TAXAND

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Comments on the Public Consultation Document Secretariat Proposal for the Global Anti-Base Erosion Proposal ("GloBE") - under Pillar Two published on 8 November 2019

Dear Sir / Madam,

Taxand welcomes the opportunity to provide comments on the Public Consultation Document Secretariat Proposal for the Global Anti-Base Erosion Proposal ("GloBE") - under Pillar Two published on 8 November 2019. We would like to share our thoughts, based on our experience in advising multinational enterprises.

Taxand is the world's largest independent tax organisation with more than 400 tax partners and over 2,000 tax advisors in 48 countries. While the network was founded in 2005, our partners have more than 50 years of experience in advising multinational enterprises as well as governments in their reform plans. We therefore would like to share our thoughts on the Public Consultation Document with you and stand at your disposal for any further questions:

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I. Question 1

1. Use of financial accounting

The use of financial accounting principles seems to provide a solution for defining a common tax in order to determine the effective tax rate of an MNE group in a uniform and consistent manner as MNEs are already required to prepare consolidated accounts in accordance with international accounting standards. We also welcome the approach to define globally applicable rules to define the tax base in order to determine the effective tax rate as this prevents MNEs from recalculating their income under multiple rules for tax purposes. We therefore think that it is essential that all jurisdictions agree and commit to a **single set of rules** to do this exercise.

We also think that the definition of entities that are considered to be part of an MNE should also be in line with the thresholds imposed by international accounting standards.

However, financial reporting deviates notably from what is usually used as a tax base and therefore comprehensive adjustments are necessary to achieve a tax base that is likely to be accepted by all 135 members of the Inclusive Framework. The identification of such necessary amendments is likely to require a lot of detailed work and will may significantly increase compliance and administration burdens of MNEs. Attention also has to be paid to avoid distortions arising from transactions between group entities.

Against the background that under the GloBE a MNE would always be required to perform an extra exercise to determine its taxable income, an alternative might also be to stipulate that taxable income has to be recalculated under a seconds set of domestic rules of a jurisdiction that is accepted to define a broad tax base, e.g. France, Germany, Italy, the US etc. If the effective tax rate exceeds the minimum tax rate under the domestic set of rules and the second set of rules, then such income would not be subject to GloBE. This approach would skip the cumbersome exercise of defining new rules and allow a fall back to an already established framework.

2. Application of financial accounting at the UPE level

We welcome the approach that only one set of accounting rules should be applicable for all entities of an MNE group and think that it is essential that all jurisdictions accept the accounting standards adopted by the parent entity. However, if the question implies that there might be different accounting rules applicable depending on where the UPE of an MNE is situated this might lead to random and arbitrary results that could favour or disadvantage MNEs depending on where they are headquartered. We think that for determining the effective tax rate a **single globally accepted set of amended accounting rules** is essential.

An alternative approach could be to determine a second set of tax rules to determine the effective tax rate (see above A.I.1)

3. Determination of appropriate financial accounting methods

According to our understanding, there are currently no accounting rules that are suitable to serve as a replacement of a harmonised tax base. When choosing between different accounting principles, however, it seems reasonable to use such principles that deviate the least from tax accounting standards, e.g., principles that:

- do not allow the activation of a fair market value, if such value has not been realised in a transaction or,
- include the prudence principle (activation of profits only if they have been realised), or
- allow the accrual of reserves if the probability of occurrence of a "harmful" event is certain or very likely (chance of occurrence higher than 50%).

4. Allowance of different financial accounting rules

We think that allowing different sets of accounting rules would lead to random, unpredictable results that could distort fair competition (see above A.I.2). We therefore favour a **single globally accepted set of amended accounting rules.**

5. Consolidated accounting of smaller MNEs

We understand this question to ask for direction whether the rules should only apply to MNEs that are either listed companies or earn revenues above the EUR 750 Mio threshold or whether all MNE groups that are present in more than one country should be subject to the GloBE proposal.

Business models are increasingly international and therefore almost all businesses are involved in some form of cross border activity. Requesting all international MNEs regardless of their size to provide consolidated financial statements or an extra set of financial statements would therefore put smaller MNE in a structural disadvantage as they might not have the necessary resources available. Such a requirement might even prevent smaller MNEs of operating cross border in order to avoid the additional burden of providing extra financial statements and would therefore distort free trade and investment.

Therefore, we believe that it is important to define a **minimum threshold in turnover** and in **numbers of countries** (e.g. more than five countries) for the obligation to provide additional consolidated financial statements with the to-be-agreed amendments.

6. Considerations for purposes of the UTP rule

According to our understanding, the UTP rule denies the deduction (of a certain percentage) of payments that are made to entities that are located in a low tax jurisdiction. Currently no jurisdiction provides provisions to determine the effective tax rate on a single payment, but only on the total income by end of the

year as such. The determination of the tax rate on a single payment, taking into account conduit structures, would therefore require the introduction of a completely new framework that would probably require extensive additional administrative resources.

