
# Response to the OECD Consultation on the Reports on the Pillar One and Pillar Two Blueprints

**14 December 2020**

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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 country's 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. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the 30,000 strong international CTA network which includes the Chartered Institute of Taxation UK and the Tax Institute of Australia. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members and our role in serving the best interests of Ireland's taxpayers in a new international world order.

**Irish Tax Institute – Leading through tax education**

## 2. Executive Summary

The Irish Tax Institute welcomes the opportunity to contribute to the OECD/G20 Inclusive Framework on BEPS public consultation on the Reports on the Pillar One and Pillar Two Blueprints.

We note that the Blueprints for Pillar One and Pillar Two reflect the progress that has been made by the members of the Inclusive Framework to progress the development of technical and policy solutions to agree new allocations of taxing rights between jurisdictions which are more reflective of today's digitalising economy and to address any remaining BEPS challenges, while recognising that many technical details are yet to be finalised pending decisions by members of the Framework at a political level.

We recognise that reform of the international tax framework is necessary to ensure that countries can reach a stable global consensus on how and where companies should be taxed in a digitalised world.

Given the importance of tax certainty for taxpayers, which has been recognised as a key factor that influences investment and other commercial decisions which impact economic growth, we firmly believe that sufficient time needs to be given to consider and analyse such fundamental reforms to the international tax framework. In fact, continued consultation with stakeholders is an imperative to ensure a robust and workable solution can be reached that is sustainable in the long term.

We would urge that regular dialogue with businesses should take place throughout the process to inform the development of the technical solutions under both Pillars. This could be achieved by establishing a business advisory group to the Working Parties developing both Pillars to provide input on the practical challenges and the complexities involved for global businesses in advance of their deliberations at Working Party meetings. This approach works well in the case of other Working Parties at the OECD.[1]

We have summarised below the Institute's key comments and observations on the Reports on the Pillar One and Pillar Two Blueprints, further details of which are contained in the body of this submission:

**Pillar One**

- Clarity is urgently needed on the range of business models that fall within the scope of the new taxing right under Amount A.
- Consider implementing the new taxing right on a phased basis, starting with automated digital services (ADS), to address the uncertainty and layers of complexity that exist when applying the rules more broadly to consumer-facing businesses (CFB).
- Consider imposing a much higher threshold for global revenue than €750 million, even for several years, to ensure the compliance burden would only be imposed on

[1] For example, the Technical Advisory Group to Woking Party 9 on Consumption Taxes and the Expert Sub-group to Working Party 10 on Exchange of Information and Tax Compliance.

the largest multinational enterprises, while at the same time helping to build the capacity of tax administrations to operate the new rules.

- More consultation needs to be carried out on the practical challenges of how businesses will be able to track the data and determine the information required to compute Amount A, as the cost to perform these administrative exercises could be immense.
- In our view, it would be unfair to impose a time-limit on pre-regime losses, otherwise countries in which multinational enterprises have invested either during their start-up phase or in the development of a new product may have to absorb losses, while such multinational enterprises are paying taxes on profits elsewhere.
- Regarding Amount B, it would be overly simplistic to assume that a standardised benchmark will work for marketing and distribution across the board as each market is different.
- The level of complexity of the technical solutions proposed to calculate the new taxing right under Amount A is a major concern as the disruption, additional administration costs and increased uncertainty for taxpayers and tax administrations seem to far outweigh the limited revenues the proposals are anticipated to generate.
- In our view, all areas of the new rules should be subject to legally binding and effective dispute resolution mechanisms. We would urge that where a country signs up to the new taxing right, they must also sign up to mandatory multilateral binding dispute resolution for all aspects of the new rules.

