Ernst & Young, LLP
1101 New York Avenue, NW
Washington, DC 20005-4213

Tel: +202-327-6000
ey.com

Building a better working world

02 December 2019

Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
International Cooperation and Tax Administration Division

Sent via email: taxpublicconsultation@oecd.org

Subject: Comments on Public Consultation Document *Global Anti-Base Erosion ("GloBE") Proposal – Pillar Two*

Ladies and Gentlemen:

We appreciate the opportunity to submit these comments on behalf of EY on the public consultation document *Global Anti-Base Erosion ("GloBE") Proposal – Pillar Two* released by the OECD on 8 November 2019. In this submission, we first provide some overall comments on Pillar Two and the GloBE proposal and then provide comments in response to the specific questions raised in the consultation document.

Overall comments on Pillar Two and the GloBE proposal

We believe it is important to begin with some big picture considerations regarding Pillar Two and the GloBE proposal and the need for the agreed GloBE recommendations to reflect clear and commonly understood rules and for processes to be in place to ensure consistent implementation of the recommendations and prevention and resolution of disputes in their application.

Protection of sovereignty

In our March 2019 comments on the initial consultation document on *Addressing the Tax Challenges of the Digitalization of the Economy*, we expressed concern that the Pillar Two proposal outlined in that document could have the effect of eroding the sovereign right of countries to choose the corporate tax rate and features that are best for their particular economic circumstances and their particular tax system. We continue to be concerned about the potential encroachment on sovereignty, particularly as it has become clearer that the focus of Pillar Two is squarely on tax competition among jurisdictions. We believe that the work under Pillar Two must be approached with great caution as it could undermine the OECD's long-

Building a better working world

standing support for the principle that decisions as to tax rate are left to each country and that low tax rates alone cannot be viewed as a harmful tax practice.

As the design work on the GloBE proposal continues, we urge the OECD to ensure that the proposal does not operate to affect the global tax treatment of income that arises from real economic activity in a country, regardless of the level of tax such country imposes on that income. As discussed in more detail below, we believe that the new GloBE system should include an exception for situations involving business substance in a country. Such an exception would be consistent with the work under Base Erosion and Profit Shifting (BEPS) Action 5, under which a low or no tax jurisdiction or regime is not considered to be a harmful tax practice if there is a substance requirement. Providing for a substance-based exception under the GloBE system is critically important in limiting the interference with countries' sovereign rights over the design of their corporate tax systems, including the ability of countries, including smaller and developing countries, to attract real commercial activities to spur economic growth, innovation, technological advancement, and job creation.

Clarity of focus and coordination

We encourage the OECD to provide more clarity regarding the focus and purpose of the work on Pillar Two and to ensure that the GloBE proposal is appropriately targeted. While the initial consultation document described Pillar Two as aimed at addressing "the continued risk of profit shifting to entities subject to no or low taxation," more recent documents and discussions have shifted the emphasis to addressing tax competition among countries. It is important that the objective be unambiguously understood and agreed by all participating countries.

In this regard, it is important to acknowledge that the BEPS project was aimed at concern about base erosion and profit shifting. Since the BEPS final reports were issued in 2015 with recommendations and minimum standards in the fifteen action areas, countries around the world have been implementing these recommendations and standards. It would be premature at this point to attempt to evaluate the impact of that work without allowing the ongoing implementation to fully play out. It would similarly be premature to attempt to design a new set of rules aimed at the same concerns that are in the process of being addressed already.

The fact that the work under Pillar Two is being done simultaneously with the work under Pillar One on new profit allocation and nexus rules and also while the implementation of the BEPS is still ongoing necessarily creates challenges that must be managed. While the three workstreams have different objectives, it is essential that all the work is coordinated so that all the rules are properly integrated. We urge the OECD to develop a process for this necessary coordination as the design work on Pillars One and Two continues.

Building a better working world

Economic impact assessments

As the OECD and the participating countries work to prepare assessments of the economic impact of the proposals under both Pillar One and Two, we urge that thorough analysis be done not only with respect to the tax revenue implications but also with respect to the potential effects of the new rules on investment and economic growth. In addition, we urge that the assessments take into account all the costs associated with the proposals, including the costs associated with increased compliance and tax administration burdens.

