

# **Submission to the Public consultation on the Reports on the Pillar One and Pillar Two Blueprints**

14 December 2020

## **Submission by the following organisations:**

11.11.11

Alliance Sud

APIT Portugal

Asia Initiatives

Church Action for Tax Justice

Centre national de coopération au développement (CNCD-11.11.11)

Comité Catholique Contre la Faim et pour le Développement – Terre Solidaire (CCFD-Terre Solidaire)

European Network on Debt and Development (Eurodad)

Finnwatch

Global Alliance for Tax Justice

Global Policy Forum

Oxfam

Plateforme Paradis Fiscaux et Judiciaires

Society for International Development (SID)

Sisters of Charity Federation

Tax Justice Europe

Tax Justice Netherlands

Tax Justice Network

Tax Justice Network – Norway

Vienna Institute for International Dialogue and Cooperation (VIDC)

## **1. Overall comments**

Large-scale corporate tax avoidance and injustice are costing governments around the world hundreds of billions of dollars in lost tax income every year and, not least in light of the global Covid-19 crisis, this problem is now more urgent than ever. But unfortunately, we, the undersigned organisations, find that the Inclusive Framework process has failed to deliver solutions to address the fundamental flaws in the international corporate tax system. Not only are the approaches outlined in the Blueprints for Pillar One and Pillar Two far too limited, and would largely maintain the existing system that allows large multinational corporations to avoid paying taxes to *all* governments, but they will create a system that is highly complex and has clear biases towards the interests of the home countries of multinational corporations (residence countries) at the expense of source countries where corporations do business but

are not headquartered. Keeping in mind that residence countries are primarily OECD countries, whereas developing countries, and especially poorer developing countries, are normally source countries, this bias is of great concern.

In the Inclusive Framework negotiations, these highly political issues are buried in hundreds of pages of technical details and complex concepts. This contributes to the severe lack of transparency, making the discussions very difficult to follow and engage in –for the public, the media and civil society organisations, as well as for countries with low or over-stretched capacities. If the proposed measures are adopted, the high levels of technical complexities would also add a heavy administrative burden to an international corporate tax system which is already too complex to function. Furthermore, since the scheme proposed would need a multilateral tax convention binding on all states, there are strong doubts that it would ever become operational.

We also note that there are clear signs that the inputs, concerns and interests of developing countries have not been properly considered in the Inclusive Framework negotiations. For example, as explained below, we do not believe that the proposal put forward by G-24 was given proper consideration. We also note that the Executive Secretary of the African Tax Administration Forum has raised strong concerns that the issues developing countries have raised have not been considered by the developed countries, and that they sometimes feel like “collateral damage” in the negotiations.<sup>1</sup>

For these reasons, we find it hard to see why countries, and in particular developing countries, should have an interest in signing up to the measures outlined in the Blueprints.

In light of the concerning outcomes of the Inclusive Framework negotiations, we reiterate our call for a fundamental reform of the global corporate tax system to be carried out by an intergovernmental body where all countries can participate as equals. As explained below, we find that the United Nations (UN), as the only truly universal body, is the place where such a negotiation needs to happen, and we call for a transparent and inclusive intergovernmental UN tax process to be initiated as a matter of urgency.

In this context, we welcome the growing recognition among governments of the shortcomings of the transfer pricing system and the arm’s length principle. We also welcome the fact that a rapidly growing number of governments recognise the value of taxing multinational corporations on the basis of their global consolidated profits, with taxing rights being allocated between governments based on an agreed formula. We believe that such a system should be introduced as the central approach to taxing profits of multinational corporations, and it should replace the existing transfer pricing rules and the arm’s length principle. This is, in our view, the only way to fulfil the G20’s stated aim of ensuring that “*profits are taxed where economic activities occur and value is created*”.<sup>2</sup>

