UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

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VIA EMAIL
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RE: USCIB Comments on the OECD Public Consultation Document on the Reports on the Pillar One and Pillar Two Blueprints

Dear Sir or Madam:

USCIB[1] is pleased to provide comments on the OECD Public Consultation Document on the Reports on the Pillar One and Pillar Two Blueprints.

General Comments

Introduction

We commend the OECD Secretariat, the members of the Inclusive Framework on BEPS (the "IF"), and the OECD technical working parties for the volume and quality of their work as reflected in the Pillar One and Pillar Two Blueprints (the "Blueprints") of October 12, 2020 to develop coherent rules to address the tax challenges arising from the digitalization of the economy.

Taxation Principles

We wish to reiterate the taxation principles that we feel are critical to the Blueprints as drafted and which underly our analysis of, and comments to, both Pillar proposals in this letter. The rules should be developed with consideration of their potential impact on global growth and business investment decisions. The rules should be designed in a way to support the achievement of tax certainty for taxpayers and tax administrations and not be too complex or too onerous in compliance to discourage global investment. The rules, even the acknowledged formulaic guidance, should be based, to the maximum extent possible, on internationally accepted principles of taxation for coherency in their creation and consistency in their application. The rules, either in their design or application, must not ringfence any sector of the economy. Net income taxation should remain the fundamental objective. Where there is double taxation risk and/or unnecessary complexity at the intersection of Pillar One's net income rules with existing gross basis taxation such as withholding taxes on in-scope revenue, the guidance should

[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.

provide rules to eliminate such double taxation risk in favor of the net income taxation system. To insure that the rules meet tax certainty requirements, above all, scoping (i.e., inclusions and exceptions) and quantum rules should be as economically (empirically) based as possible. There should be no opportunity created in the design of the rules for an unprincipled or ambiguous interpretation of the rules by tax administrations.

The rules should be as simple as possible for taxpayers and tax administrations to apply. For determining the application of the various carve-outs, sourcing rules, thresholds for scope and phase-ins, hierarchies, etc., that already exist in the blueprints, MNEs should be permitted to use the information and data which they already collect and process in their normal course of business. Information that is collected for Pillar compliance purposes only should be kept at a minimum, if not eliminated. It is important for the sustainability of these rules that the ongoing compliance cost does not outweigh the incremental tax that any rule is estimated to generate. There should be a reasonable approach to measure this cost-benefit relationship as part of the economic impact assessment. The rules should be designed to eliminate the risk of double taxation in their operation in order to mitigate the need for dispute resolution, especially where these rules override existing international taxation rules, for example, when the same revenue stream is subject to both gross-basis withholding tax and net income tax under the Pillars. The mechanisms for dispute prevention and dispute resolution must be comprehensive and designed to reach resolution within consistent, specific time frames. The design of these mechanisms should take into account the strengths and weaknesses of other international dispute resolution mechanisms already in place.

The guidance should include an efficient approach or mechanism for any post-agreement effective date amendments to the rules. Finally, USCIB notes that we are in general agreement with BIAC's application of its principles to the Blueprints as described in the BIAC consultation letter.

Reference to Economic Impact Assessment

USCIB wishes to comment here on the OECD Economic Impact Assessment (EIA) of October 12, 2020, given its value as an empirical analysis on which to base essential Pillar rule and design decisions. We commend the Secretariat for their significant achievement in producing the EIA in the time needed. As the Secretariat and business stakeholders have indicated, the economic data on which the current version of the EIA is based relate to a period that precedes the implementation of both BEPS measures internationally and the US Tax Reform Act of 2017 (TCJA) which included the BEPS-inspired global intangible low-taxed income (GILTI) regime. The EIA included GILTI revenue estimates from the US Joint Committee on Taxation. USCIB continues to believe that it would be appropriate to consider the actual economic data post-BEPS/TCJA enactments to determine the extent of the variation in the economic impact on which assumptions have been made in the Blueprints. USCIB believes, for example, that the enacted BEPS changes combined with the relevant TCJA changes have eliminated the ability (at least for US MNEs) to earn income subject to low or no tax.

