OPINION STATEMENT

Opinion Statement on the EU Proposal for a Directive on Minimum Tax & OECD Model Rules Implementing Pillar 2 (Global Minimum Taxation)

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CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 33 national tax institutes, associations, and tax advisers' chambers from 24 European countries. CFE was the initiator of the Global Tax Advisers Platform through which it is associated with more than 600,000 tax advisers worldwide. CFE is part of the EU Transparency Register no. 3543183647-05.

We would be pleased to answer any questions you may have regarding our Opinion Statement. For further information, please contact Bruno Gouthière, Chair of the CFE Fiscal Committee or Aleksandar Ivanovski, Director of Tax Policy 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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1. Introduction

CFE welcomes the opportunity to comment on the EU implementation of the draft minimum tax directive. CFE's statement is addressed to the European Union and to the OECD, considering that the EU and the OECD Model Rules are substantially similar in scope, and EU is proposing implementation of the OECD-agreed rules into the EU legal order.

CFE welcomes the delay of the entry into force of the proposed EU Directive as discussed in the Compromise Text[1], due to the inherent complexity and ambiguity and the need of taxpayers, advisers and administrations to get acquainted with these rules before they become operational. Not many countries of the Inclusive Framework have the resources to implement these rules, and certainly they could not put in place these measures in the desired timeframe.

CFE strongly suggests the directive should establish a link with the entering into force and effective implementation of Pillar 2 by most of the jurisdictions participating to the Inclusive Framework. In the opinion of Tax Advisers Europe, the proposed directive should come into force and be effectively applicable only as of the year following that in which at least 2/3 of the members of the Inclusive Framework have effectively introduced the necessary legislation so as to apply the OECD Pillar 2 rules.

CFE also welcomes the compromise agreement, as indicated in Article 47 a of the Compromise Text, whereby countries in which no more than 10 ultimate parent entities of groups falling within the scope of the proposed directive are located may elect not to apply the IIR and the UTPR for each fiscal year beginning as from 31 December 2023 to 31 December 2025.[2]

[1] Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union {SWD(2021) 580 final} of 22 December 2021, as amended by the Permanent Representatives Committee, Council of the European Union with a draft Compromise Text of 12 March 2022, interinstitutional file 2021/0433(CNS), FISC 61; ECOFIN 199 ('Compromise Text').

[2] In addition, Article 47(2) of the Compromise Text provides that where the ultimate parent entity of a MNE group is located in a Member State that has made an election pursuant to paragraph 1, the Member States, other than the one in which the ultimate parent entity is located, shall ensure that the constituent entities of this group are subject, in the Member State in which they are located, to the UTPR top-up tax amount allocated to that Member State for the fiscal years beginning as from 31 December 2023 in accordance with Article 13.

2. Key Remarks on Complexity, Implementation, and Whitelist of Pillar 2-Compliant Jurisdictions

CFE Tax Advisers Europe welcomes the historic agreement on the global tax reform with a key objective of stabilising the international corporate tax framework and bringing up to speed with the challenges of the digitalising economy, as well as more transparency and fairness in the global tax environment. In this respect, CFE also welcomes EU's commitment to ensure that the global rules are enacted in the EU legal order through an EU-wide coherent framework. CFE is however concerned that this exercise, at both OECD and EU level, does not amount to meaningful engagement with stakeholders as Member states have proceeded with amendments to the Commission proposal while the public consultation is ongoing. This makes it difficult to conceivably provide input that would be considered and incorporated in the draft directive. CFE notes that this is one of the most significant reforms of international tax rules for many years and stresses that it therefore merits full and detailed discussion and consideration. The consultation process at OECD level is not sufficient to cover consultation with relevant stakeholders for the purposes of EU law. The EU should not rely on what is said at level of OECD.

