RESPONSE TO THE OECD PUBLIC CONSULTATION ON THE GLOBAL ANTI-BASE EROSION PROPOSAL – PILLAR TWO

2 December 2019

Oxfam welcomes the opportunity to provide civil society input to the OECD/G20 IF work. In this response to the consultation document of 8 November, we first provide general comments on Pillar Two. After that, we respond to the three specific issues for this consultation, taking into account the design of source country rules as well as the Income Inclusion Rule (IIR). Oxfam's comments have been prepared by Francis Weyzig and Susana Ruíz Rodríguez (Spain), with input from Joab Okanda (Kenya), Henry Ushie (Nigeria), Rosa Maria Cañete (Dominican Republic), Nguyen Thi Hong Nga (Viet Nam), Didier Jacobs and Daniel Mulé (US), Quentin Parrinello (France), Oliver Pearce (UK), Johan Langerock and Maaike Vanmeerhaege (Belgium), Christian Hallum (Denmark), and Joanna Spratt (New Zealand).

General comments on making minimum tax rules effective

Pillar Two is essential to limit profit shifting out of source countries. A minimum effective corporate tax rate, set at an ambitious and sufficient level, and applied to profits in every country, would greatly reduce the incentive for companies to shift profits from source countries to low/zero-tax jurisdictions. Note that 'source countries' refer to jurisdictions where real activities of a multinational take place. These include developing countries as well as OECD members. Real activities can be everything from mining of natural resources and manufacturing to financial services and interacting with online users, and these involve production locations as well as market jurisdictions. Pillar Two needs to work for all types of source countries. Usually, the home country of a multinational is also a source country with regard to domestic activities.

Pillar Two is also needed to put a floor in damaging tax competition between countries. Minimum tax rules will make it ineffective for source countries to offer full tax holidays. Source countries may continue offering tax rate reductions and other benefits to attract foreign investors. However, once the tax rate hits the minimum, further reductions will have no effect. This takes away the pressure from investors and other countries to offer further tax reductions, resulting in higher tax revenues. It would also create a more level playing field for investors. The total amount of investment will not be strongly affected, because countries mostly compete for concrete foreign investment projects that can go to different countries, but would be undertaken anyway.

Limited reallocation of taxing rights under Pillar One reinforces the need for strong and comprehensive minimum tax rules. For taxable profits that are allocated on the basis of objective factors (Amount A) or fixed margins (Amount B), instead of individual transactions between related entities, Pillar One would already address profit shifting. For those profits, Pillar Two would complement Pillar One by setting a minimum rate to limit tax competition for real economic activities. However, the Unified Approach proposal

is limited in scope. As it is proposed now, Amount A would only strengthen taxing rights of countries where consumers or users are located and not apply to business-to-business sectors, such as agriculture, engineering, construction, or manufacturing of product components. Yet under current transfer pricing rules, firms in these sectors can allocate key risks, assets and functions, and thus shift profits, to low-taxed distribution hubs that sell directly to business clients in other countries. Such distribution hubs would also fall outside the scope of Amount B, because they are high-risk instead of low-risk. Moreover, even for highly profitable consumer-facing businesses, only a limited portion of residual profits would be reallocated, thus leaving opportunities for tax-aggressive firms to allocate a substantial part of their profits in low/zero-tax jurisdictions. The design of Pillar Two should therefore be strong and comprehensive.

Pillar Two requires a combination of home country and source country rules. In this submission, we assume the Income Inclusion Rule (IIR) will be the implemented by the ultimate home country of a multinational, where its global top holding is located. We will not address the Switch-over Rule, which would complement the IIR by modifying tax treaties to allow home country taxation of certain low-taxed foreign income. Furthermore, we understand that the Undertaxed Payments Rule (UPR), which is the main source country rule, can take different forms. In this submission, we distinguish two alternative forms: conditional withholding taxes on payments to a low-tax jurisdiction and non-deduction of such payments. We leave open the possibility that the UPR could take other forms too. Regarding conditional withholding taxes, we mainly discuss their application in intra-group situations, but some countries may prefer to apply them on payments to third parties as well. This would make them less precise, but more robust and easier to apply (provided the burden of proof is on the company). The Subject to Tax Rule (StTR) would complement the UPR, by modifying tax treaties to allow source country in case the UPR applies.

The combination of all these rules is needed to uphold the minimum tax effectively and achieve the overall objective. They serve as a back-up for each other, to prevent gaps in global implementation of the minimum tax. The need for such a combination is reinforced by indications that some major home countries, such as the UK or Switzerland, may not implement an IIR.

Conditional withholding taxes (or another from of UPR) should take priority, to enable source countries to recover revenue losses from profit shifting. The new rules can reduce such revenue losses in different ways. If the minimum effective tax rate is set at sufficiently high level, the potential tax advantage of profit shifting will become much smaller. Some multinationals would then stop shifting profits out of source countries, which would lead to increasing revenues. It is important for this effect that the minimum rate is set high enough, for example close to the current global statutory average could be considered a good benchmark. However, it is likely some tax-aggressive multinationals will continue shifting profits and simply pay the minimum rate, even if the difference between the source country rate and the minimum rate is small. Therefore the rules should be designed in such a way that the minimum tax charge is levied as much as possible in the source country, regardless of the policy response of low-tax countries. In particular, if low-tax countries raise their own tax rate to the minimum, the new rules should still make the higher tax payments by profit shifting firms end up in source countries as much as possible.