With respect to Pillar Two, as discussed below, we are concerned about recent statements that the use of global blending of taxes as a design feature of the GloBE proposal would necessarily require that the minimum rate of tax be set at a higher level than would be required if a jurisdictional approach were used instead. This statement seems to reflect an assumption that there is a specific amount of global tax revenue that must be generated by the new GloBE system. We do not believe that is an appropriate basis on which to make the policy decisions that are required in designing the GloBE proposal. We urge the OECD and the participating countries to take a broader approach in analyzing both the potential economic implications of policy decisions with respect to the GloBE proposal and the economic effects of any decision to implement final agreed GloBE recommendations.

Implementation, peer review, and dispute prevention and resolution

It must be recognized that the work of the Inclusive Framework will not be finished when the design work on the GloBE proposal is completed and a final set of recommendations is agreed. Work also must be done to analyze the interaction of the GloBE proposal with existing treaty obligations, recognizing that modifications to treaty provisions might be required to allow application of the rules reflected in the GloBE proposal. Implementation of the GloBE recommendations will require that countries integrate new rules into their existing international tax systems so that the result is fully consistent with the recommendations. In addition, all countries that choose to follow the GloBE recommendations must apply the operative rules in practice consistent with the recommendations in order to ensure that double taxation does not arise because of inappropriate or overlapping application of the new minimum taxes.

The work conducted through the Inclusive Framework must continue throughout the implementation period and beyond. Ongoing dialogue and some form of review process will be required to ensure consistent implementation and operation of the new GloBE system. In this regard, we believe that it will be appropriate to put in place a workable mechanism for stakeholder input into the review process so that taxpayers can provide information on how the new rules are being applied in practice – and can do so without fear of reprisal and with the legitimate expectation that practices that are not consistent with the agreed recommendations will be addressed promptly.

We also believe that it is essential that effective dispute prevention and resolution mechanisms for addressing the application of the new GloBE system be put in place. These mechanisms will need to work on

Building a better working world

a multilateral basis. The best way to prevent disputes is to ensure that the rules are clear and easy to comply with and administer by taxpayers and tax administrations. Therefore, clarity and precision in all aspects of the design are critically important. As discussed below, in order to avoid different views as to the facts relevant to the application of the GloBE system, we believe that review of the computation of the income base and tax expense must be the exclusive responsibility of the tax authority of the group parent's country of residence. There also should be an effective mechanism for advance determinations regarding application of the new rules, and taxpayers must have real access to this mechanism. Finally, as a last resort, access to mandatory and binding arbitration should be available.

Design development

We appreciate the OECD providing the opportunity for stakeholders to comment on the GloBE proposal as outlined in the consultation document. However, the comments are necessarily high-level given that the outline of the proposal is itself quite high-level. Moreover, there is significant interaction among the key design parameters, which means that decisions made on one parameter necessarily will affect perspectives on other factors. Therefore, we look forward to the OECD and the participating countries continuing this consultative approach as the GloBE proposal is further developed. Consistent with a point we made in our prior comment submissions on this project, stakeholder input on the practical issues and economic and commercial implications of the proposal will be more nuanced, and thus will likely be more valuable, as the approach is fleshed out further and more detail is provided.

Design parameter with respect to prioritization

Recognizing that there is significant interaction among the key design parameters as noted above and that the intention is for the Inclusive Framework to address the matter of the rate to be set as the minimum tax rate only after other design parameters are agreed, in our view prioritization of the rules is a fundamental design element that should be determined early in the design process. We believe that the income inclusion rules must be given priority, starting with the top parent company and then moving down the chain of intermediate holding companies, with the undertaxed payment rules only potentially applicable where there has been no application of the income inclusion rules. The undertaxed payment rules involve significant complexity given the number of jurisdictions and payments that could be involved, while in comparison the income inclusion rules involve just the jurisdiction of the group parent applying rules that could be crafted along the lines of controlled foreign company regimes that are in place in many countries around the world. Moreover, if the undertaxed payment rules were to be given priority, it is not clear whether and how the parent company income inclusion rules could differentiate between income to which the undertaxed payment rules have been applied and income to which there has been no application of such rules. In addition, the deduction denial element of the undertaxed payment rules is punitive in that it effectively results in gross basis taxation, while the parent company income inclusion rules impose minimum tax in a more equitable way. Given the nature of the rules, we believe that prioritizing the income inclusion rules is

Building a better working world

the only way to ensure that the rules are properly coordinated and applied on a global basis without potential double or otherwise excessive taxation.

