ICAEW
REPRESENTATION 125/19

GLOBAL ANTI-BASE EROSION PROPOSAL (GLOBE)-PILLAR TWO

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ICAEW welcomes the opportunity to comment on the *Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two* published by the OECD on 8 November 2019, a copy of which is available from this link.

The consultation period ran for the three weeks to 2 December 2019, the consequences of which were to limit severely our own process for preparing a response and will have implications for the OECD's ability to draw valid conclusions from the consultation exercise.

1. We recommend the Global Anti-Base Erosion (GloBE) proposal adopts simpler solutions wherever there is a choice. A pragmatic approach is more likely to be accepted than a perfect but over engineered solution.
2. We recommend an approach which focuses the responsibility for, and therefore the compliance burden of, eliminating profit shifting on the jurisdiction rather than on taxpayers, since it is local tax rates and rules which make profit shifting for tax desirable.
3. Enterprises based in any of an agreed blacklist of countries could be required to comply with the rules set out in Pillar Two. This would ensure that the compliance burden is placed only on those businesses and jurisdictions that do not participate in the framework in order to try and seek a tax advantage.
4. Pillar 2 leaves much that is open to interpretation and is inherently over engineered. An overly complex policy could stifle international investment.
5. We recommend a deminimis carve-out for smaller Multi National Enterprises and all charities.

Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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KEY POINTS

SUMMARY

1. Pillar Two calls for the development of a co-ordinated set of rules to address the ongoing risks from structures that allow Multi National Enterprises (MNEs) to shift profit to jurisdictions where they are subject to no or very low taxation.
2. Pillar One addressed the allocation of taxing rights between jurisdictions and considered various proposals for new profit allocation and nexus rules.
3. This response is in relation to the Pillar Two proposals.
4. ICAEW Tax Faculty assesses new tax policy using 10 core principles (see appendix). Given the complexity already inherent in developing any new framework to be applied internationally, we recommend the Global Anti-Base Erosion (GloBE) proposal adopts simpler solutions wherever there is a choice. A pragmatic approach is more likely to be accepted than a perfect but over engineered solution.
5. We recommend an approach which focuses the compliance burden on the jurisdiction rather than on taxpayers since it is local tax rates and rules which make profit shifting for tax desirable.
6. We recommend that only enterprises based in any of an agreed blacklist of countries should be required to comply with the rules set out in Pillar Two, while those based in whitelisted countries would not. This would place the compliance burden only on those businesses and jurisdictions that do not participate in the framework in order to seek a tax advantage, greatly simplifying the application of the provisions without diluting their ability to achieve the policy objective.
7. The consultation has not addressed how tax incentives are dealt with. Imposing a minimum ETR across all jurisdictions will be ineffective if each state can create its own tax base, for example through exemptions.

GENERAL COMMENTS

8. Given the recent Base Erosion Profit Shifting (BEPS) activity and associated unilateral and multilateral measures, the tax complexity of businesses operating internationally has increased significantly. Planning and then executing transactions which involve cross-border activity is making it increasingly difficult for MNEs to understand and ensure they are compliant at both ends of a cross-border transaction. The constantly changing landscape is also more challenging for the tax authorities seeking to monitor such activity.
9. Overall Pillar 2 leaves much that is open to interpretation and is inherently over engineered.
10. If the OECD is looking for a unified consensus-based approach (which is a must and not an option) for countries to comply with Pillar 2, simplicity needs to be the guiding principle.
11. When there is tax simplicity, taxpayers are more willing and able to comply and structure their affairs accordingly, and the policy will be more effective.
12. An overly complex policy could stifle international investment, which would be a highly undesirable policy outcome that must be avoided.

CONFIRMING THE POLICY OBJECTIVE AND AN APPROACH TO ACHIEVING THAT OBJECTIVE

13. The consultation document is framed on the premise that, even in a post-BEPS environment, there remain opportunities for multinational enterprises to shift profit between entities, including to low tax jurisdictions, in what could be considered to be a harmful manner. The

policy objective would, therefore, appear to be pinned around decreasing the incentives to shift profits and so prevent a race to the bottom on corporation tax rates.