A three-tier rule order makes it more attractive to implement source country and home country rules. Making the minimum tax rules as attractive as possible for jurisdictions that implement them is important for the success of Pillar Two. This will help to generate the critical mass of source and home countries that is needed to effectively uphold the minimum tax globally. Also, when more countries implement the new rules, the international corporate tax system becomes more consistent, and when countries choose to replace

more diverse existing anti-avoidance rules by Pillar Two rules, the system becomes less complex. Implementation would become more attractive with the following three-tier rule order, which splits the UPR between the first and third tier.

1. **Conditional withholding tax**, for those source countries that choose to implement a withholding tax variety of the UPR
2. **Income Inclusion Rule**, implemented by home countries, giving a credit for conditional withholding taxes levied by the source country under tier 1
3. **Non-deduction**, implemented by source countries only in case tier 1 and tier 2 do not apply; that is, for specific base-eroding payments not subject to (conditional) withholding taxes that are made by firms not subject to an IIR

A conditional withholding tax, linked to the Effective Tax Rate (ETR) in the recipient jurisdiction, should get priority to increase the attractiveness of Pillar Two source country rules. If the UPR would only be applied to multinationals not subject to an IIR, it would be more attractive for many developing countries to stick to normal withholding taxes instead. That would make IIR priority self-defeating. Moreover, limited implementation of Pillar Two source country rules would make the global minimum ETR less effective. Next, the IIR should get priority over non-deduction to make it more attractive for home countries to implement an IIR. Some source countries, especially countries that currently do not have withholding taxes, might prefer to implement only the non-deduction UPR elements. By making non-deduction a last resort, home countries with an IIR would get a larger share of Pillar Two revenue gains. It would also reduce complexity, because non- deduction can get complicated when the ETR in the recipient country is above zero. This is especially the case for proportional instead of full denial of deduction, to achieve a top-up of the ETR to the minimum.

Source country rules should be simple enough to implement for developing countries. This applies especially to conditional withholding taxes. Otherwise, implementation of Pillar Two source country rules might remain limited. Complex rules that place a large burden on capacity-constrained revenue authorities or require information that is not readily available to them must therefore be avoided. Fortunately, a conditional withholding tax can be kept relatively simple, though a combination of design choices. In the next section on tax base determination, we propose a method to limit the need for case-by-case ETR tests. In addition, for recipient jurisdictions that do require a case-by-case ETR test, the burden of proof can be placed on companies. More specifically, in such situations, a conditional withholding tax can be levied at the global minimum rate, with a rebuttable presumption that the recipient has sufficient profits to allow for a credit of the source country tax or that the recipient is effectively taxed below the minimum. In addition, developing countries could apply source country Pillar Two rules on relevant transactions to all jurisdictions that do not themselves implement comprehensive Pillar Two source country or domestic rules of a similar nature (such as normal withholding taxes or alternative minimum taxes). There would then be no need for complex rules against conduit arrangements involving multiple jurisdictions. If countries that currently rely on normal withholding taxes would replace these by conditional ones, that could be a substantial improvement. Normal withholding taxes are less targeted and therefore potentially more distortive; they can result in double taxation for firms that do not engage in aggressive tax avoidance, which is undesirable.

Coordination between the different elements of Pillar Two is essential. This has consequences for all issues in the consultation document. For example, tax base determination should be approached in a way that

works for source countries too. Furthermore, there are important interactions between Pillar Two elements, notably between the IIR, source country rules, and rule order.

Therefore all Pillar Two elements should be developed jointly. If the IIR would be developed first, without taking into account the other elements, this might reduce options for source country rules and rule coordination. It could even lead to the development of an inconsistent overall set of rules. Developing the different elements jointly might also produce a more balanced outcome and achieve broader political support. Moreover, all Pillar Two elements must urgently be further developed, because it is challenging to develop rules that are effective and relatively simple yet not too blunt, and time is pressing.

The Pillar Two impact assessments should inform decisions about *de minimis* thresholds. Whereas detailed impact assessments of Pillar Two are challenging because of data limitations, it should be possible to analyse IIR scenarios for large firms with different *de minimis* thresholds for the amount of low-taxed profits per jurisdiction. With certain assumptions about the relationship between group turnover and the size distribution of profits in zero/low-taxed jurisdictions, it might also be possible to extend the estimates to smaller multinationals. If the OECD would perform such assessments and publish at least the key findings and insights, that would help to inform the IIR design. A similar analysis of *de minimis* UPR thresholds for the amount base-eroding payments might not be feasible. However, the OECD could work with national revenue authorities of different types of countries and support them to conduct such an analysis themselves, using national tax data.

Tax base determination must work for source countries too

General view

The foreign tax base must be determined in a way that works for source countries. It is important to take this as the starting point, because source countries face additional challenges. Some approaches may work for the IIR, but not for the Undertaxed Payments Rule (UPR) and/or Subject to Tax Rule (StTR). First, source countries currently apply withholding taxes on a transaction basis. That makes it more complex to determine the corresponding Effective Tax Rate (ETR) abroad than for the IIR, which looks at the total profits of one or more entities. Second, source countries may collect withholding taxes during a fiscal year, whereas a home country determines the IIR tax charge after the fiscal year has ended. Third, a source country cannot always demand the information that is required to determine the ETR on the income of any foreign recipient. By contrast, home countries can readily obtain all information via the ultimate parent entity, which by definition has authority over all directly and indirectly controlled foreign subsidiaries. Thus, focussing on the source country ETR test is more likely to produce an approach that works for Pillar Two as a whole.

