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Dear Sir or Madam

RESPONSE FROM MOORE GLOBAL NETWORK LIMITED ('MGNL', 'WE') TO THE OECD CONSULTATION DOCUMENT 'GLOBAL ANTI-BASE EROSION PROPOSAL ("GloBE") (PILLAR TWO)'

MGNL appreciates the work that has been carried out by the OECD in this area to date and welcomes the opportunity to provide its comments and views on the complex area presented.

Detailed response

Question 1

1a) Do you agree that the use of financial accounts as a starting point can provide an appropriate income base (for the computation of an effective tax rate) and would simplify and reduce the compliance costs of the GloBE proposal?

We agree in essence that financial accounts could be a starting point to provide an appropriate income base for the computation of an effective tax rate. Their use would generally provide some advantages, which can also be drawn from the renewed proposal of the European Commission for a Common Consolidated Corporate Tax Base[1]. However, it has to be acknowledged that the use of consolidated financial statements under IFRS has a lot of shortcomings: generally, IFRS and other financial accounting standards are intended to provide a 'true and fair view' on the situation of a company[2]. The use of IFRS financial statements (consolidated or unconsolidated) for tax purposes has long been a subject of discussion in the literature. Most authors argue that only a simplified version of IFRS (especially without fair-value accounting) would be suitable for tax purposes. Nowadays, different accounting standards, such as IFRS or US-GAAP, are predominantly used for consolidated financial statements. Despite the different processes used by the standard-setting committees to align the standards, differences still exist at major important points. As

[1] See European Commission, COM (2011) 121/4, now replaced by the current 'two-steps approach' in COM (2016) 685, COM (2016) 683.

[2] See Spengel, C. (2003), 'International accounting standards, tax accounting and effective levels of company tax burdens in the European Union', in: *European Taxation* 2003, pp. 253-266; Kager, R./Niemann, R. (2013): 'Income determination for corporate tax purposes using IFRS as a starting point', in *Journal of Business Economics* 2013, pp. 437-470.

an additional point, it should be remarked that the definition and execution of standardised adjustments puts an additional administrative burden on the groups concerned. This burdensome procedure has been also acknowledged by the CCCTB proposal from the European Commission. In contrast to the original proposal from 2011[3], the renewed proposal from 2016 would provide a replacement of national tax accounting systems by the new CCTB system. This new two-staged approach proposed by the European Commission in 2016 also recognises that the use of a consolidated tax base would require an intense and detailed definition of a common tax base as a first step.

1b) What would be the consequences of using the accounting standards applicable to the ultimate parent entity of the MNE? Would you suggest a different approach?

Subsidiaries usually prepare national commercial accounts applying local GAAP principles as a starting point. In addition, they account for business transactions in line with the group-wide accounting framework set by the parent entity for consolidation purposes. Therefore, financial statements are comparable within the group to the extent that no interpretational or geographically related differences within single standards exist.

This issue has also been discussed by some studies investigating that accounting practices widely differ between different countries depending on the geographic location of the headquarters[4].

1c) How would you recommend determining whether a financial accounting standard is an appropriate standard for determining the tax base under the GloBE proposal?

The goals of financial accounting and tax accounting differ from one another. A major difference occurs with reference to the treatment of fair-value accounting or the recognition of sales for long-term projects. As an example, fair-value measurement may lead to the recognition of gains that are not yet realised. Furthermore, standards such as IFRS allow for revenue recognition according to the percentage-of-completion method. This distinct feature may diverge from the national accounting rules and might also lead to the recognition of unrealised gains.

Because of these differences, the financial profit, and accordingly the relevant tax base, may include unrealised gains. This might artificially increase the tax base relevant for the GloBE proposal.

1d) Do you have concerns that allowing more than one financial accounting standard to serve as the starting point for determining the tax base under the GloBE proposal will place some MNEs at a competitive advantage due to variations in financial accounting standards among jurisdictions?

In our view, if there were to be an exclusive financial accounting standard applicable for the determination of the tax base under the GloBE proposal, it would have to be IFRS, due to its global scope of validity. However, the respective acceptance of MNEs not otherwise obliged to apply IFRS would presumably be limited. Nowadays, most groups already operate three

[3] See European Commission, COM (2016) 685, for the definition of a Common Corporate Tax Base (CCTB), and the COM (2016) 683 for the Common Consolidated Corporate Tax Base (CCCTB).
[4] See De Simone, Lisa (2016), 'Does a common set of accounting standards affect tax-motivated income shifting for multinational firms', in *Journal of Accounting and Economics* 2016, pp. 145-165.

different systems: the national commercial accounts, national tax accounts and the consolidated financial accounts. Additional reporting requests, such as IFRS statements for taxation purposes, might not be deemed appropriate. However, we do have concerns that variations in accounting principles will probably result in different outcomes for otherwise similarly situated enterprises. Whereas IFRS primarily serves informative purposes for shareholders and investors and is intended to present a true and fair view, local guidelines partly adopt a more conservative approach with emphasis to creditor protection and prudence principles (e.g. realisation and the imparity principle). Scheduled amortisation versus impairment tests, revenue recognition in terms of the completed-contract approach versus the percentage-of-completion method, lease accounting and the recognition of internally generated intangible assets are only a few examples of potential differences at major important points. Thus, advantages and even respective structuring and planning in the event of optional application of different financial standard systems are highly probable. Moreover, it should be noted that differences might also exist within the single standards based on geography and between companies, as IFRS leaves some discretion to the preparer of the financial statements. IFRS in the EU follows the special endorsement procedure and deviations between original IFRS and IFRS as applied in the EU could occur.

