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13 December 2020

Centre for Tax Policy and Administration
Organisation for Economic Co-operation
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Paris, France

Via email: cfa@oecd.org

RE: Comments on Pillar One and Two Blueprints

Dear Sir or Madam:

The Organisation for Economic Co-operation and Development (OECD) launched its base erosion and profit shifting (BEPS) project in 2013. Action 1 of the BEPS project was entitled *Addressing the Tax Challenges of the Digital Economy*. The OECD published a final report under Action 1 on 5 October 2015 (the Final Report).[1] The Final Report concluded in part "because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes."[2] The Final Report noted the OECD would continue to monitor developments in this area, along with implementation of the other BEPS actions, with a view toward producing a follow-up report on the digital economy in 2020.[3]

Subsequent developments and substantial political pressure, however, have overtaken the "wait and see" approach of the Final Report. The OECD has thus published several additional documents addressing the tax challenges of the digital economy prior to the Final Report's anticipated 2020 follow-up date. These reports and accompanying comments from, and public consultations with, various stakeholders ultimately led the OECD to develop a "two pillar" approach to the tax challenges of digitalization.[4] Pillar One focuses on nexus and profit allocation

[1] The Final Report is available at https://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm.
[2] Final Report at 11 & 54.
[3] *Id*. at 138.
[4] See the *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* available at http://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-

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whereas Pillar Two focuses on a global minimum tax intended to address remaining BEPS issues. The OECD published its latest reports regarding the tax challenges of digitalization on 14 October 2020. These two reports, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* (the Pillar One Blueprint)[5] and *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint* (the Pillar Two Blueprint)[6] represent the OECD and the G20 Inclusive Framework on BEPS (Inclusive Framework) latest thinking, without prejudice, on how to address digitalization tax challenges.

The OECD also published a request for stakeholder input on the Blueprints entitled *Public Consultation Document on the Reports on the Pillar One and Pillar Two Blueprints* (the Consultation Document).[7] The Consultation Documents includes many questions requesting feedback on particular aspects of the Blueprints. Comments are due to the OECD no later than Monday, 14 December 2020. I am pleased to respond to the OECD's request for comments on behalf of Tax Executives Institute, Inc. (TEI).

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in Europe, North and South America, and Asia. TEI as a preeminent association of in-house tax professionals worldwide has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies in the world.[8]

TEI Comments

While there has been no political agreement on key issues, TEI commends the OECD for its continued work on addressing the tax challenges of digitalization, particularly in the face of the ongoing worldwide pandemic. Developing a consensus solution to these challenges is critical to avoid continued proliferation of unilateral digital service and similar taxes and to prevent a potential a trade war, which would be contrary to the OECD's core mission. Set forth below are our general comments on the Blueprints and responses to the specific questions posed in the Consultation Document.

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economy.pdf. The OECD changed the scope of its continued work under BEPS Action 1 from addressing the tax challenges of the digital economy to addressing the tax challenges of the "digitalization" of the economy in part because it concluded the digital economy could not be "ring-fenced" from the rest of the economy.

[5] *Available at* https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm.

[6] *Available at* https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint-abb4c3d1-en.htm.

[7] *Available at* https://www.oecd.org/tax/beps/public-consultation-document-reports-on-pillar-one-and-pillar-two-blueprints-october-2020.pdf.

[8] TEI is a corporation organized in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

Pillar One Blueprint: General Comments and Responses to Questions

The Consultation Document requests comments with respect to the Pillar One Blueprint focused "on the technical aspects of the Blueprint that may help to reduce cost and complexity, and improve tax certainty in the administration of Pillar One for both tax administrations and taxpayers alike."[9] Immediately below we provide our general comments on broader Pillar One Blueprint issues and then turn to the specific questions posed in the Consultation Document

General Comments regarding the Pillar One Blueprint

While there are many political decisions still to be made which will drive much of the current details in both Blueprints in one direction or another, we appreciate the technical progress made in the Pillar One Blueprint, along with the expected corresponding withdrawal of existing and proposed unilateral measures. There is still ambiguity to resolve, however, as well as opportunities for simplification and filling in additional details.

Any OECD solution must not discriminate against any industry or country, must be straightforward and reasonable for taxpayers and tax authorities to apply, and must not increase the incidence of double taxation. Our general comments focus mainly on the need for simplification to make any final Pillar One approach administrable while also reducing disputes. The withdrawal of existing and proposed unilateral measures should be a pre-condition for a jurisdiction agreeing to Pillar One (and Pillar Two) and should be given a greater focus in the Pillar One Blueprint. This is critical to ensure multinational enterprises (MNEs) are not subject to multiple layers of taxation from such unilateral measures as well as Pillar One. Similarly, uniformity of implementation across jurisdictions will require further focus from the OECD and clear implementation plans should be provided as a patchwork of implementation rules could also result in multiple incidences of taxation of the same profit, even if a political agreement is reached on scope and other issues.

The current range of activities covered by Amount A is broad because of the political debate over Pillar One's scope. Many companies will therefore need to do an in-depth analysis of the rather complex rules to conclude whether its activities will, in full or in part, be subject to Amount A. Revenue must be segregated between Automated Digital Services (ADS), Consumer Facing Businesses (CFB), and out of scope activities for purposes of Amount A's scope and nexus rules as currently drafted. MNE accounting systems, however, do not typically support this kind of segregation. TEI recommends an exclusion from Amount A for businesses whose activities are primarily those other than ADS and CFB, considering the complexity of calculating Amount A for both taxpayers and tax authorities.

Another problematic aspect of the Pillar One Blueprint is its approach to segmentation. Simplicity and certainty are key components for segmenting an MNE's business operations. The suggested International Accounting Standards (IAS) 14 definition is very broad leaving a great deal of room for

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[9] Consultation Document at 3.

interpretation and debate.[10] Published and audited global consolidated financial statements or published and audited financial statements by segment, under the relevant accounting standards applicable to an MNE's ultimate parent entity, should be used for Pillar One segmentation purposes. The Pillar One Blueprint indicates, however, such financial statements are insufficient if an MNE exhibits certain hallmarks and additional segmentation would be required in those cases.[11] Additional segmentation beyond what is required by the applicable financial accounting standards would create unnecessary layers of complexity and ambiguity for taxpayers and tax authorities. Audited financial statements reflect how businesses view their operations and should be sufficient for Pillar One purposes.

The OECD should also give more thought to the business-to-business sourcing rules. Sourcing income based on the place of end consumption generally works well for business-to-consumer transactions but is more difficult, if not impossible, for business-to-business transactions, especially if the purpose of the sourcing rules is to determine the location of end-use. We recommend a set of clear, unambiguous rules to identify customer location, including a clear hierarchy of how the rules are applied to provide greater simplicity. TEI believes reliance on location data such as IP address is unreliable, particularly in the case of business-to-business transactions, and in many cases such information is contained in systems unable to be reconciled to customer transactions. Existing hierarchies such as those for VAT location should be considered. Flexibility should also be provided to businesses to use the information they already have available; creating new data requirements would significantly increase complexity and compliance costs.

TEI is pleased the Pillar One Blueprint includes a general dispute resolution structure. The structure is currently drafted from a tax administration perspective and should include additional safeguards to effectively balance both taxpayer and tax authority interests and should allow for audits to focus on key areas in an efficient manner.

Paragraph 92 notes the interaction of withholding taxes on royalty arrangements with Amount A should receive further consideration. We agree, particularly because the United Nations is considering amendments to their model double taxation convention regarding digital service and software royalty withholding taxes.[12] This issue could lead to significant taxation at source through withholding taxes, followed by further double taxation at source from Amount A reallocations, unless offset mechanisms are developed.[13]

The examples at the end of the Pillar One Blueprint are somewhat helpful in understanding certain basic concepts. One of the biggest limitations of the examples, however, is assuming MNEs earn

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[10] *See* Pillar One Blueprint at paragraphs 457-58.
[11] Pillar One Blueprint paragraphs 456-461.
[12] The draft provision modifying the United Nations model double taxation convention is available at https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX%20TREATY%20PROVISION%20ON%20PAYMENTS%20FOR%20DIGITAL%20SERVICES.pdf
[13] A mechanism whereby taxpayers can offset Amount A taxes with same country withholding taxes could mitigate double taxation by source countries, for example.

such high margins. One can rarely find companies so profitable in databases used for benchmarking purposes. MNEs with the level of profitability in the examples would be statistical outliers in many industries. TEI recommends the OECD provide more examples based on more realistic complex supply chains. The examples should include businesses with low profitability across the entire profit chain, as well as examples of loss-making businesses.

