2 December 2019

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Introduction

PwC International Ltd on behalf of its network of member firms ("PwC") welcomes the opportunity to share its views in reaction to the OECD Secretariat's Consultation Document ("CD") on Pillar Two of the Work Programme on the Tax Challenges of the Digitalisation of the Economy (together with Pillar One, "the Project").

General Remarks

We note that the CD only covers part of Pillar Two (income inclusion) while mostly omitting equally important elements (the "undertaxed payments" rule, subject to tax rule, or switch-over rule). Which of these elements is the priority rule is critical to understanding and therefore commenting as fully as we would like on the operation of Pillar Two as a whole. The dynamics and effects on business of these rules can, and likely will, be very different. Furthermore, the interaction of Pillars One and Two (the effect of income reallocation under Pillar One on effective tax rates ("ETRs") under Pillar Two, and vice versa) is not addressed. This interaction is also crucial in its effects on tax certainty, business investment, and the level of disputes, just to name three items. Under your general invitation to address other issues not specifically raised, we address these issues below, but only at a level of generality at this time.

The focus of Pillar Two on adding global anti-base erosion and profit shifting ("GloBE") measures to the existing base erosion and profit shifting ("BEPS") framework requires careful consideration, in part, because the many changes in law caused by the 2015 BEPS reports are still being implemented by participating jurisdictions and economic results are just being reported and analysed by member governments. The objectives of Pillar Two go beyond the objectives of the BEPS Project (in that they seek to divorce taxing rights from value creation where the tax outcome of such alignment results in tax rates below an agreed threshold), and it is reasonable to question (i) whether the concerns these new objectives seek to address remain significant in a post-BEPS world, and (ii) if so, whether existing BEPS measures

could be rolled back following implementation of Pillar Two.[1] Pillar Two would add great complexity to the tax system, and taking the opportunity to repeal measures that are no longer necessary could mitigate unnecessary additional complexity.

Further, the accelerated manner in which Pillars One and Two are being considered, agreed upon, and potentially implemented increases the possibility of unintended consequences, enhanced compliance burdens, and future misunderstandings and disputes between countries. Not only intensive stakeholder engagement, but also realistically more time, will be required to ensure that a stable framework can be achieved and that enhanced tax certainty is a concrete product of this Project for both taxpayers and tax administrators. Additional complexity arises from the possibility that not all Inclusive Framework ("IF") members will implement Pillar Two in a consistent manner if a consensus solution is reached.

Some of the concerns that we have previously expressed remain, including the risk of arbitrary taxation, limitations on sovereigns' ability to use their tax systems to incentivize investment or stimulate economic growth, a narrow focus on effective tax rates, and compatibility with existing treaties and EU law. For the latter we refer particularly to the switch-over rule mentioned in the CD. We encourage the OECD to look again at these concerns against the backdrop of this limited CD. We also urge the OECD Secretariat to ensure that it proceeds with a second consultation on Pillar Two once further work has led to a refinement of the income inclusion element and there are more detailed proposals on the other key elements of the pillar and on the interaction with Pillar One. Given the proposed reliance Pillar Two will have on non-tax components, such as the use of financial statements, it is critical that accounting experts have the opportunity to provide inputs on the many technical details. We do not believe that Pillar Two has advanced far enough yet for us to be able to offer complete thoughts on practical implications that will depend on how various aspects of the system are developed.

A Need for Clear Objectives

Finally, we note the CD raises many questions. These questions are important, but it is of even greater importance to clearly articulate the fundamental motivating purpose of Pillar Two (and its interaction with the same in Pillar One). This is critical to properly scoping and shaping the proposal, ensuring the consistency and stability of its application, and the ability of stakeholders to measure progress against defined goals. We look forward to this more detailed articulation in the near future.

[1] It also appears that Pillar Two goes beyond the most recent (2018) OECD report on harmful tax practices, which concluded that a low or nominal rate of tax per se is not a harmful practice provided that the substantial activities requirement is met; authorising the use of coordinated defensive measures (e.g. income inclusion and base eroding payments rules) undercuts the refreshed substantial activities requirement.

