ICRICT

Independent Commission for the Reform of International Corporate Taxation

13 December 2020

ICRICT response to the OECD Consultation on the Pillar One and Pillar Two Blueprints

Att. OECD Centre for Tax Policy and Administration

ICRICT welcomes the opportunity to respond to the OECD's request for input on the Pillar One and Pillar Two Blueprints.

As an independent Commission, since the beginning of the G20/OECD Base Erosion and Profit Shifting process we have urged governments to **move away from the existing transfer pricing system towards a unitary approach to taxation of multinationals ("MNEs"), based on a system of multi-factor global formulary apportionment, together with a global effective minimum tax on a country-by-country basis of 25%**. Different allocation formulae (i.e., choice of factors and weighting) could be developed for broad sectors of the economy (e.g., manufacturing, services, extractive industries) to recognise the principle that different supply and demand factors interact in creating MNEs' global profits (e.g., sales, employees, capital, natural resources), but distinctions and carve-outs should be kept to a minimum to reduce complexities and opportunities for tax avoidance.

Every year, according to OECD's own estimates, $240 billion dollars[1] of corporate tax revenue are lost due to tax avoidance by MNEs. On the basis of this conservative estimate, since the beginning of this process in 2013 the global amount of revenue losses now exceeds $1.5 trillion dollars, whilst tax avoidance by MNEs continue unabated.

As the world suffers the consequences of the worst recession in nine decades in the midst of a global pandemic, the G20/OECD Inclusive Framework has put forward for consultation blueprints that are unlikely to deliver an outcome that is a substantial improvement on the existing framework but which reinforces the current allocation of taxing rights between source and residence countries, penalising countries in the Global South.

The current proposals have not obtained agreement, despite having sacrificed all ambition and simplicity in the search for support of the dominant OECD member governments, which come to negotiations under the misplaced sense that national interest is served by protecting MNEs headquartered in their own countries. This has prevailed over genuine, global public interest with the result that MNEs continue to avoid taxes that could help pay for public expenditure to support health, income and employment.

This is exemplified by the failure of the G20/OECD Inclusive Framework to give proper consideration to the proposal put forward by the group of countries represented by the G-24[2].

[1] https://www.oecd.org/about/impact/combatinginternationaltaxavoidance.htm

[2] G-24 (2019), *Proposal for Addressing Tax Challenges Arising from Digitalisation*, G-24 Working Group on tax policy and international tax cooperation, 17 January 2019, https://www.g24.org/wp-content/uploads/2019/03/G-24_proposal_for_Taxation_of_Digital_Economy_Jan17_Special_Session_2.pdf

And the process is unlikely to succeed as long as it continues to promote only marginal reform and excludes most countries from real equal participation, while allowing a few to protect 'their' MNEs at the expense of public services and economic recovery everywhere. As such, this process might become inconsistent with States' obligation under human rights law to cooperate internationally and to create a global environment that enables the full realization of human rights, including on tax matters[3].

Whilst the blueprints "*go beyond the arm's length principle*[4]" and acknowledge that MNEs' global profits should be allocated through formulary apportionment, our critique of the previous proposals, summarised in Appendix A, remains largely unaddressed in the two new blueprints and the expected modest revenue impact of the blueprints is unlikely to justify the ongoing political investment in the process.

It is not possible to distinguish conceptually between residual or routine profits of a multinational as currently proposed in Pillar One, as profits are essentially the result of the global activities of the firm. Furthermore, the proposed Pillar One would still leave in place the existing complex and unworkable transfer pricing rules to allocate the vast bulk of MNEs' profits, while layering new rules on top of them. The new taxing right would be administered by the tax authority of the home country, consulting others only through panels, and disagreements would be resolved by mandatory binding dispute resolution, which might extend beyond the new right. The system could only be introduced by a multilateral treaty among all states, which the US has already rejected.

Pillar Two proposes a global minimum corporate tax, a concept we have long supported. Such measures could be introduced unilaterally by governments; indeed, some have already done so. Notably the US in 2017 enacted measures to protect its tax base in relation to both inbound and outbound investment. However, the Pillar Two proposals as currently formulated are fundamentally inequitable, in that they give the prior right to apply a top-up tax (to the agreed global minimum) to undertaxed profits to the home countries of MNEs, while host countries would have only a secondary, back-up right. This would be a direct transfer of revenue from developing countries, which are generally only hosts to foreign MNEs, to the rich home countries.

