BUSINESSEUROPE

2 December 2019

Comments on the OECD Public Consultation on the Global Anti-Base Erosion Proposal (GloBE) under Pillar 2

KEY MESSAGES

1 We welcome the opportunity to provide comments on the significant steps the OECD intends to make in reforming the international tax system under Pillar 2, and we urge all participants to cooperate closely. Only through a global consensus can we hope to reform the global tax system in a coherent way. As the OECD considers the corporate tax as 'the most harmful tax to growth', we are concerned about the negative effects a likely increase of corporate tax rates will bring about. We are also concerned that transparent and fair tax competition may be reduced, in particular for smaller countries with few natural resources or viable policy options.

2 While the GloBE-proposal is still under development, the overall reform should be focused on those cases where artificial arrangements are taking place, insofar as these were not addressed by BEPS or Pillar 1, and not on genuine commercial transactions. It will be essential that the GloBE is simple to apply and calculated on an aggregate basis as opposed to a per jurisdiction or per entity basis. Further clarification is needed, in particular on the calculation of a common tax base. The Inclusive Framework (IF) should also consider whether some BEPS-rules, such as for CFC and hybrids, could be improved, replaced or simplified rather than imposing an additional complex layer of rules, to keep the administrative burden as low as possible for both businesses and tax administrations.

3 Any agreement made should be informed by a thorough impact assessment on a country-by-country basis, covering the effects on tax revenue, investment, growth, employment and business models. Prior to any agreement, the impact assessment should look at the results of the agreed BEPS-measures and Pillar 2's relationship with Pillar 1, and whether this already not sufficiently counters the practice of artificial arrangements.

WHAT DOES BUSINESSEUROPE AIM FOR?

- Any solution found should tax net profits once and never revenue, and the new rules should be as simple and easy to administer as possible, focusing exclusively on artificial arrangements (with considerably strengthened dispute mechanisms), whereby the current transfer pricing rules and the arm's length principles are retained as much as possible for transactions with commercial value. Existing unilateral measures must be repealed when the IF finds an agreement. A sharp increase in the effective corporate tax rate and compliance costs should be avoided as it would harm growth, jobs, R&D and the development of innovative business models.

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To: OECD - International Co-operation and Tax Administration Division, Centre for Tax Policy and Administration

BusinessEurope is the leading advocate for growth and competitiveness at the European level, standing up for companies across the continent and campaigning on the issues that most influence their performance. A recognised social partner, we speak for all-sized enterprises in 35 European countries whose national business federations are our direct members.

The Tax Policy Group in BusinessEurope, under the chairmanship of Krister Andersson, has been actively engaged in and supported past BEPS-work and we continue to believe that the global nature of the issue of taxation requires a global solution at the OECD. Only through a global and deep consensus, and not through unilateral initiatives, can we hope to reform the global tax system in a coherent and lasting way, without risking a competitive disadvantage or legal uncertainty for companies as they adopt new business models and get digitalized.

The recent public consultation on Pillar 2, which explores an income inclusion rule, a switch-over rule, an undertaxed payments rule and a subject-to-tax rule shows that the OECD intends to make significant steps in a reform of the international tax system, and we urge all participants in the Inclusive Framework to cooperate closely. As we are steadily nearing the deadline for the final report, one of the objectives, while respecting the sole competence of the participating countries in the field of taxation, must continue to be to avoid unilateral actions by individual countries which only lead to a rapid fragmentation of the international tax system, and to avoid a further increase in international double taxation.

While the GloBE will still need significant development, and further clarification is required on the use of blending, the tax base and GloBE's compatibility with EU-law, we fundamentally believe in any case that countries should be able to set and conduct their tax policy in such a way that it induces and supports sustainable economic growth, creates jobs, promotes R&D and innovation, and that it is competitive to attract foreign direct investment. Therefore, the overall reform should be focused on those cases where artificial arrangements are taking place, insofar as these were not addressed by BEPS or Pillar 1, and not on genuine commercial transactions. By focusing only on those artificial arrangements, the reform would be more focused and proportionate and above all, it could be simplified significantly, by decreasing the need to have specific complex rules on blending, adjustments of temporary and permanent differences, and carve-outs.