## **2. Ensuring transparency and participation on an equal footing**

We believe that the **negotiation of new global tax rules** should take place in a forum that allows all countries to participate on a truly equal footing during all stages of the process, serviced by a neutral secretariat. The United Nations is the only truly universal body, and thus we believe that this is the appropriate forum for such a negotiation. While the Inclusive Framework has allowed countries to participate in ongoing discussions, we note that not all countries had an equal say when the mandate for the negotiations was developed. We also find it problematic that participation in the Inclusive Framework is conditioned on countries signing up to the BEPS minimum standards. Lastly, we are concerned by statements by the OECD secretariat suggesting that the commitment to deliver a “*consensus-based solution*” does not entail a commitment to ensuring that all members of the Inclusive Framework agree to the outcome, and that in particular concerns from smaller countries, which are not part of the secrecy jurisdictions network, might be disregarded.<sup>3</sup> This, in our view, does not suggest that the members of the Inclusive Framework are participating on an equal footing.

We also believe that **transparency is urgently needed**, both in relation to international tax negotiations, and in relation to the tax rules in general. Specifically, we believe that:

- Any intergovernmental negotiation about new global tax rules should be open to participation by observers, and negotiating texts should be available to the public. Such transparency is vital for ensuring the accountability of governments when making decisions that impact people all over the world, and this will allow effective participation of civil society organisations, unions and other actors. Furthermore, transparency and participation are vital for creating the public pressure needed to ensure that governments show the level of ambition needed to create a clear, effective and fair international corporate tax system.
- The financial accounts of multinational corporations should be made public. In addition to financial accounts, public country by country reporting should be introduced, and should be integrated into the starting point for determining the tax bases and effective tax rates of multinational corporations. This transparency should apply to all large corporations<sup>4</sup>, rather than be limited to those with a minimum turnover of €750 million, as is the case for the current OECD country by country reporting rules. Unlike the current system of automatic exchange of country by country reports, public country by country reporting would ensure that all governments have access to the information. Furthermore, it would provide citizens, parliamentarians, journalists and civil society organisations with information which is important when assessing the fairness of the corporate tax system. Experiences from the European Union show that public country by country reporting can discourage large-scale corporate tax avoidance by multinational corporations.<sup>5</sup> Lastly, in case the concept referred to as ‘Amount A’ under Pillar One is introduced, we also believe that host countries should be obliged to publish the overall numbers and calculations showing how Amount A has been determined, as well as how taxing rights relating to Amount A have been allocated between countries.

### **3. Pillar One – general comments**

As regards the report on the Pillar One Blueprint, we would like to highlight the following points:

- 1) **The Blueprint has maintained the deeply concerning approach of dividing profits into separate categories and attempting to run two fundamentally different tax systems in parallel.** In essence, the proposal is to introduce a new set of tax rules that will be applied to a yet to be determined share of “residual” profits of a very limited number of multinational corporations, while at the same time maintaining the existing transfer pricing system and applying those rules to all other profits. We believe that such a division will be highly artificial, and that there is no rational basis for segmenting the global profits of an integrated multinational corporation among different lines of business. Furthermore, due to the fundamental flaws in the existing transfer pricing rules, we are very concerned that these rules would continue to be the basis for taxing a very substantial part of corporate profits. At the same time, we believe that the outlined approach will exacerbate one of the most central problems in the international corporate tax system – namely rule complexity. We note that many of the technical challenges raised by the questions in the public consultation document are in fact problems that have arisen due to the chosen overall approach, which inevitably creates complexity.  
Rather than creating an additional scheme to run in parallel with existing international corporate tax rules, we believe that the transfer pricing system must be replaced. It is now widely accepted that fair and effective taxation of multinational corporations must start from their global consolidated profits, and use easy to administer formulaic methods to allocate profits and tax fairly according to where they have real activities. This is the only way to provide certainty for business, and ensure that there is neither double taxation nor double non-taxation, and to restore public confidence in the international tax system.
- 2) **The allocation of taxing rights.** The Blueprint has maintained a strong focus on allocating more taxing rights to “market jurisdictions”, and as highlighted in previous submissions, we have strong concerns about this approach. A study from 2019 by Cobham, Faccio and FitzGerald found that “*reallocation of taxing rights towards “market jurisdictions”, as it is currently understood, is likely to be of little benefit to non-OECD countries.*” In the study, the authors also highlight that a much broader distribution of benefits could be achieved if “*some element of taxing rights is apportioned according to the location of multinationals’ employment, and not only of sales.*”<sup>6</sup> For that reason, while we welcome the willingness to consider the allocation of taxing rights based on an agreed formula, we believe that such a formula must include multiple factors that reflect the real economic activities of multinational corporations, including factors related to the number of employees a corporation has in a given jurisdiction.

