UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

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Re: USCIB Comments on the OECD Public Consultation Document on Global Anti-Base Erosion Proposal ("GloBE") Pillar Two

USCIB[1] is pleased to provide comments on the Public Consultation Document ("consultation document") on Global Anti-Base Erosion Proposal ("GloBE") Pillar Two.

General Comments

Timing

USCIB understands that there is enormous political pressure to achieve progress in an extremely tight time frame. The consultation document raises a number of very difficult issues and allows only 25 days to develop responses. This is insufficient. It is important that there be careful vetting of these issues and the compressed time frame does not allow for that. It is essential, therefore, that this consultation be followed up with additional opportunities for input as the proposals are developed further.

GILTI Must be Considered an Acceptable Income Inclusion Regime

USCIB members have worked diligently over the last few years to comply with the new GILTI regime. While U.S. multinationals[2] have significant concerns over the operation of the GILTI rules,[3] it would be onerous and inconsistent with the emphasis on tax certainty, to require US tax resident parented

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[1] USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

[2] For purposes of this letter, U.S. multinationals includes U.S. headquartered companies and U.S. tax resident parented companies.

[3] Advocating for GILTI to be white-listed should not be interpreted as advocating for the 13.25% to be the rate for determining whether income is low-taxed.

companies to adapt to yet another set of rules having essentially the same goal. Therefore, we strongly recommend that the GILTI regime be considered an acceptable and appropriate income inclusion regime. Companies subject to the GILTI regime should be excluded from further application of Pillar Two. Given that the GILTI regime applies to a U.S. based multinational's domestic and foreign controlled subsidiaries, the right to "tax back" should be solely vested with the U.S, and the U.S. should be vested with the sole right to audit and administer the income inclusion rule as applied to U.S. based multinationals.[4] USCIB responses to specific questions reflect this view; most importantly the headquarter jurisdiction should have the sole right to tax and administer the income inclusion rule and global "blending" needs to be permitted consistent with the US GILTI regime and sound tax policy.

<u>Interaction of Income Inclusion and Undertaxed Payments Rule[5]</u>

USCIB acknowledges that this topic is not covered by the consultation document, other than to say that coordination is needed to ensure that income is not double taxed. We nevertheless address it briefly here because we consider coordination between the income inclusion rule and undertaxed payment rule must be understood to properly evaluate the proposal.

It is USCIB's view that the income inclusion rule must be the primary and exclusive rule to the extent the headquarter jurisdiction adopts an income inclusion rule into law. The income inclusion rule and the undertaxed payments rule of course should not both apply to the same income. Thus, the income inclusion proposal should take precedence over the undertaxed payments rule. Any potentially undertaxed payments made by any company to a company subject to a qualifying income inclusion regime such as the US GILTI regime should not be considered an undertaxed payment and, therefore should be eligible for local country deduction and any otherwise available treaty benefits and not subject to the switchover rule. This priority rule is based on sound tax policy principles. The country imposing the income inclusion rule is in the best position to ensure that the minimum tax is applied to net income and not gross income, that losses are accounted for appropriately, etc. The undertaxed payments rule, on the other hand, raises the practical specter of excessive taxation, such as taxation of gross payments. It is inappropriate where an income inclusion regime applies.

The undertaxed payments rule essentially looks at the tax imposed on a transaction-by-transaction basis. This would be un-administrable, could result in excessive taxation that does not account for allocable deductions or losses, and incompatible with any form of a top-up tax.

We also believe that an intermediate country's income inclusion rules should not apply if a higher tier parent jurisdiction has income inclusion rules which apply. Anything other than income inclusion at the ultimate parent level would require calculations on a partially consolidated basis, further complicated by the fact that many subsidiaries may have more than one related shareholder. Again, the complexity for both taxpayers and tax administrations would make this extremely difficult.

[44] The US inclusion regimes are actually much more comprehensive than GILTI covering subpart F income, which is generally passive or easily movable. Thus, the US system provides a comprehensive anti-deferral regime.

[5] References to the undertaxed payments rule should be considered to include references to the switch-over and subject to tax rules.