Deliberative process

Finally, we urge the OECD and the participating countries to devote the time that will be needed to fill in the details of the GloBE proposal in order to ensure that the final recommendations can be implemented and applied consistently by those countries that choose to adopt them. It also will take time to put in place the peer review mechanisms and dispute prevention and resolution processes that will be needed to ensure that the recommendations operate as intended in practice. Continuation of the collaborative and deliberative process within the Inclusive Framework to accomplish this should not sacrificed to unrealistic deadlines.

Comments in Response to Specific Questions Raised in Consultation Document

1. Tax Base Determination

If financial accounting data is to be used as a proxy for a globally consistent tax base, we believe that the accounting standard used in preparing the particular group's consolidated global financial statements should be used for determining the tax base under the new GloBE system. While there are numerous local country financial accounting standards, the two most common accounting standards required to be used in preparing consolidated global financial statements are IFRS and US GAAP. Given the importance of a globally consistent measure for any given taxpayer, it is appropriate to require use of the accounting regime used in preparing consolidated global financial statements rather than any of the various accounting regimes that may be used in preparing local jurisdictional financial data. Such an approach should be consistent with the approach for measuring group profits under Pillar One.

The general trend in recent years has been increasing conformity between US GAAP and IFRS. Moreover, IFRS and GAAP reflect significant similarity in their general principles and conceptual frameworks. Therefore, most material differences between the two standards affect the timing of recognition of an item of income or expense rather than the item's absolute recognition or not. Given the burden that would be associated with identifying and tracking any required adjustments, and the fact that consistency within a taxpayer group is more important than consistency across taxpayers, we believe there should be no requirement to make adjustments to the accounting standard used in preparing the consolidated global financial statements in an attempt to reconcile any differences between the financial accounting standards. The new GloBE system could include guidance identifying specific areas where adjustments may be made, at the discretion of the taxpayer, if the effect of the difference in such area is material for the taxpayer.

It is important to recognize that the preparation of consolidated global financial statements involves many adjustments that are made in consolidation on a global basis and that are not then pushed down to be

Building a better working world

recorded in the financial accounts of particular subsidiary entities. As a result, groups typically do not have entity level financial statements for subsidiaries that fully reflect the accounting standard used for the consolidated global financial statements. Moreover, it generally would not be feasible to accurately allocate global financial statement income to individual subsidiaries within the consolidated group. As discussed in more detail below, this would make it very difficult to use any approach other than global blending of taxes.

Given the complexity involved in identifying, computing, and tracking adjustments to financial statement income, we also urge the OECD to limit any adjustments that are to be required to be made to financial statement income to reflect tax policy considerations in an attempt to more closely align financial statement income with taxable income concepts. To the extent that some limited adjustments are to be required because of material differences between accounting and tax policy, they should be clearly identified and the required adjustments should be based on the tax accounting standard and tax policies applicable in the jurisdiction of the group's parent company.

In computing tax expense for purposes of determining effective tax rate, we believe it is appropriate to use the deferred tax accounting approach as outlined in the consultation document. Deferred tax accounting aligns with the objective of Pillar Two to identify situations where low headline corporate tax rates exist in a jurisdiction. The use of an approach that involves carrying forward excess taxes and tax attributes as described in the consultation document not only would introduce a high degree of complexity but also would inappropriately expand the reach of Pillar Two beyond its purpose of setting a limit on tax rate competition among countries. The use of such a methodology not only would capture headline rate competition but also would sweep in timing differences that are reflected in the local fiscal incentives often utilized by countries such as accelerated depreciation. Further, the use of a multi-year averaging approach as described in the consultation document would not effectively address the impact of timing differences given the long-term nature of many differences.

We believe that it is imperative that the new GloBE system specify that all aspects of the computation of the global income base and tax expense should be subject to audit only by the tax authority of the group parent's jurisdiction of residence. Allowing multiple jurisdictions to audit these computations would create unnecessary administrative burdens on taxpayers as well as the potential for multilateral disputes involving countries seeking to apply overlapping minimum taxes due to computational differences.

2. Blending

We welcome the statement in paragraph 8 of the consultation document that "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." We do believe that the new GloBE system necessarily will involve significant compliance and administration burdens for both taxpayers and tax

Building a better working world

authorities. And we further believe that the choice made with respect to blending is a key design decision in terms of affecting compliance and administration costs and the overall complexity of the GloBE system.

Bearing in mind the significant additional compliance burden that will be created by the new GloBE system, we believe that only use of a global blending rule based on the consolidated financial statement information would make the additional compliance burden and costs manageable. Use of global blending also would make it easier for tax authorities to implement and apply the new minimum tax rules. In addition, global blending would help ensure greater consistency across countries, which is important to avoiding double taxation. Finally, global blending based on consolidated global financial account information best reflects the results of an integrated global business.

