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

Response by the Chartered Institute of Taxation

1 Introduction

1.1 We refer to the public consultation on the *Global Anti-Base Erosion Proposal ('GloBE') - Pillar Two* published on 8 November 2019. This builds on the Programme of Work for Addressing the Tax Challenges of the Digitalisation of the Economy agreed by the Inclusive Framework in May 2019.

1.2 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

1.3 In our view objectives for a tax system should include rules which translate policy intentions into law accurately and effectively, without unintended consequences. The tax system should aim to provide simplicity (so far as possible) and clarity, so businesses can understand how much tax they should be paying and why, and also to provide certainty so that businesses can plan ahead with confidence. It is also important that there is responsive and competent tax administration, with a minimum of bureaucracy.

1.4 We welcome the opportunity to remain engaged with the ongoing debate around global taxation and in this response we set out some thoughts and views on the issues and challenges presented by the Pillar Two proposals. We also suggest some points for consideration around the three technical design aspects of the GloBE proposal described in the consultation document. However, it is not, at this stage, possible for us to engage with all of the detailed questions set out in the consultation document as fully as we consider would be necessary in order to be able to assess whether the proposal could meet all or any of the desirable objectives, set out above, for a tax system. There are too many potential permutations and ramifications which could arise from the open policy and key design questions, including, for example, whether the effective tax rate will be tested on a global basis or jurisdiction by jurisdiction, which entity in the multinational enterprise (MNE) group will pay any 'top up' tax due and what the minimum effective tax rate will be. We believe further consultation is essential as the policy objectives and proposals are refined, and we look forward to opportunities to contribute at such times.

2 Underlying policy aims

2.1 The consultation document reminds us that Pillar Two is aimed at devising a set of rules 'to address the ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or little tax'. We commend the Secretariat for seeking to pull together the different, and sometimes opposing, political objectives that inevitably exist between nation states, overlaid by the global public opinion around these issues. In our view it is very important to continue to seek to build global consensus because we are increasingly facing an international tax landscape of unilateral actions being taken independently by countries.

2.2 The GloBE proposal comprises four components, namely:

1. An income inclusion rule,
2. An undertaxed payments rule,
3. A switch-over rule, and
4. A subject to tax rule.

Broadly, the subject to tax rule complements the undertaxed payments rule and the switch over rule can be viewed as variation which builds on the income inclusion rule.

2.3 Thus, the GloBE proposal is approaching the perceived problem from two different perspectives. It is not clear whether the fundamental principle underlying the proposal is to achieve a minimum effective tax rate for any entity, either in that entity or at shareholder level; or whether it is to allow countries to protect their own tax base from base eroding payments. In our view pursuing one of these aims should be sufficient, as succeeding in that one goal should lead to the other also effectively being addressed. The four component parts of the GloBE proposals could be constructed as to address either or both of these policy objectives, but they will not do so without an upfront agreement on which are the primary goals. Any one of the four components would be difficult and complicated to implement effectively; the added challenge of the GloBE proposal is to address how these rules could be made to work effectively together (and with existing rules and Pillar One), without giving rise to significant levels of double or multiple taxation, and a compliance and administrative burden out of all proportion to the issues which are being addressed.

2.4 The most fundamental question which has not been addressed is how the four components will interact. Clearly they are not intended to apply at the same time, but no decision has been made as to which rule will take priority. We assume that the income inclusion rule would be applied in priority to the other rules, but this has not been confirmed. It would make sense to us if the scheme is intended to work in a similar way to the hybrid rules, in that if the income inclusion rule applies, then there is no need to apply the other rules but, if it does not apply, then a country may apply the undertaxed payments rule (to deny deductions or apply withholding tax). We are also working on the basis that the GloBE rules would apply after existing international and domestic rules, such as controlled foreign companies (CFC) rules and hybrid mismatch rules, and after Pillar One.

2.5 In addition, the consultation document acknowledges that several key design issues remain undetermined, including (as per paragraph 9 of the consultation document) the determination of the tax base, the extent to which the rules will permit blending and the rate, as well as the need for (and design of) carve-outs and thresholds; this is reflective of the fact that the underlying policy aims and objectives are unresolved.

