Response to the OECD Consultation

on the

Global Anti-Base Erosion Proposal (“GloBE”) – Pillar Two

2 December 2019

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1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. With over 5,000 members in Ireland, along with the Chartered Institute of Taxation UK and The Tax Institute of Australia, we are part of the 30,000-strong international CTA network and a member of *CFE Tax Advisers Europe*, the European umbrella body for tax professionals.

Our members provide tax education and expertise to thousands of businesses, multinationals, and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue, state bodies and the European Commission.

After 50 years, the Institute remains deeply committed to the role it can play in education, tax administration and tax policy in Ireland and in building an efficient and innovative tax system that contributes to a successful economy and society. We are also committed to the future of the tax profession, our members and our role in serving Ireland's taxpayers and best interests in a new international world order. Our *Irish Tax Series* publications and online database *TaxFind* are respected and recognised as Ireland's most extensive tax information sources.

Irish Tax Institute - Leading through tax education.

2. Executive Summary

The Irish Tax Institute welcomes the opportunity to contribute to this consultation on Pillar Two of the *Programme of Work for Addressing the Tax Challenges of the Digitalisation of the Economy*.[1] We note that the proposal has been prepared by the Secretariat of the OECD and does not represent the consensus view of the Inclusive Framework, the Committee on Fiscal Affairs or their subsidiary bodies.

As noted in the consultation document, the Global Anti-Base Erosion ("GloBE") proposal under Pillar Two calls for the development of a co-ordinated set of rules to address ongoing risks from structures that allow multinational enterprises (MNEs) to shift profits to jurisdictions where they are subject to no or very low taxation.[2]

The consultation document specifically requests feedback on three technical aspects of the GloBE proposal:

a) the use of financial accounts as a starting point for determining the tax base under the GloBE proposal, as well as different mechanisms to address timing differences;
b) the extent to which an MNE can combine high-tax and low-tax income from different sources taking into account the relevant taxes on such income in determining the effective (blended) tax rate on such income; and
c) stakeholders' experience with, and views on, carve-outs and thresholds that may be considered as part of the GloBE proposal.

The consultation document notes that Pillar Two seeks to comprehensively address remaining BEPS challenges by ensuring that the profits of internationally operating businesses are subject to a minimum rate of tax.[3]

The full impact of existing BEPS measures is still unknown

There is undoubtedly an impetus to progress the work on Pillar One to reach a consensus-based solution for new nexus and profit allocation rules that are not dependent on physical presence, given BEPS Action 1 did not conclude how to address the tax challenges of digitalisation of the economy in 2015 and the plethora of uncoordinated and unilateral measures that have been enacted since then by some members of the Inclusive Framework. However, the requirement for a global minimum tax rate to address remaining BEPS challenges proposed under Pillar Two is not yet evident in our view.

To date, 135 countries have joined the Inclusive Framework on BEPS and have committed to implementing the internationally agreed BEPS standards. EU Member

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[1] OECD (2019), Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.
[2] Public Consultation Document Global Anti-Base Erosion Proposal ("GloBE") (Pillar Two), OECD, 2019, page 3.
[3] Public Consultation Document Global Anti-Base Erosion Proposal ("GloBE") (Pillar Two), OECD, 2019, page 6.

States are also in the final stages of implementing measures to counteract BEPS, as part of the EU Anti-Tax Avoidance Directives, ATAD[4] and ATAD 2[5].

Within the EU and in many countries around the world, BEPS measures, such as Country-by-Country Reporting, Controlled Foreign Company (CFC) rules, interest limitation rules, anti-hybrid rules, anti-treaty abuse clauses (i.e. Limitation on Benefits or the Principal Purpose Test) under BEPS Action 6 and updated OECD Transfer Pricing Guidelines have either only just been implemented or are in the process of implementation. We believe that sufficient time has not yet been given to evaluate whether these measures are working as intended.