An OECD/G20 IF body should classify tax regimes, limiting the need for case-by-case ETR tests. This could greatly reduce the administrative burden for tax authorities as well as tax payers, and provide certainty and a level playing field. Even for OECD-member source countries with high administrative capacity and a broad network of tax information exchange relationships, determining the ETR of all foreign recipients on a case-by-case basis would be a huge challenge. This is illustrated by the Netherlands, which is introducing a conditional withholding tax on related-party interest and royalty payments to low-tax jurisdictions, similar to the proposed UPR. The Netherlands concluded that it is currently not feasible to implement an ETR test on is own, and uses a general statutory tax rate test instead. Home countries face similar challenges to implement

an effective IIR (with jurisdictional blending and without carve-outs). Classification might solve this problem and could work as follows. Some jurisdictions do not have a corporate tax system, or have a general statutory tax rate that is below the agreed minimum ETR. These would be classified as jurisdictions for which the minimum tax rules always apply. At the other end of the spectrum are jurisdictions without tax rules that provide for an ETR below the minimum. To confirm this, an assessment is needed of a jurisdiction's tax base rules. This could be done by the Forum on Harmful Tax Practices (FHTP), building on its current work but expanding the scope and purpose of its assessments. For jurisdictions with accepted tax base rules and a statutory rate above the minimum, the minimum tax rules should never apply. That leaves a third category of jurisdictions for which case-by-case information is needed: jurisdictions with special low-ETR regimes and/or with a general statutory tax rate above the minimum but tax base rules that deviate from internationally accepted criteria.

Classification of tax regimes also allows simplification of case-by-case ETR tests, assuming jurisdictional blending (as argued in the section on blending below). For simplified tests, the third category of jurisdictions mentioned above can be subdivided. Many jurisdictions have a general tax regime that meets the minimum ETR standard, but also one or more special regimes with an ETR below the minimum for qualifying income. If a taxpayer can provide proof to the source country tax authority that a potentially base-eroding payment is made to a jurisdiction where all the group's profits are taxed under a general regime that is classified as minimum-ETR compliant, the minimum tax rules would not be activated and no further ETR test is needed. Only in the remaining cases, the source country would require further information to determine if the income of a foreign recipient is effectively taxed at the minimum rate or above. These remaining cases can be further subdivided, depending on the tax base rules of the relevant regimes. If the tax base rules comply with the international standard, information about the group's total income before tax and tax charge in the recipient jurisdiction would be sufficient to determine the ETR. Such a simplified test would also provide an incentive to jurisdictions to bring their tax base rules in line with internationally agreed criteria. Only in case one or more applicable regimes in the recipient country have deviating tax base rules, the source country would need additional information to determine the foreign tax base.

Classifying tax regimes could rely on focussed criteria to identify base-narrowing rules. The classification of general and special tax regimes of IF members could be done by the FHTP, because this is closely connected to the FHTP's current system of reviews. FHTP already provides an assessment framework to identify low effective tax rates, which considers whether there is an artificial definition of the tax base. The FHTP would also continue to assess whether regimes are harmful and monitor the implementation of real economic activity requirements, which by itself is insufficient though to address aggressive tax avoidance (see also the answer to Question 11. below). The FHTP assessment framework could be developed into a set of criteria for internationally accepted tax base rules. In practice, this means agreeing on what kind of tax base rules are not generally accepted and can therefore be regarded as base-narrowing from another country's perspective. Typical examples of such rules are special regimes that exempt all or part of a certain type of income from profits, super-deductions in excess of actual expenditures, or notional interest deductions. Such tax base rules would still be allowed. However, for ETR tests for Pillar Two home and source country rules, the effect of such base-narrowing rules would be taken into account. In other words, a special regime with a 30% statutory tax rate that exempts three quarters of a company's interest income would be treated the same way as a special regime that taxes a company's interest income at 7.5%. This also means that it will become attractive for countries to replace partial exemptions with more transparent reduced statutory rates.

Tax base criteria should be strict enough to prevent proliferation of new loopholes. If a specific tax base rule of a jurisdiction is assessed and approved, other jurisdictions can introduce a similar tax base rule, knowing that this rule would not be regarded as base-narrowing under Pillar Two rules. This creates a risk as well. If tax base criteria would lead to international endorsement of certain rules that provide a substantial tax advantage to firms, but that are not applied by many jurisdictions at present, this could trigger a race to the bottom in tax base rules. For example, if capital expensing would be endorsed as an acceptable tax base rule, it is likely that more countries will introduce it. Similar dynamics have occurred with FTHP-approved special regimes, such as patent boxes or notional interest deductions. Without taking a position on capital expensing here, we emphasize that such dynamics should be taken into account, and tax base criteria must be strict enough to prevent a new kind of race to the bottom. Moreover, the procedure, schedule and outcomes of the assessments of individual tax base rules should be fully transparent. These considerations also apply to alternative approaches for Pillar Two rules, such as basing ETR tests on agreed adjustments of financial accounts without seeking agreement on what underlying tax rules are acceptable (which is an approach that we do not support). For a decision about the fixed percentage of the minimum rate, it should be taken into account that some degree of tax base narrowing may be impossible to avoid. Some margin may be needed on top of the fixed percentage that policy makers currently have in mind to accommodate this effect. Inversely, a fixed percentage that is low to start with would further reinforce the case for strict tax base criteria.

Classifying tax regimes would not involve comprehensive harmonization. It does not require the development of a full set of international tax base rules. The criteria would serve to identify deviations from a broad diversity of tax base rules that are generally acceptable to other countries. Complying with these criteria leaves a broad scope for countries to determine their own tax base rules. Moreover, with jurisdictional blending, companies can still benefit from base-narrowing tax incentives, provided that the average ETR on their total income in a jurisdiction does not fall below the minimum.