2.6 While all of these questions remain open it is very difficult to comment constructively on the detailed questions presented in the consultation document. Therefore, while we discuss below some of the

complications, pros and cons of the various mechanisms suggested and offer some thoughts on the questions arising from the proposal, it is difficult to comment in a more meaningful way on the detail until the policy objectives are clarified and the options are narrowed.

2.7 We suggest that the next step may be for the focus of the work to be on what is practically achievable around the overall policy objectives, which options could be accepted by individual countries and which could achieve a broad, even if not global, consensus. For example, how realistic is it that a consensus will be achievable around an income inclusion rule that is not very similar to the US regime for taxing Global Intangible Low-Taxed Income ('GILTI')? It is recognised in paragraph 98 of the consultation document that the income inclusion rule would build on the Action 3 recommendations and draw on aspects of GILTI. We suggest, for example, that it would narrow the focus of the ongoing work if a decision could be taken that the US GILTI rules are the starting point for the income inclusion rule.

2.8 In any event, we consider that there are some fundamental principles that the final design of the GloBE proposal should reflect:

- Certainty for taxpayers and tax authorities,
- Minimise administration and compliance costs and complexities, and
- Avoid double (or multiple) taxation

2.9 **Certainty.** With regard to certainty, as with the Pillar One proposals, we recognise that a balance must be struck between accuracy/certainty and simplicity. We would venture to say that the final design of the GloBE proposal will never be simple and that it will be more important to ensure that the rules are clear and certain for taxpayers, even if achieving certainty increases the complexity of the rules. We have a preference for rules that are clear (even if the cost of that clarity is some complexity), as long as this produces an outcome that is expected to be stable into the long term, for example by being binding on tax administrations. Taxpayers would be more likely to accept the compliance costs associated with complex new reporting and calculation rules if they produced more certain outcomes and the investment in compliance systems did not need to be changed again in short succession.

2.10 **Administration and compliance.** The GloBE proposal is likely to result in a significant new administration and compliance burden for tax authorities and taxpayers. For example, it is likely that countries will need to exchange information with other jurisdictions to determine that these rules are being applied correctly and it will be necessary to consider whether that information can flow under existing mechanism or whether new ones will be required. The additional resource required by tax authorities, on top of that required for Pillar One, should be taken into account. The timing of compliance with these rules is also likely to be problematic, with adjustments being required as disputes and other matters around existing rules and arising under Pillar One are resolved. The reallocation under Pillar One will require multilateral agreement between many jurisdictions and is unlikely to be resolved for many years. It is not clear how this will be practically managed, and it may present significant administration and compliance issues for the administration of the GloBE proposal. In our response to the consultation on Pillar One we suggested that the practical challenges around implementing the new rules may require a bold multilateral administrative solution. The complex proposals for Pillar Two confirm this need for a streamlined process; otherwise the system will become unworkable.

2.11 **Double taxation.** The greatest challenge in designing the detail of the rules to implement the GloBE proposal, once the policy decisions which will determine the scope and targets of the new rules have been taken, will be ensuring that the rules for the various components of the GloBE proposal do not interact with each other, or with existing international and domestic rules, so as to give rise to double or multiple levels of taxation.

2.12 To address these challenges and deliver an effective solution there will need to be a high level of multilateral co-operation around priority of rules that are introduced as part of the GloBE proposal; this is recognised at paragraph 6 of consultation document. We would emphasise that this prioritising and interaction of the rules must not only be considered as between the component parts of GloBE, but also in relation to domestic and international tax rules, including CFC rules, hybrid mismatch rules and, of course, Pillar One.

2.13 As with Pillar One enhanced dispute prevention and resolution mechanisms will be essential, including multilateral mandatory binding arbitration. In addition, for the GloBE proposal a key part of dispute prevention mechanisms will be ensuring that a consistent tax base is used.

2.14 It is not clear whether it is intended that all four component parts suggested in the consultation document will form part of the fully developed GloBE solution, as there is considerable overlap between them. In any event, the fundamental challenge will be to ensure that only one rule applies to each structure, recognising that countries may have different preferences as to which rule they would prefer to adopt. It seems to us, for example, that the income inclusion rules is necessarily an alternative to the undertaxed payments rule – if both rules were to apply in respect of a particular structure, there would be double (or more) taxation.