Depending on the level of blending it would therefore be preferable to determine the effective tax rate under the new globally accepted set of amended accounting rules for each entity or country of an MNE group and only deny the partial deduction of payments that directly fund such low taxed income.

Furthermore, the interaction between the income inclusion rule and the UTP rule has to be clearly defined as the application of both rules could lead to double taxation. Therefore, to avoid double taxation, a rule order in the form of a primary rule and a secondary rule should be introduced. This prevents the contemporaneous application of both rules by two or more jurisdictions to the same items of income. In this regard, the income inclusion rule should take priority over the UTP rule having the latter a more limited scope (i.e., it applies to single payments to related parties, if they were not subject to tax at or above a minimum rate). In this regard, it should be stipulated that the UTP rule would also not apply where the income inclusion rule is applied at any level of the MNE group, regardless whether it is the level of the direct shareholding entity of the low taxed entity or the Ultimate Parent Entity.

II. Question 2

1. What are material permanent differences between financial accounting income and taxable income

Financial accounting standards already address deferred taxation and should therefore provide a basis; thus this should ideally be in line with these standards, especially since the concepts included in the standards have been in use for quite some time.

The most common deviations appear in the following situations:

- Treatment of dividends and the sale of shares and stocks;
- Transferrable profit in a tax group, as the transferrable profit is determined under financial accounting rules;
- Accrual of reserves for anticipated losses; and
- Forfeiture of carry forward losses for tax purposes.

2. Methods dealing with permanent differences between financial accounting income and taxable income

This question addresses the necessary amendments of the financial statements in order to serve as a basis to determine a generally accepted tax base. According to our understanding there are two options how permanent differences can be addressed.

The first option would be to identify the main differences in financial and tax accounting and to agree how such differences should be handled. This would be a legislation-based exercise that would require all members of the IF to provide an overview of their tax rules, that exclude certain types of income and expenses. In a second step the members would have to agree which exclusions should be globally accepted and which provisions can be ignored. Such work would necessarily have to be completed before introducing the GloBe across the jurisdictions of the Inclusive Framework and would require unanimous consent.

The second option would be – as introduced under A.I.1 – to agree and to determine an already existing set of tax accounting rules to serve as a generally accepted method to determine the tax base of a MNE.

3. Comments on practicality of making adjustments for permanent differences

See comments above, A.II.2. While Option 1 would be the correct approach, this would require a lengthy procedure in order to collect and analyse all tax rules of the members of the IF, which furthermore is subject to future change and inaccuracy.

An easier approach would be to determine already existing tax rules to serve as a basis to determine the tax base.

4. Are other adjustments required?

No further comments.

III. Question 3

The question of temporary differences addresses the differences between different tax accounting principles (and not the differences that occur between financial and tax statements within the same jurisdiction). According to our understanding such differences do not only cause temporary differences as outlined in para. 31 of the paper, but can also lead to permanent differences, e.g. the forfeiture of loss carry forwards when acquiring a new entity into the group. Such difference would also have to be identified and addressed (would countries that foresee a forfeiture of carry forward losses accept that the use of losses in another jurisdiction?).

One option that may involve the least administrative burden would be to blend at the global level because tax administrations would not have to look at every single subsidiary and branch but would only apply the

rules on the top level. This would make the requirement of the carry forward of excess taxes or tax attributes obsolete.

1. Use of carry forward and excess tax as a mechanism for addressing temporary differences

We welcome the approach of considering the use of carry forward excess taxes or tax credit volume for taxes paid under the income inclusion rule on the shareholders level when the effective tax rate of a subsidiary exceeds the minimum tax in subsequent years as well as the carry forward of operating losses. All three rules give effect to the policy objective to ensure that the MNE pays an agreed minimum tax on its worldwide income without leading to an excessive over-taxation by evening out differences taking into account the tax burden paid over several years.

The success of these rule rules will mainly depend on the implementation on a global level. If the members of the Inclusive Framework manage to introduce a comparable system with compatible electronic mechanisms that ensure that tax carry forwards are credited without double counting the different measure, then this approach offers the most accurate outcome. However, from a practical perspective this approach also requires significant administrative resources to ensure a correct tracking of the three rules.

2. Use of deferred tax accounting

Deferred tax calculation is probably the preferred approach in terms of simplicity as MNEs that are required to prepare financial statements under common financial accounting standards are already required to have this information available on an entity level. Further analysis might be required for situations where intra group transactions lead to reverse deferred tax accounting for tow or more group entities.

