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## Reports on the Pillar One and Pillar Two Blueprints

### Response by the Chartered Institute of Taxation

#### Executive Summary

While we continue to believe that clearer policy principles need to be articulated, we recognise the need for a global consensus and support the work towards a multilateral solution which is based around a reallocation of taxing rights based on profits (Pillar One) and completion of the work addressing the issues identified by the G20/OECD BEPS project (Pillar Two). We welcome the progress that is reflected in the Blueprints. It is also clear that significant hurdles remain and that the path to political agreement around the outstanding issues faces many challenges. It is also clear that the new rules will be immensely complicated. They will result in a very significant additional administration burden for tax administrations and a very substantial for all (and unprecedented for many) additional compliance burden for large multinational enterprises (MNEs).

The further work required to reach an agreement of the rules for Pillar One and Pillar Two should focus on the practicalities of any agreed solution and ensure that the solutions result in a set of new rules which is proportionate to the intended objectives, which we recognise include building an increased trust in the international tax system itself. Every opportunity should be taken to simplify the rules, and take businesses which will not be significantly affected (that is to say the amount of additional tax payable will be zero or minimal), nor directly targeted, out-of-scope.

In addition significant demands are proposed on the financial reporting and accounting systems of MNEs. The cost and complexity of adapting reporting and accounting systems to generate different figures from those produced for the purposes of the business should not be underestimated.

The intention is to reach agreement by mid-2021. The revised timeline still seems ambitious. We suggest that a phased approach is considered, whilst recognising that time taken to implementation must be balanced against the large number of individual and jurisdiction-specific rules aimed at the digitalised economy which are increasingly being introduced and becoming effective in a number of countries.

It also remains as important as ever that the solutions address issues around double (or multiple levels of) taxation and contain robust and effective dispute resolution mechanisms.

## Part One: Introduction and key points

### 1 Introduction

- 1.1 The Reports on the Pillar One and Pillar Two Blueprints were published on 12 October 2020, together with a public consultation document setting out questions for public consultation. We welcome the continued work by the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) seeking to develop a solution to the tax challenges of the digitalisation of the economy and the progress towards a consensus-based, long term reform of the international tax system.
- 1.2 We remain supportive of this initiative; reaching global consensus is important because we are increasingly facing an international tax landscape of unilateral measures (and retaliatory actions) being taken independently by countries, which lead to less alignment of tax bases globally, resulting in double taxation and a significant compliance burden for businesses and, consequently, stifling economic growth and innovation. Against the alternative, we support the work towards a multilateral solution which is based around a reallocation of taxing rights based on profits (Pillar One) and completion of the work addressing the issues identified by the G20/OECD BEPS project (Pillar Two). We welcome, therefore, the progress that has been made and which is reflected in the Blueprints. However, it is also clear that significant hurdles remain and that the path to political agreement around the outstanding issues faces many challenges. It is also clear that the new rules will be immensely complicated. They will result in a very significant additional administration burden for tax administrations and a very substantial for all (and unprecedented for many) additional compliance burden for large multinational enterprises (MNEs). It also remains as important as ever that the solutions address issues around double (or multiple levels of) taxation and contain robust and effective dispute resolution mechanisms.
- 1.3 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 1.4 In our view objectives for a tax system should include rules which translate policy intentions into law accurately and effectively, without unintended consequences. The tax system should aim to provide simplicity (so far as possible) and clarity, so businesses can understand how much tax they should be paying and why, and also to provide certainty so that businesses can plan ahead with confidence. It is also important that there is responsive and competent tax administration, with a minimum of bureaucracy.
- 1.5 The Blueprint for Pillar One, in particular, builds on the profound ideas developed by the Inclusive Framework over the past year or so that challenge the existing principles that underpin the current international fiscal philosophy and which, if adopted, would result in considerable upheaval within the international tax system and inherently risk undermining the entire framework by moving away from the arm's length principle. In our view the proposals still do not set out a coherent vision of the principles underpinning the solution to address the challenges that have been identified; we discussed the basis, rationale and principles underlying the 'Unified Approach' in more detail in our response to the OECD in November 2019. We recognise that the lack of consensus at a political level as to the how the challenges should be addressed have resulted in a proposal that seeks to address the impact of several different challenges simultaneously (which may not be pulling in the same direction), meaning that the proposals are not underpinned by a unifying principle. We continue to believe that clearer policy principles need to be articulated; our concern is that without a clear underlying principle, the partial move to a formulary (or partially formulary) system will be inherently unstable.

- 1.6 We suggest that the further work required to reach an agreement of the rules for Pillar One and Pillar Two should focus on the practicalities of any agreed solution. It must be recognised that the scope and detail of these proposals is vastly complicated and will create an enormous administrative burden for tax administrations and MNEs alike. The aim of future work should be to minimise these burdens to the greatest extent possible, and ensure that the solutions result in a set of new rules which is proportionate to the intended objectives, which we recognise include building an increased trust in the international tax system itself.
- 1.7 We note that intention is to bring the process to a conclusion by mid-2021. We welcome the additional time being taken from the original commitments to deliver a consensus-based solution by the end of 2020. In our view the revised timeline still seems ambitious. In particular we would urge caution around the timetable for implementation of any new rules, whilst recognising that time taken to implementation must be balanced against the alternative prospect of a large number of individual and jurisdiction-specific rules aimed at the digitalised economy which are increasingly being introduced and becoming effective in a number of countries.
- 1.8 We set out below our key points in relation to Pillar One and Pillar Two. Part Two of this response addresses the detailed questions in the public consultation document in relation to Pillar One. Part Three below addresses the detailed questions in the public consultation document in relation to Pillar Two. Abbreviations and acronyms used in this response have the same meaning as in the Blueprints.
- 1.9 The CIOT would like to take part in the virtual consultation meetings scheduled for mid-January 2021.

## 2 Key points: in relation to Pillar One and Pillar Two

- 2.1 **Practicability:** by this we mean the difficult balance between simplicity, certainty, fairness and proportionality. The proposals in the Blueprints are very complicated and, as noted above, the new rules will create an enormous additional administrative burden for tax administrations and compliance burden for MNEs. Clearly the global solution to the many challenges being addressed will not be simple. The fact that there are so many facets to the aims of different countries inevitably leads to further complications. However, every opportunity should be taken to simplify the rules as much as possible, and take businesses which will not be significantly affected (that is to say the amount of additional tax payable will be zero or minimal) out-of-scope.
- 2.2 In our view the proposals for the Pillars are too complicated. Resolution around some of the outstanding issues around, for example, the scope of Pillar One and the application of safe harbours, may allow for some of the complexities to be removed, if these cease to be relevant as the proposals develop further. Similarly, agreement on the thresholds which will apply may lead to simplification in some areas, or a more proportionate result for MNEs. In addition, consideration could be given to more safe harbours which take businesses that are not significantly affected nor directly targeted out-of-scope. The simplification options presented in the Blueprints are discussed further below but, generally, we suggest that these options should be taken.
- 2.3 Simplification of the rules will also minimise the administration and compliance costs for tax administrations and MNEs, as well as reducing the areas where disputes could arise.
- 2.4 However, in a drive for simplicity, it is recognised that a balance must be struck between accuracy/certainty and simplicity. We would venture to say that a long term solution to the challenges being addressed will never be simple and that it will be more important to ensure that the rules are clear and certain for taxpayers, even

if achieving certainty increases the complexity of the rules. We have a preference for rules that are clear (even if the cost of that clarity is some complexity) over a simplified position which relies on interpretation and guidance. At present, the proposals achieve neither objective nor a balance of the two – they are extremely complicated and in several cases could result in outcomes that are not aligned with the policy objectives.

