Trade Union
Advisory Committee
to the OECD
Commission
syndicale consultative
auprès de l'OCDE

Comments to the Public Consultation on the OECD's Progress Report on Implementing Pillar 1 of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS)

Paris, 4 October 2022

The Trade Union Advisory Committee to the OECD is submitting these comments prior to its representative participating in the Public Consultation on September 12, 2022 on the OECD's Progress Report on implementing Pillar 1 of the OECD's Base Erosion and of the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) to implement the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy.

Table of contents

General remarks 1
Specific Recommendations 4
Determination of Eligibility 5
Determination of Excess Profits 5
Allocation of Excess Profits Among Nations with a Nexus to the Payer Company 6
Determination of Amount of Double Taxation and Allocation of Payments to Resolve Double Taxation 6
Conclusion 7

General remarks

From the beginning of the BEPS process TUAC has expressed its strong support for the goals of the project—addressing the global erosion of the effectiveness of corporate taxation in the context of globalization, digitalization, and the shifting of nominal economic activity to tax havens. In the course of the BEPS process, TUAC has made clear what is in the interests of working people and the OECD's goal of strengthening democracy in relation to corporate taxation. In our Comments to the December, 2020 Public Consultation on the Pillar 1 and Pillar 2 blueprints, TUAC made clear that, while it viewed the BEPS process as a whole to be a historic and positive effort to address growing inequities in the taxation of large corporations, the concept of Pillar 1 itself risked being inadequate to the intertwined problems of (1) the under-taxation of the world's largest and most profitable corporations, and (2) the growing separation of taxes from activities through the location of digital assets in low tax jurisdictions.

TUAC's view is that the international tax system should move to a fully unitary system, where internal transfer pricing plays no role in determining either the amount or location of corporate profits for tax purposes.

Instead, Pillar 1 sets a minimum tax level for the largest and most profitable global corporations and reallocates the taxes on those profits to at least in part reflect where the underlying revenue came from. This structure authorised signatory governments to enact corporate taxes at a rate of 25% on profits in excess of 10% of revenues. In return (from a corporate perspective) signatory governments would agree to not levy Digital Services Taxes.

Since the adoption of the Inclusive Framework, TUAC has reiterated the view that in implementing the Inclusive Framework, the OECD should seek at every point to shape the Framework to minimise opportunities for the kind of tax manipulations exemplified by those associated with internal transfer pricing, and to build a system that seeks fundamentally to maximize overall tax revenues from the world's most profitable corporations and ensure that those revenues are fairly shared with the governments of the countries where both production and consumption actually occur - in particular with the governments of developing countries where the need for revenue to address climate, public health, and general development goals are increasingly urgent.

In reviewing the Progress Report, the public comments that the OECD has received in advance of the Public Consultation, and independent studies made of the Inclusive Framework, we believe that our concerns have been borne out by the difficulties the OECD has faced in seeking to implement the Inclusive Framework. The Progress Report in all its complexity reveals the severe difficulties in implementing a half way step of the kind embodied in Pillar 1 of the Inclusive Framework.

In particular, the Progress Report includes a framework that has been designed in good faith to attempt to implement the purposes of BEPS in a manner consistent with the Inclusive Framework, and as a result is dizzyingly complex and filled with opportunities for skilful lobbyists for large corporations to subject the plan to a death of a thousand cuts. The comments those corporations, their associations, and their tax consultants have submitted are replete with suggestions for how to erode the modest positive effects we believe Pillar 1 should have.

There is a risk that Pillar 1 in its current form is unworkable and will not be adopted by sufficient numbers of governments to bring it into force. It is critical that in these circumstances there is no accompanying delay to the implementation of Pillar 2 and that the OECD is clear that signatories to the Inclusive Framework are free to continue Digital Services Taxes.