3. Use of multi-year approach

A multi-year averaging approach appears to have the same effect as the first proposal (tax credits and attributes). However, from a practical perspective recalculating the effective tax rates on a rolling basis seems to be more cumbersome and less accurate than the suggested carry forward and backward of excess taxes and losses.

4. Limitations on normal financial accounting rules for deferred tax assets and liabilities

All approaches to even out temporary differences should ensure that the decision of one jurisdiction to raise taxes above the minimum tax rate does not lead to a tax refund in another jurisdictions that allows for a credit of excess taxation.

Another challenge is jurisdictions that apply progressive or gradual tax rates.

5. Opportunities for potential abuse in any of the approaches

As seen with cum ex and cum cum tax credits are a potential source of abusive behaviour. Thus, it is important to introduce coherent self-executing systems on a global level and possibly mandatory audits of the calculation of a group's tax calculation (including the deferred tax calculation). However, looking at the current refund procedures of most developed countries, especially in Europe, the objective should be to implement a system that allows for an automatic refund instead of a refund procedure based on an individual analysis as this might take several years for each single refund application.

6. Alternative mechanisms to deal with temporary differences

Worldwide blending would probably prove to be the simplest approach to administer and also the most adequate as it gives the opportunity to MNEs to off-set high rates of tax against lower rates of tax whilst making sure that their overall tax rate represents a fair share of tax paid. This would also help smaller economies that usually attract foreign investment through lower tax rates whilst making sure that MNEs do not abuse of such incentives to paying no overall taxation in the jurisdictions they operate.

7. Any additional comments

In order to reduce the administrative burden for such MNEs, it should be considered to not apply the UTP rule to MNEs that operate in several jurisdictions and that have an overall effective tax rate substantially above the minimum tax rate.

IV. Question 4

1. How would you assess the general compliance costs and economic effects depending on the level of blending?

Even though we acknowledge the policy intent of the GloBE proposal, it has to be noted that the administrative burden raises with the level of detail of blending. If the income of an MNE is not blended on a global level, this requires the application of the financial accounting rules on the level of each entity and therefore causes additional administrative burden. However, if the introduction of a jurisdiction-based blending would lead to the abolition of domestic anti-abuse provisions such as CFC rules, hybrid rules or the interest license barrier, the overall administrative burden would be smaller than to comply with a global blending and additional domestic rules.

If the members of the Inclusive framework should agree to blend on a global level, it should be kept in mind that not all MNE groups are structured with a single Ultimate Parent Entity. Depending on the industry, some MNEs, including those exceeding the EUR 750 Mio. Threshold, may be structured with several entities

on the top level, e.g. in the energy industry or also in the Private Equity or Venture Capital Fonds sector. The proposal should consider these structures and provide clear guidance to which extent such group structures are entitled to apply global blending across the whole group.

V. Question 5

1. Would a worldwide approach be effective at managing the volatility issues?

As outlined under A.III.6 global blending would definitely mitigate the challenges of permanent and temporary differences that arise with the use of financial accounting standards or different domestic tax rules. However, such an approach is only preferable over a blending on a jurisdiction level, if jurisdictions would hold on to domestic anti abuse rules even after the introduction of the GloBE proposal.

VI. Question 6

1. Compliance implications when using financial accounting depending on the level of blending

Where MNEs are required to prepare CBC reports, the additional administrative burden appears to be reasonable. However, where the GloBE proposal is aimed to MNEs below the size threshold of EUR 750 Mio., the decision to apply blending on a global, on a jurisdiction, or on an entity level comes along with enormous additional administrative burden. A blending below the global level can therefore only be justified if jurisdictions abolish domestic anti-abusive measures that already cause substantial compliance costs for MNEs operating on an international level.

2. Compliance implications when determining the income by using rules for calculating the tax base of the shareholder jurisdiction

This approach follows our proposal under A.I.1. This approach would require MNEs to calculate its income according to two sets of rules which causes additional administrative burden, however, the extent of the additional work is foreseeable. However, where this approach is applied with a blending below the global level, it is not able to address temporary differences stemming e.g. from different depreciation methods and therefore should be combined with a carry forward and backward of excess taxes.

VII. Question 7

1. Apportionment of income of an entity between head office and branch

This question relates to the work that is envisaged under the unified approach of pillar 1 and our understanding is that the determination of an effective tax rate is only possible when the allocation of income between head office and branches is synchronised for purposes of financial and tax accounting.

Otherwise it might lead to the outcome, that the income inclusion rule is applied even though the tax base for tax purposes is smaller for tax purposes than for financial accounting purposes, thus leaving the MNE with excessive taxation that is not intended by the policy objective of the GloBE proposal.

2. Compliance implications of such allocation depending on the level of blending

Where MNEs are already required to prepare CBC reports, this information should already be available. MNEs below this threshold should have this information also available where the applicable double taxation treaty foresees the application of the AOA.