Consisting primarily of US parent-controlled groups, USCIB membership is unique among BIAC member affiliates. From a US MNE perspective, USCIB views Pillar One primarily as a profit allocation rule rather than a residual tax in the market jurisdiction on US MNE global earnings, as US MNEs are already subject to BEPS-inspired rules such as GILTI. USCIB generally agrees with the BIAC analysis of the EIA as presented in the annex to its consultation letter.

We suggest that the EIA be updated to reflect more current economic data and that the updated analyses be available in time for the next round of political discussion. We believe that inclusion of the economic impact of the GILTI regime is essential to the IF member decisions related to the GloBE-coexistent comments we provide below.

Elimination of Unilateral Measures

Unilateral taxation measures which have been enacted, proposed or contemplated in the absence of a multilaterally agreed global solution for the taxation of the digitalized economy (and discriminate against specific companies) must be specifically identified in the guidance. The IF members that enacted, proposed or contemplated such measures must commit to the repeal, withdrawal, and cessation of such measures, effective on the date of the global agreement.

Continued Support for OECD Process

Our comments in this letter represent the consensus views of the members of USCIB (unless otherwise indicated). We note the amount of technical work still outstanding as identified in the Blueprints for the further development of the Pillars required to achieve consensus in the IF. USCIB requests the opportunity to present at the January public consultation hearing and will continue to be an active and constructive contributor to the further development and completion of consensus guidance.

Pillar One Blueprint

Amount A

We recognize with respect to Amount A there are a number of issues subject to political deliberations and that many of the technical issues commented on here are subject to the specific outcome of those deliberations.

In general, we applaud the Secretariat's focus on simplification in designing the Amount A rules.

We recommend that special dual category rules be eliminated due to the uncertainty and subjectivity they introduce into the determination of whether certain activities are in scope.

Need for Tax Certainty

Pillar One should include a workable dispute prevention and resolution mechanism to minimize tax uncertainty. The Blueprint's proposal for an Amount A review and determination approach is commendable but will require substantial revisions to ensure a workable solution that does not create significant additional administrative and compliance costs and uncertainty for both taxpayers and tax administrations. For example, the Blueprint proposal for positive and negative lists to simplify the determination of in-scope and excepted activities suggests that individual jurisdictions will be able to make unilateral changes to update these lists over time. This apparently uncoordinated feature will greatly increase taxpayer uncertainty, tax disputes, and the greater potential for double taxation. These lists should be defined as specifically as possible, with no possibility of unilateral, uncoordinated deviations from the lists by any IF member.

The Amount A review and determination panels should be limited to jurisdictions with a direct and material interest in the tax allocations before each individual panel, conducted under confidentiality rules, and it must be clear that the taxpayer information submitted cannot be used for other purposes.

It is important for the MNE's lead tax administration to participate in the determination panel under rules that do not allow other countries to override the lead tax authority by a simple majority vote.

It is inevitable that there will be transfer pricing adjustments upon audit occurring many years after Amount A has been reallocated for a particular year, but that would have impacted that particular year's Amount A reallocation. The Blueprint acknowledges that no solution has been developed to ensure that this does not lead to double taxation. This is an essential piece of work and Pillar One should not be concluded until a solution for this has been agreed.

Since market jurisdictions without locally headquartered businesses subject to Amount A may be aggressive in reallocating income where there exist allegedly gray areas, whether intended or not, care must be taken to rely on the lead tax authority for the MNE subject to the Amount A reallocation and minimize disagreement among the impacted tax administrations in the review and determination process. We agree that it is important that Amount A is limited to a manageable number of MNE groups from the perspective of many tax administrations as a resource issue, but caution against thresholds (or phasing in thresholds) that result in a concentration of in-scope businesses in a particular industry or country while other country's locally headquartered businesses are exempt or deferred significantly. This risk could be avoided through an economic impact analysis of such an approach. In any case, any thresholds adopted must be subject to a timeline that is binding on all IF members.