**Pillar Two**

- More time is needed to fully evaluate recently implemented tax reforms (including the BEPS package, ATAD measures and US tax reform) to assess whether they have achieved the desired behavioural impact, before moving to implement very complex new rules that would increase tax uncertainty for business, create additional compliance burdens and risk double taxation.
- Any solution reached under Pillar Two must be compatible with the EU fundamental Freedoms[2] and the principles expressed in EU law.
- Providing for a substance based carve-out from the GloBE proposal 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, as part of Action 5 of the BEPS project, to identify preferential tax regimes that unfairly impact the tax base of other jurisdictions.
- When estimating the Effective Tax Rate (ETR) on a jurisdiction-by-jurisdiction basis, the adjustments agreed to measure the tax base using accounting principles must recognise the diverse design elements of tax regimes in different jurisdictions, to ensure that a multinational 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 could result in an inaccurate approximation of the multinational's ETR.
- Deferred tax accounting should be explored where accounting standards are applied in measuring the tax base for the period to address the problem of temporary differences.

[2] 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)

- It would be important to ensure that companies who are incentivised to carry out Research & Development (R&D) or spend on green initiatives to tackle climate change through tax incentives, would not be penalised under the proposal, even if such incentives result in a low ETR.
- To reduce complexity and help business to manage the substantial compliance burdens that will be caused by the interaction of the four interlocking rules under the GloBE, we would urge that the same size threshold of €750 million considered for the Income Inclusion Rule would be similarly applied to the Subject to Tax Rule.
- In our view, an Income Inclusion Rule should operate in the first instance, as the primary rule applying before any Subject to Tax Rule.

**Conclusion**

We believe that an internationally agreed tax framework is an essential tool which facilitates cross border trade and investment. However, adequate time must be afforded to the reform process to ensure a fully considered and practical solution can be reached which will stand the test of time.

Accordingly, we believe the ongoing work at the OECD must focus on ensuring tax certainty and minimising the enormous administrative burdens that will accompany any agreed solution. This will require continuous consultation with all stakeholders, in particular with businesses, to fully comprehend the practical challenges and the vast complexities involved for tax administrations and taxpayers to implement what is proposed under both Pillars.

## 3. Pillar One Blueprint

The Blueprint for Pillar One proposes to deliver a sustainable taxation framework reflective of today's digitalising economy by expanding the taxing rights of market jurisdictions where there is active and sustained participation of the business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction.[3] This new taxing right will conversely reduce the taxing rights of jurisdictions where the multinational entities that are entitled to the residual profits under existing profit allocation rules, currently reside.

We recognise that reform of the international tax framework is necessary to ensure that countries can reach a stable global consensus on how and where companies should be taxed in a digitalised world and we support the work at the OECD level to agree a coordinated international policy response in this regard.

We welcome the commitment by members of the Inclusive Framework to the removal of existing digital tax measures that have been unilaterally introduced, when implementing any globally agreed solution that may be reached by the Framework.[4]

The Institute believes that tax certainty in the international tax framework is of the utmost importance and must be a priority for policymakers. Any suggested methodologies and reforms should be guided by the Ottawa taxation framework principles[5] of neutrality, efficiency, certainty and simplicity, effectiveness and fairness and flexibility.

The interaction between the existing international tax framework based on the arm's length principle with the proposed solution to allocate residual profits on a multilateral basis will undoubtedly result in extremely challenging practical issues and vast uncertainty for taxpayers.

### 3.1 Definition of Scope

It is important that clarity is urgently provided in the reform process regarding the range of business models that fall within the scope of the new rules. This would help to provide the necessary tax certainty for taxpayers, which is recognised as a key factor that influences investment and other commercial decisions, with significant impact on economic growth.[6]

Given the determination of whether a business is within scope is fundamental to the application of the rules, the Blueprint puts forward two elements to define the new taxing right to define the scope of Amount A – an activity test and a threshold test

[3] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris – page 11.
[4] Ibid.
[5] Electronic Commerce: Taxation Framework Conditions - A Report by the Committee on Fiscal Affairs, 8 October 1998 https://www.oecd.org/ctp/consumption/1923256.pdf 19 OECD Model Tax Convention on Income and on Capital 2014.
[6] IMF/OECD (2019), 2019 Progress Report on Tax Certainty, Paris. www.oecd.org/tax/tax-policy/g20-report-on-tax-certainty.htm

which are welcome, although scope remains a critical open issue that needs to be resolved politically by the members of the Inclusive Framework.

