CFE tax advisers europe

OPINION STATEMENT

CFE Tax Advisers Europe Response to the OECD Public Consultation Document: GloBE Proposal Under Pillar Two

Submitted by CFE to the OECD on 2 December 2019

CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 33 national tax institutes and associations and tax advisers' chambers from 26 European countries, associated via the Global Tax Advisers Platform (GTAP) with more than 600,000 tax advisers. CFE is part of the EU Transparency Register no. 3543183647-05.

CFE Tax Advisers Europe would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Piergiorgio Valente, President of CFE Tax Advisers Europe, Stella Raventós-Calvo, Chair of the CFE's Fiscal Committee, or Aleksandar Ivanovski, CFE Tax Policy Manager at info@taxadviserseurope.org. For further information regarding CFE Tax Advisers Europe please visit our web page http://www.taxadviserseurope.org/

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CFE Tax Advisers Europe welcomes the opportunity to contribute to the OECD public consultation under Pillar Two - Global Anti-Base Erosion Proposal (GloBE). These comments supplement the response by CFE Tax Advisers Europe concerning the Unified Approach under Pillar One, submitted to the OECD Secretariat on 12 November 2019.

Key Remarks of CFE Tax Advisers Europe

CFE welcomes the ongoing discussion at intergovernmental level aimed at addressing the shortcomings of the international tax system that are exacerbated by the digitalisation of the economy. We therefore welcome the Public Consultation document 'Global Anti-Base Erosion Proposal' as blueprint for further negotiations among the members of the Inclusive Framework. From our perspective, however, there are too many variables in the GloBE proposal, with ramifications that could arise from the open policy and key design questions, including, for example, whether the solutions would focus on average global tax rate or jurisdiction by jurisdiction approach.

Therefore, as a minimum, CFE considers that the final design of the GloBE proposals should reflect the following fundamental principles:

- Certainty for taxpayers and tax administrations,
- Simplicity and minimal compliance costs and complexities, and
- Absence of double or multiple taxation.

Considering that Pillars One and Two serve distinct but concurrent objectives, we would like to set out the following key elements that according to CFE should be embedded as part of this whole process and its outcome:

1. The process needs to **address the interaction of the four elements of Pillar Two**, as it transpires that these are not intended to apply simultaneously, but no decision has been made as to which rule will take priority.

2. **The complexity of this proposal Pillar Two confirms the need for a streamlined multilateral cooperation process; otherwise the system will become unworkable.** The GloBE proposal is likely to result in a significant new administration and compliance burden for tax authorities and taxpayers: the additional resource required by tax authorities, on top of those required for Pillar One, should be taken into account. The profit reallocation rules under Pillar One will require multilateral agreement between many jurisdictions and is unlikely to be resolved for many years. It is not clear how this will be practically managed, and it may present significant administration and compliance issues for the administration of the GloBE proposal.

3. The introduction of **CFC rules are designed to achieve the same objective as the income inclusion rule**. From CFE's perspective a simpler alternative to the income inclusion rule might be world-wide introduction of effective CFC rules.

4. There are potentially a **number of EU law points raised with the income inclusion rule.** Primary EU law (fundamental freedoms) requires EU Member States to refrain from imposition of additional taxes on the profits of an entity established in another Member State, unless the measures are limited in scope and target 'wholly artificial arrangements'.[1] Similarly, the tax on base eroding payments faces EU law challenges: denial of deduction by an EU Member State due to a lower tax rate in another Member State would be contrary to primary EU law (freedom of establishment and freedom to provide services in the Single Market).

5. The achievement of the policy aim to **establish global minimum tax** will depend significantly on the chosen model: jurisdiction-by-jurisdiction approach or an average global rate approach. The complexities in designing a minimum tax rate in a global context will be not only technically challenging but will require redoubling of the political efforts by the Inclusive Framework governments to ensure consensus, and subsequently, close international coordination.

6. **Clarity would be welcome on the interaction between Pillar One and Pillar Two –** CFE welcomes introduction of multilateral instruments where treaty benefits/ payments are being denied based on effective rate under Pillar Two, if the effective tax rate is based on a payment that is subsequently spread across multiple jurisdictions under Pillar One.