Finally, the undertaxed payments rule should only apply to interest and royalty payments (not including software transactions treated as product sales) and should not apply to payments between unrelated parties.

Coordination with Pillar One

The calculations under Pillar Two should be made after reallocations of income under Pillar One. These interactions would be made easier if global blending is permitted. If global blending is not permitted, then it would need to be clear which jurisdiction and entity is the taxpayer under Pillar One and which state is the surrender state.

Elimination of Unilateral Measures

It is essential for the coherence of the international tax system that non-compliant unilateral measures be eliminated by Inclusive Framework members adopting Pillar Two. The final agreement must not only contain an agreement to eliminate unilateral measures but also list unilateral measures that need to be eliminated. If unilateral measures are not listed, then some countries may assert that their measures are not unilateral measures covered by the agreement and may continue to impose additional tax on multinational enterprises. In the same way that BEPS Action 5 agreed to review all preferential regimes to determine if they were harmful, and to then continually update those reviews for new regimes, so too should the OECD/IF review all unilateral measures and then continually update those reviews for new unilateral measures, with sanctions for countries that fail to repeal or introduce new unilateral measures.

Global Race to the Bottom

The entire GloBE proposal is premised on the need to stop a harmful race to the bottom on corporate taxes. USCIB recognizes that countries are sovereign and if they decide to pursue this policy, they are within their rights to do so. We believe, however, that this conclusion is not self-evident. Indeed, Pascal Saint-Amans has stated: "While these corporate tax cuts have created some concerns of a 'race to the bottom,' most of these countries appear to be engaged in a 'race to the average,' with their recent corporate tax rate cuts now placing them in the middle of the pack."[6] We raise some countervailing considerations.

- Countries have very different economies, populations and needs for revenue. It is a core function of national sovereignty to balance these considerations and decide on the mix of taxes to raise revenue[7] and how those revenues are to be spent. To require the imposition of a global minimum corporate tax undercuts that sovereignty.
- All countries exercise their sovereign right to use their tax codes to incentivize some activities and disincentivize others. Well-targeted tax incentives can increase investment in desirable activities in a way that minimizes bureaucracy and delivers results quickly. A global minimum

[6] (http://www.oecd.org/tax/tax-reforms-accelerating-with-push-to-lower-corporate-tax-rates.htm)

[7] The OECD has concluded that corporate taxes are the most inefficient taxes, so countries could reasonably conclude that they prefer other more efficient taxes to raise necessary revenues.

tax, without exceptions for acceptable incentives, will impose significant constraints on a country's right to use incentives because the incentive would go not to the investor, but rather the country imposing the minimum tax.

- The BEPS project was intended to align taxing rights with value creation. The OECD should recognize the progress that has been achieved, and progress will be more evident as business adapts to new laws and non-compliant regimes are phased out, as a result of the BEPS changes and their implementation. Aggressive tax planning has been reduced. If value is properly attributed to where value is created, then that country where the value is created should have the taxing right; including the right to tax at a low-rate if that is consistent with that country's fiscal policy.[8]
- A jurisdiction-by-jurisdiction approach exacerbates these problems because the tax incentive is isolated and there is no possibility of blending to offset low-taxed income with high-taxed income.

Dispute Resolution

Dispute resolution will be critical to successful implementation of both Pillar One and Pillar Two. The OECD should require any country that wishes to be part of the new consensus to adopt mandatory binding arbitration, with peer review, as a minimum standard to resolve any disputes arising as a result of the new rules. We also believe that the OECD should be seeking more efficient and effective ways to permit taxpayers to achieve advanced certainty for cross-border transactions.

It is important to note, however, that including a meaningful dispute resolution process will not be enough to make such comprehensive changes effective, if broad consensus is lacking and if the new system does not have simple, administrable rules to prevent conflicting claims to tax the same income.