- 2.5 **Mandatory binding dispute resolution:** as we noted in our previous submissions to the OECD in respect of the Pillars in 2019, effective dispute prevention and resolution mechanisms will be critical to the success of the new rules and to achieve tax certainty. Robust mechanisms will be required to prevent double (or multiple levels of) taxation and also to ensure that tax administrations and MNEs can achieve certainty as to the amounts of tax that are due. We welcome the emphasis on mandatory binding dispute resolution to achieve tax certainty in the Blueprints and the work done around achieving tax certainty in respect of Amount A, in particular. We strongly support an approach that that countries signing up to the new taxing rights must also sign up to mandatory multilateral binding dispute resolution for all aspects of the new rules.
- 2.6 **Implementation:** a roadmap for implementation of the pillars should be developed. We suggest that the next phase of work by the Inclusive Framework should continue to focus on the practical steps that are required to be taken in order to implement an agreed multilateral solution. We note and welcome the consideration of this has already been undertaken. The ambition set out in the Blueprint for Pillar One is that *'a new multilateral convention would be developed to implement the solution, recognising that it would offer the best and most efficient way of implementing Pillar One'*; and in the Blueprint for Pillar Two *'the development of model legislation, standard documentation and guidance, designing a multilateral review process if necessary and exploring the use of a multilateral convention, which could include the key aspects of Pillar Two.'* is envisaged. The steps that are required to realise these ambitions are considered in the Blueprints.
- 2.7 We agree, broadly, with these approaches for implementation. However, it is also necessary to address more detailed aspects of implementation; such as questions around how many countries must agree to the proposals, have agreed the wording of the multilateral convention and standard documentation etc., have signed up to a new multilateral convention, have this and necessary domestic legislation in force and have repealed any unilateral digital services tax. A roadmap could set out the steps and requirements that are required to be in place before the new taxing rights can go 'live'. Recognising that multiple taxation is in fact the aim of Pillar Two, *unintended* double taxation arising as a result of its application is not expected to be dealt with through any multilateral convention; clarity over the rules and ensuring that they do not apply to businesses already suffering tax above the minimum rate are thus even more important here.
- 2.8 It is clear that the implementation of the Pillars will require significant resource from the OECD and national tax administrations, as well, of course, from MNEs. Members of the Inclusive Framework should be encouraged to commit to providing the additional resource that will be required.
- 2.9 We also suggest that consideration is given to a phased implementation. The aim would be to impose the compliance burden on only the largest MNEs, at least initially, and to reduce the administration burden on tax administrations, allowing experience and knowledge of the new rules to develop and the necessary resource to be built up. This could be achieved by imposing a much higher threshold for global revenue than the €750 million envisaged for a number of years. The table in paragraph 181 of the Blueprint for Pillar One indicates that a threshold for global revenue of €10 billion would bring 350 MNEs within scope of the suggested activities. Dealing with this smaller number of MNEs for the first, say, five years of the operation of the new rules may be sufficient for the resources of many tax administrations. It should also be considered whether a 'trial run' could take place between some tax administrations and taxpayers before the rules enter

into force, given how difficult and time consuming it will be to change the multilateral convention once it is in effect.

- 2.10 We mention this in the context too of the COVID-19 pandemic. Whilst this pandemic arguably makes the need for a solution even more compelling than when it was first considered, as stated in the cover statement by the Inclusive Framework on the Reports on the Blueprints, the pandemic also means that tax administrations will already be stretched, to differing extents, as a result of it.
- 2.11 The alternative to the activities-based test discussed in paragraphs 165 to 169 of the Blueprint for Pillar One, described as a safe harbour basis, operating on an elective basis could also be considered for a limited number of years. This alternative could operate as a pilot or trial phase for the new rules by those MNEs that elect to avail themselves of the Pillar One safe harbour envisaged.
- 2.12 **Existing unilateral tax measures:** It is our view that a condition of benefiting from the new taxing rights under the Pillars should be the repeal of unilateral measures, such as digital services taxes. Having DSTs and the Pillars operating simultaneously will be both highly complex and have potentially very significant negative impacts on business and investment. At the very least in the meantime, covered taxes should include DSTs.
- 2.13 **Financial reporting and accounting systems:** significant demands are proposed on the financial reporting and accounting systems of MNEs to arrive at figures required for the application of the Pillar One and the Pillar Two rules. In addition, the figures required for the various computational elements of the Pillars are often different. The cost and complexity of adapting reporting and accounting systems to generate different figures from those produced for the purposes of the business should not be underestimated. In many cases the requisite data will not currently be tracked at all so it is not merely a case of reconfiguring existing systems and could require real business change in order to collect it.
- 2.14 As part of the overall drive for simplification of the rules, we suggest that it is very important that the accounting requirements are as flexible as possible and permitted to work as closely as possible with MNEs existing systems. In many cases elements of optionality to various approaches may help to address this issue, to accommodate the huge variety of different organisational business structures.
- 2.15 This issue is discussed further below where relevant.

### 3 Key points: specific to Pillar One

- 3.1 **Double counting and double tax relief:** As we discuss in more detail in our response to Chapter VII of Pillar One, there are two separate issues with regard to double counting: double taxation in the residence jurisdiction (to be resolved by exemption or credit) and double taxation in the market jurisdiction (double counting). In our view the current proposals do not sufficiently deal with these issues to remove the risk of double taxation to a sufficient degree.
- 3.2 **United Nations suggested new UN Model Article 12B:** we note that there have been discussions within the UN and, in particular, its Subcommittee on Tax Challenges Related to the Digitalisation of the Economy. This Subcommittee has considered a new Article 12B for the UN Model. This new article would seek to address similar issues to those being considered by the Inclusive Framework. As mentioned above, our preferred solution to the challenges arising from the digitalisation of the economy is a multilateral, global solution which negates the need for unilateral measures by jurisdictions. Similarly, an alternative approach to the same

issues arising from the UN could result in issues around less alignment of tax bases globally, double taxation and increased compliance burdens for businesses. While we do not comment on or express a preference for the policy outcomes of the UN proposals vs the OECD proposals, each will face similar challenges and we do not consider separate systems to be an optimal solution.

#### **4 Key points: specific to Pillar Two**

- 4.1 **Proportionality:** The design of the GloBE rules should ensure that the end result is a proportionate regime with regard to its intended objectives, which we understand to be targeting of undertaxed profits. The finally agreed regime should take into account the compliance burdens and double tax risks, as well as the impact of BEPS measures that have already been implemented. The proposals in the Blueprint for Pillar Two do not achieve this.
- 4.2 **Accounting and deferred tax:** As mentioned above, the cost and complexity of adapting MNEs' reporting and accounting systems to produce the figures required for the current Blueprint proposals will be significant. In our view, the proposals for both Pillars should seek to simplify the accounting for businesses as much as possible. In particular, for some businesses the inability to utilise deferred tax accounting as a basis for their ETR calculations will be detrimental and will have practical implications, which are discussed further below.
- 4.3 **GILTI:** The proposals must be implemented on a consistent basis for all jurisdictions if they are to achieve their intended objectives and be fair, proportionate and relatively straightforward. In this respect, in particular, we suggest that the effects of GILTI grandfathering (and coexistence) on the overall implications of Pillar Two, and ensuring that there is a level playing field, warrant further consideration. We discuss this further below.
- 4.4 **Subject to tax rule:** As a stand-alone gross basis tax, the STTR sets an unwelcome precedent. Gross basis taxes generally have negative impacts (and compliance costs) and often give rise to a very high effective rate of tax. This would be contrary to the objectives of the GloBE proposals.

**Part Two – Report on Pillar One Blueprint – public consultation questions****1 I The activity test to define the scope of Amount A.**

- 1.1 The Blueprint sets out that the new taxing right established through Amount A will bring in MNE groups that fall within scope based on an activity test and a threshold test. The activity test is based around two types of in-scope activities: automated digital services (ADS) and consumer-facing businesses (CFB). We recognise that although the scope is not yet agreed, it is likely to be wider than only highly digitalised businesses.
- 1.2 Broadly we find the general approach – with a positive list and a negative list – to define businesses within scope as helpful and clear. The various proposed exclusions from scope are strongly supported.
- 1.3 However, the approach requires a business to categorise its activities, and, more specifically, the revenues (and then the profits) arising from them, as either ADS, CFB or out-of-scope in order to determine Amount A. This approach is likely to give rise to significant challenges for many businesses whose financial reporting and accounting systems produce data that does not align with the categories of ADS and CFB activities as defined. This could be, for example, because a business is organised along divisional, rather than regional or geographical lines, rather than by reference to business lines/activities, or because the business activities involve elements of both ADS and CFB activities. In many cases the current proposal would entail segmentation of revenue streams which is unavailable within an MNE's current and financial systems – segmenting profits will be more challenging for the reasons outlined in the Blueprint. Additionally, allocations of shared costs or inter-segment costs may not be equitable where the activities within a single segment are very diverse (for example where an entire value chain exists within a segment rather than a range of different products or services). We suggest that this requires further consideration, as implementing and running a parallel accounting system solely for Pillar One purposes would be both costly and inefficient.
- 1.4 We recognise that it is probably not satisfactory in most cases to simply 'follow the accounts', because the effect of that would be to potentially place large profit streams unintentionally either in- or out-of-scope. However, in order to reduce the impact of this issue, we suggest that lines are drawn between ADS, CFB and out-of-scope activities based to the greatest extent possible on existing segments in an MNE's accounting system.
- 1.5 Additionally, it is considered that a threshold regarding in-/out-of-scope activities would be useful, for example, where a given segment has less than, say, 10% in-scope (with no distinction required between the ADS or CFB elements) revenues attached to it, the entire segment should be out-of-scope. This would be particularly useful to address challenges outlined below in paragraph 5 of this Part with respect to segmentation for otherwise excluded businesses. The threshold should be set at a fairly low level to ensure that such out-of-scope segments include only de minimis in-scope revenues. The use of such a threshold has the potential to simplify the regime for both MNEs and tax administrations, without undermining the Pillar One objectives. It is critical that this threshold is based on revenues rather than profits, as these will be much easier to identify.
- 1.6 Similarly the level of the thresholds will be important to ensure that these complex rules apply only to the largest MNEs when the issues which Pillar One is aiming to address are most acute.
- 1.7 Paragraph 171 of the Blueprint for Pillar One makes what is, in our view, a massive understatement: that additional compliance and administrative costs are 'likely'. It seems inevitable to us that the administrative burden and costs on tax administrations and the compliance burden and costs for MNEs will be considerable, with more to be borne by businesses who are not wholly in-scope because segmentation of revenues and

profits will be extremely burdensome. Therefore, the greater the extent of these burdens can be reduced, and particularly where they arise with little overall tax benefit to national exchequers, the better; and this will increase the simplicity for both tax administrations and MNEs.

