The **BEPS** Monitoring Group

COMMENTS ON THE IMPLEMENTATION FRAMEWORK OF THE GLOBAL MINIMUM CORPORATE TAX

These comments by the BEPS Monitoring Group (BMG) analyse the proposals for a global anti-base-erosion minimum tax on corporate profits issued by the G20/OECD Inclusive Framework on BEPS in December 2021 and January 2022. The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This report has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. It is based on our previous reports, and has been drafted by Sol Picciotto, with comments and contributions from Jeffery Kadet, Sakshi Rai, Chenai Mukumba, Séverine Picard, Sudarshan Rangan and Tommaso Faccio.

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SUMMARY

The agreement on measures to end international tax competition is a historic feat of international cooperation. However, its main component, the global anti-base erosion tax (the GloBE) has serious flaws. Implementation must respect states' tax sovereignty, and each country must decide after a full democratic debate whether to adopt the GloBE, and if so how to incorporate its rules into national law. In our view most low-income countries will not implement the GloBE itself, partly due to its complexity, but above all because of the bias in its rules in favour of the home countries of multinational enterprises (MNEs). This gives lowest priority to taxation of profits at source, where they arise, by MNE host countries, disadvantaging low-income countries which generally are only hosts to MNEs.

Nevertheless, adoption of the GloBE could benefit all countries, provided that it is not implemented in a way that reinforces this unfair bias. Ensuring that all profits will be taxed at least at the minimum rate should enable and encourage all countries to end unsuitable tax incentives to MNEs and adopt appropriate measures to strengthen source taxation. These measures should not be limited to those provided in the GloBE itself. For those participating in the scheme, they need only be compatible with the GloBE outcomes, while those not participating should be allowed and encouraged to adopt any measures they consider suitable, particularly to prevent the shifting of profits out of countries that are hosts to MNEs. The aims of the GloBE should be clearly stated as enabling MNEs to be taxed where they have real economic activities, and ending the secular decline of corporate taxation that damages all countries in the long run.

1. Background and Context

The agreement on measures aiming to end international tax competition resulting from globalisation is a historic feat of international cooperation, after a quarter-century of attempts by the OECD.[1] It has been designed as a 'concerted approach', aiming to enable all states to defend their tax base from the harmful effects of the tax avoidance strategies of multinational enterprises (MNEs), now referred to as base erosion and profit shifting (BEPS). Although the project to combat BEPS was launched by the OECD in 2012, and was adopted also by the G20 in 2013, the large package of reforms agreed in 2015 only patched up some defects, while creating greater complexity and uncertainty.[2] Work has continued, with involvement open to all states through the Inclusive Framework on BEPS, resulting in proposals under two Pillars.

The proposed measures to combat tax competition form Pillar Two, the key component of which is the design of a global anti-base erosion tax (the GloBE). This is the most likely element to be implemented by states, since they can do so without the need for a multilateral convention. Indeed, the structural format of the GloBE is based on rules adopted unilaterally by the US in late 2017, although with significant improvements.

We are grateful for this opportunity to comment on the implementation framework for the GloBE. It is particularly welcome as there was no public consultation on the final version of the GloBE model rules, despite significant changes made following the consultation on the Pillar Two blueprint in late 2021. We nevertheless published our February 2022 comments analysing the model rules, particularly from the perspective of low-income countries.[3] This present submission is based on that analysis, focusing on the implementation aspects.

2. Limitations of the GloBE

Although reaching an agreement was a significant achievement, regrettably the design of the GloBE itself still has serious flaws. In brief, these are as follows:

> (i) the agreed minimum effective tax rate (ETR) of 15% is low compared to the global average corporate tax rate of 25%, particularly when combined with the possibility of offering even lower rates (down to zero) on income carved-out by the substance test; this will continue to provide strong incentives to shift profits out of host countries where real activities occur. Its scope is also too narrow, particularly by excluding MNEs with less than €750m turnover, as well as international shipping income.
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> (ii) Its rules are highly complex, largely because the scheme creates a new layer on top of the existing international tax rules; these are based on the misleading fiction that MNE corporate groups consist of independent entities dealing with each other at arm's length, which enables and encourages BEPS practices.
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> (iii) The GloBE has been formulated with three interacting rules for allocating the right to tax undertaxed profits, ignoring proposals that were put forward for a single formulary method.[4] These rules give priority to the home countries of MNEs to apply

[1] This began with the G7 Lyon Summit in 1996, see the Economic Communiqué (paragraph 16), available at http://www.g8.utoronto.ca/summit/1996lyon/communique.html

[2] See J. Andrus & R. Collier (2017). *Transfer Pricing and the Arm's Length Principle After BEPS*: Oxford University Press.

[3] Available at https://www.bepsmonitoringgroup.org/news/2022/2/9/comments-on-the-model-rules-for-the-globe .