In light of this, CFE finds it problematic that the Compromise text refers to subsequent OECD commentary as regards rules of interpretation. As discussed in more detail below, recourse to OECD guidance to interpret provisions of EU law is extremely problematic for multiple reasons.[3]

CFE's reservations on the proposed EU Directive implementing Pillar 2 are principally focused on the complexity, the ambitious implementation timeline and lack of opportunity for meaningful engagement with stakeholders in developing the model rules, on which the EU directive is based.

As agreed by the Members of the Inclusive Framework, Pillar 2 consists of two rules intended for introduction in national domestic tax laws, and a treaty-based rule. The two domestic tax rules, the Income Inclusion Rule (IIR) and its backstop, the Under Taxed Payments (or rather, Profits) Rule (UTPR),

[3] Para 11, Preamble of the draft Directive, Compromise Text

are together known as the Global anti-Base Erosion (Globe) rules. The Subject to Tax Rule (STTR) is a treaty-based rule that allows source jurisdictions to impose limited source taxation on certain related party payments that are subject to tax below a minimum rate. In line with the OECD rules, the EU proposal for a Pillar 2 directive entails a substance carve-outs, intended to limit impact of the Globe rules to multinational groups with significant economic presence (e. g. tangible assets or payroll), as well as a de minimis exception. CFE is supportive of such exceptions.

In a significant departure from the OECD model rules, the EU directive covers domestic groups (Article 1a and Article 5(2)) to ensure consistency with the general principles of EU law/ EU fundamental freedoms/ non-discrimination rules. If the directive provides for exhaustive harmonisation of EU law, then different issues and considerations may arise.[4] Consequently, a parent company located in an EU member state will be subject to the income inclusion rule top-up tax on the low-taxed income of its subsidiaries even if they are located in the same jurisdiction.

Whilst appreciative that the Commission proposal implements the OECD model rules, CFE notes that there are technical inconsistencies in the OECD model rules which by verbatim implementation in the EU directive will be transferred to the EU legal order without technical scrutiny. Thus, the EU is losing the possibility to amend the substantive rules in the event that other jurisdictions choose to depart from the OECD model rules or do not implement it at all. In reality, the implementation of Pillar 2 is a highly politicised exercise where jurisdictions weigh their domestic political considerations against the policy options at the negotiating table. The proposed Directive will not achieve its purpose and large corporations can avoid it unless all countries apply same rules. Countries need to implement binding rules to ensure the purpose of the OECD agreement and the provisions of the directive are not able to be circumvented by countries which do not apply the rules. A clause to that effect should be considered.

Furthermore, it is uncertain whether the OECD model rules, as implemented by the EU directive, implement faithfully the political agreement reached by the Members of the Inclusive Framework.

[4] Case C-75/18, Vodafone Hungary; Case C-323/18, Tesco-Global; Case C-562/19 P, European Commission v. Republic of Poland, Hungary; Case C-596/19 P, European Commission v. Hungary, Republic of Poland.; The issue of exhaustive harmonisation is further raised, per para 15, Case C-6/16 Eqiom (Judgment of the Court of 7 September 2017 Eqiom SAS, formerly Holcim France SAS and Enka SA)

Many governments will struggle with the enormous complexity of these rules, and by extension, potentially understaffed tax administrations would struggle with their implementation. Taxpayers, such as large multinational groups, may also have difficulties reconciling the complexity of the rules with the reality of their business operations on the field. Lack of consultation with businesses has led to significant problems with the Model Rules – both in terms of the rules not delivering on the policy and at a more technical level.

Some of the issues that have been identified may be dealt with through the OECD commentary that is still to be developed throughout this year. But the OECD commentary will not have legal force in the EU (except perhaps in some countries). In addition, some of the issues simply cannot be dealt with through commentary. Therefore, a significant constraint to an immediate implementation of the OECD model rules and the upcoming commentary in the EU is linked to the "legal value" of these rules in the EU legal order.