Source country rules should place the burden of proof for the ETR on the company. This will make it much easier for tax authorities to apply the minimum tax rules in those cases where an ETR test is needed. A domestic company making a potentially base-eroding payment to a foreign affiliate may have no formal authority over the recipient to demand the required information, even if that information is limited to total income before tax and the total tax charge of the multinational in the recipient jurisdiction. However, when it is in the interest of the firm to provide that information, that would solve the problem for tax authorities. With a classification system as described above, in many cases the information that a company needs to provide would be limited. Moreover, if the foreign recipient can fully credit any withholding taxes levied under source country Pillar Two rules against its own corporate tax charge, there may be no need to claim back the withholding tax in the source country.

1. Questions on the use of financial accounts

a) Simplification should focus on limiting the need for detailed case-by-case ETR tests. We have presented a proposal on how this could be achieved in the 'General view' section above. In our view, the OECD/G20 IF should focus on assessing directly whether a jurisdiction's tax base rules contain base-narrowing elements when assessed against internationally agreed criteria. Developing a set of adjustments to enable tax authorities to use diverse financial account information to determine the ETR on a multinational's income in a foreign jurisdiction, without limiting the need for detailed case-by-case ETR tests, will result in a much higher administrative burden for tax authorities. Firms, governments or advisors that seek to undermine the

Pillar Two rules might also invoke the resulting complexity as an argument to advocate ineffective designs, such as an IIR with global blending or limiting the scope of Pillar Two to large multinationals.

For limited ETR tests, the use of foreign tax accounts might be easier. In the system for classification of tax regimes explained above, there is an important sub-category of jurisdictions that have tax base rules fully in line with international standard and offer special regimes with a low statutory rate. For these jurisdictions, the use of tax accounts might be easier, because for an ETR test, other countries can rely on the tax base determined according to the jurisdiction's tax rules. The revenue authorities of other countries could then simply divide the total tax charge by the total income before tax in the foreign jurisdiction to determine if the average ETR in the jurisdiction was above the minimum. However, this depends on design choices. If the ETR definition excludes the effect of tax losses r forward, the use of tax accounts requires adjustments to the ETR numerator and denominator (see also answer to Questions 3a-b below).

Where detailed ETR tests are needed, financial accounts can be used. Adjustments to financial accounts would then still be needed, but financial accounting data would be used in a much smaller number of cases. Moreover, once the specific base-narrowing features of a foreign jurisdiction's tax rules have been identified by an OECD/G20 IF body, it will be easier for a tax authority to use financial accounting information to assess the ETR in that jurisdiction. For example, if a foreign jurisdiction allows a super-deduction for R&D costs or partly exempts a certain type of income, simply dividing the tax charge for the current year by income before tax can already give a good approximation of the ETR according to internationally agreed tax base criteria. Alternatively, in such situations the tax authority could focus on permanent differences between tax and accounting profits to determine the ETR.

For large firms, simplification can also be achieved by adjusting the CbC reporting format. Many firms already use financial accounts as the bases for their CbC reports. Incorporating required adjustments to financial accounts into the evolving CbC guidance could reduce the administrative burden for firms. It would also allow simplification by creating a single set of information that can be used by firms and tax authorities for various tax purposes, related to Pillar Two as well as Pillar One (e.g. allocation of residual profits to market jurisdictions and identification of 'surrender' jurisdictions).

This must be accompanied by broader changes in the CbC system. Obviously, tax authorities should be allowed to use CbC data for the specific purpose of implementing Pillar One and Pillar Two rules. Moreover, simplification and reduction of the administrative burden for firms will only be achieved if all relevant tax authorities have access to the CbC data. This means that current conditions for local filing requirements must be lifted, because many developing countries currently do not have access to CbC data. Local filing, including in OECD countries, would also provide tax authorities with more timely data. Under the current CbC data exchange system, tax authorities may receive the data in time for a risk assessment to prioritize audits after tax returns have been filed. However, for the application of Pillar One and Pillar Two Rules, the CbC data must be filed together with the tax return, because they are needed to determine the tax charge for situations covered by the new rules. Finally, the CbC reporting threshold should be lowered to increase availability of financial accounting data that has already been adjusted for the purposes Pillar Two.

b-e) Any accounting standard might be used, provided a foreign ETR is assessed applying internationally agreed tax base rules. The use of financial accounting information is a tool to verify whether, by international tax standards, the ETR on a multinational's income in a jurisdiction is above the minimum. (See 'General view' section above for our proposal on tax base criteria.) For source country rules, it is difficult to

think of a reason why accounting standards of the ultimate parent entity should be preferred above another accounting standard, especially for source countries that no not receive CbC reports. Home countries may be more familiar with the accounting standard used for consolidated accounts than with other standards. However, there are also home countries that may not implement an IIR, for example because they do not have a corporate tax. Some of these countries, such as Bermuda, are home to a substantial number of large multinationals. Smaller multinationals that do not prepare consolidated financial accounts or CbC reports could use local accounts instead, in case they need to proof that their ETR in a foreign jurisdiction is above the minimum. Thus, the accounting standards of the ultimate parent entity are not always the most logical choice.

Although financial accounts can be used, tax base criteria should be based on tax rules, for various reasons. If the ETR definition itself were based on accounting standards, differences between accounting standards would create complexity and ambiguity. Moreover, it could trigger base-narrowing competition via accounting standards between countries that try to attract corporate headquarters. It would also give accounting standard setting bodies inappropriate control over international corporate tax rules.