Additionally, there are market factors clearly attributable to local market jurisdictions. The lower profitability of distributors, in many cases, is explained by business factors unrelated to transfer pricing. A distributor in a high-tax jurisdiction, for example, may be negatively impacted by labor strikes in the jurisdiction. Why a "paying" entity in one high-tax jurisdiction should effectively subsidize a second high-tax jurisdiction by increasing the amount allocated to the second jurisdiction when low profitability is the result of the strike is not clear from a policy perspective.

Finally, flexibility should be maintained regarding the implementation timeline for various countries. The time necessary to adopt and implement the Pillar One Blueprint will differ across jurisdictions and could give rise to disputes and/or multilayer taxation. Nevertheless, unilateral measures should still be withdrawn at the time of political agreement even if the Pillar One implementation timeline is lengthened. We recommend the OECD outline a collaborative approach to this issue.

<u>Responses to Questions Posed Regarding the Pillar One Blueprint in the Consultation Document</u>

I. **The activity test to define the scope of Amount A**. Comments are invited on the design and implementation of the proposed activity test relating to Automated Digital Services and Consumer-Facing Businesses, including any challenges and suggestions on how to address them? [*Refers to paragraphs 38-170 of the Blueprint*]

A response with concrete recommendations is difficult as a threshold matter because, as the Secretariat has repeatedly pointed out, political decisions regarding the scope of Pillar One are necessary before deciding on the appropriate technical guidance to determine what activities are in-scope. Any proposed activity test should, as a general principle, be objective and use quantitative screening metrics.

One option to simplify the approach would be to limit the scope of Amount A to ensure a modest operating margin percentage of remote sales booked outside a market is subject to tax in a market jurisdiction. This should be consistent with a non-routine marketing intangible return supported by empirical data, provided there is a commensurate reduction in tax due to jurisdictions surrendering the tax under this approach. Should an additional return be required above the return provided by a current permanent establishment (PE), then such return should be modest. Further, the OECD and Inclusive Framework members must agree on such an amount and include a mechanism to minimize double counting and double taxation. We note in this regard the vast majority of MNE revenue is earned in jurisdictions where an MNE currently has a taxable presence. MNEs ordinarily do not establish a taxable presence in a jurisdiction until reaching a certain revenue threshold. Care must be taken as such to prevent an administrative morass simply to allocate a small return to jurisdictions without a PE. Such

an allocation in any event should not include routine returns which are properly due to another jurisdiction in which there are functions, assets, and risk.

The definition of "automated" digital services as opposed to "bespoke interaction" will create significant controversy and confusion. Further, it disregards significant investment in capital expenditures, research and development (R&D), and employment in creating or supporting the business. Lack of clarity of in-scope and out of scope businesses may also create competitive distortions within industries.

Footnote 14 notes the definition of ADS under the Pillar One Blueprint differs from "electronically supplied services" under European Union (EU) VAT law. The proposed definition of ADS would add to taxpayers' compliance burden by creating a new defined term interpreted independently of the definitions of similar concepts in other tax provisions.

There will be increased bundling of services (cloud, bespoke, standardized) and the "dual category of ADS and bundled services" will become increasingly complex. Any determination of "appropriate materiality" or "substantial part" or "ancillary" will result in future controversies.[14] Cloud services design and implementation for customers require significant initial and recurring bespoke services. Importantly, all cloud services should be treated equally, with a level playing field, as the concept of "bespoke services" will lead to ambiguity and disputes and could result in disparate treatment amongst cloud service providers.

Finally, the Pillar One Blueprint's discussion of the positive and negative lists to simplify the determination of in-scope and excepted activities suggests individual jurisdictions will be able to make unilateral changes to these lists.[15] The ability of individual jurisdictions to make unilateral changes to these lists will greatly increase uncertainty, disputes, and the potential for double taxation. The list should be based on a principled approach as any political decisions will create long-term uncertainty.

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**. More specifically, comments are invited on what would be the best approach to define and identify the domestic or home market of an MNE group (e.g., the residence of the ultimate parent entity). [*Refers to paragraphs 182-184 of the Blueprint*]

We agree on the importance of limiting Amount A to a manageable number of MNE groups. Caution should be taken, however, to ensure thresholds (or phasing in thresholds) do not result in a concentration of in-scope businesses in a particular industry or country while other country's national champions are exempt or deferred.

While we understand there is no political agreement on the Pillar One Blueprint, we note the repeated example of an Amount A formula (*see* footnote 39) where 20% of the MNE's profits in excess of

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[14] *See* the discussion of "Dual category ADS / bundled packages" in paragraphs 48-51 of the Pillar One Blueprint.

[15] *See* paragraphs 40-41 of the Pillar One Blueprint.

a 10% profit margin would be allocated to the market. Consistent with our understanding of the purpose of this effort to allocate a "modest" portion of non-routine marketing intangible returns to the market, this formula is not "modest." A "modest" incremental Amount A allocation would be no more than two percent over an existing arm's length return.

Regarding the *de minimis* foreign in-scope revenue test, the two-step test discussed in paragraph 184 of the Pillar One Blueprint is confusing because it appears the MNE would only have to proceed to step 2 if it was not excluded under step 1. We request this be clarified.

III. The development of a nexus rule. More specifically, comments are invited on the following points:

a. The "plus factors" suggested for CFB will be examined as potential indicators which denote an engagement with the market beyond the mere conclusion of sales. In terms of compliance costs and administrability, do you have any comments on these plus factors? [*Refers to paragraphs 202-211 of the Blueprint*]

The "physical presence" plus factor suggests the Secretariat has abandoned "remote selling" as the fundamental driver behind the work on digitalization. Remote sales revenue booked outside a market jurisdiction above an appropriate threshold in TEI's view should be included in Amount A (for both ADS and CFB), which would be a significant simplification for both tax administration and tax compliance. "Physical presence" remains relevant for the marketing and distribution safe harbor, which should apply for all MNEs in-scope for Amount A.

Paragraph 189 references the new nexus rules apply to Amount A only and "do not alter the nexus for other tax purposes, customs duties or for any other non-tax area." TEI recommends adding VAT to the list to clarify the new nexus rules are inapplicable to VAT.

Paragraph 191 suggests a higher nexus standard may be justified for CFB when compared to ADS. We disagree. This suggestion is based on the following unfounded asserts: (i) a CFB's ability to participate in an economy remotely is less pronounced than ADS; (ii) the use of third-party distributors create more complexity for CFB than ADS; and (iii) "the broad acknowledgment that profit margins are typically lower for CFB compared with ADS." ADS businesses often sell via third party distributors and often have profit margins lower than CFBs. Thus there should not be a higher nexus standard for CFB when compared to ADS.

Should ADS and CFB both be scope, each should have "plus factors" clearly limited related marketing and sales functions.

Paragraph 210 suggests a preferred approach to use a "single self-standing group PE definition, instead of relying on a PE definition in a tax treaty or domestic law." This addresses the question of whether physical presence is a sensible "plus factor." TEI agrees a new standalone PE definition will be required to cut across treaty definitions if it is determined such a plus factor is workable.

TEI recommends, in general, the OECD provide as much clarification and detail on what constitutes a sustained and significant presence in a jurisdiction to avoid disputes. Clarification of whether the use of a third-party distributor in a local jurisdiction constitutes sustained participation by an MNE in the jurisdiction would be useful.

b. Do you consider the suggested plus factors (and hence a taxable nexus under Amount A) could be deemed to exist once a certain level of sales is exceeded? If so, what should be the criteria for establishing such level? [*Refers to paragraph 212 of the Blueprint*]

TEI would accept this only if the proposal is limited to remote sales booked outside the market jurisdiction. Should an MNE compensate an in-market entity above the common LRD return, the affiliate is already compensating the market jurisdiction for a nonroutine return, and the marketing and distribution safe harbor should minimize or eliminate any incremental Amount A reallocation to the market jurisdiction.

While a deemed PE is a practical solution, the bottom-line question is how to determine the sales threshold. A distinction should be made between business-to- business sales versus business-to-consumer sales. MNEs may have multiple and complex supply chains with different third parties involved before the goods are sold to a customer. When considering these complex supply chain models there is often no way to identify accurately what has been sold to a customer and where.