As companies have experienced in implementing the BEPS country by country reporting requirements, the creation and implementation of new systems that are designed to achieve compliance with the new rules will take time. The analysis of such systems will not be simple. Companies will need a significant lead time to prepare for the requirements proposed in the Pillar One Blueprint.

Multiple Obligations for the Use of Business Data

Pillar One has a significant number of methodologies, thresholds, definitions etc. that rely on data and information in their application. The hierarchy indicators for sourcing should be based on information MNEs already collect in the normal course of business. The collection, processing and sharing of personal customer data with tax administrations is generally subject to the national data privacy laws of the jurisdiction or jurisdictions in which the data is collected and processed. Such national laws typically contain special rules for the retention and sharing of personal customer data with tax administrations for tax compliance purposes. Further work on the Pillars should proceed with these international data privacy obligations in mind.

Further clarity is needed as to what information should be considered "available" to an MNE group for Pillar One sourcing purposes. Even for information collected in the normal course of business within an

MNE group, extracting and formatting that information for use in tax compliance files may present significant operational challenges. The hierarchy of sourcing indicators should not be designed in a way that would force a taxpayer to use a particular piece of information that may be present somewhere in the MNE group, where, in their reasonable judgment in light of their particular business, the taxpayer concludes that doing so would result in unreasonable costs or pose a risk of violating legal constraints.

Similarly, while the blueprint in some circumstances requires taxpayers to attempt to obtain information held by unrelated third parties, there will in most cases be valid business reasons for unrelated third party distributors or customers not to provide that information, or to only provide that information at a significant cost to the requesting MNE. We recommend, therefore, that a taxpayer should not be required to incur significant additional costs or modify commercial arrangements in order to obtain information in the possession of an unrelated third party.

Segmentation

The financial segmentation rules are an important component for the Amount A calculation. Segmentation should only be required in very limited and clearly articulated cases that, in the absence of segmentation, would result in distortive impacts in determining the allocation for the purposes of Amount A. Segmentation may lead to similarly situated MNEs (e.g., with similar consolidated sales revenue and profit levels) that segment their financial statements in different ways (for entirely non-tax-related purposes) realizing very different Amount A allocations. Financial statement disclosure, including any segmentation, should be driven by the intention to inform investors about the economic status of the business without the influence of potential tax outcomes.

The general rule should be that MNEs can use their consolidated financial statements for the Amount A allocation calculation. If segmentation is required, the default rule should be based on the MNE's segmentation reported in their public financial statements. Where the MNE is not required to report a segment separately for financial purposes, e.g., due to size, and distortion would occur, then taxpayers should have the option to segment based on books and records. Considering that the principle purpose of Amount A is to achieve a global reallocation of the tax base, the default rule should be that Amount A should be calculated based on consolidated accounts, with an elective option that an MNE can choose to use product line or geographically segmented accounts, if they provide a more accurate result for the MNE.

Pillar One Phase-in Rules

We support the use of phase-ins for the determination of scope, dispute prevention and dispute resolution, provided that such a phase-in is subject to a timeline for full implementation that is binding on all IF members. Without a binding timeline there could be a significant risk of ringfencing on a global and jurisdictional basis since any phase-in would likely start with a relatively small number of the largest global MNEs in an even smaller number of jurisdictions. We agree that it is important that Amount A is initially limited to a manageable number of MNE groups, but caution against thresholds (or phasing in thresholds) that result in a concentration of in-scope businesses in a particular industry or country while other country's headquartered businesses are exempt or deferred. This risk could be avoided through an economic impact analysis of such an approach. We also note that the consideration for a phased-in approach, even for the smaller group of MNCs that are above the revenue thresholds, underscores the complexity of the Pillar One rules and the significant burden placed on both taxpayers and tax administrations in their implementation and application.