The OECD Model and its Commentary are "recommendations" under art. 5 (b) of the OECD Convention. Contrary to "decisions", they are not binding upon the members. The terminology used in the OECD Convention is in line with general international practice, where the term "recommendation" indicates a nonbinding suggestion by an international organisation.[5] Similarly, these considerations apply to the OECD model rules on Pillar 2 and its upcoming commentary.

As a result of the rules of the EU legal order, where a Directive is binding upon member states as to the result to be achieved, it would be impossible for such a binding EU directive to defer to subsequent modifications of the OECD commentary. In plain words, the EU going first would tie the hands of Member states to depart from any 'misjudged' provisions that the EU implemented the earliest and the OECD or other jurisdictions may wish to remedy certain provisions further along the way. CFE strongly suggests the directive should therefore put a link between its entering into force and the effective implementation of Pillar 2 by most of the jurisdictions participating to the Inclusive Framework. The directive should accordingly come into force and be effectively applicable as of next

[5] Freymond, P., "Les decisions de l'Organisation Europeenne de Cooperation Economique (OECE)", Annuaire Suisse de Droit International, vol. 11, 1954; Douma, Sjoerd, and F. A. Engelen, eds. "The legal status of the OECD commentaries." Vol. 1. IBFD, 2008.

year following the year in which at least 2/3 of the members of the Inclusive Framework have effectively introduced the necessary legislation for applying the OECD Pillar 2 rules.

Finally, CFE welcomes the inclusion of the provisions on assessment of equivalence ('white-list') in the Compromise Text.[6] The inclusion of a list of third country jurisdictions that have implemented a legal framework in their domestic law, which can be considered equivalent to a qualified income inclusion rule will minimise the compliance burden. However, this endeavour might be constrained by the fact that no other country (at present) has implemented the rules, apart from the UK intention to do so quickly.[7]

3. Further comments related to the Compromise Text of the draft EU Directive

3.1. Penalties (Article 44 of the Compromise Text):

CFE welcomes the modifications introduced in the Compromise Text concerning penalties. It is proposed that it is left for the Member States to determine the penalties for non-filing or late filing of relevant tax return in line with existing domestic tax penalties, provided that they are effective, proportionate and dissuasive, in accordance with applicable law (Article 44).[8]

3.2. Eligible distribution tax systems (Article 38 of the Compromise Text), i.e. corporate income tax is paid at the time of profit distribution only

Eligible distributions tax systems (mainly Estonia and Latvia) are discussed in Article 38. The wording seems unclear as to whether the deemed distribution tax should be booked in accounting as deferred tax liability in accordance with IFRS or local generally accepted accounting principles (GAAP) or followed otherwise. If treated/booked as 'deferred tax' item, such tax would be covered by Article 21

[6] Article 51 of the Compromise Text.
[7] OECD Pillar 2 – Consultation on Implementation - GOV.UK (www.gov.uk)
[8] *Cf.* draft Directive proposing penalty in the amount of 5% of the annual turnover.

(which in turn does not separately cover deferred tax recognised/booked in accordance with Article 38). Clarification is needed in this respect in view of ensuring consistency with IFRS rules.

Further clarification is needed whether the deemed distribution tax should be recognised by applying the minimum tax rate or local tax rate (if exceeding the minimum tax rate).

3.3. Post-filing adjustments (Articles 24 and 28 of the Compromise Text):

Given that the tax calculation for minimum tax purposes is based on the accounting/financial accounts, clarification is needed how to treat, for instance, transfer-pricing adjustments and counter-adjustments that are not recognised in the accounts, when they would have an effect on the tax income/cost in low tax jurisdiction. The effective tax rate (ETR) cannot be calculated for companies subject to transfer pricing adjustments solely based on the accounts but the unaccounted adjustments to the taxable income and tax-deductible costs need to be taken into consideration as well.

