9 December 2020

Comments on the OECD Public Consultation on the Pillar 1 & Pillar 2 Blueprints

KEY MESSAGES

1 We believe that the blueprints demonstrate the significant and ambitious progress the OECD is making in reforming the international corporate tax system to address the tax challenges of the digitalised economy. While the blueprints will need to be thoroughly adapted in order to avoid excessive administrative burden on companies, we hope to see an agreement by the OECD-deadline. We urge all participants to cooperate closely by supporting the international negotiations. Proposing or implementing unilateral taxes would not be a well-founded way forward as this creates great uncertainty and, as demonstrated by the OECD impact assessment, unilateral measures have the potential to damage the economic recovery significantly.

2 However, the current blueprints are deeply complex and, without extensive changes to the overall framework, they are likely to lead to significant administrative costs and decreasing levels of tax certainty for companies. In advance of any agreement, we strongly encourage the Inclusive Framework to explore and consider multiple simplification measures.

3 We welcome the OECD's impact assessment and we encourage the Inclusive Framework to take the OECD's recognition into account that increases in the effective corporate tax rate (ETR) have a negative impact on growth and investment. Any significant increase in the ETR and compliance costs must be avoided, in particular as companies are now faced with high post-COVID-19 recovery costs and important innovation challenges in many policy areas.

WHAT DOES BUSINESSEUROPE AIM FOR?

- A global agreement on new profit-based international tax rules - which addresses harmful tax practices, eliminates double taxation and keeps administrative burdens to a minimum - will be most effective through a deep and harmonised implementation in a new Multilateral Instrument covering both Pillar 1 & Pillar 2.

- Countries should make a binding commitment to repeal existing or pending unilateral measures when a global agreement is found, as these would lead to increasing tax and trade disputes. Digital services taxes in particular, based on turnover, are "leading to higher prices, lower sales and less investment", according to the OECD's own impact assessment.

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To: OECD - 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. (An overview of the Member Federations of BusinessEurope can be found on the last page)

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 digital economy 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 digitalised. As the negotiations on a significant reform of global tax rules are reaching their final stage, we are strongly concerned by the uptake and speed of implementation of several unilateral digital taxation initiatives, launched both inside and outside Europe. We encourage the members of the Inclusive Framework to cooperate closely together. Proposing or implementing unilateral taxes would not be a well-founded way forward as this creates great uncertainty and, as demonstrated by the OECD impact assessment, unilateral measures have the potential to damage the economic recovery significantly.

The recent blueprints, covering a tax on automated digital services (ADS) and consumer-facing businesses (CFB) as well as a minimum corporate tax rate, demonstrate the ambitious steps the OECD intends to take in reforming the international tax system. We recognise that the COVID-19 pandemic has made international negotiations more challenging, and we welcome the OECD's continued efforts throughout this period in bringing the Inclusive Framework together and keeping negotiations on-going.

The COVID-19 pandemic may be the most major economic shock since the 1930s. This makes an international agreement to address and counter aggressive base erosion and profit shifting more pressing in order to sustain public revenue. At the same time, as demonstrated by the OECD's impact assessment, it is essential that any significant increase in the effective corporate tax rate is avoided, in particular as companies are now faced with heavy post-COVID-19 recovery costs and important innovation challenges in many policy areas (e.g. the European Green Deal).

One way to ensure that investment, jobs and sustainable growth are supported is by ensuring that the Pillars' tax rules are predictable, provide as much tax and legal certainty as possible, while at the same time ensuring that administrative costs can be kept to a minimum. Given the importance of this to all businesses involved - regardless of country of origin, size or sector - we will focus in our response to this public consultation primarily on these issues.

We encourage the OECD to take these concerns into consideration when developing further detailed proposals in this area and 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.

Pillar 1

The complexity of the Pillar 1 blueprint together with the limited potential tax revenue involved raises concerns about the IT and human resources costs companies would incur to cope with the new requirements. We invite the Inclusive Framework to explore different possibilities in simplifying the Pillar.

I: Automated Digital Services (ADS) & Consumer-Facing Businesses (CFB)[1]

The concept of “consumer-facing businesses” remains one of the most significant stumbling blocks surrounding Pillar 1. We welcome the OECD’s great efforts in further defining this category and providing as much clarity as possible. Without taking a specific stance on which sectors should be included or excluded, it is important that the Inclusive Framework works first on further defining this category and provides companies with certainty in advance of any agreement on whether their activities are included in Amount A or not. Clear, proportionate and aligned rules should underline in any case the exclusion of B2B-activities from the scope of the proposal.

It is clear that the concept of “consumer-facing businesses” is heavily impacting the pace of negotiations, and has already led to discussions about phased approaches, different thresholds, political “packaging” of Pillar 1 & Pillar 2, etc. As long as there is no clear final answer on the scope, it makes it difficult to provide a final assessment of the proposal’s impact by both taxpayers and tax authorities and the technical guidance that will be needed by a specific set of companies in preparation for the Pillar’s implementation. Providing as much clarity as possible on the issue of CFB first, will drive the negotiations forward and build confidence with both taxpayers and tax administrations. Above all, it will decrease the need for any phased approaches, special rules, exceptions, etc.