### 3.1.1 Activity Test

To define in-scope activities, the Blueprint for Pillar One identifies two categories of activities where the Report considers the policy challenge of circumscribing the allocation of taxing rights and taxable profits by reference to physical presence, as most acute. These are automated digital services (ADS) and consumer-facing businesses (CFB).

The definition of ADS includes a positive and negative list and a general definition, which is a notable attempt to simplify and identify highly digitalised businesses to be in-scope for the new rules but the administration of this could be problematic. Some of the language around the scope of ADS, for example, in the area of cloud computing is somewhat ambiguous in the Blueprint and more guidance would be needed for such businesses to understand if they are in-scope or if they are excluded because the services they provide are considered more akin to engineering and consulting services.

The inclusion of the much broader group of CFB in the scope of Amount A is creating a lot of uncertainty for businesses operating internationally. Many of these multinational enterprises would not be subject to current digital services taxes but fall within the application of rules under Pillar One. Further guidance on scope is urgently needed to alleviate the prevailing uncertainty for these businesses.

The proposed development of additional guidance to differentiate between providing prescription drugs and over the counter drugs for the pharmaceutical sector is welcome. Similarly, the carve-out for financial services in the Blueprint is warranted given the highly regulated nature of the services. Consideration could also be given to extend the carve-out to unregulated subsidiaries of regulated groups. Afterall where the parent is a regulated entity, it puts constraints on its subsidiaries, which can be subject to regulations as part of the group.

However, the “plus” factors suggested in the Blueprint for CFB will inevitably add further layers of complexity to Pillar One. Careful consideration must be given to how this approach can operate with the existing Permanent Establishment and profit attribution rules. If a multinational enterprise has a physical presence in a country, it should be paying the corresponding correct amount of tax due to the presence in that jurisdiction, it is questionable then why it should fall within the parameters of Pillar One.

Every opportunity should be taken to simplify the rules as much as possible and to remove businesses out-of-scope which are not disrupted to a high degree by digitalisation. It may be preferable therefore to proceed with a phased implementation of the new taxing right, starting with ADS, to address the uncertainty and layers of complexity that exist when applying the rules more broadly to CFB.

### 3.1.2 Threshold Test

The Blueprint for Pillar One suggests the €750 million gross revenue threshold used for country-by-country reporting (CbCR) requirements could be considered to limit the types of companies that would be subjected to the new rules. We would agree that the measures envisaged should be confined, at a the very minimum, to larger multinational enterprises as they would be better placed to deal with the heightened complexity of the proposed new international tax framework.

But the Economic Impact Assessment shows that setting the threshold at €750 million would lead to substantial compliances burdens, with a significant number of multinational enterprises in scope, without the commensurate reallocations of revenues to market jurisdictions.[7]

Imposing a much higher threshold for global revenue than €750 million, even for several years, would ensure that the compliance burden would only be imposed on the largest multinational enterprises, while at the same time reducing the administration burden on tax administrations.

The Blueprint for Pillar One notes that a threshold for global revenue of €10 billion would bring 350 multinational enterprises within scope of the suggested activities.[8] Focusing on a smaller number of multinational enterprises initially might be appropriate to help build the capacity of tax administrations to operate the new rules. This would in turn permit knowledge and experience of the new rules to develop and the necessary resources to be expanded over time.

## 3.2 Amount A

### 3.2.1 Segmentation and Tracking Financial Data

The Blueprint confirms that the starting point for the determination of the tax base for Amount A tax would be the consolidated group financial statements. It is welcome that the consolidated financial statements should be prepared in accordance with an existing internationally recognisable accounting standard comparable with International Financial Reporting Standards (IFRS). This ensures transparency and consistency in financial information.

