# Public consultation on the Secretariat's Proposal for a "Unified Approach" under Pillar One

**Submission by the following organisations:**

Alliance Sud
Attac Austria
Centre national de coopération au développement (CNCD-11.11.11)
Church Action for Tax Justice
Comité Catholique Contre la Faim et pour le Développement – Terre Solidaire (CCFD-Terre Solidaire)
Diakonia
Ekvilib Institute
European Network on Debt and Development (Eurodad)
Finnwatch ry
Kairos Europe
Oxfam International
Plateforme Paradis Fiscaux et Judiciaires
Tax Justice Europe (TJ-E)
Tax Justice Network Norway (TJN-Norway)
Tax Reconciliations
Vienna Institute for International Dialogue and Cooperation (VIDC).

**Overall comments**

We, the undersigned organisations, welcome the growing recognition of the shortcomings of the transfer pricing system and the arm's length principle, and agree with the overall perspective that digitalisation of the economy is exacerbating international corporate tax avoidance.

We also welcome the growing recognition of the value of taxing multinational corporations on the basis of their global consolidated profits, with taxing rights being allocated between governments based on an agreed formula and supplemented by a minimum effective tax rate. We believe that such a system should be introduced as the central approach to taxing profits of multinational corporations, and it should replace the existing transfer pricing rules and the arm's length principle. This is, in our view, the only way to fulfil the G20's stated aim of ensuring that "*profits are taxed where economic activities occur and value is created*".[1]

However, we consider that as it stands, the OECD Secretariat's Proposal for a "Unified Approach" is a missed opportunity to address the fundamental flaws in the international tax system. In our view, the problems with the existing international corporate tax rules relate to the system in its entirety, and apply to all sectors of the economy. Therefore, we disagree with the perspective that there are areas where the existing rules are "*widely regarded as working as intended*", and instead we believe that a fundamental reform is needed. Unfortunately, such a reform is not foreseen in the Secretariat's proposal.

We would like to highlight the following specific concerns:

1) **The Secretariat's proposal to divide profits into "routine" and "non-routine"**. We believe that such a division would be highly artificial, and that there is no basis for considering some corporate profits to be different from others. Furthermore, due to the fundamental flaws in the existing transfer pricing rules, we are very concerned that these rules would continue to be the basis for taxing a very substantial part of corporate profits.

2) **The Secretariat's proposal for allocation of taxing rights**. We disagree with the Secretariat's proposal which entails allocation of taxing rights solely based on sales. A recent study by Cobham, Faccio and FitzGerald found that "*reallocation of taxing rights towards "market jurisdictions", as it is currently understood, is likely to be of little benefit to non-OECD countries. Indeed, the proposal is likely to reduce revenues for a range of lower-income countries.*" In the study, the authors also highlight that a much broader distribution of benefits could be achieved if "*some element of taxing rights is apportioned according to the location of multinationals' employment, and not only of sales*."[2] Therefore, while we welcome the willingness to consider the allocation of taxing rights based on an agreed formula, we believe that such a formula must include multiple factors that reflect the real economic activities of multinational corporations, including factors relating to the number of employees a corporation has in a given jurisdiction.

3) **Lack of proper consideration of the G-24's "Significant Economic Presence" proposal**. We note that the group of developing countries represented by the G-24 put forward a very important proposal in the negotiations under the Inclusive Framework.[3] This proposal has a number of key elements, including the fact that it does not divide profits into "routine" and "non-routine" and suggests that the allocation of taxing rights should be based on both supply and demand side factors, instead of solely on sales. We do not believe that this proposal has been given the attention it deserves, and regret that the central elements of the proposal are not reflected in the Secretariat's proposal for a "Unified Approach".

4) **Complexity of the international tax system**. We welcome the growing recognition of the fact that the complexity of the international tax system is a problem in itself. With this in mind, we find it concerning that the Secretariat's proposal would increase, rather than reduce, the complexity of the system. This is in particular the case for the proposal of introducing new taxing rules for some corporate profits while maintaining the existing rules for other corporate profits. This would increase the complexity of the system (see also point 1 above).