It must be taken into account that any demarcation for CFB is likely to influence the business models that companies choose to pursue and it may influence the stock market valuation of not only highly profitable businesses, but also businesses with a low profit margin. In combination with a profit threshold, incentives for restructuring into conglomerates may be created which could lead to the introduction of further anti-avoidance rules, making the tax system even more complex. Such a development should be resisted and should be taken into account before launching a new international tax allocation system among countries. BusinessEurope notes that the impact assessment does not explicitly address the economic effects of incentives created for business restructuring.

The use of positive and negative lists by the OECD is a helpful method. However, given the fundamental importance of defining who is included and who is not included in Pillar 1, it is worth having a separate consultation to identify gaps and outstanding issues, and

[1] Chapter headings refer to Public Consultation chapters.

potentially consider more objective and quantitative metrics if needed, in order to avoid unnecessary and costly disputes and compliance costs amongst tax authorities and taxpayers. Due to the ever-changing economy, we understand that there may exist a situation in the future to update the OECD 'list'. However, paragraphs 40-41 do not explain how these updates should take place. It should be clarified how this process would happen (e.g. procedure and timeliness) and it should be stressed that jurisdictions cannot update these lists unilaterally. A consistent interpretation of the definitions amongst all jurisdictions combined with a one-stop-shop system to clearly know what is in and out of the scope is essential to avoid any costly tax disputes.

II: Revenue Thresholds (Amount A & Nexus)

In terms of the de minimis foreign in-scope revenue test, we agree that this could be a helpful way forward, with designating the residence jurisdiction of the ultimate parent entity as the "home market" as the most straightforward approach. However, there needs to be more clarification on the two-step process suggested by the OECD.

Without taking a stance on the issue itself, we note that the blueprint suggests having a higher market revenue threshold for CFB than for ADS. The OECD should clarify the motivation behind this further as the current assessment seems to be solely based on such motivations as "the broad acknowledgment that profit margins are typically lower for CFB compared with ADS" and that CFB operate through complex distribution channels (e.g. third party). Is there sufficient data-driven evidence to motivate this particular rationale?

It would be helpful to clarify as well in paragraph 189 that VAT is excluded as part of the new nexus rules.

In addition, the OECD's suggestion to include "plus factors" as a way to designate market interaction is a sensible way to demonstrate sustained engagement. We believe it is important to keep in mind that the mere conclusion of sales in a market jurisdiction - even if those sales are significant - should not be sufficient to characterize the type of sustained and "remote" engagement that an MNE has in such a market. We are concerned that the current discussion is somehow losing sight of this initial objective of Pillar 1.

However, we are also concerned that the suggested "plus factors" only seem to exist for CFB, and not for ADS. Additionally, the choice of excluding plus factors from ADS does not seem to be justified in detail (paragraph 201). We can understand that a physical presence test would not be workable for many in-scope ADS. A potential plus factor for both groups, that should be explored by the Inclusive Framework further, may be that the in-jurisdiction sales must be at least a certain percentage of the business in Amount A's-scope revenue, which suggests the business' "intentional" engagement with the market jurisdiction, thereby screening out situations where the business' down-channel distributors may have sold products to peripheral jurisdictions without any in-country engagement on the business' part. This should be combined with the physical presence test as a necessary additional plus factor for CFB. This would reflect a purposeful engagement with the market jurisdiction such that there is the requisite level of nexus to justify the market jurisdiction's enhanced taxing rights.

However, whichever “plus factors” are introduced, an MNE Group should always have the possibility to rebut the presumption by proving based on facts and circumstances that it does not specifically target a market jurisdiction and that it does not have a significant/active and sustained participation there.

III & IV: Revenue Sourcing

In terms of revenue sourcing, and to provide greater simplicity in application, the Inclusive Framework should agree on harmonized and robust rules regarding the identification of customer location, taking into account privacy concerns (e.g. GDPR) and data storage. The rules around VAT on electronically supplied services can serve as inspiration here, as a number of taxpayers covered under Pillar 1 will already be familiar with these rules. The Inclusive Framework should look primarily at whether the information needed is already available or easily retrievable for businesses and willingly given by customers/users.

In this light, we want to stress that the discussion on Amount A’s scope and revenue sourcing should not be split. Some businesses sell products through intermediaries and through very complex distribution channels, involving multiple stages of resellers and retailers between the MNE, a first-level distributor and the end customer, leading to situations where the MNE does not have access to information regarding sales to end users in particular jurisdictions. In such cases, these MNEs would be faced with an extremely complex task of collecting this information, and it is unclear whether they could collect this information in full. Simply put, where the MNE’s operations are such that it cannot track sales of its products to consumers in a market jurisdiction, one would need to re-evaluate whether the company is really engaged in sustained interactions with customers and users in that market jurisdiction, and therefore in the scope of Pillar 1.