7. As with Pillar One **enhanced dispute prevention and resolution mechanisms will be essential**, including multilateral mandatory binding arbitration. In addition, for the GloBE proposal a key part of dispute prevention mechanisms will be ensuring that a consistent tax base is used.

8. CFE is concerned that **the use of financial accounts as a starting point for determining the tax base for the GloBE proposal would amount to more complexity**. Whilst we recognise the limitations and difficulties with determining the tax base by reference to the CFC rules of the shareholder's jurisdiction, it should be agreed that there would be *worldwide blending*[2].

9. CFE will **refrain from commenting on carve-outs at this stage of the process**, considering that there is at present no decision or consensus around the level of the minimum rate of tax that would apply under the GloBE proposal.

10. Finally, to evaluate the full effect of the existing BEPS standards, some of which are still under implementation in most countries of the Inclusive Framework, a longer-term perspective seems more appropriate to appreciate the entirety of the remaining BEPS issues. Within the **EU a number of anti-BEPS policy and legislative measures have been introduced with the ATAD directives, which significantly reduce the incentives to shift mobile tax bases to low-tax jurisdictions**.[3] Consequently, more time should be allowed to evaluate the full effect of the BEPS-related anti-avoidance measures, before any such complex rules are introduced.

[1] Judgment of the Court of Justice of the European Union, Case C-196/04 *Cadbury Schweppes*, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue

[2] "Blending" means mixing of low-tax and high-tax income from different sources as set out in the GloBE proposals.

[3] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market and Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

Impact Assessment

A comprehensive economic impact assessment is required before taking this process forward, in particular to assess the impact and the combined effects of Pillar One and Pillar Two, as these two projects serve distinct, but concurrent objectives.

Considering the historic significance of this project, much greater information must be ascertained on the serious impact that is to be expected. The impact analysis should establish the collateral economic and red-tape impact of this project.

GloBE and the Residual BEPS issues

Under the present proposals, there is a policy intention to address any remaining BEPS issues and the 'rate arbitrage' by exploring rules designed to give jurisdictions a remedy in cases where income is subject to no or very low taxation.

- **Income inclusion rule**, where income of a foreign (related) company would be included in the taxable base of the controlling one, provided the income was subject to no or very low taxation.

- **A tax on base eroding payments (undertaxed payments rule),** that would allow jurisdictions to deny treaty benefits if the beneficiary is not sufficiently taxed in the other jurisdiction.

- **Switch-over rule** that allows the **residence jurisdictions** to switch from an exemption to a credit method where profits belonging to a PE are undertaxed (below the minimum tax rate) and

- **Subject to tax rule** allowing assessment of withholding tax to income at source and denying treaty benefits on income subject to tax below the minimum tax rate.

Specifically, Pillar Two "Global Anti-Base Erosion Proposal", or "GloBE" proposal seeks to address outstanding BEPS issues by introducing a global minimum tax and providing "jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation". The approach would seek to apply an income inclusion rule and deduction denial in tandem to achieve the intended aim of global anti-base erosion.

We believe that a number of outstanding issues remain concerning the design and operation of the proposed rules. From CFE's perspective, it is not clear whether the fundamental principle underlying the Pillar Two proposal is to achieve a minimum effective tax rate at company/ entity level or at shareholder level; or whether it is to allow countries to protect their own tax base from base eroding payments. Achieving one of these goals would be sufficient to address the remaining concerns regarding the other goal. The four component parts of the GloBE proposals could be constructed as to address either or both of these policy objectives, but they will not do so without an upfront agreement on which are the primary underlying goals.

Any one of the four components would be difficult and complicated to implement effectively; additional challenge of the GloBE proposal is to address how these rules could be made to work effectively together (and

with existing rules and Pillar One), without giving rise to significant levels of double or multiple taxation, and a compliance and administrative burden out of proportion to the issues which are being addressed.

Furthermore, CFE would recommend ensuring that only one rule or GloBE element applies to each structure, considering that the income inclusion rule is an alternative to the undertaxed payments rule – if both rules apply in respect of a particular structure, there would be double or multiple taxation. This is particularly relevant considering that countries may decide to adopt different rules. Consequently, it is essential that a clear demarcation is made as a matter of design between the four elements of the proposed GloBE solution, as there transpires that a considerable overlap between them exists.