Loss Carryforwards, Pre-regime and Prospective, and Profit Shortfalls

USCIB supports the use of loss carryforwards in the calculation of Amount A. This includes pre-regime losses, i.e., losses that can be properly allocated under the Amount A rules but which were incurred in taxable periods prior to the effective date of the regime (which also account for any phase-in timelines) and which are limited to only those direct losses and allocable group-level expenses realized by specific, identifiable Amount A activities. Overall MNC losses should not offset Amount A income. The business models of MNEs subject to the Amount A scope are often capital intensive or involve capital intensive investment phases. Local tax loss carryforward principles recognize the relationship between the capital investment timing and the profitability levels of the business over time. Given the significant capital investment values involved for in-scope MNEs we believe such pre-regime loss carryforward rules are warranted. The same principle of course applies to Amount A related losses incurred after the effective date of the Pillar One regime and what the Blueprint refers to as profit shortfalls, i.e., the situation in which the MNE is in scope for Amount A but the consolidated or segmented Amount A profit percentage is below the threshold for inclusion in the allocable pool on a global or jurisdictional basis. For symmetry purposes, the profit shortfall for any year and for any jurisdiction should also be carried forward and available to use against corresponding profits on a global or jurisdictional basis for an unlimited period.

The carry-forward regime should extend to both losses and profit shortfalls, both of which are increasingly likely to be realized in the near term given the impact that the COVID-19 pandemic has had on profitability of MNE groups around the world. It is a core concept that amounts subject to reallocation under Amount A include only a portion of profits in excess of a threshold that effectively acts as a deemed residual return. For purposes of determining whether an MNE earns such a deemed residual profit, providing a carryover only for economic loss (i.e. the extent by which expenses exceed income) would fail to address the situation in which profits in a previous year may have been greater than zero but less than the threshold return.

For example, consider the following: Suppose that the profit threshold for application of Amount A is set at 10%. MNE Group A earns profits of 10% each year on identical sales revenues. MNE Group B earns 5% in two years and 20% in the third. Over the course of three years, both MNE Groups earn the same total profit. Under an approach that fails to take into account the profit shortfalls in the first two years, however, Group B would be subject to Amount A in the third year, while Group A would not. To address this disparity in treatment, we recommend that the draft comments support extending the carry-forward regime for losses to include profit shortfalls. In the example above, this would permit Group B to carry forward its profit shortfall of 5% in years 1 and 2 to offset its 20% profit in year 3, which would put it into parity with Group A.

Double Counting

A mechanism to eliminate double counting and double taxation by imposing a cap on the Amount A re-allocation is a critical component of any IF agreement but more refinement of the Blueprint proposal is required. At the very least, the amount of local tax due on the tentative Amount A reallocation to a jurisdiction should be reduced by the amount of any related withholding tax collected by that jurisdiction.

The relief from double taxation mechanism discussed in the Blueprint mitigates double counting only to the extent that a taxpaying entity in a local market is treated as the paying entity with respect to that jurisdiction's Amount A reallocation. In other cases, there is a risk that Amount A will result in an increase in taxation in a jurisdiction that may also collect substantial corporate income taxes (and withholding taxes) under existing rules. While an effective marketing and distribution safe harbor, an essential part of the Pillar One framework, may provide some help with this problem where local marketing and distribution activities are giving rise to double counting, it does not fully address the issue. A more comprehensive measure to eliminate double counting is therefore needed to avoid this outcome by reducing the additional tax imposed under Amount A in a jurisdiction by the amount of income tax or equivalent tax already paid in that jurisdiction.

Double counting for in-scope distribution activities: A number of tax jurisdictions assert and collect, as part of their current audit and settlement practices, residual income claims beyond a reasonable arms-length return when auditing multinational affiliate distributor returns. The Blueprint is attempting among other objectives to standardize a reallocation of additional jurisdictional taxing rights to market jurisdictions under Amount A, while avoiding double taxation. To be effective at this objective, the in-scope distributor return for Amount B should only represent functional-based arms-length result and not include a residual income claim. The proposed marketing and distribution safe harbor is directionally helpful but the suggested fixed return for marketing and distribution activities (suggested in paragraph 543 to be an operating profit of 4% of sales, with possible additional adjustments for region and industry profitability differences) is generally considered excessive of an arm's length return for a typical affiliate distributor and would clearly result in double counting by effectively including residual income in an Amount B in addition to the residual income included in Amount A.