There is also a question of how a deemed PE can arise based on a local third-party distributor selling the MNE's product. The MNE is paying per definition an arm's length compensation to the third party so there should be no additional income allocation to the market jurisdiction in any event.

c. Should the market revenue threshold contain a temporal requirement of more than one year? If so, what should it be? [*Refers to paragraph 196 of the Blueprint*]

Yes. One approach would be a three-year average. Alternatively, certain non-recurring items could be excluded from revenue.

IV. The development of revenue sourcing rules. More specifically, comments are invited on the following points:

a. Do you have any comments with respect to the proposed sourcing rule and proposed hierarchy of indicators as the basis for the sourcing of revenue for Amount A? [*Refers to paragraphs 227-321 of the Blueprint*]

The multiple simplifying changes to the hierarchy along with elevating the customer billing address indicator to a number two position is a positive development. The primary rule for indicators should be consistency with the information MNEs already collect. The recognition in the outline of customers/users refusing to provide location data should push geolocation lower in the hierarchy.

We recommend the sourcing indicators be consistent with VAT indicators and similar indirect taxes.

The Pillar One Blueprint should also consider the impact upon, and any possible conflict with, relevant privacy rules and regulations (e.g., the EU's General Data Protection Regulation (GDPR)). Collecting information where a product has been sold may also raise concerns under EU competition law (e.g., parallel export).

Regarding sourcing rules for cloud service providers, such providers should not be required to rely on information collected by another taxpayer who may or may not have location information and are under no obligation to provide such information to the cloud service provider. Additionally, requiring cloud service providers to collect information on users will exponentially increase the amount of data required to be collected. Mining such data, connecting it with financial data, and trying to ensure the accuracy of data of a cloud service provider's users would be a monumental task which could also violate business and governmental privacy policies.

b. What factors should be taken into account in determining "reasonable steps" required to obtain information that is unavailable (such as changing contracts with third party distributors)? [*Refers to paragraphs 378-387 of the Blueprint*]

We recommend current MNE information collection practices be followed. It is impractical to ask customers/users for even more information, which they may be reluctant to provide and the OECD should consider such reluctance when devising information collection requirements. Government privacy rules (such as the GDPR) must also be considered as they may restrict an MNE's ability to ask for certain information, as noted above.

Moreover, it is unrealistic to renegotiate all third-party distributor contracts, which in many cases may be in the hundreds, to require customers to provide the necessary information. Requesting information from customers/distributors, which in many cases may be small businesses, would create an additional compliance burden and unfairly penalize such businesses.

Finally, it is important to distinguish between business-to-business models and business-to-customer models. One proposal for business-to-business models would be requiring an MNE only to collect data one level down the third-party supply chain (e.g., local affiliate sells to third party distributor sells to wholesaler sells to retailer: the only information to be collected would be sales by the first third party distributor to the wholesaler).

c. What simplification measures, if any, should be considered in the revenue sourcing rules, such as safe harbours or de minimis rules? [*Refers to paragraphs 388-405 of the Blueprint*]

The OECD should apply the general rule comparing the cost to collect, comply, and administer a rule compared to the impact on tax revenue. When the former is greater than the latter, then the rule should not be adopted.

d. Do you consider that VPNs and/or any other emerging technology may have an impact on the accuracy and/or reliability of proposed revenue sourcing rules? If yes, what options or

design changes should be considered to eliminate or minimise such an impact? [*Refers to paragraphs 305-309 of the Blueprint*]:

TEI recommends the OECD consult MNE system and technology experts to better answer this question.

V. The framework for segmenting the Amount A tax base, and how it could be further developed to deliver its objectives. As a simplification, this framework includes different options to limit the need for segmentation, including calculating the Amount A tax base on a consolidated basis as a default rule (and applying it to in-scope revenues to produce a proxy for in-scope profits.). More specifically, comments are invited on the following points:

a. Do you consider that hallmarks drawing on IAS 14 constitute an appropriate basis for developing a test to determine whether an MNE group is required to segment? If not, what other options should be considered to identify relevant segments for Amount A purposes? [*Refers to paragraphs 456-461 of the Blueprint*]

International Financial Reporting Standard (IFRS) 8, *Operating Segments*, superseded IAS 14 effective for annual periods beginning on or after January 1, 2009, as the Pillar One Blueprint notes. IFRS 8 closely resembles the approach of the Financial Accounting Standards Board (FASB) statement number 131. Therefore, we support using approaches pursuant to IFRS 8 and FASB statement number 131 for segment reporting. A U.S. headquartered MNE under this approach will follow FASB statement number 131 and a foreign headquartered MNE will follow IFRS 8 solely for the purpose of Amount A reporting. The IAS 14 definition, as noted above, is very broad leaving a great deal of room for interpretation and debate, which would lead to disputes and controversies.

b. Do you consider that existing segments (under financial accounting standards) should be used in the majority of cases as a basis for segmenting the Amount A tax base (for example by using a rebuttable presumption)? If not, what other options should be considered? [*Refers to paragraphs 462-463 of the Blueprint*]

The general rule should be MNEs can use their consolidated financial statements to determine whether segmentation is required and then report Amount A on such basis.

c. Do you consider that groups should be permitted to calculate Amount A on a geographically segmented basis? If so, what should be the criteria for determining when geographical segmentation is permitted and what those geographic segments should be? [*Refers to paragraph 459*]

This option, if offered, should be at the sole discretion of the MNE and cannot be a requirement imposed by individual jurisdictions on MNEs as many MNEs do not have geographical segments.

d. Alternatively, do you consider that MNE groups should be required or permitted in some cases to segment their profits before tax between in-scope activities (i.e. ADS and/or CFB) and

out-of-scope activities? If yes, what criteria could be used to determine when this approach to segmentation should be applied as opposed to calculating the Amount A tax base on a consolidated basis? [*Refers to paragraphs 442-446 of the Blueprint*]

Segmentation should only be required if necessary to accomplish the objectives of Amount A, as noted above. The general default rule should be for MNEs to use consolidated income as the basis for their Amount A allocation computation. We support the Pillar One Blueprint's expressed objective of minimizing the need for segmentation to increase simplification in the application of the Amount A rules. Should segmentation be necessary to achieve Amount A objectives, or to ensure there are no competitive distortions, then it is appropriate for it to be based on the MNE's financial statement segmentation.

VI. **The development of a loss carry-forward regime that would ensure that Amount A is based on an appropriate measure of net profit**. More specifically, comments are invited on the following points:

a. Do you consider that Amount A tax base rules should apply consistently at the level of the MNE group (or segment where relevant) irrespective of whether the outcome is a profit or loss (symmetry)? [*Refers to paragraphs 475-476 of the Blueprint*]

Yes.

b. Do you consider that the carry-forward regime should account for some pre-regime losses and, if so, are any specific rules required to ensure symmetry, limit complexity and compliance costs (e.g., time limitations)? [Refers to paragraphs 477-478 of the Blueprint]

Only for losses realized by specific, identifiable Amount A activities. Overall MNE losses should not offset Amount A income.

c. Do you consider that losses for Amount A purposes should not be allocated to market jurisdictions (unlike profits), but instead reported and administered through a single account for the MNE group (or segment where relevant) and carried forward through an earn-out mechanism? If so, do you have specific suggestions to improve the design and administration of this approach? [*Refers to paragraphs 479-480 of the Blueprint*]

No comments.

d. What is your view of the proposal to extend the carry-forward regime to 'profit shortfalls'? Do you or do you not agree with the conceptual rationale behind it? [*Refers to paragraphs 488-491 of the Blueprint*]

The rationale for the "profit shortfalls" proposal is questionable, would result in significant complexity and therefore lead to disputes, and thus should not be allowed. The calculation of profit shortfalls reducing the Amount A allocation if allowed should be consistent with the calculation of the

Amount A allocation. Non-Amount A shortfalls should not be available to offset the Amount A income allocation.

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. More specifically, comments are **invited** on the following points:

a. Do you consider that the proposed mechanism to eliminate double taxation from Amount A will have an impact on the scope and relevance of possible double counting issues? Do you have suggestions on the design of this mechanism that would improve its ability to resolve (or reduce) possible double counting issues? [*Refers to paragraphs 531-532 of the Blueprint*]

Yes, a mechanism to eliminate double counting and double taxation by imposing a cap on the Amount A re-allocation is a critical component of any OECD agreement, but more refinement is required.

b. Do you consider that there is an interaction between withholding taxes in market jurisdictions and the taxes under Amount A? If so, how could such interactions, including double counting issues, be addressed [*Refers to paragraphs 506, 528 and 555 of the Blueprint*]?