Yours sincerely,

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Executive Summary

PwC appreciates being able to provide its perspective on the questions posed in the Consultation Document, as well as other elements of Pillar Two not directly raised therein. The principles, goals, and scope of Pillar Two will need further clarification to allow for detailed stakeholder input as many design elements and important details have not yet been settled. Accordingly, our present comments must, of necessity, be relatively high level. Additionally, without more details, uncertainty increases as does the likelihood of increased tax disputes and disproportionate compliance burdens. A summary of our comments follows.

- As with all aspects of the Project, we believe it will be necessary to articulate the principles underlying Pillar Two. In this case, that will not just involve the articulation of why base erosion and profit shifting must be eliminated, but also why these particular measures are needed. With the original 2015 BEPS actions still in the process of being implemented, we think it is important to explain why it is not premature to have this Project claim to be fixing remaining gaps. More effort is needed to review BEPS implementation — which is still ongoing — and its effects before commencing an ambitious new program that may be duplicative or unnecessary.
- If tax systems are compliant with BEPS and international standards (e.g. compliant IP boxes, non-harmful regimes), then it would be reasonable to consider exclusions from application of Pillar Two. This could be achieved, for example, by reference to a list of compliant regimes or of commonly accepted criteria — either of which could be subject to peer review. We understand this could be complex, but the positive spillover effects of, for example, research and development incentives means in this narrow case that some additional complexity is a price worth paying for societal benefit.
- With reference in the Pillar Two CD to a “race to the bottom,” we note the economic evidence shows no decline in corporate tax receipts and remain concerned that minimum levels of taxation impose an artificial restraint on jurisdictional sovereignty to set tax policies that promote economic efficiency. Countries should have the right to set tax policy to encourage genuine economic activity (subject to internationally agreed norms on ring-fenced regimes, etc.). There is substantial economic evidence that encouraging investment in, for example, research and development, helps both correct market failure and produce beneficial spillover effects. A narrow focus on “low or no taxes” may have detrimental consequences not only for national welfare, but also for global welfare. Where tax competition is driving investment, removal of such benefits may result in additional emphasis and focus on other ways in which countries can attract investment, which may be less transparent and/or more economically distortive.
- An economic impact analysis is critical for all stakeholders – governments, businesses, civil society, and citizens – to clearly understand what effects any proposal will have on tax base, revenue collections, innovation, and investment.
- While we understand the desire for Pillar Two to feature simplified mechanisms to reduce compliance burdens and administrative resources, using financial accounts as the basis for these rules needs to be carefully considered. Financial accounts serve a specific purpose – providing

information to investors or potential investors that is useful in making investment decisions – and that should not be influenced by tax considerations.

- The method of determining the ETR or “blending” is a critical component of any Pillar Two solution. Although each method of blending – worldwide, per-country, or per-entity – involves trade offs, a worldwide approach best meets the goal of establishing a minimum global floor while reducing costly compliance burdens and technical complexity.
- The interaction between Pillars One and Two, which is not addressed in either of the consultation documents, remains a very important part of this Project. Either further time will need to be given to addressing these interactions, or, if Pillar One is held to be a priority, then in the absence of addressing the interaction between the two pillars, the IF should consider postponing further work on Pillar Two until completion of Pillar One.
- It is also critically important to establish the rule ordering of the GloBE elements. We strongly recommend that the income inclusion rule apply before any consideration of a denial of deductions (or withholding) via the undertaxed payments rule.
- We believe it important that Pillar Two also be covered by enhanced dispute resolution procedures because nothing like this, and certainly nothing as ambitious as this, has been tried before on a multilateral basis and increased disputes are inevitable.
- With regard to implementation, the Pillar Two framework must be written with a sufficient level of detail so that countries who decide to apply these rules can do so in a consistent manner, particularly regarding any globally agreed rate.

For further detail, we attach a recent report on design choices for unilateral and multilateral foreign minimum taxes written by three PwC tax colleagues (Appendix 2).

Appendix 1: Detailed points

Use of financial accounts to determine income

General remarks

Although the use of financial accounts may appear to be a helpful starting point in terms of simplicity to determine a consistent tax base for GloBE measures, it is important to understand the purpose of financial reporting and whether that purpose is consistent with the objectives of making tax calculations and determinations. In this respect, it is important to recognize that where the purpose of financial reporting does not align with the objectives of GloBE measures, the use of financial statements may not provide an appropriate foundation for calculating a GloBE tax base or the computation of an effective tax rate.

