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

Response from the American Chamber of Commerce Ireland to the OECD Public Consultation Document

December 2019

We are pleased to set out the comments of the American Chamber of Commerce Ireland (the American Chamber) with respect to the OECD Public Consultation Document on the Global Anti-Base Erosion Proposal ("GloBE") - Pillar Two.

The American Chamber represents the Irish-based enterprises that form an important hub for the two-way transatlantic economy between the United States and Europe. The American Chamber is the leading international business organisation in Ireland. Membership includes the top US companies in Ireland, the Irish companies that support them, and the growing number of Irish companies doing business in the US.

The American Chamber continues to be supportive of the evolution of the international tax framework, provided it ensures consistency for global businesses, and supports global trade and investment flows. The American Chamber understands the importance of the OECD's actions on the taxation of the digital economy, given the alternative will negatively impact on business, investment and trade flows (i.e. the unilateral approach being taken by countries currently).

Executive summary

In our earlier (March 2019) response to the OECD's Public Consultation on Addressing the Tax Challenges of the Digitalisation of the Global Economy, the American Chamber made a number of observations in relation to the OECD's proposals for a Global Anti-Base Erosion under pillar two which remain valid.

The American Chamber is concerned at the possible significant impact of such proposals in their current format. The rules are potentially complex, and where implemented by countries in different ways or where countries can unilaterally determine the minimum tax rate to be applied, could lead to significant complexity, double taxation and controversy.

These proposals come at a time when the work from the original OECD BEPS project is still being embedded into national tax systems and tax treaty frameworks. While many global businesses are still in the process of restructuring to ensure compliance with the OECD BEPS measures and EU ATAD measures, these initiatives have helped to resolve many tax anti-avoidance issues. As the OECD and others move forward to develop various design options for addressing challenges from digitalisation for businesses of all sizes and sectors, the focus should be on Pillar I and, where relevant, specific problems of tax avoidance and tax base erosion through abusive practices. The Chamber believes additional measures should only be considered in the future, if there is broad and consensus agreement that original OECD BEPS actions have failed or failed to target specific BEPS issues. This work should include a clear assessment of the impact of the original OECD BEPS project measures.

Overall comments – implementation and design considerations

Fixed rate concerns and impact on wage rates

The consultation document refers to the establishment of a "fixed rate" to establish a floor for tax competition among jurisdictions. Contrary to the premise of the BEPS Project, the GloBE proposal implies that low rates of corporate income tax are a problem, even if the MNE conducts substance-based business activities producing the taxable profits in the low tax jurisdiction. Where the objective of Pillar II is to end tax competition, this should be clearly identified as the objective of this work stream. The use of a fixed rate in the public consultation document without an indication as to what this fixed rate might be is problematic for two reasons, firstly because it contradicts countries' ability to set their own head line corporation tax rates, and secondly due to the body of evidence linking increased corporate tax rates to lower wages[1].

Cross county data and studies conducted in recent years suggest that corporate tax rates are significantly related to wage rates across countries. Estimates suggest that a 1% increase in corporate tax rates leads to a 0.5% decrease in wage rates. Such results hold true for statutory tax rates, effective marginal tax rates and average tax rates[2].

The OECD submitted that corporate taxes are found to be most harmful for growth, followed by personal income taxes, and then consumption taxes[3]. If this has been found to be the case it remains to be seen how a minimum tax etc. would fit in with a growth led approach.

The development of a strong knowledge-based economy is a key consideration for the American Chamber and the facilitation of cross border trade necessarily requires companies to be able to offer attractive remuneration packages. Where such remuneration cannot be offered due to an increase in corporate tax rates, this can only act as a blocker to genuine investment and growth.

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[1] https://taxfoundation.org/labor-bears-corporate-tax/

[2] ibid

[3] Johansson, Å., et al. (2008), "Taxation and Economic Growth", *OECD Economics Department Working Papers*, No. 620, OECD Publishing, Paris, https://doi.org/10.1787/241216205486.

Consistent implementation

To avoid the risk of double-taxation and tax disputes, and as a consensus agreement emerges in relation to the Unified Approach, the OECD must provide much greater guidance to taxpayers on how to comply with the rules as well as tax administrations on how to implement and audit the rules. Detailed guidance is required to be available no later than the effective date, given the novel nature of the proposals and to ensure uniform adoption of the measures. In addition, significant dispute resolution measures will be required to ensure that any new measures can be implemented clearly and consistently such that companies can be provided with some level of certainty with regards to these significant changes.

The American Chamber would also suggest that it is imperative that all unilateral measures outside the OECD treaty framework, already introduced by countries to deal with the issues raised under the BEPS project should be withdrawn before there is any implementation of the measures under Pillar I and II.

Collection mechanism

The American Chamber does not support the use of withholding tax as a means to collect any additional tax due. The use of withholding tax regimes would be particularly challenging, especially for Groups operating across many countries, given the complex registration and refund procedures which may be in place. Any delays to refund procedures could for example potentially lead to liquidity issues for taxpayers.