- 1.8 We suggest that sales via intermediaries and dual use intermediate products should be out-of-scope, as it is often very challenging if not impossible for the seller to obtain intermediary information regarding the final use or destination of final sale.
- 1.9 We discuss at paragraph 2.11 of Part 1 above that the alternative to the activities-based test of an elective regime proposed by the US could be utilised as a pilot or trial phase for the new rules by those MNEs that elect to avail themselves of the Pillar One safe harbour to ease implementation. We also suggest that some smaller businesses who would be below the threshold may wish to opt in to the Pillar One rules to avail themselves of the perceived benefits described in the Blueprint of increased administrability, greater tax certainty and mandatory binding dispute resolution procedures. If they are competing with larger businesses in the same area, they may be at a disadvantage because they are typically in a high tax jurisdiction and cannot organise themselves as to where their profits arise. The introduction of the Pillar One rules would otherwise create a two-tier system which is not necessarily desirable.

## **2 II The design of a specific Amount A revenue threshold (in addition to a global revenue threshold) to exclude large MNEs that have a de minimis amount of foreign source in-scope revenue.**

- 2.1 We suggest that both of the threshold tests should be applied separately to each of the ADS and CFB activities, even where those take place within the same business. In addition to taking immaterial businesses out-of-scope, and hence reducing the administration and compliance burdens, this will ensure that there is clarity when applying the hallmarks to an activity that is above the threshold. There will be additional hallmarks that differ between the two types of activity, so it does not make sense to add together the revenues and then get confused about which other hallmarks to apply. An ordering mechanism may be required where revenues are both ADS and CFB simultaneously.
- 2.2 The level of the thresholds will be important and should be set so as to take businesses for which there would be minimal reallocation of taxing rights out-of-scope.
- 2.3 As we have already said the administrative and compliance burden and costs arising from the implementation of Pillar One (and Pillar Two) will be considerable. Therefore, the greater the extent of these burdens can be reduced, and particularly where they arise with little overall tax benefit to national exchequers, the better. Thus, sensible levels of a de minimis foreign in-scope revenue test, to take businesses with minimal cross-border trade out-of-scope of Pillar One, are very welcome to increase the simplicity for both tax administrations and MNEs.
- 2.4 As currently proposed it seems that the 'home markets' test could have very different impacts for centralised and decentralised business models. This is unhelpful as it could create distortions across different industries, jurisdictions or taxpayers. We suggest, therefore, that the de minimis foreign revenue threshold is structured to make it clear that the threshold applies separately to ADS and CFB lines of business, on a segmented basis. Further, such a threshold should be globally standardised to prevent regional variations causing complexity and unwelcome distortions.

### **3 III The development of a nexus rule.**

- 3.1 Anything more than a consistent revenue based threshold is an over complication which adds to compliance requirements rather than reducing them.
- 3.2 It is not clear why, in every case, there should be a higher nexus standard for CFB activities than for ADS activities. The impact of these additional nexus 'plus factors' will depend to a large extent on both the structure and the business sector of the organisation. Generally, however, we agree that MNEs should have the option to assess additional nexus 'plus factors' but this should be optional, as for some CFB sectors, the 'plus factors' assessment will be an additional compliance burden for little benefit. If the option to apply the 'plus factors' is not taken, we suggest that only the revenue threshold should apply, as for ADS activities.
- 3.3 The removal of the ADS and CFB nexus distinction could be linked to a more flexible approach regarding the bundling of ADS and CFB activities.
- 3.4 With regard to the 'plus factors', we would not welcome the creation of a new, standalone permanent establishment (PE) definition. To the extent that a PE is a 'plus factor' we would prefer to use the existing treaty definition of a PE to avoid unnecessary additional new rules.

### **4 IV The development of revenue sourcing rules.**

- 4.1 The rules appear to be broadly designed, from a theoretical perspective, to meet the objective of allocating taxing rights to where the end use or consumer resides. However, in practice, the theory may not interact easily with the actual data that is available to MNEs. As mentioned throughout this response, in order to minimise compliance burdens, it is important that the rules seek to minimise the work that must be undertaken by MNEs to deviate from their existing financial reporting and accounting systems and do not create unnecessary additional reporting obligations.
- 4.2 These issues have been faced before by many jurisdictions in devising their digital service tax rules and the answer requires a recognition of the imperfect data available to most MNEs.
- 4.3 There needs to be adequate flexibility built into the overall design around the principles and indicators, which permits MNEs to use the types of information that businesses have. The rules are currently framed as a hierarchy. However, for each particular organisation, just because a type data set is listed first in the indicator list, might not mean that it would be the best data set available to that business to use for the purposes of determining revenue source – an indicator further down the list may be the one that is more comprehensively used by that particular business. The rules should be developed to allow flexibility for businesses to ascertain which indicator is most available and is most comprehensive from its accounting and reporting systems for the purposes of identifying revenue source. Thus, while some heed could be paid to hierarchy of indicators, what is considered 'reasonably available' should also be considered alongside the quality of data available in relation to that indicator. Further, MNEs should not be required to take onerous steps to begin to collect, or improve their collection of, data within any particular indicator, if they have data available in another indicator which could reasonably be used.
- 4.4 In summary, it is unlikely that any MNE will have perfect data, and the data that is available will be very specific to each business. We would welcome an approach which permitted each business to identify the data that is

most appropriate for it to use as long as it can demonstrate a reasonable basis on which it has determined revenue source. The process for determining revenue source should be explained to the parent tax administration as part of the process of agreeing Amount A.

## **5 V The framework for segmenting the Amount A tax base, and how it could be further developed to deliver its objectives.**

- 5.1 As discussed above, in our view the extent to which segmentation is required beyond that which is already available within the MNE accounting system should be minimised. Different businesses' systems will segment differently and, therefore, the rules should permit some optionality regarding which segments are used would be welcome (for example financial accounting, business line, jurisdictional, in-/out-of-scope etc.).
- 5.2 A segmentation materiality threshold would broadly be welcomed.
- 5.3 There is clearly a trade-off between the level of complexity within the rules and an increased amount of segmentation flexibility. Any single approach would create issues for different groups, but permitting multiple approaches may create complexity and unforeseen competition issues.
- 5.4 We also suggest that requiring a business to break down its accounting segments into multiple new segments is likely to increase tax uncertainty, as it will potentially give rise to disputes regarding each new segment created. This is particularly the case where organisations are, as a result of the new rules, required to adopt and maintain entirely new, parallel accounting systems for Pillar One purposes.
- 5.5 As noted above, we strongly support the exclusions from scope of Pillar One outline in the Blueprint. We also agree that there may be elements of otherwise excluded businesses that are in fact CFB, and that such activities (for example retail fuel or the sale of cut and polished gemstones directly to consumers) should be brought into scope of Amount A in accordance with the broader policy objectives. However, the Blueprint is silent on the interaction of the broader exclusion and the segmentation requirements. A significant challenge that will need to be addressed within the segmentation framework is that an otherwise excluded business with a small amount of profits related to the in-scope activities will be more challenging to segment than other businesses because the segment itself is likely to encompass an entire value chain rather than a range of related or discrete products with shared costs and branding. Specific segmentation rules or additional consideration and guidance should therefore be considered for otherwise excluded businesses and/or segments. As noted above in paragraph 1.5 of this Part, one way to significantly alleviate the burden for such businesses which are predominantly out of scope would be to extend the exclusion to cover all segment profits where there is a proportionally low amount of in-scope revenues (which are easy to identify), for example in-scope revenues of, say, less than 10% of total segment revenues.
- 5.6 As regards the specific question (a) in the public consultation document around using hallmarks which draw on IAS 14, we do not consider that these would constitute a suitable basis for development a test to determine whether or not an MNE group is required to segment. IAS 14 is a repealed accounting standard based on arguably arbitrary segmentation. We suggest that the rules should follow IFRS8 which is the current standard and which reflects how a business is run and is audited. In addition, the suggested IAS 14 definition is very broad and open, leaving a lot of room for interpretation and debate.
- 5.7 More generally, in line with our overall comments, we consider that segmentation should be able to align as closely as possible with existing business processes (question (b)).

