The **BEPS**

Monitoring

Group

SUBMISSION TO THE PUBLIC CONSULTATION DOCUMENT ON THE REPORTS ON THE PILLAR ONE AND PILLAR TWO BLUEPRINTS

This Briefing 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, with contributions and comments from Jeffery Kadet, Sudarshan Rangan, Attiya Waris, Annet Oguttu and Tovony Randriamanalina.

14 December 2020

SUMMARY

These blueprints are a testament to the commitment and efforts of many dedicated government and OECD officials, and provide many building blocks for potential solutions. Regrettably however, the proposals as a whole do not deliver on the mandate for the BEPS project to align taxation of multinational enterprises (MNEs) with where their activities occur and value is created.

Instead, the new taxing right in Pillar One would cover only a small part of the profits of a small number of MNEs, while further entrenching the current ineffective separate entity concept and transfer pricing rules for allocating the vast majority of MNE profits. The need to separate in-scope from other business lines, and to manage the interaction of the new right with existing rules, would simply add further complexity and confusion to international tax and create a further level of bureaucracy. There would be self-reporting by MNEs to their home country tax authority for verification, and any unresolved disagreements over the allocation would be settled by a mandatory binding procedure, which might also apply beyond the new taxing right. The scheme could only be introduced by a binding multilateral treaty which is unlikely to have wide acceptance, let alone the universal coverage that would be necessary. A more feasible outcome would be to introduce Amount A as a presumptive safe harbour, which could be an alternative to digital services taxes on gross revenues for those MNEs which accept it.

A well-designed global anti-base erosion tax would be a major advance in curbing the competition that has spurred the ‘race to the bottom’ in effective tax rates on MNEs. The Pillar Two blueprint provides many of the building blocks for such a tax, but the current proposal is not only complex, it is grossly inequitable. It allocates the primary right to apply a top-up tax on undertaxed profits to the home countries of MNEs, which would be a direct transfer of tax revenues from host to home countries of MNEs, affecting mainly developing countries. This could only be remedied if tax haven countries that act as conduits for undertaxed income accepted changes to their tax treaties to allow application of new withholding taxes, which is unlikely.

We propose an alternative approach for a minimum effective tax rate (METR), that would provide a fair and balanced allocation of rights to apply a top-up tax based on the MNE’s real activities in each country. This could be introduced by willing states without the need for tax treaty changes, and would also be compatible with non-discrimination rules in international trade and investment, including in the EU.

A. GENERAL COMMENTS

In our view, the blueprints contain important building blocks for potential solutions, but the design of both is far too complex, and the package as a whole is unsatisfactory. The reason is clear: the scheme attempts to achieve consensus amongst all governments involved by combining incompatible approaches, as we explain further below. It also seems unworkable, since it would need to be implemented by a multilateral convention.[1] Such a convention would need to coexist with existing tax treaties, while overriding all these treaties in material respects (Pillar One blueprint, para. 839). Given the unsatisfactory nature of the proposals, it is hard to see why there should be widespread take-up by states, let alone the universal coverage effective implementation would require. Furthermore, cementing into binding international law such partial and patchy expedients would condemn international corporate taxation to potentially decades of further inequity, confusion, and uncertainty.

Since 2019 the BEPS project has correctly focused on the central question in international corporate tax reform: how to allocate the income of multinational enterprises (MNEs) in line with the substance of their activities in each country. Appropriately, the OECD secretariat’s design for a unified approach in 2019 aimed to address this directly, starting from the global consolidated accounts of each MNE. However, the measures in the Pillar One and Pillar Two blueprints would apply only to MNE groups with €750m of global sales. Hence, they would add special new rules applicable only to a small minority of MNEs, and then only to a very limited extent within those MNEs. Although these are the largest, the vast majority of MNEs would still be governed solely by the existing rules.

The aims of achieving simplicity and certainty, and aligning MNE income and tax with their real activities, are given only lip-service. The reality that the current rules for allocating MNE income generate uncertainty and conflict is revealed by the continuing pressure to establish mandatory binding dispute resolution.[2] The claim that the rules work well in most cases is also belied by the need for anti-base-erosion taxes, which have been introduced unilaterally by OECD states starting even before publication of the first BEPS project reports.[3] Pillar Two

[1] The possibility is mentioned that some states would need instead to amend their treaties bilaterally, but this alternative is clearly not favoured (Pillar One blueprint, para. 842).
[2] This would be an integral part of Amount A in Pillar One, but is also ‘being explored’ for other disputes (Pillar One blueprint, para. 19).
[3] The UK’s Diverted Profits Tax enacted in 2015 aims to stop avoidance of source taxation, and similar measures were introduced by Australia in 2017. The US, which strongly resisted any significant changes to

now proposes a multilateral approach for these, but it has been designed to give priority to the countries of residence of MNEs, thereby taking tax revenues from developing countries, which are generally only source countries. The only remedy for source countries would be inclusion of a ‘subject to tax rule’ in a general multilateral treaty which, in the unlikely event it could ever be achieved, would bind them even more firmly into an inequitable and ineffective system.

1. Pillar One

In addition to the size limitation, Pillar One would cover only MNEs with revenues from either automated digital services (ADS) or consumer-facing business (CFB). This would limit it to some 2,300 MNEs of the 8,000 MNEs above the size threshold (Pillar One blueprint, p.63). This specification of scope results essentially from conflicts among OECD countries, and the limitation to ‘consumer-facing’ creates an invidious distinction which has no rational basis.[4] Applying this distinction would require complex domestic legislation and administrative procedures, making it difficult for under-resourced tax authorities to apply, especially in developing countries.

Importantly, it would exclude business services, although an even stronger case can be made for taxation of those profits in the state where they are earned than for consumer services. Business services involve close links with clients, and payments for them are deductible so result in direct tax losses to source states. Yet neither Pillar One nor Pillar Two would remedy this problem, perhaps because it damages mainly developing countries and benefits primarily OECD members.

Pillar One does recognise the need for a clear and easy to administer approach to allocating MNE income. Hence, it proposes a formulaic method for specifying a proportion of the profits of each MNE to be allocated according to its sales in each country, described as Amount A. However, that proportion would be determined by arbitrary percentages, decided at political level, applied as one-size-fits-all. The bulk of the profits for in-scope MNEs, as well as all profits for those excluded, would continue to be allocated under the OECD’s transactional transfer pricing methods that are based on the independent entity concept. This would leave in place the current complex and flawed rules for allocating the bulk of MNE income, based on the fiction that they consist of independent entities dealing with each other at arm’s length.