However, as the allocation of income is often challenged in tax audits, the OECD should pay special attention to this work and consider to introduce specific tax certainty measure in order to avoid the outcome that a branch income is subject to the income inclusion rule and after the conduct of an audit subject to a tax adjustment.

3. Are compliance implications smaller for MNEs that are already subject to CbC reporting requirements?

Where MNEs below the CBC threshold are required to produce this information, this will impose additional administrative burden. Therefore, that numeric framework that is used for tax purposes should be allowed as a starting point for the income allocation.

VIII. Question 8

Please refer to our answers to Question 7.

The additional challenges regarding the allocation of income between head offices and branches or shareholders of transparent entities can be avoided by applying a global blending approach that would thus reduce the overall compliance burden.

IX. Question 9

1. Attribution of taxes that arise in another jurisdiction or entity under a jurisdictional or entity blending approach

This question addresses the question of which jurisdiction has the primary right to apply the income inclusion rule. Where only the jurisdiction of the Ultimate Parent Entity is allowed to apply the income inclusion rule, taking into account taxes paid under domestic CFC rules seems to be sensible. However, if jurisdictions are allowed to apply the income inclusion rule on every level, this would require an agreement on a stringent rule order. Not taking into account taxes paid under domestic CFC rules or other domestic anti-abuse provisions would lead to excessive taxation of the MNE and should be avoided. To mitigate the

risk of double or multiple taxation for taxpayers we advocate that the application of the income inclusion rule as well as for the UTP rule should be subject to legally binding and effective dispute prevention and resolution mechanisms.

2. Comments regarding the practicality of crediting taxes paid in an intermediate jurisdiction or entity, such as a CFC rule, against income of the subsidiary or branch

Crediting taxes paid under domestic CFC rules or other domestic anti-abuse provisions is essential to avoid excessive taxation that goes beyond the policy objective of the GloBE proposal and would therefore on a long-term basis lead to a distortion of trade and investments. It is therefore important to consider the implementation of further tax dispute prevention and resolution methods in order to ensure taxpayers that actual taxes paid are considered in the jurisdiction applying the income inclusion rule.

When it is considered to introduce the income inclusion rule with blending below the global level, we strongly advocate the abolition of domestic anti-abusive provisions in order to simplify the international taxation landscape.

X. Question 10

Income from dividends and other profit distributions as well as income stemming from the sale of shares and stocks should be disregarded when determining the effective tax rate to avoid a cascade effect of taxation. When applying the income inclusion rule with blending below the global level such income would have already been taxed on the level of the operative entity, either because the resident jurisdiction applies a tax rate above the minimum tax or because the income has already been subject to the income inclusion rule.

XI. Question 11

1. Comments regarding the design of carve outs taking into account simplicity, compliance costs, certainty, incentives and behavioural impacts

Several OECD members have special tax policies aimed at stimulating research & development by attractive tax allowances, such as patent boxes, to take into account the enormous investments and the significant risks that are associated with R&D, or measures to support start-ups with lower tax rates.

We agree that the effectiveness of the GloBE proposal depends on the comprehensive application with potentially no or only small exemption. However, we think that tax incentives such as nexus compliant patent boxes offer a very digital tax benefit should not be subject to the application of the income inclusion rule. Patent boxes are often an expression of appreciating the high investments and the notable risk that are faced by MNEs active in this area and perceived as fuelling the motor of future economic growth. Income benefitting from a patent box should therefore not be subject to the GloBE proposal at all to avoid distortion in this specific environment.

2. Thresholds based on the size of the taxpayer and suggested metric

As outlined throughout the public consultation document the assumption is that MNE already subject to CbC requirements will most likely have the necessary information available to apply the GloBE proposal, regardless of the level of blending. However, groups below the turnover threshold of EUR 750 Mio. – depending on the level of blending – will be required to provide a large amount of additional information and comply with additional compliance requirements thus adding substantial administrative burden. It should therefore be considered to introduce GloBE for MNEs above the EUR 750 Mio. threshold and to explore from there whether an inclusion of smaller MNE groups is practically viable.

3. *De minimis* carve-out

Please refer to our comment under A.XI.2.

4. Carve-outs for specific sectors or industries

We do not see a reason to carve out particular sectors or industries from the proposal. However, the GloBE proposal should take into account group structures that do not have a single Ultimate Parent Entity. Such group structures are normally found in the energy sector as well as in the Private equity or Venture Capital Fonds sector. The proposal should therefore provide clear guidance to which extent such group structures are entitled to apply global blending across the whole group.

5. Other comments

The current proposal seems to contravene with fundamental European freedoms such as the freedom of establishment or capital. Before proceeding with the further design of the GloBE proposal we would welcome a more fundamental analysis how to include the envisaged rules with EU law.