Yes. They should be applied against local tax on the Amount A re-allocation to the extent withholding taxes relate to the revenue generating nonroutine profits in the local market jurisdiction. A withholding tax on royalties (and in-scope dividends) by definition is a return in the market jurisdiction and should be credited against amounts otherwise due on Amount A.

c. What would be the most important design and technical considerations in developing a marketing and distribution profits safe harbour for MNE groups with an existing taxable presence in the market jurisdiction? For example, do you consider this approach would be effective in dealing with possible double counting issues? Do you have views on how the fixed return could be designed? How should subsequent transfer pricing adjustments be dealt with in relation to this safe harbour? [*Refers to paragraphs 533-546 of the Blueprint*]

Eliminating double counting and clarifying the point at which the marketing and distribution profits safe harbor applies is critical, which may not necessarily be the same amount as Amount B. There must be a binding agreement from OECD and Inclusive Framework members on a clear set of rules, including the scope of Amounts A and B.

d. Should a domestic-to-domestic business exemption be considered to exclude part of a group's business that is primarily carried on in a single jurisdiction from the calculation of the Amount A tax base? If so, do you have views on how this exemption could be designed? [*Refers to paragraphs 547-553 of the Blueprint*]

Should a *de minimis* foreign revenue exception be in place, it should be all or nothing rather than creating ambiguity and controversy regarding the definition of "primarily."

e. Besides the mechanisms proposed in the Blueprint, do you have any other suggestions on how to resolve the possible double counting issue?

The most important features would be to have a robust marketing and distribution safe harbor and a binding dispute resolution agreement among all OECD and Inclusive Framework members.

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. More specifically, comments are invited on the following points:

a. What are your views on the proposed approach to eliminate double taxation from Amount A? Do you have any suggestions to improve this approach, including any alternative approach to eliminate double taxation?

The most important factor is acceptance and consistent implementation by OECD members of a binding agreement. More specifically, paragraphs 561-62 look to functions, assets, and risk, for purposes of determining what activities contribute to a group's residual profits, but such focus seems to override the development, enhancement, maintenance, protection and exploitation (DEMPE) returns developed during the BEPS project.

Separately, paragraphs 570-71 recommend both the exemption and credit method may be used to eliminate double taxation. Use of either method will only create confusion. TEI recommends the OECD adopt the exemption method as the exclusive method.

b. Do you consider that the activities test can be developed based on existing transfer pricing concepts and documentation? If not, what additional concepts or documentation requirements would you suggest, recognising the need to retain a test that is as simple as possible? [*Refers to paragraphs 579-591 of the Blueprint*]

Paragraph 582 states "The OECD Transfer Pricing Guidelines (TPG) identify a series of factors that may entitle an entity to participate in the residual profits generated by an MNE group for transfer pricing purposes that will also be relevant for identifying the paying entities." The paragraph also states "the activities of the paying entity will likely consist of the performance of some or all of the important [DEMPE] functions related to the . . . intangible assets of the MNE group that are specific to the MNE group's market engagement." These include "intangibles related to technology that facilitates market engagement such as technology used in the ADS business to gather user data and content contributions." The implication of this language in paragraph 582 in our view is that the Amount A reallocation overrides the agreement regarding DEMPE in the BEPS project. The OECD should prioritize the use of current transfer pricing concepts with additional documentation requirements as necessary for this new purpose. Further, these rules must be simple and binding.

c. Do you consider that the profitability test should be calculated as a return on payroll and assets or should alternative approaches be considered? Could the profitability test apply

instead of, rather than in addition to, the activities test? [*Refers to paragraphs 592-598 of the Blueprint*]

The activities test should have priority over the profitability test because it is more aligned with currently accepted rules and thus more likely to be accepted by the states surrendering taxes. Once again, the most important requirement is a binding acceptance by OECD members of the final agreement.

d. Do you consider that a market connection priority test should form part of the process to identify a paying entity? Why or why not? [*Refers to paragraphs 599- 607 of the Blueprint*]

This seems too complex given the distributed supply chains currently used by MNEs to conduct business.

IX. The issue of scope of Amount B and definition of baseline marketing and distribution activities. More specifically, comments are invited on the following points:

a. Do you consider that Amount B should be narrow in its scope or should it take on a broader scope? What are the advantages or disadvantages of a narrow or broader scope? [*Refers to paragraph 659 of the Blueprint*]

Assuming the purpose of the Amount B fixed return for marketing and distribution functions is certainty and simplification, then Amount B should be sufficiently broad to minimize the likelihood of market jurisdictions asserting more revenue due to additional functions being performed in the market not included in the Amount B scope. The Amount B scope to be fit for purpose should be consistent with the arm's length principle and cover the vast majority of local country affiliates, which is also important for an effective marketing and distribution safe harbor but need not be the same number.

b. Do you consider the baseline activities outlined in the positive and negative list achieve the narrow scope definition examined in the Blueprint? If not, what changes should be considered? What changes to these lists would be required if a broader scope was adopted? [*Refers to paragraphs 664-673 of the Blueprint*]

No. The list should include products and services sales-related system design, implementation, set-up, training, and on-going services.

c. Do you consider that quantitative indicators or thresholds should be used when establishing whether or not entities are in the scope of Amount B? Why or why not, and if not what other factors should be considered? [*Refers to paragraph 674-679 of the Blueprint*]

When the fixed marketing and distribution returns are based on customer revenue in the market, even if not booked by the local affiliate, then there is no need for quantitative rules for the local affiliate.

d. Do you consider that multifunctional entities (i.e. entities that perform baseline marketing and distribution and other activities) should be eligible for Amount B? [*Refers to paragraph 680-684 of the Blueprint*]

Yes. However, this issue should be minimized in advance by increasing the scope of Amount B to include marketing and distribution-related activities.

e. Do you consider that Amount B will be effective in reducing disputes? If not, why? [*Refers to paragraphs 664-673 of the Blueprint*]

Yes, but only if the scope is increased. Otherwise, market jurisdictions will assert additional revenue due to additional functions which will result in additional, rather than fewer, disputes.

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. More specifically, comments are invited on the following points:

a. What the appropriate profit level indicator should be, for example whether a return on sales set at the (potentially adjusted) EBIT or PBT level should be used? [*Refers to paragraphs 686-688 of the Blueprint*]

No comment.

b. Do you consider that Amount B should account for variation in returns to baseline marketing and distribution activities by industry and/or region? If yes, what industry and/or regional variations should be considered? Are there any other differentiation factors that should be considered? [*Refers to paragraphs 690-693 of the Blueprint*]

While TEI members are supportive of an Amount B fixed marketing and distribution return, care must be taken to ensure it is consistent, as intended, with the arm-length principle for both low-margin businesses and profitable businesses alike. Marketing, sales, and distribution returns consistent with the arms-length standard are low across industries, regions, and profitability levels for both value added activities and for limited risk distributors, according to a transfer pricing analysis conducted by KPMG.[16] While low margin businesses necessarily must have reduced distribution returns, contrary to some unsubstantiated assertions, KPMG found that there is a ceiling for returns to sales, marketing and distribution functions, even where an industry segment is highly profitable.

It will also be important to consider the potential impact of Amount B on low margin businesses. If an MNE has profits below the Amount B fixed marketing and distribution return, for example, it would have no profits left to remunerate its other activities such as manufacturing, etc. This would inevitably lead to double taxation for low margin businesses. As such, the level of profits allocated through Amount

[16] The KPMG analysis is available at https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/institute/WU_Global_Tax_Policy_Center/KPMG_-_Amount_B_Econ_Analysis_-_full_report.pdf.

B should to some degree consider the system profit of the MNE to avoid such situations from arising. Therefore, we believe the profit level indicator should be determined in accordance with principles under the OECD Transfer Pricing Guidelines.

XI. The development of an early tax certainty process to prevent and resolve disputes on Amount A. More specifically, comments are invited on the following points:

a. What do you consider will be the key challenges in the early tax certainty process described in the Blueprint and how do you think would they best be addressed?

The suggestion for a phased approach for tax certainty purposes, beginning with the largest MNEs, makes sense because it will reduce work load volume, cover a large percentage of the relevant income base, and larger MNEs have more experience preparing the necessary documentation. The phased approach, however, should not discriminate against any particular industry or country and should include a mandatory timeline of when each phase will be implemented.