5) **Transparency**. We believe that transparency is urgently needed, both in relation to the ongoing negotiations of new international tax rules, and in relation to the tax rules themselves. Specifically, we believe that:
    - The impact assessments of the proposed new rules should be made public, to allow all relevant actors including governments, citizens, journalists, parliamentarians and civil society organisations, to better assess how the proposed rules will affect them.
    - Any intergovernmental negotiation about new global tax rules should be open to participation by observers, and negotiating texts should be available to the public.
    - Public country by country reporting should be introduced for all large multinational corporations. Unlike the current system of automatic exchange of country by country reports, public country by country reporting would ensure that all governments have access to the information. Furthermore, it would provide citizens, parliamentarians, journalists and civil society organisations with information which is important to assess the fairness of the corporate tax system. Finally, experiences from the

European Union show that public country by country reporting can discourage large-scale corporate tax avoidance by multinational corporations.[4]

6) **Mandatory arbitration**. We note with concern that some countries, and in particular the members of the G7, have argued in favour of mandatory arbitration.[5] We find such a system problematic for a number of reasons. Firstly, the process of arbitration is shrouded in secrecy, and the public is not able to access information about arbitration cases or their outcomes. Secondly, the central approach is to send disputes between countries to a group of appointed tax experts, such as experts from the big four accounting firms, who act as arbitrators. These arbitrators would make interpretations of the international tax rules, which are in many cases highly subjective. Thirdly, if mandatory arbitration was to be introduced, countries would be bound to follow the (secret) decisions of the arbitrators. We find this approach deeply concerning, and thus reject the proposal to introduce mandatory arbitration.

7) **The process of negotiating new global tax rules**. We believe that negotiation of new global tax rules should take place in a forum that allows all countries to participate on a truly equal footing during all stages of the process, and which is serviced by a neutral secretariat. The United Nations is the only truly universal body, and thus we believe that this is the appropriate forum for such a negotiation. While the Inclusive Framework has allowed countries to participate in ongoing discussions, we note that not all countries had an equal say when the mandate for the ongoing negotiations was developed. We also find it problematic that participation in the Inclusive Framework is conditioned on countries signing up to the BEPS minimum standards. Lastly, we are concerned by recent statements by the OECD secretariat suggesting that the commitment to deliver a "*consensus-based solution*" does not entail a commitment to ensuring that all members of the Inclusive Framework agree to the outcome, and that in particular concerns from smaller countries might be disregarded.[6] This, in our view, does not suggest that the members of the Inclusive Framework are participating on an equal footing.

The problems related to the global corporate tax system require a global solution. However, due to the concerns outlined above, we believe it is important that the outcome of the Pillar One negotiations does not restrict the possibility for countries to go further and apply unilateral measures to protect their tax base and ensure that multinational corporations pay their share of tax. This includes measures such as fractional apportionment and taxation of income or profits from services.

In our view, the shortcomings in the Secretariat's proposal for Pillar One make it even more vital that a strong outcome is delivered under **Pillar Two**. In this context, we would like to highlight the following key points:

- Over the last 40 years, the global average corporate tax rate has dropped from above 40% to well below 30%. Pillar Two provides an important opportunity to stop this race to the bottom and prevent further harmful tax competition between governments.
- It can do so by setting a minimum effective tax rate at a fair level that is high enough to effectively stop the global race to the bottom. For example, we note that the highly respected Independent Commission for the Reform of International Corporate Taxation has suggested that such a rate be set at 25%.[7]
- Within Pillar 2, and in line with the principle that corporations should pay tax where they do business, priority should be given to source country rules. It is furthermore important to ensure that these rules are easily administrable.
- As noted in the Work Programme for the ongoing negotiations, carve-outs would undermine the effectiveness of the rules. This includes carve-outs based on the BEPS Action 5 standards on harmful tax practices (such as carve-outs for patent boxes).[8]

Therefore, we find it important that carve-outs are not incorporated into the rules under Pillar Two.

- o The rules must be applied on a jurisdiction by jurisdiction basis, to avoid multinational corporations using "blending" to offset undertaxed profits in low-tax jurisdictions with profits taxed in other jurisdictions where the tax rates are higher than the minimum.