- 5.8 With regard to the segmentation options referenced in questions (c) and (d), as noted above, no single option will be the preferred or best one across the vast spectrum of sectors and structures in which MNEs operate. Therefore providing some optionality for taxpayers regarding segmentation is much preferable to attempting a 'one size fits all' approach. We suggest that MNEs are permitted to segment based on their existing business segmentation processes, provided that they are able to show, upon inspection, to the relevant tax administration that the chosen segmentation approach does not produce competitive distortions and produces a reasonable result in the context of Amount A. Assessing and documenting this reasonableness is likely to be far less resource intensive than implementing revised accounting systems for Pillar One purposes. This aspect of the rules may be one where early agreement of the processes adopted for segmentation as part of the binding mandatory dispute resolution procedures should be considered.
- 6 VI The development of a loss carry-forward regime that would ensure that Amount A is based on an appropriate measure of net profit.**
- 6.1 We welcome the proposal to include a loss carry-forward regime and, in particular, that this is intended to take into account both pre- and in-regime losses; this is, in our view, essential.
- 6.2 We consider that Amount A tax base rules should be applied consistently at the level of the MNE group (or segment where relevant) irrespective of whether the outcome is a profit or loss (question (a)).
- 6.3 We also consider that the carry-forward regime should take into account all pre-regime losses, at least in so far as they related to in-cope activities, and do not think that this should be limited in any sense, whether by reference to time or otherwise (question (b)).
- 6.4 We broadly agree that the preferred and simplest way to deal with losses for Amount A purposes is to report and administer these through a single account for the MNE group, rather than allocated these to market jurisdictions, recognising the resultant asymmetry with the treatment of profits (question (c)).
- 7 VII The scope and relevance of possible double counting issues arising from interactions between Amount A and existing taxing rights on business profits in market jurisdictions.**
- 7.1 There are two separate issues with regard to double counting which must be considered. Firstly there is double taxation in the residence jurisdiction (to be resolved by exemption or credit) and secondly, double taxation in the market jurisdiction (double counting). These issues should be considered separately.
- 7.2 With regard to the proposed mechanism to eliminate double taxation from Amount A, we prefer the exemption over credit method regarding double tax relief in the residence jurisdiction (question (a)). The credit method will not always give full relief, depending on the particular regime in the residence jurisdiction. The exemption mechanism more consistently provides double tax relief in respect of residence jurisdiction double taxation.
- 7.3 In our view there is an interaction between withholding taxes in market jurisdictions and the taxes under Amount A. It seems clear that withholding tax related double counting, that is to say market jurisdiction double taxation, will arise in connection with Amount A. It is important that these interactions are addressed. One way of achieving this would be for the withholding tax suffered in a market jurisdictions to be creditable against any Amount A liability for that jurisdiction (question (b)).

7.4 We welcome the inclusion of a marketing and distribution profits safe harbour. This will assist in dealing with possible double counting issues and, therefore, we agree that this will be important, particularly in for decentralised MNE groups (question (c)). However, the proposals in the Blueprint are both narrow and somewhat complex. We would encourage a broadening and simplification of the safe harbour.

7.5 We support the principle of a domestic-to domestic business exemption (question (d)). However the current, narrowly-drafted exemption is likely to be of limited use. We suggest that a broadening of the criteria for the exemption should be considered.

## **8 VIII The development of a process to identify the entities in an MNE group that bear the Amount A tax liability (the paying entities) for the purpose of eliminating double taxation.**

8.1 The profit based approach set out in Chapter 7 of the Blueprint is unduly complex, and onerous in accounting terms (effectively introducing further, different, detailed accounting analysis and segmentation requirements) and it seems to be internally inconsistent with the Amount A approach.

8.2 It is not clear why the same base as has been used to calculate Amount A is not used to calculate the profitability of the group (at step 2) in the elimination of double taxation mechanism.

8.3 The approach only anticipates (in the third step) in the first instance a market connection with one other entity. We suggest that this is unrealistic, and for a divisionalised business will become arbitrary. Thus, we suggest that if this route is pursued the option to apportion between multiple entities in paragraph 605 of the Blueprint for Pillar One should be considered. In addition, we suggest further consideration is given to how existing transfer pricing concepts and methods can best be used to provide as simple as possible an approach to identifying entrepreneur entities which are potential Amount A paying entities and allocating the tax pool between them. If that is to be a profit-based allocation, then we suggest that that should be done based on high-level margin data used to support existing transfer pricing analysis, rather than on the granular basis currently proposed.

8.4 It is not appropriate to make charges to entities entirely unconnected with the income. A clear and reasonable process to identify paying entities is needed. We suggest that some further reflection on this aspect of the Blueprint for Pillar One is required.

## **9 IX The issue of scope of Amount B and definition of baseline marketing and distribution activities.**

9.1 Having a clear definition of Amount B is vital as it should lead to certainty and a reduction in tax disputes. We have no philosophical preference for a broad or a narrow scope; there are advantages and disadvantages with each approach.

9.2 A narrow scope may be easier to agree; it may be preferable to start with a narrow scope and then expand this in due course as experience of operating these rules develops. Additionally a well-defined, narrow scope has the benefit of potentially being simpler to apply. However a narrow scope may exclude entities whose activities are, in whole or part, the target of Amount B. We suggest that the Amount B scope should cover the vast majority of local country affiliates (which is also important for an effective marketing and distribution safe harbour).

- 9.3 Whilst a broader scope rule would be potentially more complex to apply, the exclusionary effect would be less pronounced as it should, if properly devised, give the simplification benefits to more businesses. However, defining the base line will be more difficult if there is a broader scope. In addition, a broader scope which involves more tests, will increase the incidence of tax disputes around what activities fit into each category. These tax disputes will negate the intended simplification effects.
- 9.4 On either a broad or narrow scope rule, it is essential that the scope is clearly defined and that the benchmarked margins used are realistic (accounting for industry variances as appropriate). This will be more difficult, the broader the scope. We agree with the points noted in the Blueprint around the varying sensitivities arising for specific industries and sectors which will complicate the task.
- 9.5 Amount B will be effective in reducing disputes where the scope and thresholds are clearly defined and as simple to apply as possible.

**10 X The appropriate profit level indicator for calculating Amount B, and how it should be calculated assuming Amount B is based on a narrow scope.**

- 10.1 With respect to question (a) we consider that return on sales would be the most appropriate profit level indicator given the nature of in-scope activities. This would be consistent with usual practice in transfer pricing. It is also standard practice in transfer pricing in this context to set the profit level indicator at the level of EBIT. Consistency here would be a potential advantage. Some tax administrations might, however, prefer use of EBT for reasons of practicality and simplicity. We note in this context that given the limited nature of the in-scope functions and risks, there should be less economic requirement for funding than might be the case for capital or inventory intensive business activities. For that reason, using EBT rather than EBIT may present fewer issues relating to capital structure than would otherwise be the case, and should be acceptable. The point nonetheless would need to be considered in the selection of comparable data.
- 10.2 On question (b), we agree that the variations discussed in the Blueprint arising as a result of factors such as the jurisdictional environment should be accounted for within Amount B. The precise extent to which these should be reflected in the rules should be the subject of further discussions with businesses.

**11 XI The development of an early tax certainty process to prevent and resolve disputes on Amount A.**

- 11.1 As we have said previously, it is clear that the implementation of the Pillar One proposal will require significant resource from national tax administrations, as well, of course, from MNEs (and the OECD). Resource will be one of the key challenges in achieving tax certainty (question (a)). Countries should be encouraged to commit to providing the additional resource that will be required. In addition, bringing together panels will be administratively challenging. Cases where an MNE disagrees with the outcome would lead to very long and costly dispute process. In particular, it is our strong view that dispute prevention and resolution mechanisms must be binding on tax administrations and that agreeing to these mechanisms should be a condition of adopting the new taxing right in respect of Amount A.
- 11.2 Generally an MNE's ultimate parent entity will be the most suitable entity to provide the co-ordinating role (question (b)). However, this may not always be the case and, therefore, the rules should permit some flexibility for those group structures where a different entity would be a more appropriate co-ordinating entity.

- 11.3 MNEs are likely to participate in the Amount A tax certainty process to gain clarity both as to whether they are in the scope of Amount A and the determination and allocation of Amount A. Ensuring that the process is binding, so that it could not be the subject of challenge by other tax administrations will, in our view, be critical to ensure that the Pillar One proposal can be successfully translated from a theoretical set of rules into a practical regime (question (c)). If the process is not binding and not all tax administrations would accept the same amounts of allocations of Amount A, this would increase and exponentially complicate the resulting disputes.
- 11.4 With regard to a separate process to determine whether MNE is within scope of Amount A (question (d)), in our view, any process that gives certainty is welcome, depending on the complexity of the process itself. If a simple process could be designed to allow for this certification (and that certification did actually give certainty) then this would be very helpful and probably widely used. If this cannot be done, then the regime is unlikely to be useful.

