax base for the effective tax rate calculation, but only for the consolidated accounts of the MNE as whole. Because of choices in how different expenditures may be reported and assets valued care is need in

[3] See Markle, K and Shackelford, D (2011), 'Cross-country Comparisons of Corporate Income Taxes', *National Tax Journal* 65 (3): 493-528.

interpreting this data even if prepared using for example US GAAP or IFRS. Hence, as we argue in section 1.3 above, there should be an appropriate revision of the template for Country by Country reports, so that they could provide an administrative basis for coordinated application of this anti-base-erosion tax.

Under the formulaic approach that we put forward (section 1.2 above), there would need to be an adjustment of the financial accounts only at the level of the consolidated group. This would be a major advantage. The tax authority of the ultimate parent's residence country could be primarily responsible for auditing, and the relevant data could be made available to others via the CbCRs. The approach that seems to be currently under consideration would create significant complications. In all cases, MNEs should be required to reconcile their CbCRs at the country-level with their consolidated accounts. Again, this reconciliation can best be audited by the tax authorities of the ultimate parent's resident country.

b) What would be the consequences of using the accounting standards applicable to the ultimate parent entity of the MNE? Would you suggest a different approach?

In our view, this question is relevant only in determining which standards are appropriate for the consolidated accounts, to be used as the starting point for determining the tax base. The attribution of profits by jurisdiction should not rely on the financial accounts of the entities in each jurisdiction, but should be done formulaically, as outlined in section 1.3. Most MNEs use IFRS, or the GAAP of leading G20 countries, and those that do not should be required to do so (see answer to question (e) below). The technical work under Pillar Two should therefore focus on specifying the adjustments needed to these dominant standards to define the appropriate tax base.

c) How would you recommend determining whether a financial accounting standard is an appropriate standard for determining the tax base under the GloBE proposal?

See previous answer.

d) Do you have concerns that allowing more than one financial accounting standard to serve as the starting point for determining the tax base under the GloBE proposal will place some MNEs at a competitive advantage due to variations in financial accounting standards among jurisdictions?

See previous answers. The variations in accounting standards between jurisdictions, even where they are based on IFRS, can be very significant. That is why we propose defining the tax base at the global level, with a formulaic approach to attribution by jurisdiction in order to identify under-taxation.

e) There may be some instances where MNEs, particularly smaller MNEs, do not prepare consolidated financial statements for any purpose. How much of an issue do you think this is and for what types of MNEs? Where this is the case, how would you suggest the issue should be addressed?

The issue of smaller MNEs not producing consolidated accounts is of less importance than very large privately owned MNEs not producing consolidated accounts, or not producing publicly available accounts for key markets, for example Koch. In addition, disclosure of information useful for tax compliance by publicly traded MNEs can give privately owned MNEs a competitive advantage. This is another argument for publication of CbCRs. There should be a requirement for all MNEs to prepare, and indeed publish, accounts based on IFRS or another appropriate GAAP.

f) Are there additional or different considerations that apply to the tax base determination for purposes of an undertaxed payments rule?

As we argued in section 1, it is essential that Pillar Two should be designed in an integrated way. Otherwise there would be insuperable coordination problems, leading to uncertainty and conflict.

2. Permanent Differences

a) What are the material permanent differences between financial accounting income and taxable income that are common across jurisdictions and that you think should be removed from the tax base without undermining the policy intent of the GloBE proposal?

The reasons for differences between financial accounting income and taxable income should be disclosed in accounts of MNEs. This applies in particular to differences due to differing tax rates and other fiscal incentives. This is a disclosure requirement for Form 10K required by the US SEC.

For the purposes of the GloBE, it is important to define the tax base (taxable income) broadly. As we argued in section 1.3, it should not include accelerated depreciation, R&D allowances, or other notional deductions. The basic principle of tax accounting is well known: to recognise only actual expenditures and receipts. The rules agreed within the EU for definition of a Common Corporate Tax Base should provide relevant experience for this work.

It seems to us appropriate that intercompany dividends can be excluded from the tax base. The company paying the dividend will have had the Pillar Two tests applied to it as either a separate entity or as part of some blended group of related entities. The same should be true for any equity method income or loss recognized within a group member from its ownership in another group member.

On the other hand, gain or loss from the sale or other disposition of shares in another group member or non-group member should never be treated as a permanent difference. First, many countries tax gains on shares. There can be legitimate taxation both at the level of the operating company and at the level of the shareholder that transfers the shares. The participation exemptions or other exemptions that some countries allow are not a reason for eliminating income or loss from the measurement of the denominator. Rather, they are a reason for including such gains or losses. Often, such exemptions have been used in tax structuring at the intermediary holding company level. Perhaps such exemptions should only be potentially recognized as permanent difference adjustments at the parent company level.

