Trade and Investment

Commission on Taxation

ICC Comments on OECD public consultation document on the Global Anti-Base Erosion (GloBE) Proposal under Pillar Two: Addressing the tax challenges of the digitalisation of the economy

ICC appreciates the opportunity to provide input on the OECD public consultation document on the Global Anti-Base Erosion (GloBE) Proposal under Pillar Two, as part of the ongoing work of the OECD/G20 Inclusive Framework on BEPS (the Inclusive Framework) to address the tax challenges of digitalisation. ICC advocates for a consistent global tax system, founded on the premise that stability, certainty and consistency in global tax principles are essential for business and will foster cross-border trade and investment. ICC recognises the efforts by the OECD to enable countries, within the context of the Inclusive Framework, to work collaboratively towards the development of a solution for its final report to the G20 by the end of 2020. ICC fully supports a harmonised approach to ensure that international tax rules remain relevant and applicable in an increasingly digitalised global economy.

GENERAL COMMENTS

Under the Programme of Work regarding Pillar Two, members of the Inclusive Framework agreed to explore issues and design options in connection with the development of a co-ordinated set of rules to address risks from structures that allow multi-national enterprises (MNEs) to shift profit to jurisdictions where they are subject to no or very low taxation. The GloBE proposal under Pillar Two seeks to comprehensively address remaining base erosion profit shifting (BEPS) challenges linked to the digitalisation of the economy by ensuring that the profits of internationally operating businesses are subject to a minimum rate of tax intended to curb a race to the bottom on corporate taxes.

ICC supports the work of the OECD to combat tax evasion and aggressive tax planning and the implementation of the BEPS initiative, one of the the premises of which is to ensure taxation where value is created. ICC recognises that addressing tax avoidance is a key political issue for many countries, but respectfully recommends that new policies should take into account the degree to which recent policy changes, such as BEPS and the US tax reform have addressed this issue. ICC strongly recommends a simplification of measures to drive design and implementation and that any proposals under Pillar Two should avoid creating an additional layer of rules, which would increase complexity and complicate administrability of the international tax system. The interaction of the GloBe proposal with other existing international and domestic tax rules would be an essential consideration in this regard. Before further developing details on the various components of Pillar Two, a framework clarifying the interaction of the GloBE proposal with existing international and domestic tax rules, the interaction with Pillar One as well as the interaction and/or prioritisation between the four component parts will be required.

The four component parts of the GloBE proposal include: (i) the income inclusion rule, (ii) the undertaxed payments rule, (iii) a switch-over rule (iv) and the subject to tax rule. The design of the income-inclusion rule and the under-taxed payments rule draw similarities from the US Global Intangible Low Tax Income (GILTI) and the Base Erosion and Anti-Abuse Tax (BEAT) international rules in the 2017 US tax reform law.

In this respect, ICC is of the view that the income inclusion rule (*that would tax the income of a foreign branch or a controlled entity if that income were subject to tax at an effective rate that is below a minimum rate*) would be the most appropriate and effective approach, and should, for all intents and purposes, function as the primary rule/method for application. Furthermore, ICC suggests that the income inclusion rule be applied at parent level, on a global basis. Considering the efforts made by tax administrations and businesses in the implementation of the existing international tax framework, an approach that aligns more closely with existing rules, would reduce the complexity and administrative burden of having to comply with an additional set of rules, that essentially have the same objective. ICC agrees that the GloBE proposal should be designed in a manner that is consistent with principles of simplicity that would minimise compliance and administration costs as well as the risk of double taxation.

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SPECIFIC COMMENTS

Rule co-ordination and double taxation

The Inclusive Framework will consider the priority in which the four rules would be applied and how they interact with other rules in the broader international framework. It will also explore compatibility with international obligations (such as non-discrimination) and how that compatibility could depend on the rule's detailed design.

ICC believes that it is imperative that the co-ordination among the undertaxed payments rule, subject to tax rule, switch-over rule and income inclusion rule minimises the risk of double taxation and includes measures to reduce compliance costs. In ICC's view a truly globally implemented income inclusion rule at parent level would make the need for implementation of the undertaxed payment rule, subject to tax rule and switch-over rule obsolete. If all four proposed rules were to be progressed simultaneously, ICC is convinced that whatever rule co-ordination would ultimately be agreed would not lead to effective avoidance of double taxation. Such co-ordination among potentially four countries in respect of a single payment would be immensely complex (thereby creating high compliance costs) and prone to mistakes and controversy (thereby increasing double taxation risks).

ICC also notes for example, that the Pillar Two computations should take all the Pillar One amount adjustments into account before calculating the minimum tax rate to be applied. Otherwise, the elimination of double taxation would not be achieved.

As fundamental changes to the international tax framework are being considered, ICC stresses the importance of continuing to improve dispute avoidance and dispute resolution mechanism procedures. New concepts of taxing companies and allocating profits to countries may be subject to different interpretations and the business community will most likely risk being confronted with increasing instances of double taxation. The risk of double taxation in such circumstances would discourage cross-border trade and investment – which would be harmful for both countries and for businesses of all sizes. It is therefore imperative that robust and efficient dispute resolution procedures are in place to reduce double taxation disputes.

Scope and carve-outs

The Pillar Two consultation document calls for the exploration of possible carve-outs as well as thresholds and exclusions to restrict application of the GloBE proposal. The document contains measures to ensure a minimum level of taxation via top-up in the residence country or withholding/denial of deduction in the source country.

Regarding the potential carve-outs, ICC respectfully suggests the exclusion of those MNEs that are already subject to high tax rates (usually coinciding with non-mobile activities) since the existing regulations already ensure that in these cases no profit shifting is carried out to low-tax jurisdictions and accordingly, no additional rules would be required.