These methods attribute profits separately to each individual entity in the MNE group. Hence, intricate rules are proposed to reconcile the formulaic and separate entity approaches, avoid double counting and eliminate double taxation. Thus, although Amount A would be allocated by a simple formulaic method, its interaction with existing rules adds an overlay of further complexity. This is the reason for the highly complex rules for the ‘new taxing right’, which will be layered on top of the existing transfer pricing rules, creating an administrative nightmare.

The only attempt at a simplified method for attribution of income is the one being developed for marketing and distribution activities, under so-called Amount B. However, what is now proposed would be little more than a standardised version of the most widely used OECD method, the TNMM, attributing only ‘routine’ profits. Any claim to tax MNE super-profits,

---

transfer pricing rules during the BEPS project, included unilateral measures against BEPS practices in its tax reforms of 2017, covering both inbound and outbound investment.

[4] The US opposed the targeting of digitalised business, so proposed the inclusion of brand-name consumer businesses (many of which are European); but it is not happy with the proposal for ‘consumer-facing’ business, a distinction hard to justify or to apply, e.g. to pharmaceuticals.

resulting for example from large sales volumes or synergies from integration, would depend on Amount A. This would accrue solely to market countries and not at all to those where production, R&D, and other functions integral to the MNEs' operations and profitability occur.

The blueprint proposes only procedural methods for dealing with uncertainty. The scheme would rely on each MNE filing a self-assessment with a 'lead tax administration'. This would usually be its home country, which would be responsible for validating the calculations and the allocations (Pillar One blueprint, para. 717). Other relevant tax authorities would obtain access to this documentation only through a mechanism for its exchange, similar to the current arrangements for country-by-country reporting (CbCR). Yet even now, nearly five years after the introduction of the CbCR arrangements, the vast majority of developing countries still do not have access to these reports.

A complex procedure is proposed for resolving any disagreements that may arise with other affected countries, based on creating review panels of officials that would be representative of affected countries. Ultimately, disagreements would be settled by binding decisions from 'determination panels', but the specifics of these procedures have not yet been agreed. The system could only be introduced by a multilateral treaty signed and ratified by all states. This would be totally unprecedented, and it is difficult to envisage how it could be achieved. The US suggestion that the system should operate only as a 'safe harbour' would make it optional for MNEs, and is unacceptable to other states.[5]

Indeed, there seems to be no good reason for most states, particularly developing countries, to join such a scheme. The OECD's own impact assessments show that the likely benefits from Amount A would be 'modest - less than 1% of global CIT revenues'.[6] In return, countries would be required to withdraw existing unilateral measures, particularly digital services taxes (DSTs).

Furthermore, and even more importantly, the design of Pillar One seems to assume that the bulk of the 'residual' profit is attributable to the MNE's home country. This assumption would lock states into accepting rules that allow MNEs to attribute only 'routine' profits to entities around the world engaged in production, R&D, logistics and other real activities, while attributing 'control' of these activities, and hence high profits, to entities in countries where these profits are low-taxed. Recognising that such outcomes would inevitably create conflicts, the blueprint suggests that this one-sided approach would be enforced through stronger mechanisms, including the possibility of mandatory binding dispute resolution.

Hence, the Pillar One proposals would only add a new layer of complexity, and do little to nothing to change the existing rules for allocation of MNE profits. Yet it is these same rules that enable BEPS practices by MNEs, the persistence of which is the reason for the Pillar Two proposals.

2. Pillar Two

A global corporate minimum tax can be achieved more easily, since such a tax could be devised so as to be compatible with tax treaties, as well as other international obligations. Indeed, the US has already enacted measures that impose a minimum level of tax on MNEs in its 2017 tax reforms. These are: the global intangible low-taxed income (GILTI) provisions on US-based MNEs, and the base erosion anti-abuse tax (BEAT) mainly focused on foreign-

[5] It may nevertheless be the basis for a compromise that would allow MNEs which accepts such a safe harbour to be exempt from DSTs.
[6] OECD (2020), Tax Challenges Arising from Digitalisation - Economic Impact Assessment, p. 61.

based MNEs. The OECD proposals under Pillar Two are along similar lines to these. Hence, this type of tax can even be introduced unilaterally, as the US has done. However, there would be advantages to formulating it as a global minimum tax through a joint initiative by a group of willing states working together to develop a coordinated and well thought out solution. There is no good reason for tying such a measure to Pillar One.

Yet the presentation implies that both Pillars would be a single multilateral system. Given the unsatisfactory nature of Pillar One, and the enormous obstacles facing its adoption, this would fatally damage any prospects for effective progress to a multilateral solution. Even more seriously, tying the two has greatly weakened the design of Pillar Two. The blueprint for Pillar Two demonstrates the disadvantages of trying to design this type of measure by consensus among *all* states. The design inevitably becomes severely diluted, tending towards the lowest common denominator. A strong global minimum tax could both reduce the scope for profit-shifting by MNEs, and also counteract the pressures on states to give preferential tax treatment to MNEs. This would benefit all governments and greatly improve competitive equality for business. However, it is still opposed by governments of some states that have become captured by the international tax avoidance industry, and have been acting as conduits or tax havens, which therefore seek to dilute the proposals. Many other governments are cautious and could be convinced by a proposal that is clearly formulated, seems likely to be effective, and would strengthen the international tax system in the long run. Hence, the best way forward would be by a coalition of willing states, which could design strong measures to generate a positive momentum.

A further consequence of attempting to reach consensus in the Inclusive Framework is that the Pillar Two blueprint is excessively technically complex, and fails to provide a simple methodology that could be accepted as fair and effective by all states. Like the Pillar One blueprint, it rightly starts from the reality that MNE corporate groups operate as unitary, centrally directed organisations, in which each entity performs its assigned functions, rather than acting independently. However, the blueprint proposes separate measures for home and host countries to apply top-up taxes. This entails a complex system of rules to manage the interaction of these rights. For no valid reason, home countries of MNEs are given priority in the allocation of top-up taxes.