Even though the accounting standards of the countries[9] identified in the Blueprint 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.

[7] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris – page 22.
[8] Ibid – Table 2.1 at Paragraph 181 on Page 63.
[9] GAAP of Australia, Canada, Hong Kong (China), Japan, New Zealand, the People's Republic of China, the Republic of India, the Republic of Korea, Singapore and the United States.

However, the Blueprint proposes that it may be necessary to compute the Amount A tax base on a segmented basis because the new taxing right will only apply to group profits that derive from in-scope activities.[10] This could add layers of complexity given the different local GAAPs that can operate within multinational groups across jurisdictions.

It would be essential to consult closely with internationally operating businesses regarding the practical implications of such an approach, as we understand that difficulties would undoubtedly be encountered by businesses in trying to produce such financial information and data.

Segmental reporting for the purposes of the published accounts of a multinational company would not normally include details of profits before tax on a segmental basis. Multinational enterprises often operate multiple businesses within one legal entity, with resources spread over different business lines, for example, salespeople selling across several different business lines.

The administrative burden of the proposals for business, particularly mixed businesses, should not be underestimated and it may even be necessary in certain circumstances for a reorganisation to take place for the business to be able to provide the financial information envisaged. This is contrary to the key tax design principle of simplicity. Indeed, where a multinational group may already have a presence (and people) in the market, this would make the calculation even more complicated.

A large burden would be placed on businesses to track data in order to comply with the rules for Amount A. We understand that the cost to perform these administrative exercises could be immense, with the risk that the outcome may not even be correct. For example, how would you separate the profit and loss account of a business that sells to both end users and distributors? Equally, an entrepreneur entity could be profitable in one business and invest heavily in another for the future of the business which results in a break-even position, resulting in a range of businesses that have different percentages of profitability.

The trigger for revenue in Amount A is the consumer but many businesses that provide ADS do not track this information. For example, how can a business validate an IP address, especially when a consumer may use a VPN.

In our view, there has not been enough consultation on the practical challenges of how businesses will be able to track the data and determine the information required to compute Amount A.

### 3.2.2 Loss carry-forward and other tax attributes

We firmly believe that any methodology for allocating residual profits to market jurisdictions should include the tax attributes of a business, such as the carry forward

[10] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris – page 109.

of losses and tax depreciation for investment in assets. It should not be the case that only profits are allocated to market jurisdictions, with losses being borne by the residence jurisdiction.

The Blueprint for Pillar One indicates that loss carry forward rules will apply to Amount A through an earn-out mechanism at the level of the group but acknowledges that specific design aspects of these rules need to be refined, including the treatment of pre-regime losses.[11]

The computation of residual profits to be allocated must consider the investment made by multinational companies in creating and exploiting production or trade related intangibles, such as, expenditure incurred on R&D, in the commercialisation of scientific and technological developments and in driving production efficiencies and service enhancements.

Most businesses take many years to become profitable and this is particularly prevalent in the case of digital services companies that invest heavily in R&D and technological developments. It would be unfair to impose a time-limit on pre-regime losses, otherwise countries in which such multinational enterprises have invested either during their start-up phase or in the development of a new product may have to absorb losses, while such multinational enterprises are paying taxes on profits elsewhere.

Any agreed methodology should also provide for start-up losses relating to the market jurisdiction, which can occur when developing new markets for products and services.

## 3.3 Amount B

The purpose of Amount B according to the Blueprint for Pillar One is two-fold. Firstly, to simplify transfer pricing tax administration and reduce compliance costs for taxpayers and secondly to enhance tax certainty and reduce tax disputes. Amount B is intended to standardise the remuneration of related party distributors that perform “baseline marketing and distribution activities” in the market jurisdiction.