Incomplete Impact Assessment

USCIB members believe a completed impact assessment is critically important to enable progress on Pillar One and Pillar Two. Consensus at any level will be difficult to achieve if IF members do not have a reasonably clear understanding of the impact of any proposals on their tax receipts, business investment, and broader economies. Because the Pillar One and Pillar Two propose numerous significant taxation methods that go well beyond the current ALP, countries cannot use their prior or current experiences to determine if the proposals adequately address the challenges of digitalization and accomplish the desired re-allocation of taxing rights. Countries are unlikely to agree on new double tax avoidance rules (especially with respect to surrender

[8] USCIB continues to believe that it would be more appropriate to consider data post-BEPS and determine whether there is a significant concern with low or no taxed income. USCIB believes that the BEPS changes combined with US tax reform, have eliminated the ability (at least for US-based multinationals) to earn income subject to little or no tax. Once the examination of the post-BEPS/post US tax reform is complete, as mandated by Action 11, it would then be possible to determine whether additional measures addressing low-taxed income are necessary.

states) if they are uncertain about the potential changes to their tax base. Resolving these political questions will depend on complete impact assessments that countries may rely on.

<u>Global Groups Headed by Fiscally Transparent Entities Should Be Considered</u>

Some U.S.-headquartered multinationals are headed by a fiscally transparent entity, such as a US S corporation or a partnership. The consultation document highlights some issues related to fiscally transparent entities within a multinational group. These questions are less relevant if a global blending approach is adopted, per our recommendation. However, even if a global blending approach is adopted, issues related to multinational groups headed by fiscally transparent entities would need to be addressed, to not ignore taxes imposed on the business profits of the fiscally transparent entity (or group) on a current basis paid by tax resident owners rather than paid by the entity.

Responses to OECD Questions

<u>Use of Financial Accounts to Determine Income</u>

As stated above, USCIB believes it is necessary that GILTI be considered a good minimum tax regime for purposes of Pillar Two. GILTI is not based on financial accounting income and, therefore, USCIB would not support requiring that financial accounts be the starting point in all cases. For those jurisdictions that have adopted a compliant minimum tax regime, USCIB believes that companies tax resident in those jurisdictions should be permitted to follow their existing rules as applied to both domestic and foreign controlled subsidiaries.

For those jurisdictions that have not yet adopted a minimum tax regime, USCIB believes that using parent entity's consolidated financial accounts may be an appropriate starting point. For companies using consolidated financials as their starting point, the OECD should accept any standard that is regularly used by securities regulators. Therefore, IFRS, US GAAP and Japanese GAAP should all be acceptable standards. USCIB is not concerned about the use of different standards because the application of an accounting standard is not driven by tax concerns and the complexity of applying a single standard to corporate group that is not otherwise using that standard outweighs any tax advantage or disadvantage. The goal should not be a single global definition of the tax base, but a method that is consistently applied within a global group. The consolidated group should consistently use the same sources of data from year to year.

USCIB also believes, that the consolidated group should be able to use information from its separate entity statutory financial statements. These separate entity accounts may, in some cases, provide the most appropriate information for determining whether an appropriate level of tax has been paid.

Consolidated or separate entity financial statements may exclude taxes paid by owners on business profits of an MNE headed by a fiscally transparent entity, and such taxes should be considered as taxes imposed on the business profits of such entities in appropriate cases.

USCIB believes that global harmonized tax base is either possible nor desirable. Therefore, the focus should be on defining an acceptable minimum standard. GILTI should be an acceptable minimum standard, but other countries could use different approaches that could also be considered acceptable.

Permanent Differences

The questions posed for both permanent and temporary differences are difficult; and the answers vary by company.[9] One reason this is difficult is that the book tax differences will differ depending on both the book[10] and the tax system. That is, some tax systems will be closer to a corporation's books than others, so there is no one answer to what adjustments should be made.

USCIB believes that if the starting point for a particular group is financial accounts, then it may be appropriate to consider adjustments for, for example, the following permanent differences, keeping in mind that it will be necessary to determine whether book and tax vary in a particular case:

- Purchase accounting
- Impairments
- Discontinued Operations
- Valuation Allowance Releases
- Intercompany Asset Transfers
- Valuation Allowances
- Tax Reserve Movements
- Tax credits (e.g., R&E tax credit- should that be added back for this purpose)
- Foreign exchange gain or loss

Timing Differences

Initially, USCIB would like to point out that in some cases, even though timing differences should reverse over time, the amount of the differences and the period of time necessary for those amounts to reverse (decades in some cases), could mean that the differences should be effectively considered as permanent.