The two main provisions of the global anti-base-erosion tax (GloBE) in Pillar Two are an income inclusion rule (IIR), and an undertaxed payment rule (UTPR). The IIR allows the MNE's home country (or, failing that, an intermediate parent under a 'top-down' approach) to apply a top-up tax to the income of its foreign constituent entities, to ensure that they are taxed at the agreed minimum effective tax rate (ETR), applied by jurisdiction. The IIR is based on the same principles as measures on controlled foreign corporations (CFCs), first introduced by the US in 1962, and subsequently in various formats by other states.[7] However, under CFC rules the state normally grants a unilateral credit for foreign taxes paid on the income, if it considers them eligible. Under the Pillar Two proposals, the Blueprint specifies which taxes are considered 'covered taxes' and included in the calculation of the ETR. These would be taxes on net income, or 'in lieu of' such taxes. Taxes on gross revenues, including DSTs, would not be covered (Pillar Two blueprint, para. 148).

Indeed, it would be preferable for the home states of MNEs to extend full home country taxation of their MNEs, for example through comprehensive CFC rules along with a credit for foreign taxes paid,[8] or to introduce a minimum tax on foreign income of MNEs on a

[7] Countries would be permitted to continue to apply their own CFC rules as well.
[8] J. Kadet (2013) 'U.S. Tax Reform: Full-Inclusion Over Territorial System Compelling'. *Tax Notes* 139: 295-301.

country-by-country basis.[9] These approaches give the ultimate right to tax MNEs' worldwide profits to their home countries, but with a prior right to source countries, at least for taxes that the home countries are willing to accept as eligible for credit. They would be more effective than the complex Pillar Two proposals in discouraging profit shifting by MNEs, while allowing appropriate taxation of profits at source.

The counterpart to the IIR is the UTPR, which allows source countries to effectively tax profits attributed to low-tax constituent entities of an MNE group derived from payments by an affiliate of that MNE in the source country. Both the IIR and the UTPR use the same computational rules to determine the top-up tax.

However, the blueprint gives priority to the IIR, and designates the UTPR only as a secondary back-up rule. The only explanation given for this is that it is 'largely driven by simplicity and lower compliance costs' (Pillar Two blueprint, p. 17). This is obfuscation. The source country has the rightful claim to tax such low-taxed income, since much of it results from payments that have directly reduced its tax base as deductions from business income. Granting priority to the IIR creates a transfer of tax revenue from developing countries, which are generally source states, to OECD members, which are generally the home countries of MNEs. The decision to make the IIR the main rule reflects the viewpoint of OECD countries that priority should be given to taxation by residence countries rather than at source. This is the wrong solution.

As a partial acknowledgement that this would be considered unjust, the Pillar Two blueprint also provides for a subject to tax rule (STTR), to help protect the source tax base. This is clearly seen as essential to ensure support for the blueprint, especially from developing countries (Pillar Two blueprint, p.12). The STTR is proposed as a new tax treaty provision, hence it would have priority over the IIR, since a tax conforming to it would be regarded as a covered tax. However, the STTR has been designed in the blueprint as a measure to deny treaty benefits to specified payments that are taxed at a low rate in a treaty partner country.[10] This would make it highly complex and difficult to administer, for several reasons, including the need for the tax authorities in the country of the entity making the payment to determine taxability in the recipient's country.

Furthermore, the STTR would require an amendment to all relevant tax treaties, particularly those with countries which have established themselves as conduits or investment hubs. It is hard to see why such jurisdictions would join this scheme. It would be easier and more effective for source countries wishing to introduce taxes to protect their tax base to renegotiate any such treaties, or failing agreement simply to cancel them. Treaty changes would also be needed to introduce a fourth provision, a switch-over rule (SOR). This is necessary because top-up tax with respect to a constituent entity that is a permanent establishment (PE) may in some instances be paid by the home office of the PE in the home office's country of residence. Where a treaty between the country of the home office and the country of the PE prevents home office country taxation of PE profits, application of the IIR would require such treaties to be amended.

---

[9] K. Clausing, E Saez and G Zucman (2020) Ending Corporate Tax Avoidance and Tax Competition: A Plan to Collect the Tax Deficit of Multinationals. Available from http://gabriel-zucman.eu/files/CSZ2020.pdf.

[10] It would apply to specific types of payments (interest, royalties, and a variety of other payments elaborated in the blueprint), although only if between connected persons. To ease the compliance burden (for MNEs) a threshold would apply, the methodology and details of which are still under consideration. Since it would apply to payments, it would not define low tax by reference to the ETR, but by a low nominal tax rate: the statutory rate adjusted for any preferential rate or exemptions. Despite its complexity, the blueprint claims it is suitable for countries 'with lower administrative capacities' (Pillar Two blueprint, p.14).

In sum, instead of designing minimum tax measures that any willing state could implement, the OECD has formulated a highly complex set of interacting rules that would give priority to the rich home countries of MNEs, with only a partial and difficult to apply concession to host countries, which is dependent on changes to all tax treaties.

3. An Alternative Approach: a Minimum Effective Tax Rate (METR)

Despite the unsatisfactory nature of the package as a whole, the blueprints contain the building blocks for a workable global minimum tax. To this end, we propose a recombination of the main elements of the GloBE into a revised methodology for a minimum effective tax rate (METR). This could be introduced by any countries that choose to do so, whether they are home to MNEs, host of MNEs, or both.[11] Like the GloBE, it would be compatible with existing tax treaties, but it would also be non-discriminatory and hence would also comply with other international trade and investment obligations, including EU law.

Like the GloBE, the starting point for the METR is the constituent entity-level financial information that is used in preparing an MNE's global consolidated accounts. We would follow the procedure proposed for computing the effective tax rate by jurisdiction (Pillar Two blueprint, p. 72*ff*).

However, the METR then calculates the share of an MNE's undertaxed profits that have not been effectively taxed, and allocates them among all countries where the MNE has a taxable presence, to allow each such country to apply its own taxation under its own rules and rates. To compute the non-effectively-taxed profits (NETs), profits reported in countries with an ETR below the set minimum rate are multiplied by the quotient of (i) the difference between the minimum ETR and the actual ETR, divided by (ii) the minimum ETR. This method, illustrated in Figure 1, identifies on a jurisdictional basis the portion of profits that have economically not been taxed after determining the portion of profits that have been taxed at the set minimum rate. The MNE-wide aggregate of these country NETs (MNE NETs) is allocated by applying factors reflecting the MNE's real activities in each country. This allocation uses a substance test, similar to the 'substance-based carve-out' proposed in the blueprint, as the rule for allocating taxing rights over the MNE NETs.