- 3) **The concept of “Consumer facing businesses”.** The rules outlined in the Blueprint distinguish between businesses that are “consumer facing” and those that are not. We find it hard to see the value and logic behind this separation and believe it adds new complexity and confusion to the international tax system. Furthermore, we find it hard to understand why a reallocation of taxing rights is needed when businesses are “consumer facing”, but not in other instances.
- 4) **Lack of proper consideration of the G-24’s “Significant Economic Presence” proposal.** We note that the group of developing countries represented by the G-24 put forward a very important proposal in the negotiations under the Inclusive Framework.<sup>7</sup> This proposal had a number of very important elements and advantages, including the fact that it did not divide profits into separate categories, and suggested that the re-allocation of taxing rights should not only focus on the interests of “market jurisdictions”. We do not believe that this proposal was given the attention it deserves during the negotiations in the Inclusive Framework.
- 5) **Mandatory binding dispute resolution mechanisms.** We note with concern that the Blueprint has a strong focus on mandatory binding dispute resolution mechanisms, despite the fact that this continues to be highly controversial. While many OECD countries and multinational corporations are in favour of such mechanisms, strong concerns have been raised by developing countries. We agree with these concerns for a number of reasons. Firstly, we note that existing binding arbitration procedures are shrouded in secrecy, and the public is not able to access information about arbitration cases or their outcomes. Secondly, these procedures often place great power in the hands of a very limited group of “arbitrators”. Thirdly, given the unclear nature of the international corporate tax rules, existing and potential future binding dispute resolution mechanisms will lead to interpretations of the rules that are in many cases highly subjective. We find that the high number of disputes about the international tax rules have to be addressed by creating a clear, fair and effective international corporate tax system – not by introducing new levels of secretive binding mechanisms that enforce unclear and unjust rules.
- 6) **Maintaining the possibility for countries to strengthen their rules.** The problems related to the global corporate tax system require a global solution. However, due to the concerns outlined above, we believe it is important that the outcome of the Pillar One negotiations does not restrict the possibility for countries to introduce measures they consider appropriate to their circumstances to protect their tax base and ensure that multinational corporations pay their share of tax. This includes measures such as alternative minimum taxes, fractional apportionment and taxation of profits from services in the country where they are performed, and, in case of digital services and e-commerce, in the jurisdiction where the customer is domiciled.

#### **4. Pillar Two – general comments**

In relation to the report on the Pillar Two Blueprint, we would like to highlight the following points:

- 7. The proposed rules discriminate against developing countries by giving priority to residence country rules.** We believe that any base erosion protection tax that is introduced internationally should have a balanced allocation of taxing rights between source and residence countries. Furthermore, as we have stressed in previous submissions, we believe that if any hierarchy between different rule systems is introduced, it should give priority to source country rules. This is important in light of the fact that developing countries are primarily source countries. Furthermore, it would reflect the principle that corporations should pay tax where they do business, including in those jurisdictions where they do not have tangible assets nor employees, but where they deliver digital services.