## **12 XII The introduction of new approaches to provide greater certainty beyond Amount A.**

- 12.1 We have previously raised that there are two aspects of certainty arising from these proposals. The first is around clarity of the rules, in order to prevent disputes so far as possible, and the second is around resolving disputes that will inevitably arise.
- 12.2 We recognise that many of the concepts in the proposal are not yet able to be fully defined, pending political agreement as to what these should be. As a general point, in our view it will be important that, where possible, definitions of, the concepts in the Pillar One rules, for example, 'group', what is a 'baseline activity' (for Amount B) should be agreed and set out in an OECD publication, with limited room for states to adopt different, and potentially inconsistent, interpretations.
- 12.3 We also welcome the continued focus on dispute prevention as, while dispute resolution is necessary, it is not the best solution for business because of the time it takes; businesses need certainty from the outset.
- 12.4 The Blueprint recognises that that there will have to be new approaches to dispute prevention and resolution; we agree.
- 12.5 There needs to be a clear, strong and effective multilateral arbitration process agreed by tax administrations. We suggest that countries which sign up to the right to tax Amounts A (and the resulting changes to the existing system represented by Amounts B and C) must also sign up to binding multilateral arbitration. It seems that this is what the proposal is suggesting, and, if this is correct, we strongly support this, notwithstanding that it will be difficult for countries opposed to mandatory arbitration on grounds of sovereignty.
- 12.6 The timing and process of the mandatory multilateral arbitration system should also be clearly established to address the current delays that taxpayers currently face in obtaining relief from double taxation (for example, under the mutual agreement procedure (MAP)). This will take on further importance if disputes around Amounts B and C, and any liability under Pillar Two, will have to be determined before the calculation and allocation of Amount A can be finalised.
- 12.7 It should also be acknowledged that, although in our view the OECD should strongly discourage this, and to the extent possible build repeal of unilateral measures into the proposals for Pillar One and Pillar Two, some jurisdictions will continue to follow the unilateral measures currently being adopted and may not sign up to

the approach on which general consensus is reached. The resulting inconsistencies between competing systems may need to be resolved.

### Part Three – Report on Pillar Two Blueprint – public consultation questions

#### 1 Chapter 1: Introduction and Executive Summary (GILTI co-existence)

- 1.1 It is accepted that GILTI grandfathering is necessary for the US to agree to Pillar Two, and we understand that to mean that GILTI will be treated as a qualifying IIR by Pillar Two implementing jurisdictions.
- 1.2 However the Blueprint remains unclear as to how GILTI grandfathering would operate in practice and how precisely it would ‘coexist’ as a qualifying IIR and interact with Pillar Two. It is currently difficult to ascertain what the impacts will be and, we suggest, that further analysis and detail is needed. In particular, there should be clarity that GILTI grandfathering will remain under review and that the option retained to withdraw grandfathering if the US amends the GILTI rules in the future, resulting in a regime that is materially divergent from the Pillar Two IIR rules. This would reflect the fact that all other jurisdictions’ IIR regimes will be required to remain Pillar Two compliant.
- 1.3 Other potential implications that should be considered include:
- The compliance burdens for non-US groups with US operations, who are subject to both GILTI and Pillar Two. We suggest that GILTI grandfathering should be matched with a corresponding exclusion of US intermediate holding companies from GILTI. Recognising the challenges that may arise in relation to US law changes, an alternative solution may be required with respect to the UPEs’ operation of the IIR rules in relation to such subsidiaries. A broader review of overlaps and how to minimise multiple compliance burdens and additional timing or other double tax related risks is also needed.
  - How the BEAT rules will interact. We suggest that the operation of BEAT should be limited in respect of payments to entities that are subject to a qualifying IIR. Specifically, payments made to foreign connected parties who have a relevant parent entity who has implemented a qualifying IIR should be excluded from being considered as base erosion payments for the purposes of BEAT. If this is not politically feasible, then BEAT should clearly be made a ‘Covered Tax’ for Pillar Two.
  - Global blending is utilised by GILTI (and further facilitated by US check the box regimes), whereas it is proposed that Pillar Two will use jurisdictional blending. A global blending approach may mask significant variations in underlying jurisdictional tax rates, which a jurisdictional blending approach will not. Global blending thus assists groups with high effective tax rates (ETRs) who also have low-taxed income sources. This creates a different basis of taxation for GILTI compared to Pillar Two. We have heard challenges that overall the competition effects should be minimised because GILTI disadvantages some US (and non-US) taxpayers through its own operation (eg excess carry forward limitations). However, we do not believe that arbitrarily disadvantaging some taxpayers is appropriate under any circumstances, and doing so more freely because a competing regime arbitrarily disadvantages some other taxpayers is not sustainable or appropriate policy, and it will not solve the underlying issue that jurisdictional blending gives much less freedom than global blending to those taxpayers that are able to take advantage of it.
  - The application of the IIR to post-acquisition capital transactions when exiting acquired ‘tax haven’ entities may both block desirable restructuring and give US acquirers a comparative advantage, where US acquirers can utilise regimes such as ‘check the box’ and other elective basis step-ups. Pillar Two should be amended to equalise the treatment between the two regimes.
  - If GILTI is allowed to co-exist with the IIR, any exclusions applied to GILTI should be broadly available to any jurisdiction for other similarly consistent regimes on the same basis.
  - It is very unclear how losses and excess taxes carried forward under GILTI will interact with those under a qualifying IIR, because GILTI and Pillar 2 operate these concepts differently. This should be addressed both within the technical Blueprint and any guidance issued as part of implementation.

- 1.4 As the grandfathering/coexistence discussion develops, further consideration will be required of how the rules interact and whether there are double tax risks and/or risks to a level playing field, including how jurisdictional blending would operate where part of a jurisdiction's operations are held under the US so subject to GILTI, whilst other part of the same jurisdiction may be held outside the US regime. These issues cannot be addressed in detail until it is settled as to what grandfathering of GILTI, at a high level, will mean. We suggest that further consultation of the potential interactions and implications (including those outlined above) would be helpful when there is political agreement around GILTI grandfathering.

## **2 II. Chapter 2: Scope of the GloBE rules**

- 2.1 The CIOT does not have any specific comments on this chapter which focusses on investment funds. The general considerations around simplicity, certainty, fairness and proportionality are relevant to this chapter as to they are to all the others. Beyond that we will leave detailed comments to be provided by industry specific representative bodies and businesses.

## **3 III. Chapter 3: Calculating the ETR under the GloBE Rules**

- 3.1 With regard to the calculation of ETR under the GloBE rules, our principal concern is that the proposals result in significant divergence between the Pillar Two rules and standard financial reporting. The Blueprints do not reflect the considerable practical difficulties that will arise for MNEs seeking to apply the GloBE rules from the starting point of their existing financial reporting accounting systems. For example, it is not clear how business and income stream figures in the consolidated accounts will be divided up in order to arrive at the jurisdictional pre-adjustment PBT and associated covered taxes, where the MNE accounting system (and tax grouping systems) are not organised in that way.
- 3.2 MNE accounting systems are hugely varied depending on industry, business lines, internal reporting requirements, external reporting requirements, business geography and other factors (including the history of the acquisitions and/or mergers within the MNE). As a result of this the consolidation processes, following similar high-level patterns, will also be hugely varied. The extent of this variety means that a one-size-fits-all approach to jurisdictional blending will be significantly costly for many groups and in some cases, may in fact be impossible to comply with.
- 3.3 Specifically, the method of jurisdictional blending being proposed for Pillar Two, where it can be done, will require many MNE groups to run parallel accounting systems solely for the purpose of the GloBE rules. Further, in some groups we understand that the required information will not currently be available at all, which would mean that new information gathering processes would also need to be developed solely for the purpose of the GloBE rules. In our view, these practical outcomes for MNEs are not proportionate to the expected tax outcomes of Pillar Two (and in fact could cause additional timing differences to be recorded for accounting purposes).
- 3.4 There is therefore a need to consider what additional simplifications and flexibilities can be built in to the accounting and information requirements for Pillar Two in order to minimise compliance costs and complexities and enable MNEs to more easily use their existing financial reporting and accounting systems and the information available to them.

3.5 For example, no decision has been made as to how to deal with tax groups (for example where 'covered tax' data may only be available on a tax group basis and not on a Pillar Two Constituent Entity basis). One solution, which may also provide MNE groups with additional flexibility concerning how to collate their accounting data, may be to permit Constituent Entities in the same jurisdiction which form a 'tax group', to be treated as a single Constituent Entity, thus reducing compliance requirements. Similarly it could be explored whether or how groups which have already developed their accounting systems and processes to deal with CbCR reporting requirements could best be given flexibility to build on these processes to meet more detailed Pillar Two requirements. At a minimum, however, and as discussed further in connection with Chapter 5 below, the existing use of CbCR as a risk assessment tool should be built on in order to develop risk-based simplification measures for Pillar Two.

3.6 We would also welcome clarity on the global minimum rate at the earliest possible time, as the level of this will impact on the significance of the complexities discussed.

### 3.7 **Treatment of dividends and gains from disposition of stock in a corporation**

We do not have any specific views as to an appropriate ownership threshold. However, it will be important for any threshold that is agreed upon to be applied consistently across all jurisdictions.