14. There is an overarching question concerning the target for behavioural change. Is it jurisdictional tax authorities, offering unacceptably low tax rates, or is it taxpayers who seek to shift profit to low tax jurisdictions?
15. While both are contributing to the problem, it is likely that it is the tax rates offered by jurisdictions which drive taxpayer behaviour and therefore the focus should be aimed primarily at a jurisdiction level. With this in mind, perhaps the route the OECD should take is to influence jurisdictions on their tax rate and overarching tax policy, rather than impose complex and onerous administrative burdens on all taxpayers.

Support for a jurisdiction level solution

16. One model could involve the OECD creating and managing a new blacklist of those territories which fail to satisfy certain criteria determined by the OECD. These criteria could include low corporate tax rates among other criteria.
17. The consequences of a territory being on the blacklist would be that taxpayers based there would have to apply rules along the lines of those set out in the GloBE proposal to the extent they have operations in those territories
18. Any territory not on the blacklist would not be subject to the GloBE rules. In this way, only those seeking to abuse the principles would be faced with the complexity of the rules.
19. The OECD would monitor jurisdictions to mitigate the risk of taxing jurisdictions artificially inflating their tax rates and then providing other reliefs and incentives that yield similar economic outcomes for taxpayers. The OECD would therefore be monitoring compliance of a jurisdiction with the criteria that it sets on an ongoing basis, and countries may come onto or come off from the blacklist as their policies change over time. This is similar to how other blacklists are already being managed by the OECD.
20. The outcome is likely to be similar to that proposed by the current consultation, as territories will be motivated to stay off the blacklist to protect inward investment. Taxpayers would reflect more carefully on using blacklisted jurisdictions within their structures due to the relative decreased benefit and enhanced compliance burden.
21. The benefit of this approach is to
    - Target in a more focused way those jurisdictions where the OECD believes there could be harmful tax competition
    - Decrease significantly the compliance burden for multinational groups, removing the burden from millions of taxpayers and placing it instead onto the few which seek to benefit from profit shifting and also towards the OECD which will need to maintain a central list.
    - Use an existing approach which is well understood. The OECD has used the Blacklist approach well in other circumstances and has resulted in countries changing tax laws to ensure they became compliant and removed from the blacklist. The ultimate aim of the current proposals seems to be to drive jurisdictions towards tax rates above an agreed minimum, so this would be a less burdensome way to achieve the same result. The approach of using a blacklist would make the rules more dynamic and able to react better to evolving business models. Rather than changing the rules, the blacklist criteria could be changed to ensure that jurisdictional tax policy remains appropriate as businesses continue to evolve.

Impact on investment decisions

22. The OECD's timeline for moving forward with its proposals is ambitious. Swift tax policy conclusion typically leads to poorly drafted law that fails to account for the complex reality of modern businesses. This results in unclear legislation, which is then clarified through guidance and regulations once the law itself has been enacted. Uncertainty surrounding the application of law pending the issue of such guidance and regulations (and even following the issue of such guidance) has a direct and detrimental effect on investment.
23. Unless the tax consequences are certain, key investment decisions will be delayed.
24. Translating this to the current consultation document, trying to coordinate Pillar 2 across multiple territories for implementation from a single date seems very challenging. It is inconceivable that all possible challenges will be identified prior to its implementation. This could impact global investment as businesses try to predict what the rules might mean, followed by further uncertainty as disputes ensue.

SPECIFIC POINTS

Minimum Tax Rate

25. The concept of a minimum tax rate on GloBE completely disregards the concept of aligning profits with business substance, which has been the key focus of the OECD in recent years. Pillar 1 Amount A has a similar effect. Alignment of profit to substance is a key international tax principle and any departure should be acknowledged more directly.
26. The consultation has given no indication of the level at which the minimum rate might be set, nor how it might be determined. One approach might be to begin with a low minimum and then to raise it within a set time frame once the system has become established. The level of the rate would also help to clarify how the rules might be applied. For example, a lower rate would affect fewer businesses.
27. We note that in setting a minimum acceptable tax rate, the OECD is essentially determining economic and tax policy for countries around the world. Jurisdictions falling below this rate will be impacted as investment into that country may be reduced in favour of those which do not.
28. This may be problematic for emerging countries which are using lower tax rates or incentives to reduce an entity's tax burden and attract inward investment and increase work opportunities.
29. The consultation paper has not addressed how tax incentives are dealt with. For example in Canada, Scientific Research and Experimental Development (SRED) credits can reduce the effective tax rate (ETR) well below the combined statutory rate of 26-31%. Canada may appear to fall below the minimum tax threshold however SRED have policy objectives beyond just tax such as increasing investment and attracting talent into the Canadian economy. Other countries have similar incentives programs that would also reduce ETRs.
30. Many countries offer 'grant' programs such as investment funding, research and development funding, or for employment. A forced increase in statutory tax rates could be offset by a grant for certain business activities yielding nil economic impact for a taxpayer. By encouraging minimum tax on profits, countries may move to offer other incentives. Tax havens may have limited alternatives. The OECD would need to assess whether these are acceptable and how it would draw the line and also monitor compliance. Grant based incentives are likely to be more subjective, highly administrative and could distort the effect of the minimum tax rate.