Until the overall BEPS and ATAD measures have been fully implemented by countries, the full effect of these significant changes to the international tax system will not be known. It would be important to firstly measure increases in the effective tax rates (ETRs) of large international groups and then report on those outcomes, to ensure accurate data is used to drive the next century of tax policy.

We believe it is an imperative that more time should be permitted to evaluate the full impact of the BEPS-related anti-avoidance measures, before such a complex global minimum tax rate proposal should be contemplated.

The core principle of the BEPS process of aligning the taxation of profits with value creation should be maintained

Nonetheless, it is critical that any agreed solution which may be reached on Pillar Two should continue to reflect and be aligned as closely as possible with the core principle that underpinned the BEPS project, that profits are taxed where the underlying substantial economic activity takes place and value is created.

Indeed, many MNEs have undergone significant change and relocated personnel at substantial cost and increased complexity, to adapt their group structures and business models, to ensure that their profits are now aligned with substance and where value is created, in keeping with the updated 2017 OECD Transfer Pricing Guidelines.

Smaller and developing economies should not be disproportionately impacted

Furthermore, any agreed solution should strike an appropriate balance and not disproportionately prejudice smaller and developing economies that seek to attract and rely on substantive foreign direct investment in order to develop their economies. It would be important for the Inclusive Framework to evaluate the practicalities of placing the compliance burden on businesses as a mechanism to discourage countries from exercising their sovereign right to use tax incentives to encourage investment.

The consultation document states that a minimum tax rate on all income would reduce the incentive for taxpayers to engage in profit shifting and would establish a ‘floor on tax competition among jurisdictions’.[6] The OECD recognised during the BEPS project that

[4] Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

[5] Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

[6] Public Consultation Document Global Anti-Base Erosion Proposal (“GloBE”) (Pillar Two), OECD, 2019, page 6.

taxation is at the core of countries' sovereignty, and each country is free to set up its corporate tax system as it chooses, including charging the rate it chooses.[7]

Previously, Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration in the OECD observed that countries, such as Ireland, could benefit from the BEPS process, as they would end up competing with higher tax, rather than zero-tax countries. In describing the purpose of the BEPS project, he stated that *"It is about putting an end to the divorce between profits and tax allocation, not about putting an end to tax competition."*[8]

We would contend that fair tax competition should continue to be recognised as a legitimate tool for smaller countries to use to balance against size, geographical location or resource advantages that other larger countries may enjoy. The GloBE proposal as it is currently envisaged strays into the realm of tax competition which is a sovereign issue for individual countries.

The technical aspects of the GloBE proposal

Use of financial accounts

If the accounting standards used to prepare the MNE's consolidated financial statements are used as a starting point to determine the tax base for the GloBE proposal, it would be important that they are prepared in accordance with existing internationally recognised generally acceptable accounting principles (GAAP), such as the International Financial Reporting Standards (IFRS) or US GAAP. This would ensure transparency and consistency in financial information.

Should accounting results be used as a proxy for the tax base under GloBE, it would be essential for the rules to have sufficient flexibility to recognise the diverse design elements of tax regimes in different jurisdictions (for example, the adoption of tax grouping or fiscal consolidation regimes and the tax treatment of losses), to ensure that a multinational group's ETR in a relevant jurisdiction could be approximated as closely as possible. Failure to recognise such differences could otherwise result in an inaccurate estimation of the MNE's ETR.

Blending

We believe a jurisdictional or entity level blending approach would create very significant additional compliance obligations for MNEs that would be hugely complex and time-consuming. Both approaches would effectively require MNEs to prepare sub-consolidated financial accounting information for either each jurisdiction or each entity, which they would not currently be required to prepare. Indeed, many tax systems that provide formal consolidation, group relief or fiscal unity make an entity ETR approach impractical to apply as the standard approach.