It should be added that transfers at fair market value recognize value within an entity the shares of which have been transferred, but which the entity may not have yet realized as income for accounting purposes. An example is the development of real property by an entity, the shares of which are then sold prior to any sale of the developed property. When the buyer chooses to use the developed property, there may be no sale and only rental income over a long period of time within the entity in the future. The 'development profits' within the entity are not recognized at the time of development.

b) Do you have views on the methods that could be used for dealing with permanent differences?

The technical work on Pillar Two (in conjunction with Pillar One) should focus on specifying the adjustments that should be made to consolidated accounts, prepared under IFRS or other well-known GAAPs, to identify the global tax base of each MNE. Once that tax base is

defined, the attribution of profit by jurisdiction should be done formulaically, for the purposes of Pillar Two, as outlined in section 1.2 above.

c) Do you have any comments on the practicality of making adjustments for permanent differences?

d) Do you think any other adjustments to the financial accounts require attention?

3. Temporary Differences

a) Do you have any comments on the use of carry-forward of losses and excess tax as a mechanism for addressing temporary differences under the GloBE proposal?

A clear distinction should be made between carry-forward of operating losses and of tax. Under our proposed approach the problem of carry-forward would be much less acute, as it would be relevant mainly to the consolidated accounts. At jurisdictional level, the focus would be on over-attribution of profits as tested against the relevant allocation formula, with an allowance of 20%, as outlined in section 1.2.

b) Do you have any comments on the use of deferred tax accounting as a mechanism for addressing temporary differences under the GloBE proposal?

See section 1.3 above. In our view, the T/P calculation should be based on cash tax paid. Variations over time could be dealt with by using multi-year averages, as suggested in para. 44 of the discussion document.

c) Do you have any comments on the use of a multi-year approach to measure the average effective tax rate as a mechanism for addressing temporary differences under the GloBE proposal?

The central aim of the GloBE mechanism is to discourage MNEs from creating aggressive structures in the first place. With this in mind, it seems to us appropriate to make it very simple at the expense of theoretical accuracy. This suggests that multi-year averaging and other blunt simplified approaches and assumptions should be considered. Adjustments could be made for only relatively major issues.

d) Do you have any comments on what limitations (if any) should be imposed on the normal financial accounting rules for deferred tax assets and liabilities and the practicalities of imposing those limitations?

A number of MNEs have used a structure of transferring intangibles into a mid- to high-tax jurisdiction at a high fair market value, thereby creating a very large base for amortization of those intangibles. The group member selling those intangibles and realizing gain is not taxed on that gain. Whatever system is used must account for this and not allow the benefit of a permanent difference adjustment from this technique.

e) Do you see opportunities for potential abuse in any of the approaches for addressing temporary differences described above? Do you have suggestions for designs to prevent those abuses?

Restrictions should be put on the nature of losses that may be offset against future profits, for example those arising from trading, rather than asset write downs. Trading losses that are tax deductible should also be restricted to those arising from trading outside the group.

f) Do you have any suggestions for alternative mechanisms for dealing with temporary differences?

g) Do you have any additional comments on Section 2, including comments based on experiences with existing regimes that you suggest should be adopted or avoided?

4. Blending

a) How would you assess the general compliance costs and economic effects of a GloBE proposal that is based on either an entity, jurisdictional or worldwide blending approach?

In our view, it would be completely counter-productive to allow global blending, i.e. to apply the tax only if an MNE's aggregate tax on income falls below the minimum. This would encourage MNEs to continue to devise complex structures seeking to take advantage of preferential tax regimes, and stimulate further tax competition between states. The aim should be to halt the decline of effective tax rates on MNEs, narrow the gap between nominal and effective rates, and promote convergence of effective rates to levels that all taxpayers can accepts as legitimate, and that support adequate and sustainable government revenues.

However, it may be desirable to leave policy space for countries to provide incentives for income resulting from real employment and business activities, and which are not only aimed at foreign MNEs. This could be done by allowing 'blending' at the jurisdictional level. This would mean that a corporate group benefiting from a low rate must also have sufficient income taxed normally in the jurisdiction to bring its combined effective tax rate above the minimum. In this way, countries could offer tax relief for economic development activities, provided that the benefits do not go to MNEs with no other economic activities in the country. It would also allow other tax and non-tax benefits targeted at specific types of investments by any company, as long as the company's overall effective tax rate in that jurisdiction is not reduced below the minimum.

5. Blending and Volatility

In the absence of any of the approaches for addressing temporary differences discussed in Section 2, do you consider that a worldwide approach would be effective at managing the volatility issues discussed above?