USCIB supports Pillar Two providing options to MNEs to neutralize the impact of timing differences. USCIB would also like to reiterate that we favor those methods that apply at the ultimate parent level. Thus, the ability to carryover taxes at the subsidiary level, particularly because this is not an attribute of the GILTI regime, is not favored. Carryforwards that apply at the parent level will be much simpler to apply.

The OECD should also consider optionality with respect to these minimum tax determinations and methods to neutralize timing differences. That is, companies should have flexibility to use the method of adjustment that best conforms with their accounting methods. For example, not all companies use deferred tax accounting and therefore should not be required to adjust for temporary differences using these numbers. Also, deferred tax accounting may be done at the parent level (not

[9] USCIB members would be willing to meet with the OECD to discuss these issues in more detail.
[10] This will depend on whether IFRS, US GAAP or Japanese GAAP or other approved accounting method is used.

entity-by-entity or jurisdiction-by-jurisdiction) so that for those companies using deferred tax accounting to make temporary adjustments, that may need to be done at the parent level. Given the significant timing differences between financial account and tax recovery, there is a strong case for adopting multiple methods to neutralize timing differences. For instance, allowing MNE's to use deferred tax accounting principles as a basis to establish taxes paid and allowing an appropriate carryforward of tax attributes. Said another way, the potential cures for timing differences outlined in the consultation document should not be treated as mutually exclusive.

USCIB understands that deferred taxes may be a significant component of any differences between cash taxes paid and tax expense accrued for financial statements -- but not the only component. OECD agreed guidance should clarify the treatment of these differences in a manner consistent with the objectives of Pillar Two, while recognizing that GILTI properly addresses these differences.

The consultation document briefly raises issues concerning change of ownership.[11] The complexity of these rules would be minimized by a global approach. That is a change of ownership would not occur if there were an in-house reorganization, while an entity-by-entity approach would maximize the complexity because it would maximize the number of ownership changes.

Blending

The consultation document proposes three options for blending: global, jurisdictional, or entity-by-entity. USCIB strongly supports global blending. First, as pointed out above, a global blending would have to be acceptable for GILTI to be an acceptable minimum tax regime. Second, USCIB simply believes that a global blending approach is the most appropriate and administrable approach and, therefore, is the right answer. The global blending approach assures that an MNE is paying at least a minimum tax rate on earnings outside its home country. That in combination with all the other anti-avoidance rules in existence globally and the DEMPE and other enhancements to the transfer pricing rules should be seen as sufficiently addressing the BEPS concerns.

In addition, the complexity involved in determining both income and taxes on a jurisdictional basis would make the jurisdictional approach more complex and would undo much of the value of starting with parent consolidated financials. A MNE's consolidated financials will not be broken down by jurisdiction and the taxes associated with income in a particular jurisdiction would also need to be determined. This might be especially difficult for withholding taxes or "tiering" taxes. A withholding tax should be attributed to the country imposing the withholding tax. If, however, the recipient country also imposes tax on that income would the two taxes be blended? If not, how, would the income and taxes be divided? Similarly, if a lower-tier subsidiary pays taxes to its country of residence, but those earnings are also taxed by a higher-tier (but not the ultimate parent) how are those taxes "sourced" and can the two levels of taxes be blended? These problems do not exist if global blending is permitted.

The entity-by-entity approach seems both misguided and exceedingly complex. The objection to the global approach is that it permits blending of high and low-taxed income. The entity approach would

[11] The United States has extremely complex rules on separate return limitation years.

permit blending as long as the income is earned in the same entity (and would probably encourage such planning). The entity-by-entity approach also would be even more difficult to apply than the jurisdictional approach because the necessary allocations would be more granular.

Aside from reducing complexity, the global blending approach may represent an opportunity for political compromise between those countries that support substance based carve-outs based on Action 5 and those countries that oppose those carve-outs.

Including a substance based carve-out protects 100% of the benefit provided by any regime that is considered not harmful.