Therefore, we are deeply concerned to see that the approach taken in the Blueprint is the opposite. As explained in paragraph 9 of the Blueprint, the “principal mechanism” proposed is the (residence country based) income inclusion rule (IIR), with the (source country based) undertaxed payments rule (UTPR) being relegated to the role as “backstop”. Although a (source country based) Subject to Tax Rule (STTR) has been added as a complementary rule, it is designed as a standalone treaty provision, which is very unlikely to receive widespread and effective implementation.

- 8. The proposed rules seem highly complex and difficult to administer.**

As illustrated by the numerous and complex questions raised in the public consultation document, the chosen approach results in a high degree of complexity, which will make the rules difficult to administer, especially for developing countries. Furthermore, the complexity of the rules opens up new risks of inefficiency and loopholes.

- 9. It is not clear why such a complex system is necessary.** The Blueprint suggests a hierarchical order of different rules but fails to explain why such a multi-layered approach is necessary.

- 10. The level of ambition.** We see the value of countries developing joint approaches to counteract the “race to the bottom” and protect their tax bases. In fact, we believe such a coalition is urgently needed to create a “race to the top”. However, looking at the current state of the Pillar Two Blueprint, we are concerned that the level of ambition is dropping, and that the (highly secretive) negotiations in the Inclusive Framework are being strongly influenced by the countries and jurisdictions that cater to the corporate tax avoidance industry and lead the race to the bottom. As mentioned above, we believe that allowing observer participation and public transparency in international negotiations are vital for ensuring government accountability and public pressure to keep ambitions high. Furthermore, as with Pillar One, we would stress the importance of ensuring that countries – or progressive coalitions of countries –

continue to have the option of introducing more fair and ambitious measures than what is currently outlined in the Pillar Two Blueprint.

**11. It is positive that the idea of “global blending” has been abandoned.** As pointed out in previous submissions, we believe the Pillar Two rules must be applied on a jurisdiction by jurisdiction basis to prevent multinational corporations from offsetting undertaxed profits in low-tax jurisdictions with profits taxed in other jurisdictions where the tax rates are higher than the minimum. Therefore, we welcome the fact that the Pillar Two Blueprint has taken this approach.

## **Annex: Comments on specific questions raised in the consultation document**

### **Pillar One**

#### ***a. Questions regarding the activity test to define the scope of Amount A.***

As noted above, we believe that the problems with the existing international corporate tax rules relate to the system in its entirety, and apply to all sectors of the economy. Furthermore, we believe that applying special rules for specific types of multinational corporations and business segments, and applying the existing rules for their remaining profits and for all other types, will maintain the current problems with the international corporate tax system while at the same time greatly increasing the complexity. Notably, the concept of ‘consumer facing business’ involves distinctions that open up a number of questions and uncertainties.. This would fail to provide the simplicity and easy of administration called for by tax administrations, especially of poor countries, or the certainty that business seeks.

#### ***b. Questions regarding the framework for segmenting the Amount A tax base.***

We note that segmentations will increase the complexity of the system even further, and make the rules even more difficult to administer. As noted under point 1 above, we have strong concerns with the approach of dividing profits into separate categories and running two fundamentally different global corporate tax systems in parallel.

#### ***c. Questions regarding the development of a loss carry-forward regime.***

We are concerned that a loss carry-forward regime will introduce loopholes in the rules and undermine a system that is already deeply ineffective. Furthermore, as illustrated by the questions in the public consultation document, a loss carry-forward regime introduces a number of technical problems that are not easily resolved.

***d. Questions regarding the scale and relevance of possible double counting issues arising from interactions between Amount A and existing taxing rights on business profits in market jurisdictions.***

This is an example of a complexity that arises from the decision to try to run two fundamentally different international corporate tax systems in parallel. As highlighted under point 1 above, we believe the solution to the problems is to replace the transfer pricing system with one coherent new system that taxes multinational corporations on the basis of their global consolidated profits, with taxing rights being allocated between governments based on an agreed formula.

***e. Questions regarding the development of a process to identify the entities in an MNE group that bear the Amount A tax liability (the paying entities).***

This is another example of a complexity that arises from the decision to try to run two fundamentally different international corporate tax systems in parallel. See the answer to the previous question.