Challenges include a single aggressive country delaying and thwarting a review panel and resulting in panels taking significantly longer to complete their work than referenced in the Pillar One Blueprint. Further, Amount A review and determination panels must be limited to countries with a direct and material interest, conducted under confidentiality rules, and the information acquired by the panels must not be used for other purposes. Finally, it is important for the MNE's lead tax administration to participate in the determination panel under rules that do not allow other countries to override the lead tax authority by majority vote.

We note the requirement of a phased-in approach, even for the smaller group of MNEs above the revenue thresholds, underscores the complexity of the Pillar One Blueprint. Any such phased approach must include a legally binding agreement for all countries to implement the approach and should not ring-fence the digital economy or lead to a concentration of businesses from one specific jurisdiction being included in the first phase.

b. Do you consider that there are circumstances where an MNE group's ultimate parent entity would not be the most suitable constituent entity to be the group's co-ordinating entity? If so, which constituent entities in an MNE group are likely to be more suitable. [*Refers to paragraph 718 of the Blueprint*]

Situations where a constituent entity would be more suitable to be an MNE group's coordinating entity than the group's ultimate parent entity would be rare. They may arise, however, in the context of joint ventures among MNEs.

c. Are there any features that could be incorporated into the Amount A tax certainty process to encourage participation by MNE groups? Do you see any features in the proposed design that could discourage participation by MNE groups? [*Refers to paragraphs 728-729 of the Blueprint*]

The OECD must ensure the tax certainty process is conducted in a confidential manner and the data obtained must be strictly limited and only be used for the certainty process and not for any other purposes. The lead tax authority must be included in the determination panel, which must proceed by a super-majority (qualified majority) vote or consensus with limitations on the ability of individual countries with a direct and material interest to object and stall the panel's efforts.

Many elements of the tax certainty process are drafted in an anti-taxpayer manner and should be amended to ensure a more balanced approach. The Pillar One Blueprint states for example a taxpayer and its constituent entities must suspend the relevant statute of limitations.[17] This could result in costly and resource intensive delays in resolution of issues for both taxpayers and tax authorities. The Blueprint also states the tax certainty provided will fall away if any member of the MNE group pursues domestic remedies with respect to Amount A. Moreover, the Pillar One Blueprint also provides if it is later discovered that information provided by the MNE for purposes of review is inaccurate, incomplete, or misleading,[18] affected tax administrations are not restricted from conducting audits or other compliance activities concerning issues impacting the level of residual profit in a jurisdiction, etc.[19] These provisions should be amended so the Pillar One Blueprint is a more balanced document.

d. Do you consider that a separate process to determine whether an MNE group is within scope of Amount A would be beneficial, or that in practice this is unlikely to be used? [*Refers to paragraphs 729 and 782 of the Blueprint*]

This depends on the final political decisions on the scope of Amount A. Any resolution process permitting aggressive market jurisdictions to object or override the lead tax authority will result in additional disputes and controversies taking years to resolve (if ever).

XII. The introduction of new approaches to provide greater certainty beyond Amount A. More specifically, recognising that Inclusive Framework members continue to hold different views as to the extent to which Pillar One should incorporate new tax certainty approaches beyond Amount A, what are your views on the four-element approach explored in the blueprint? What

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[17] The Pillar One Blueprint states constituent entities "agree to the suspension of time limits on domestic compliance activity for the period of the review . . . ." Pillar One Blueprint at paragraph 730.

[18] *Id*.

[19] *Id*. at paragraph 732.

other suggestions and ideas do you have that would take into account these different views and help advance tax certainty beyond Amount A? [*Refers to paragraphs 710 and 801 of the Blueprint*]

The four elements of the tax certainty approach in the Pillar One Blueprint are entitled: (i) In-scope taxpayers; (ii) Other taxpayers; (iii) Amount B; and (iv) Developing economies with no or low levels of mutual agreement procedure (MAP) disputes.

In-scope taxpayers. The "last resort" nature of the new tax certainty approaches and accompanying mandatory binding dispute resolution (MBDR) would significantly delay the application of this tool, reducing its effectiveness. Therefore, it should be made available at the option of the in-scope MNE and not after "the exhaustion of all other dispute prevention and resolution tools . . . ."[20]

Other taxpayers. No comments.

Amount B. We agree MBDR should be available for Amount B but disagree with the approach of treating MBDR as a "last resort."

Developing countries with no or little MAP experience. We agree electivity is important for developing countries, but they should not be required to go through a multi-year MAP before utilizing MBDR as such an approach will leave few resources available to the developing country for MBDR.

Pillar Two Blueprint: General Comments and Responses to Questions

The Consultation Document requests stakeholders to address the Pillar Two Blueprint's "more technical aspects focused primarily on administration, implementation, calculation, and simplification where stakeholders and in particular businesses that would be subject to Pillar Two are likely to have insights and suggestions that may help to reduce cost and complexity, and improve tax certainty in the administration of Pillar Two . . . ."[21] Immediately below we provide our general comments on these and other Pillar Two Blueprint issues and then turn to the specific questions posed in the Consultation Document.

General Comments regarding the Pillar Two Blueprint

Pillar Two's policy objective is to impose a top-up tax on an MNE when its effective tax rate in a particular jurisdiction is below a certain threshold. This approach was not a part of the OECD's original BEPS project and has been added to address remaining BEPS risk of profit shifting to entities subject to no or very low taxation. Because of the relatively new approach set forth under Pillar Two, there are general areas of concern the OECD should to address, in addition to the technical work represented by the Pillar Two Blueprint and the related questions in the Consultation Document.

[20] Pillar One Blueprint at paragraph 800.
[21] Consultation Document at page 8.

A. Elimination of Unilateral Measures

The final agreement under Pillar One and Pillar Two should require the removal of all implemented and proposed unilateral tax measures (e.g., digital service taxes, multinational anti-avoidance laws, diverted profits taxes, equalization levies, offshore receipts in respect of intangible property) be withdrawn effective on the date of agreement on Pillars One and Two, as noted above. Such unilateral taxes, to the extent removal does not occur, should be treated as covered taxes (which should include all taxes levied "in lieu" of income taxes).

B. Group Reporting

The Pillar Two Blueprint includes several decision points aimed at finding a balance between the Blueprint's policy objective and simplicity for both MNEs and tax authorities. One decision point is to establish a new, independent way of calculating GloBE income and the kind of taxes eligible to be included in the calculation of the GloBE effective tax rate (ETR) (such taxes, Covered Taxes).[22] The proposed approach would only rely to a limited extent on an MNE's externally audited consolidated financial statements. More reliance on such data would, however, serve both the GloBE policy objective and simplicity of the GloBE ETR test. Externally audited consolidated financial accounts provide the most consistent and transparent information, for both taxpayers and tax authorities, for determining an "Accounting" ETR. Another advantage of using such an Accounting ETR is it already considers all material permanent differences under the tax law applicable to each constituent entity.

a. Deferred taxation

We understand certain Inclusive Framework members are concerned about the subjective nature of particular adjustments in accounting for deferred taxes which are effectively afforded permanent difference treatment upon establishment or adjustment of valuation allowances or uncertain tax positions. The associated impact of subjective elements of tax accounting (e.g., deferred tax asset derecognition, tax risk provisions) is subject to the highest level of scrutiny from external auditors and their oversight bodies and, consequently, the impact of such elements on the Accounting ETR can be easily identified and efficiently addressed using the same externally audited data. One way to address concerns around deferred tax recognition judgements for example is simply to ignore the impact on the Accounting ETR from derecognizing (or re-recognizing previously unrecognized) deferred tax amounts, or simply to include all movements in deferred taxation (both recognized and unrecognized).

We understand the concern regarding potential inconsistent approaches to deferred tax items leading to a distorted ETR, which in turn may produce outcomes contrary to the GloBE policy objective. The alternative approach of using an MNE's externally audited consolidated financial statement data, however, is dismissed in the Pillar Two Blueprint without a substantial discussion of the reasoning behind the decision. Moreover, the use of externally audited consolidated financial statements not even mentioned as an area to be explored for possible simplification ideas. Certain tax accounting conventions could, if not addressed, undermine the policy objectives of the GloBE rules and there are areas of

[22] We comment on the definition of Covered Taxes below.

judgment required to estimate "taxes to be paid in the future". However, those conventions and areas of judgment are exceptional, subject to the highest scrutiny of the MNE and its external auditor, and therefore easily addressed/resolved in line with the GloBE policy objective. More specifically, the determination of deferred taxes may involve judgment in the three areas set forth below. Practical solutions, however, are available to alleviate GloBE policy concerns and are also set forth below.