We strongly encourage the OECD to look at further simplification measures for the revenue sourcing rules, such as safe harbours and de minimis tests, as the current rules are one of the most complex parts of the overall Pillar 1 structure and they could become even more complex as the works for defining them proceed further. The level of detail required in the application of the sourcing rules does not seem to reconcile with the envisaged difficulties that tax administrations may encounter in reviewing the punctual dataset collected by the MNEs. As noted in paragraph 400, taxpayers will probably be obliged to keep extracted reports of those data (and not the underlying databases) to prove the effectiveness of their tax control framework. Paragraph 400 also notes that the documentation retention periods will be based on domestic law. Having an unharmonized approach on the required duration of data storage is likely to lead to further problems and confusion.

We recommend the Inclusive Framework to look back at some of the high-level principles first (i.e. where the eyes are for online advertising, final destination of goods, etc) before working out specific guidelines. We recognise the challenges in creating easy and harmonised rules in this area, and it may perhaps be beneficial for everyone to launch another public consultation (focused on certain sectors) dedicated to this topic in order to address the great uncertainty businesses, and some sectors in general, face in this area. Any solution that would impose potentially significant recalculations under Amount

A for companies with little business in scope and/or with businesses in scope clearly below profitability thresholds would put unnecessary stress on tax authorities and taxpayers alike without generating additional revenue.

As a general rule of thumb, the Inclusive Framework should consider not only the cost to collect and administer the information, compared to the impact of tax revenue but also the cost associated with changed corporate behaviour.

V & VI: Segmentation Framework & Loss Carry-Forward Regime

We welcome the OECD's efforts to devise a system for loss carry-forwards. This is understandably a very complex issue. However, we want to underline that, given the heavy costs of the COVID-19 pandemic, many businesses are facing significant losses. E.g. the European Commission has analysed that the 2020-economic crisis is expected to reduce companies' equity by between €720B and €1.2T, leading to periods of reduced investment and employment[2]. This is why a system to cover both pre-regime losses and in-regime losses is crucial in any final agreement in order to avoid any distortions and loss-making businesses being suddenly faced with taxes after the implementation of Pillar 1.

No distinction should be made between pre-regime losses and in-regime losses, i.e. the features of the carry-forward regime should apply similarly to pre-regime and in-regime losses. To ensure a level-playing field, only losses realised by specific, identifiable Amount A activities should be utilisable. Pre-regime losses should be carried over for an unlimited period in order to cover businesses with long-term economic cycles and to take account of the major losses resulting from the COVID-19 pandemic and the 2008-2012 economic crisis. Regarding the carry-forward regime itself, we believe that the suggested earn-out mechanism is a sufficient and simple way to address future losses, although clear guidance on how this will work (e.g. any time restrictions) should be developed in the next few months to provide a proper assessment.

Regarding the segmentation framework, this is another very complex area of Pillar 1 where simplification should be sought. Segmentation along different lines than the financial accounts segmentation, following the business, may potentially be impossible if financial data needs to be mapped and tracked differently than for accounts separation. Rather than designing complicated rules which may depart from the practice of MNE groups for financial/investor information requirements, we would suggest to explore whether anti-abuse rules may be used instead (allowing taxpayers to rely on their existing segmentation unless they segment differently than what they would have done for financial/investor information requirements with the sole purpose to circumvent Pillar 1).

VII & VIII: Double Counting in Amount A

A full solution on this issue is essential in any binding agreement by the Inclusive Framework. The proposed marketing and distribution profits safe harbour with the "cap-

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[2] https://ec.europa.eu/info/sites/info/files/economyfinance/assessment_of_economic_and_investment_needs.pdf

mechanism" (which limits the allocation of Amount A to market jurisdictions that already have taxing rights over a group's residual profits) is helpful. However, as the OECD notes, further determination is still needed on the computation of the fixed return for in-country routine marketing and distribution activities. In terms of possible retroactive effects of transfer pricing adjustments on the functioning of the safe harbour mechanism, the Inclusive Framework should also explore the possibility of introducing "a grace period" for procedures which were already pending before the implementation of Pillar 1.

The Activities Test in Amount A seems to be mostly looking at the Functions, Assets and Risk (FAR)-profile of an entity. The document should clarify that this should also cover the new BEPS-rules (Action 8-10) on returns related to DEMPE, and stick close to these recently implemented rules. E.g. we are concerned that the blueprint seems to suggest that this should include intangibles related to technology that facilitates market engagement such as those used in ADS to gather user data and content contributions (paragraph 582). In our understanding, this seems to result in the Amount A reallocation overriding the agreement regarding DEMPE in the BEPS project.

We look forward to further work on the coordination of existing withholding taxes and the Amount A framework. An effective, coordinated solution on this is essential to a final agreement as double counting could arise if the market jurisdictions are allocated Amount A on top of certain existing withholding tax liabilities.

XI & XII: Tax Certainty, Dispute Prevention and Resolution and Review Panel

We strongly welcome the OECD's commitment to both dispute prevention and dispute resolution, with mandatory binding arbitration to provide taxpayers as much certainty and legal clarity as possible. As we are moving away from relatively well-established profit allocation principles, there is likely to be a proliferation of bilateral discussions and negotiations that the current dispute mechanisms are not equipped to deal with. We note that according to the most recent statistics from the OECD the number of cross-border tax disputes continues to increase. In 2019, the number of times that taxpayers needed to resort to the mutual agreement procedure in tax treaties to resolve transfer pricing disputes increased by more than 20% compared to 2018[3]. This is a very serious and negative development.