A worldwide blending approach would absolutely defeat the purpose of the GloBE mechanism since it would allow absorption of large amounts of zero- and low-taxed income against the group's higher taxed income. Hence, it should not be used. The volatility issues are simply not relevant to this more basic point about the unacceptability of worldwide blending.

6. Use of Consolidated Financial Accounting Information

a) Assuming that the MNE's income for purposes of the GloBE proposal would be determined by reference to financial statements (adjusted as necessary) and assuming further that an MNE already prepares consolidated financial accounts, what are likely to be the compliance implications for MNEs in (i) separating the income and taxes of their domestic and foreign operations under a worldwide blending approach, (ii) separating the income and taxes to a jurisdictional level, or (iii) breaking down income and taxes to an entity level?

With few exceptions, each group member within an MNE has legal obligations to its country of establishment and/or the countries in which it operates to report entity level information. Accounting systems may create significant data for management at a divisional or product/service line level with legal entity lines being ignored, but the detailed books and records will still be kept primarily on a legal entity basis. As such, the norm will be that the compliance burden will be lowest for entity-level determination of income and taxes. Regarding the separation of income and taxes between domestic and foreign, the reporting requirements for segment and geographic reporting will most often mean that such separation will necessitate little additional compliance burden. Because many MNEs have multiple divisions/product or service lines operating in each country and management reports tend to focus on division/product or service lines, there may be relatively more compliance burden in many cases to assemble jurisdictional level income and taxes.

b) How would these compliance implications change if the income for purposes of the GloBE proposal was determined by reference to the rules used for calculating the tax base in the shareholder jurisdiction?

As stated above, compliance would be greatly simplified by adoption of our proposed approach, using only consolidated accounts at group level, adjusted for tax purposes applying an agreed standard, and verified primarily by the tax authority of the ultimate parent jurisdiction.

7. Allocating Income between Branch and Head Office

a) How would you suggest to apportion the income of an entity between the branch and the head office and do you think it should follow what is done for tax purposes?

See our previous answers referring to our proposed formulaic approach.

We believe the best approach is to apply, as a general rule, what is done for tax purposes. However, in the event that management accounts and/or management reporting determines branch income on a different basis, then that basis should be used. For example, say that a branch determines branch taxable income on a percentage of expenses basis. Despite that, the management reports that are used in evaluating and compensating branch management reflect a pro forma profit and loss account for the branch. In such a case, the approach used in the management reports would be used.

b) What are the compliance implications of such an allocation under a worldwide, jurisdictional and entity blending approach?

c) Is the compliance impact smaller for those MNEs that are subject to CbC reporting requirements and that are already required to report the income of a branch and head-office separately even where no such requirement exists under financial accounting rules?

8. Allocating Income of a Tax Transparent Entity

a) How would you suggest to apportion the income of a transparent entity and do you think it should follow what is done for tax purposes?

Same answer as for Question 7 a). above

We note that while there is this focus on transparency, there is no mention of hybrid entities in the discussion document. Since such entities are such an important part of many profit shifting structures, we consider that some attention should be paid to them. For example, take the Dutch CV/BV structures where the CV is transparent under Dutch rules but is a taxable entity under U.S. rules. Also, the many structures where there is a holding company in a tax haven that is treated as a corporation by its country of incorporation and for U.S. tax purposes, but its operating subsidiaries are hybrids treated as branches or divisions of the tax haven holding company for U.S. tax purposes. Often, in their countries of establishment and operations, the hybrids will pay tax at a mid- or high-rate on limited amounts of income, but the non-hybrid holding company will pay little or no tax. While our overall preference is for an entity-by-entity approach with no blending, perhaps such structures should have blending that includes the holding company and all hybrid subsidiaries. However, the need for simplicity may justify retaining entity-by-entity blending.

b) What are the compliance implications of such an allocation under a worldwide, jurisdictional and entity blending approach?

c) Is the compliance impact smaller for those MNEs that are subject to CbC reporting requirements and that are already required to report the income of a transparent entities separately even where no such requirement exists under financial accounting rules?

9. Crediting Taxes that Arise in Another Jurisdiction

a) How would you suggest dealing with attributing taxes that arise in another jurisdiction or entity under a jurisdictional or entity blending approach?

See the explanation of our proposed formulaic approach in section 1.2.

b) What comments, if any, do you have on the practicality of crediting taxes paid in an intermediate jurisdiction or entity, such as under a CFC rule, against income of the subsidiary or branch?

On the basis that intercompany dividends and CFC income inclusions should be a permanent difference that requires adjustment, taxes on such income should be attributed to the country of the CFC. However, given the difficulty of any tax authority determining the attribution of

such taxes, the burden should be on the taxpayer group to establish any amounts of tax on CFC income that should be attributable to other countries.