**<u>Comments on specific questions raised in the consultation document</u>**

***1. Scope.***

As noted above, we believe that the problems with the existing international corporate tax rules relate to the system in its entirety, and apply to all sectors of the economy. Furthermore, as highlighted under point 1 and 4 above, we believe that applying special rules for specific types of multinational corporations and profits, and applying the existing rules for other types, will maintain the current problems with the international corporate tax system while at the same time greatly increasing the complexity. We find this very concerning. We also note that the concept of "consumer-facing businesses" opens up a number of questions and uncertainties, which we do not find helpful.

***2. New nexus.***

In relation to the development of a new nexus rule, we find it important that the interests of small countries, and in particular small developing countries, are not overlooked. This speaks in favour of applying a very low threshold, or adapting the threshold to the size of the market.

***3. Calculation of group profits for Amount A.***

As noted above under point 5, we believe that public country by country reporting should be introduced for all large multinational corporations. In addition to the many advantages highlighted above, public country by country reporting would also provide a stronger basis for the calculation of group profits.

***4. Determination of Amount A.***

See point 1 above.

***5. Elimination of double taxation in relation to Amount A.***

We believe the most important way to address double taxation, as well as double non-taxation, is through the creation of a simpler and more effective international tax system. As described above, we believe this should be done by replacing the current transfer pricing rules and the arm's length principle with a system that taxes all multinational corporations on the basis of their global consolidated profits, with taxing rights being allocated between governments based on an agreed formula and supplemented by a minimum effective tax rate. This would increase tax certainty for both tax administrations and tax payers.

The risk of double taxation increases substantially when different taxing rights are applied to different parts of the profits of multinational corporations, as suggested in the Secretariat's Proposal. For more details on why we find this proposal problematic, see points 1 and 4 above.

### *6. Amount B.*

As highlighted above, we believe that the problems related to the transfer pricing system go far beyond the distribution functions of multinational corporations.

Furthermore, while a system based on fixed returns is relatively easy to administer, we find that the mechanisms outlined as "Amount B" appear to be an attempt to compensate for some very specific shortcomings in the transfer pricing system, rather than to solve the underlying problems.

### *7. Amount C/dispute prevention and resolution.*

We believe the most important way to address disputes is through prevention. This can be achieved through the creation of a simpler and more effective international tax system. As described above, we believe this should be done by replacing the current transfer pricing rules and the arm's length principle with a system that taxes all multinational corporations on the basis of their global consolidated profits, with taxing rights being allocated between governments based on an agreed formula and supplemented by a minimum effective tax rate.

As described under point 6 above, we have strong concerns about the specific proposal of introducing mandatory arbitration, as suggested by some countries.

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[1] G20 (2013), *Tax Annex to the St. Petersburg G20 Leaders' Declaration*, September 2013, https://www.mofa.go.jp/files/000013928.pdf

[2] Alex Cobham, Tommaso Faccio and Valpy FitzGerald (2019), *Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals*, October 2019, https://osf.io/preprints/socarxiv/j3p48/

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

[4] Michael Overesch and Hubertus Wolff (2018), *Financial Transparency to the Rescue: Effects of Country-by-Country Reporting in the EU Banking Sector on Tax Avoidance*, 1 July 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3075784

[5] G7 (2019), *Chair's Summary: G7 Finance Ministers and Central Bank Governors' Meeting*, July 2019, https://www.gouvernement.fr/sites/default/files/locale/piece-jointe/2019/07/g7_chairs_summary.pdf

[6] Julie Martin (2019), *Unanimity not required to update global rules for taxing multinational groups, OECD's Saint-Amans says*, MNE Tax, 18 October 2019, https://mnetax.com/unanimity-not-required-to-update-rules-for-taxing-multinational-groups-oecds-saint-amans-says-36188

[7] ICRICT. (2019), *International Corporate Tax Reform: Towards a fair and comprehensive solution*, https://static1.squarespace.com/static/5a0c602bf43b5594845abb81/t/5d979e6dc5f7cb7b66842c49/1570217588721/ICRICT-INTERNATIONAL+CORPORATE+TAX+REFORM.pdf

[8] OECD (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Inclusive Framework on BEPS, May 2019, https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf, page 29.