Applying a single substance rule would greatly simplify the tax, as it removes the need for the complex rules on linking and priority, and the associated procedures for monitoring implementation of the interlocking rules proposed in the current GloBE blueprint. Instead of a series of interlocking rules, rights to tax MNE NETs are allocated by a single combined rule that integrates the IIR and the UTPR: a formulaic apportionment rule (FAR). The IIR and UTPR, the main elements of Pillar Two, are both premised on participating states including in their own tax base MNE income that is not effectively taxed in another jurisdiction. The IIR would do so by requiring a parent to pay top-up tax on its share of the profits of its foreign subsidiaries or branches, while the UTPR would adjust accounts relating to intra-group transactions or make other adjustments to achieve the same objective. Under our FAR the same mechanisms are used, but they can be applied simultaneously by all countries where the MNE has activities that create a taxable presence, to ensure that their respective shares of the undertaxed profits are taxed at an appropriate rate.

A key advantage of integrating the IIR and UTPR through our FAR approach is that it does not need to give priority in applying a top-up tax to either the home or host countries of MNEs. All countries in which the MNE has a taxable presence can simultaneously apply the METR to determine their fair share of MNE-NETs, and can impose additional tax using their

[11] The concept was put forward in our submission to the previous consultation on Pillar Two, in November 2019.

own domestic law to achieve an ETR equivalent to their own tax rate. Thus, unlike the GloBE, the METR would allow all countries to defend their own tax base simultaneously, without the need for priority rules that would result in revenue transfers.

Since the METR integrates the IIR and the UTPR, which the Inclusive Forum has found could be applied under national tax rules, the METR also could be implemented without the need for treaty changes. Combining the IIR and the UTPR would also ensure that the measures are non-discriminatory and hence valid under trade and investment treaties, as well as EU rules. The same test of substance would be applied by each country to both its locally based MNEs and foreign-based MNEs, thereby ensuring fairness and non-discrimination.

Our proposed FAR would apply a multi-factor allocation of profits based on (i) capital (physical assets), (ii) personnel, and (iii) sales (by location of customers and users), with appropriate weightings to be agreed. This will be the same whether from the perspective of the host (source) or home country of the MNE. This test of substance is similar to the formulaic substance based carve out proposed in the GloBE (Pillar Two blueprint, chapter 4.3), but with the inclusion of sales revenues, to provide a balance of supply-side and demand-side factors. Hence, it could apply the specifications in the Pillar Two blueprint for defining and quantifying payroll costs and tangible assets (Pillar Two blueprint, ch. 4.3). The need to allocate a proportion of profits to countries where sales are made has been recognised in Pillar One, which provides detailed sourcing rules for sales revenues based on the location of customers and users (Pillar One blueprint, ch.4). Further work would be needed to develop similar sourcing rules for business sectors and models not covered by Pillar One.

The METR would place MNEs on a more equal footing with purely national businesses, which have all their activities, and hence their costs and revenues, in the same jurisdiction. It is also designed to encourage convergence towards an optimum tax rate. Hence, the minimum ETR should be set at approximately the weighted average nominal corporate rate; we suggest that it be no lower than 25%.[12]

The rights to apply a top-up tax would be allocated to all countries where the MNE has a taxable presence, regardless of their tax rate, in proportion to the MNE's real activities in the country. Each country would be free to maintain its own corporate tax rate, even if this is below the minimum ETR, and apply any top-up tax accordingly. This would remove the incentive for MNEs to design structures to enable attribution of high levels of profit to countries where they are taxed at lower rates, out of line with their real activities. The tax rate would still of course be taken into account by MNEs in deciding where to locate investments, but since these would need to involve real activities, the predominant consideration would be suitability of the location (infrastructure, skilled workforce, etc.). Including sales in the formula would discourage the choice of countries that only offer a platform for exports.

Table 1 provides an example of how such a system would work.

[12] The regular survey by the Tax Foundation found that the average rate across 176 countries weighted by GDP was 26.3% in 2019, see https://taxfoundation.org/corporate-tax-rates-around-the-world-2020/.

Table 1: Application of the Substance Rule

	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 ('covered taxes')	20	37.5	0	1	29	87
ETR by jurisdiction	20	12.5	0	25	30	
Minimum ETR	25	25	25	25	25	
Undertaxed profits	100	300	500	0	0	900
Profits that have not been effectively taxed (for allocation)	20	150	500	0	0	670
Allocation percentage based on objective location-specific factors (FAR)	37%	30%	5%	5%	23%	100%
Allocated non-effectively-taxed profits	248	201	33.5	33.5	154	670
Top-up tax payable (at country's standard rate)	49.6	25.1	0	8.4	46.2	129.3

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

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. RUP, FOM, and OTB all apply a tax rate below the minimum ETR, while CSB and FMM's tax rates are equal to it or higher. For the sake of simplification, this table assumes that each country's nominal tax rate is also its ETR. Countries with an ETR at or above the minimum ETR, as well as losses, have no potential undertaxed income. To obtain the non-effectively-taxed profits for allocation, the undertaxed profits are multiplied by the quotient of (i) the difference between the minimum ETR and the actual ETR, divided by (ii) the minimum ETR.

The METR would not on its own provide a complete solution. It should be accompanied by additional steps, particularly the adoption of a wider definition of taxable presence, to ensure that all countries where an MNE has a significant economic presence can tax their fair share of its profits.[13] We believe that adoption of the METR would provide an impetus for countries finally to come together to agree on the principles and details for a fairer system for allocation of MNE profits based on formulary apportionment as a long-term solution.

[13] A number of countries have already begun to do so unilaterally, and this could become multilateralised by the adoption of an agreed model provision; the UN Committee of Tax Experts plans to adopt a new article 12B to cover 'automated digital services' which would resolve many problems, particularly if taken together with the wider scope of article 5 of the UN model, and its article 12A.