If a jurisdictional approach is chosen, it would be vital that the effect of carry forward losses on the current period tax position would not negatively impact the ETR of an entity

[7] http://www.oecd.org/tax/beps/bitesize-beps/ Q121: Is the BEPS Project meant to stop tax competition? "*Taxation is at the core of countries' sovereignty, and each country is free to set up its corporate tax system as it chooses, including charging the rate it chooses. The work is not aimed at restricting the sovereignty of countries over their own taxes; instead, it is aimed at restoring and strengthening sovereign taxing rights by ensuring that countries can tax the profits arising from the economic activities undertaken there. The project achieves this in a number of ways such as by addressing regimes that apply to mobile activities and that unfairly erode the tax bases of other countries, potentially distorting the location of capital and services".*

[8] Speaking at an OECD webcast, 2 April 2014

and lead to an inaccurate conclusion that the minimum tax rate test was failed. Otherwise, the operation of any new measures could potentially become a barrier to innovation and the development of new markets.

Irrespective of which blending approach is proposed, it would be important to ensure that companies that are rewarded for investment in environmentally conscious initiatives (such as wind farms) and investment in innovation through research and development (R&D) tax credits would not be penalised, arising from the impact of the credit on their ETR.

In addition, any approach to blending must also consider the fact that an entity's income may have been taxed in more than one jurisdiction. It would be crucial that tax paid in respect of the income of a foreign subsidiary, say in a parent jurisdiction or in another jurisdiction (under CFC rules or other income inclusion rules, like the global intangible low-taxed income (GILTI) regime in the US) should be taken into account when computing the ETR on the profits of the subsidiary, when blending on an entity or on a jurisdictional basis.

Carve-outs

Providing for a substance based carve-out from the GloBE proposal in our view could serve as an opportunity to build upon and align with the existing work that is currently undertaken by the Forum on Harmful Tax Practices[9], as part of Action 5 of the BEPS project, to identify preferential tax regimes that unfairly impact the tax base of other jurisdictions. Indeed, the objectives of the EU Blacklist[10] are also closely aligned with this work which is intended to increase transparency and encourage compliance with anti-BEPS measures.

We believe consideration should also be given to the appropriateness of the GloBE proposal for smaller and less well-developed businesses, given the inevitable increased compliance burden for companies. We would suggest that such a measure should be confined to larger multinational enterprises that may be better placed to deal with the heightened complexity and costs associated with applying the GloBE.

Compatibility of the GloBE proposal with EU law should be considered

In an EU context, the measures contained in the GloBE proposal could potentially be incompatible with the EU fundamental freedoms and principles expressed in EU law, unless the measures are targeted at wholly artificial and non-genuine arrangements and do not apply to entities that generate profits from real and substantive economic activities.

Conclusion

Given the extent of the BEPS measures which are still being implemented by members of the Inclusive Framework, in addition to the ongoing work on preferential tax regimes and the operation of the EU Blacklist, we believe adopting a longer-term perspective

[9] OECD (2019), Harmful Tax Practices - 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, paragraph 6.
[10] The EU list of non-cooperative tax jurisdictions

would be more appropriate to fully understand and evaluate any remaining BEPS concerns, before a complex global minimum tax rate proposal should be contemplated.

In the event that consensus is reached among the countries of the Inclusive Framework that a GloBE measure is necessary to address any remaining BEPS concerns, it would be imperative for it to be targeted at wholly artificial arrangements, where profits do not arise from genuine economic activity.

Finally, further consultation with stakeholders would be necessary to consider the full technical details of any potential solution reached under Pillar Two, together with the publication of a comprehensive impact assessment of the potential economic and administrative consequences of such a proposal on developing and developed economies and small and larger countries.

3. The Requirement for Pillar Two

The GloBE proposal puts forward two inter-related rules, an income inclusion rule and a tax on base eroding payments. The income inclusion rule proposes to tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate. A tax on base eroding payments would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless that payment was subject to tax at or above a minimum rate.[11]

We recognise there is an impetus to progress the work under Pillar One to reach a consensus-based solution for new nexus and profit allocation rules that are not dependent on physical presence, given BEPS Action 1 was not conclusive and the plethora of unilateral measures that have been enacted since then to address the tax challenges of digitalisation. However, the requirement for a global minimum tax rate to address remaining BEPS challenges proposed under Pillar Two is not yet evident in our view.