Marketing and Distribution Profits Safe Harbor

The marketing and distribution profits safe harbor is a key element of Amount A. USCIB strongly supports the adoption of an effective marketing and distribution profits safe harbor as part of the Pillar One framework. It is very important to eliminate double counting and clarify the point at which the marketing and distribution profits safe harbor applies to reduce or eliminate the Amount A reallocation.

Amount A should not be reallocated to a jurisdiction that already recognizes sufficient non-routine profits in that country under existing transfer pricing rules. To do so would be contrary to the policy rationale of Amount A, overly burdensome to administer, and ineffective in eliminating double taxation.

The policy rationale for Amount A is premised on giving market jurisdictions taxing rights over a portion of residual profits. Where market jurisdictions already have such taxing rights the policy objective would already be met without the need to overlay complex new rules. Applying the mechanism to eliminate double taxation to decentralized businesses that realize residual profits in many entities and jurisdictions would be overly complex to administer. It is also likely to be ineffective in eliminating double taxation, e.g. in situations where profits are allocated to a jurisdiction and relief from double taxation is provided by an entity in the same jurisdiction that has unused carry-forward losses, resulting in the inability to use those carry-forward losses.

The marketing and distribution profits safe harbor, if designed adequately, is an appropriate mechanism to help address these issues by avoiding a duplicate Amount A reallocation to jurisdictions that recognize non-routine profits under existing transfer pricing rules. For the reasons stated, the threshold amount for this safe harbor should be set to ensure that the total residual profit allocated to the market jurisdiction is not greater than the Amount A reallocation. One way to accomplish this would be to limit the safe harbor fixed return component to the Amount B fixed return. Otherwise, the prevention of double counting has not been achieved.

Design simplicity is essential. Total in-scope profits in the market jurisdiction should be compared against the safe harbor amount to determine if there is sufficient profit already allocated to the jurisdiction under existing rules to reduce, and ultimately eliminate, any additional Amount A reallocation. The Blueprint often suggests that all in-scope, in-market profits are to be compared against the safe harbor amount, but at times instead suggests that only a portion of the in-scope, in-market profits are to be considered. All in-scope, in-market profits should be considered against the safe harbor, rather than limiting this to only a sub-set of in-scope, in-market profits.

Amount B

USCIB supports the Amount B profit allocation mechanism discussed in the Blueprint. USCIB members welcome it as an important component of Pillar One and for its role the marketing and distribution profits safe harbor. Above all, the Amount B fixed return provides tax certainty as its computation is based on established arm's length principles (ALP). USCIB fully supports the statement in the Blueprint that "Amount B is intended to deliver a result that approximates results determined in accordance with the ALP" (para 686). A recent publicly available study[2] examined thousands of independent distributor returns and found that marketing, sales, and distribution returns consistent with the ALP are low across industries, regions and profitability levels for both value added activities and for limited risk distributors. While low margin businesses have reduced distribution returns, contrary to some unsubstantiated assertions, the study found that there is a ceiling for returns to sales, marketing and distribution functions, even where an industry segment is highly profitable. It will also be important to consider the potential impact of Amount B on low margin businesses. The level of profits allocated to marketing and distribution affiliates through Amount B for low margin businesses should consider the system profit of the MNE to avoid situations where the Amount B allocation exceeds system profits which would lead to double taxation.

To be fit for purpose, the Amount B scope should cover the large majority of local country affiliates (which

[2] KPMG, Transfer Pricing Analysis of Arm's Length Returns to Sales, Marketing & Distribution Activities (February 2020).

is also important for an effective marketing and distribution safe harbor).