In addition, following the decision of the CJEU in the Brisal case (C-18/15) it is difficult for EU Member States to impose withholding taxes on payments made to residents of other EU Member States without infringing the freedom to provide services. In that case, the CJEU held that imposing withholding tax on gross amounts made to residents of other EU Member States should not be permitted where similar receipts are taxed on a net basis for residents of the Member State imposing the withholding tax. The decision in Brisal followed a series of similar CJEU decisions including Miljoen (Case C-10/14), FKP Scorpio (Case C-290/04) and Truck Center (Case C-282/07). These cases mean that on an intra-EU basis, withholding tax may not be an appropriate collection mechanism.

Income inclusion rule

With regards to the income inclusion rule it remains unclear what the rationale for same is when the policy document proposes having a common tax base across jurisdictions. However, were such a rule to be introduced, consideration should be given to the interaction with the other rules proposed. In particular, it would be important that the income inclusion rule should take preference over the undertaxed payments rule so as to avoid any double taxation issues which could arise.

Undertaxed payments rule

At present, complex anti-hybrid rules have been or are in the process of being implemented in EU Member States through the transposition of the Anti-Tax Avoidance Directive. Anti-hybrid rules are also present in US tax law. Clearly such rules present a significant challenge both in design and implementation, and the American Chamber would be concerned that the introduction of an additional disallowance for certain payments would create further taxpayer uncertainty. It is also not clear what the policy rationale for such a rule would be, given that base eroding payments with no commercial substance should be addressed by the BEPS Recommendations.

Furthermore, the ongoing work as part of the implementation of the Multilateral Instrument (MLI) has brought about the introduction of a subject to tax rule as well as beneficial ownership and principle purpose tests into the framework of most international tax treaties. The proposal now for an undertaxed payments rule would introduce an additional layer of administration and complexity to these international agreements which may not be required. The interaction of the undertaxed payments rule with existing articles of OECD treaties is unclear. We would therefore recommend that the impact of the changes brought about by the MLI be considered before an undertaxed rule is considered.

The denial of a deduction also leads to a practical issue with respect to the level of knowledge payees are expected to have with regards to the operation of a foreign tax law as they would be required to understand how income derived from their payments is taxed in other jurisdictions in which they operate before considering whether a deduction should be available for domestic purposes or whether a withholding tax applies. Additional complexity will arise when the recipient in the other jurisdiction is a member of a group whereby each entity's ultimate tax liability is not individually determined, e.g. tax consolidation groups, fiscal unity, group relief, etc.

In addition, and as noted above, the use of a withholding tax regime would also be particularly challenging, especially for groups operating across many countries, given the complex registration and refund procedures. Any delays to refund procedures could for example potentially lead to liquidity issues for taxpayers.

Switch over rule

The consultation document outlines the potential use of a switch over rule whereby a residence jurisdiction may switch from an exemption to a credit method where the profits attributable to a permanent establishment or derived from immovable property are subject to an effective tax rate below the minimum rate. Such a rule would present practical difficulties for jurisdictions operating under a territorial tax regime where foreign tax relief is primarily granted by way of exemption as opposed by credit method. While by contrast Ireland operates a worldwide taxation regime and therefore already has developed domestic double tax relief rules, it is unclear as to how territorial regimes would adapt to this switch over rule. Such a rule would likely require the drafting and adoption of new double tax relief rules in case of a switch over which could increase complexity unnecessarily.

Subject to tax rule

With regards to the subject to tax rule, we would recommend that this should be limited in scope to payments to related parties only as it would not be practical for companies to determine this treatment for payments made to third parties.

Determination of tax base and effective tax rate

Use of financial accounts in identifying consistent tax base

The consultation document outlines the potential use of financial accounts to identify a consistent tax base, subject to agreed adjustments for tax differences. The introduction of any GloBE measures will lead to increased complexity and add a further level of compliance burden for MNEs. The use of financial accounting standards offers the most appropriate means of determining the GloBE tax base and the American Chamber would recommend the use of internationally recognised accounting standards, such as IFRS or US GAAP. In addition, consideration should be given to using the current tax liability as per the financial statements as part of the effective tax rate calculation.

Overall, a number of concerns must be raised with this proposal. Firstly, the consultation document suggests that the financial accounts would be adjusted for determining the tax base for GloBE purposes and that the use of financial statements would be a ‘simplification’ over using a parent’s CIT base, but explains that this would be the case only if such financial accounts would be ‘subject to any agreed adjustments as necessary’. This suggests that neither the financial accounts (as prepared under accounting standards) nor the taxable income (as determined under the laws of their local jurisdiction) is appropriate for determining a common tax base. As such, the consultation document is in effect suggesting a third way to calculate the tax base, implying taxpayers must maintain a separate set of books and records solely for GloBE purposes. Such a recalculation will ultimately lead to additional compliance obligations and costs for such groups.