4. The Income Inclusion Rule and CFC Legislation

The issue of the future of Member states CFC legislation is being raised with the introduction of the Income Inclusion Rule in the EU legal order. As noted by the OECD, the income inclusion rule is drafted with reference to the *modus operandi* of CFC rules.[9] Substantively, the Income Inclusion Rule could be seen as a wider-reaching CFC legislation with different scope of application compared to national CFE rules. As a result, the income of a subsidiary shall be included in the taxable income of a parent company even when no distribution has been made from the subsidiary to the parent. The OECD BEPS Action 3 Report on CFC rules suggests that EU Member States' CFC rules should put in scope both domestic and cross-border subsidiaries. Pursuant to the report, such an approach would make the CFC rules safe from ECJ scrutiny, i.e. compatible with the non-discrimination principle. However, since the matter is very much unclear, CFE suggests a thorough dialogue with member states on the future of CFC rules post-Pillar 2 and the interaction of the CFC rules with Pillar 2 and ATAD/ ATAD3[10].

[9] OECD, Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy (OECD Publishing 2020), at [28]
[10] 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 (ATAD).

CFE would welcome a dialogue on the interaction with ATAD3/ Unshell proposal given the interconnection of these rules and the same underpinning objective- taxation of shareholders as if an entity did not exist. For instance, in order to determine whether 15% tax has been paid or not, one should take into account that income may be subject to tax in another jurisdiction under CFC legislation. As long as the income has been taxed in the country of the shareholder under CFC legislation at least at rate of 15%, the Directive/ OECD Model rules should consider that Pillar 2 rules should not be applicable.

In addition, Pillar 2 does not consider the taxation of look-through/ transparent entities. Where the income of a partnership is taxable in the hands of the partners, the taxes paid should be taken into account for the determination of the 15% tax rate. For instance, an Italian corporation that is a partner of a French partnership is taxable in France on its prorate share of income at the standard French corporation tax rate; the situation should therefore not fall within Pillar 2.

5. Specific Comments on the OECD Model Rules

CFE suggests to further postpone the entry into force of the proposed directive, due to the inherent complexity and ambiguity and the need of taxpayers, advisers and tax administrations to get acquainted with these rules before they become operational. Not many countries of the Inclusive Framework have the resources to implement these rules, and certainly they could not put in place these measures in the desired timeframe.

Otherwise, CFE also wishes to make the following more specific comments (for the purpose of the following, the articles quoted refer to the proposed OECD Model rules on Pillar 2).

5.1. The operation of the UTPR even where an IIR is applied at the UPE level

Article 2.5.2 is clear that there is no Top-Up tax for an individual entity if it is subject to an IIR by (e.g.) a UPE jurisdiction. However, Article 2.5.1 appears to still apply to every constituent entity of the group. Unless qualification for Article 2.5.2 is confirmed to exempt entities from UTPR in full where they are subject to an IIR, this would require calculations and filings for every Constituent Entity (presumably with credit then applied for tax paid in the IIR jurisdiction). Clarification that the interaction between these two Articles should not result in this extraneous requirement would be welcome.

5.2. Ambiguity in respect of key terms and concepts

Across the OECD Model Rules, certain key terms are not defined, although in some cases they do not mirror accounting terms. If these are supposed to defer to accounting standards then this should be confirmed – although even if this is the case it is concerning as in many cases they do not align with the understood meanings of (e.g.) IFRS. A good example is "tangible assets":

- The term "Tangible Assets" is relevant for three areas of the rules:
    - The Recapture Exception Accrual (Article 4.4)
    - The Substance Based Income Exclusion (Article 5.3)
    - The UTPR percentage (Article 2.6) and the single country exclusion from UTPR (Article 9.3)

- "Tangible Assets" are defined in Chapter 10– although specifically this definition is said only to apply "for the purposes of the UTPR percentage and for Article 9.3 [exclusion from UTPR]". Accordingly, for the purposes of the Recapture Exception Accrual and the Substance Based Income Exclusion, there is no definition for "Tangible Assets". It would be useful if the Commentary were to confirm whether a separate definition is to be used for these Articles (and, if so, what it should be), or whether the same definition should in fact apply across all three Articles.