[4] In particular, the proposal put forward by a group of independent commentators to apportion the top-up tax by a formula using factors reflecting each MNE's real presence in each country; this would be simpler to apply and fairer, so much more likely to be widely adopted: Alex Cobham, Tommaso Faccio, Javier Garcia-Bernardo, Petr

an income inclusion rule (IIR), while the right of host countries to apply an undertaxed profits rule (UTPR) is only a back-up. The new provision for a domestic top-up tax (DMTT) would benefit only countries where MNEs declare relatively high levels of profit that are taxed below the ETR; these are essentially tax havens that offer preferential tax regimes to attract 'conduit' intermediary entities, used to channel profits shifted out of source countries. This gives lowest priority to ensuring an appropriate level of tax at source, where profits arise. While this bias affects all countries, it particularly discriminates against lower-income countries, which are generally only hosts to MNEs, and are also more highly dependent on corporate income tax, thereby disadvantaging poor countries that are battling economic crisis resulting from the pandemic and other international events.

(iv) The DMTT encourages continued tax competition, particularly since in combination with the substance-based carve-out it results in an overall ETR below 15%, contrary to the GloBE's aims, and risks turning the minimum to a maximum.

(v) The method of calculating the ETR encourages competition over the definition of the tax base, for example by providing generous allowances for research and development, capital investment and depreciation, and the acquisition of intellectual property rights and other intangibles (particularly for acquisitions made prior to December 2021).

(vi) The use of financial accounting rules as the basis for calculating the ETR, albeit with some defined adjustments, reverses the normal approach in which tax authorities have powers of detailed examination that are independent of audited financial accounts, and hence allows MNE management considerable discretion in determining the relevant tax base.

3. Implementation and the GloBE's Intended Outcomes

Despite these flaws, the introduction of the GloBE by some states could benefit all countries, by reducing the temptation to offer tax incentives to attract investment, since undertaxed income is likely to be subject to a top-up tax by another country. Each country must decide whether to join the GloBE scheme, but in view of its complexity and unfairness, we expect that few low-income capital-importing countries will choose to implement it. Instead, they could, and we believe should, seek to adopt complementary measures to protect their tax base. This includes reviewing their incentives regimes to ensure that, at least where such incentives result in profits taxed at a lower ETR than the minimum tax, these profits are not taxed by another country through a top-up tax. Countries should also adopt complementary measures, such as alternative minimum taxes, and withholding taxes on fees for services, that provide a stronger protection of the tax base. It should be borne in mind that non-residents earning income in a country with little or no substantive presence there do not boost local investment or jobs, and if they do not pay tax they compete unfairly with local providers of similar goods or services who do pay tax.

The countries that do choose to implement the GloBE will be required to implement the rules 'in a way that is consistent with the outcomes provided for under Pillar Two, including in light of the model rules and guidance agreed to by the IF'.[5] They would not be legally bound to apply the GloBE rules literally or in every detail, but could implement them in their

Janský, Jeffery Kadet, and Sol Picciotto (2021), 'A Practical Proposal to End Corporate Tax Abuse: METR, a Minimum Effective Tax Rate for Multinationals.' IES Working Papers 8/2021: IES FSV. Charles University. Available at https://ies.fsv.cuni.cz/sci/publication/show/id/6412/lang/en

[5] Statement on a Two Pillar Solution, October 2021, p, 3.

domestic law as seems suitable for them, following appropriate democratic scrutiny. It is important to retain sufficient flexibility to allow incorporation of (i) clarifications and interpretations, (ii) modifications resulting from economic developments and changes in business models and practices, and (iii) improvements to remedy some of the defects and limitations of the current rules.

In our view, any multilateral review process for the implementation of Pillar Two should respect national tax sovereignty and policy choices made democratically. It would be a mistake to insist on uniformity in implementation. Variations between countries in the way the rules are implemented and interpreted are inevitable, and indeed desirable. Arrangements will no doubt be made for administrative cooperation in applying the GloBE, and these can be used to iron out the inevitable glitches and inadvertent errors. However, countries should not be put under pressure to change their policies or interpretations of the rules as adopted in their jurisdiction. The multilateral adoption of agreed interpretations, as well as any revisions to the model rules or their commentary, must be done in a fully transparent manner, including opportunities for appropriate public consultations and feedback for any that are significant.

No doubt the paid advisers to MNEs will plead for a high degree of uniformity, arguing that variations would increase compliance costs. Such special pleading should be treated sceptically. MNEs gain significant economic advantages from globalisation and the ability to operate in many countries, and must accept the costs of complying with the laws and regulations of every jurisdiction where they have a presence. In fact, they frequently choose to create complex structures involving entities in jurisdictions where they do not have genuine business activities, for the purpose of avoiding tax and other regulations. The GloBE aims to encourage them to dismantle such structures, and doing so would be the best way for them to reduce the transaction costs involved in any diversity of regulatory requirements.