In addition, accounting standards vary in their application such that, a permanent adjustment under one accounting standard might be treated as a temporary adjustment under another accounting standard. Therefore, two companies with the same set of circumstances in a given year may calculate a different amount of taxable income for GloBE. Trying to understand the various nuances in the application of accounting standards would require subject matter experts in multiple accounting standards and would appear to be difficult to implement from a practical perspective. Trying to do this in the timelines suggested is a significant concern.

Furthermore, the consultation document suggests adjusting for timing differences and provides simple illustrative examples in respect of same. However, it should be acknowledged that deferred tax calculations are generally quite complex and we would therefore recommend that deferred tax adjustments should not be used as a method of determining the tax base under GloBE. Otherwise this would unnecessarily increase the compliance costs for companies which is in contrast with the consultation document, which notes:

> *"The GloBE proposal should be designed to achieve these objectives consistent with principles of design simplicity that will minimise compliance and administration costs and the risk of double taxation."*

The use of accounting standards which are applicable to the parent company of an MNE would be the most suitable for the purpose of calculating an initial tax base for GloBE purposes. This would limit the compliance burden for MNEs, many of whom already prepare consolidated financial statements. However, the significant complexity which may be encountered as a result of adjustments between accounting standards as noted above would be a cause for concern held by the American Chamber.

Blending

The consultation document provides for three blending mechanisms to identify whether the effective tax rate aims have been achieved overall. From a simplicity and implementation perspective, a worldwide blending approach would appear to be the most appropriate as opposed to the more granular jurisdictional or entity based approaches. However, we note that the worldwide approach takes account of the foreign taxes paid only and consideration should be given to include the taxes paid in the parent company's jurisdiction as appropriate. In addition, consideration should be given to the use of averaging across a number of years to prevent volatility for companies.

From an EU law perspective, it seems unlikely that it will be permissible to impose a tax on a parent company in an EU jurisdiction on the basis that subsidiaries in other EU jurisdictions are taxed at too low a rate. The decision in Cadbury Schweppes (C-196-04) was emphatic that CFC rules (which are not dissimilar from an income inclusion rule that applies on an entity by entity basis or jurisdiction by jurisdiction basis) infringed the taxpayers' freedom of establishment. The taxpayer's intention to reduce its overall tax liability by establishing the subsidiaries did not preclude the taxpayer from being permitted to rely on the freedom of establishment. The infringement of the freedom of establishment could only be justified by the parent jurisdiction if the rules targeted wholly artificial arrangements. It is difficult to see how an income inclusion rule applied on a country-by-country basis or entity-by-entity basis within the EU would not infringe the freedom of establishment in the same way.

The design of such a worldwide blending should take into account issues which may be caused by the surrender or claim of group relief for losses or other reliefs and tax attributes.

Carve outs and thresholds

The consultation document suggests that certain carve outs and thresholds could be appropriate and should be considered.

The American Chamber is of the view that carve outs for tax reliefs contingent on the presence of suitable substance and physical infrastructure are important. Existing regimes which provide tax relief on capital expenditure which are inherently linked to substance based requirements should, in the view of the American Chamber, be carved out from the application of the GloBE proposals.

Given that the Proposal will result in a significant additional compliance burden for taxpayers, the American Chamber would welcome the introduction of a revenue threshold to exclude smaller Groups. Such a threshold should certainly be set at the €750 million threshold used for the Country-by-Country-Reporting requirements, at a minimum, and consideration could be given to a higher threshold.

The OECD must confirm that the Pillar Two relates solely to corporate income tax and that there should be no impact to other taxes, regulations, or to duties such as VAT and customs.

In addition, the Chamber notes that there are inherent difficulties in applying an income inclusion rule on an intra-EU basis if no carve-outs are available. The decision in Cadbury Schweppes (referenced above) should be taken as clear precedent for the requirement to have substance-based carve-outs where any such rules apply on an intra-EU basis. The absence of a substance carve-out would likely result in income inclusion rules infringing the freedom of establishment.

Furthermore, a considerable amount of work has already been undertaken by multinationals that are subject to the new Global Intangible Low-taxed Income (GILTI) provisions under US tax principles which, in effect, acts as a minimum tax rule similar to those provided for under pillar 2. Companies which are already subject to tax under GILTI should not also be required to calculate an additional tax under any GloBE calculation. However, detailed consideration as to how a GILTI carve out can be made effective will need more attention.

Furthermore, we would recommend that where a consolidated group's effective tax rate, as reported under local GAAP, is above the GloBE rate then that group should not be subject to the GloBE provisions.

Conclusion

We are pleased to set out the American Chamber's observations with respect to the OECD Public Consultation Document on Pillar Two. Our members understand that current initiatives seek to further modernise tax codes to reflect the transformation that digitalisation is bringing to the global economy. The American Chamber remains strongly supportive of multilateral consultation and agreement to address BEPS related matters. However, the objectives of Pillar II are, we argue, not sufficiently clear and premature. The American Chamber believes they should only be considered after BEPS actions and Pillar I are finalised and an impact assessment undertaken.