Tiberghien

OECD
Centre for Tax Policy and Administration

by email to cfa@oecd.org

Brussels, 14 December 2020

SUBJECT: TIBERGHIEN COMMENTS ON THE PILLAR ONE AND PILLAR TWO BLUEPRINTS

Dear Sirs, Madams,

Tiberghien Lawyers and Tiberghien Economics are pleased to provide you with comments on the OECD/G20 Inclusive Framework's package consisting of the Report on the Pillar One Blueprint ("Pillar One Blueprint") and the Pillar Two Blueprint ("Pillar Two Blueprint") - collectively referred to as "the Blueprints" – dated 12 October 2020.

We recognize the efforts made by the OECD/G20 Inclusive Framework in this field and appreciate the possibility for stakeholders to provide the Centre for tax Policy and Administration with their input on both Pillars. Taking into account the political uncertainty surrounding both Pillars and the timing on the entry into force of international and domestic legislative rules implementing both Pillars, we have limited our comments.

From a general point of view, we would appreciate that the Centre for Tax Policy and Administration gives due attention to the following concerns and basic principles when continuing its work on both Pillars:

1. The principle of reality that also applies in international law
2. The complexity of both Pillars
3. The principle of legal certainty
4. The principle of equality
5. The democratic process of legislation
6. The impossible co-existence of two systems and the undermining of the ALP
7. Closing remarks

1. THE PRINCIPLE OF REALITY

As a first general remark, we would like to stress the importance of the general principle of reality. National and international income tax rules indeed need to apply to the reality as it presents itself to taxpayers and governments. Under the reality principle, there is no room for national or international legislators to tax taxpayers on facts that do not correspond to reality. This rule is a rule of common sense. It applies not only in a national context but also in the context of double tax treaties or multilateral treaties.

Some rules under Pillar One and Pillar Two seem to be at odds with the principle of reality. For example, under the reality principle, legislators need to recognize the reality of real losses incurred by taxpayers. Failure to recognize the existence of losses effectively incurred by taxpayers, automatically results in taxpayers being taxed on fictitious profits. Hence, there should not be a debate around the question whether pre-GloBE losses should be limited or not. Quite rightly, §315 of the blueprint on Pillar Two states: "Failure to take appropriate account of pre-regime losses could (...) result in the MNE Group being overtaxed".

Under the same principle there is no room either to create a GloBE tax liability on a presumed reality which differs from the reality on which a taxpayer is taxed under domestic rules. Hence, it should be made clear that tax neutral restructurings (§211-212) can never lead to a GloBE tax liability that would be higher as compared to the situation where the taxpayer did not enter in such a restructuring.

Finally, the so-called "Formulaic substance-based carve-out" does not respect the principle of reality either. On this issue, the Pillar Two Blueprint states in §332: *"The policy rationale behind a formulaic carve-out based on expenditures for payroll and tangible assets is to exclude a fixed return for substantive activities within a jurisdiction from the scope of the GloBE rules. The use of payroll and tangible assets as indicators of substantive activities is justified because these factors are generally expected to be less mobile and less likely to lead to tax induced distortions. Conceptually, excluding a fixed return from substantive activities focuses GloBE on "excess income", such as intangible-related income, which is most susceptible to BEPS risks."*

However, as all tax rules, a substance based carve-out rule has to respect the principle of reality. This means that such rule should be based on the real substance of a taxpayer in any jurisdiction as such substance presents itself to all parties involved, hence taking into account "all facts and circumstances". The mere statement in §332 of the Pillar Two Blueprint that intangible-related income is more susceptible to BEPS risks is not sufficient to exclude such income from the carve-out rule. Failure to take appropriate account of all facts and circumstances when assessing the substance of a taxpayer, results in taxing a taxpayer on a fictitious reality and as such breaches the principle of reality. Not surprisingly, the European Court of Justice adheres to this approach.