Simplified business models, where routine and non-routine functions are carried out by separate entities cannot be assumed, as a single entity will often undertake both routine and non-routine activities. Indeed, an entity engaged in marketing and distribution activities may also interact with other entities in the supply chain, such as those engaged in manufacturing whose activities would be subject to transactional-based transfer pricing, using the long-established arm’s length principle.

In such a scenario, tensions could arise where the application of a fixed return for certain baseline marketing and distribution activities allocated under Amount B could result in insufficient profits left to be allocated to other entities in accordance with the

[11] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris – page 103.

arm's length principle under transactional-based transfer pricing. It would be essential that an appropriate balance is achieved in setting any baseline and that any proposed solution should incorporate a methodology for resolving such disputes.

Certainty regarding the definition of routine profits that would be acceptable as a baseline amount would be welcomed. However, such baseline returns would need to be reviewed in the event of a significant change in economic conditions or in the event of an update to best practice, as may be set out in OECD guidelines on transfer pricing. It would be overly simplistic to assume that a standardised benchmark will work for marketing and distribution across the board as each market is different.

At paragraph 693 of the Blueprint, it states "*On the assumption that the narrow scope of Amount B set out here is the one used, no attempt is made to account for functional intensity, as broadening the scope of baseline activities may increase complexity and increase the areas for dispute."* This approach would appear to contradict the arm's length principle, as regional functions may be discounted for Amount B. This would usually be determined by an arm's length amount using appropriate transfer pricing analysis to reflect the increase in functions in a jurisdiction. This perhaps could be addressed if Amount B would be calculated on a cost-plus basis, instead of a percentage of a return on profit.

## 3.4 Level of Complexity

Whilst the solutions in the Blueprint for Pillar One aim to improve tax certainty and strive to be as simple and administrable as possible, the feedback from our members, who are tax professionals that provide tax services and business expertise to thousands of Irish owned and multinational businesses is that the methodologies put forward in the Blueprint are immensely complex and would be very difficult to manage and implement for both tax administrations and taxpayers.

The level of complexity of the technical solutions to calculate the new taxing right under Amount A is a major concern as they are likely to impose significant additional administrative burdens on the capacity of tax administrations and on businesses. The disruption, additional administration costs and increased uncertainty that will be caused by the current proposed methodologies seem to far outweigh the limited revenues the proposals are anticipated to generate.

In fact, the 2020 OECD Economic Impact Assessment[12] notes the anticipated global revenue gain from Amount A under Pillar One would be modest (i.e. less than 1% of global corporate income tax revenues). Indeed, this assessment was based on data for multinational enterprises' profits and its location for 2016 and 2017, pre-dating the significant international tax reforms that have taken place, including the implementation of various BEPS measures and US tax reform, which have shown to

[12] OECD (2020), Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/0e3cc2d4-en

be considerable influencing factors on the tax structuring decisions of multinational groups over the last three years.

The adoption of the 2017 OECD Transfer Pricing Guidelines, with the implementation of BEPS Actions 8-10 (Transfer Pricing), has resulted in multinational enterprises now paying more taxation in market jurisdictions because of the application of the arm's length principle under existing profit allocation rules.

Any new tax initiative that deviates significantly from the international tax framework and settled tax practice will inevitably result in increased tax uncertainty and where businesses are concerned about an uncertain business environment and complex tax administration, this can act as a considerable barrier to entering new markets and pursuing new investments.

## 3.5 Dispute Prevention and Dispute Resolution

The Blueprint provides for appropriate mechanisms to prevent and resolve disputes over the tax base, implementation of the formula and any other features of the new taxing right, which would allow businesses to obtain certainty as to whether they are within the scope (or not) of Pillar One. This is critical, as it should not be for any individual country to decide the matter where the issue is disputed.