Pillar 2 Blueprint

USCIB supports in principle the concept of a global minimum tax. In the 2017 TCJA, the US enacted the GILTI regime which was inspired by BEPS and is similar in objective to GloBE. The Secretariat has publicly stated that the GILTI regime is more onerous than the GloBE as proposed, and per modeling raises more tax revenue. GILTI is new to the US tax system although the concept does relate in part to controlled foreign corporation (CFC) regimes which were created by the US and eventually became an international tax norm (as GILTI might develop, in the absence of an OECD agreement). A similar regime does not exist yet in any IF member jurisdiction. Since 2017, US taxpayers have gained valuable experience in applying GILTI to defined intangible income earned in their non-US operations. As a relatively novel regime, the GILTI rules in practice have been under considerable scrutiny by the US Treasury Department, the US tax administration, the US tax advisory community and US taxpayers. This scrutiny is based on the same taxation principles that we listed at the top of this letter, above.

USCIB has a strong preference for GILTI to have complete coexistence for all GloBE purposes but our comments also address the Blueprint-proposed IIR coexistence as discussed below.

GloBE-coexistence – Pillar Two Compliant

USCIB feels strongly that the GILTI regime should be considered Pillar 2 compliant for all purposes, including the Income Inclusion Rule, the Undertaxed Payment Rule, and the Subject to Tax Rule because it is consistent with the principles of Pillar Two. US companies are already subject to the GILTI regime which imposes a minimum tax on global intangible income. The Blueprint suggests that GILTI may be considered a compliant income inclusion rule (IIR) for the purposes of the GloBE rules. This would mean that US companies could still be subject to the Undertaxed Payment Rule (UTPR) as well as the Subject to Tax Rule (STTR).

If GILTI is treated as a compliant regime, then there should be no intermediate GloBE tax down the corporate ownership chain for US-based MNEs. Accordingly, there should also be no separate compliance obligations on US MNEs related to the GloBE rules (including the IIR and the UTPR) and the STTR. GILTI should be an acceptable minimum standard and other IF members could use approaches similar to GILTI that could also be considered acceptable. The principles on which GILTI qualifies as a compliant regime can be relied on by other IF members in developing their own GLoBE compliant rules in the same way the US-developed CFC regime became an international norm through the unilateral action of other interested countries. Unlike the Pillar One rules, the Pillar Two rules are voluntary. If linked in this way, the GILTI/GloBE rules will be easier to adjust over time than the Pillar One rules.

GloBE-coexistence – IIR Compliant

While it is not the preferred position of USCIB, if, as the Blueprint contemplates, GILTI is treated as GloBE compliant for IIR purposes only, there needs to be clarity around how GILTI would coexist with the remainder of Pillar Two in that case. For example, how would the UTPR and STTR apply to a group subject to GILTI? What would cause GILTI to cease to be a compliant regime (e.g., a change in US tax rules for GILTI)? Under what principles could minor amendments be made to the GILTI regime without invalidating the IIR exemption? Similarly, what GILTI features must be retained in order to maintain the exemption? These kinds of issues are essential for the GloBE compliance sustainability for GILTI and similar compliant regimes enacted by other IF members. In any event, GILTI legislative and regulatory changes that increase the tax burden on MNEs should not invalidate GILTI coexistence.

Subject to Tax Rule

The STTR, which applies in priority to the GloBE rules, would levy a gross basis withholding tax on a wide range of payments. As such it sets a bad precedent and represents a departure from long-established principles for profit-based taxes advanced by the OECD. It will likely lead to double taxation and should not be a part of the Pillar Two framework. USCIB strongly supports reversing the priority rule so that GloBE has priority over STTR.

The STTR operates separately from the GloBE rules, and is framed as a way for source countries to address concerns they may have about surrendering withholding tax rights under tax treaties in cases in which a particular income stream may not be subject to a high nominal rate of tax in the recipient entity. This is a fundamentally different concern than the concerns addressed by Pillar Two, including the GLoBE proposal. It would ideally therefore be left for future discussion, rather than included as an add-on to a comprehensive package of GloBE rules that otherwise appear intended to complement each other.