We respectfully ask the Centre for Tax Policy and Administration, in the further elaboration of both Blueprints, to pay close attention to ensure that all proposed rules are in line with the general principles of law governing international taxation, including the principle of reality.

2. THE COMPLEXITY OF BOTH PILLARS

In his first memoires published in 1982 the founding father of our firm, Albert Tiberghien (1915-2001)[1], who is considered to be the founder of fiscal studies in Belgium, devoted a chapter to the complexity of our tax laws. The chapter was titled: “De simplicitate in rebus fiscalibus – O sancta simplicitas”, which he translated as: “Nothing is as simple as the tax rebus – Only the saints have the gift to simplify”.

As early as 1982, Albert Tiberghien wrote that one of the major flaws of our tax system is its lack of simplicity. Of course, he recognized that in an incredibly complex economy, an incredibly complex tax system cannot be avoided. Hence, his starting point was clear. Quite rightly, he added however that this does not mean that complexity should be accepted as a given. On the contrary, each time regulators draw up regulations, they should ask themselves how the regulations can be worked out in the simplest possible way without creating unnecessary complexity and without contributing even more to existing complexities.

We appreciate the theoretical work already done on both Pillars. However, we need to stress that the theoretical framework is simply too complex. We are not alone with this conclusion. Tax technicians in the United States even refer to a “Rube Goldberg”-like complexity when commenting on both Pillars.

The Pillar One Blueprint has approximately 230 pages. The Pillar Two Blueprint counts 250 pages. Hence, no less than 480 pages are needed to work out a theoretical framework and even then, this turns out to be insufficient. The Public Consultation Document indeed counts about 100 questions or issues stakeholders are invited to comment on. This is just too much. It shows that the work is far from finished. Absent a political agreement on both Pillars, the question may be asked what the added value is to release both Blueprints in this state to the business community today.

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[1] Albert Tiberghien (1915-2001) started his career as a tax lawyer in 1939. In 1941, he was appointed professor in tax law at the Brussels Sint-Aloysius business school. In 1951, he was at the root of the National Union of Tax Lawyers, of which he was president until 1974. In 1958 he co-founded the 'Confédération Fiscale Européenne', of which he remained president for twenty years. One of his greatest accomplishments was the establishment of the Brussels Tax College in 1969. Numerous publications and more than 4000 articles and columns contributed to his monumental status in the field of tax law. In 1955, he wrote the ‘Tax law manual’ (often referred to as ‘the Tiberghien’). This reference work is still updated on an annual basis and is still considered to be the ‘bible’ for tax lawyers in Belgium.

On top of the additional layer of complexity imposed by both Pillars on international taxation, states will take additional individual measures to make the rules of both Pillars workable in national systems. The expectation is that a state X will impose additional levies in those cases where an MNE is not taxed at the intended minimum rate in state X. States are already considering how to organize such additional taxes, in particular by introducing a new limitation on the deductibility of expenditures or simply by introducing an actual additional tax that would work as a domestic top-up tax. It is also to be expected that a state that does not wish to impose disproportionate taxes will have to provide for special adjustment mechanisms in cases where, following a tax audit in another state, the tax base and by consequence the effective tax payable is revised in the other state to such an extent that the national top-up tax imposed in the first state proves to be too high. Conversely, there may also be situations where the national top-up tax appears to be too low due to a tax refund in another state. Moreover, when making such adjustments, states will have to take into account the tax assessment periods in other states, which are often different. It may indeed be the case that a state has to make a tax adjustment because of an adjustment in another state, but where a national statute of limitation does not permit such an adjustment whereas the rules in the other state do. Where, through both Pillars, the Inclusive Framework tries to harmonize substantive tax rules on a worldwide basis, a similar harmonization will also be necessary in the field of formal tax rules if the authors of the Pillars want to avoid double taxation of companies.