We would first and foremost like to see the development of a framework, clarifying how and when the various new component parts of Pillar 2 will interact with each other, with Pillar 1 and with pre-existing legislation as well as what the criteria would be for existing legislation, and when unilateral measures could be reversed. The interaction between

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Pillar 1 and Pillar 2 needs to be fully analysed to ensure both regimes are operating as intended and not inadvertently impacting or undermining each other. The framework should include considerations, to be determined, prior to any agreement on the GloBE, whether the recent BEPS-rules, as well as the forthcoming Pillar 1, would not already address countries' concerns, and if not, whether some complex BEPS-rules, in particular CFC, could be simplified or even removed if replaced by a minimum tax through GloBE. It should also cover which instruments take precedence (and overrule) other instruments and components.

We believe that the implementation of the principles of the framework to be determined as well as the GloBE instrument as described in the consultation draft, will require a multilateral approach, to be captured in a multilateral agreement. Only if countries agree multilaterally, in particular on the coordination of the tax base, can the 'GloBE' proposal limit the administrative burden, offer legal uncertainty for businesses, and limit or eliminate double taxation.

Given the limited time provided to respond to the consultation and given the complexity of the proposals put forward which themselves will require further development and elaboration, our comments should be seen as preliminary.

Determination of the Tax Base for GloBE:

- **Importance of a consistent tax base**
  Although recognizing that a common tax base could be required in order to ensure a consistent and comparable application and to limit the administrative burden of companies, we are concerned that - in particular if the GloBE proposal adopts blending at the country or entity level - the proposal to refer to the accounting standard of the parent company in groups as a starting point may not achieve those goals.

  Subsidiaries draw up their statutory accounts according to local GAAP, which is different in different jurisdictions and also different from e.g. IFRS and US GAAP. Few countries require the annual accounts of a single company to be prepared by using e.g. IFRS. According to our understanding, reports provided by subsidiaries to the parent company for consolidation purposes seldom contain a full set of data reflecting the accounting standard applied for the consolidated reports (e.g. IFRS in a European listed company). Subsidiaries would therefore need to create a new set of accounts for tax purposes reflecting both the accounting principles applied in the parent company as well as tax adjustments required by the GloBE proposal.

  Adding to this, the consultation seems to underestimate the challenges in applying accounting principles for tax purposes. Some examples can be given: Many financial instruments are valued at fair value in accounting, meaning that unrealized gains and losses will affect profit or loss for accounting purposes. Should this also be the case in taxation? Another example is the valuation of plant, machinery and intangible assets, or tax treatments in the oil and shipping industry. Judgement is required by the specific entity when estimating the economic life and hence the amortization period of the asset. This is very difficult

to align with the idea of a common tax base. We note that the European Commission considered it necessary to develop a common consolidated tax base for the CCCTB since accounting rules could not be used as a tax base when applied on a member state by member state basis.

Whilst complex in our view, the OECD should consider whether the application of deferred tax accounting principles to compute the tax base, can be done in a simple way.

- **Adjustments (Permanent & Temporary Differences)**
  It will be essential that a multilateral, harmonised view is found on the issue of the treatment of Permanent & Temporary differences through simplifications to limit the administrative burden and legal uncertainty for businesses. The OECD/IF should provide full transparent clarification on this, prior to any agreement.

  Whilst a multi-year averaging approach to measure the effective tax rate could provide more stability (for example "smoothing out" the effect of one-off items), its adoption would add additional complexity and potentially increase opportunity for abuse.

Blending:

Mandating an entity by entity approach or jurisdiction approach as well as a calculation in the parent jurisdiction for all group companies creates significant complexity and causes high compliance costs for both taxpayers and tax authorities. We would therefore recommend a worldwide blending approach which meets the policy objectives of Pillar 2 in a proportionate and focused way. This approach may also address some of the concerns around EU-law compatibility.