Implementing such a change across the board without giving thought to the existing level of withholding tax under the relevant treaty may lead to outcomes not consistent with the intent of the negotiators. In a treaty negotiation between a developed and developing country, the withholding rate may already represent a significant concession to the developing country treaty partner. Adding an STTR top-up tax to an existing withholding tax rate that already represents a significant concession by a treaty partner may make the rate unacceptable to the treaty partner. Further, suggesting the STTR should apply to gains underestimates the difficulty of adapting treaties to deal with offshore indirect transfers, which raise many complex issues that cannot be solved by a simple top-up tax. We believe, therefore, that if the STTR is included as a provision in a multilateral instrument to implement the Pillar Two outcomes, it should not be a minimum standard for joining that instrument. Instead, each country should be able to choose whether it believes the STTR is an acceptable modification to its existing tax treaties. Each treaty should be modified only where both parties have consented to the change. Where no such agreement is present, the matter should be left to bilateral negotiation.

There is consideration being given to expanding the scope of the payments covered by the STTR. The scope is already wide, and its application should be narrowed.

Exclusion from GloBE

USCIB welcomes the exclusion from the GloBE rules of certain ultimate parent entities (UPE) subject to tax neutrality regimes (see section 2.3.6., paras 96-106). In particular, paragraphs 103 – 106 describe the circumstances in which tax administrators may be confident that the owners of a UPE are subject to tax above the minimum rate on the entire income of the UPE as a result of a tax transparency regime, and accordingly in which the income of the UPE should be excluded from application of the GloBE rules. These circumstances are illustrated by reference to the S corporation rules of U.S. tax law. We believe that this approach is consistent with the objectives of Pillar Two and should be retained in future work. In addition, we recommend that paragraph 617 be clarified to include UPEs subject to tax neutrality regimes among the categories of entities the income of which is excluded from the scope of the GloBE rules and, by extension, the STTR.

Undertaxed Payments Rule Should Not Apply to Payments to the UPE of the MNE

UTPR should not be applied to payments to the UPE of the MNE. First, the objective of Pillar Two is to ensure a minimum level of tax on foreign income earned by MNEs so as to address remaining international base erosion and profit shifting issues. The home jurisdiction of an MNE typically is the center of that MNE's economic interests and the place of ultimate management of the MNE. The home jurisdiction is more appropriately considered to be the natural location of the residual profits arising from the operation of the business, rather than a place to which profits are shifted to minimize tax.

Second, and relatedly, while all jurisdictions have a sovereign right to determine their own tax systems, that right is especially pronounced with regard to the system for taxing resident MNEs (as recognized implicitly by the design of the IIR, which permits the home jurisdiction of an MNE to impose a top-up tax on low-taxed foreign subsidiaries). The home jurisdiction of an MNE should have the right to determine the appropriate manner of taxing the domestic income of its resident UPE, balancing revenue concerns with tax incentives to encourage positive economic activity within its jurisdiction. Applying the UTPR to payments to UPEs would inappropriately encroach on the right of the home country to balance these domestic policy interests.

An obvious solution to this issue is to exempt payments to UPEs from the UTPR. To the extent there is a concern that such an exemption could facilitate profit shifting, for example in limited cases in which the UPE is not located in a jurisdiction is reflective of substantive economic activities, targeted rules can be designed to mitigate such concerns without impacting all substantive MNEs operating in their UPE jurisdictions.

Finally, the UTPR should only apply to interest and royalty payments (not including software transactions treated as product sales).

Loss and Tax Carryforwards

The loss and tax carryforward rules will create additional compliance burdens but may be beneficial to MNEs. The loss carryforward rules could be beneficial depending how each jurisdiction's income/loss is calculated (e.g. intragroup allocations). The IIR and local tax credit rules also seem helpful in that the MNE group can use IIR tax credit carryforwards from each jurisdiction to offset the MNE group's IIR tax liability from another jurisdiction. While these rules are unlikely to impact GILTI taxpayers, they may be helpful for GloBE purposes.

Pre-regime losses and local tax carryforwards would need to be calculated using the GloBE rules. No IIR credit carryforwards would arise since no tax under the IIR will have been paid in pre-regime years.