***f. Questions regarding the appropriate profit level indicator for calculating Amount B, and how it should be calculated assuming Amount B is based on a narrow scope.***

We note that the Report on the Pillar One Blueprint states that “*This Blueprint assumes that in-scope distributors are to be identified based on a narrow scope of baseline activities, which is a view shared by a group of Inclusive Framework members. However, there is another group of members, particularly developing countries, that consider the rule will be only be effective in its policy objective if it is broad in scope and wish to explore broadening the scope of Amount B.*” (paragraph 15). With this in mind, we do not see a reason to assume that Amount B would be based on a narrow scope.

However, at the same time, we would like to stress that the problems related to the transfer pricing system go far beyond what can be addressed through the “Amount B approach”. The Blueprint makes clear that the methodology for Amount B would remain within the narrow interpretation of existing transfer pricing rules, particularly the transactional net margin method, which allocates only ‘routing’ profits. While a system based on fixed returns may be relatively easy to administer, it would lock tax administrations into the existing unsatisfactory approach, rather than solve the underlying problems.

***g. Questions regarding the development of an early tax certainty process to prevent and resolve disputes on Amount A.***

Especially given the fact that Amount A will likely include a very limited share of global corporate profits, the “early tax certainty process” outlined in the Blueprint seems to be a very resource-demanding process for tax administrations. The system of self-reporting by multinational corporations, subject to verification by ‘lead tax administrations’, normally their home country, would be difficult or impossible for others to monitor. Keeping in mind the capacity limitations of tax administrations, particularly in smaller developing countries,

we find this concerning. We believe the most important way to prevent and resolve disputes is to ensure that the international corporate tax rules are clear, fair and effective. Unfortunately, as mentioned under point a) above, we find that the concept of Amount A will increase the complexity of the international rules. We do not believe that this problem can be resolved by adding a human resource intensive “early tax certainty process” on top.

**h. *Questions regarding the introduction of new approaches to provide greater certainty beyond Amount A.***

We believe the most important way to address disputes is through prevention, and as stressed above, this can be achieved through the creation of a clear, fair and effective international tax system. Furthermore, as stressed under point 5 above, we have major concerns about the issue of mandatory binding dispute resolution mechanisms.

**Pillar Two**

**i. *Questions regarding GILTI co-existence.***

We believe it is important that the Inclusive Framework negotiations, as well as other tax-related OECD and G20 processes, do not become places where pre-existing domestic legislation already introduced in the United States is “rubber-stamped” as in line with international standards. We note that the GILTI system has a number of important weaknesses, particularly global blending (see point 10), which allows US-based multinational corporations to continue to exploit tax avoidance. International negotiations should require all countries to adapt to the outcomes. This should include the United States, which we also note has played a very dominant role in the Inclusive Framework negotiations.

**j. *Questions regarding carry-forwards and carve-outs.***

The Report on the Pillar Two Blueprint highlights that “*the GloBE rules, as described in this Blueprint, would be more permissive than GILTI, depending also on their final design. These include the carry-forward of losses and excess taxes, a broader definition of covered taxes and a carve-out based on a broader range of tangible assets and payroll.*” (paragraph 26). We see no reason why the Pillar Two Blueprint should open up new loopholes and water down the parts of GILTI that are actually effective, including by introducing carry-forwards of losses and excess taxes. Such rules would both undermine the effectiveness of the system and at the same time increase the complexity.

**k. *Questions regarding simplification options.***

As highlighted above, we believe the Pillar One and Two negotiations should be seen as an opportunity to improve and strengthen the country by country reporting system, including by introducing reporting requirements that support the fight against international corporate tax avoidance; lowering the threshold for which corporations are obliged to report; and introducing publicly available country by country reports. Along the same lines, we do not believe that the current country by country reporting system should function as a “Safe Harbour” in the effective corporate tax rate system under Pillar Two.