10. Treatment of Dividends and other Distributions

a) Assuming that the starting point for calculating the income of the MNE under the GloBE proposal is based on the financial accounts do you have any comments on the practicality of dealing with taxation of dividends under worldwide, jurisdictional and entity blending approaches?

As mentioned earlier, we believe that worldwide blending is not an acceptable approach.

Under our proposed formulaic approach, the tax paid amounts could include taxes on dividends and other intra-group distributions.

b) Do you have any comments on how the taxation of dividends should be dealt with under the GloBE proposal?

We believe that intercompany dividends should be eliminated and any withholding or direct taxes paid on such dividends be attributed to the country of the payer of the dividend. As noted earlier, the burden should be on the taxpayer to establish the amount of any such taxes and the countries to which they should be attributed.

c) Are they any other issues that you wish to highlight regarding worldwide, jurisdictional or entity blending?

11. Carve-Outs

a) Do you have any comments, based on your own experience, as to the preferred design of a carve out taking into account factors such as simplicity, compliance costs, certainty, incentives and behavioural impacts?

In our view, carve-outs are not appropriate, as explained in section 1.1, for fundamental policy reasons. In addition, any carve-outs would increase complexity, add compliance costs especially for tax administrations, and create undesirable incentives for MNE lobbying for tax preferences. Hence, they would defeat the aims of the GloBE proposal.

b) Are there any technical or compliance considerations that would make you concerned about a particular type of carve-out (i.e. based on facts and circumstances or on a formulaic approach), or suggest that there should be no carve-outs at all? If so, please explain based on your own experience.

No carve-outs at all.

c) Would you favour thresholds based on the size of the taxpayer? If so, please give your reasons and suggest a metric that you think should be used.

d) Would you favour any de minimis carve-outs? If so, what type of carve-out do you consider would result in the right balance between compliance costs and benefits?

e) Would you favour a carve-out for specific sectors or industries? If so, please state the sector or industry, explain your reasons and share thoughts on how such a carve-out could be operated with as little compliance cost and uncertainty as possible.

f) Do you have any additional comments on carve-outs, including comments based on experiences with existing regimes that you suggest should be adopted or avoided?

APPENDIX 1

Our Proposed Approach

A new approach is needed for a long-term solution fit for the 21st century.

We propose a combination of principles and pragmatism that will provide (i) results that are fair to both taxpayers and tax authorities, and (ii) true simplicity of application.

- First, a **single enterprise principle** should be adopted, to replace the inappropriate fiction that affiliates of a multinational corporate group are independent of each other.
- Secondly, the aim should be to allocate income and taxes according to the fundamental factors that generate profits: **labour, capital and sales**. This would provide a balance between operational factors (employees, physical assets and users where appropriate) and sales to third-parties (without which profits cannot be realised).
- Thirdly, based on closer analysis of different industries/sectors and their commonly-used business models, the Inclusive Framework, along with other relevant organisations, would develop detailed definitions of these broad factors and their quantification and appropriate weightings. This work would pragmatically develop standardised allocation keys and weightings that would mandatorily apply to taxpayers using these industry/sector common business models. A rebuttable presumption would apply for appropriate flexibility.
- Lastly and importantly, the quantification (i.e. the allocation keys) must be **objectively measurable and location-specific**, using only physical factors reflecting the actual assets, activities, and sales in the countries concerned.

The use of standardised keys and weightings eliminates any need for the resource-consuming functional analyses and other extensive work required for a taxpayer to support its transfer pricing, or for the tax authorities to evaluate and, as necessary, adjust that transfer pricing. This would create greatly simplified international tax rules that would reduce the administrative burdens especially for poor countries, reduce compliance costs and provide greater certainty for business, and improve competitive equality between multinationals and domestic firms. They should be underpinned by an institutional framework to resolve issues and conflicts as well as to formulate appropriate changes to the detailed methodologies as technology and business practices evolve.

This approach is in our view compatible with existing tax treaty rules but would be a sharp departure from the present OECD guidelines on transfer pricing. These have become impossibly complex and difficult to apply, generating continuing conflicts and disputes.

In a more general system, revised OECD guidelines would reflect the proposals outlined in the discussion draft, which have some commonalities, indicating the possibility of convergence. None of these proposals would be adequate or appropriate alone, but they could all be subsumed into the approach we outline. The 'user contributions' and 'marketing intangibles' proposals entail some allocation of tax to market jurisdictions but not a completely sales-based formula, and the 'significant economic presence' proposal explicitly suggests a balanced formula.

See our submission to the public consultation in March 2019 for a fuller explanation.