B. RESPONSES TO SPECIFIC QUESTIONS

B-1 PILLAR ONE

1. The activity test to define the scope of Amount A.

The limitations of scope proposed have no justifiable rationale. The reports in Action 1 of the BEPS project in both 2015 and 2018 showed clearly and at length that digitalisation affects the whole economy, and has merely exacerbated the defects of the current rules on both taxable presence and allocation of MNE income. Hence, what is needed is a reform of both these principles that would apply to all MNEs. It is also unjustifiable to limit the scope to 'consumer-facing' business, which would exclude business-to-business (B2B) services. B2B service providers also have close relationships with their customers and clients, justifying recognition of a taxable nexus. Furthermore, payments for such services are deductible from business profits, thereby causing direct losses to the source tax base. This particularly damages developing countries, and the scope limitations have clearly been devised from the perspective of OECD countries.

The lack of rationale for these scope limitations is shown by the impossible complexity of the rules that would be needed to try to implement them. These already take up 40 pages in the blueprint, and some details are still to be agreed. They would need to be implemented by detailed regulations in national laws. All tax administrations are hard-pressed, but poor countries particularly lack the necessary resources of skilled personnel. While the OECD and other organisations offer them capacity-building, it would be far more effective to simplify the tax rules. The Pillar One blueprint now states that it has been agreed 'to make any rules as simple as the tax policy context permits' (p. 11). Yet the policy decisions underlying the blueprint result in inevitable complexity, defeating the possibility of simplification. The main remedy proposed in the blueprint to deal with the resulting uncertainty is mandatory binding dispute resolution, which would further extend the over-stretched resources of tax administrations.

This is clearly tackling the problem at the wrong end. The only way to provide simplicity and certainty is through rules that are clear and easy to administer, because they are in line with business reality, and hence do not give rise to disputes. The introduction of Amount A would add another layer of complexity on top of the existing subjective and ineffective transfer pricing rules that rely on the artificiality of the separate entity concept for allocation of MNE profits. This would be an administrative nightmare.

If the proposal proceeds, some simplifications could improve it slightly. In particularly, we suggest there is no need for a positive list, there should be only the negative list. Any services that do not come under the negative list will come under positive list, avoiding difficulties with overlaps between them. This would also make it easier to ensure that new digital services could be included in the scope without a need to update the positive list. In the current epoch with new innovative business models mushrooming frequently, updating the positive list will be a gargantuan task for any tax administrator more so for tax administrators from the developing economies.

2. The design of a specific Amount A revenue threshold (in addition to a global revenue threshold) to exclude large MNEs that have a *de minimis* amount of foreign source in-scope revenue.

A new taxable nexus test should have a de minimis threshold based on sales in the jurisdiction to make it easy to administer. This should be tailored to the size of the relevant economy. However, the design of Pillar One has created complexity, because a significant

proportion of its Amount A is likely to be allocated to the MNE's home jurisdiction, which is also a 'market'. The blueprint accepts that the additional threshold proposed would be difficult to administer, but suggests that MNEs would have an incentive to comply if they could thereby be relieved of the remaining compliance burdens (para. 184). We can only admire this logic, but an additional threshold also adds to the complexity of the system.

The secondary de-minimis foreign source in-scope revenue threshold is unnecessary and adds to the uncertainty, especially in light of the complex revenue sourcing rules. Since, MNEs will possess the necessary data pertaining to revenue sourcing rules, this opens up a window for MNEs to classify in-scope revenue as domestic source, thereby enabling them to take advantage of the secondary threshold to escape the Amount A allocation.

3. The development of a nexus rule.

The blueprint suggests that the ability to interact closely with the market jurisdiction is less pronounced for CFB, so 'plus factors' are needed for the nexus test to apply (para. 191). This is mistaken. First, consumer goods by their nature entail a close relationship with consumers, and with their daily lives, creating valuable goodwill and brand value. Secondly, MNEs in this sector greatly benefit from their access to markets in many countries around the world, due to economies of scale in production, and the higher marginal returns on high up-front investments in intangibles. The ability to sell in worldwide markets generates considerably higher rates of profit than can be achieved by purely domestic producers selling only in their own home market. Hence, a share of these super-profits should be allocated to market countries. Current methods for allocation of MNE profits wrongly disregard these factors, and generally attribute only 'routine' returns to market countries.

We see no need for 'plus factors', a simple test based on revenues related to the size of the market would be sufficient, and easier to administer.

In regard to the discussion of 'plus factor' in para. 192, it is noted, in part, that: '… One plus factor could be a subsidiary, or a "fixed place of business" (e.g. a permanent establishment based on the commonalities of the UN and OECD Model definitions) …' Many countries allow the establishment of representative offices or other local offices or presences of foreign persons that do not constitute a permanent establishment or taxable presence under local law or applicable tax treaties, often because the local activities are expressly limited to certain auxiliary functions. Such representative offices and other local presences must without question be included as a sufficient 'plus factor'.

Further, since the taxes are computed on a yearly basis, temporal requirements of more than one year need not be considered for determining the market threshold. This is also against the existing PE concept under tax treaties where PEs are determined on a yearly basis.

4. The development of revenue sourcing rules.

Once it is understood that there are increasingly close links and interactions between suppliers and consumers or users, sourcing rules become crucial. In this respect the Pillar One blueprint is an important step forward, and the work done on this topic will remain valuable even if (as we expect) the Pillar One proposals are never implemented. These rules should in any event be introduced to improve the recording of sales revenues in country-by-country reports.

That said, careful attention is needed to the formulation of these rules, particularly to avoid unnecessary complexity, particularly for tax administrations which would have to monitor compliance. The burdens on MNEs of introducing the proposed data collection obligations to identify and record in documentation the location of customers and users have been

minimised in the blueprint by (i) selecting indicators based on data which businesses have a commercial interest in collecting (and therefore are already like to have), and (ii) allowing in most cases several indicators, although in a hierarchy.

While this approach seems reasonable when introducing new requirements, we are concerned that it introduces complexity and uncertainty. This is particularly the case in relation to determining what constitutes 'reasonable steps' to obtain the data higher in the hierarchy, or how to determine that an indicator is 'unreliable'. We would caution against the adoption of safe harbours or de minimis rules at the outset.