The blueprint's proposal for a self-assessment return related to Amount A is a positive step. We encourage the Inclusive Framework to agree on a fully harmonised template in order to make the drafting and processing for both taxpayers and tax authorities around the world as easy as possible. We agree with the OECD's recognition that under the current blueprints it would be 'impractical, if not impossible' for the tax administrations to assess and audit all MNEs' calculations and allocations of Amount A.

In particular, if the OECD requires that the parent entity of an MNE would be responsible for the provision of the standardised self-assessment return of Amount A, it is likely that a very limited number of tax administrations will be faced with the overwhelming majority

[3] https://www.oecd.org/tax/oecd-releases-2019-map-statistics-and-calls-for-stakeholder-input-on-the-beps-action-14-review-on-tax-certainty-day.htm

of the work. While it would very often indeed be the parent entity of the MNE who would be best placed to undertake the self-assessment, we disagree with the OECD's suggestion that this should be the standard rule. The MNE itself would be the most qualified to decide whether its parent entity or a (foreign) subsidiary has the necessary capacity, skills and resources to deal with this issue. An approach whereby MNEs can decide for themselves on this may also help in 'spreading' the work of tax administrations (thereby avoiding situations where a small number of countries' tax administrations would be overburdened).

The blueprint's suggestion to have a review panel to provide tax certainty and guidance to MNEs can be very helpful as well, in particular in the first years of implementation. As the review panel would be in charge of an important list of topics, it is important that the Inclusive Framework clarifies in advance of a final agreement how this panel will be set-up, financed, resourced (with perhaps larger resources in the first years of implementation), in what timeline it would need to work to solve disputes, and how disputes within the panel would be solved (e.g. unanimity rule/supermajority rule? Ability of a single country to block or stall resolutions, …). In addition, it should be clarified that the information provided to the panel can only be used in order to fulfil the Pillar 1-obligations, is confidential and should not be used or shared for any other purposes.

A separate process to determine whether an entity is included in Amount A should not be encouraged at the moment. As we noted above, more focus and political decisions in advance on the scope of Pillar 1 can decrease the need for any special processes, exceptions, thresholds or phased approaches.

Pillar 2 (GloBE)

While we understand that a political decision has not yet been taken on the minimum rate itself, it is clear that the eventual decision will need to be motivated by impact-driven evidence. The sooner some guidance on this is provided (even a range of considered percentages), the sooner taxpayers will have more insight as to whether and how this part of Pillar 2 will impact them. The common rate should be the same globally.

We are concerned that businesses will struggle significantly with the current proposal, leading to high administrative costs, legal uncertainty and lengthy and costly double taxation disputes, even for those companies whose effective tax rate (ETR) would be above the minimum rate, which may negatively offset the estimated revenue potential.

Therefore, the overall goal of the simplification process should be to limit the complex work regarding Pillar 2 for everyone - tax authorities and taxpayers, regardless of country of origin or sector - and in particular for those taxpayers and tax authorities in those countries where the ETR is sufficiently above the chosen minimum rate. This can be done first and foremost e.g. through the OECD's suggested administrative guidance.

III: ETR Calculation

We welcome and recognise the OECD's thorough analysis on the issues related to adjustments that will need to be made to financial accounting rules. With regard to adjustments to account for timing differences introduced by immediate expensing and

accelerated depreciation of assets, the OECD suggests two alternative options: a deferred-tax based approach and an approach based on the use of tax depreciation in the ETR calculation.

In our view, in theory, either method could in principle be suited for purpose, however, we note that the deferred tax-based approach would likely result in less administrative burden and it also seems more suited to comprehensively address timing issues arising from book tax differences in general. We therefore call on the Inclusive Framework to reconsider its policy decision not to build upon deferred tax accounting, possibly with the introduction of safeguard measures in order to overcome any concerns that may have been raised. Regardless of what method the Inclusive Framework decides to use, it will be important to combine it with a strong (local tax) carry forward regime.

IVa: (Pre-Regime) Carry-Forwards

We agree with the OECD's recognition that transition rules are needed on the GloBE tax liability effects of pre-regime losses and excess taxes. When developing this system, in terms of simplification, we think it is essential to take a similar approach as under Pillar 1 in terms of unlimited duration of carry-forward in order to account for the economic situation of MNE Groups, notably those with long-term business cycles. This is a critical issue in the current context of the COVID-19 crisis and the devastating effect it is having on many businesses. Some MNE Groups still have losses from the 2008-2012 crisis. In terms of simplicity, the obligation to establish and maintain carry-forward accounts would be on the taxpayer alone; there would be no additional administrative burden placed on tax authorities or taxpayers that do not wish to carry-forward taxes from pre-regime periods.