#### 3.8 **a. The treatment of re-organisations under Pillar Two.**

We support the general principles set out in the Blueprint with regard to gains and losses from non-taxable restructurings. Considering mergers and acquisitions raises a level playing field point which is relevant to GILTI co-existence provisions, as US MNEs would generally be able to facilitate such post-acquisition restructuring by check the box or other elections or action agreed with the seller. A level playing field could therefore be preserved by a more general Pillar Two IIR exclusion of capital items (comparable to the similar UK CFC exclusion for a 'Temporary Period of Exemption'; this provides a 12 month temporary exemption in respect of acquisitions and reorganisations, providing certain conditions are met).

#### 3.9 **b. Rules to adjust for accelerated depreciation**

In our response to this section we would like to initially note that there are other timing differences in addition to accelerated depreciation that impact on MNEs' accounts. In addition, we note that there are several timing differences which are economically equivalent to depreciation or linked to fixed assets in other ways (for example. impairments on fixed assets, impairment reversals, financing of fixed assets, discount unwinding, etc.), such that even when looking at fixed asset timing differences, accelerated (or decelerated) depreciation does not give the full picture.

3.10 Timing differences are very common and arise from the difference in timing of the recognition of income and expenses between local tax laws and financial accounting standards. As the GloBE proposals are currently presented, timing differences between the recognition of income and expenses between local tax jurisdictions and international accountings standards are not adequately addressed. The objective stated (paragraph 290 of the Blueprint for Pillar Two) that temporary differences should not give rise to permanent tax liability under the GloBE rules is not met.

3.11 In our view a broader range of fixed asset timing differences, if not all timing differences should be taken into account in calculating the GloBE base. Impairments on fixed assets may be reversed after the regime commences, resulting in accounting profits with (typically) no recognition in the tax base, reversing the relative over-tax when the original impairment was booked. Another common fixed asset timing difference is for

capitalisation of interest related to acquisition of fixed assets, which is often only allowable for tax purposes when the interest is paid rather than accrued.

- 3.12 The current GloBE proposals consider alternative approaches to deferred tax accounting to address some of the issues that arise. Whilst we recognise that deferred tax accounting is complicated for some MNEs, in our view utilising existing accounting rules is to be preferred where possible, in order to minimise the overall compliance burden. We believe that any attempt to invent new rules, to replace a well-understood regime which has been developed by audit and financial reporting standards specialists over a number of decades, to address what is fundamentally the same measurement issue is likely to give rise to unforeseen consequences.
- 3.13 The reasons for the Inclusive Framework disregarding an approach of utilising deferred tax accounting include a concern around the perceived subjectivity of deferred tax accounting. We do not agree that deferred tax is entirely subjective. Deferred tax is disclosed in statutory accounts which are subject to independent audit processes for most if not all MNEs which provides a strong independent verification of judgements made. Further, where judgment/subjectivity does exist, this is predominantly in relation to whether deferred tax should be recognised in the accounts. Judgement is not usually required in relation to whether these deferred tax assets or liabilities exist; the underlying calculations of the gross deferred assets and liabilities are (for the most part and certainly with respect to matters such as provisions and fixed asset timing differences) entirely mechanical. We suggest that a solution to the concern regarding judgement subjectivity would be to include unrecognised deferred tax for Pillar Two.
- 3.14 Our preference would be to utilise deferred tax accounting where possible. Although this approach has been thus far rejected by the Inclusive Framework at a general level, we note, and welcome, the use deferred tax accounting as a simplification measure in relation to associates and joint ventures discussed below. For similar reasons of simplicity and the ability for MNEs to follow more closely their existing accounts we would support a wider use of deferred tax accounting.
- 3.15 The proposals in the Blueprint for Pillar Two to deal with deferred tax are not completely clear, but, so far as we understand them, would not adequately address all of the issues around accelerated depreciation and the multitude of other issues giving rise to timing issues which are dealt with by deferred tax accounting.
- 3.16 The methodology for Option 1 (Adjust Covered Taxes by the deferred tax accounting movement relating to depreciable assets only (paragraph 222 of the Blueprint for Pillar Two)) requires the net deferred tax accounting movement to be included as covered taxes each year. The mechanism requires some clarification, but it is assumed that the net movement (akin to deferred tax expense) that relate to tangible depreciating assets either increases or decreases the covered taxes in the GloBE ETR calculation each year. This methodology causes issues regarding carrying forward, carrying back and monetising IIR credits and local tax carry forwards because the deferred tax accounting movement is an adjustment of covered taxes.
- 3.17 With regard to Option 2 (Replace accounting depreciation conventions with local tax depreciation rules applied to the accounting carry values (paragraph 223 of the Blueprint for Pillar Two)), applying tax depreciation rules to the accounting base of assets is extremely complex and will be virtually unworkable for some industries – assets are often pooled and rates of writing down may be straight line, reducing balance, or they may be different from year to year or fixed or enhanced allowances may be available upfront. Due to the large variance between local tax and accounting capitalisation policies, the accounting carrying value will often be significantly higher than the local tax base for the same assets (and this will be the case in most situations – it is rare for accounting depreciation to be accelerated compared to tax depreciation as this would discourage investment in fixed assets). In addition, it will require MNEs to maintain a third GloBE fixed asset register in addition to their current accounting and tax fixed asset registers. These might be helpful in the scenario where

you are booking accelerated depreciation, but extremely unhelpful in the years where a corresponding deferred tax liability is unwinding (unless there is also corresponding loss recognition).

- 3.18 Allied with these discussions around timing differences there is a concern that the IIR credit, as currently proposed, achieves its objective of smoothing the ETR figure over time. This is because the IIR credit would be required to be effectively unlimited in terms of carry-forward duration, to account for long-cycle businesses. In any case, unless the respective MNE is subject to lower rates of tax in future years, the IIR credit is of little use, as it cannot be carried-back under current proposals. As a result, this will incentivise MNEs that have suffered IIR tax, where they suffer high ordinary taxation on the future profits from that investment, to seek out low ETRs on other investments so as to utilise their 'blocked' IIR credits. This appears to be contrary to the stated aim of Pillar Two.
- 3.19 If agreement cannot be reached with regard to using deferred tax accounting, the following issues will need to be addressed in the GloBE rules and included as alternatives:
- Local tax losses (both capital and non-capital): should be allowed for in full (carry-forward and back) with no time limit, including pre-regime losses without restriction. Otherwise there is a significant risk that the difference in companies' business cycles arbitrarily advantages some sectors over others. This is particularly acute where there are restrictions in utilisation of local losses (for example, limited to 50% of profits per annum in the UK) and thus the losses may be available and utilised for longer than the accumulated accounting losses.
  - Excess taxes: unlimited carry forward of excess taxes (including pre-regime, due to the long-term nature of some businesses). Not doing so will distort the overall taxes paid in a jurisdiction and cause top up taxes to arise in unintended circumstances.
  - Top-up taxes (as per above): A mechanism to have top up taxes carried back, and indeed repaid, if a regime has dipped below the minimum ETR for a year or two due to the mechanics of Pillar II, but over its life it is above the minimum ETR, there is no reason for the top up tax to have been suffered, and it should be repaid.
  - Uplifts in asset valuations: These should be removed from the Pillar Two tax base, consistent with general approach for taxation for most regimes, and recognise these as and when they are taxed.
  - Share based payments: jurisdictional differences in approach could cause different timing differences for individual companies depending on their particular structures. This will create unnecessary complexity. We suggest that these should be allowed for in full up-front.
  - Fixed asset tax and depreciation mismatches: in our view it would not be a simplification to seek to use the tax depreciation figures in the Pillar Two base. To achieve this, either the accounting depreciation figure would need to be replaced with the tax depreciation figure each year (which would create a problem for scenarios where accelerated tax depreciation had already been utilised before the commencement of the regime, thus resulting in businesses paying high cash tax rates appearing to suffer low ones) or completely separate books and records would need to be kept to identify the 'tax' depreciation that would be allowable on accounting fixed asset bases (which – given the complexity of different asset classes and the allowances available to them – would result in significant accounting assets where it was unclear what tax depreciation should be utilised). Although these issues could theoretically be solved by identifying appropriate opening balances to bring into the regime, the complexity of trying to identify this without reference to deferred tax cannot be overstated, particularly where tax depreciation may have been claimed and thus converted into a tax loss subject to different Pillar Two rules. We recommend instead that deferred tax methodology, that is to say identifying each year the difference between future accounting depreciation and tax depreciation, and adjusting the tax charge or tax base for movements in this figure, regardless of whether these differences are recognised in the accounts or not, would be a preferred.

- Provisions: brought forward untaxed (ie not deducted) provisions at entry into the regime must be removed from PBT when released/used so as to ensure no distortions are created due to Pillar Two mechanics ignoring the tax already paid on those profits before entry into Pillar Two.
- Adjustments and reversals from prior periods resulting from later tax audit. An adjustment in the year of audit outcome is acceptable, provided that the Pillar Two regime is stable over time - which it may not be.
- R&D incentives: Pillar Two should not discourage innovation or render R&D investments ineffective by removing the benefit of government incentives eg innovation boxes. The OECD have evaluated innovation and incentives as part of BEPS action 5. Pillar Two should recognise the outcome of this work stream.
- Pensions: adjustments and revaluations should be allowed for in the Pillar Two calculation.
- Functional currency vs tax payment country could also be a big permanent difference.