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments, and providing or settling loans and other forms of credit.[2] Other parties, such as regulators and members of the public other than investors, lenders, and other creditors, also may find general purpose financial reports useful, but the reports are not primarily directed to such groups.[3]

Considering then the purpose of financial statements, their orientation is different than that which would be required for tax reporting. For both IFRS and U.S. GAAP, in order to meet their purpose, financial statements:

- Provide information intended to help investors assess the ability of the company to generate returns – and the timing and certainty of these – as they are the fundamental drivers of the value of the business.
- Emphasize consolidated financial statements that reflect the overall economic substance of the organization rather than the financial statements of individual legal entities which may contain significant levels of intercompany or related party transactions.
- Often use fair value measurement, as this is regarded by some as providing more relevant information in the context of the objectives of financial statements than historic cost.
- Focus on the economic position of a company, not legal form. Accordingly, accounting is concerned with the economic substance of transactions rather than their legal form and therefore the accounting standards under both frameworks contain certain substance over form concepts (such as derecognition of financial assets and liabilities under IFRS 9 or guidance on debt modifications under U.S. GAAP).
- Provide specific accounting models to account for some items that may or may not be appropriate for calculating tax base; for example, acquisition accounting, impairments, intercompany transactions, and equity items.

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[2] *See* U.S. GAAP concept statement OB2; IFRS concept statement 1.2.
[3] See U.S. GAAP concept statement OB10; IFRS concept statement 1.10.

Adjustments to financial statement income

Regardless of the accounting standard applied (IFRS, U.S. GAAP, or otherwise), a local country tax base will often not align with income statement outcomes under a relevant financial reporting standard. This may be as a result of a particular jurisdiction's desire to define the local tax base in a manner that encourages certain taxpayer behaviours. When the objectives of the local tax base differ from the general objectives of the relevant financial reporting, permanent and temporary differences arise between a local jurisdiction's taxable income and the net income determined under relevant financial reporting standards. Permanent differences may include items such as participation exemptions and other gross income permanently excluded from the local tax base, while temporary differences may include differences in the timing of the recovery of the cost of property, plant, and equipment over a period of reporting years.

Proposals that seek to utilize financial reporting accounts as a starting point for the determination of a minimum tax will need to adjust for these permanent and temporary differences. For permanent differences, effective tax rate reconciliation included in consolidated financial statements usually only identify such differences at a level relevant for external reporting. Moreover, while deferred tax accounting requirements of the relevant accounting standards may provide for a reconciliation of existing temporary differences, the specificity of such tracking may vary at a legal entity level, and such requirements are subject to multiple exclusions and other adjustments that are particular to the relevant deferred tax accounting standard(s). To the extent that any minimum tax proposal seeks to utilize such measures to adjust for permanent and temporary differences in application of an appropriate tax base, multinational enterprises ("MNEs") will face additional compliance burdens, particularly if such a proposal is at a separate legal entity level.

To the extent the proposal is not at a consolidated ultimate parent level, the use of financial statements may be even more challenging. Consolidated financial reporting does not focus on separate underlying legal entity accounting for consolidated affiliates. While an MNE may ultimately have separate entity local statutory reporting and tax filing obligations for its affiliates (as a general matter, typically prepared subsequent to the completion of the consolidated financial accounts), such MNEs may not maintain separate accounting records for each legal entity in line with an accounting standard consistent with the global consolidated financial accounts. This may arise as a result of disparate financial reporting systems among legal entities (often as a result of prior acquisition(s)) or a lack of standardization of financial reporting processes on a global basis. Moreover, financial statement materiality and/or "de minimis" reporting thresholds may influence current consolidated financial reporting processes and may not align with an acceptable threshold for application of a GloBE tax base. MNEs will likely incur significant costs, both in the form of increasing personnel resources and expanding financial reporting capabilities, to comply with any proposal that seeks to utilize financial statements as a foundation for determining a minimum tax base, particularly if such proposal applies at a lower tier regional or separate legal entity level.

<u>Addressing temporary differences</u>

The CD suggests three different methods to address temporary differences, each of which may present its own challenges. Under all three approaches, the CD mentions providing time limitations. However, the time limitations would need to be of sufficient length to provide time for the temporary differences to reverse. In some cases, the economic useful lives of assets for financial reporting purposes might be 15 years or more.