However, based on paragraph 287 of the report, the blueprints speaks of "qualified pre-regime losses", which is defined as "losses that are incurred by a Constituent Entity prior to the MNE Group becoming subject to the rules". However, this definition does not provide sufficient clarity: in particular, what is to be considered as "qualified"? We would be very concerned if by "qualified" it means "calculated under Pillar 2 rules". Some losses could have been incurred more than 10 years ago (e.g. the financial crisis of 2008-2012). Recomputing the loss basis with the Pillar 2 rules over such a period would be very complex. We would recommend a certain 'time period' above which (e.g. more than 5 years before Pillar 2's implementation) losses can be calculated under the current rules.

It is welcomed that the GloBE carry-forward regime on in-regime losses is designed in a way that it is effectively unlimited in duration. The OECD correctly acknowledges that certain industries face very long business cycles and may be profitable in some years and not profitable in others. An unlimited carry-forward, as adopted in the Pillar 2 blueprint, would ensure that MNE groups are not subject to tax on more than their economic income.

However, it is not clear how domestic legislation on the carry-back is to be aligned with the GloBE rules. In cases where domestic law allows, for example, a carry-back of losses on an entity-by-entity basis, there is uncertainty about how the carry-back of losses will be treated and allocated for purposes under the GloBE rules. In addition, not only operational losses but also capital losses should be taken into account when computing

the GloBE tax base.

IVb: Formulaic Substance-Based Carve-Out

In general, the formulaic substance-based carve-out fails to recognise the rising role of intangibles in business models – across all sectors. We believe a measure of the contribution of intangible investments should form part of the calculation. In an era where the importance of intangibles is growing, this would be consistent with providing similar benefits to different types of business models regardless of their investment profile. As it stands, the proposed carve-out takes a very narrow view of what type of assets might constitute substantial activity. This in turn will disadvantage business models in highly productive, research-driven and innovative sectors. As Europe stands before many innovation challenges in different policy areas (e.g. the European Green Deal), it is our continued view that strong support for R&D, in line with BEPS Action 5 and reflecting genuine economic activity, should be given a significantly more favourable treatment than is currently the case under the blueprint.

We believe that the formulaic carve-out for tangible assets should be based on the carrying value of the assets rather than on depreciation. We note that the required adjustments on tangible assets are a major source of concern as data from consolidated accounts are not accepted. It would be a huge burden to go back to statutory accounts of entities. Allowing MNE Groups to use data from consolidation accounts would be preferred. A return-on-assets approach provides a robust method for determining a routine return to business investment. This is recognized by the OECD Transfer Pricing Guidelines, which provide that a return on assets is appropriate in evaluating the profits of manufacturing or other asset-intensive activities, and that cost-based indicators should be used only in those cases where costs are a relevant indicator of the value of the functions, assets, and risks of a business (paragraph 2.98 and 2.103 of the OECD TPG). A return-on-assets approach is also consistent with sound economic and finance theory (pursuant to which returns are earned on investments, not expenses). While there is a mathematical relationship between depreciation expense and carrying value, a "routine" markup on depreciation expense is likely to fall far short of a routine return on the carrying value of long-lived assets in a capital-intensive business. The use of a markup on depreciation expense in the carve-out, rather than a return on tangible assets, effectively penalizes capital intensive businesses in a manner that is inconsistent with the objectives of the GloBE rules.

VI: Simplification Options

We greatly welcome the OECD's commitment to simplification, as it is of utmost importance that the Inclusive Framework focuses in the upcoming months on making the current very complex blueprint easier for everyone, and especially for those taxpayers and tax authorities in those countries where the ETR is sufficiently above the minimum rate. This should not only mean looking at the helpful provisions, suggested by the OECD, in particular the tax administrative guidance, but also taking a broader view on the whole set-up of Pillar 2.

In this light, we fully understand the discussion on the different blending approaches and the advantages (higher revenue potential under jurisdictional blending) and dis-

advantages (higher administrative costs and ETR under jurisdictional blending) different approaches can bring. We encourage further analysis on this issue as we believe that a global blending system would still be the most profound and effective simplification[4]. A global blending approach may also decrease concerns about the compatibility of EU law with Pillar 2. The blending analysis should also be taken into account when considering the recognition of GILTI as an acceptable equivalent to GloBE as GILTI works to a large extent under a global blending approach.

Furthermore, we invite the Inclusive Framework to also consider simplification options other than those already suggested by the OECD by building as much as possible on existing BEPS-conclusions. Tax administrations and taxpayers have spent the last few years implementing and integrating these measures in their daily work and have grown familiar with the legal obligations and necessary documentation that came with these complex requirements.

This can be done in two ways:

- Use the BEPS-measures as instruments to simplify the current Pillar 2 blueprint

  For example, many countries have introduced CFC regimes (BEPS Action 3, EU-ATAD), which take into account entity-by-entity ETRs. The OECD can explore for example how criteria based on the ETR in countries with a CFC Action 3-compliant tax regime could potentially be used to narrow the number of jurisdictions subject to the ETR calculations.

- Explore how the BEPS measures can be simplified after Pillar 2.

  Considering that Pillar 2 would act as an all-encompassing anti-BEPS measure, tax authorities should look at the use and necessity of certain other BEPS-measures and consider how such measures, such as for CFC and hybrids, could be improved, replaced or simplified when imposing an additional complex layer of rules with Pillar 2. The on-going Pillar 2 work should also be followed by an overall assessment of the impact of the BEPS measures (as well as ATAD and TCJA).