Hence, the complexity introduced by both Pillars is not limited to international tax law alone. It will also affect the national tax law of states. Moreover, the additional complexity will not be limited to substantive tax rules but will also affect formal procedural rules. We doubt whether these additional complexities are in proportion to the objective the authors of both Pillars have in mind.

Finally, as it stands today, in our estimate, the Blueprints will generate a significant administrative burden, whilst leading to a lower level of tax certainty (cf. below), which is to be avoided.

3. THE PRINCIPLE OF EQUALITY

The aim of both Pillars is to only hit those MNE's that achieve revenues above a certain threshold.

In an attempt to create synergies with the current BEPS Action 13 Country by Country Reporting (CbCR) rules, they only apply to businesses that meet or exceed a EUR 750 million annual gross revenue threshold. However, CbCR rules are of a completely different nature than the rules to be enacted by states under both Pillars. CbCR rules indeed only relate to formal tax law and as such do not affect the tax base of taxpayers nor the applicable tax rate. The Pillar One and Two Blueprints, on the other hand, do as they relate to substantive tax rules.

The objectives of CbCR rules being completely different from the objectives underlying both Pillars, they are not interchangeable. Hence, the threshold of EUR 750 million as provided for in the CbCR rules cannot be used as a mere justification for defining the scope of application of the substantive tax rules under both Pillars. The distinction made in both Pillars between MNEs above and below the thresholds is therefore at odds with the principle of equality and the general principle of non-discrimination.

In addition, the Pillar One Blueprint contains two thresholds: a global revenue test combined with a de minimis foreign in-scope revenue test. It is however unclear how both thresholds would interact. Suppose the global test is set to EUR 750 million EUR and the de minimis test at EUR 50 million. Under such rules, an MNE with revenues of EUR 700 million euros of which 50% would be allocable to market jurisdictions would apparently be out of scope. Considering the objectives pursued, such outcome would however be at odds with the principle of equality. Please note that the Belgian Council of State already made the same observation when commenting on a draft proposal of law on the introduction of a DST in Belgium.

Each time the application of a substantive tax rule depends on an artificial threshold, such rule risks colliding with the prohibition of discrimination and as such will not be honored by courts, especially Constitutional Courts. We therefore urge the OECD to properly justify the scope of application of both Pillars.

4. THE PRINCIPLE OF LEGAL CERTAINTY

The complexity surrounding both Pillars and the uncertainty about their possible entry into force disproportionately contributes to legal uncertainty.

The OECD should refrain from taking initiatives which lead to uncertainty and animosity in the business world. Unfortunately, our experience shows that this is exactly the effect both Blueprints have on the business community today.

The expansion of Pillar One to Consumer Facing Businesses (CFB's) beyond the digital economy is a striking example of this. Whereas Pillar One was originally designed to redistribute the taxing power over profits made in the digital economy alone, today's Pillar One goes much further than initially intended. This creates uncertainty for businesses suddenly faced with questions they did not expect. In addition, the detailed elaboration of both Pillars creates the mistaken impression for companies that they will be caught by the rules, although no political agreement is reached yet.

5. THE DEMOCRATIC PROCESS OF TAX LEGISLATION

We do not believe that the legal process the OECD/G20 Inclusive Framework is currently following is appropriate. As a rule, legislation, be it national or international, is only drafted when a political agreement on the underlying principles is reached. Today the legislative process seems to be working in the opposite way.

In addition, all observers, including EC and OECD officials, seem to agree that it will not be possible to come to a political agreement on both Pillars before mid or even end 2021, if any agreement will ever be reached. Even more, no observer seems to expect that the new rules will effectively come into effect before 2025.

Despite these various uncertainties, the OECD continues to work on texts and digs further into details. However, the more rules are already worked out in detail, the more these rules will be regarded as a given although the political decision-making process has yet to start. In this way, both Blueprints may have a disproportionate impact on the democratic decision-making process and the OECD risks putting itself in the place of legislators.