ICC believes that the scope and carve outs should be applied consistently across jurisdictions that are part of the Inclusive Framework. This will ensure that an element of consistency is maintained in the source and residence state(s) and that double taxation is avoided.

Top up taxation

This involves the residence country imposing an extra tax on income arising in source countries which do not subject the income to a certain minimum level of taxation either because the tax rate is below the minimum rate, or because the income in question is eligible for incentives or exemptions.

There are certain situations where the top up tax may be problematic.

1) Where the residence country itself offers similar tax incentives or special tax treatment for the type of income in question, the top up tax will discourage outbound foreign investment. This is not in accordance with the Capital Export Neutrality principle, which often guides taxation policy in respect of outward investment. The EU Treaty and tax principles will also need to be considered.
2) Where there is a domestic industry in the source country within the same sector which can also avail itself of the low tax rate or incentives, the inbound investors will be subject to a higher tax burden than domestic businesses, putting them at a competitive disadvantage. This was pointed out on page 18 in the 2007 OECD report “Tax effects on Foreign Direct Investment – No. 17”:

   ‘home taxation of low-tax profits may not be feasible where this tax burden means that resident firms cannot compete with local/other producers not subject to this level of tax.’

The withholding tax/ denial of deduction measures in the source country may also have undesirable effects:

1) Where domestic businesses in the source country enjoy an effective tax rate below the minimum rate, foreign businesses would be at a competitive disadvantage. They would either have to gross up their charges to compensate for withholding tax or accept a lower margin to match the after tax pricing of domestic competitors.

These observations would suggest that a carve out mechanism should be provided to cover cases where the countries involved offer the same low rates or incentives to domestic businesses.

In this respect ICC notes that it would be useful to consider a solution that includes substance-based carve-outs from existing regimes aiming at attracting certain investment, that are compliant with the BEPS Action 5 standards with respect to core income generating activities, such as tax credits for research and development and capital investments, together with patent boxes. The benefits of these regimes should be retained and individual jurisdictions will have the prerogative regarding their application. ICC would support an exemption for fixed return on assets, which aligns with the GILTI rules.

ICC believes that the application of *de minimis* thresholds would be not be effective in this context if applied globally.

<u>Tax base determination and Blending</u>

The GloBE proposal is based on a minimum effective tax rate test, therefore rules are needed in order to set out the extent to which a taxpayer can combine its low-tax and high-tax income within the same entity or across different entities within a group. The consultation document proposes three forms of ‘blending’, namely: worldwide blending, jurisdictional blending and entity blending. ICC strongly supports the option for worldwide blending, where a group would be required to pay an average minimum rate of tax on all of its foreign income. ICC believes that global blending would better align with existing international rules. Determining income and taxes on a jurisdictional or entity basis would greatly increase complexity and complicate administrability of the rules. Additionally, the more granular approach of jurisdictional and entity blending would undermine the value and practicability of working from parent consolidated financials. The application of global blending would also support the inclusion of substance-based carve-outs, effectively protecting the benefit provided by regimes that are considered unharmful.

ICC believes that global blending would solve many issues for industries with cyclical businesses, long lead times or that are subject to variations of profit taxation. Whilst a number of these issues are timing differences, global blending would easily address the majority of issues, particularly as most of these businesses, over the lifetime of their projects, tend to have average or even above-average taxation.

Nevertheless, it should be noted that global blending *per se* might not consider all relevant timing differences which sometimes span over a longer horizon and could therefore discriminate against businesses with longer investment cycles.

In addition to carve-outs and blending, the consultation document notes the challenges inherent in the GloBE proposal concerning the use of a consistent tax base. The document draws on experience in practice of applying equivalent rules such as the US GILTI rules and demonstrates how a divergence in tax base approach between two jurisdictions that apply the GloBE income inclusion rule could significantly undermine its policy intent and effective operation. The consultation document seeks input on the suggestion that the GloBE proposal should use the financial accounts of a group's ultimate parent entity, combined with agreed adjustments to take account of permanent and temporary differences. To this end, ICC respectfully suggests that countries should be able to determine whether they use financial accounting or tax reporting as a basis, on the condition that the global parent rules are applied. This approach would avoid the application of different sets of rules to the same chain of entities, and provide for more flexibility. Financial accounting would inevitably be more complex on a jurisdictional basis.

ICC holds that MNEs should be permitted to follow the existing rules of jurisdictions that have adopted a minimum tax regime where they are headquartered. Alternatively, ICC believes that a parent entity's consolidated financial accounts could be used as a basis in instances where jurisdictions have not adopted a minimum tax regime. In the case of consolidated financial accounts, the Inclusive Framework should accept accounting standards such as IFRS, US GAAP, etc.

The consultation document seeks input with respect to the nature of the most common permanent differences between financial accounting income and taxable income across jurisdictions. The document also discusses three approaches to addressing temporary differences, (namely, the carry-forward of excess taxes and tax attributes, deferred tax accounting, and multi-year averaging). ICC notes that the tax differences will vary based on the methods used between financial accounting methods such as IFRS and tax reporting. As such responses could vary for individual circumstances ICC suggests that in the case where consolidated group financial accounts are used as a basis, adjustments should be made for permanent differences. Furthermore, ICC believes that methods, such as carry forwards, that apply at the parent level, would be preferable in terms of application and administrative efficiency.

ICC suggests that it would be useful to provide flexibility regarding the use of adjustment methods that best correspond with MNE accounting methods. For instance, MNEs who do not use deferred tax accounting, should not be required to make temporary adjustments on the basis of deferred tax accounting.

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