An analysis by tax experts at Oxford's Said School of Business estimated using the Inclusive Framework as a guide, and without taking into account the type of erosions that are included in the Progress Report that Pillar 1 would raise $87 billion annually from 78 multinational enterprises.[1] This is a troublingly low number in light of:

1) the revenue potential from Digital Services Taxes that Pillar 1 is replacing;
2) just 4 of those 78 companies-- Apple, Facebook, Google and Microsoft—reported $330 billion in pre-tax profits in the last year covered by their financial statements—with rates of profit between 30 and 40% of revenues-- and none of them reported paying more than 17% of their profits in taxes; and
3) the total after tax profits of the roughly 600 global firms that meet the initial threshold of $20 billion in sales is well in excess of $3 trillion, meaning that for example the difference

[1] https://www.econpol.eu/sites/default/files/2021-07/EconPol_Policy_Brief_36_Who_Will_Pay_Amount_A_0.pdf

between taxing these firms at a 15% rate and at a 25% rate is $300 billion in revenue, or over a ten year period relevant to infrastructure investments and bond financing $3 trillion—a figure dwarfing for example the promises made and yet to be kept in the Paris Climate Agreement process to assist developing countries in the transition away from carbon intensive economies.

These numbers demonstrate why the implementation of the Inclusive Framework should in no way lead to backdoor reductions of the 25% rate for profits in excess of 10% of revenues of the world's largest and most profitable corporations. The OECD should interpret the language of the Inclusive Framework in every instance from this perspective. This means TUAC specifically opposes a number of provisions in the Progress Report that effectively reduce the tax rate on the excess profits. The provisions that we oppose in the form taken in the Progress Report include, but are not limited to, the Marketing and Distribution Profits Safe Harbor in its current form, which is in effect an across the board reduction in the actual rate, the provisions governing the Elimination of Double Taxation in their current form, which would create obligations for refunds for taxes companies have not actually paid, and any attempt to include withholding taxes in the calculation of amounts subject to any Double Taxation provisions, which could easily lead to double counting of taxes paid.

In important respects, the Progress Report is struggling with a fundamental contradiction embedded in Pillar 1 of the Inclusive Framework: while the Inclusive Framework does envision that signatories will not impose Digital Service Taxes, it does not impose a "maximum" income tax rate on multinational corporations. And, as the OECD is well aware, numerous OECD countries have corporate tax rates significantly higher than the implied rate of Pillar 1.[2] At the same time, while the Inclusive Framework implies that countries will necessarily adopt and implement Pillar 1, the Framework speaks of the tax obligations surrounding Amount A as taxation *rights*, not taxation *obligations*. Thus, the entire concept of double taxation in the summary of the Inclusive Framework appears incoherent. Signatory governments have a clear right to impose whatever level of corporate income tax they chose to, above the minimums in Pillar 2, and at the same time governments with existing taxation powers over Covered Groups appear to be the only governments with any obligations under the proposed Double Taxation rules.

Similarly, since governments may choose not to exercise the "right" to impose Amount A taxes, double taxation payments built around the assumption that the entirety of Amount A payments will be collected would amount to an unjustified tax cut for the very companies that Pillar 1 is trying to tax more fairly.

In the hybrid system created by Pillar 1, there is no inherent level of taxation for Covered Groups for which the concept of double taxation has any meaning. In this context, the OECD's approach should be to make the cursory reference to double taxation in the Inclusive Framework consistent with the core of the Inclusive Framework—the 25% tax rate for excess profits of Covered Groups. This could be done by making clear that the obligation to refund taxes on the part of countries with the ability to tax Covered Groups is limited to circumstances where those countries' statutory income tax rates for Covered Group earnings are less than the blended rate that results from the application of Pillar 1 rules. We go into more detail about this approach below.

[2] https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT

Beyond our specific substantive concerns with the Progress Report, TUAC believes the OECD should maintain a clear course towards the ultimate goal of a broad, inclusive, transparent and more just international tax framework, capable of addressing the rising issue of under-taxed large corporations while avoiding ultimately a minimal agreement that only responds to the interest of large MNEs, locking in an inadequate taxation mechanism and low tax revenues.

We also encourage the OECD to keep the bar straight in a changing political landscape, including delays that are inevitable in OECD member country implementation, including in major players such as the US. In this context, the timeline for the adoption of Pillar 1 might also be affected, but the OECD and adhering countries should avoid the temptation of further watering down the original proposal in order to achieve larger and quicker consensus, at the expense of a fairer global tax system.

We urge the OECD to in general review carefully the implications of the key structural weaknesses of Pillar 1 and the implications of those weaknesses for the OECD's effort to implement the intent of Pillar 1—specifically the asymmetries between the voluntary nature of Amount A taxation, the mandatory ability to reclaim dual taxation, and the obligation to reject any digital services taxes (DSTs) at national level, once Pillar 1 is implemented.