A worldwide blending would also address the issue of temporary differences between accountable and taxable income in some cases, which would also simplify administration for tax authorities. However, for MNEs that are loss making overall (or have joint ventures for individual projects which are not consolidated) this would not be of assistance. These scenarios should still be dealt with under a worldwide blending approach.

Carve-outs:

- **BEPS Action 5 & Action 3**
  We support a reform that is both focused and proportionate, recognising that the BEPS-project (and the on-going work on Pillar 1) is already addressing significant concerns about profit shifting, and we should find the right balance in addressing countries' concerns on artificial arrangements and countries' right to initiate an incentive-driven tax framework, which attracts FDI, R&D, employment, etc through transparent and fair tax competition.

  In that sense, we think that it is critical that the proposals support a carve-out of

those incentive schemes which have shown to be fully compliant with BEPS Action 5 ('Unharmful Tax Regimes') and the EU's Code of Conduct. Adversely impacting these types of regimes risks encouraging the provision of incentives outside the tax system, thereby reducing transparency and risking undermining the BEPS output to date.

Action 3 also set out good principles that can be followed and some parallels between this proposal and Action 3 can be recognised. We would thus encourage the OECD to build on the work already done and consider how to include in the GloBE a safe harbour provision in those cases where the ultimate Parent company's country has a BEPS Action 3 compliant CFC regime. For example, if the US' GILTI-regime already amounts to an income inclusion rule, companies subject to GILTI should not be subject to both GILTI and GloBE.

- **Threshold**
  To increase certainty, and allow a more focused approach, by not burdening smaller businesses with significantly complex rules, the OECD/IF should explore a fixed threshold, under which the GloBE-proposal would not apply, and the CBCR-threshold would seem appropriate in this case. However, at the same time, we would be open to consider additional mechanisms which must ensure that a level-playing-field would exist between bigger and smaller businesses.

- **Other**
  In addition, and in combination with the CBCR-threshold, a carve-out should be explored for those business with a sufficiently high global effective tax rate (ETR) - as set out in their group consolidated financial statements - in excess of the GloBE minimum rate .This would be particularly important to provide parity for companies that are incorporated in a country that does not have or want to adopt a minimum tax CFC regime. The IF should also explore whether the ETR should be considered as an average rate over the period of a number of years to avoid extraordinary operations, such as a change in rates.

  We would also like the IF to consider simple gateway tests to assess whether any additional tests and instruments should be applied.

  In line with what we noted above, the IF should also consider whether some BEPS-rules, such as for CFC and hybrids, could be improved, replaced or simplified.

Income Inclusion Rule:
The Income Inclusion Rule intends to protect the tax bases of the jurisdictions in which the group operates by disincentivizing profit shifting through the establishment of a minimum tax rate via top up where the income is not taxed at least at the minimum level.

- **Tax Rate**
  While the proposal is still under basic development, we would already welcome the public consultation's recommendation of the use of a minimum fixed top-up uniform rate (as opposed to using a percentage of the parent jurisdiction's CIT

rate or a range of rates) uniform fixed. This should lower the administrative burden to some extent.

Within the EU, if the proposal can be set-up compatible with EU-law, we would encourage the top-up rate to be fixed below the existing national rates. The top-up to the minimum rate should be made by reference to the tax rate determined globally rather than on a country-by-country. The reason for a global approach is that the operations of each company in each jurisdiction will vary due to regulatory, legal, and business constraints. In addition, highly integrated businesses would not be well served by a view that considers each country on a stand-alone basis.

- **EU-Law**
  As the legal consequences of the Income Inclusion Rule resemble the so-called Controlled Foreign Corporation (CFC) regimes[1], and as the proposal could only work under a broad multilateral agreement, special emphasis should be placed on its compatibility with primary and secondary EU law.