The deferred tax method

While the deferred tax method is used for both IFRS and U.S. GAAP, there are areas where consideration would need to be given to determine if adjustments were necessary. For example, not all deferred taxes are recorded through the income statement; in some cases they are recorded through equity. While not all inclusive, consideration would need to be given to whether and how to address the following in connection with the deferred method:

- realizability of deferred tax assets: Under U.S. GAAP, a "valuation allowance" is recorded to the extent that a deferred tax asset does not meet the standard for recognition; while often recognition may be similar under both IFRS and U.S. GAAP, IFRS does not use a valuation allowance but rather records only the amount of deferred tax asset that can be reliably measured and of which the benefit is likely to flow to the entity, in line with other asset recognition tests;
- uncertain tax positions (which can be for both permanent and temporary items);
- deferred taxes from a business combination;
- items that were recorded in equity versus the income statement;
- effect of changes in tax law;
- deferred taxes for equity interests or other temporary differences related to investments in subsidiaries; and
- other exceptions to recognition including initial recognition under IFRS.

For the reasons described above, together with some of the specific GAAP requirements applied to income taxes, in particular deferred income taxes, financial statements may not be a good source for determining ETR (numerator or denominator). Simply using an ETR derived from financial accounts (without adjustment) is likely to produce a number that could vary significantly year-to-year given accounting entries relating to, for example, changes in the realizability (U.S. GAAP) or recognition (IFRS) of deferred taxes or the effect of recording uncertainties related to tax positions taken on tax returns, or the effect of changes in estimates. Additionally, the effect of acquisitions, dispositions, and the accounting for investments when there are minority interests all have the potential to create incremental complexities. For example, if a company owns 75 percent of an entity, the consolidated financial statements will reflect 100 percent of the assets, liabilities, and income of that entity; the 25 percent minority interest is only reflected as an adjustment in equity. These would need to be considered when determining income and ultimately the ETR for the group. These specific GAAP requirements make the task of determining if certain income is subject to a minimum amount of tax challenging. Without adjustments it could likely produce extreme results (i.e. rates greater than 100 percent or negative tax rates). The practice of making

required adjustments to mitigate these potential problems chips away at simplification and might result in the need for a second set of taxable income calculations.

Carryforward and Multi-year Averaging Methods

Carryforward of excess foreign tax credits ("FTCs") helps to ensure that the tax imposed on foreign income more closely approximates the statutory rate of the minimum tax. Failure to do so may result in a higher tax rate than intended by imposing residual tax in a year in which the foreign effective tax rate is measured as below the minimum tax rate, even though the average foreign effective tax rate over a period of years meets or exceeds the minimum tax rate. It may also treat otherwise similarly situated taxpayers differently based on the pattern of tax payment and income realization. To the extent the pattern of tax payment and income realization is attributable to temporary differences, this may create a distorted picture of the firm.

If excess foreign taxes paid in earlier years are not properly taken into account, timing differences may end up resulting in permanent effects, which would undermine the policy objectives of the foreign minimum tax and distort its effect. For example, no carryforward of excess FTCs is allowed under the U.S. regime generally known as "GILTI,"[4] so foreign taxes paid at a rate above 13.125 percent in one year are not considered in a future year when foreign taxes may be less than 13.125 percent. Allowing excess FTCs in high-tax years to be carried forward offsets deflated foreign effective tax rates in subsequent years to reflect more accurately the average foreign effective tax rate imposed over time. This may not provide full relief, however, because FTCs that are carried forward lose value over time as the taxpayer has to wait to realize the benefit. This can be addressed by carry back of excess taxes.

Similar issues arise with respect to carryforward losses because they affect the computation of the average tax rate against which any minimum tax rate is compared. In addition to allowing a carryforward, computing the tax rate at a worldwide level further mitigates concerns about the proper treatment of losses if losses are not correlated across countries and across time.

Using a rolling period for determining the foreign effective tax rate can help smooth fluctuations in the effective tax rate resulting from timing differences between income tax base determinations of countries, but if the period is not sufficiently long, it may ignore the effect of long-reversing temporary differences such as those with respect to real estate, intellectual property, and other long-lived assets.