### 3.20 c. **The treatment of tax transparent entities**

We do not have any comments specific to this question.

### 3.21 d. **Allocation of 'cross-jurisdictional' taxes (particularly, anti-avoidance rule).**

Allocation of 'cross-jurisdictional taxes' – we agree that these taxes should follow the jurisdiction in respect of which they arise (eg the royalty recipient jurisdiction). There seems no evident reason why an anti-avoidance rule as contemplated in paragraph 284 of the Blueprint for Pillar Two should be needed.

## 4 **IV. Chapter 4: Carry-forwards and carve-out**

### 4.1 a. **Treatment of pre-GloBE losses and excess taxes under the carry-forward approach**

The proposal to allow historic losses to be recognised on commencement of the GloBE regime is welcomed. However, the transitional rules as proposed do not adequately address the recognition of historical timing differences for two key reasons. Firstly, the transitional measures propose a limited 'look back' time period to recognise GloBE losses on commencement of the regime. Secondly, the proposed transitional rules are limited to carry forward GloBE losses (akin to accounting losses) and do not recognise timing differences including carry forward tax losses that are often very material. Our comments here overlap with those made in response to Chapter 3 above around timing differences more generally.

4.2 We suggest that carried forward timing differences, including carry forward tax losses, should be recognised on entry to the GloBE regime. If not, timing differences arising prior to commencement of the GloBE regime will become permanent differences resulting in IIR tax liabilities that do not align with economic profits. For example, a project coming out of the construction phase may have lower accounting losses or even accounting profits in the years immediately prior to commencement of GloBE but may have significant tax losses (for reasons such as different capitalisation policies and depreciation rates between local tax and accounting rules). These tax losses must be recognised for GloBE purposes on commencement of the regime to prevent unintended GloBE tax liabilities arising.

4.3 In order to address these issues, firstly, there should be an unlimited 'look back' to recognise GloBE losses on commencement of the regime. Once these GloBE losses are brought into the regime, there should be an indefinite carry forward of these losses. Secondly, there should be unlimited 'look back' recognition of timing differences that can be brought into the GloBE regime under the transitional rules. MNE groups should have the option to calculate their starting GloBE base on commencement of the regime in a way that enables the

GloBE mechanisms for addressing timing differences to be included in this starting GloBE base. For example, either adopting the starting deferred tax accounting position on commencement (with adjustments for matters that require estimation) or alternatively recognition of timing differences using a set of principles which could be described as ‘Modification to GloBE Base for Timing Differences’<sup>1</sup>.

- 4.4 A simplification option could be adopted (such as 3-5 years ‘look back’ of tax attributes) for MNE groups that do not want the compliance burden of computing and recognising timing differences on commencement of the regime.
- 4.5 Loss carry-forward should not be time limited and pre-regime losses should all be brought in without limitation. Flexibility will alleviate possible issues around timing differences later on. As well as the indefinite carry forward (and carry back within a jurisdiction) of excess taxes and losses, it is important to consider the interaction between losses and other timing differences. The current proposal for losses (including pre-regime losses) appears to utilise the GloBE base rather than actual tax losses; it is difficult to comment on this as a result of the open questions on (for example) fixed asset timing differences. In addition, existing losses may exist in relation to other timing differences (for example accelerated depreciation) from prior years.
- 4.6 The ability to carry forward GloBE losses without restriction is welcome but will not fully address the material timing issues in capital intensive industries. It is worth noting in relation to all timing differences that restrictions in carry back or forward (including lack of full recognition for pre-regime differences) will have the most impact on the businesses with the longest lifecycles and greatest capital intensity – businesses for which certainty on tax payable is particularly important.
- 4.7 **b. Formulaic substance-based carve out.**  
The carve-out appears to be attempting to mirror the equivalent GILTI provision, albeit it takes account of payroll costs whereas GILTI does not. Whilst this carve-out will provide a welcome relief for many groups who are not the intended target of these proposals, we recommend that it is made an optional relief, as for other groups the calculation of the carve-out may prove onerous and may be of very limited benefit.
- 4.8 **c. Computation of ETR and top-up tax:**  
Please refer to our general comments around the challenges arising from MNEs very different accounting systems, timing differences and covered tax issues. Additionally, consideration should be given to tax that is accrued in one year and paid in another (should be included as a covered tax in year 1), also for later local audit tax adjustments and retrospective refunds of top-up taxes.

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<sup>1</sup> **Modification of GloBE base using agreed principles:** The Globe Base could be modified through a limited number of agreed mechanical adjustments to address timing differences. The established principles will ensure that adjustments may only be included in the GloBE base to the extent that they do not result in less tax being paid over the life of relevant projects. Each year, the accounting expense relating to the agreed items would be removed and replaced with the tax deduction based on the local tax laws. The key adjustments should include:

- Depreciation of tangible assets and related items
- Timing differences relating to the recognition of interest income and interest expense
- Employee related provisions
- Foreign exchange movements

## 5 V. Chapter 5: Simplification options.

### 5.1 a. General.

Broadly, none of the proposals are simple. This is particularly true because Amount A is within covered taxes. Therefore MNEs must calculate Pillar One first, then STTR (and presumably SOR), then IIR, then UTPR. This will be a lengthy and complex process. It seems clear that the GloBE rules require significant simplification in order to make them practicable for many MNEs. We discuss above some general simplification options around segmentation, accounting systems and deferred tax.

5.2 Beyond these, we consider it essential that further simplification options are developed. However, these must result in genuine simplifications, rather than being options around additional ways of performing the same complex calculations. We suggest that focus should be given to developing a risk-based approach which assesses the risk of genuinely low taxed income in a jurisdiction (measured over time) and, where this risk is low, the need for detailed Constituent Entity by Constituent Entity and jurisdiction by jurisdiction calculations are reduced or eliminated.

5.3 We suggest that consideration is given to combining risk-based approaches, in order to provide additional comfort or more focussed targeting of the rules without the need for excessive complexity. For example, as a simple mathematical matter, a global ETR-based assessment (for example where the consolidated ETR is, say, 5% above the Pillar Two minimum tax rate) should provide comfort that insufficiently taxed income, if it exists at all, is small in comparison to high taxed income. That suggests that requiring detailed calculations for all jurisdictions would be disproportionate and that targeting is needed. As a second stage, administrative guidance measures could develop hallmarks to be used so that detailed calculation work could then be limited to jurisdictions with low nominal rates or specified base narrowing type regimes.

5.4 Most simplification measures should be available at the option of the MNE, in order to allow MNEs to access those which provide the targeted results efficiently, without undue compliance burdens. Given the variety of structures and processes MNEs may adopt, it cannot be assumed that any given simplification option would be an actual simplification for all groups.

5.5 Other possible simplification measures that could be considered are:

- Unexpected ETR results. Consideration could be given to a multilateral appeal mechanism by an MNE which has an unexpected ETR result. This is discussed further below in our comments below regarding tax certainty in Chapter 10.
- (as above) Safe harbour/exemption if MNE group's overall global tax rate is at a sufficiently high level based on consolidated accounts above the minimum Pillar Two tax rate. If this is the case the MNE is out of scope of Pillar Two.
- To help ensure that the IIR applies in a proportionate way and to reduce the compliance burden, we suggest that it could incorporate a number of specific exemptions based on the type of exemptions from CFC taxation found in the CFC regimes adopted by many OECD member countries (reflecting the work done under Action 3 of the OECD/G20 BEPS project (Designing Effective Controlled Foreign Company Rules)).

### 5.6 b. CbCR ETR safe harbour.

We welcome the CbC Report ETR Safe Harbour measure, including the ability to incorporate deferred tax accounting into the ETR safe harbour calculation. Our concern is that the simplification method is not part of

the core rules to address timing differences. This simplification methodology incorporating deferred tax accounting will address the multiple issues with timing differences identified above.

5.7 In addition, comprehensive data collection systems and reporting tools have already been developed to address CbCR disclosure requirements so adopting this methodology would significantly reduce the compliance burden that will be imposed by the GloBE regime on MNEs. This proposal should work as a simplified risk based exclusion for high taxed jurisdictions, with required adjustment and calculation detail kept to a minimum. In the absence of a deferred tax based approach to calculating ETR, a multi-year averaging approach for a CbC report based safe harbour is helpful. However, to use it groups must have confidence that high tax jurisdictions will consistently benefit from the safe harbour, which will be extremely challenging if the safe harbour is based on metrics that are not linked to stable and collected amounts such as accounting charges.

5.8 In addition, if CbCR is to be used on this basis, there needs to be a period of transition so groups can align CbCR for the new purpose.

5.9 **c. De minimis profit exclusion**

Overall, this exclusion appears overly complex to be a useful simplification.