A striking example thereof is the so-called "Formulaic substance-based carve-out" which under the current Blueprints seems to be a given although no democratic debate took place yet on the subject. The Public Consultation Document indeed only asks one question to stakeholders, namely whether one has "any comments on the overall design of the carve-out?" although this subject is of very high importance for smaller states with open economies and numerous innovative businesses, like Belgium. The lack of attention given to this subject is the more striking as the OECD is substantially deviating from the modified nexus approach under BEPS action 5. States that adhered to this approach and modified their rules to align with what the OECD recommended are now confronted with another substantial change in no less than 5 years without a proper mechanism to oppose to such a change. In addition, it is generally accepted that the current rules respect EU law, especially EU state aid law. Innovative companies rely on the current rules and rightfully expect that governments honor their expectations.

6. THE IMPOSSIBLE CO-EXISTENCE OF TWO SYSTEMS AND THE UNDERMINING OF THE ALP

With the implementation of Pillar One and Pillar Two, and their respective targeted scope, there would be two distinct international tax systems in place – for which participation to one or the other is wholly arbitrary.

However, even more important, in this respect, and most in particular in relation to the Pillar One Blueprint, is that the Pillar One tax system undermines the working of the Arm's Length Principle ("ALP") that would be retained for those businesses out of scope of the Blueprints. Whereas the OECD has been the advocate of the ALP to be the international standard for dealing with transfer pricing, it is the OECD itself that keeps steering away from this position.

Since the 2015 BEPS report – although the OECD states that the ALP remains to be its standard of choice, and not a global formulary approach– plenty of deviations have entered into the arena of guidance that undermine a correct and consistent interpretation of the ALP – e.g. (i) the modified nexus approach as an ALP-shortcut or proxy to determine the value of own contribution of R&D/IP companies, (ii) the introduction of a risk-free rate ‘penalty’ notwithstanding independent parties in reality would never agree to risk-free compensations (cf. earlier on the principle of reality) and latest, (iii) the excessive reference to group considerations in view of applying the ALP to financial transactions.

The Pillar One Blueprint is a next step in the process of undermining the ALP, rather than improving its base of application. Leaving in the middle the discussion whether or not the new taxing right could have - or should have - been taken care of as an update of Article 5 of the OECD Model Tax Convention, and accordingly Article 7 on the attribution of profits to permanent establishments, the Pillar One Blueprint to us seems to be a laboratory to explore the global formulary approach as the successor of the ALP.

Whilst one may have opted to introduce a new taxing right (based on a proper debate), the formulas of determining Amount A, and particularly Amount B, are highly in contradiction with the ALP, and the principle of reality as highlighted earlier.

However, again assuming there has been a proper political, democratic (and not technocratic) debate and legislative process to materially update the international tax system, in contrast to what lies on the table today, the way forward in our view is not to introduce a second and competing (arbitrary) international tax system.

Rather, and most notably in view of the massive administrative burden these Blueprints bring combined with significantly increased levels of uncertainty, one should opt for reaching one internationally consistent tax system: whether fully based on the ALP, or fully on global formulary apportionment - both potentially with an extended taxing right. In respect of the first option this would mean staying fully true to business reality, and when introducing the new taxing right, only to introduce the mechanics as an (optional) safe harbor. As to the second option, this would mean letting go reality all together and introduce global tax arbitration in full. A mixed reality is in our view not sustainable for businesses.

7. CLOSING REMARKS

We appreciate the work already done under both Pillars. However, we are of the impression that both Pillars are mainly drafted from the perspective of large states with bigger economies and that no proper attention is given to the possible negative effects both Pillars may have on smaller states with open economies.

As Belgian tax practitioners, we urge the OECD to remain objective and to treat all Inclusive Framework members on an equal footing.

Finally, we ask the OECD not to precede, nor to improperly influence, the political debate on any issue.

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We trust that our comments provide you with additional insights to carry on your important work and we remain at your disposal in case you would like further clarifications and/or supportive analysis.

Sincerely,

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