It is essential that multiple simplification measures are introduced simultaneously. The blueprint describes four potential simplification measures, including (i) CbC Report ETR safe harbour, (ii) de minimis profit exclusion, (iii) single jurisdictional ETR calculation to cover several years, and (iv) tax administrative guidance. While some options may be more effective than others – with the tax administrative guidance being the most clear-

[4] In the OECD study on the impact of the Pillar 1 & Pillar 2 proposals on investment costs of MNEs, it is estimated that under a 12,5% minimum tax scenario, the effective average tax rate under jurisdictional blending could be 0.28 percentage points higher than under a global blending scenario (0.34 vs 0.06). Given the OECD's recognition of the negative impact of increased EATRs for investment - whilst we understand that the Impact Assessment already needs to take several factors into account - we would like to have seen a comparison between the tax revenue and compliance cost estimations of global blending and jurisdictional blending in order to provide the Inclusive Framework with a full assessment of the important choice that will need to be made in this area. While lower revenue estimates are expected under a global blending approach, it would result in lower compliance costs, fewer tax disputes and less damage on investment and growth, all of which would have positive economic effects.

cut, effective and simple – we underline that the proposed options should be considered simultaneously as a package.

- **CbC Report ETR Safe Harbour**

  As Pillar 2 already builds on the CbC reports, as introduced by BEPS Action 13, through a €750 million threshold, it seems logical to use the CbC reports as the basis for further simplification.

  However, while we understand the need for some adjustments to streamline CbC reports and the consolidated financial accounts, the required adjustments bring too many complexities on their own. Furthermore, the CbC report is only a high-level risk assessment tool and the information included is prepared on this basis. We are concerned that the standard CbC report and the CbC report used for the Pillar 2 administration would start to lead their own separate lives in the long run, undermining both the Pillar 2 work and the important introduction of CbC-reporting.

  We encourage the Inclusive Framework to study this simplification option further and see whether introducing a CbC-ETR threshold at a sufficiently high level would not overcome the need to require several adjustments to the CbC report. Should this not be possible, we encourage the Inclusive Framework to explore other options to ensure that the CbC report and the Pillar 2 requirements do not require multiple adjustments.

- **De-Minimis Profit Exclusion**

  We welcome this option as another useful simplification, building on BEPS Action 8-10, which would exclude certain jurisdictional entities from the Pillar 2 rules if they have less than a certain percentage of an MNE Group's pre-tax profit. The use of a percentage rather than a lump sum is preferable.

  However, it is important to study this simplification together with the CbC report safe harbour, as MNEs would still be required to calculate the pre-tax profit for every jurisdiction. A de-minimis profit exclusion without the CbC report would only render very minimal benefits on its own.

  Under the current blueprint proposal, it seems possible that one country can represent more than 100% of the total group pre-tax basis. When taking up all the entities, both profit and loss-making, you may end up in situation where an entity is not subject to GloBE one year but is included in the following, not because its basis increased but because in one entity of the group there was a significant loss which reduced the total pre-tax basis. As loss-making entities would not be subject to the top-up tax in any case, and in order to increase the benefits of this simplification, it would be logical to only include the profitable entities when calculating the de-minimis profit exclusion.

- **Single Jurisdictional ETR Calculation to Cover Several Years**

  This option would seem useful and the expressed need for special anti-abuse requirements (in order to avoid situations where companies spike the ETR in the base year) is understandable. However, similar to the CbC report simplification option, complexities may arise again due to the proposed obligation for businesses to make “no business changed”-presentation in order to stay in the grace period.

- **Tax Administrative Guidance**

  We believe this to be by far the most effective and straight-forward simplification, and we urge the Inclusive Framework to prioritise this option in the months ahead and in particular work out a procedure for how to respond and update the provision when a jurisdiction implements material changes to its ETR or tax base.

  We would support, in terms of simplicity, a determination of ‘low-risk’ being applied to all MNEs within a certain jurisdiction. It should also be explored whether this simplification can be extended to the Subject to Tax Rule (STTR).

  At the same time, when jurisdictions plan a tax reform that materially changes the ETR or tax base, it is important that taxpayers and tax authorities are notified as soon as possible how this reform will impact a country’s relationship with the tax administrative guidance procedure The Inclusive Framework should consider how the procedure around changes to this administrative guidance will take place: as most significant tax reforms tend to take effect at the start of the year, it would be helpful to know in advance how this would impact a country’s place on a list. The Inclusive Framework should consider in this regard e.g. a fixed annual ‘summer update’ to the tax administrative guidance in view of significant changes to national tax systems taking place in January. A question that would need to be addressed is what should happen if countries fail to notify by a certain date that a significant tax reform will take or has taken place, which may alter the country’s position regarding administrative guidance (in both directions)?