- In any event, the definition provided in Chapter 10 is not extensive enough to confirm whether many common types of assets should be deemed "Tangible". Under IFRS, the terms "Tangible" and "Tangible Assets" are not defined – the IASB Framework defines an asset as "a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity", and guidance on accounting treatments (including additional supporting definitions) are provided in a number of accounting standards including but not limited to IAS 16 (Property, Plant & Equipment), IAS 38 (Intangible Assets), IAS 39 / IFRS 9 (Financial Instruments) and IAS 40 (Investment Property).

- While the definition in Chapter 10 is explicit that it does not include "cash or cash equivalents, intangibles, or financial assets", these are not themselves defined terms, and prima facie many significant assets that are capitalised for accounting purposes may not meet the dictionary definition of being "tangible". For example:
    - Directly attributable (but not "tangible") costs required to bring the asset to the location and condition necessary for it to be capable of being operated in the manner intended are capitalised for accounting (and typically tax) purposes – e.g., labour expense from construction, direct materials used, delivery costs, installation, testing and professional fees.
    - Capitalised costs of site construction work (e.g., stripping costs (incurred when removing overburden or waste materials) and underground mine development costs).

CFE would welcome confirmation in the commentary that all fixed assets as defined by accounting standards - other than those specifically excluded (i.e., intangible assets financial assets, cash and cash equivalents – also as defined by accounting standards) – should be considered "Tangible Assets".

Other examples of definitional ambiguity not linked to accounting concepts include the following:

- It is not clear what is meant by "tax credits" in Art 4.4.1(e), i.e., rebates or items that reduce tax payable, and if and how this Article is meant to interact with Article 4.1.5.

- It is not clear if "reflected or disclosed" in Art 9.1.1 includes amounts referred to in the accounts but which are not booked, e.g. as recognition criteria have not been met. Clarity is then needed as to which set of accounts is being referred to; is it the Consolidated Financial Statements?

- Previous drafts of the Model Rules were clear on the interaction of Pillar 1 and Pillar 2. That clarity seems to have been disappeared in the final Model Rules. There should be clarification as to whether any profits reallocated under Pillar 1 are also reallocated for Pillar 2 purposes and whether Pillar 1 tax is a covered tax for Pillar 2.
- It would be helpful to clarify whether withholding taxes on dividends, interest or royalties are covered taxes for the Purposes of Pillar 2 and to which entity they are assigned. We note the reference in 4.3.1 to "taxes on distributions" but it is not clear whether that relates to withholding tax on dividends or to taxes under an eligible distribution system.
- Covered taxes per Article 4.2.2 do not include "top up tax accrued by a Constituent Entity under a Qualified Domestic Minimum Top Up Tax". This is presumably because domestic top up tax reduces Jurisdictional Top Up Tax under Art 5.2.3. However, it is not clear that Art 4.2.2 also applies to the Ultimate Parent Entity.
- The wording of Article 4.4.2(c) and 4.4.1(c) is confusing. Taken together do they mean that a DTA loss is recognised within GloBE even in the year the loss arises where it is not recognised (as failing to meet the recognition criteria)?
- Article 4.4.5(b) creates a new category of Recapture Exception Accrual but there is no definition of "similar arrangement". Would it be possible to clarify that this is wider than simply an ownership interest and could include, for example, a right of use?

5.3. Lack of explanation on how sections of the rules will work in practice

- Article 4.4.4 implies that a deferred tax liability that is not a Recapture Exception Accrual needs to be tracked to understand if the amount is paid within the five subsequent fiscal years. As a number of deferred tax balances may not fall within the Recapture Exception Accrual list, we would appreciate guidance on how this should be done in practice and specifically the level of granularity required. The Model Rules use the wording "category of deferred tax", and it isn't clear what this would mean and how it would be applied. While deferred tax was agreed by business to be the correct mechanism to deal with timing differences (because the rules are based on accounting profits), restricting their use to undefined categories that are not tracked for accounting purposes creates an impossible compliance burden.