31. We observe that those jurisdictions which already have a corporate tax rate below the illustrative rate of 15% used in the consultation are likely to be strongly opposed from the outset.

Global minimum ETR or Foreign minimum ETR

32. Paragraphs 53 and 54 consider the options for how the effective rate of tax might be calculated for each group of companies: by reference to each individual entity, for all entities in the group within a particular jurisdiction, or across all the entities within a group on a wordwide basis.
33. The OECD consultation wants the group to be subject to a minimum rate of tax. The issue is whether and to what extent income and tax paid across different jurisdictions might be combined and what effective tax rate (ETR) this produces. It is this which is then compared with the minimum floor rate.
34. In our view, the amount of blending and the minimum rate which is decided upon must be considered together. Taking the illustration below and a jurisdictional level view, with a minimum floor rate of 15%, entities in countries X and Z would be would be above the minimum, but group entities based in country Y would be below it and penalised.

	Country X	Country Y	Country Z
Tax charge	2.0	2.4	4.0
Accounting income	10	20	25
ETR	20%	12%	16%

35. Following a worldwide blending approach, (2.0+2.4+4.0)/(10+20+25) x100% = 15.27% and the entire group would pass the test. A different minimum acceptable rate set at, say 16%, would mean the entire group failed, while still only entities in country Y failed on a jurisdictional basis.
36. Section 3 is has looked at some of the complications that might arise and has made a valiant attempt at suggesting solutions. We regret that these serve merely to highlight the fundamental complexity which lies at the heart of each of the single entity, all entities in a jurisdiction and also the worldwide group. They are just too complicated and elements of unfairness creep in. The consultation recognises one aspect of this in para 3.5 where it suggests crediting taxes that arise in other jurisdictions against those where the ETR falls short. A more pragmatic approach using worldwide blending would make this unnecessary.

Use of financial accounting standards

37. Accounting standards can differ widely depending on the jurisdiction and the GAAP chosen; the financial statements will show different results which can distort ETR computations.
38. It is not uncommon where there is a foreign parent that US GAAP or IFRS GAAP will be used for reporting in the financial statements and for the audited results, but for local tax reporting local GAAP is used. Further, in some jurisdictions the base from which tax is calculated differs very significantly from the base from which the accounts are prepared. While a consistent approach is desirable, if the results have to be restated using different GAAPs, this will cause an additional administrative burden and also move further away from the principle of simplicity.
39. Also, if accounting income is used as the base, will this required audited statements at the entity level? Paragraph 20 highlights the inherent problem of creating such a granular approach to creating the set of rules to underpin Pillar 2.

> 'It may be difficult for a tax administration to audit the income of subsidiaries that use a different accounting standard than is required in the parent jurisdiction because the auditors may be unfamiliar with some or all of the accounting standards applied by the various subsidiaries. Obviously, the application of different standards to different subsidiaries could produce different results for otherwise similarly situated enterprises. More significantly, however, the use of different accounting standards creates the possibility of distortions arising from transactions between subsidiaries. In addition, it may significantly increase compliance and administration burdens of an undertaxed payments rule if each entity making a payment were required to re-compute the recipient's income according to its financial accounting standards.'

40. In our view a focus on jurisdictions rather than the taxpayer is simpler as there are fewer of them to police. Hence our suggestion of a new jurisdiction Blacklist.