1. Recognizing a tax risk provision for an uncertain tax provision when it is probable a tax return position will not be sustained. The tax impact of a tax return position in fact being challenged would be part of the tax true-up impact for the year concerned and only affect such year's ETR (in line with the Blueprint impact).

2. Recognizing deferred tax assets based on the probability they will be recovered against taxable profit in the future. The derecognition or re-recognition of a deferred tax asset could have a permanent impact on the accounting tax charge. However, in light of the GloBE policy objective, such impacts can be relatively easily reversed from the accounting tax charge to result in an ETR ignoring any such judgment.

3. Recognizing deferred tax on outside basis differences (e.g. the undistributed earnings of subsidiaries) based on the probability such differences will reverse (e.g. earnings will be distributed) in the future. Distributed earnings are often exempt from (withholding) tax by virtue of participation exemption and/or tax treaties, in which case they would not lead to the recognition of deferred tax in the first place. However, in the situation where undistributed earnings would be taxable upon distribution and deferred tax would be recognized, any movements in such deferred tax balance can be relatively easily reversed from the accounting tax charge to result in an ETR ignoring any such judgment.

b. Country specific information

Country specific permanent differences are already considered in the accounting tax charge. When such information is available, the Blueprint proposal to only adjust for a few permanent differences complicates the GloBE ETR calculation and more importantly, leads to a distorted view of the ETR applicable to a MNE in a jurisdiction. Country specific temporary differences are also already reflected in the accounting tax charge. When such information is available, the Blueprint proposal to only adjust for accelerated tax depreciation leads to a distorted view on the ETR applicable to a MNE in a jurisdiction.

Taxpayers and tax administrators would then be able to prioritize resources efficiently to only those constituent entities or jurisdictions having an Accounting ETR below the GloBE ETR threshold, rather than first having to create/review a separate, unaudited and more interpretable data set for each and every constituent entity (which can be more than 1,000 for large MNEs). Clearly, the latter approach will represent a significant amount of work for MNEs to produce the new information and for tax authorities to audit the computations.

c. Cost considerations

The costs of complying with tax legislation and administrative regulations are often underestimated. Creating new information technology (IT) systems and internal processes to be able to comply with BEPS Action 13 country-by-country reporting (CBCR) requirements, for example, cost millions of U.S. dollars for larger MNEs. Given the complexity of the Pillar Two Blueprint, taxpayers will again be faced with devoting significant material resources merely to implement appropriate IT systems and internal processes, as well as incurring ongoing compliance costs each year. Similarly, tax authorities will also require appropriate resources to review the complex calculations, assumptions, processes and outcomes for each entity within each relevant MNE. The more adjustments required to more complexity, especially when the temporary differences will otherwise reverse over time.

We recommend for simplicity and efficiency:

i. MNE financial statements be used as a basis for Pillar Two provided they are prepared under a generally accepted accounting principle (GAAP) and independently audited;

ii. An MNE blended ETR be used (at a higher GloBE ETR threshold rate than would be applicable to a jurisdictional based GloBE ETR threshold) at least as a gateway for the Pillar Two rules; and

iii. Deferred tax amounts in group accounts be included in full (including movements in unrecognized deferred tax if it helps address concerns over judgmental areas).

Should these recommendations be unacceptable, it would be helpful if the OECD clarified the reasons why so effective solutions can then be discussed, and consensus achieved, within the OECD and Inclusive Framework.

C. Potential Simplification of Group Reporting

Significant simplifications should be introduced to manage the excessive complexity of the Pillar Two Blueprint if the general considerations regarding Group Reporting set forth above are not adopted.

We request the OECD and the Inclusive Framework to consider an approach whereby:

1. The accounting ETR is used at a jurisdictional level, by dividing aggregate accounting tax charge by the aggregate accounting income before tax, subject to adjusting for potentially ETR increasing items as follows:

    a. Excluding the impact (if any) on the accounting tax charge of:

        i. Movements in tax provisions for uncertain tax positions

        ii. Derecognition or re-recognition of previously unrecognized deferred tax assets; and

        iii. Movements in deferred tax on outside basis differences (e.g., undistributed subsidiary earnings); and

b. Excluding from the accounting income before tax: the seller's losses arising in connection with dispositions of stock, including mergers and sales of equity interests accounted for under the fair value accounting method.

2. When the "worst case" adjusted accounting ETR as calculated under 1. above is below the GloBE ETR threshold, then the MNE may make further adjustments for any of the following ETR increasing items (as outlined in the Pillar Two Blueprint) which may bring the ETR above the GloBE ETR threshold:

   a. Exclude dividends distributed from one Constituent Entity to another of the same MNE Group;

   b. Exclude from the seller's GloBE tax base all gains (or losses) arising in connection with dispositions of stock, including mergers;

   c. Stock based compensation, if not already included in the accounting tax charge of the constituent entity;

   d. Covered Taxes.[23]

Only if the adjusted accounting ETR as calculated under 2. above is still below the GloBE ETR threshold, would the MNE apply the formulaic substance-based carve-out to reduce any top-up taxation (which by then would likely be based on a true and fair reflection of the low tax burden of a MNE in a jurisdiction).

The above approach may be further refined for other items impacting ETR as required under the GloBE policy objective. Importantly, this simplified approach has significant benefits in that:

1. The ETR is based on the country specific tax rules, to leave the best indication of the actual tax burden of the Constituent Entities as desired under the GloBE policy objective;

2. The ETR is determined making use of externally audited data determined most consistently under Accounting Standards;

3. Deferred tax is duly considered, without potential judgmental impacts, thereby

   a. Reducing the risk of MNE's having to prepay (and account for) top-up taxation with uncertainty around ever being able to effectuate (and account for) an IIR tax credit; and

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[23] This list could be longer and include the unwind of deferred tax recognized as part of a business combination. Typically, a deferred tax liability (DTL) would be recognized at acquisition date due to the increased accounting value. This DTL would be recognized against goodwill (no ETR impact) but unwind through the tax charge (DTL release is a tax reduction reducing ETR). So even if a Constituent Entity would see such purchase price allocation impacts in its accounting ETR, it would have reduced its ETR. Only if the ETR is below the GloBE ETR threshold, would there be a need to go through a more detailed analysis.

   b. Avoiding the need for a carryforward mechanism to address the undesired outcomes of ignoring most temporary differences under the Blueprint proposal (and avoiding associated concern around planning around IRR credit / carryforward optimization).

4. The adjusted accounting for many Constituent Entities' ETR already shows the GloBE ETR threshold is passed. Those Constituent Entities and their tax authorities will benefit from not having to interpret or debate Covered Taxes, any other GloBE ETR increasing items, or the formulaic substance based carve out.

5. MNE, tax authorities and any other stakeholder (e.g. external auditors) would be able to calculate how much headroom would at least be available for a jurisdiction, by multiplying the excess of the adjusted accounting ETR over the GloBE ETR threshold, by the (adjusted) accounting profit. This allows for a risk assessment for each party and the deployment of resources accordingly, if so desired.

D. Definition of "Covered Taxes"

Considering the objective of Pillar Two to ensure a minimum level of tax is paid by MNEs, the definition of Covered Taxes should include all relevant tax payments by MNEs related to their profits and production. The Pillar Two Blueprint defines "Covered Taxes" as "any tax on an entity's income or profits (including a tax on distributed profits), and includes any taxes imposed in lieu of a generally applicable income tax. Covered taxes also include taxes on retained earnings and corporate equity."[24] TEI agrees with this definition, particularly the inclusion of "in lieu of" taxes, but notes the definition should be broadly interpreted. Unilateral taxes (e.g., digital services taxes, equalization levies, diverted profits taxes) for example should be treated as Covered Taxes as noted above to the extent they are not repealed as part of a consensus agreement on the approach of the Pillar One and Two Blueprints.

