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Response To Public Consultation Document Global Anti-Base Erosion Proposal (“GloBE”) - Pillar Two

We take this opportunity to respond to the Public Consultation Document Global Anti-Base Erosion Proposal (“GloBE”) - Pillar Two.

General comments

The Pillar Two proposal is only necessary if the Pillar One proposal and CFC legislation together do not achieve what they are intended to achieve. But a decision should be made for either Pillar One plus CFC rules or for Pillar Two with the scrapping of Pillar One and CFC rules; piling up one set of rules on top of another with the possibility of taxation of the same income in three or more different jurisdictions cannot be the way forward. Pillar Two creates a new taxing jurisdiction on an arbitrary basis (namely the location of the holding entity) rather than where value is created.

Necessity and complexity

In order to thrive businesses need good legislation which is not unnecessary, clear, consistent, as simple as possible and not subject to constant change.

The Pillar Two proposal does not meet all these requirements. If the Pillar One proposal plus CFC rules do not adequately deal with profit shifting with respect to mobile income then those rules are inadequate and should be adjusted or they should be scrapped and replaced by the Pillar Two proposal. Otherwise there is a clear case of overkill and extra complexity with the possibility of income in one jurisdiction being taxed in a second jurisdiction under CFC rules and in a third jurisdiction under these proposals.

The proposal creates a potential additional tax liability even where there is no question of any abuse and will even cover non-mobile income unless there is a carve-out adding to the complexity.

Unrelated entities or entities which do not form part of an MNE will be treated differently under these rules than those forming part of an MNE. Acquisitions and spin-offs can result in sudden changes in treatment.

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The minimum tax and where it is collected

The proposals result in an entitlement to tax a "shortfall" being granted to the jurisdiction of the entity at the top of the structure. This means that the top-up may fall in a jurisdiction which has nothing to do with the activities which have led to the profit. In today's global economy the residence of the entity at the top of the structure may in fact be based on the chance location of one of the founders and would have a different result if the top jurisdiction were elsewhere (for instance, one should consider the case of the top holding entity in a low tax jurisdiction). Furthermore, on an acquisition of the holding entity the tax top-up might suddenly fall in a different jurisdiction. This is not logical and it is difficult to see how this can comply with the "fair" description which today is often considered an essential part of the tax system. This would be alleviated if the "excess" were then allocated and paid to the jurisdictions where the tax levied is below the minimum more across all the members of the group.

A standard "one size fits all" minimum level of taxation does not reflect the fact that some jurisdictions use resources more efficiently than others or that some jurisdictions have a structural deficit even with a relatively high tax rate while others do not, even with a relatively low tax rate. Why should tax revenues effectively be transferred from the latter to the former when arguably a jurisdiction with a structural deficit has a rate of tax which is too low?

Costs

Many of the proposals made by the OECD with respect to Pillar One and Pillar Two result in entities being liable for tax irrespective of whether the entity itself has or can be considered to have made the profit or not. This results in an enormous extra layer of complexity for officers of companies who may be sometimes be personally liable for such taxes, auditors, creditors and others. This surely cannot to the benefit of a large number of stakeholders. This does not minimise compliance and administration costs.

Developing countries

In paragraph 8 the proposal states that GloBE might shield developing countries from pressure to offer inefficient tax incentives but there is no explanation as to how this might be the case. This should be explained.

Comments specific to the operation of the proposal

Irrespective of the points mentioned above we have a number of comments with respect to the operation of the proposal.

Tax base determination

Consolidated profit and intragroup transactions

IFRS accounts are not appropriate in situations where the parent consolidating entity has control but economically a non-100% or even a minority interest in the group entities. It can be subjected to tax on income which it can never receive even if the relevant subsidiary pays out all of its profits as a dividend, since part of those profits will fall to other parties.

The determination of profit at a group level is unnecessarily complex. Assuming the taxes in different jurisdictions cannot be offset against each other why cannot the calculation be made on an entity basis or at least a country by country basis? This also deals better with the issue of profits made on transactions between group entities which should be considered at a jurisdiction level in determining the tax rate but would not be included in the consolidated accounts.

A disposal of an entity in the course of a year will mean that it is no longer consolidated, even if the disposal occurs towards the end of the year. A transfer of entity from one MNE to another will also not be properly covered using IFRS consolidated accounts.

Carry forwards and deferred tax

A carry forward arrangement is complex and, despite the fact that the view has to be taken on certain aspects of the future, a deferred tax arrangement would seem better, also because in the case of most MNEs it would already be calculated and it would be audited. Admittedly, there could be an issue in a year in which the corporate income tax rate is reduced since this would affect the deferred tax liability.

Multi-year averaging will not necessarily give a reasonable result where the results of entities fluctuate substantially.

We do not see why there should be a time limit on a deferred tax approach. If the calculation is done on an entity basis there is also no reason to terminate the situation on a change of ownership of the subsidiary.

A complication may arise on a change of ownership of the ultimate parent because the new ultimate parent (together with its group) may have an entirely different tax profile. This should be limited if the calculations are done on an entity basis rather than a group basis.

Company law

Liabilities can arise for an entity at the top of the structure even if there is no cash flow to pay it. This is particularly the case where there are minority holdings (see comments above) or where exchange control rules apply. This needs to be dealt with.

An additional liability for the holding entity as a result of activities of a subsidiary should under normal arm's length rules be recharged to that subsidiary. This should be a transaction which is not recognised for tax purposes. It will still be necessary to determine how this should be treated from the company law point of view.

Blending

Since tax systems are jurisdiction wide there is some logic in blending being jurisdictional. We believe that this is the simplest and most reasonable approach.

We do not see blending as an alternative for dealing with temporary differences.

CFC rules

The current proposal does not sit comfortably with CFC legislation. Indeed, there will be an incentive for jurisdictions to expand their CFC legislation to get a greater share of the total pie. While these proposals do not operate in the same way as CFC legislation there are many similarities.

It would be unreasonable not to provide a credit for taxes paid in an intermediate jurisdiction against the income of the subsidiary or branch. A real administrative simplification of be achieved if CFC legislation were abolished under these proposals and the "top up" tax allocated across the various group members as suggested above under "General comments". This is perhaps not unreasonable since CFC rules are often aimed to tax income from excess passive assets and arguably such assets should not then be attributable to any one entity in a group because they are not needed for the business as a whole.

Carve-outs

We believe that a carve-out for controlled corporations with related party transactions below a certain threshold does not contribute to a level playing field and adds to the complexity of the arrangements. Furthermore, there is the problem of determining what a related party transaction is. Should this just be for transactions within the group or with other related parties? Do entities get left out whether or not there income is taxed at the minimum rate or not? What happens in the case of adjustments by the tax authorities? It also makes the calculation of a groupwide tax rate much more complex.

Similarly a carve-out on the basis of the size of the group creates different tax treatments for similar situations and complicates any expansion or reorganisation since this may affect the tax treatment of the MNE significantly.

Conclusion

The proposal creates substantial overkill and fails to meet the basic requirements for businesses to thrive. It adds a layer of complexity to existing rules and proposals which themselves should deal with the problem. It creates additional cost and complexity and even non-abusive situations are affected. If the existing rules are inadequate they should be scrapped and replaced by this proposal.

Unless the "top up" tax levied under these proposals is reallocated to the source jurisdictions or at least across the entire group then they do not create a fair system since the location of the jurisdiction which levies the additional tax under the proposal is arbitrary.

Liability issues need to be addressed for entities and officers of entities where taxes are payable even though the income has not been made there.

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