We suggest instead that there could be transitional arrangements to deal with any initial difficulties of introducing measures requiring the collection of data, for example from subcontractors. In time such data collection arrangements will become routinised, and the allowable alternatives in the hierarchy should be reduced, to simplify the methodology.

5. The framework for segmenting the Amount A tax base, and how it could be further developed to deliver its objectives.

As we stated in the General Comments in section A, the scope limitations proposed have no good rationale. They will inevitably result in administrative complexity, high compliance costs for MNEs, and greater difficulty in monitoring of compliance. The possibilities of sub-segmentation still under negotiation, to distinguish for example between over-the-counter and prescription drugs, and dual use goods or services, will further exacerbate these problems. These segmentation proposals for Amount A are clearly not cost-effective, and should be abandoned.

6. The development of a loss carry-forward regime that would ensure that Amount A is based on an appropriate measure of net profit.

a. We agree that Amount A tax base rules should apply consistently irrespective of whether the outcome is a profit or loss, thereby providing symmetry.

b. The complications and headaches for all concerned that would result from attempting to account for pre-regime losses are such that no pre-regime losses should be allowed at all. If this means that, economically speaking, some MNEs pay a little extra tax following the introduction of the Amount A, then it will be a small price to pay. Further, since the Amount A tax would qualify for an exemption or a foreign tax credit under the rules to eliminate double taxation, much or all of any additional Amount A tax cost would likely accrue to the country that grants the credit or exemption. In some cases, this will be the home country of the MNE. In a significant number of other cases, it may be a zero- or low-tax country in which an MNE group member is recording the sales revenues and the profits before tax. In the case of the former, some or all of the additional tax costs will likely be offset by the savings due to less administration of Amount A calculations and audits thereof. For the latter, the zero or low tax rate will mean that there will be little or no tax cost to the country. While this would seem to leave the bearing of most or all additional tax cost with the MNE, such additional tax cost at the end of the day should reduce any Pillar Two top-up tax. To summarize, it would be better to keep things simple. With the passing of time, any effects from pre-regime losses will pass away.

c. We agree with the proposed single account at the level of the group (or segment when relevant).

Like the residual profits, losses must also be allocated to the market jurisdictions where they arise. The loss carry-forward regime proposed in the blueprint as a simplifying measure may work effectively in a unitary taxation regime. There is a possibility that under the earn out

approach that a particular market jurisdiction which has contributed profits on a stand-alone basis will lose out its share owing to another jurisdiction's loss. This approach favours the home country of the MNEs. Hence, a formula to apportion losses may be arrived at. Further, in a given period if one of the market jurisdictions does not satisfy the threshold and is excluded from Amount A, clarification would be needed on whether the carried forward losses would lapse or remain suspended.

d. The carry-forward regime should not be applied to "profit shortfalls". With the exception of loss carry-forward rules, taxes for the most part are a period-by-period computation as to rates, the events that have occurred as of year-end, etc. The reasons in para. 490 are well stated. These reasons plus the need to cut back on complexity whenever possible forces this conclusion.

7. The scope and relevance of possible double counting issues arising from interactions between Amount A and existing taxing rights on business profits in market jurisdictions.

a. While we have no suggestions on the design of this mechanism, we believe that it should be the sole mechanism to deal with this issue of possible double counting.

b. No comments.

c. We believe that there should be no marketing and distribution profits safe harbour. A first point, of course, is the complexity. Given discussion of the possible approach in paras. 535 and 541-545, it appears that the 'fixed return for in-country routine marketing and distribution activities' could well be defined the same as the 'baseline' marketing and distribution activities for use in Amount B. It would seem that these two uses of local marketing and distribution activities should be considered together. Where an MNE maintains sufficient activities in a market country to justify placing significant non-routine profits in that country, its activities will very likely exceed by a significant amount that defined 'baseline' level that is contemplated for Amount B. This safe harbour requires the very subjective process of identifying the excess activities and then the further subjective effort of determining a fixed return on sales (as described in para. 543). This is of course another matter that would require time and expertise that local tax authorities mostly do not have. If an MNE believes that it is being grossly overcharged as a result of the combined taxation from existing transfer pricing rules and Amount A, then it could consider future changes to its structure and transfer pricing.

d. In theory, excluding from Amount A a truly independent business operated within only one country seems reasonable. Para. 551, however, says it all when commenting: '… it is unlikely that there are many examples of MNE groups with completely standalone domestic businesses. …' Since today's MNEs operate mostly as integrated businesses on a worldwide basis, the goal of simplicity strongly suggests that there be no domestic business exemption.

e. No comments.

8. The development of a process to identify the entities in an MNE group that bear the Amount A tax liability (the paying entities) for the purpose of eliminating double taxation.

No comments.

9. The issue of scope of Amount B and definition of baseline marketing and distribution activities.

The proposals for Amount B demonstrate that the OECD Transfer Pricing Guidelines (TPGs) make it difficult to develop simplified methods for allocation of MNE income that can also be appropriate and effective. This is because of the emphasis in the TPGs on the need for an analysis of the individual 'facts and circumstances' of each entity within an MNE group, and of its specific functions performed, assets owned and risks assumed. This favours the use of one of the 'one-sided' transfer pricing methods, particularly the transactional net margin method (TNMM), which is the most commonly used. These methods require the identification of comparable independent enterprises to provide a benchmark or range of appropriate profit margins, based on the assumption that only 'routine' profits are attributable to these functions.

As Amount B is expected to be applied under the TNMM concept, it would attribute only 'routine' profits to marketing and distribution functions. This means an effective ignoring of the super-profits resulting from factors such as large sales volumes and other economies of scale, group synergies, oligarchic and monopolistic market power, and unique marketing intangibles and distribution arrangements. Of course, where an MNE is earning no super-profits, there is no issue. However, in the many cases in today's modern economic world where industrial, product, and market concentrations are at an historic high and are only becoming more so, there are many cases of MNE super-profits. The Amount B structure simply facilitates profit-shifting MNEs to book those profits within zero or low-taxed group members rather than spreading those super-profits in a fair and objective manner over all jurisdictions in which the MNE is factually conducting its integrated worldwide business.