In our view, all areas of the new rules should be subject to legally binding and effective dispute resolution mechanisms. Potential areas of dispute are likely to arise in several areas, from such fundamental matters as to whether a business comes within the scope of the new taxing right, to the more detailed elements of the profit allocation mechanisms contemplated under Amount A and Amount B.

The dispute resolution mechanisms that competent authorities currently have in place, which are focused on dispute resolution in a bilateral context, could not effectively deal with the inevitable increase in disputes resulting from the measures envisaged which would be on a multilateral basis. Without a radical reform of the current dispute resolution mechanisms, double taxation disputes are likely to result in increased costs for businesses and they could ultimately impact decisions on whether to invest or indeed trade in each jurisdiction.

The Institute welcomes that the Blueprint states a new multilateral tax certainty process for Amount A would be developed, which would include appropriate mandatory binding dispute resolution. We would urge that where a country signs up to the new taxing right, they must also sign up to mandatory multilateral binding dispute resolution for all aspects of the new rules.

It is important that more clarification is also provided regarding how this new multilateral tax certainty process will fit with the existing Mutual Agreement Procedure (MAP) and existing Advance Pricing Agreements (APA) when these new rules would come into force. Failure to do so could impact the willingness of businesses to engage in these processes in the interim.

## 4. Pillar Two Blueprint

The Blueprint on Pillar Two (known as the Global Anti-Base Erosion "GloBE" proposal) outlines a systemic solution designed to ensure that internationally operating businesses will pay a minimum level of taxation regardless of where such businesses are headquartered or the countries in which they operate, to address remaining base erosion and profit shifting (BEPS) challenges.

The Pillar Two proposal puts forward four interlocking rules that would provide jurisdictions with the right to "tax back" where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation.

These are:

a. Income Inclusion Rule (IIR)
b. Undertaxed Payments Rule (UTPR)
c. Switch-Over Rule (SOR)
d. Subject to Tax Rule (STTR)

We recognise there is a strong 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 need for a global minimum tax rate ("GloBE") to address remaining BEPS challenges proposed under Pillar Two is not yet clear in our view.

The full effect of the far-reaching changes to the international tax system because of the implementation of the BEPS minimum standards by the 137 member countries of the Inclusive Framework has not yet been fully evaluated. The 2018 OECD Interim Report confirmed early indicators that the BEPS measures were having a significant impact on tax structuring decisions of multinational groups.

The 2017 US tax reform has also played a significant part in influencing the behaviour of US-owned multinational groups over the last three years. While the implementation of the Anti-Tax Avoidance Directives (ATAD and ATAD2) have set the parameters to tackle BEPS within the EU, with the introduction of controlled foreign company (CFC) rules and anti-hybrid rules across all EU Members States for the first time.

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 adopted by all EU Members States from 1 January 2019 and anti-hybrid rules from 1 January of this year, are designed to achieve many of the same objectives as the Income Inclusion Rule and Subject to Tax Rule now being proposed. In these circumstances, the requirement at this stage for the measures proposed under Pillar Two is not yet apparent.

Indeed, the BEPS project has pushed the tax transparency agenda to a significant milestone globally with OECD Secretary-General Angel Gurría recently describing the

Global Forum on Transparency and Exchange of Information for Tax Purposes as a *"game-changer"* and that *"ensuring access to financial account information for tax administrations helps ensure everyone pays their fair share of tax, boosting revenue mobilisation for countries worldwide, and particularly for developing countries."*[13]

It is critical that more time is given to consider and fully evaluate the significant reforms that have taken place in recent years, including the overall BEPS package, ATAD measures and the effect of US tax reform to assess whether the measures are working as intended and whether they have achieved the desired behavioural impact, before moving to implement very complex new rules that would increase tax uncertainty for business, create additional compliance burdens and risk double taxation.

Any solution reached under Pillar Two must be compatible with the EU fundamental Freedoms[14] and the principles expressed in EU law. 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 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…"*.[15]

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.