  From a primary law perspective, the Freedom of Establishment (Art. 49 TFEU) and the Free Movement of Capital (Art. 63 TFEU) are particularly relevant. In addition, tertiary EU law sources should serve as a reference as well as any agreed rules, which must ultimately have to withstand CJEU scrutiny. As the Income Inclusion Rule may potentially establish a difference in treatment for cross-border cases, the imposition of a top up in accordance with the Income Inclusion Rule could constitute a restriction of the mentioned fundamental freedoms as a difference in treatment is established, creating a tax disadvantage for the resident company.

  A restriction is permissible only if it is justified by overriding reasons of public interest and the legislation is proportionate. In the CFC context, the CJEU emphasised the prevention of abuse as a justification. The specific objective of such a restricting measure must be not to prevent genuine commercial activity but to prevent conduct involving the creation of artificial arrangements, which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried in the parent's resident state.

  If we understand the proposal correctly, a top up in accordance with the Income Inclusion Rule could be triggered exclusively by low effective taxation, with no concrete criteria relating to practices of abuse. Since this could constitute an unjustifiable restriction of the fundamental freedoms, we believe that the Income Inclusion Rule should include further criteria such as significant or controlling ownership, certain activities as well as de minimis thresholds to determine not only if income has been subject to tax at a minimum effective rate but also if the

[1] Generally, CFC regimes intend to thwart practices which have no purpose other than to escape the tax due on the profits generated by activities in the state of residence of the parent but artificially moved to a low taxed subsidiary. In this context, CFC regimes commonly stipulate a low tax rate threshold, consider the nature of the activities, contain a significant or controlling ownership criteria and contain some sort of carve-outs that include substance and motive tests as well as de minimis exceptions.

low taxation is the result of conduct involving the creation of artificial arrangements which do not reflect economic reality.

It must further be determined whether that legislation is proportionate. A measure is not proportionate when it goes beyond what is necessary to achieve its purpose. The introduction of a standardized escape possibility/carve-out can align the Income Inclusion Rule with the standards set by CJEU case-law. The parent company should be given an opportunity to produce evidence that the subsidiary is actually established and that its activities are genuine. The definition of such substance, activity and/or motive requirements could be based on a combination of various criteria (e.g. capital investments, education level of employees, etc.).

Additionally, secondary EU law such as the Interest and Royalty Directive (2003/49/EC), Merger Directive (2009/133/EC), the Parent-Subsidiary Directive (2011/96/EU) or the Anti-Tax Avoidance Directives (2016/1164/EU and 2017/952/EU) should be considered for evaluation of the Income Inclusion Rule from an EU law perspective. In recent judgements, the CJEU assessed the compatibility of a national measure on the basis of the anti-abuse definition included in the Anti-Tax Avoidance Directives, further highlighting the need to analyse the compatibility of the Income Inclusion Rule with secondary EU law.

- **BEPS**
  It is essential that the Income Inclusion Rule developed under Pillar 2 should not result in taxation where there is no economic profit, nor should it result in double taxation. Therefore, the introduction of a standardized 'escape possibility/carve-out' would not only serve to ensure compatibility with EU law (see above), but would also recognise the basic premise of the BEPS action plan, which is that value is taxed where created. This said, we want to repeatedly highlight the need to introduce a standardized escape/carve out for activities (alternatively sectors or type of entities) which are to a significant extent locally sourced (i.e. capital investments, infrastructure, industries with high tangible assets) as such activities are less likely to be part of profit shifting activities. Including a white list for certain activities, countries or acceptable minimum tax regimes as well as the introduction of a locally sourced revenue threshold as part of the test to determine whether income is effectively taxed below a minimum rate would ensure that activities which are not subject to profit shifting and which are not adversely affected by the Income Inclusion Rule.