The 135 member countries of the Inclusive Framework have committed to implement the BEPS standards, while EU Member States are in the process of implementing ATAD and ATAD2 to address BEPS issues within the EU. Until the overall BEPS package and ATAD measures have been fully implemented by countries, the full effect of these far-reaching changes to the international tax system will not be known and whether they have achieved the desired behavioural impact. Certainly, the early indicators in the 2018 OECD Interim Report confirm that the BEPS measures are having a significant impact on tax structuring decisions of MNEs. The 2017 US tax reform has also played a significant part in influencing the behaviour of US-owned multinational groups.

Part of the Inclusive Framework's work under Action 5 of the BEPS project relates to the identification of preferential tax regimes. Peer reviews have been undertaken to identify features of regimes that can facilitate BEPS and therefore, have the potential to unfairly impact the tax base of other jurisdictions.

The most recent progress report published by the Inclusive Framework contains details of the agreement by the Forum on Harmful Tax Practices of a new standard for substantial activities requirements within no or only nominal tax jurisdictions. The purpose of the new standard is to ensure a level playing field between those introducing substantial activities requirements in preferential regimes, with those offering a general zero or almost zero corporate tax rate. The objectives of the EU Blacklist are also closely aligned with those of Action 5, to increase transparency and encourage compliance with anti-BEPS measures.

Given the extent of the measures which are still being implemented by countries of the Inclusive Framework and the EU and the ongoing work on preferential tax regimes and the EU Blacklist, it would appear adopting a longer-term perspective would be more appropriate, in order to fully understand any remaining BEPS concerns.

This is particularly the case where the proposed measures under Pillar Two appear to address issues that have already been tackled. For example, CFC rules, which were

[11] Public Consultation Document Global Anti-Base Erosion Proposal ("GloBE") (Pillar Two), OECD, 2019, page 29.

adopted by all EU Members States by 1 January of this year, are designed to achieve many of the same objectives as the income inclusion rule now being proposed. In these circumstances, the requirement at this stage for the measures proposed under Pillar Two is not yet apparent.

More time should be given to consider the full impact of the BEPS measures, including the effect of US tax reform, on the behaviours of MNEs to evaluate whether the measures are working as intended. We understand that the GILTI regime, introduced as part of US tax reform in 2017, has resulted in very significant additional compliance burdens being placed on US-owned multinational groups. Undoubtedly, the inherent complexity of the GloBE proposal would also put a very significant compliance burden on taxpayers.

Any solution reached under Pillar Two must be compatible with the EU fundamental freedoms[12] and the principles expressed in EU law.[13] We would have concerns that it may not be possible to apply an income inclusion rule within the EU, particularly one that is designed to apply on an entity-by-entity basis or on a jurisdiction-by-jurisdiction basis.

The Court of Justice of the European Union (CJEU) has considered that a restriction on free movement could in certain circumstances be justified but has stated that "*The need to prevent the reduction of tax revenue is not one of the grounds… or a matter of overriding general interest which would justify a restriction on a freedom…".*[14]

The CJEU has determined that any taxing provision which seeks to impose additional taxes by one Member State on the profits of an entity established in another Member State will be contrary to EU law, unless such measures are targeted at wholly artificial and non-genuine arrangements and are limited in scope to profits arising in a company which does not carry on real and substantive economic activities.

In addition, the decision of the CJEU in *Brisal*[15] makes it clear that imposing withholding taxes on an intra-EU basis is extremely problematic and likely to infringe free movement. This matter should be considered when designing any proposed withholding tax collection mechanism under Pillar Two.