To ensure that decisions on consistency with GloBE outcomes are taken in a clear and principled manner, the aims of the GloBE should be made explicit. We suggest that these are:

> (i) to achieve the objective stated by the G20 in 2013,[6] and all UN member states in the 2015 Addis Ababa Action Agenda,[7] of enabling MNEs to be taxed according to where they have real economic activities, and
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> (ii) to put a brake on the competition to reduce tax to attract investment and to reverse the secular decline in effective corporate tax rates, which damages all states in the long run.

We are concerned by the references in the Commentary to the need to avoid 'the risks of double or over-taxation' (Introduction, paras. 1 and 14). We see no risk of 'over-taxation' of MNEs, and the risks of 'double taxation' are often overstated; it is because tax rules have prioritised the prevention of double taxation for too long that the result has been double non-taxation. Tax competition over the past 30 years has resulted in a serious under-taxation of the profits of MNEs, helping to enable many of them to become mega-sized global entities by exploiting the weaknesses in the international tax framework. The GloBE should be implemented in a way that helps to reverse this process. There should be little sympathy for MNEs that have created complex and convoluted tax-motivated structures if those structures create somewhat higher taxes under the GloBE.

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[6] St Petersburg Declaration, Tax Annex, available at https://www.oecd.org/g20/summits/saint-petersburg/Tax-Annex-St-Petersburg-G20-Leaders-Declaration.pdf

[7] Para 23, available at https://sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf

5. The Scope for Alternative Measures to those in the GloBE

The issue of compatibility will arise also in relation to taxes applied by states as an alternative to those aiming to comply with the IIR, DMTT or the UTPR. This will affect countries that do not participate in the GloBE scheme as well as those that do.

Such taxes will raise the question of whether they should be treated as 'covered taxes' for the purposes of calculating the ETR. These are defined in article 4.2 as taxes on income, or taxes 'in lieu of a generally applicable income tax'. The Commentary explains that taxes on income are generally applied to net profits; although that can include a 'simplified estimate of net profit', but not if done by reference to a gross amount (para. 27).

However, the 'in lieu of' test allows 'taxes that are not described in the generally applicable income tax definition but which operate as substitutes for such taxes.' Explaining this criterion, the Commentary states that it 'would generally include withholding taxes on interest, rents and royalties, and other taxes on other categories of gross payments such as insurance premiums, provided such taxes are imposed in substitution for a generally applicable income tax' (para. 31). This does not specifically refer to withholding taxes on fees for services, which are widely applied by low-income countries, and should equally be considered covered taxes.

The test of consistency should not be used to reinforce the unfair and inappropriate imbalance in the GloBE rules against source taxation. On the contrary, it should be acknowledged that the intended outcomes of the GloBE include the removal of incentives to shift profits out of source countries, and the strengthening of measures by those countries to protect their tax base. Hence, it should be applied so as to allow and indeed encourage countries to adopt measures in addition to those provided by the GloBE, to deal with the BEPS practices that each country experiences. This is particularly important for measures to protect taxation at source of income arising in a country.

These should not be limited to measures based on the UTPR, nor the proposed STTR being designed as part of Pillar Two. This will merely offer a possible new tax treaty provision, the suitability of which should be evaluated in the context of each country's existing treaties, and other available options, particularly those in the UN model convention. Scope should also be allowed for the application of simplified methods for the determination of taxable income, particularly by low-income countries, which are particularly disadvantaged by the difficulties of administering the current rules for attribution of income.

The determination of 'net income' can be particularly problematic for source countries, as regards specifying both the source of the income and of the related expenses. This is especially difficult for income from services, and income attributable to intangibles, which are less dependent on physical presence in a particular country. Employees providing services, as well as those involved in research and development (for example of software), can often work with little physical contact with either their company's home base or even that of their client or customer. This trend has accelerated due to Covid-19, and is likely to continue.

These problems are indeed at the heart of the BEPS project, and regrettably remain unresolved, though significant progress has been made on technical aspects. The proposals under Pillar One would apply a new methodology for attributing taxing rights to source countries where income arises, and will include rules for defining the source of income from services. However, even if they enter into force, they will apply only to about one hundred of the largest and most profitable MNEs and for only 25% of the residual profits. The momentum for the allocation of more taxing rights to the countries where income is generated (so-called 'market' countries) will inevitably continue.[8] Hence, these issues will remain a point of contestation. This will create questions of interpretation for the GloBE rules, especially as regards the definitions of covered taxes. It is clearly important that the GloBE rules should not be implemented so as to enforce the priority they give to home country taxation of MNEs.