  The Income Inclusion Rule overlaps with existing and already implemented tax regimes with similar objectives on national level as well as with measures implemented in the context of the BEPS project. Therefore, introducing an Income Inclusion Rule (which includes the beforementioned modifications) should be coordinated with a mandatory modification, simplification or preferably abolition of existing CFC regimes. Introducing GloBE as a supplement to a jurisdiction's CFC regime would further complicate international tax law and jeopardize the objectives of this initiative. Furthermore, the parallel existence of measures with similar objectives would result in high bureaucratic costs, the risk of multiple tax credit carry forwards and cause significant administrative cost and

legal uncertainty in order to comply with the parallel measures. This holds in particular for multi-tier structures where multiple CFC regimes apply. Therefore, in line with what we noted above, the Income Inclusion Rule should be coordinated by a mandatory modification, replacement or simplification of CFC-rules.

- **Other**
  Further detail is required regarding the timing of the test for effective low taxation. For instance, a profit allocation which was not subject to low taxation could be subsequently altered under Pillar One allocation rules, creating a situation in which the income of the foreign company is effectively low taxed, therefore, triggering the Income Inclusion Rule. In this context, the timing for the evaluation of the effective tax rate requires substantial clarification. The outcome of audits may not be known for many years. It is important to clarify how reassessments should be handled.

  Double taxation could be avoided by introducing a tax credit carry forward or allowing for deduction of the foreign tax. The latter option is feasible only when the jurisdiction recognizes loss carry-forwards.

  We are concerned that the Income Inclusion Rule may also punish projects or activities that over the full life of the project carry a significant level of taxation, even though this may not occur year by year, e.g. due to long term lead in costs like large infrastructure projects.

  For the income inclusion rule, the minimum tax rate should not require an effective tax charge, i.e., the use of deferred tax assets, tax credits, and exemption of income to avoid double taxation, should not trigger the application of the income inclusion rule. Only the jurisdiction where the global headquarters of an MNE is established should be allowed to top up the tax to the minimum level.

  In conclusion, the Income Inclusion Rule developed under Pillar Two should prevent abusive practices but should not punish activities that are not subject to profit shifting. The introduction of an Income Inclusion Rule can potentially set an overarching standard which simplifies international tax law. However, the proposed Income Inclusion Rule, which may potentially be incompatible with EU law, without testing for abusive practices, could result in taxation where there is no economic profit, significant administrative burden as well as double taxation.

Switch-Over Rule:
The Switch-over Rule covers foreign branches as well as immovable property and allows the state of residence to apply the credit method instead of the exemption method where the profits attributable to a permanent establishment (PE) or derived from immovable property are subject to tax at an effective rate below the minimum rate.

As mentioned before, we would encourage Pillar 2 to stay focused on those arrangements which are artificial and hurt the level-playing field. Consequently, the Switch-over Rule should be linked to a criteria/definition of abusive practices,

ideally identical to the criteria/definition maintained in the Income Inclusion Rule. The above comments concerning the Income Inclusion Rule about the countries' CFC rules and EU law applies mutatis mutandis.

Switching from exemption to credit method incorporates the income of a branch into the corporation's domestic taxation. Insofar, further clarification on the avoidance of double taxation is required. Given the parents domestic income is negative and remains so after the income of the foreign branch is incorporated, the foreign tax credit should be subject to a carry forward or be deductible from the domestic income. The latter option is feasible only when the jurisdictions allows loss-carry forwards.

The introduction of a switch-over rule in accordance Pillar Two would require changes in every major DTA. Insofar, the implementation of the Switch-over Rule would require a multi-lateral instrument (MLI) or similar legal instrument.

Undertaxed Payments Rule & Subject-to-Tax Rule

The undertaxed payment rule would deny a deduction or impose source-based taxation for a payment to a related party if that payment was not subject to tax at a minimum rate. In this regard, the following challenges must be considered:

A rule of precedence, whereby the Income Inclusion rule would take priority, would prevent double taxation that results from the simultaneous application of both the Income Inclusion and Undertaxed Payments rule. Insofar, further clarification on the communication between the national tax authorities should be explored. For example, in case, the Income Inclusion Rule is applied, this should trigger a notification process for other tax authorities in order to avoid an application of the Undertaxed Payment Rule. Insofar, the use of binding cross-border administrative acts should be explored.