  However, when listing those countries with a sufficiently high ETR, it is important that countries and stakeholders take the listing process forward as a simplification exercise. Jurisdictions not listed should not in any way be deemed as tax havens facilitating aggressive avoidance, nor singled out in a new “blacklist”, and the Inclusive Framework should make this clear to avoid any misunderstandings. Lists of “non-cooperative jurisdictions” (such as those of the OECD and EU) are helpful, and have been shown to encourage countries to change their behaviour, but these should be reviewed and assessed in their own right according to their own specific criteria, and not as part of the current Pillar 2 work.

VII: Undertaxed Payments Rule (UTPR)

We strongly believe that the UTPRs should not be applied to payments to the UPE of an MNE, in particular if the jurisdiction of the UPE has introduced an income inclusion rule

(IIR). First, the objective of Pillar 2 is to ensure a minimum level of tax on foreign income earned by MNEs so as to address remaining international base erosion and profit shifting issues. The home jurisdiction of an MNE typically is the center of that MNE's economic interests and the place of ultimate management of the MNE. The home jurisdiction is more appropriately considered to be the natural location of the residual profits arising from the operation of the business, rather than a place to which profits are shifted to minimize tax.

Secondly, while all jurisdictions have a sovereign right to determine their own tax systems, that right is especially pronounced with regard to the system for taxing resident MNEs (as recognized implicitly by the design of the IIR, which permits the home jurisdiction of an MNE to impose a top-up tax on low-taxed foreign subsidiaries). The home jurisdiction of an MNE should have the right to determine the appropriate manner of taxing the domestic income of its resident UPE, balancing revenue concerns with tax incentives to encourage positive economic activity within its jurisdiction. Applying the UTPR to payments to UPEs would inappropriately encroach on the right of the home country to balance these domestic policy interests.

A solution to this issue may be to exempt payments to UPEs from the UTPR. To the extent there is a concern that such an exemption could facilitate profit shifting, for example in cases in which the UPE is not located in a jurisdiction that represents the center of its economic activities, targeted rules can be designed to mitigate such concerns. For example, the exemption for payments to UPEs can be limited for UPEs located in jurisdictions identified as "investment hubs" by the OECD (FDI to GDP of 125%), unless the UPE's activities in its home jurisdiction met objective substance-based criteria (e.g. relative headcount or tangible assets).

X: Implementation of the Rules and Co-ordination

We agree that the IIR should be the primary rule. The STTR and the UTPR should only be considered at a later stage once a thorough assessment has been carried out and has established that loopholes remain. In particular, the STTR, being a withholding tax regime, would likely be a blunt policy instrument and should not be used unless absolutely necessary. Indeed, by levying a gross basis withholding tax on a wide range of payments (and which dangerously has been given priority over the GloBE rules), it sets a bad precedent and represents a departure from long-established principles for profit-based taxes.

At the same time, to ensure a smooth implementation, countries should start considering how the implementation of Pillar 2 would be compatible with their domestic law provisions. We want to highlight here that the Council of the EU has asked the Commission to "actively monitor and provide expertise on EU law aspects to Member States" in relation to the OECD-work[5]. Co-existence of the Pillars with domestic law provisions should start being examined in detail in advance of a global agreement[6]. The income inclusion rule, in particular, must be carefully designed if it is to be compatible

[5] https://data.consilium.europa.eu/doc/document/ST-12979-2020-INIT/en/pdf
[6] E.g. Some academics have questioned the compatibility of Pillar 2 with EU-law: https://www.law.kuleuven.be/fisc/globe-ldb.pdf

with the EU's free movement of capital and freedom of establishment. This is significantly more important if the proposals in the blueprint are intended to operate on a jurisdictional basis.

Building on the good practice of the multilateral instrument (MLI), we would welcome a similar multilateral convention to ensure consistency and co-ordination of the IIR and UTPR. We think it is essential that this MLI also includes the provisions of Pillar 1, in order to ensure a good understanding of the interaction between the two Pillars for tax authorities.

Regarding dispute resolution and prevention: while an overall phased approach may help tax authorities and taxpayers as part of a learning process (and limit any potential damage of double taxation), we would rather encourage members of the Inclusive Framework to embrace an ambitious ex ante approach with the development of a multilateral convention which contains strong provisions, with significant ambition in terms of scope, enforcement, effectiveness and timeliness, for both dispute prevention and resolution concerning the application of both the Pillar 1 and Pillar 2.

Impact Assessment

We strongly welcome the impact assessment the OECD has made to guide members of the Inclusive Framework and stakeholders through the Pillars-work. This assessment is not only useful in providing estimates to tax authorities on the potential revenue impact, but we also strongly welcome the approach and detail on such important indirect effects as investment, taxation incidence and the dangers of unilateral initiatives. The OECD, through the impact assessment as well as through their insightful participation in several webinars and easy-to-follow brochures, has done an impressive job in informing countries, stakeholders, the media and the general public on the scale of the project.

While we understand the very challenging nature of an impact assessment on such a global reform, where there may be an endless series of scenarios that can be worked out with limited sets of global data, we would like to provide comments on those parts of the impact assessment where we detected some important limitations.

Investment

The study estimates the impact on investments through investment costs, using basically a King & Fullerton, Devereux & Griffith approach of forward-looking ETRs, calculated at the MNE level. Further assumptions are that the firm is a large MNE in a profit position and that investment is financed only by retained earnings; the treatment of loss-making firms is, therefore not considered. The investment is constructed as an unweighted average across three broad asset categories: non-residential structures, tangible assets and acquired intangibles.