Furthermore, how a Subject to Tax Rule would operate in an EU context would also need to be examined given the decision of the CJEU in the *Eurowings*[16] case, where the Court determined that a difference of tax treatment cannot be justified either by grounds linked to the need for coherency of taxation or by the fact that the taxpayer established in another Member State is subject to lower taxation there.

In addition, the decision of the CJEU in *Brisal*[17] makes it clear that imposing withholding taxes on an intra-EU basis would be extremely problematic and likely to infringe free movement. This matter needs to 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

[13] Speaking at the Plenary Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes on 9 December 2020.
[14] 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)
[15] Court of Justice of the European Union decision in *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*, Case C-196/04 14
[16] Court of Justice of the European Union decision *in Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna,* Case C-294/97.
[17] Court of Justice of the European Union decision in *Brisal,* Case C-18/15.

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.

## 4.1 Technical Aspects of Pillar Two

Notwithstanding that we believe the requirement for the proposals put forward under Pillar Two is not yet evident, as more time is needed to fully evaluate whether the BEPS measures implemented to date are working as intended, we have provided specific comments below regarding some of the technical design aspects of the GloBE.

### 4.1.1 Determination of the Tax Base

The Blueprint on Pillar Two provides that the determination of the tax base for the GloBE starts with the financial accounts prepared under the accounting standards used by the parent of the multinational enterprise group to prepare its consolidated financial statements.[18] The Blueprint confirms that this must be IFRS or another acceptable accounting standard.

**Use of Parent Financial Accounting Standards**

We acknowledge that this could offer a more consistent basis for calculating an effective tax rate (ETR). However, there are many different accounting standards that currently operate, none of which are identical. Even though different accounting standards around the world 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, multinational groups that are not listed on a recognised stock exchange may not have a legal obligation to prepare consolidated financial statements under any accounting standards.

The complexity involved in preparing sub-consolidations on a jurisdictional level basis would be immense. Reaching agreement on the adjustments required to estimate the tax base of a multinational group 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 multinational groups that adopt the same accounting standards, considerable differences can arise in the extent of recognition and the carrying value

[18] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris – page 16.

of assets and related amortisation expense in the consolidated accounts that are self-generated by subsidiaries of the parent, depending on whether the multinational group has grown organically or by acquisition. This is because of the effect of acquisition accounting principles on the consolidated financial statements.

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, for example, 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, such as 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 is an approach that would fit 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 a multinational group across the jurisdictions in which it operates.

When estimating 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 a multinational 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 multinational’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.

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 needs to be considered when adopting a jurisdictional approach. Multinational groups who have invested either during their start-up phase or in the development of a product may have losses carried forward for several 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.

We consider that deferred tax accounting should be explored where accounting standards are applied in measuring the tax base for the period to address the problem of temporary differences.

As noted above, multinational groups that have grown by acquisition can reflect different accounting treatments of assets which are self-generated by their subsidiaries in comparison to multinational group 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 multinational groups 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.

**Jurisdictional Blending**

We believe a jurisdictional blending approach will present multinational companies with immense difficulties and would effectively require the multinational group to prepare sub-consolidated financial accounting information for each jurisdiction within the group and require them to consider the interaction of local GAAP and the GAAP of the parent entity, the cash tax position and the ETR.

Undoubtedly, the jurisdictional approach being considered under the Blueprint for Pillar Two would involve a very significant additional compliance burden which would be hugely time-consuming and would result in significant additional costs for multinational groups.

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 under Pillar Two would obligate multinational groups to create additional financial accounting reporting systems to compute the top up tax in parent jurisdictions. It would be essential that any agreed technical solution 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 United States.

Therefore, it would be important where accounting results are to be used as a proxy for the tax base for the purposes of determining a multinational'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 the relevant jurisdiction could be approximated as closely as possible. Failure to recognise such differences could result in the estimated ETR being wholly inaccurate.

The proposed jurisdictional 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. It 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 like 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 considered when calculating the ETR of the subsidiary or the subsidiary jurisdiction.