Additionally, in view of the complexity of the proposal, TUAC recommends that there be a full review of its effectiveness no later than three years after it goes in to effect, and that that review specifically begin with the eligibility criteria, which is the fundamental building block of Pillar 1.

Finally, we encourage the OECD to conduct and share in a transparent manner country-by-country simulations for those economies that have already put in place DSTs, particularly in Europe, to assess and compare tax revenues stemming from existing taxation and the ones that would stem from the implementation of Pillar 1. The results of these simulations should be made public. In case potential revenues turn out to be lower, either Pillar 1 needs to be re-calibrated, or the obligation to repeal national DSTs should be reconsidered.

The working people of the OECD countries are desperate for a fairer tax system. We know that if the world's richest corporations are able to continue to shirk their public obligations, our democratic government's ability to serve the people who elect them will be severely impaired, and in return the global public's faith in democracy will be further damaged. Everything from the daily work of educating, housing and caring for the health of the people of the OECD to the profound crises of climate change and the threat of further pandemics will be affected.

Specific Recommendations

Pillar 1 is made up of a four step calculation: first the determination of eligibility, based on revenues; second a determination of excess profits over a 10% of revenue margin; third, the allocation of the tax on those profits (25%) among the countries which the corporation does business in and, fourth, the allocation of which countries refund any amounts that would otherwise constitute double taxation under the terms of the Progress Report.

This process is both conceptually flawed, as argued above, as well as vulnerable at each step to being eroded, much as existing corporate tax structures have been eroded. The Progress Report contains already provisions that would erode the effectiveness of the structure, and the organized global business community is seeking to expand those exceptions. Depending on how their suggestions will be implemented, they could render the proposal as a whole a dead letter in terms of the original purposes of the BEPS project.

Determination of Eligibility

There are approximately 600 corporations worldwide with more than $20 billion in annual revenue. However, only a fraction of them, approximately 90, have profits over 10% of revenues and are not either engaged in extractive industries or financial services. The Progress Report envisions subjecting portions of firms to Pillar 1 up to the point where 75% of the firm in question is either in extractive industries or financial services. This threshold is too low for exclusion from Pillar 1 as a whole and opens the door for various sorts of tax arbitrage involving corporate structures. The appropriate percentage of extractive industrial activity of financial services activity for exclusion from Pillar 1 as a whole should be 95%.

The provisions relating to growth companies are too lenient, and should be revised so that immediately upon reaching the rigorous thresholds required to be me to be subject to Pillar 1 taxation as measured by their annual financial statements they are covered by Pillar 1 for that year and for every succeeding year in which they meet the requirements.

In general we are opposed to provisions that segment Covered Groups, and such segmentation should be minimized subject to the constraints of the Inclusive Framework.

Determination of Excess Profits

While the Progress Report seeks to base the determination of the profit amount for Amount A on one of several generally accepted financial accounting systems, the Progress Report also proposes adjustments to those calculations that have the effect of eroding the fundamental profit calculation inappropriately. Among those are the ability of affected companies to apply loss carry-forwards for ten years, including loss carry-forwards for losses that predate the implementation of Pillar 1. It is absurd to include pre-implementation losses unless there is a proposal to have the Amount A obligation itself predate implementation. Loss carry-forwards should also be far more limited—no more than three years. More generally, the OECD should be wary in general of corporate proposals to amend standard accounting principles' measure of profits for the purpose of calculating Amount A.

Second, there is an important issue that is unaddressed in the Progress Report: corporate financial reports and corporate tax compliance is only as good as the quality of the independent audit of those reports. While there are clear provisions in the Progress Report requiring use of accounting measures under specified financial accounting systems, there are no provisions requiring those statements to be independently audited or overseen by an effective audit regulator. This is a flaw in the Progress Report that should be remedied by having a specified list of national audit regulators which must oversee the financial statements being relied upon in the calculation of Amount A.

Third, there is a lack of clarity about the inclusion or exclusion of minority interests from the calculation of excess profits. The nature of the capital structure of these firms should not be a relevant consideration in determining Amount A. Consequently, profits that are allocated to minority interests must be included.