It should be recognized that the results in these models are driven by the dispersion of tax parameters and the relative distribution of distortions. There are often no or very weak links to the investor level or his/her decision to work, save and invest overall. A certain investment bundle is assumed to be invested and the effect of taxes is the distribution across jurisdictions rather than on the decision to invest at all. An outcome

with lower dispersion of rates is seen as enhancing effectiveness. However, clearly not all investments will be undertaken if the tax rate yields a low after-tax rate of return at the investor level. Therefore, the absolute level of taxation must also be considered, and not only the relative distribution of effective tax rates.

The calculations are done assuming a large profitable MNE and not the rate of return to the investor after dividends are paid and capital gains realized so that the investment decision is put to a market test and a possible consumption/investment decision or reallocating to other investment opportunities, like in a purely domestic sector (like real estate). The underlying ultimate parent entity is in this respect not representative for how investment decisions are taken.

BEPS

Pillar 1 and Pillar 2 are assumed to lead to a relatively small increase in the average (post-tax) investment costs of MNEs. The ensuing negative effect on global investment is estimated to be very small, as the proposals would mostly affect highly profitable MNEs. A reason for the assumed low elasticity is that the highly profitable MNEs are assumed to engage in tax planning and profit shifting behavior to a greater extent than other MNEs.

To base the calculations on a tax planning assumption is surprising. The very purpose of BEPS Actions, and now Pillar 2, was to eliminate or substantially reduce artificial profit shifting due to differences in the level of effective taxation. While the use of pre-BEPS data is an understandable limitation, the assumption of extensive profit-shifting undermines the deep and thorough BEPS (Action 2-15) measures, and the rationale for these measures, which have been implemented recently or are in the course of being implemented. The BEPS project was a major initiative to reduce aggressive profit shifting (in particular through CFC-legislation, prevention of treaty shopping, hybrid mismatches, CbC reporting, etc.) and we believe the effectiveness and impact of these measures should not be questioned in such an unfortunate way.

Regardless of the impact of the COVID-19 crisis, important initiatives such as the US Tax Cut and Jobs Act and the EU's Anti-Tax Avoidance Directive have changed the international taxation landscape significantly. It remains to be seen to what extent the impact assessment's estimated €100B of extra corporate tax revenue is not partly the result of the recent TCJA and ATAD. If the direct revenue impact of Pillar 2 is potentially lower, this can also lead to concerns about the cost of its administrative complexities and the heightened ETR vis-à-vis a more limited direct revenue impact.

Government Response

We understand that the scale of the potential reaction by some governments is difficult to anticipate, as it will be heavily influenced by the exact design of Pillar 1 and Pillar 2.

If Pillar 1 and Pillar 2 are implemented, we believe that government behavior is likely to be profoundly affected. Governments typically try to create a sound environment for innovation and entrepreneurship by recognizing start-up costs and allowing for loss-offset provisions in the tax code, and R&D incentives are common. However, if a country

has to share the tax revenues with other countries from a few highly profitable businesses within its jurisdiction, but will remain with start-up costs and possible heavy losses in the first years, the business and innovation climate may worsen. The reduced revenues from the profitable companies may have to be recouped from other businesses, if certain budgetary objectives are to be met. The investment response from such changed government behavior is not fully recognized in the analysis but it may over time be very important for jobs and tax revenues.

Tax Competition

Regarding the impact on tax competition, it is recognized in the impact assessment that under certain conditions the new tax rules proposed could serve to limit the ability of government to provide generous tax incentives, including investment tax incentives. It appears that it is assumed that countries with a low tax rate will not suffer from reduced investments since their governments are assumed “to respond flexibly and adapt their policy mix to the[se] structural changes in the international tax environment if there is a concern about the level of innovation in their countries”.[7]

The elimination or reduced effectiveness of their tax policies are in our view likely to reduce the attractiveness of these investment locations and lead to less capital being invested. Such an effect also points in the direction that the assumed investment elasticity is too low.

There are also likely to be effects from the two pillars on the business models and the structure of MNEs and their business lines. It is well known that certain business lines have a very low profit margin. By combining high profitable business lines with low profitable lines, the overall level of profitability may be affected in such a way that allocation rules according to Pillar 1 may become irrelevant. Such behavior is of course costly in economic efficiency terms and the magnitude of such behavior ought to be included in the overall cost assessment of the reforms.

Dispute Prevention and Resolution

Smaller countries with a limited consumer market and developing countries may suffer from a disadvantaged position in terms of the dispute prevention and resolution mechanisms, as they may have more limited market power to exert pressure on the tax outcome when disputes arise between tax authorities. By allocating taxation powers to large market jurisdictions, MNEs will be incentivized to locate headquarters and functions in large economies since their tax authorities are likely to have more bargaining power than tax authorities from smaller countries. This may further disadvantage peripheral countries, and the impact assessment should where possible estimate or reflect on the consequences of this.

[7] Page 167 of the impact assessment.

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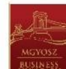

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