5.10 **d. Single jurisdictional ETR:**

This is not generally favoured as it does not appear that it would be a simplification for most MNEs.

5.11 **e. Tax administrative guidance**

We welcome this suggestion for a simplification, but note the resource that will be required to implement it. The result should recognise jurisdictions that do not present a global base erosion risk and carve them out of the GloBE regime. This approach could also help to address other areas which are not able to be fully dealt with in the rules themselves. For example, the possible adverse net present value impacts where IIR tax will be payable notwithstanding that the ETR in a jurisdiction exceeds the minimum tax rate solely due to timing differences not being adequately addressed in the GloBE rules.

5.12 More broadly, this simplification measure could work towards a safe harbour list of countries that have acceptable tax rates (accepting this may be difficult to define), with a proviso built in that a business can only use the list, if not also using special regimes in any of these jurisdictions that reduce ETR. This list could have a process of peer reviews so that OECD country teams all agree on the list.

5.13 However, it will also be important to have clarity that a jurisdiction not considered to have a tax regime that qualifies for any safe harbour list should not be considered to have an inappropriate tax regime, merely because it does not meet the criteria for the particular 'safe harbour' list which has been created solely for Pillar Two purposes.

## 6 VI. Chapter 6: Income Inclusion and Switch-over rules

### 6.1 a. Top-down approach

We agree that a top-down approach is most appropriate.

### 6.2 b. Integrity measures

We do not have any comments.

### 6.3 c. Split-ownership

It is acknowledged that further work is required on the design and methodology of the split ownership rules (paragraph 452 of the Blueprint for Pillar Two). The split ownership rules are highly complex and as proposed result in different net IIR tax liabilities depending at which level of an MNE group minority shareholders are introduced. In addition, there is economic inequity for minority shareholders that invest in a project controlled by an MNE group through a Partially Owned Intermediate Parent Entity in comparison to minority shareholders investing directly into the project vehicle (that is to say the low taxed Constituent Entity itself).

- 6.4 As proposed, the split ownership rules present a disadvantage to MNE groups with multiple Partially Owned Intermediate Parent Entities compared to MNE groups without minority investors (in excess of 10%). The IIR tax credits of an UPE and each Partially Owned Intermediate Parent Entity in the same MNE group is quarantined and cannot be used to offset IIR tax payable by other Partially Owned Intermediate Parent Entities in the same MNE group (paragraph 312 of the Blueprint for Pillar Two). This may be to prevent the minority shareholders in the Partially Owned Intermediate Parent Entity benefiting from the IIR tax credit from a project in which they do not beneficially own. In contrast, in an MNE group without Partially Owned Intermediate Parent Entities, any IIR tax credits of an Ultimate Parent Entity can be used to reduce IIR tax payable in any other jurisdiction of the MNE group.
- 6.5 Further, there is inequity in the case of Partially Owned Intermediate Parent Entity if an Ultimate Parent Entity pays CFC tax in its jurisdiction that is allocated to the source jurisdiction under the GloBE rules. If the Partially Owned Intermediate Parent Entity has an IIR tax liability that is wholly or partially sheltered by the CFC tax paid by the Ultimate Parent Entity this results in the minority shareholders benefiting from CFC tax paid by the Ultimate Parent Entity for which they do not have a beneficial interest. In regard to minority shareholders, as currently proposed, the split ownership rules will encourage minority shareholders to invest directly into the project vehicle itself so that the IIR tax does not apply to their investment share.
- 6.6 We suggest that the split ownership rules should be removed from the Pillar Two proposal altogether, because the rules introduce unnecessary complexity and economic disparity for different MNE group holding structures. The objective of the rules (paragraph 437 of the Blueprint for Pillar Two) is to address horizontal inequities (making a minority investment in the parent of an MNE group less valuable after tax than a minority investment in a MNE group subsidiary). However, the rules introduce greater economic disparity (such as IIR credit quarantining) than the issue the rules attempt to address. If the split ownership rules remain, an election could be introduced to enable IIR tax credits to be utilised by Partially Owned Intermediate Parent Entities within the same MNE group. It is at the discretion of the MNE group in this case if they wish to be compensated by the minority shareholders for the IIR tax credit shelter or vice versa.
- 6.7 We recommend an example is included in the Pillar Two explanatory documents that outlines the IIR tax outcome where this is a Partially Owned Intermediate Parent Entity that of itself invests in a low taxed Constituent Entity that has minority shareholders. It is not clear how the split ownership rules operate in this circumstance.

## 7 VII. Chapter 7: Undertaxed payments rule

- 7.1 The UTPR is a complex rule which introduces a further detailed set of calculations to the Pillar Two proposals that are materially different to the IIR calculations. Clearly having two separate sets of rules adds to the overall

complexity and makes it very difficult to understand or indeed accurately predict how they will interact in practice. There is also a concern that what are in reality high taxed jurisdictions will be impacted by the rule in some periods due to timing or other ETR measurement related issues - with consequential double tax arising. Therefore the double-tax relief mechanisms will need to be robust – but these will also ultimately create more compliance burdens for MNEs.

- 7.2 The UTPR could apply to a number of intermediate companies within an MNE's group which makes the rules very complicated. It remains unclear which rule will take primacy with regard to intermediate companies.

## **8 VIII. Chapter 8: Special rules for Associates, joint ventures and orphan entities**

- 8.1 We welcome the proposed simplification measure proposed for associates and joint ventures. In particular we note that deferred tax accounting is the suggested solution to address timing differences for joint venture entities and associate entities which are not consolidated for accounting purposes (paragraph 546 of the Blueprint for Pillar Two). This recognises that deferred tax accounting is in an appropriate method stating that *'this simplification eliminates the need to determine the amount of cash taxes paid by each associate entity or JV and its subsidiaries. It also eliminates the need for local tax carry forward and IIR tax credits.'*

- 8.2 As discussed above, in our view deferred tax accounting is an appropriate method that should be more widely used throughout the GloBE proposal.

- 8.3 Notwithstanding this general point, we are aware of some circumstances where an investor in a joint operation may not consolidate the tax charge of the underlying entity. It would therefore be most appropriate if the accounting tax charge used were that of the joint venture rather than the investor.

## **9 IX. Chapter 9: Subject to tax rule**

- 9.1 We understand the reasons for the introduction of the STTR in conjunction with the GloBE rules and can see its merit to address the risk of mobile income being shifted to jurisdictions with very low or zero nominal tax rates. However, there is a serious concern that the STTR would give rise to double taxation. It is important that the nominal rate that will trigger an STTR withholding tax liability is set at a low rate since it is applied to gross payments.

- 9.2 We understand that it is envisaged that the minimum rate which will trigger the STTR will be the same as the overall minimum rate. However when considering whether the STTR is triggered, the ETR is not calculated in the same way as it is when considering the IIR. The STTR uses a nominal tax rate arising from the statutory rate, with only small changes. As a result the tax rates are in fact different between these two rules.

- 9.3 We suggest that simplifications to this rule are considered as it will be important to ensure that it is properly framed to minimise over taxation. As a withholding tax, the person making the payment is likely to err on the side of caution. There will need to be clear mechanisms for the recipient to be able to recover the tax if it is withheld in error. However, in any event, there will be a cash flow cost to the recipient. We suggest that errors will be minimised if the liability is calculated happens on an annual basis, rather than on a payment by payment basis and would, therefore, agree that an annual ex-post balancing payment would be administratively simpler.

- 9.4 We have other concerns about the general interactions of STTR, IIR and UTPR rules, albeit these are partially addressed by the priority rules. In addition, that the STTR introduces a principle of gross basis taxation is unwelcome.
- 9.5 The STTR also introduces another compliance burden because although STTR is not the primary rule, it is necessary to calculate it first, because tax liabilities arising under it are taken into account when calculating ETR for the IIR.

## **10 X. Chapter 10: Implementation and rule co-ordination**

- 10.1 As we have said in our response above in relation to tax certainty under Pillar One, it will be important for the Pillar Two rules to be clear in themselves with limited room for jurisdictions to adopt different, and potentially inconsistent, interpretations.
- 10.2 We also welcome the continued focus on dispute prevention as, while dispute resolution is necessary, it is not the best solution for business because of the time it takes; businesses need certainty from the outset.
- 10.3 The Blueprint for Pillar Two (similarly to the Blueprint for Pillar One) recognises that that there will have to be new approaches to dispute prevention and resolution; we agree.
- 10.4 In particular, the complexity of Pillar Two emphasises the need for a clear, strong and effective multilateral arbitration process agreed by tax administrations which is binding on them.
- 10.5 The timing and process of the mandatory multilateral arbitration system should also be clearly established to address the current delays that taxpayers currently face in resolving multilateral tax disputes. This will take on further importance if, as seems to be the case, disputes around Amounts B and C under Pillar One, and any liability under Pillar Two, will have to be determined before the calculation and allocation of Amount A can be finalised.

## **11 Acknowledgement of submission**

- 11.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

## **12 The Chartered Institute of Taxation**

- 12.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most

effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

14 December 2020