In addition, the introduction of CFC rules are designed to achieve the same objective as the income inclusion rule. Similarly, the project needs to ensure that the EU's objectives as set out with establishment of a list of non-cooperative jurisdictions for tax purposes are closely aligned with those of the OECD, which is to increase transparency and encourage compliance with anti-BEPS measures.

To the extent that further action is required, from CFE's perspective a much simpler route to achieve the income inclusion rule might be to focus on existing CFC rules:

- All jurisdictions to reach an agreement on introducing effective CFC rules;
- CFC rules to include an additional minimum tax level test;
- Where income is taxed at a rate below the minimum tax level (using either the tax rules applicable to the parent company or the subsidiary jurisdiction) a CFC charge would automatically arise.

Furthermore, there seems to be an overlap of the proposed global anti-base erosion proposals with the current work under Action 5 of the BEPS project relating to identification of preferential regimes. Indeed, the recent progress report on preferential regimes also contains details of a new standard for substantial activity requirements within jurisdictions with no or low taxation, aiming to establishing a level playing field between the jurisdictions introducing substantial activity requirements in preferential regimes, with those offering low or no corporate tax.[4] The GloBe proposal might encourage countries to focus on patent boxes, due to the fact that 10% tax is the acceptable norm under the OECD BEPS Action 5 recommendations. The implication of this is that multinational companies will pay different tax rates because they have different types of business models – principally IP v the others.

More generally, it is critical that the measures are targeted at profits arising in countries where no real or substantive activity is carried on, in line with the aspirations of the BEPS project to pay tax where the "value is created". In addition, *de minimis* threshold should be considered to prevent these rules from becoming a barrier to business development, innovation and new markets.[5] This is relevant in particular as the risk of increased profit shifting concerns large global companies of a particular size.

[4] OECD, *Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (2019), paragraph 6

[5] The Base Erosion and Anti-Abuse Tax (BEAT) under the Tax Cuts and Jobs Act in the United States applies to companies that exceed the $500 million revenue threshold only

Clarity would be welcome on the further steps concerning the income inclusion rule and whether it is OECD's policy to introduce globally the US Global Intangible Low-Taxed Income ("GILTI").[6] If this is indeed the case, we would welcome clarity that GILTI as a regime implemented in the US is the starting point for further work on the income inclusion rule, building on the recommendations of BEPS Action 3.

Carve Outs

CFE will refrain from commenting on any carve-outs at this stage of the process, considering that there is at present no decision or consensus around the level of the minimum rate of tax that would apply under the GloBE proposal. The minimum rate will no doubt determine the scope of the rules and will impact on other issues such as whether the rules are compatible with international obligations, including the EU fundamental freedoms. Therefore, a decision around the minimum rate is likely to drive the subsequent policy decisions around whether other carve-outs are required or desirable.

Use of Financial Accounts

CFE is concerned that the use of financial accounts as a starting point for determining the tax base for the GloBE proposal would amount to more complexity. Whilst we recognise the limitations and difficulties with determining the tax base by reference to the CFC rules of the shareholder's jurisdiction, the way forward might be *worldwide blending*.[7]

Such a broad approach to blending must be balanced against the increased complexity and administrative burden of either "jurisdiction-blending" or "entity blending". A *worldwide blending* approach would reduce compliance costs, if it is based on consolidated financial statements that have already been prepared for accounting purposes. For most taxpayers, this approach would entail separate system of accounting applied across a group. In addition, worldwide blending based on accounts might be consistent with the policy aim of addressing the 'public disquiet' about MNE's tax liability, because the amount of corporate income/ profits and tax paid globally are relatively easy to extract and confirm. A worldwide blending approach would also address some incidental tax design issues: for example, around the treatment of intra-group transactions such as dividends and foreign taxes which could be credited without having to determine whether that tax was paid at branch level, head office level or under CFC rules of a third jurisdiction.