One particular benefit arising from looking at a multi-year average is minimizing distortions that result from carryforwards, such as the possibility of a smaller minimum tax base (and inflated foreign effective tax rate) in the year the deduction is disallowed and a larger minimum tax base (and deflated foreign effective tax rate) in the year to which the deduction is carried.[5]

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[4] A U.S. shareholder of any controlled foreign corporation must include in gross income for a taxable year its global intangible low-taxed income ("GILTI") in a manner generally similar to inclusions of subpart F income.

[5] This is another suboptimal feature of GILTI. *See* sections 904(c) (preventing FTCs for GILTI from being carried forward, including when the carryforward would arise from shareholder-level losses), and 250(a)(2) (preventing the reduced rate of tax applicable to GILTI from applying to the extent a shareholder's GILTI exceeds its taxable income, such as because of shareholder-level losses).

In summary, we note that it will not be possible to align tax systems perfectly. The more rigid the Pillar Two rules, the greater the difficulties that will be encountered and the greater the likelihood that double taxation will not be relieved.

Blending issues

There are several features of worldwide blending that are instinctively attractive and avoid certain complications arising from jurisdictional or entity blending. First, worldwide blending requires only determining whether items of income (or expense) are subject to tax (or taken into account) in the parent entity jurisdiction. Because the tax base is measured on a worldwide basis, intercompany transactions generally can be disregarded. This can be accomplished by identifying and disregarding intercompany transactions or by allowing the income and expense "legs" of intercompany transactions to offset each other (and disregarding intercompany transactions with only one "leg", such as dividends). This approach also simplifies coordination with consolidation, anti-hybrid, and base-eroding payment rules, and better preserves the value of losses.

Second, worldwide blending is more consistent with the globally integrated nature of modern multinational firms, which operate supply chains across several jurisdictions. Globally integrated supply chains improve efficiency by eliminating the need to replicate stages of production in each market and typically are designed to minimize localized risks to global supply, such as currency volatility, political unrest, labour disputes, natural disasters, and facility disruptions. Multinational firms evaluate the performance of their existing investments, and make decisions about new investments, by considering the entirety of the firm's integrated supply chain, not fragments of the chain taken in isolation. By measuring the tax imposed on the entire integrated supply chain, worldwide blending more accurately determines whether or not a given firm's operations have been subject to a level of tax sufficient to satisfy the policy objectives of a GloBE measure. U.S. policymakers expressly recognized the effect of this modern economic reality in designing GILTI.[6]

Third, because jurisdictional and entity blending likely constrain tax competition more than worldwide blending, they likely create more pressure for countries to attract investment with nontax incentives, which are more often discretionary in nature. Research has identified three fundamental difficulties with discretionary incentives: 1) higher administrative costs; 2) errors in identifying marginal investments; and 3) less transparency and greater risk of corruption or rent-seeking behaviour. Moreover, discretionary incentives are less likely to affect investment decisions than tax incentives. Thus, jurisdictional and entity blending may encourage countries to pursue investment incentives that are both less effective and more costly.

Fourth, worldwide blending results in less volatility in the tax base as long as the differences in the components of the base across countries are less than perfectly correlated (in which case the volatility would be the same). This applies not only to timing differences arising from accounting conventions, such as depreciation, but also to carrybacks and carryforwards arising from current-year limitations on the use of deductions or losses and to differences arising from transactions between affiliates in different

[6] *See* H.R. Rep. No. 115-409, at 389; *see also* S. Prt. 115-20, Reconciliation Recommendations Pursuant to H. Con. Res. 71.

countries. To the extent the tax base is less volatile as a result of worldwide blending, the revenue stream to the countries levying the minimum tax is also less volatile.

Finally, this is not just a theoretical discussion since U.S. policymakers previously considered the issue of blending – i.e. the level at which to structure an income inclusion rule – and chose a worldwide approach after considering the trade-offs among the various options. When U.S. policymakers agreed on a policy framework for the Tax Cuts and Jobs Act, they signalled a clear intent to focus on a comparatively competitive rate with worldwide blending. The framework stated:

> To prevent companies from shifting profits to tax havens, the framework includes rules to protect the U.S. tax base by taxing at *a reduced rate* and *on a global basis* the foreign profits of U.S. multinational corporations. The committees will incorporate rules to level the playing field between U.S.-headquartered parent companies and foreign-headquartered parent companies (emphasis added).[7]