E. Economic Effects of Pillar Two

The OECD's Economic Impact Assessment (the Impact Assessment) published in conjunction with the Blueprints[25] found the impact of Pillar Two would fall largely on MNEs engaging in profit shifting. We understand the Impact Assessment largely utilizes data from 2016 and 2017, which pre-dates implementation of many of the BEPS project measures. This data also excludes the impact of U.S. tax reform, the effect of which was to levy tax on accumulated foreign earnings and to ensure taxation of all income on a current basis. The ability of MNEs to earn untaxed current income has, therefore, been significantly reduced, at least for U.S. based MNEs. The Impact Assessment should be updated accordingly using more current data so the effect of the BEPS project and U.S. tax reform can be fully evaluated to inform the OECD's work under Pillar Two.

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[24] Pillar Two Blueprint at pages 45-6.

[25] The Economic Impact Assessment is available at https://www.oecd-ilibrary.org/docserver/0e3cc2d4-en.pdf?expires=1604675249&id=id&accname=guest&checksum=61FA862DBE3C5B1A8447B6428A6239BF.

F. Minimum Effective Tax Rate

The Pillar Two Blueprint does not discuss the minimum effective tax rate. The minimum effective tax rate is fundamental to Pillar Two and should be part of the public consultation process going forward.

G. The Subject to Tax Rule

The STTR would levy a gross basis withholding tax on a wide range of payments. This sets a bad precedent, represents a departure from long-established principles for profit-based taxes advanced by the OECD, and will likely lead to double taxation. Further, the OECD is apparently considering expanding the scope of the payments covered by the STTR. We recommend rejecting this potential expansion and limiting the application of the STTR to interest and royalties.

H. Tariffs and Customs Duties

Pillar One, in part, targets CFBs and would create a significant additional administrative burden. Pillar Two in this regard should give CFB MNEs the option to consider customs duties and tariffs as a form of minimum tax. Unlike VAT or sales taxes, in which MNEs collect and remit sales taxes as "collection agents" to the various levels of government, customs and tariffs are an additional tax on MNEs. These costs cannot always be passed on to consumers via product pricing and are therefore akin to a minimum tax.

Responses to Questions Posed Regarding the Pillar Two Blueprint in the Consultation Document

I. Chapter 1: Introduction and Executive Summary

a. GILTI co-existence. [Refers to paragraphs 25-28 of the Blueprint]

1. Do you foresee any other technical implications of GILTI co-existence - in addition to those already identified in the Blueprint that should be taken into account?

The Pillar Two Blueprint states GILTI may be considered a compliant IIR for purposes of Pillar Two's GloBE proposal. This suggests, however, U.S. companies could be subject to Pillar Two's undertaxed payment rule and STTR. TEI strongly believes any final GloBE rules must treat the U.S. GILTI regime as a compliant minimum tax regime for all GloBE purposes (i.e., for the IIR, the undertaxed payment rule, and the STTR). Should GILTI be considered a compliant regime, then there would be no intermediate minimum tax down an MNE's ownership chain and thus no reason for a new set of rules for companies subject to GILTI. Based on the Secretariat repeated asserting GILTI is a more onerous provision and raises more revenue than GloBE, a comprehensive exception for GILTI taxpayers is consistent with Pillar Two's policy objectives.

Assuming GILTI is a compliant IIR, the OECD should clarify how GILTI would coexist with the GloBE going forward, particularly if changes are made to the GILTI regime. For example, what would cause GILTI to cease to be a compliant regime? Would minor amendments to the GILTI regime

invalidate the exemption? Must certain features of GILTI be retained to maintain the exemption? The OECD should answer these and similar questions in final guidance under Pillar Two.

If the OECD intends for GILTI and the GloBE to coexist, it would be helpful if the OECD provided numerical examples of their interplay for non-U.S. Headquartered MNEs who are subject to GILTI on a portion of their U.S. group activities. This situation may arise because of an acquisition by a non-U.S. headquartered MNE of a U.S.-based group (with its own foreign affiliates) where the U.S.-based group was subject to the GILTI regime.

There should also be some discussion of the potential creditability of Pillar Two taxes in the United States. The newly proposed U.S. foreign tax credit regulations[26] create some doubt about the taxes proposed under Pillar Two being creditable in the United States.

Finally, the OECD should assess whether rules similar to the U.S. GILTI regime in other jurisdictions should be considered for the same treatment as the U.S. regime under the final Pillar Two Blueprint rules.

2. What are the interactions between GILTI and the GloBE rules that would need to be coordinated and how should they be coordinated?

There should be little coordination necessary depending on how GILTI is grandfathered into Pillar Two as an exception to the GloBE regime. The timing of when U.S. tax returns are due and the due date of Pillar Two taxes, however, should be considered, especially because GILTI foreign tax credits are determined on a current year basis. Should Pillar Two taxes not be determined until after the U.S. tax return is filed, there may be complex foreign tax credit redetermination issues to address which will require subsequent amendment of the U.S. tax return under recently modified U.S. tax rules.

II. Chapter 2: Scope of the GloBE rules

No comments on this Chapter.

[26] The proposed U.S. foreign tax credit regulations are available at https://www.irs.gov/pub/irs-drop/reg-101657-20.pdf. *See also* 85 Fed. Reg. 72,078 (Nov. 12, 2020).

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

a. **Treatment of dividends and gains from disposition of stock in a corporation**. [*Refers to paragraphs 181-191 of the Blueprint*]

1. Do you have any views on the appropriate ownership threshold and the methodology of how to determine that threshold, both for the exclusion of portfolio dividends and the exclusion for gains and losses on the disposition of stock from the GloBE tax base?

Assuming the purpose of this guidance is to exclude income from investments accounted for under the equity method of accounting then the thresholds and methodology should be consistent with the applicable financial accounting rules, *e.g.*, U.S. GAAP for U.S. headquartered MNEs.

b. **The treatment of re-organisations under Pillar Two**. [*Refers to paragraphs 211-212 of the Blueprint*]

1. What types of re-organisations risk inappropriately triggering a liability under the GloBE rules and what are the technical issues that need to be considered in developing a rule that will allow MNE groups to undertake those re-organisations without triggering a liability under the GloBE rules?
2. Should the rule apply to a re-organisation involving an acquiring entity and an acquired entity located in different jurisdictions? How can these issues be addressed in the design of a rule that minimises compliance costs and the risk of over- or under-taxation?

No comments.

c. **Rules to adjust for accelerated depreciation**. [*Refers to paragraphs 220-225 of the Blueprint*]

1. What are the technical issues that need to be considered in developing a rule that will minimise the instances of a tax charge under the GloBE rules and a corresponding IIR tax credit due to accelerated depreciation or immediate expensing of assets capitalised in the financial accounts?

Many jurisdictions have prolonged due dates for tax returns or statutory financials for a subsidiary included in a consolidated financial statement. Each jurisdiction has different rules for depreciation reportable on its local statutory financial accounts versus depreciation reported on tax returns. Taxes under Pillar One and Pillar Two, however, may be due sooner than local statutory financials and tax returns are due. Considering all the above factors, it will likely be easier to administer the forthcoming rules by using depreciation on an MNE's public consolidated financial statements. A U.S. MNE in this situation will use its U.S. GAAP depreciation for its U.S. and foreign subsidiaries included in its annual report (i.e., U.S. Securities and Exchange Commission Form 10-K). This amount is more trustworthy as it is audited by an independent auditor and should be easy to verify under the future rules.

Using tax depreciation (tax depreciation per local statutory tax return, bonus depreciation ,or the alternative depreciation system under the U.S. GILTI regime) only adds more work without driving a cumulative difference between an MNE's effective tax rate and cash tax paid. Additionally, it imposes challenges for timely reporting and administration.

2. How can these issues be addressed in the design of a rule that minimises compliance and administration costs? Should the rule be based on deferred tax accounting, or rather allow the GloBE tax base to be computed by reference to tax depreciation instead of financial accounting depreciation?

Considering tax returns are not always audited while consolidated financial statements generally are, it would be less burdensome to use book depreciation as reflected in publicly reported or other audited financial statements.

d. **The treatment of tax transparent entities**. [*Refers to paragraphs 274-278 and 283 of the Blueprint*]

1. Are there further technical issues to consider in regard to the treatment of fully or partially tax transparent and (reverse) hybrid entities?

No comments.

e. **Allocation of "cross-jurisdictional" taxes (particularly, anti-avoidance rule)**. [*Refers to paragraph 284 of the Blueprint*]

Paragraph 284 discusses the potential abuse of allocating withholding taxes and controlled foreign company (CFC) taxes to lower tax jurisdictions to satisfy the minimum tax threshold for those jurisdictions. Withholding taxes economically borne by a CFC should remain assigned to the CFC for GloBE purposes.