As discussed above, for most groups, financial accounting information on an entity or jurisdictional basis in a consistent accounting standard is not readily available. This is because the accounting standard required to be used for global consolidated financial statements is applied only at the global level and the adjustments to meet that standard are not pushed down to the local entity level. Requiring the creation of financial accounting information for the sole purpose of determinations under the new GloBE system would impose on taxpayers the burden of significant additional investments in systems and processes. In this regard, it is important to note that these significant investments would have to be made by all groups simply to determine whether or not the group would be subject to additional tax in any jurisdiction in any year under the GloBE system.

In addition to the significant compliance burdens that would be associated with any approach other than global blending, use of any such approach could lead to additional controversy as a result of multiple sources of information that could be inconsistent and that could need to be reconciled. Disputes among jurisdictions due to inconsistent implementation of the rules would be reduced with the global blending approach. Using global blending – based on a common global framework – would make the new rules easier for the tax authorities to implement and apply on a consistent basis.

The consultation document makes reference to the potential use of country-by-country reporting information in connection with the GloBE proposal. We are concerned about this suggestion as we believe that it would be highly inappropriate to use country-by-country reporting information for any other purposes, including any purposes related to GloBE calculations. As is stated in the final report on BEPS Action 13, country-by-country reporting data was intended to be used as a transfer pricing risk assessment tool containing aggregate information (see paragraphs 24 and 25 of the BEPS Action 13 final report). Because country-by-country reporting does not take into account intercompany eliminations, it necessarily involves multiple counting of some items, which would create distortions if used for any purpose related to the new GloBE system. In addition, because there is little detailed guidance on how country-by-country reports should be drafted and because there are multiple different data sources that are permitted to be used,

taxpayers use various approaches in compiling this information, which means that such reports would not provide consistent information for use for GloBE purposes.

Finally, as noted above, we are concerned about recent statements suggesting that there is a linkage between the deliberations on blending and the deliberations on the minimum tax rate, such that the minimum tax rate would have to be "significantly higher" if a global blending approach is used. This suggests that there is a targeted amount of tax revenue expected to be generated from the GloBE proposal and that maintaining such level of tax revenue is an independent objective of the proposal. We believe that this would be an inappropriate conflation of what should be separate policy considerations. First, establishing such a linkage would impede fair and effective consideration of the policy and administrative issues involved in the design decision with respect to blending. We highlight above the significant administrative issues that would make application of the GloBe proposal on a jurisdictional or entity basis wholly impractical. Real feedback and debate would be hindered if policymakers and stakeholders must choose between administrability and an appropriate minimum tax threshold. Second, we are very concerned that any such revenue target mapping between the choice as to blending and the minimum tax rate would be so difficult as to be essentially speculative. For example, some countries will modify their tax rates in response to the new GloBE system, which will have the effect of lowering the incremental revenue gain from the minimum tax. A revenue estimate that does not appropriately account for such behavior would systematically exaggerate the blending/tax rate mapping. Moreover, because the output of Pillar Two is expected to be agreed recommendations for countries to consider rather than a consensus with full commitment by all countries to implement, it does not seem possible to reliably measure the tax revenue that could be generated by any aspect of the design of the GloBE proposal. We believe that it is important for the OECD to clarify that the policy objectives of the GloBE proposal are not revenue based and that the design decisions with respect to the GloBE proposal should be made based on policy considerations.

3. Carve-outs

We appreciate the prominence given by the OECD in the consultation document to the matter of carve-outs. As noted above, we expect that the compliance and administration burdens for both taxpayers and tax administrations under the new GloBE system will be significant. Appropriate carve-outs will be important in terms of limiting those burdens by ensuring that the GloBE recommendations appropriately target situations that raise the concerns at which Pillar Two is aimed. Carve-outs also can be used to exclude situations where the burden for the taxpayer to comply with the new rules and for the tax authorities to administer the new rules would far outweigh any potential additional tax revenue that could be collected. More fundamentally, carve-outs will help reduce the GloBE system's encroachment on fundamental sovereign rights of countries.

Building a better working world

We believe a series of carve-outs will help achieve an appropriate balance in the operation of the GloBE system. In this regard, we want to stress that in order to achieve this balance, it is essential that carve-outs be clearly scoped and defined so that there is certainty in their application.