Both tax writing committees acted on the direction provided in the framework document and articulated it as a clear design feature of GILTI. Both tax writing committees clearly and unequivocally expressed their intent that blending of tax attributes should be allowed and on a global basis.[8]

<u>Reliance on country-by-country reporting ("CbCR")</u>

It is important to note that Action 13 does not require financial accounting information for CbCR, and does not align with tax standards either, because the data is aggregated without eliminations, etc. A typical example is intra-group dividends. Consequently, it cannot be relied upon for anything other than its purpose of high-level risk assessment (which is the specific and sole purpose identified in Action 13).

<u>Foreign tax credit regimes</u>

The U.S. experience with GILTI shows that 100 percent creditability for foreign taxes paid must be part of the design. GILTI allows an FTC for only 80 percent of foreign taxes paid or accrued, commonly referred to as a "haircut". Such haircuts may be incompatible with bilateral and multilateral tax treaty obligations, which generally require treaty partners to fully mitigate double taxation.

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[7] Treasury Department, press release, "United Framework for Fixing Our Broken Tax Code", September 27, 2017. The "Big Six" policy makers who authored the framework were House Speaker Ryan, Senate Majority Leader McConnell, House Ways and Means Committee Chairman Brady, Senate Finance Committee Chairman Hatch, Treasury Secretary Mnuchin, and National Economic Council Director Cohn.

[8] The Ways and Means Committee stated, "it is more appropriate to look at a multinational enterprise's foreign operations on an aggregate basis, rather than by entity or by country." H.R. Rep. No. 115-409, at 389; *see also* S. Prt. 115-20, Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 371.

Carve outs

Design of the GloBE proposal must weigh the costs of the administrative compliance burden on both companies and tax administrators against the potential benefits from desired behavioural changes and tax revenue. It is likely that a relatively large number of companies, below some size threshold for which the costs exceed the benefits, could be relieved of the compliance burdens with little impact on the overall revenue effect of the proposal. However, any exclusion creates an incentive to distort behaviour as companies try to remain just below the threshold to avoid application of the tax regime. The risk of distortions is greater if there are a significant number of companies in the vicinity of the threshold. Policymakers should consider the distribution of firms around any potential size threshold to minimize the threat of such distortions. If global as well as per-country thresholds are contemplated, such an analysis would be necessary for each threshold in each country.

The appropriateness of excluding any sector or business activity depends on the goals of the policy. Subjecting some activities to the tax while excluding others increases administrative burdens around enforcing those distinctions. To the extent that some activities are subject to tax while others are excluded, such distinctions may create competitive distortions in favour of some activities or companies at the expense of others, reducing overall societal welfare and raising questions around equity of treatment (which can cause challenges under international agreements or domestic/constitutional law).

To the extent that countries have in place mechanisms that are designed to reduce tax liability to promote broadly desirable nontax policy objectives, the GloBE proposal may wish to take such mechanisms into account. For example, many countries have tax incentives to encourage research and development, in part based on economic literature that finds the social return to research may be substantially greater than its private return. In the absence of such incentives, governments risk companies underinvesting in research. If a minimum tax does not adjust for these tax incentives, it will diminish the effectiveness of the incentives in addressing the failure of the market to provide the optimal level of investment in research. A country may find the tax subsidy intended to go to companies that undertake more of the socially desirable activity instead is transferred to a foreign treasury. Failure to take the tax incentives into account encourages countries to pursue instead nontax incentives, which have the difficulties discussed above.

Participation exemptions are commonly used by countries to avoid economic double taxation of profits of qualifying subsidiaries. To qualify for the participation exemption, countries require the ownership of a minimum percentage of the shares of the subsidiary, and more often than not only exempt ‘active’ income at the level of the subsidiary. Further consideration is needed on the interaction between participation exemption regimes and the various measures under Pillar Two, and on how the ETR is determined if a participation exemption applies.

Other issues

There are a number of associated issues that arise under the GloBE proposal that are not specifically identified for comment in the CD. We address several in this section, and reiterate our desire to more fully

expand on concerns covering the entirety of Pillar Two when a subsequent consultation document is released.