An approach that does not include a substance based carve-out but includes blending on a jurisdictional basis, eliminates any benefit from the nonharmful regime, because the tax will instead be paid to the jurisdiction imposing the minimum tax.[12]

Not including a substance based carve-out and applying blending on a global basis, preserves some benefit for the regime – which by definition is nonharmful. That benefit, of course, depends on the existence of high-taxed income elsewhere in the group, but many companies have excess foreign tax credits.

Global blending also reduces the possibility of double taxation. If there is not precise agreement on the allocation of income and therefore on the allocation of taxing rights, then global blending takes some of the pressure off this lack of precision. Taxpayers can effectively eliminate double taxation by allowing some of the high-taxes to offset tax on other low-taxed income. While it might be better to have a precise allocation of income, it is likely that there will continue to be disagreements between taxpayers and fiscal authorities, and taxpayers should not be required to go through time intensive and costly dispute resolution to resolve every case of double taxation.[13] Global blending would relieve some of that tension in the system.

Carve-outs

As discussed above, USCIB strongly recommends that the GILTI regime be considered an acceptable and appropriate income inclusion regime. USCIB also believes that the Inclusive Framework should allow sufficient time for the results of the BEPS project to become apparent before considering new anti-base erosion provisions. To the extent, that carve-outs reflect confidence in the BEPS conclusions, USCIB believes that they should be accepted by the Inclusive Framework, at least at this stage. The BEPS guidance has changed the behavior of both companies and countries. In order to take advantage of nonharmful tax regimes, companies had to put real activities in those jurisdictions.

[12] There might be some blending depending on the tax rate of the jurisdiction providing the benefit and any other income that is earned in that jurisdiction, but the overall benefit would be minimized.

[13] The United States does not permit a credit for foreign taxes that exceed the amount of the liability under foreign law. Taxpayers are required to exhaust all effective and practical remedies to ensure that only the correct amount of tax is paid. A remedy is effective and practical only if the cost is reasonable in light of the amount in issue and the likelihood of success. (Treas. Reg. §.901-2(e)(5)(i)). Thus, the US would allow some double tax relief for the imprecision in properly allocating income to foreign countries, regardless of whether the taxpayer pursues every available avenue of relief.

Undercutting both the tax policy decisions of sovereign countries and the investment decisions of the companies is inappropriate.

USCIB supports a carve-out for a fixed return on assets. This would be consistent with the GILTI rules and is also a good tax policy. As we point out above, there are strong arguments to be made for rejecting the global race to the bottom argument. These contrary arguments may be strongest, when there is measurable investment in tangible assets in a jurisdiction. That is the benefits of foreign direct investment may be most obvious when a foreign corporation commits resources to the physical development of the jurisdiction of the investment. Carving out a routine return on fixed assets is an acknowledgment that an investment in fixed assets is not the type of investment where profits are susceptible to shifting to tax havens. These investments may generate significant employment during the construction phase and significant collateral benefits as assets are placed in service.

USCIB also supports a carve-out for an MNE group with an effective tax rate (as reflected on consolidated financial statements) in excess of the income inclusion rule's "minimum tax rate". The policy objective of Pillar Two should be to "tax-back" MNE's that are *systematically* paying income tax below a "minimum tax rate" by shifting income tax base to low-tax jurisdictions. An MNE with an effective tax rate reflected on consolidated financial statements in excess of the identified "minimum tax rate" is not running afoul of this policy objective. In addition to accomplishing the policy goals of the income inclusion rule, this carve-out is administratively simple for all parties and reliable, given the data used to qualify for the carve-out is generally audited by an independent accounting firm. Given the policy goal of "taxing-back" profits of MNE's that systematically pay tax below a designated minimum rate, an MNE should be permitted to carryforward any "excess tax rate" to a future testing period. A carryforward acknowledges that an MNE's effective tax rate may vary from year-to-year based solely on timing differences between financial accounting and tax or market conditions, and not based on shifting profits to low-tax jurisdictions.

USCIB believes that de minimis thresholds are not likely to be helpful if they are applied on a global basis (other than perhaps a limitation with respect to the overall size of the group). Because we strongly support global application of these rules. We do not specifically recommend de minimis thresholds. If, however, a jurisdiction or entity blending approach is adopted. USCIB believes that appropriate de minimis thresholds should be provided.

Sincerely,

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