Adjustments: Permanent v Temporary differences

41. Accounting standards have long tried to smooth out the differences between accounting and tax rules for profits by using deferred tax. The concept is not well understood by non-accountants and the approaches suggested in paragraph 34 et seq serve merely to emphasise its complexity.
42. To introduce an element of this into the ETR calculation would make an administratively and complex set of rules unmanageable. Perhaps one approach could be to adjust accounting income only for permanent differences and ignore temporary differences (since by their nature temporary differences will reverse, although the timing of reversal could vary).
43. We are particularly concerned that the administrative record keeping burden of keeping memorandum accounts to track excess taxes and losses, while simple in an academic context, would be onerous and costly in reality.

Carve-outs, thresholds and exclusions

44. We agree that carve-outs based on objective criteria would be simpler to work with than any based on specific analysis of facts and circumstances.
45. The principles for these must be clear and consensus-based.
46. Any 'in/out' threshold should be tested on prior year data, not the current year.
47. There could be rationale for excluding certain sectors, for example, the charity sector (see below) or a collective investment where tax neutrality for a pooled investment vehicle is key to facilitating international investment from multiple territories.
48. We would like to explore a more modern approach to safe harbours than one based solely on tangible assets. As an illustration, if an entity beneficially owns a patent or a loan portfolio, why are its assets 100% irrelevant while basic raw materials are 100% acceptable, other than that they are simple and objective to administer?

Charity sector

49. The UK is unusual in having a mature and well established charity sector and we recommend that a carve-out for charities should be considered. There is a risk that the proposals in Pillar 2 could be applied to any multinational entity (MNE), whether engaged in business activities or not.
50. The OECD's definition of a MNE for country-by-country (CbC) reporting purposes covers any entity with one or more branches or subsidiaries in another territory. Several of the proposals in the Programme of Work set out in Annex B are potentially troubling for charities and other tax-exempt entities:

- an income inclusion rule
- the imposition of a minimum or blended income tax rate
- a tax charge on payments that are deemed to erode the tax base because they are undertaxed or not subject to tax.

51. Where charities operate across borders, they are typically faced with the problem that the host country does not accord them a tax status that is equivalent to the charity relief that they are granted in their home country. Consequently, such groups are likely to comprise a mix of tax-exempt and taxable entities. It would be extremely damaging for countries to apply to these types of charitable operations the new tools that are being designed to counter tax avoidance by MNEs.
52. The Pillar 2 proposals risk damaging the growing markets in cross-border charitable services, grant making and other forms of charitable support.
53. If the concern is that the host country is at risk of its tax base being artificially depleted by payments to a foreign parent charity, the more appropriate remedy might be to levy a withholding tax on targeted payments that complies with the existing principles of international tax policy.
54. The UK currently has legislation in place, sections 259A to 259NF Taxation (International and other provisions) Act 2010, to counter the use of payments with a hybrid character to deplete its tax base, but these include a carve-out for payments that are not taxed in the recipient's hands as a consequence of its charitable status. We are not aware of any charities which have encountered problems in the application of these rules, so we suggest that this approach is suitable for adoption by other countries.
55. In taking forward these rules, care will be needed when defining a recipient eligible for a carve-out because, for example, a "subject to tax" test would be prone to different interpretations by different countries, as noted in INTM162090. Moreover, the threat to disallow tax treaty benefits for payments that are not "subject to tax" would conflict with the policies of a number of States to allow charities recognised by those States to benefit from the treaty limits on withholding tax rates.
56. Applying a minimum or blended tax rate to a group which includes charitable entities is likely to produce an artificial result and risks undermining the home country's policy of granting tax privileges to entities that genuinely pursue charitable activities. This would be the case whether the additional tax is imposed on a charitable parent entity or a taxable subsidiary, since the subsidiary's activities are ultimately intended to fund or otherwise further the charitable activities of its parent.

Carve-out for smaller MNEs and all charities

57. We recommend a deminimis carve-out for smaller MNEs, to include smaller charities. This might take the form of a minimum annual revenue (income plus capital gains) threshold similar to the EUR 750 million threshold for CbC reporting, which would also be likely to take all but the largest charities out of scope of these proposals.
58. It is clear that the consequences of breaching a size threshold under the Pillar 2 proposals would be far more costly for a charity than merely having to file a CbC report.
59. In considering a carve out for smaller MNEs and so also smaller charities, we would then also question why a charity should be penalised on account of its size, which leads to our conclusion that the carve out should apply to all charities.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).