In the event there is a consensus on the need for the GloBE proposal under Pillar Two, it would be imperative for it to be targeted at wholly artificial arrangements where profits do not arise from genuine economic activity. This approach would be in keeping with the core principles of the BEPS project to ensure that profits are taxed where economic activities take place and value is created and would adhere to the principles which have been clearly expressed in EU law.

[12] Freedom of establishment, free movement of services and free movement of capital as contained in Articles 49, 56 and 63 of the Treaty on the Functioning of the European Union (TFEU)

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

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

[15] Court of Justice of the European Union decision in Brisal Case C-18/15

4. Technical Aspects of the GloBE Proposal

Whilst we have provided comments below regarding the three technical design aspects of the GloBE proposal which were specifically requested to provide feedback on in the consultation paper, we would reiterate at the outset that we believe the requirement for the proposals put forward under Pillar Two is not yet clear.

The consultation paper acknowledges that some of the technical and design aspects of the GloBE proposal depend on policy choices to be agreed by the members of the Inclusive Framework. For example, the mechanics and operation of the undertaxed payment rule and the nature and scope of the subject to tax rule need to be further developed by the Inclusive Framework for a clearer outline of these rules to emerge which could benefit from further public consultation.[16]

In particular, rule order would need to be determined by reference to the principles of good rule design, including effectiveness, simplicity and transparency.[17] In our view, it would make sense for an 'income inclusion rule' to operate in the first instance, as the primary rule applying before any 'subject to tax rule'.

4.1 Tax Base Determination

The consultation document suggests taking accounting profits estimated based on the accounting standards used to prepare consolidated financial statements as a starting point for determining the tax base of an entity for the purposes of the GloBE proposal. We acknowledge that this could offer a more consistent basis for calculating an effective tax rate in comparison to adopting an approach that would require MNEs to re-compute the profits of their subsidiaries worldwide using the tax principles of the parent company jurisdiction.

There are many different accounting standards that currently operate, none of which are identical. In order to ensure transparency and consistency in financial information, it would be important that the accounting standards adopted to prepare the consolidated financial statements are aligned with existing internationally recognised GAAP, such as IFRS or US GAAP. However, even though these accounting standards have converged in many respects over recent years, differences remain between internationally recognised accounting standards in the timing of recognition of income and expense across accounting periods, as well as the extent to which assets owned by different entities are recognised as assets (and related income) of the entity preparing consolidated accounts.

It also needs to be recognised that financial accounts do not have to be prepared in some countries. For example, MNEs that are not listed on a recognised stock exchange may not have a legal obligation to prepare consolidated financial statements under any accounting standards. In addition, the position of joint ventures and their impact on an entity's ETR would also require careful consideration.

[16] Public Consultation Document Global Anti-Base Erosion Proposal ("GloBE") (Pillar Two), OECD, 2019, page 7.
[17] Public Consultation Document Global Anti-Base Erosion Proposal ("GloBE") (Pillar Two), OECD, 2019, page 29.

The effect of any of the three proposed approaches to blending; worldwide, jurisdictional or entity, would require companies to prepare sub-consolidations of their accounts. The complexity involved in preparing sub-consolidations on a jurisdictional or entity level basis would be immense. Even a worldwide approach, which would require a sub-consolidation of the accounts for all of the foreign subsidiaries and branches taken together, would effectively amount to a doubling of the annual consolidation exercise for companies and would be enormously time-consuming.

Reaching agreement on the adjustments required to estimate the tax base of an MNE for a period using profits estimated in accordance with the accounting standards adopted for the consolidated financial statements could prove very difficult, given the vast number of scenarios which would need to be considered, together with the various adjustments that would be necessary for the different accounting standards used to prepare local entity accounts within multinational groups.

Even in the case of MNEs that adopt the same accounting standards, significant differences can arise in the extent of recognition and the carrying value of assets and related amortisation expense in the consolidated accounts that are self-generated by subsidiaries of the parent, depending on whether the MNE group has grown organically or by acquisition. This is due to the effect on the consolidated financial statements of acquisition accounting principles.