It is inappropriate to focus only on the distribution function in isolation. These issues are implicitly reflected in the difficulties that have been encountered in formulating the Amount B proposal, notably the question of 'functional intensity'. The result is a proposal that is far from simple, involving the application of a range of qualitative and quantitative criteria, to attempt the impossible task of isolating 'routine' functions.

A better approach to simplification would be to allocate the MNE's global profits according to its real activities in each country. This could build on the profit-split method, by developing standardised allocation keys and weightings for different economic sectors and business models. These could be introduced as presumptive sectoral safe harbours or advance pricing agreements. This approach would obviate the need for both an individual analysis of facts and circumstances and a search for comparables. The profit split method based on the contributions of each entity provides a better basis for simplification than the one-sided methods.

As a final point, it seems unlikely that with the implementation of such a standardised system that many MNEs holding marketing intangibles and conducting local marketing, distribution, and other functions that go beyond the defined 'baseline' will voluntarily declare those to local tax authorities. As such, local authorities will simply apply tax on Amount B and will only learn of such marketing intangibles and locally conducted beyond 'baseline' functions in the unlikely event that they conduct a significant and time-consuming taxpayer audit.

10. The appropriate profit level indicator for calculating Amount B, and how it should be calculated assuming Amount B is based on a narrow scope.

The Amount B concept originated with proposals by MNEs (Johnson & Johnson and Procter & Gamble) which have both sales and other activities in virtually all countries, whose tax advisers frankly recognised the unsuitability of current transfer pricing rules, particularly for

developing countries.[14] The Procter & Gamble proposal in particular included two features which would give the proposal some advantages over the TNMM.

First, it proposed that the profit level indicator should be profits before tax (PBT), rather than operating profits as recommended for the TNMM in the TPGs. The use of operating profits facilitates profit-shifting by MNEs through excessive deductions of interest, which are inadequately prevented by other measures such as rules on thin capitalisation or limitations on interest deductibility.[15]

Secondly, the Procter & Gamble proposal provided for a sliding scale allowing for higher profit margins for higher volumes. This is in line with the arm's length principle, since distributors would commonly expect higher margins for higher volumes.

We strongly urge that both these be adopted if Amount B is to have any credibility.

11. The development of an early tax certainty process to prevent and resolve disputes on Amount A.

As stated in our General Comments above, Amount A is designed as one-size-fits-all, applying fixed percentages. This does have the advantage that it avoids subjective judgments and hence conflicts on quantum. However, the limitations on its scope create distinctions which are invidious and will be hard to apply, creating uncertainty. The complex methodologies for segmentation of accounts between business lines of the same MNE will create further uncertainty. In our view, the proposal for Amount A is inherently unsuitable, and does not justify the enormous apparatus that would be needed to administer it.

Particularly problematic is the dominant role given to the 'lead tax administration', which would normally be that of the MNE's home country. This is especially marked in the proposed process for 'early tax certainty'. Although it appears to be similar to an advance ruling procedure, it is very convoluted. Considerable discretion is provided to the lead tax administrator of the MNE group. Instead of the multiple steps proposed, we suggest that the review panel should be the first step, thereby enabling fairness for the market jurisdictions.

12. The introduction of new approaches to provide greater certainty beyond Amount A.

As we have pointed out in previous consultations, the uncertainty and increase in conflicts over MNE taxation result from the ad hoc and subjective judgments involved in applying the current transactional approach to 'transfer pricing'. The proposals for Pillar One would leave these in place for the allocation of the remaining residual profit after allocation of Amount A, as well as for all the MNEs out of scope. Hence, uncertainty and conflict will continue beyond Amount A. The justification for the design of Pillar One has been that the existing methods are said to work well in the vast majority of cases, but this is contradicted by the emphasis on the need for mandatory binding methods to provide certainty.

The only effective basis to provide certainty in the allocation of MNE profits is to base the rules on the reality that they operate as unitary enterprises. This would guarantee that there is neither double taxation nor double non-taxation. Greater certainty could be achieved, as outlined in our answer to question 9 above, by simplified approaches building on the profit-split method. The aim should be prevention of disputes.

---

[14] See presentation by Tim McDonald of Procter & Gamble at the OECD in March 2019, reported in Sol Picciotto, 'Developing countries' contributions to international tax reform', 28 Nov. 2019).

[15] See Michael C. Durst (2020) 'A Simplified Method for Taxing Multinationals for Developing Countries: Building on the 'Amount B' Proposal to Repair the Transactional Net Margin Method.' ICTD Working Paper 108, available here.

The continuing pressures to adopt mandatory binding dispute resolution are misplaced, as they attack the problem at the wrong end. If negotiators are unable to agree on clear and easy to administer methods to allocate MNE profits, it is inappropriate to decide the inevitable disputes by procedures that lack any transparency or accountability.

B-2 PILLAR TWO

1. GILTI co-existence.

The incoming US administration is committed to revising and strengthening the GILTI through an increase in the GILTI tax rate to 21% and converting it to a country-by-country calculation. This should provide the basis for ensuring that it is more aligned with Pillar Two, and that revised versions of both the GILTI and Pillar Two incorporate the best features of each. In particular, Pillar Two should apply to all MNEs, and the GILTI should apply on a jurisdictional basis. It may be, however, that the incoming US administration will not have sufficient support in Congress to reform the GILTI. In such a case, GILTI co-existence would mean that many of the most aggressive profit-shifting MNE groups would remain effectively out-of-scope of the Pillar Two minimum tax. This plainly unfair result would make it hard to reach a wide consensus on Pillar Two as it stands.

The blueprint also points out that the interaction of the IIR with the UTPR means that the BEAT also needs to be aligned. However, the same issues also arise with other measures introduced by OECD members to protect their source tax base, notably the UK's Diverted Profits Tax, and the similar provisions in Australia's Multinationals Anti-Abuse Tax. Since these are taxes on income they would constitute covered taxes under Pillar Two, and in effect pre-empt application of the IIR by other countries.

This clearly points to the need to integrate the IIR and the UTPR into a single rule that can provide a proper balance between residence and source country taxing rights. We have outlined how this could be achieved in our proposed METR in section A.3 above.

2. Scope of the GloBE rules.

Treatment of Investment Funds

No comments.