- The volume of 'new' datapoints required by the Model Rules means that many MNEs will need to embark on significant IT projects to fully model and then comply with the Model Rules. This of course will ultimately be done, but to complete this work in a short period of time when the detailed country rules are still to be written (and Commentary and Implementation Guidance has not been released by the OECD or the EU) is extremely challenging. Accounting systems simply do not capture detailed P&Ls and balance sheets for every legal entity that are rolled into a consolidation – for complex groups it is often the opposite. Safe harbours or other options to simplify would be critical in this respect.

5.4. Joint ventures and joint operations

- Art6.4.1(a) treats the JV as the ultimate parent entity of its own group. It is unclear whether this means that the GloBE rules of the JV jurisdiction should be applied.

- Art 6.4.1(b) states that 'a Parent Entity' … shall apply the Income Inclusion Rules in respect of its Allocable Share of the Top Up Tax of a member of the JV Group". It is unclear whether 'a Parent Entity' in this article refers to the deemed parent entity in Art 6.4.1(a) (i.e., the JV itself), or whether it refers to a parent entity above the JV company as is perhaps implied by Art 6.4.1(c) such that the JV company is included in two IIR calculations. The degree of blending between the JV and the rest of the MNE group will depend on the answer to this question.

- It should be noted that there may be commercial issues in obtaining some of the data required to apply the JV rules (and also the Partially Owned Parent rules).

5. Conclusion

CFE welcomes the historic agreement on the global tax reform with a key objective of stabilising the international corporate tax framework arising from the challenges of the digitalising economy. In this respect, CFE also welcomes EU's commitment to ensure that the global rules are enacted in the EU legal order through an EU-wide coherent framework. CFE is however concerned that this exercise, at both OECD and EU level, does not amount to meaningful engagement with stakeholders as Member states have proceeded with amendments to the Commission proposal while the public consultation at EU level is still ongoing. CFE's reservations on the proposed EU Directive implementing Pillar 2 are principally focused on the complexity, the ambitious implementation timeline and lack of opportunity for meaningful engagement with stakeholders in developing the model rules, on which the EU directive is based. This makes it difficult to conceivably provide input that would be considered and incorporated in the draft directive. CFE notes that this is one of the most significant reforms of international tax rules for many years and stresses that it therefore merits full and detailed discussion and consideration. The consultation process at OECD level is not sufficient to cover consultation with relevant stakeholders for the purposes of EU law.

In light of the above, CFE finds it problematic that subsequent iterations of the EU Compromise text as discussed by the Member states representatives refers to subsequent OECD commentary as regards rules of interpretation. As discussed in more detail in CFE's statement, recourse to OECD guidance to interpret provisions of EU law is extremely problematic for reasons of legal certainty. CFE strongly suggests the directive should establish a link with the entering into force and effective implementation of Pillar 2 by most of the jurisdictions participating to the Inclusive Framework. In the opinion of CFE Tax Advisers Europe, the proposed directive should come into force and be effectively applicable only as of the year following that in which at least 2/3 of the members of the Inclusive Framework have effectively introduced the necessary legislation so as to apply the OECD Pillar 2 rules.

The issue of the future of Member states CFC legislation is being raised with the introduction of the Income Inclusion Rule in the EU legal order. As noted by the OECD, the Income Inclusion Rule is drafted with reference to the modus operandi of CFC rules. CFE would welcome a dialogue on the interaction of the CFC rules with ATAD/ ATAD3/ Unshell proposal given the interconnection of these rules and the same underpinning objective - taxation of shareholders as if an entity did not exist. In light of the above, CFE suggests further postponement of entry into force due to the inherent complexity and ambiguity of the OECD Model Rules on Pillar 2 and the need of taxpayers, advisers and tax administrations to get acquainted with these rules before they become operational. Few countries of the Inclusive Framework have the resources to implement these rules, and certainly they could not put in place these measures in the desired timeframe.