Further analysis is needed to identify base-narrowing tax rules that may not show up in financial accounts. This could occur if the financial accounts fail to (fully) recognize income that is excluded from the tax base. In that case, the base-narrowing tax rules would not give rise to a permanent or temporary difference, and the effect would not show up in the tax rate reconciliation of the accounts. An example would be a subsidiary that benefits from some kind of superdeduction internationally recognized as a base-narrowing measure, for an investment in an asset purchased from its foreign parent company, with accounting rules recognizing the asset at a lower value than the valuation of the asset for tax purposes. In this example, the financial accounts would not fully show the effect of the superdeduction for tax purposes. However, this seems a rather unusual situation. Whereas this issue merits further consideration, probably it can be dealt with. The issues below, about situations where permanent or temporary differences do arise and may potentially distort the ETR test, might be more challenging.

f) A common ETR test is needed that also works for an UPR and StTR. Source countries face additional challenges, including access to the required information, therefore the foreign tax base must be determined in a way that works for source countries too. We explained this in the 'General view' section above, because this should be the starting point for developing the ETR test, not an afterthought.

2. Questions on permanent differences between tax and financial accounts

a-d) Adjustments are required for permanent differences from internationally agreed tax base rules. In other words, the key criterion is that adjustments should be made when these are needed to create a reliable measure of the foreign tax base, after correcting that tax base for base-narrowing rules that are not internationally accepted. This means that not all permanent differences between financial and tax accounts must be eliminated. For example, consider a jurisdiction that allows amortization of the full market value of trademark rights that were acquired (before Pillar Two rules were agreed) from a related party in a zero-tax jurisdiction, for a compensation equal to the much lower book value. This would result in a series of deductions with a corresponding inclusion in a jurisdiction that levies at least the minimum ETR, and should thus be classified as a base-narrowing rule. If financial accounts already include amortization of the book value, this permanent difference should not be eliminated. Similarly, a notional interest deduction that would classify as a base-narrowing measure according to internationally agreed criteria should be

disregarded to determine the tax base for the ETR test. If financial accounts already disregard such a deduction, which they usually do, the accounts should not be adjusted for this permanent difference. By contrast, if a jurisdiction exempts dividend income received from a foreign subsidiary, and that exemption is in line with internationally agreed tax base rules, financial accounting data must be adjusted if the accounts include this dividend income in profits before tax.

Adjustments for permanent differences and guidance for CbC reports can be developed jointly. Some adjustments have already been incorporated into the guidance for CbC reports, for example on the treatment of dividends and gains from the sale of shares in the calculation of pre-tax profits. These instructions can also be applied for detailed ETR tests based on financial accounts where no CbC report is available. The other way around, further adjustments that are developed for the ETR tests for Pillar Two rules can be integrated into future guidance for CbC reports. This will improve consistency, and ensure equal treatment of multinationals regardless of the data source that is used for ETR tests.

Again, simplification requires limiting the need for detailed case-by-case ETR tests. This applies to home country and source country rules alike. Acquisitions and divestments of business units occur frequently, for example, and such transactions may require complex adjustments to the valuation of many assets. Therefore, in certain situations, the use of foreign tax accounts could be easier (see answer to Question 1a above).

3. Questions on temporary differences between tax and financial accounts

a-b) The tax charge needs to correspond with the tax base to calculate the ETR. As argued above, tax base criteria should be based on tax rules, and adjustments to financial accounting data should follow internationally agreed tax base rules. The tax measure, in other words the ETR numerator, needs to match this tax base. In principle, with regard to temporary differences, this leaves two options to define the ETR. The first option is to define the ETR using the regular tax base as the denominator, after deductions for tax losses carried forward, and the total tax charge as the numerator. This option is closest to using tax rules as the basis for determining the ETR. It allows qualifying certain treatment of tax losses as base-narrowing measures, such as rules that allow tax losses being carried forward over a very long period. The second option is to define the ETR using the tax base for current year income or loss as the denominator, excluding deductions for tax losses carried forward, and the tax charge for the current year as the numerator. This option seems more robust, because it would not allow artificial inflation of the ETR through indefinite deferral strategies. Note that corrections for income taxes over previous years could be treated in the same way as the utilization of tax losses carried forward.

We propose that the ETR is defined as current tax charge divided by current year profit or loss. For years in which a multinational incurs a loss in a jurisdiction, or has a total profits below a *de minimis* threshold, the loss or small profit in that jurisdiction can be exempt from Pillar Two rules. For years in which a multinational has total profits above the threshold, Pillar Two rules would apply if these profits are subject to an ETR below the minimum. This option is not only fairly robust, it is also practical when financial accounting data are used to measure the ETR. Financial accounts include profit or loss before tax (excluding deductions for tax losses carried forward) and income tax accrued for the current year. By contrast, the tax base after deduction of tax losses carried forward can only be indirectly reconstructed from financial accounts. For this reason, the item 'income tax accrued – current year' is included in the CbC report as well. This definition would thus allow to build on current CbC reporting guidance. Moreover, by disregarding deferred tax assets, the ETR test avoids

complex issues involving future tax rate changes and judgements about the likelihood that tax losses can be used in the future.

However, the use of cash tax expenses should be further explored as well. In contrast to tax accrued, cash tax expenses do not correspond with the income or loss in one particular year because of advance payments or payments for previous year tax charges. Cash tax expenses have a major advantage though: it is virtually impossible to manipulate this measure. Normally, tax expenses should follow current tax charges with limited timing differences only. Therefore the use of tax expenses should be further explored too, either as the primary tax measure, possibly with multi-year averaging, or in a backstop rule to prevent manipulation of the current tax charge measure.