Some of the most common differences between internationally recognised accounting standards that can result in differences in the timing and recognition of income and expense across accounting periods include: the extent to which fixed assets are periodically restated to market or fair value, instead of being carried at cost; the timing of recognition of revenues and costs on contracts for services; adoption of inflation based accounting principles for entities operating in a high inflation environment; the extent to which asset disposals are recognised as sales: the recognition of executive compensation (including share based compensation); the recognition of assets and related income or losses from employer obligations related to defined benefit pension schemes and the functional currency adopted by the subsidiary in preparing its accounts.

Some of these (e.g. the timing of recognition of revenues and costs on contracts for services) can be expected to produce timing differences in the recognition of income or expense compared to the local tax regime, whereas others (e.g. the recognition of employer funded pension scheme assets and obligations) can be expected to result in permanent differences with the taxable base of profits in the local jurisdiction.

The use of the tax charge (including deferred tax) in the financial statements to calculate the tax attributable to the period could be an approach that fits with the adoption of accounting principles in measuring the tax base. It can be expected that the combination of the current and deferred tax amounts for a period should capture many of the timing and permanent differences between the accounting and taxable measure of profits of the MNE across the jurisdictions in which it operates.

Particularly if looking to estimate the ETR on a jurisdiction by jurisdiction basis, the adjustments agreed to measure the tax base using accounting principles must also recognise the diverse design elements of tax regimes in different jurisdictions, to ensure that an MNE group's ETR in a relevant jurisdiction could be estimated as closely as possible. Failure to recognise such differences in an individual country's tax regime, like

fiscal consolidation, could result in an inaccurate approximation of the MNE's ETR. Therefore, it would be essential that the rules would be easily applicable to all facts and circumstances, recognising that there is complexity in both business structures and in countries' tax systems.

As the consultation document notes, there may be both temporary and permanent differences between the accounting profits and the profits included in taxable income. In addition, a difference that is considered temporary under one accounting standard may be classed as a permanent difference under another set of standards. For example, the treatment of amortisation and fair value adjustments for assets in consolidated financial statements under acquisition accounting principles, that are never recognised at a local entity for tax purposes.

Regarding the impact on deferred tax accounting of temporary differences, the position of carry forward losses would need to be considered should a jurisdictional approach be chosen. MNEs who have invested either during their start-up phase or in the development of a product may have losses carried forward for a number of years. It would be critical to ensure that such carry forward losses would not negatively impact the ETR of an entity. Otherwise, the operation of any new global minimum tax rate could potentially become a barrier to innovation and the development of new markets by multinational groups.

The consultation document puts forwards three approaches to addressing the problem of temporary differences:

(i) carry forward of excess taxes and tax attributes;
(ii) deferred tax accounting and
(iii) a multi-year average ETR.

In the event that a jurisdictional approach is chosen then each of these approaches would need to be considered. We consider that deferred tax accounting appears to be an approach worth exploring where accounting standards are applied in measuring the tax base for the period.

As noted above, MNEs who have grown by acquisition can reflect different accounting treatments of assets which are self-generated by the MNE subsidiaries in comparison to an MNE which has not made acquisitions. In this context, adjustments may be required to the measure of deferred tax related to assets recognised as part of acquisition accounting, in order to reflect a more comparable position between MNEs which have grown through acquisitions and those which have not.

For example, in the case of acquisitions, a deferred tax liability may have to be recognised on the acquisition of a target company/group or asset, on the basis that the company or asset may be sold at some stage in the future, even if there is no intention to sell that company or asset at a future date.

4.2 Blending

According to the consultation document, a worldwide blending approach would require the income of a multinational group to be determined by reference to the consolidated

financial statements, prepared under the relevant accounting standards of the parent entity, to be separated between the MNE's domestic and foreign operations. A jurisdictional or entity blending approach would require such income to be further broken down to ultimately determine a jurisdictional or entity level basis.[18]

Our understanding is that this would require MNEs to prepare recast (or estimated) accounts to determine the tax base under the accounting standards applicable to the parent entity, instead of local GAAP and that similar recasting of the deferred tax accounting would also be required.