As noted above, we believe that there should be a carve-out for any low-tax income arising under a preferential tax regime or in a no or nominal tax jurisdiction in connection with substantial activity. This would be consistent with the work that has been done in connection with BEPS Action 5 on harmful tax practices. BEPS Action 5 shares similar objectives as the GloBE proposal relating to curtailing tax competition. The Action 5 final report sets forth a minimum standard (one of the four BEPS minimum standards), which is based on an agreed methodology to assess whether there is substantial activity within a preferential regime. The Action 5 minimum standard is subject to ongoing peer review to ensure timely and accurate implementation of the standard and thus safeguard the level playing field. All members of the Inclusive Framework have committed to implementing the Action 5 minimum standard. Low-taxed income from regimes and jurisdictions that have passed muster under the Action 5 minimum standard should be excluded from application of the new GloBE system.

As discussed above, setting the corporate tax rate is very much a matter of national sovereignty and can be driven by different and valid domestic political motives. Countries should be able to decide on their domestic income tax policies without interference. To the extent that income relates to and is supported by assets, people, and functions in a jurisdiction, and does not represent income artificially shifted into the jurisdiction, the sovereign policy choice related to rates should be respected. Therefore, we believe that the carve-out for income derived from substantial activity in a jurisdiction should apply without regard to whether the particular regime has been subject to review under Action 5. This would be consistent with the substance exclusion that is contained in many controlled foreign company regimes, including for example the ATAD I controlled foreign company regime which provides an exclusion where the controlled foreign company "carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances"(ATAD I article 2(a)).

In light of the compliance and administration burdens, we believe that it also is appropriate to limit the scope of the GloBE proposal to large groups. Providing a size-based threshold for application of new compliance burdens is an approach that has been used elsewhere, including in connection with the imposition of the new country-by-country reporting under BEPS Action 13. In this regard, we think the country-by-country reporting threshold of EUR 750 million, which the Action 13 final report described as representing "an appropriate balancing of reporting burden and benefit to tax administrations", would be a reasonable threshold for application of the new GloBE system.

In addition, using this threshold would also mean that groups that are within scope of the new GloBE system will similarly be in scope of the country-by-country reporting obligation, and thus existing infrastructure

relating to relationships between countries could be leveraged for the delivery of appropriate information for the application of the GloBE system.

We also suggest that consideration be given to developing a carve-out from the undertaxed payment rules for situations where the level of deductible related party payments made by any entity is de minimis relative to its total deductible expenditures.

In our view, another appropriate carve-out would cover incentive regimes related to infrastructure. Infrastructure projects are by nature immobile, often require large amounts of capital expenditure, and last for significant periods of time. The incentive regimes that are provided for such projects, which are wholly domestic and are used to facilitate large projects with an investment by the country that yields a significant return for the country, would not implicate any question of profit shifting because the underlying activity is immobile. Moreover, there is no policy reason to interfere with countries' choices to make these investments through tax incentives rather than through other non-tax mechanisms like grants. Confirming the global recognition of the importance of such incentives, it should be noted that some tax treaties provide tax sparing credits to ensure that such domestic incentives are not effectively cancelled out with the imposition of foreign taxes. Providing a carve-out from the new GloBE system for such incentive regimes would ensure that they continue to operate as intended.

In addition, we believe that a carve-out should be provided for entities that are accorded special tax treatment based on their character or nature. This includes pension funds, government entities such as sovereign wealth funds, and other tax-exempt entities. It also includes investment vehicles that are accorded special tax treatment in order to ensure tax neutrality, such as collective investment vehicles and real estate investment trusts. Application of the new GloBE system to any of these entities would not respect the treatment accorded such entities under domestic tax law and tax treaties and would not further the underlying aims of the proposal.

With respect to investment entities, we would further note the appropriateness of incorporating in the new GloBE system the country-by-country reporting rule which specifies that the reporting group should not include an investment entity if the accounting rules instruct that the entity not consolidate with its investee companies (e.g., because the investment entity should instead report fair value of the investment). Such investment entities also should not be considered to be part of a group for purposes of the application of the GloBE system to the group.

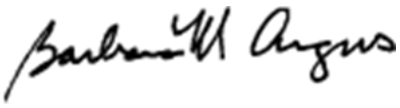
*****

Building a better working world

We welcome the opportunity to discuss these comments in greater detail and to continue to participate in the dialogue as the OECD and the participating countries advance the work on this important project.

If there are questions regarding this submission, please contact me at +1 202 327 5824 or barbara.angus@ey.com.

Sincerely,



Barbara M. Angus
EY Global Tax Policy Leader