Here it should be noted that the Commentary states that digital services taxes (DSTs) will generally not fall within the definition of covered taxes. This is stated to be because (i) they apply to gross and not net income, and (ii) they are 'generally designed to apply in addition to, and not as substitutes for, a generally applicable income tax under the laws of a jurisdiction' (para. 36).

We suggest that this approach is not consistent with the design and aims of the GloBE. It is intended to apply to undertaxed profits. If a tax falls on profits, and is appropriately recognised as an expense in the entity's financial accounts for the purposes of calculating profits, it should be taken into account when calculating the ETR. As the Commentary states (para. 32, p. 91), 'the focus is on the underlying character of the Tax'. The issue with DSTs is rather whether they take the form of a transaction tax, particularly if collected from the customer as a withholding from the payment for the service. Such taxes can be seen as the responsibility of the customer, and hence do not fall on profits. A tax designed to fall on the earnings of a company, and imposed as a legal obligation of that company irrespective of the means of collection (e.g. through a withholding mechanism), would usually be included as an expense against those earnings in its accounts. Such a tax must be a covered tax. If it is disregarded, the GloBe would not fall on undertaxed profits.

The question of whether such a tax is 'in addition to' and not in substitution for a generally applicable income tax is a distinct one, and requires a clearer rationale. Excluding such taxes from the scope of covered taxes recognised by the GloBE seems to contradict the aims stated in the Commentary of avoiding double or over-taxation. Although we ourselves do not give these aims a high priority, clear reasons should be provided for excluding taxes that fall on profits from the criteria for identifying undertaxed profits. This criterion does not seem to be integral to the aim of the GloBE of taxing undertaxed profits.

Countries have adopted a variety of measures to protect source taxation, and these are likely to continue, and even expand. For example, the UK government in its consultation on the implementation of the GloBE has indicated that it intends to retain its other anti-avoidance measures.[9] This presumably includes the diverted profits tax (DPT), enacted in 2015,[10] as well as the tax on income received for intangibles in a low-tax jurisdiction derived from sales in the UK, enacted in 2019.[11] These measures aim to protect the source tax base, but they are not modelled on the UTPR. However, they do raise issues of interpretation as regards whether they are taxes on net income, or in lieu of a generally applicable income tax.

[8] See M. Andrew & R. Collier (2022). 'Is the shift to taxation at the point of destination inexorable?' Oxford University Centre for Business Taxation WP 2022/03.

[9] HM Treasury, OECD Pillar 2 – Consultation on Implementation, pp. 57-58. Available at https://www.gov.uk/government/consultations/oecd-pillar-2-consultation-on-implementation

[10] The consultation paper explains the intention to retain existing anti-avoidance measures that 'counteract arrangements which are designed to shift particular streams of income out of the UK tax base', because with UK's plan to increase the corporate tax rate to 25% 'there will continue to be a significant rate difference with the minimum rate of 15%, and therefore potential ongoing incentives and opportunities for tax planning': *OECD Pillar 2: Consultation on Implementation*, p. 58, available at https://www.gov.uk/government/consultations/oecd-pillar-2-consultation-on-implementation

[11] Finance Act 2019, s. 15 and Schedule 3; see A. Fairpo [2019] *British Tax Review*, 298-300.

It is important that the bias in the GloBE priority rules against source taxation should not be reinforced in the interpretation of its rules. In this respect, it is highly regrettable that the Commentary has already reinforced the priority rules, in relation to the scope of the GloBE. It states that it would not be consistent with the GloBE outcomes for jurisdictions to set a lower threshold than €750m for the UTPR, but that MNE home countries do remain free to set a lower threshold for taxes 'similar to' the IIR (paras. 15-16 p. 11).[12]

This accentuation of the bias of the GloBE rules in favour of MNE home countries is likely to further discourage those that are mainly host countries from joining the GloBE scheme. They would clearly be better served by adopting measures suited to their own circumstances for protecting source taxation, especially as these need not be limited to the €750m threshold, which would exclude many MNEs that may have significant activities in countries with smaller economies.

For the countries that do adopt the GloBE, it is important that it should be applied in a way that benefits all countries, by helping to phase out all artificial profit-shifting arrangements and end the race to the bottom in corporate tax. If it is implemented in a way that reinforces the unfair and inappropriate priority that the GloBE rules give to MNE home countries, it could instead become another weapon in the international tax wars. Although the design of the GloBE rules and the processes for their interpretation and implementation are shrouded in technical detail and complexity, they clearly have important policy implications. It is important that these be transparent and discussed openly, which we would welcome in this public consultation.

[12] The blatant unfairness of this interpretation was quickly noted: see, Maarten de Wilde, 'On an animal farm and 'equality, however' according to the Pillar 2 Commentary', Kluwer International Tax blog, 15 March.