Allocation of Excess Profits among Nations with a Nexus to the Payer Company

Here the critical question should be how to determine the allocation of Amount A between the countries where the corporation and its subsidiaries operate—i.e. employees, assets and sales. Some commentators have suggested that the methods proposed in the Progress Report are too complex, and should be replaced by a sales-only method. TUAC believes in this regard that the hybrid principle—looking at sales, employees, and assets—is the best approach. However, in the absence of country specific information about current tax payments by Covered Groups and how those payments would change under the language proposed in the Progress Report we are not in a position to express an opinion as to whether the specific allocation equations in the Progress Report effectively implement the goal of a more equitable distribution of Covered Group tax revenue. This data should be made available if there is to be a meaningful dialogue with the global public about the OECD's work implementing the Inclusive Framework.

TUAC is particularly concerned that the OECD preserves the approach of measuring employment costs in ways that include both employees and independent contractors, to ensure that an incentive is not inadvertently created for companies to capsulize their workforces as a form of tax evasion.

The Marketing and Distribution Safe Harbor is an idea that again like a number of the concepts in the Progress Report is well intentioned in the context of the internal tensions in the Inclusive Framework, but which in its current form erodes the stated intent of that Framework. This is because it effectively reduces the entirety of Amount A, rather than reallocating the Amount A. The safe harbor as designed in the Progress Report essentially duplicates the effect of the structure of Pillar 1, which already has a safe harbor for profits up to 10% of revenues. The OECD should redraft this section to be consistent with the goal of a real 25% tax rate on excess profits, or eliminate it entirely.

Determination of Amount of Double Taxation and Allocation of Payments to Resolve Double Taxation

The Progress Report is written as if the concept of double taxation is straightforward, when in fact it has no obvious meaning at all in the context of the hybrid system proposed in the Inclusive Framework. In order for this concept not to function as an effective cap on corporate taxation by signatory countries, it needs to be aligned with those companies' national corporate tax systems, so that the system does not result in Covered Groups income being taxed in excess of the Amount A calculation *except if* that is precisely the tax policy of the countries with jurisdiction over the Covered Group's income, under the traditional system of transfer pricing based corporate taxation. Effectively that would mean that countries would owe refunds to Covered Groups only to the extent that they kept their corporate income taxes as applied to Covered Groups below the level of their proportionate share of Amount A. This approach preserves signatory governments' right to actually adequately tax Covered Groups, while at the same time ensuring that in the absence of such action, the effect of Pillar 1 is to establish a more fairly distributed minimum tax level, not paradoxically a maximum tax level.

There is a footnote in the Progress Report raising the question of whether withholding taxes should be included in calculations of double taxation. A number of business commentators have urged that the Amount A be netted against withholding taxes. This would almost certainly be a form of barely hidden tax evasion.

Withholding taxes are a core feature of the current transfer pricing based international corporate income tax system, and their relation to corporate income taxes is complex and varies from country to country. As a general matter to the extent withholding taxes are a part of what are ultimately corporate income tax systems, treating them as separate taxes would be a form of double counting and tax evasion. More generally, the challenge of properly dealing with withholding taxes is an example of the myriad and challenging problems arising out of (1) the failure to fully transition to a unitary system and (2) the incoherence of the concept of double taxation in the Inclusive Framework to begin with. Unless it can be shown that a given withholding tax is a true form of independent corporate income tax, in which case it should be treated as we discuss above, withholding taxes should not be included in any double taxation calculation.

Conclusion

TUAC very much appreciates the opportunity to participate in the Public Consultation on the Progress Report on Pillar 1 of the Inclusive Framework. We appreciate the extensive efforts of the OECD to implement Pillar 1 in a manner consistent with the overall objectives of the BEPS process, and the extensive amount of work that has gone into this very challenging and potentially unmanageable task.

In conclusion, we wish to emphasize two things:

First, the global public needs much more information about the actual workings of the international corporate tax system, starting with Country by Country Reporting, to be able to effectively engage with the Inclusive Framework process. The absence of such informed engagement is very dangerous for the legitimacy of the BEPS process and of the OECD itself, given that this process will shape the tax environment of the world's most visible and profitable corporations.

Second, and related, the ongoing work of the OECD must be focused on ensuring that Pillar 1 is what it claims to be, i.e. the centrepiece of a hybrid global tax regime that taxes profits in excess of 10% of revenues at least at 25%. Any other outcome would be both destructive in global fiscal terms and destabilising in global political terms.