We believe that jurisdictional or entity level blending approach would present multinational companies with immense difficulties and would effectively require the MNE to prepare sub-consolidated financial accounting information for each jurisdiction or each entity within the group.

If a jurisdictional or entity level blending approach is applied then an MNE would potentially have to consider the interaction of local GAAP and the GAAP of the parent entity, the cash tax position and the ETR.

Undoubtedly, both the jurisdictional or entity level blending approaches would involve a very significant additional compliance burden which would be hugely time-consuming and would result in significant additional costs for MNEs.

The operation of participation exemptions in many countries means that parent companies are not currently required in many instances to analyse in detail the tax base of their subsidiaries, except in the context of the application of parent country CFC rules. Often the primary concern of parent companies is whether any withholding taxes have been applied to the income received from their subsidiaries. However, the proposals contained in the consultation document would obligate MNEs to create additional financial accounting reporting systems to compute the top up tax in parent jurisdictions.

It would be essential that any approach to blending would be sufficiently flexible to take account of the technical and structural differences that can arise in determining the tax base in various jurisdictions. Disparities that currently exist between jurisdictions regarding rules relating to the calculation of the corporate tax base, including the recognition of income and expenses, could significantly hinder a consistent calculation of the ETR across different jurisdictions.

For example, the treatment of inter-entity expenses varies in many jurisdictions. In Ireland and the UK, tax is computed on an entity by entity basis, with a limited ability to consolidate or surrender amounts, such as losses, between members of a group until after the taxable income has been computed. This contrasts with the position in Germany, where there is a system of fiscal consolidation and is similarly the case in the Netherlands and the USA.

Therefore, it would be important if accounting results are to be used as a proxy for the tax base for the purposes of determining a MNE's ETR in the context of a global minimum tax rate, the rules must incorporate enough flexibility to recognise the diverse design elements of various countries' tax regimes, to ensure that the ETR computed for

[18] Public Consultation Document Global Anti-Base Erosion Proposal ("GloBE") (Pillar Two), OECD, 2019, page 19.

the relevant jurisdiction could be approximated as closely as possible. Failure to recognise such differences could result in the estimated ETR being wholly inaccurate.

Any approach to blending of the tax base must also consider the fact that an entity's income may have been taxed in more than one jurisdiction. Such a proposed measure must recognise that income can be effectively taxed, not just at the level of the immediate earner but also upon a parent entity, for example, if included in profits taxed under a CFC regime or a similar regime that taxes subsidiaries on a worldwide taxation regime or under a regime similar to the income inclusion rule.

It would be important that tax paid in a parent country or another jurisdiction in respect of a subsidiary's income, should be taken into account when calculating the ETR of the subsidiary or the subsidiary jurisdiction. Even worldwide blending would not eliminate the need to re-determine the ETR of the relevant subsidiary, as the taxes paid in the parent jurisdiction would not be considered foreign tax, as noted in the consultation document.

Paragraph 72 of the consultation document states that dividends and other distributions could be excluded from the determination of income under a jurisdictional or entity approach, on the assumption that the underlying earnings of the distributing entity would already have been subject to tax at the minimum rate. The document proposes that if dividends are excluded, then it may also be appropriate to exclude any source country withholding taxes on such dividends from being treated as creditable taxes of the distributing entity's owner under the GloBE proposal.

We believe any withholding taxes imposed on dividends paid across jurisdictions, to the extent that they are not creditable or refundable, should be added to the tax referable to the profits of the subsidiary in the jurisdiction from which the dividend is sourced and would be considered a real economic cost of doing business in that country.

Furthermore, investment in innovation should not impact the ETR of an entity. The OECD recognises that tax credits which encourage innovation, such as the R&D tax credit in Ireland and numerous other countries, are wholly legitimate and necessary reliefs to encourage desired corporate behaviour. Some jurisdictions have chosen to incentivise R&D activities through the availability of a tax credit in their country, while other countries encourage such activities through direct government funding, via grants or by offering 'super' deductions for R&D expenses.