3. Calculating the ETR under the GloBE rules.

a. Treatment of dividends and gains from disposition of stock in a corporation

No comments.

b. Treatment of re-organisations

No comments.

c. Rules to adjust for accelerated depreciation

We believe that these proposals to account for accelerated depreciation and immediate expensing of fixed asset acquisitions must be simplified. We suggest using financial basis depreciation and cash-based taxes. There should be no adjustments for local tax depreciation or expensing of acquired fixed assets or taking account of deferred taxes under financial accounting rules. To deal with legitimate cases where temporary differences cause a low effective tax rate (ETR) in year 1 and an ETR over the set minimum ETR in year 2 (or other later years), we suggest that the top-up tax computations include an optional adjustment to

support reductions in future years' top-up tax to the extent of reversals of temporary differences in those future years. This is an optional carry-forward for only those MNEs who legitimately have the issue within their constituent entities.

d. The treatment of tax transparent entities

No comments.

e. Allocation of "cross-jurisdictional" taxes (particularly anti-avoidance rule)

The so-called 'cross-jurisdictional' taxes, both taxes imposed under CFC rules and withholding taxes, are unilateral measures already introduced by states to protect their tax base. The aim should therefore be to supersede them by comprehensive and more effective multilateral rules. This could be achieved by an integrated version of the GloBE such as the METR that we propose. The current design of Pillar Two offers no incentive for source states to replace withholding taxes, and is also too weak to replace CFC rules where they still exist.

The entity and jurisdictional approach in Pillar Two would result in the inappropriate calculation of ETRs for low tax jurisdictions where profits are reported although they are in effect taxed elsewhere. This could be mitigated by the adoption of a high minimum ETR.

Given the current design of Pillar Two, targeted anti-abuse rules would be appropriate. In respect of withholding taxes, we suggest that consideration could be given to a 'throw-back rule' that would re-attribute profits of a constituent entity in a low- or zero-tax jurisdiction that have been subject to withholding to the source country.

4. Carry-forwards and carve-out.

a. Treatment of pre-GloBE losses and excess taxes under the carry-forward approach.

No comments.

b. Formulaic substance-based carve-out

No comments.

c. Computation of the ETR and top-up tax.

No comments.

5. Simplification options.

a. General

The MNEs to which these proposals would apply are large corporate groups, which should be expected to bear the relatively minor costs of compliance with their tax obligations. The measures proposed in the blueprint aim to counter the complex structures that such groups often use to minimise taxes, for which they pay substantial sums to tax advisers and corporate service providers. The best way for them to reduce any compliance costs would be to simplify their own corporate structures.

b. CbC Report ETR Safe Harbour

In our view, the CbCR reports should be aligned with the information requirements needed for implementation of the GloBE. In our submission in March 2020 we pointed out that the reporting requirements for both the CbCR and the Master File should be revised to include any information likely to be needed for the purpose of the formulaic methods under consideration. Pillar Two in particular now includes considerable technical detail in the

guidance on reporting constituent entity profits and covered taxes by jurisdiction, as well as for payroll and assets in respect of the substance-based carve-out; while Pillar One now provides detailed sourcing rules on sales. All these elements should be reported in the CbCRs or the Master Files, and it is important that this guidance is integrated into those reporting obligations.

On the other hand, it is not appropriate to allow the minimal reporting standards in the current CbCR template to be used as a safe harbour protecting MNEs subject to the GloBE from the reporting needed to enforce it.

c. De minimis profit exclusion

We see no reason for the suggested de minimis threshold for reporting covered taxes in every jurisdiction where the MNE has a constituent entity. Indeed, this information is particularly needed to monitor and apply allocation of income related to intangibles based on the DEMPE functions resulting from the reports in BEPS Actions 8-10. Far from being a simplification, the introduction of the kind of de minimis rule that seems to be contemplated would add further complexity, and open up new opportunities for avoidance.

d. Single jurisdictional ETR calculation to cover several years

We agree with the reasons given in para. 402 that this would not constitute any sort of simplification. As pointed out above, MNEs should reduce compliance costs themselves by simplifying their structures. There is no need to reduce reporting requirements for them, in the name of a simplification that would actually make the rules and guidance more complicated for tax authorities.

e. Tax administrative guidance.

Here again, it seems to us that any attempt to reduce reporting requirements would only make the rules and guidance more complex. MNEs generally have good commercial reasons to know their ETR by jurisdiction, so requiring them to report it should not create additional compliance costs.

6. Income Inclusion and Switch-over rules.

a. Top-down approach

The need for a top-down approach results from the design of Pillar Two as separate but interacting tax rights, with the consequent requirement of priority rules. Giving priority to the IIR also creates opportunities for avoidance, since MNEs could form holding companies in convenient jurisdictions to act as their ultimate parent entity. These problems would be obviated by integrating the GloBE into a single combined rule, as we propose in the METR.

b. Integrity measures

As suggested in the blueprint (para. 432), the operation of the IIR could be undermined by jurisdictions offering inducements to attract incorporation of holding companies to act as the ultimate parent entity, counteracting the effects of the IIR. This and other elements create the need for the multilateral review process outlined in ch. 10.5.2. In our view it would clearly be far preferable to design the GloBE along the lines we have proposed in the METR, which could be applied by states in a decentralised way, with a minimum of coordination necessary.

c. Split-ownership

No comments.

7. Undertaxed payments rule.

As stated in section A above, we see no valid justification for treating the UTPR as a secondary back-up rule. Source countries have a stronger need for defensive measures, since payments to low-tax jurisdictions are frequently deductible from business profits, hence directly reducing their tax base. Indeed, OECD countries have themselves introduced such measures unilaterally, for example the UK's Diverted Profits Tax and the US's BEAT. A far better approach would be to allocate the rights to apply top-up taxes fairly to all countries where the MNE has a taxable presence, as proposed in our METR.

8. Special rules for Associates, joint ventures and orphan entities.

No comments.

9. Subject to tax rule.

No comments

10. Implementation and rule co-ordination.

a. Effective co-ordination of the GloBE rules.

We would propose integration of the IIR and the UTPR into a single substance-based allocation rule, as outlined in section A.3 above. This would establish a single rule that all countries could apply simultaneously, thus ensuring fairness. It would also avoid the complexity of managing the interaction of the IIR, UTPR and the STTR, thus providing greater clarity and certainty for business.

b. Dispute prevention and resolution.

No comments.