We call for a well-designed global minimum tax that allocates rights to tax undertaxed profits fairly among all countries, in line with MNEs' real activities in each country and in order to enable each country to protect its own tax base. Furthermore, the minimum effective tax rate should be set at a minimum of 25%, which is the weighted average rate globally. This recognises that in most tax systems, depreciation, investment allowances and other measures allow a normal return on capital, and most corporate profit is rent. This is especially the case for large MNEs, which benefit from the economies of scale and scope and other advantages resulting from globalised markets. The highly digitalised companies that currently dominate our lives and have continued to reap enormous profits even during the pandemic, are only the most prominent examples.

What is needed is an inclusive process, global leadership and proposals for fundamental reform in the public – rather than corporate - interest.

The failure to deliver comprehensive and fair solutions will increase the fiscal incentive for some countries to introduce unilateral measures, under the pressure of understandably deepening public anger on the issue and the need for revenues. Any reform that does not significantly increase global

[3] Committee on Economic, Social and Cultural Rights, General comment No. 24 (2017) on State obligations under the International Covenant on Economic, Social and Cultural Rights in the context of business activities (E/C.12/GC/24), par. 37. https://www.refworld.org/docid/5beaecba4.html

[4] https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf Page 2

tax revenues from MNEs does not adequately address these concerns about tax avoidance; this will further undermine the public trust in the international tax system, which is harmful to both MNEs and governments.

It is time for powerful countries to consider global interest rather than protecting their own MNEs to deliver ambitious and comprehensive reforms. But if global reforms are hard to come by, it is time for countries to move unilaterally or at regional level to introduce interim measures. This will both deliver desperately needed resources now and create the necessary pressure to force change towards a genuinely fair international tax architecture, which will require multilateral discussions extending well beyond the current process.

Finally, countries in the Global South must be equal participants in the development of the rules of international taxation and not mere participants in processes where their views are sought merely for the appearance of broad consultation. This can only truly be possible in a space which allows equal and effective participation for all countries, including the poorest. Discussions towards creating a global tax body within the United Nations (UN) should continue, as international norm setting is only legitimate in a democratic multilateral space, and only the UN can provide this. But for the moment, Inclusive Framework members should take the claim of real and equal representation and hold the OECD to account for it.

APPENDIX A

PILLAR ONE

- The failure to come up with a comprehensive solution applicable to all MNEs is a serious limitation of the proposal, for which it is hard to see any rational justification.
- A large share of the profits for in-scope MNEs, as well as all profits for those excluded, would continue to be allocated under the OECD's transactional transfer pricing methods. The proposal will therefore add further complexity to the existing system, whilst generating little additional revenue.
- It is not possible to distinguish conceptually, between the 'routine' (i.e., locally generated) and 'residual' (i.e., internationally generated) profits of a multinational, as all profits are essentially the result of the global activities of the firm. Existing transfer pricing rules are not fit to determine "routine profits", as demonstrated by the large number of associated tax disputes under the existing BEPS system.
- In a well-designed corporate tax system, the cost of capital is fully costed (with often more than economically justifiable deductions for depreciation and interest), so that there is no disincentive to enterprise investment and sustainable growth. Thus, for practical purposes, only excess "pure" profits (i.e., economic rents) are taxed, and those economic rents are associated with the global activities of the multinational. As such, all profits of MNEs should be apportioned through a formula.
- Reallocation of residual profits by reference to sales alone will create winners and losers, and disadvantage countries with relatively small domestic markets, or those with substantial exports, particularly of natural resources and tourism. As rich countries consume more, allocation of profits by sales only is likely to result in an unequitable distribution between countries.

PILLAR TWO

- The Global Anti-Base Erosion (GloBE) minimum tax should be set at a rate of 25%. We are concerned by the possibility of a much lower minimum effective corporate tax rate becoming the international benchmark which would effectively incentivise and legitimise a "race to the minimum". Countries in the Global South, which rely relatively more on corporate tax income as a source of government revenues, would be the main losers from such a trend.
- GloBe rules should be applied on a country-by-country basis and allowing only for jurisdictional blending and exclude generic carve-outs for incentive regimes (even for those compliant with the standards of BEPS Action 5 on harmful tax practices, and other substance-based carveouts).
- Give source countries priority to apply the GloBE rules over the application by residence countries, resulting in a more equitable distribution of additional tax revenue.