Adjustments are required for temporary differences from internationally agreed tax base rules. Similar to permanent differences, the key criterion is that adjustments should be made when these are needed to create a reliable measure of the foreign tax base, after correcting that tax base for base-narrowing rules that are not internationally accepted. This means that not all temporary differences between financial and tax accounts (other than those relating to tax losses carried forward) must be eliminated. For example, consider a company that receives royalty payments from a foreign affiliate and the source country levies a withholding tax on these payments. The company benefits from a temporary low-tax regime and there cannot credit the foreign withholding tax against current profits, but it is allowed to carry forward the tax credit. Pillar Two rules will take into account the withholding tax when assessing the company's ETR for the current year, therefore no relief should be provided under Pillar Two rules for the same withholding tax in a later year. Thus, if the company utilizes the withholding tax credits in a future year, when the low-tax regime no longer applies, this should be disregarded for the purpose of Pillar Two rules. If financial accounts already exclude the withholding tax credit from the tax charge that is used to measure the ETR, the accounts should not be adjusted for this temporary difference. By contrast, if a jurisdiction allows accelerated depreciation of certain assets, and this is in line with internationally agreed tax base rules, financial accounting data should be adjusted to match the depreciation for tax purposes, fully eliminating the temporary difference. We also would like to share an illustration from an analysis of public CbC reports of EU banks. One banking affiliate reported large losses in its financial accounts in a particular year, due to a large increase in expected loan losses because of worsening overall economic conditions. When economic conditions improved again in a later year, the impairment was reversed. For the purpose of Pillar Two rules, such temporary differences need to be eliminated.

c) Multi-year averaging is not a solution for temporary differences over a long period. Moreover, multi-year averaging would fail to properly capture the tax effect of losses that occurred just before the fist year included in the average. Therefore the effect temporary differences needs to be addressed in another way. Multi-year averaging might also be more difficult to administer for source countries and would increase data needs. Averaging over two or three years would be appropriate to limit the effect of year-on-year fluctuations when cash tax expenses were to be used as the ETR numerator.

d-g) See the answer to Questions 3a-b) above. A system of carry-forward of excess minimum taxes and tax attributes would be much more complicated and require additional record keeping.

Blending should take place at jurisdictional level

General view

Effectiveness of Pillar Two as a whole should be leading for the blending question. Even if not all countries would implement Pillar Two, the rules should de designed in such a way that a minimum effective tax rate is upheld as effectively as possible by those countries that do implement Pillar Two. With a combination of home country and source country rules, universal implementation is not required to achieve the intended impact. In fact, Pillar Two will be more effective with a critical mass of jurisdictions implementing sufficiently strong minimum tax rules than with the maximum number of countries implementing much weaker rules. Only blending at the jurisdictional level or below can result in sufficiently strong rules. Global blending would make Pillar Two ineffective, as will will explain in the answer to Question 4. below.

If necessary, US GILTI rules can be accommodated in other ways, just like CFC rules. Some are concerned that US-based firms may be faced with double taxation if the US would not amend its existing GILTI rules to bring them fully in line with an IIR standard agreed by the OECD/G20 Inclusive Framework. Source countries would then treat the US GILTI rules differently from the IIR. However, this does not mean that IIR should be designed to match GILTI rules. Calling for global blending or making global blending an option, merely to achieve compatibility of the US GILTI rules with the new IIR standard, might be a thinly veiled attempt to undermine Pillar Two. If the risk for double taxation is the real concern, this should be addressed in other ways. For example, if source country rules take priority, conditional withholding taxes levied by source countries can be credited against home country taxes under either US GILTI rules or IIR. It is also possible, and indeed desirable, that Pillar Two rule coordination takes into account various types of existing ultimate and intermediate home country rules, such as US GILTI rules and different varieties of CFC rules, distinguishing them from the IIR and giving them a separate treatment to avoid double taxation. The consultation document already addresses CFC rules in paragraph 3.5; the US GILTI rule could be treated in a similar way.

4. Question on compliance costs and economic effects of different IIR blending levels

a) Effectiveness, not compliance costs, should be leading for the IIR blending level. Therefore we focus on effectiveness in out answer to this question. Compliance costs can be reduced in many ways. We have made various proposals for this in the section on tax base determination above. In addition, we support a *de minimis* threshold for the IIR (see next section on carve-outs and thresholds). However, approaches to reduce compliance costs are dependent on more fundamental design elements, in particular the IIR blending level. Thus, it is useful to think of ways to reduce compliance costs only *after* considering the level of blending, for which effectiveness is a sufficient criterion.

Global blending for IIR is not acceptable, it would make minimum tax rules highly ineffective. With global blending, the IIR will not take away the pressure on smaller developing countries to offer tax holidays, because such tax holidays hardly affect a multinational's global average tax rate. Moreover, applying the IIR on aggregate foreign profits is much less effective against profit shifting. This is because multinationals that have activities in high-tax jurisdictions can still reduce their global average rate towards the minimum by shifting profits towards zero-tax jurisdictions.

Jurisdictional blending is most effective to uphold a global minimum ETR. With jurisdictional blending, the IIR will greatly reduce pressure on source countries to offer tax holidays, putting a floor in damaging tax

competition. This positive effect will be the same for all countries, including large and small developing countries. That is crucial, because in the presence of regional competition and pressure from foreign investors, countries will only regain their sovereignty to tax multinationals at least at the minimum ETR if they know that the same multinationals cannot get a lower ETR in another jurisdiction. Jurisdictional blending will also strongly reduce the incentive for profit shifting, because the minimum ETR applies for all base-eroding payments (if the profits of the recipient are substantial, above a *de minimis* threshold).

Moreover, jurisdictional blending can be used for all Pillar Two elements, increasing coherence. It can be applied for the IIR as well as UPR, StTR and switch-over rule, creating a coherent system. Jurisdictional blending is necessary to make each type of Pillar Two rules work as a back-up for the other. When a critical mass of home countries and source countries implements Pillar Two rules with jurisdictional blending, the global minimum ETR will be upheld for a large proportion of all activities of domestic and foreign multinationals in each jurisdiction. For jurisdictions with a corporate tax system, it might then become attractive to tax all income of multinationals at least at the minimum ETR, even if there are operations in the jurisdiction from a few multinationals that are not subject to an IIR.