1. Do you have any views on how to allocate the "cross-jurisdictional" taxes (e.g. CFC regime taxes and withholding taxes)? In your response please also consider the following:

No comments.

i. Given the significant planning opportunities of reducing the MNE's tax liability by taking advantage of those "cross jurisdictional" taxes described in paragraph 284, do you have any ideas on the design of an anti-avoidance rule to avoid such planning opportunities and what are the technical issues that need to be considered in developing such a rule?
ii. How can these issues be addressed in the design of a rule that minimises compliance and administration costs?

No comments.

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

These topics, discussed in paragraphs 295-314 of the Pillar Two Blueprint, will create additional compliance issues but may be helpful. The loss carryforward rules may be helpful depending how each jurisdiction's income/loss is calculated (e.g., with respect to intragroup allocations). The IIR and local tax credit rules also seem helpful as an MNE group can use IIR tax credit carryforwards from each jurisdiction to offset the group's IIR tax liability from another jurisdiction. While these rules are unlikely to impact GILTI taxpayers, they may be similarly helpful.

Highly taxed MNE operations may be subject to increased taxes under Pillar Two without robust loss carry-forward and carry-back rules aligning with local tax legislation. Long term business investments with high early or late year costs, for example, may be subject to the GloBE in such years even if the investment, when measured across its multi-year time horizon, would not be subject to the GloBE. This result could be avoided if the OECD adopts the approach of permitting deferred tax accounting to affect an MNE's ETR, as discussed above

a. **Treatment of pre-GloBE losses and excess taxes under the carry-forward approach**. [*Refers to paragraphs 315-318 of the Blueprint*]

No comments.

1. What technical issues should be taken into account in developing a rule that would recognise the impact of pre-regime losses and benefit of taxes paid by the Constituent Entities of an MNE Group prior to becoming subject to the GloBE rules?

Pre-regime losses and local tax carryforwards would need to be calculated using the GloBE rules. No IIR credit carryforwards would arise because no IIR tax was paid in pre-regime years.

2. How can these technical issues be addressed in the design of the rule?
3. Do you have any views on the appropriate period for such losses and taxes being recognised and how to determine that period?

One approach would be to coordinate the rules with local jurisdictional rules regarding loss and tax carryforward/carrybacks.

4. Are there special considerations that apply to certain industries?

No comments.

b. **Formulaic substance-based carve-out**. [*Refers to paragraph 332-370 of the Blueprint*]

1. Do you have any comments on the overall design of the carve-out?

The Pillar Two Blueprint provides a formulaic substance-based carve-out to exclude a fixed percentage of income for substantive activities within a jurisdiction from the scope of the GloBE rules.

The carve-out as presented is very limited and solely formula-based. A strictly formulaic carve-out for substantive activities would contravene well established international tax norms, which have historically focused on actual substance, facts and circumstances, the arm's length principle, *etc*., for substance-based exclusions. Bilateral double taxation treaties, for example, generally include such exclusions. We recommend a facts and circumstances-based substance exemption be used in addition to the proposed more formulaic carve-out.

c. **Computation of the ETR and top-up tax**. [*Refers to paragraph 371-375 of the Blueprint*]

1. Do you have any comments on the proposed calculation of ETR and top-up tax?

Providing substantive comments is difficult because political decisions are necessary before appropriate technical guidance can be issued. This includes how to treat jurisdictions with low effective tax rates, withholding taxes, and the treatment of timing differences.

V. Chapter 5: Simplification options.

a. **General**. The Blueprint describes four potential simplification measures, including (i) CbC Report ETR safe harbour, (ii) de minimis profit exclusion, (iii) single jurisdictional ETR calculation to cover several years, and (iv) tax administrative guidance.

Although the inclusion of proposed simplification measures is welcomed, they reinforce the extreme complexity of the Pillar Two proposals, which will be difficult and costly to comply with and administer. Further complicating matters, in addition to the complexity of implementing Pillar Two, is the uncertainty regarding whether Pillar Two will, in fact, be implemented at all. This makes it difficult to plan and allocate resources for future compliance with the Pillar Two regime (in whatever form). Should the effective tax rate of an MNE on a consolidated basis be above a certain threshold, the Pillar Two provisions should not apply as the objective of ensuring an appropriate level of taxation would have been met.

The Blueprint also indicates the OECD is considering a simplification measure based on the CBCR implemented under BEPS Action 13. The CBCR report is solely a high-level risk assessment tool and the information in the report is prepared on this basis. Were the CBCR data for Pillar Two compliance purposes, as indicated in the Pillar Two Blueprint, a number of adjustments would be required to the CBCR data before it would be meaningful. The CBCR data, for example, does not reflect eliminations as income is tiered up and MNE's ownership change. Such data thus overstates taxable income on a global basis and does not provide an accurate or meaningful representation of an MNE's global ETR. Accordingly, utilizing CBCR data is unlikely to lead to reduced compliance costs or efficiencies. Additionally, once the adjusted CBCR data is made available, it may be used by tax authorities for unintended and perhaps improper purposes, leading to more disputes and unintended outcomes.

Finally, the Pillar Two Blueprint suggests the use of administrative guidance as a simplification measure in those jurisdictions with a tax base similar to the GloBE and a sufficiently high rate. This

would be a welcomed simplification. Consideration should be given to whether administrative guidance could also be extended to cover the subject-to-tax rule (STTR).

1. Are there any options that you consider would offer the most potential for simplification? Are there any options that you consider would offer little potential for simplification?

The use of administrative guidance as a simplification measure is welcomed. This would improve the ease for taxpayers to implement and provide greater certainty.

2. Do you have any comments regarding how any of these options could be improved in order to provide greater simplification?

Consideration could be given as to whether administrative guidance can be extended as a simplification to application of the STTR.

3. Can you identify any other overall simplification measures that could be explored by the Inclusive Framework or potential simplifications to the design or application of specific elements of the IIR or the UTPR that would not undermine their objective or effectiveness?

The Pillar Two provisions should not apply if the effective tax rate of an MNE on a consolidated basis is above a certain threshold because the objective of ensuring an appropriate level of taxation would be satisfied.

b. **CbC Report ETR Safe Harbour**. [*Refers to paragraphs 381-390 of the Blueprint*]

1. Does the requirement for using the parent's consolidated financial accounts significantly reduce the number of MNEs able to use this simplification measure?
2. Do any of the required adjustments, as described in the Blueprint, create significant additional complexity? Do you have any suggestions on how to streamline these required adjustments?
3. Do you support the idea of using deferred tax accounting to provide a more accurate picture of the MNE's expected tax liability in each jurisdiction without the burden of computing and tracking carry-forwards? Would doing so add material complexity?
4. Do you have ideas on how this simplification measure should be coordinated with the carry-forward mechanisms described in Blueprint? For example, in instances where the MNE has an ETR that is above the safe- harbour ETR for one or more prior years, but one that is below the safe- harbour ETR in the current year, should the MNE be allowed to go back and compute its carry-forward attributes for the prior years?

No comments.

c. **De minimis profit exclusion**. [Refers to paragraphs 391-398 of the Blueprint]

No comments.

d. **Single jurisdictional ETR calculation to cover several years**. [*Refers to paragraphs 399-403 of the Blueprint*]

1. Do you agree with the text in the Blueprint that this simplification option may not offer material simplification given that it requires computing an ETR in every jurisdiction in the base year?

Yes.

2. Do you agree with the text in the Blueprint that this simplification measure would likely require targeted rules to address potential abusive arrangements, which would further undermine its intended simplification?

Yes.

e. **Tax administrative guidance**. [*Refers to paragraphs 404-409 of the Blueprint*]

No comments.

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

VII. Chapter 7: Undertaxed payments rule

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

IX. Chapter 9: Subject to tax rule

X. Chapter 10: Implementation and rule co-ordination

We have no comments on these chapters of the Pillar Two Blueprint.

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TEI appreciates the opportunity to comment on the Pillar One and Pillar Two Blueprints. TEI's comments were prepared under the aegis of its European Direct Tax Committee, whose chair is Kris

Bodson. Should you have any questions about our comments, please contact Ms. Bodson at +32 2 746 36 01 or kbodson@its.jnj.com, or Benjamin R. Shreck of TEI's legal staff at +1 202 464 8353 or bshreck@tei.org.

Respectfully submitted,
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