In terms of the other suggested simplifications, we find it interesting that the questions in the public consultation document point out the fact that several of these would in fact not be simplifications. Instead, they introduce new complexities and difficulties for tax administrations – which tax administrations have stressed should be avoided. Lastly, keeping in mind the large size and capacity of the multinational corporations that would be covered by the Pillar Two system, we would like to underline the importance of ensuring that the rules are not compromised out of a concern about introducing any new obligations for these very resource-rich tax payers.

#### **l. Questions regarding Income Inclusion and Switch-over rules.**

As highlighted in a question in the public consultation document, there is a risk that the integrity of the IIR could be eroded through the use of passive holding companies at the top of the ownership chain. This risk is related to the complex design of the rules, and as highlighted under point 9 above, we see no need for this complexity.

#### **m. Questions regarding the Undertaxed payments rule.**

As stressed under point 7 above, we are deeply concerned that this (source country based) rule has been reduced to a “backstop” option. If the idea of placing the rules in a hierarchy is maintained (which we do not believe is necessary), we find it crucial that the priority be given to source country rules.

#### **n. Questions regarding the Subject to tax rule (STTR).**

As mentioned under point 7 above, we are concerned about the lack of clarity on how this rule will be further developed and – crucially – widely implemented. Developing this rule as a separate standalone treaty provision, and as a “complementary” option to the other Pillar Two elements, introduces the risk that the STTR will be sidelined. A number of questions about how the rule would work in practice also remain unanswered in the Pillar Two Blueprint.

#### **o. Questions regarding Implementation and rule coordination.**

We note that the complex and multi-layered approach taken in the Pillar Two Blueprint makes the questions regarding implementation and rule coordination more difficult than they would be if a fairer, more straight-forward and effective approach had been chosen.

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<sup>1</sup> FACTI Panel virtual consultation on improving cooperation in tax matters (May 2020). Available at <https://www.youtube.com/watch?v=Dab-hAG91kA> (from 35:00)

<sup>2</sup> G20 (2013), *Tax Annex to the St. Petersburg G20 Leaders' Declaration*, September 2013: <https://www.mofa.go.jp/files/000013928.pdf>

<sup>3</sup> Julie Martin (2019), *Unanimity not required to update global rules for taxing multinational groups*, *OECD's Saint-Amans says*, MNE Tax, 18 October 2019, <https://mnetax.com/unanimity-not-required-to-update-rules-for-taxing-multinational-groups-oecd-s-saint-amans-says-36188>

<sup>4</sup> The threshold for “large corporations” could be set to match the EU definition of a “large undertaking”, as defined in Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN>, Article 3.4. This definition states that: “Large undertakings shall be undertakings which on their balance sheet dates exceed at least two of the three following criteria: (a) balance sheet total: EUR 20 000 000; (b) net turnover: EUR 40 000 000; (c) average number of employees during the financial year: 250.”

<sup>5</sup> Michael Overesch and Hubertus Wolff (2018), *Financial Transparency to the Rescue: Effects of Country-by-Country Reporting in the EU Banking Sector on Tax Avoidance*, 1 July 2018, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3075784](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3075784)

<sup>6</sup> Alex Cobham, Tommaso Faccio and Valpy FitzGerald (2019), *Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals*, October 2019, <https://osf.io/preprints/socarxiv/j3p48/>

<sup>7</sup> G-24 (2019), *Proposal for Addressing Tax Challenges Arising from Digitalisation*, G-24 Working Group on tax policy and international tax cooperation, 17 January 2019, [https://www.g24.org/wp-content/uploads/2019/03/G-24\\_proposal\\_for\\_Taxation\\_of\\_Digital\\_Economy\\_Jan17\\_Special\\_Session\\_2.pdf](https://www.g24.org/wp-content/uploads/2019/03/G-24_proposal_for_Taxation_of_Digital_Economy_Jan17_Special_Session_2.pdf)