Jurisdictional blending should be acceptable for most jurisdictions. For jurisdictions that want to protect their tax base or put a floor in the race to the bottom in corporate taxes, it provides reasonable protection. For jurisdictions that have amended their tax regimes to comply with BEPS Action 5 and other FHTP standards, it allows the benefits of these regimes for multinationals that have high-taxed income as well and for purely domestic companies. FHTP-compliant patents boxes, for example, would still allow income from R&D-based intangibles to be taxed at a low rate, provided the average ETR on a multinational's total profits in the jurisdiction – including any income from intangibles not qualifying for the patent box, interest income, domestic businesses, etc – does not fall below the minimum. Thus, Pillar Two complements existing FHTP criteria for tax regimes. This does not mean that Oxfam supports the use of patent boxes, nor that we regard all FHTP-approved regimes as acceptable in the absence of minimum tax rules. We merely note that an IIR with jurisdictional blending would still allow high-tax countries to provide tax benefits through special low-tax regimes, therefore this should be a reasonable option for most countries.

Entity-level blending does not have added value. Dynamic effects should be taken into account. Tax-aggressive firms that have non/low-taxed entities and high-taxed entities in the same jurisdiction may simply adjust their structure to make most income of that jurisdiction end up in one entity. Thus, although for source country rules an ETR test at entity level may seem more effective, it will often be impossible to avoid that firms achieve jurisdictional blending themselves. Moreover, tax-aggressive firms may set up multi-layered profit shifting structures, with base-eroding payments made to a high-taxed foreign entity and onward payments to a non/low-taxed entity in the same foreign jurisdiction. Because of such structures, entity-level blending could even be less effective than jurisdictional blending. This implies that conditional withholding taxes, levied under the UPR/StTR, would be conditional on the average ETR on the multinational group's total profits in the recipient jurisdiction. This may seem somewhat counterintuitive, because withholding taxes are typically levied on individual payments. It is not without precedent, though. The Netherlands is currently introducing a withholding tax on intra-group interest and royalties that is conditional on the general (statutory) tax rate in the recipient jurisdiction and not on the tax rate applicable to the individual payment. To address conduit arrangements involving multiple jurisdictions, (developing) countries could apply source country Pillar Two rules on relevant transactions to all jurisdictions that do not themselves implement comprehensive Pillar Two source country rules or domestic rules of a similar nature.

5. Question on the use of worldwide blending to manage volatility

a) Worldwide blending is not an option; volatility should be managed in other ways. Apart from global blending not being an acceptable option, combining profits and taxes from different jurisdictions in the same year is not a meaningful way to address volatility of profits within a jurisdiction over time. The effect of tax losses carried forward can addressed in other ways, as explained in our answer to Questions 3a-b above.

6. Questions on the use of consolidated financial accounting information

a-b) The starting point must be an effective design of minimum tax rules, not the availability of consolidated accounts. As explained above, jurisdictional blending is crucial and global blending is not an acceptable option. Therefore the use of unconsolidated financial accounts is more practical (at least for a separate Pillar Two approach that does involve formulary apportionment). Entity-level or jurisdictional-level data from CbC reports can be used as well. For limited ETR tests (following the approach we described the section on tax base determination), the tax charges and profits/losses before tax of all entities in a jurisdiction can simply be added up, without a need for intra-group eliminations.

Besides, the use of consolidated financial accounts raises problems of its own. An example is that a multinational group's share of net income from non-controlled associates is included in the consolidated income statement, without a corresponding inclusion of the associates' underlying profit or loss before tax.

7. Questions on allocating branch income

a-c) Allocation of income and corresponding tax charges should follow tax rules. See also our general view on tax base determination above.

8.Questions on allocating income of a transparent entity

a-c) Allocation of income and corresponding tax charges should follow tax rules. See also our general view on tax base determination above.

9. Questions on taxes arising in another jurisdiction

a-b) Crediting of source country taxes needs to match Pillar Two rule coordination. The aim should be to prevent or provide relief for double minimum taxation under Pillar Two rules, while keeping the new rules simple enough to be implemented by countries with limited administrative capacity. In the first section of this submission, we propose a three-tier rule order that gives priority to conditional withholding taxes levied by source countries, thus to one UPR form. Some developing countries may also continue to levy normal withholding taxes. Thus, countries should give a credit for foreign (conditional and normal) withholding taxes against lower-tier defensive tax rules, in particular the IIR. Home countries could also give a credit for withholding taxes against other defensive tax rules that may remain in place, such as CFC rules or the US GILTI rule, or against the general corporate tax charge in the home country.

Tax paid under a CFC rule can be attributed to the jurisdiction where the income arises for IIR purposes. This would be logical as a second step, after crediting of relevant withholding taxes against the CFC rule, because CFC rules can be applied by countries where intermediate holdings are located. That makes it easier for ultimate home countries to take into account taxes paid under the CFC rule of an intermediate holding jurisdiction when applying the IIR than the other way around. It wil be in line with the aim of Pillar Two –

ensuring that al profits of a multinational are taxed at least at the minimum ETR – to attribute the taxes paid under a CFC rule to the jurisdiction where the underlying income arises, and not to the jurisdiction where the intermediate holding is located. This would not work for the same way for the US GILTI rule, because the tax paid under that rule cannot be directly attributed to individual foreign jurisdictions. However, if necessary, a formula could be developed to treat the US GILTI rule as much as possible as CFC rules, and split any tax paid under it among those jurisdictions that have an ETR below the minimujm for crediting against the IIR. Note that such tax crediting does not affect the three-tier rule order we propose in the first section; CFC rules (or the US GILTI rule) should not influence the application of non-deduction rules. It should only be possible to credit tax paid under a CFC rule against the IIR or another home country defensive measure applied higher up in the holding chain. Moreover, only if the ultimate home country of a multinational applies an IIR, which has a broader scope than CFC rules, application of Pillar Two non-deduction rules for base-eroding payments that are not subject to withholding tax would be waived.