We recognise the limitations of such an approach, as described above. Intra-group margins are generally eliminated in consolidated statements which might compromise the determination of an effective tax rate. In addition, consolidation standards and policies vary from country to country and group to group. Some do rely on IFRS, others do not and some must rely on IFRS. As a result, there could be "*standard-shopping*" by placing a holding in a flexible-legislation jurisdiction. The consultation document rightly highlights that some or even considerable processing of consolidated statements will be required. One possibility to address such shortcomings might be thorough already existing tools, such as country-by-country reporting.

[6] Paragraph 98 of the OECD Pillar Two Consultation Document (November 2019)
[7] Blending is mixing of low-tax and high-tax income from different sources as set out in the GloBE proposals

From CFE's perspective, the use of different local accounting standards, which would move away from the level playing field that international stakeholders are aiming to achieve. The use of the financial accounts in a more general (global) context should be distinguished from the use of accounts as a starting point in a domestic system, which can have huge value in reducing compliance costs. Moving to an accounts basis for the purposes of establishing a consistent tax base across different jurisdictions would potentially lead to distortive risks and it is difficult to see how it would not add more complexity and uncertainty.

EU Law Compatibility Issues

There are a number of EU law compatibility points that are raised with the income inclusion rule. Primary EU law (fundamental freedoms) requires EU Member States to refrain from imposing additional taxes on the profits of an entity established in another Member State, unless the measures are limited in scope and target 'wholly artificial arrangements'.[8] Similarly, the tax on base eroding payments faces EU law challenges: denial of deduction by an EU Member State due to a lower tax rate in another Member State would be contrary to primary EU law (freedom of establishment and freedom to provide services in the Single Market).

The minimum tax rate, which is yet to be agreed, will also determine further compatibility issues with international obligations, including the EU fundamental freedoms.

Concluding Remarks

The proposals are likely to continue to put pressure on the existing tax framework, and any disparity in the domestic implementations of minimum tax rate proposals is inevitably going to lead to double taxation, in instances where countries fail to take into account tax already paid under such regimes (under CFC rules or under the GILTI regime in the United States). In addition, a practical problem exists where the assessment of the final tax may take several years. For example, if a taxpayer enters a provision in year one, there might be a final assessment, in years two, three or sometimes longer. Loss carry-back or carry–forward rules, or fiscal unity may further change the outcome. In addition, a layer of retaliatory taxation that could come further on changes the landscape even more. Such developments could occur in different financial years, which exposes the taxpayer to the risk of multiple taxation. Hence, the proposals appear like an equation with too many variables.

Furthermore, outcomes of a global minimum tax rate will differ significantly depending on the chosen model: jurisdiction-by-jurisdiction approach or an average global rate approach. The complexities in designing a minimum tax rate in a global context will be not only technically challenging but will require redoubling of political efforts by the Inclusive Framework governments to ensure close international coordination, prior and subsequently at implementation/ administration stage.

CFE considers that the final design of the GloBE proposals should reflect the following fundamental principles:

- Certainty for taxpayers and tax administrations,
- Simplicity and minimal compliance costs and complexities, and
- Absence of double or multiple taxation.

[8] Judgment of the Court of Justice of the European Union, Case C-196/04 *Cadbury Schweppes*, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue

In addition, the risks exists of not taking into account certain permanent differences into the determination of the effective tax rate. For instance, to the extent the MNE could benefit from specific local tax incentives that allow to decrease significantly the tax rate (for instance patent box regimes, R&D incentives, tax credits etc.), these permanent differences should not be taken into account. Safeguards should be included to take into account differences due to which the effective tax rate is lowered as a result of measures/regimes that are accepted by the international community. Conversely, the new rules would likely threaten the entire systems of legitimate and genuine tax incentives that are introduced for benefit of real economic activity and investment.

Finally, it is questionable whether the present GloBE proposed solutions will solve the perceived problems, which centre on the public disquiet about multinational companies not paying enough tax. Other factors influence the amount of corporation taxes paid in a jurisdiction including the scope of the tax base, the statutory rates, any incentives etc. These solutions may address some of the problems that stakeholders have identified as arising from the taxation challenges of the digitalising economy, however, the issues of the perception of multinational companies not paying enough, or high enough rates of tax may persist. The complexity of our tax systems, nonetheless, may become even greater still.