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. Equally, businesses that are encouraged to invest in green initiatives to tackle climate change through tax incentives, should not be negatively impacted under the GloBE proposal, even if such incentives result in a low ETR.

### 4.1.2 Substance-based Carve-out

In an EU context, the GloBE proposal would need to be compatible with the EU fundamental freedoms and the principles expressed in EU law. 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.

We believe 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. Recognition should be given under Globe for the valid Action 5 approved practices, which the OECD deems not to be harmful (preferential regimes).

### 4.1.3 Co-existence with GILTI

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 must be carefully examined. Similarly, where income is included for the purposes of the Global Intangible Low-Taxed Income (GILTI) regime in the United States needs to be considered.

The Blueprint for Pillar Two suggests there are reasons for treating the GILTI regime in the United States as a qualified Income Inclusion Rule for GloBE. Should agreement be reached among members of the Inclusive Framework to introduce a globally agreed minimum tax rate on a jurisdictional basis, it should not be the case that a jurisdictional level approach to blending would apply to multinational groups parented outside of the United States and GILTI (with its “rest of the world” tax base) applying to US 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.

Therefore, efforts need to be made to ensure both regimes can be aligned to avoid the ensuing compliance complexities that will inevitably arise for multinational groups. If a multinational group has income taxed under existing CFC rules or the GILTI regime, then it should not be subject to further taxation under the GloBE.

### 4.1.4 Subject to Tax Rule

**Materiality Threshold**

The administration of the GloBE proposal will inevitably give rise to significant additional compliance burdens for many businesses. With a view to managing such compliance burdens, the Blueprint for Pillar Two proposes that the Income Inclusion Rule and the Undertaxed Payments Rule should only be effective where the gross revenues of a multinational group exceed €750 million, in line with the CBCR threshold.

However, the Report notes that the size threshold applying to the Subject to Tax Rule does not need to align with the €750 million threshold set for the other interlocking rules under the GloBE proposal because it is a standalone treaty rule, yet it should not be set too low given the lower risk of material base-eroding payments in smaller groups.[19] In an effort to reduce complexity and help business to manage the substantial compliance burdens that will be caused by the interaction of the four interlocking rules under the GloBE, we would urge that the same size threshold of €750 million would similarly apply to the Subject to Tax Rule.

***De Minimis* Threshold**

Consideration should also be given to *de minimis* thresholds for the Subject to Tax Rule so that it would not be necessary for multinational groups to assess whether the rule applies to smaller amounts. *De minimis* rules have been used effectively in the ATAD interest limitation rule[20] to reduce the compliance burden imposed on taxpayers. Any *de minimis* thresholds could be matched with an anti-abuse provision to ensure that the *de minimis* threshold operates as intended. For example, zero tax jurisdictions could be excluded from the application of the *de minimis* provision, such that only countries with a 'reasonable statutory rate' could avail of it.

**Interaction with Anti-Hybrid Rules**

The interaction between the Subject to Tax Rule and the anti-hybrid rules would also need to be carefully considered. If a payment is subject to anti-hybrid rules, it should not also be restricted by the Subject to Tax Rule, given anti-hybrid rules are designed to achieve substantially the same primary objective as the Subject to Tax Rule. Otherwise, there would be a significant risk of double taxation.

### 4.1.5 Rule Coordination

The Blueprint on Pillar Two acknowledges the need for rule coordination to ensure that the different elements of the GloBE rules interact in a way that minimises compliance and administration costs and avoids the risk of double taxation. The examples in the Blueprint effectively give priority to the Subject to Tax Rule.

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. We believe

[19] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting, OECD Publishing, Paris – page 159.
[20] Article 4 of the Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

this would address taxpayers' concerns regarding the potential for double taxation on same income stream under the Subject to Tax Rule, where it has been included for tax purposes under CFC rules or the GILTI regime.