In line with our concerns noted above, we would in particular support a carve-out of those incentive schemes which have shown to be fully compliant with BEPS Action 5 ('Unharmful Tax Regimes') and the EU's Code of Conduct, such as royalty payments or payments related to the acquisition of qualifying intellectual property made to a company which can benefit from an approved incentive scheme. Other payments such as the payment by distributors to acquire inventory or software products which they on-sell or for services) should be out of scope as well.

Although the Undertaxed payment rule is limited to payments to related parties, there is no such restriction in the Subject to Tax rule. It should be clarified that the scope is limited to payments to related parties only. It is not practical for companies to be required to determine the effective tax rate applied to payments received by third parties. It is also unlikely that an underpayment rule targeted to non-resident companies only would be compliant with EU law (on the basis of the non-discrimination principle).

Furthermore, the subject-to-tax test should be based on the nominal rate and not on the effective tax rate.

Double Taxation:

The GloBE proposal put forward in the Public Consultation document will bring a significant shift in current taxation rules and legal understanding and interpretation, leading to a proliferation of both bilateral and multilateral discussions on taxation rights. As highlighted in our response, this is likely to bring an increase in the volume of double taxation cases. This issue should not be taken lightly. Not only may double taxation lead to reduced foreign investment and tax uncertainty, in the long-run, it will also lead to reduced employment and lower economic growth. We therefore urge the Inclusive Framework to include both appropriate dispute resolution and dispute avoidance mechanisms from the outset in any agreement, with significant ambition in terms of scope, enforcement, effectiveness and timeliness. It would in our mind not be enough to rely on existing agreements on dispute mechanisms already reached in the BEPS work, nor would slight modifications to existing mechanisms bring sufficient relief. The main goal should be the introduction of mandatory binding arbitration, which must substantially reduce tax authority and taxpayer uncertainty.

Impact Assessment:

As the creation of a worldwide minimum effective tax could be one of the most significant steps in taxation history, it is important that all the participating countries have relevant information before deciding on any agreement unanimously. The impact study should cover the proposal in the broadest way possible, and address not only the effect on (corporate) tax revenue, but also on investment and growth, employment, business models, etc. We urge countries to take due account and not to increase corporate taxes, with a weakening economic outlook on the horizon. The tax incidence literature further calls for careful consideration as workers and consumers are the most impacted[2]. To the extent low tax jurisdictions are expected to increase their statutory corporate tax rates, the increase in cost of capital with its negative effect on jobs must be fully evaluated.

In addition, the consultation refers several times to stopping 'a race to the bottom'. It's not clear that there is evidence to support the notion of a race to the bottom. This was acknowledged by the OECD in Sept 2018, when introducing the Tax Policy Reforms 2018 Brochure, it was stated that "While these corporate tax cuts have created some concerns of a 'race to the bottom,' most of these countries appear to be engaged in a 'race to the average"[3]. It should also be noted that corporate tax revenues in relation to GDP has not declined. If anything, there appears to be an increasing trend in revenues.

The impact assessment should look at the Inclusive Framework's concerns where there are indeed still 'risks that continue to arise from structures that shift profit to entities subject to no or very low taxation', as many of the BEPS-rules have only just been implemented and not yet been quantitively assessed. It is also essential that this impact assessment looks at the relationship between Pillar 1 and Pillar 2 (e.g.

[2] https://www.eesc.europa.eu/sites/default/files/files/qe-03-19-343-en-n.pdf
[3] (http://www.oecd.org/tax/tax-reforms-accelerating-with-push-to-lower-corporate-tax-rates.htm).

will the reallocation under Pillar 1 occur before the application of Pillar 2?) and whether Pillar 1 does not already sufficiently act as 'a backstop' to the IF's concerns related to Pillar 2.

We encourage the OECD to take these concerns into consideration when developing a more detailed proposal in this area and the Tax Policy Group of BusinessEurope stands ready to provide further input to the policy decisions needed to ensure a successful and timely outcome of this important initiative from the OECD and the Inclusive Framework.