It would be important to ensure that companies who are incentivised to carry out R&D, through tax incentives would not be penalised under the proposal, otherwise it could result in incentives which support innovation not being treated in an equivalent manner which could mean countries within the Inclusive Framework would not be competing in a level playing field for global R&D investment.

Clear parallels exist between the income inclusion rule under the GloBE proposal and the CFC rules which already exist in many jurisdictions. Therefore, the appropriateness of such an approach in circumstances where income is already subject to CFC rules would need to be carefully examined.

Consideration would also need to be given to the position of the GILTI regime in the USA going forward and its interaction with the GloBE proposal. Should the GILTI regime continue to exist, following introduction of a globally agreed minimum tax rate, it should

not be the case that a jurisdictional or entity level approach to blending would apply to MNEs parented outside of the USA, with GILTI (with its global approach) applying to USA parented companies. Such a move would effectively mean that two very different sets of rules could apply to entities located within the same country, depending on where their parent company is resident. This outcome could drive unwanted economic distortion on a global scale and should be avoided.

4.3 Carve-outs

In an EU context, any GloBE proposal would have to be compatible with the EU fundamental freedoms[19] and the principles expressed in EU law.[20] Consequently, we believe that it would be crucial to ensure that any GloBE measure would only apply to wholly artificial arrangements and that it would be appropriate to consider a substance based carve-out, where profits are generated from real and genuine economic activities.

The most recent progress report published by the Inclusive Framework contains details of the agreement by the Forum on Harmful Tax Practices of a new standard for substantial activities requirements within no or only nominal tax jurisdictions. The purpose of the new standard is to ensure a level playing field between those introducing substantial activities requirements in preferential regimes, with those offering a general zero or corporate tax rate.[21] This standard ensures that substantial activities must be performed in respect of mobile business activities, regardless of whether they take place in a preferential regime or in a no or only nominal tax jurisdiction.

A substance based carve-out could be aligned with the current work of the Forum on Harmful Tax Practices, as part of Action 5 of the BEPS project. This could be built upon the existing peer review work carried out by the Inclusive Framework under BEPS Action 5, to identify features of preferential regimes that can facilitate BEPS and which have the potential to unfairly impact the tax base of other jurisdictions.

It is noteworthy that the objectives of the EU Blacklist[22] are also closely aligned with those of the BEPS project, which are to increase transparency and encourage compliance with anti-BEPS measures.

We note that the Programme of Work calls for the exploration of a carve-out for ‘a return on tangible assets’. The rationale for distinguishing between a return on tangible assets and a return on intangible assets or regulatory capital is unclear to us and would in our view be difficult to substantiate.

We believe that CFC rules, which have been adopted by all EU Members States since the beginning of 2019 are designed to achieve substantially the same primary objective as the income inclusion rule. In these circumstances, the appropriateness of the GloBE rules in circumstances where income is already subject to CFC rules should be examined.

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[19] Freedom of establishment, free movement of services and free movement of capital as contained in Articles 49, 56 and 63 of the Treaty on the Functioning of the European Union (TFEU)

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

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

[22] The EU list of non-cooperative tax jurisdictions

The administration of the GloBE proposal would inevitably give rise to significant additional compliance burdens for many businesses. With a view to managing such compliance burdens, any new rules should only be effective where a global company is of a particular size and therefore well established.[23]

If a revenue threshold should apply, based on the turnover of an MNE, then such a threshold should be based on the prior year rather than the current year, to allow that MNE to know from the outset of a given year that the new international tax rule applies to its operations. This would be consistent policy with the threshold for Country-by-Country Reporting legislation.

[23]The USA's Base Erosion and Anti-Abuse Tax (BEAT) measures are only effective where a company has US revenues greater than USD$500m.