It is USCIB's understanding that the OECD is considering time-limitations on the value of any excess loss carryforwards or excess tax carryforward (pages 118-119 of Blueprint). We believe these valuable tax attributes should not be time limited, and taxpayers should be permitted to carryforward these attributes until fully utilized.

The GloBE rules are technically complex and potentially apply to income that is subject to high rates of tax over time but which appears low taxed in a particular period due to timing and other differences between local taxable income and profits before tax. To smooth out such timing differences, local covered taxes paid by constituent entities for any preceding years should be carried forward to the GloBE rules, to the extent they exceed the minimum ETR. The obligation to establish and maintain carryforward accounts would be on the taxpayer; accordingly, there would be no additional administrative burden placed on tax authorities or taxpayers that did not wish to carry forward taxes from pre-regime periods. The carryforward period of taxes should be unlimited. This is particularly important for industries with long production cycles, such as high-tech manufacturing.

Capital-intensive industries and companies in cyclical industries typically are heavily reliant on large investments at the start of the product lifecycle, with a substantial time lag between the initial investment and the point in time where a company can expect to start generating revenue. From a tax point of view, the initial investment period will generally result in a build-up of tax losses.

If the OECD were to introduce limitations on the use of such tax losses, this could have a detrimental effect on investment levels, create uncertainty and a distorted view on the economic reality over multiple financial periods. In practice, this could lead to companies paying taxes on a distorted profit definition, i.e., only focusing on current-year profits without taking into account the full investment cost.

In any case, even if the introduction of new limitations would be considered, the carry forward period should be aligned with the payback period, which is typically substantially longer than the proposed 3-year period. Especially capital-intensive sectors would otherwise be penalized.

Formulaic Carve out for Tangible Assets - Carrying Value

The formulaic carve-out for tangible assets should be based on the carrying value of the assets rather than on depreciation value. A return-on-assets approach provides a robust method for determining a routine return to business investment. This is recognized by the OECD Transfer Pricing Guidelines (the Guidelines), which provide that a return on assets is appropriate in evaluating the profits of manufacturing or other asset-intensive activities, and that cost-based indicators should be used only in those cases where costs are a relevant indicator of the value of the functions, assets, and risks of a business. See para. 2.98 and 2.103 of the Guidelines. A return-on-assets approach is also consistent with the GILTI rules, and with sound economic and finance theory (pursuant to which returns are earned on investments, not expenses). While there is a mathematical relationship between depreciation expense and carrying value, a "routine" markup on depreciation expense is likely to fall far short of a routine return on the carrying value of long-lived assets in a capital-intensive business. The use of a markup on depreciation expense in the carve-out, rather than a return on tangible assets, effectively penalizes capital intensive businesses in a manner that is inconsistent with the objectives of the GloBE rules.

Special Issues

Members of capital-intensive industries are concerned regarding the possibility of timing differences generated by accelerated depreciation causing taxation under the GLoBE proposal even though over the very long periods necessary to reverse these differences the economic income is not low taxed.

Members of R&D-intensive industries are concerned regarding the possible implications of GLoBE for the OECD's long-standing policy fostering investment in research and development, which drives innovation, employment and global economic growth. It is critical that government-sponsored incentives for innovation such as R&D credits and deductions be preserved through substance-based carve outs from GLoBE, e.g. for full payroll costs in country.

Tax Certainty – Dispute Resolution

The proposed Pillar Two rules are extremely complex. They will be difficult and costly for companies to implement and for tax authorities to administer. The provision of certainty and elimination of double taxation requires all tax authorities to interpret and implement the Pillar Two rules in the same way. Will it be possible to avoid disputes given the complexity and breadth of the proposed rules? To avoid disputes and provide certainty, strong dispute resolution mechanisms are essential. Mandatory binding dispute resolution mechanisms with peer review should be included within the proposal.

Minimum Tax Rate

We note that there is no discussion in the Blueprint of an absolute minimum effective tax rate. This would appear fundamental to achieving a consensus agreement on Pillar Two.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)