2.15 The same question arises in relation to the interaction of these rules with existing rules. For example, the hybrid mismatch rules will also deny a deduction on payments which may fall to be considered under the income inclusion rule – so if the income inclusion rule gave rise to tax on the receipt of those payments, there would be double taxation. A similar principle applies in respect of all national tax rules which deny deductions; for example thin capitalisation rules.

2.16 We suggest that the interaction of all of the existing rules and the new ones will be extraordinarily complicated. For example, how would a jurisdiction wishing to disallow a deduction know that there was not an effective tax rate being paid? The position becomes more complicated when considering the likely outcomes of Pillar One - how will an effective tax rate be established in respect of a particular receipt in a country if globally MNEs are not necessarily being taxed on a particular receipt in that country – because there has been a re-allocation of an Amount A. We understand that these issues are being considered by the Inclusive Framework.

3 An alternative approach

3.1 The consultation document raises many questions and there is currently no clarity around the overriding policy objectives and desired outcomes. However, in our view, proponents may be significantly under-estimating the potential complexity of the GloBE proposal. Fundamentally, the GloBE proposal is far too complex and we would like to see more work done to ascertain the extent to which new solutions are genuinely needed to address the concerns identified, given the work which has already been done under the base erosion and profit shifting (BEPS) Project.

3.2 Further time should be allowed to see the full impact of the BEPS measures that have been agreed to date and are in the process of being implemented around the world, before it is decided whether this additional proposal is required. In many respects the proposed measures seem to be addressing issues that have already been addressed; for example the CFC rules are designed to achieve the same objective as the income inclusion rule and these, and the work on harmful tax practices, should be permitted time to take effect and the results seen. Even to the extent that the GloBE proposal seeks to achieve different policy aims to the BEPS Project, the extent of these concerns and, therefore, the impact of achieving these policy aims may be diminished

once the BEPS recommendations are fully implemented (and accordingly the cost of implementation should be assessed against these reduced benefits).

3.3 To the extent that further action is required, a much simpler route to achieve the income inclusion rule may be to focus on existing CFC rules, along the following lines:

a. All jurisdictions to agree to have CFC rules (most already do);
b. CFC rules to include an additional minimum tax level test
c. Where income is taxed at a rate below the minimum tax level (using EITHER tax rules applicable to the parent OR subsidiary jurisdiction – to be discussed further) then a CFC charge would arise

3.4 Using existing CFC rules would build on a well-known system rather than adding yet another level of complexity. It would also retain a greater degree of sovereignty, with the need only to agree the extent to which an additional rule is required. The process for this could be similar to the multilateral instrument (MLI) (principal purpose v limitation of benefit) process which has already been undertaken.

3.5 With regard to the rules intended to counter base erosion, we suggest that these are already mostly dealt with by BEPS Action 4 (interest), the MLI, and the ability of countries to impose withholding taxes on dividends, interest and royalties, subject only to their bilateral treaty networks. To the extent that there are any gaps, treaties and domestic rules could deal with this by only allowing reductions in withholding tax if the recipient is not either taxing at a minimum rate itself, or within scope of CFC rules at the level of its shareholders - this would naturally leave more taxing rights to source countries.

3.6 However, we recognise that whilst it is simpler to address the perceived issues as part of existing CFC rules, it still requires questions to be answered on the appropriateness of blending and carve-outs. So, for example, if the policy objective is to allow substance based carve-outs, then we suggest that building on the CFC rules would be simpler (because so many CFC rules already have these). If not, however, then this would be a significant rewrite of many countries' CFC rules (and to use the UK as an example, would void many of the current exemptions). A solution could include a safe-harbour based on global accounts' blended rate, with implementation through augmented CFC rules where this is not met. There will be pros and cons of any particular approach, and the trade-offs of each will need to be considered, but it seems to us that the route currently being indicated by the GloBE proposal is not the only one (and may not be the easiest one) to meet the policy objectives.

3.7 We suggest that there should be an impact assessment undertaken of the combined effects of Pillar One and Pillar Two, and including an evaluation of the impact of the current BEPS measures that are being implemented, in order to inform the policy makers of the scale of the remaining perceived issues that should be addressed. Without this it is not possible to know the scale of the additional concerns and whether it is worth the monumental effort of the devising and introducing these new rules, with the resulting significant and complex administrative and compliance burdens; they may be disproportionate to the issues that remain to be addressed.