For multinationals not subject to an IIR, other home country rules can provide relief for non-deductions under Pillar Two. This would be similar to the treatment of non-deductions under existing tax rules of foreign countries when applying home country rule such as CFC rules or the UG GILTI rule.

10. Questions on dividends and other distributions

a-b) Worldwide blending is not an acceptable option; intra-group dividends can be excluded from jurisdictional income. Dividends are typically paid out of profits after tax and often dividend income from qualifying subsidiaries is laregely or fully exempt from income tax under a participation exemption. For this reason, the latest CbC reporting guidance also requires that intra-group dividends are excluded from the reported profit or loss before tax. Some countries have switch-over rules that disable the exemption for certain intra-group dividends received from low-tax jurisdictions. Under Pillar Two rules, such existing switch-over rules may become largely redundant, because the minimum tax would be levied on all foreign profits regardless of whether the profits are distributed.

Unlike dividends, capital gains must be included. Gains or losses from the transfer of shares (or similar financial assets) must be included in profits or loss before tax, because many countries tax such gains or losses. There are legitimate reasons for doing so. Moreover, including capital gains in the ETR test would help source countries to address tax avoidance via offshore indirect transfers. Unlike dividend payments, large gains from the sale of shares can arise even when no profits have been reported and no corporate income tax has been paid in the source country for a long period. The participation exemptions granted for capital gains by some jurisdictions, including jurisdictions that have been used for the structuring of indirect offshore transfers, are not a reason for excluding capital gains. Source country taxes on gains from the transfer of shares by a foreign entity may be attributed to the jurisdiction of that recipient for the crediting against the IIR, similar to (conditional and normal) withholding taxes.

c) We reiterate that blending must take place at jurisdictional level, for the reasons provided above.

Carve-outs must not be allowed

General view

Effectiveness of Pillar Two as a whole should be leading with regard to carve-outs and thresholds. As argued in the section on blending, Pillar Two should be designed in such a way that a minimum effective tax rate is upheld as effectively as possible by those countries that implement the new rules. Pillar Two will be more effective with a critical mass of jurisdictions implementing sufficiently strong minimum tax rules than with the maximum number of countries implementing much weaker rules. Sufficiently strong rules would only allow for certain limited thresholds. Any carve-outs will greatly undermine the effectiveness of minimum tax rules, as we will explain in our answer to Question 11 below, thus they must not be allowed.

If necessary, US GILTI rules can be accommodated in other ways. Some are concerned about double taxation for US-based firms if source countries would treat the US GILTI rules differently from the IIR. Apart from the blending level, GILTI rules could be incompatible with the IIR if the US would not amend the allowance for a return on tangible assets (QBAI) under the current GILTI rules. However, this does not mean that IIR should be designed to match GILTI rules. As explained in the blending section, risks of double taxation should be addressed in other ways, notably via rule coordination.

11.Questions on carve-outs and thresholds

a-b) There should be no carve-outs for approved low-tax regimes or for real economic activities. These would make the rules completely useless. The IIR must be applied to all profits, active and passive, distributed and retained. Considering some carve-outs will be seen as unsuitable even those not regarded as not harmful under BEPS Action 5 by FHTP. Carve-outs will undermine the principles of effectiveness against profit shifting, as well as going against the principle of neutrality. Also, if decisions are taken to protect some tax regimes through carve outs, it can be expected that more countries will quickly introduce such tax regimes, and tax-aggressive multinationals will modify their structures to take advantage of that. Any carve-outs, even if seemingly small or well-targeted, would therefore undermine the whole Pillar Two. There should also be no allowance for a return on tangible assets and no exemption for CFCs with related party transactions below a certain threshold. Any such exemptions will make that Pillar Two fails to put a robust floor in damaging tax competition between source countries.

c) There should be no thresholds based on the size of a multinational group. A multinational that is small by global standards can still have operations in a developing country that are relatively large from that country's perspective.

d) The only type of thresholds that would be acceptable are *de minimis* thresholds that exclude transactions or jurisdiction-level profits below a fixed minimum amount. The order of magnitude of such thresholds could be around €100,000. *De minimis* thresholds would serve a dual purpose. First, they would exempt relatively small local activities in low/zero-tax countries. This means that multinationals that only have relatively limited operations in a country would compete on a level playing field with domestically owned businesses. Second, they would limit the administrative burden for tax authorities as well as small multinationals, ensuring the Pillar Two rules proportional. The BEPS Action 5 standard and other FHTP criteria for tax regimes would continue to apply in the current way, regardless of the Pillar Two threshold.

e) There should be no carve-outs for specific sectors or industries. There is no economic justification for any sector or industries as a principle of rule. All business sectors, business lines and industries should be subject to a minimum tax, for simplicity, to minimize system costs and to ensure a level playing field. There might be potential justifications for some ad-hoc tax treatments to incentivize some specific activities or protect economic interests in view of potential positive impact to the source country in terms of job creation or any other positive economic or social spill over effect. However, such specific tax treatment should always be considered to fall below the de minimis threshold.

f) Other issues regarding carve-outs: see general view above.