The threshold for control should be set at more than 50 percent; otherwise, minority owners may have difficulty in getting access to documents necessary to comply with the Pillar Two regime. To the extent that the threshold for financial accounting consolidation and tax consolidation differ or that tax consolidation for purposes of Pillar Two differs from tax consolidation for other purposes, taxpayers will need to restate items for purposes of complying with the Pillar Two regime.

Pillar Two will also need to account for tax disputes (e.g. foreign tax redeterminations) that will affect the income inclusion rule. Pillar Two has the potential to create numerous disputes among countries, and the same reasons for enhanced effective dispute prevention and resolution in Pillar One apply to Pillar Two.

As with our comments on the Pillar One Unified Approach, we strongly encourage the IF to release an economic impact analysis publicly, with sufficient time for all Project stakeholders to reflect and give input to IF members, before any high-level political decisions are made. The potential effect of Pillar Two may be substantial for individual countries regarding revenue and innovation incentives, and these should be known for a fully informed debate.

Although not directly addressed in the CD, an important design feature for any Pillar Two framework is ordering how the various rules will interact to form a cohesive system. We strongly believe that the income inclusion rule must be applied before any consideration of the other GloBE elements come into play (e.g., a denial of deductions via the undertaxed payments rule, etc.). Allowing countries to apply a denial of deduction first would be more likely to result in double taxation and administrative complexity, which would be antithetical to the stated goals underpinning the IF's entire digitalizing economy project. Also, there must be clear direction given on how Pillars One and Two will interact with each other. Depending upon the design of the income inclusion rule, there is a high risk that revenue raised under Pillar Two in a jurisdiction overlaps with Amount A allocations under Pillar One, resulting in double taxation. We strongly urge the IF to take an integrated approach so that profits are only taxed once under this radically new system.

Recognizing that the switch-over and subject-to-tax rules form part of the complete Pillar Two strategy, we nonetheless would like to emphasize that these two rules operate in the form of defensive measures, should the primary income inclusion rule fall short in limited instances, and should be designed in a manner to reduce administrative complexity and administrative burdens for both taxpayers and tax administration.

We also take note of the implications the Pillar Two proposal has for legality under EU law. As already outlined in our comments of 6 March 2019 with respect to the Public Consultation Document on Addressing the Tax Challenges of the Digitalisation of the Economy (as per the invitation for public input dated 13 February 2019), attention must be drawn to the compliance with EU law of the rules to be established under Pillar Two. The new set of rules must be in line with the fundamental freedoms of the Treaty on the Functioning of the European Union as well as with secondary law. Since the envisaged income inclusion rule as well as the non-deductibility rule for base eroding payments result in a discrimination of cross-border scenarios, there must be an appropriate overriding reason available so no

breach of fundamental freedoms is given. Considering the mechanism of the envisaged set of rules and referring to the case law as it stands, at the moment the question might be asked whether the anti-abuse doctrine of the Court of Justice of the European Union (CJEU) (e.g. Cadbury Schweppes (C-196/04)) is of direct relevance within this context. However, the application of this doctrine would require that the new rules' scope of application be limited to prevent artificial structures. If such a modification of the Pillar Two rules is not feasible, a new justification reason in the jurisprudence is required. It is questionable whether such a justification could be seen simply in the aim to establish a "level playing field." Based on the current case law of the CJEU it is rather doubtful whether such a justification can be brought forward without the enactment of a new EU Directive reflecting the principles of Pillar Two. Such an EU Directive seems to be required to even allow for the argument to be asserted that Pillar Two is in line with the fundamental freedoms (and it seems unlikely, therefore, that an agreement at the level of the OECD is sufficient to ensure the compatibility with EU law).

Finally, we note the previous work some countries have done regarding policies underlying Pillar Two. For example, the U.S. GILTI regime attempts to tackle perceived base erosion and profit shifting transactions through a system similar to an income inclusion rule. Where countries have already taken steps to address issues covered by Pillar Two, if such regimes generally align with the Project goals, the final requirements of Pillar Two should not require disposal or rewriting of implemented tax policies. To be clear, we do not advocate for Pillar Two to follow all design aspects of GILTI the U.S. has chosen, but because GILTI effectuates the end goals of Pillar Two, that “compliance” should be recognized as in step with Pillar Two.

Appendix 2: Tax Notes Article on Minimum Tax Design Choices

[See article only available in pdf format.]