4 Behavioural changes and the future

4.1 In addressing the policy challenges and building consensus around the overall aims, it would be useful to consider what a successful outcome would look like. The consultation document says that the GloBE proposal is expected to affect the behaviours of taxpayers and jurisdictions (at paragraph 7).

4.2 We envisage that tax rates will converge and governments may seek to attract investment through subsidising activities outside of the tax line (in potentially less transparent ways), meaning that there could be complex rules with little benefit. We also envisage that Pillar Two is unlikely to cause MNEs to move their intangible assets, opting to bear slightly higher tax on it as a result of it being based in low tax jurisdiction, but a rate that is still lower than if it were moved to a high tax jurisdiction (depending on the minimum effective tax rate).

4.3 Thus we would not expect a significant shift in taxing rights over the long term, other than to parent or sub-holding companies under the income inclusion rule. In fact, the income inclusion rule could be viewed as legitimising the MNEs ability to have intellectual property (IP) where it chooses, making the holding of IP different from other activities where tax is paid where the activity is. In terms of outcome, therefore, we would not expect the GloBE proposal to result in a change in location of IP, although we can envisage that it might impact future investment decisions.

4.4 We can also envisage that this proposal might encourage countries to boost patent boxes, because tax at 10% on these activities is the acceptable norm as a result of the work under BEPS Action 5 on harmful tax practices. The implication of this is that MNEs will pay different rates of tax because they have different types of business – principally IP v other.

5 Tax base determination

5.1 Whilst recognising the limitations and difficulties with determining the tax base by reference to the CFC rules of the shareholder's jurisdiction, it is not clear to us that the use of financial accounts as the starting point for determining the tax base for the GloBE proposal will necessarily be a simplification, unless it is also agreed that there will be worldwide blending (discussed in paragraph 6 below). The use of the financial accounts in this context can be distinguished from the use of accounts as a starting point in a domestic system, which can have huge value in reducing compliance costs. But moving to an accounts basis for the purposes of establishing a consistent tax base across different jurisdictions leads to significant risks of distortions arising as a result of the use of different local accounting standards, which would move away from the level playing field that the OECD is trying to achieve; and it is difficult to see how it would provide any simplification (discussed further below).

5.2 There are significant difficulties with seeking to arrive at an agreed tax base from a set of financial accounts. First, there would need to be agreement on approved accounting principles and, for example, there are already many differences between US and International Financial Reporting Standards (IFRS) rules. Second, not all groups prepare consolidated accounts. Third, the discussion on permanent vs timing differences will lead to a need for many adjustments to the accounting base. Fourth, financial accounts are prepared for different purposes and different stakeholders. This could be a strength as well as a weakness; a strength, because it makes them less open to manipulation as companies prefer to report profits. We also accept that weaknesses, for example, marking to market, can be mitigated by specific adjustments, but overall financial accounts are not (in their raw form) suitable for this tax use. For example, would revaluations and unrealised capital gains have to be reversed? In practice, we would expect (as the consultation implicitly suggests) that separate books and records would need to be kept in any event to satisfy the requirements of the tax rules.

5.3 The consultation document recognises many of the issues and questions that arise from starting with the accounts for these purposes as a result of the differences between accounts and taxable profits and the differences between tax bases, and accounting treatment in different jurisdictions. It seems to us that in many respects starting with the accounts is compounding the problem by overlaying accounting differences onto

tax differences. Clearly, the more adjustments required to accounting figures to get closer to the actual taxable income of each entity, the less of a simplification starting with the accounts becomes. Deciding what adjustments are necessary will ultimately be a political decision as to what is an acceptable level of approximation is accepted as a 'proper measure of taxable income' to achieve the policy aim.

5.4 In addition to the points that will have to be considered and determined that are noted in the consultation document, which we agree with, we have the following additional thoughts:

- Accounting treatment can vary from country to country even when the same accounting standard (say) IFRS is being applied as a result of different interpretations of the accounting standards between jurisdictions.
- Accounting is necessarily subjective to an extent and requires the exercise of judgement.
- It would be more difficult for tax administrations to monitor compliance where the tax base is determined according to local accounting standards in another jurisdiction.
- Other issues around current year provisioning (current example is reflecting State Aid decision in UK company accounts).
- Prior year adjustments will be a significant problem.

5.5 The consultation document considers how to tackle adjustments which may be required to reflect the differences between accounting income and taxable income in terms of both permanent and temporary differences. We agree that this is an appropriate distinction, but would note that it is not always clear whether a difference is permanent or temporary, or, indeed, when a temporary difference becomes a permanent one. In any event, each of the three methods proposed have their difficulties.

5.6 We find the method of 'allowing carry-forward of excess taxes and tax attributes' the most realistic and easily targeted at the specific differences that are intended to be eliminated, although there are disadvantages, for example, around the likely result of paying more tax up front as a result of accelerated capital allowances.

5.7 Using deferred tax accounting seems superficially simple as an approximation for difference between accounting profit and taxable profit, and may be the least burdensome for the majority of MNEs that will already use deferred tax accounting. But there are many facts and circumstances that are not appropriately addressed by deferred tax accounting that would need to adjusted for these purposes, such as intra group transfers (depending on decision regarding blending), acquisitions of new businesses and deferred tax assets.

5.8 Taking an average of the effective tax rate over a number of years is the most conceptually simple, but also the bluntest.

5.9 The consultation document indicates that the solution could involve a combination of each of the three approaches. In conclusion, it is clear that as the detail is addressed, there are challenging issues in each of the approaches suggested in respect of which policy decisions will have to be made, and the result is likely to be one of considerable complexity, although much will also depend upon the decisions made in respect of blending and carve-outs.

6 Blending

6.1 Whilst recognising that the broader approach to blending, the lower an MNE's potential liability to tax under the GloBE proposal will be, this must be balanced against the greatly increased complexity and administrative burden of either jurisdiction blending or entity blending. A worldwide blending approach would reduce

compliance costs, if it is based on consolidated financial statements that have already been prepared for accounting purposes (that is to say that above the line entries in global accounts have effectively already been 'blended', although demonstrably not through amalgamation; for most businesses this will be a completely separate system of accounting applied across a group). In addition, worldwide blending based on accounts might be consistent with reassuring the general public because the amount of corporate income/profits and tax paid globally are relatively easy figures to extract and check/confirm.

6.2 Our understanding is that generally MNEs accounting systems would not lend themselves extracting the information that would be necessary to support jurisdiction or entity blending. Worldwide blending would also alleviate some of the other difficult design issues that would otherwise need to be addressed: for example, around the treatment of intra-group transactions such as dividends and foreign taxes which could be credited without having to determine whether that tax was paid at branch level, head office level or under CFC rules of a third jurisdiction.

7 Carve-outs

7.1 The extent of the carve-outs and thresholds built into the design of the GloBE proposal will be determined by answering the broad policy questions around what the target of the rules should be and what is fair tax competition between countries. That these questions have not yet been resolved means that the GloBE proposal with, potentially, four component parts is currently looking inordinately complicated.

7.2 What carve-outs and thresholds there should be from the rules is a policy question, which is likely to be controversial. For example, as noted, while a carve-out for regimes compliant with the standards of BEPS Action 5 would seem logical, given that the work around harmful tax practices has already arrived at an answer as to what is acceptable tax competition, we accept that to include such a carve-out would 'undermine the policy intent and effectiveness of the proposal', which appears to be derived from an underlying principle that that there should be a 'level playing field'.

7.3 As mentioned above, it is notable that there is currently no decision or consensus around the level of the minimum rate of tax that would apply under the GloBE proposal. Clearly the minimum rate will itself operate as a very significant determiner as to the scope of the rules (and will impact on other issues such as whether the rules are compatible with international obligations, including the EU fundamental freedoms). Therefore, a decision around the minimum rate is likely to drive the further policy decisions around whether other carve-outs are required or desirable.

7.4 We would welcome consideration of a sensible thresholds based on turnover or other indications of the size of the group, and also de *minimis* thresholds, in order to minimise compliance burdens on smaller MNEs (from which little or no additional tax would be collected) and tax authorities.

8 Acknowledgement of submission

8.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the list of respondents.

9 The Chartered Institute of Taxation

9.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

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