1e) There may be some instances where MNEs, particularly smaller MNEs, do not prepare consolidated financial statements for any purpose. How much of an issue do you think this is and for what types of MNEs? Where this is the case, how would you suggest the issue should be addressed?

The obligation to prepare consolidated financial statements arises from national legislation[5], stock exchange regulations, accounting principles or contractual agreements. Whereas capital-market oriented and listed companies must usually prepare consolidated annual financial statements in line with IFRS or local GAAP, other MNEs may not be subject to consolidation procedures due to various exemption provisions in their respective countries. These may include, for example, size-dependent exceptions, exemptions resulting from the inclusion of the company in the consolidated financial statements of a parent entity, materiality-related exclusions of subsidiaries or the exclusion of entities due to disproportionately high costs and delays. Beyond that, IFRS 10 provides for an explicit consolidation exception for investment companies under certain conditions. Since such exemption rules were basically implemented to avoid disproportionate costs and additional compliance efforts in practice – especially for smaller groups – appropriate simplifications should also be applied for taxation purposes. The definition of general thresholds or the introduction of size-dependent simplifications such as the usage of total financial values instead of consolidated accounts for MNEs that do not otherwise prepare consolidated financial statements for any purpose could be a practical approach.

Moreover, exemption from consolidation requirements may extend not only to smaller MNEs but also to MNEs organised in the structure of joint ventures or associated companies. Thus, baseline information such as group profits, income and tax rates cannot be generated easily and a further reporting system for joint ventures and associated enterprises could be necessary.

[5] In EU Member States, domestic legislation reflects the transposition of Directives 83/349/EEC and 2013/34/EU.

As a possible solution, we suggest the adoption of a minimum applicability threshold, similar to that applying under the proposed Common Consolidated Corporate Tax Base ('CCCTB') Directive or Country-by-Country ('CbC') reporting for transfer-pricing purposes. In order to avoid multiple thresholds and in order to give the group enough time to prepare for such a burdensome obligation, we think that the adoption of these rules should be limited to groups with a total consolidated group revenue that has exceeded EUR 750 million during the two financial years preceding the relevant financial year.

1f) Are there additional or different considerations that apply to the tax base determination for purposes of an undertaxed payments rule?

The Pillar Two proposal needs to be coordinated with other BEPS-derived provisions that have already been adopted, such as those related to Action 2 (Neutralising the Effects of Hybrid Mismatch), as these normally also fall under the undertaxed payments rule.

Some parts of the GloBE proposal seem not to be clear or well-coordinated, possibly leading to double taxation if not explained properly at OECD level and/or wrongly implemented into national legislation. An example may help to identify our doubts.

Suppose Company A, resident in Country X pays a deductible payment (e.g. a royalty) to Company B, resident in Country Y. Country X has a low corporate tax rate under the minimum-rate threshold. As a consequence, the royalty may fall under the 'undertaxed minimum rule', but what happens if in the meantime Country Y also applies an effective corporate tax rate on royalties that falls below the threshold, perhaps because of a special 'patent-box regime' (which is not considered 'harmful' from a BEPS Action 5 perspective) which halves the effective rate of tax on such income? In this case, would Country X deny the deduction (to the payee) or has it to apply a withholding tax (on the payor), because of the 'subject-to-tax rule', or do both? And then what happens in Country Y, if the income is only partially subject to tax because of the abovementioned patent-box regime? Would it be different in the case of non-deduction in Country X or in the case of withholding tax?

In our opinion any 'undertaxed minimum rule' must be written in a way that also takes into consideration the other country's 'subject-to-tax rule'.

Question 2

2a) What are the material permanent differences between financial-accounting income and taxable income that are common across jurisdictions and that you think should be removed from the tax base without undermining the policy intent of the GloBE proposal?

As far as earnings or expenses are recorded in either the commercial or the tax accounts only, permanent differences arise. Non-tax-deductible expenses usually include income and personal taxes, contributions to political parties, fines and penalties, expenses for illegal activities such as bribes and kickbacks, a certain portion of entertainment expenses, business gifts exceeding defined values, expenses related to tax-free earnings, interest expense exceeding a certain scale and licence payments under certain circumstances. Tax-free earnings primarily relate to allowances and subsidies of all kinds as well as corporate profits received from the disposal of corporate shares or respective dividends. Recently, various jurisdictions have introduced or enhanced tax incentives for research and development activities in order to increase their economic attractiveness. If a tax incentive has genuine purposes and is not considered ‘harmful tax competition’ (i.e. some types of patent-box regime, temporary exemptions or tax-rate reductions for economically depressed areas), the tax-free earnings should be removed from the GloBE tax base (as illustrated in the ‘carve-outs’ section). However, the extent to which such non-tax-deductible expenses or tax-free earnings arise, fundamentally varies depending on the business model and functions, corporate structure and strategy as well as practices and objectives of the respective company on the one hand and the political and economic environment, industry and market competition on the other hand. Therefore, it is hardly possible to define content-related distinctions between permanent differences that should be removed from the tax base for GloBE purposes and those that could be regarded as immaterial.

2b) Do you have views on the methods that could be used for dealing with permanent differences?

In order to deal with or eliminate permanent differences for tax-base determination, a separate reporting system for such earnings and expenses in the form of a tax reconciliation would be required based on the consolidated financial statements. However, this would oblige MNEs to operate a new recording system in addition to the national commercial and tax accounts and the consolidated financial accounts. As this leads to further costs and effort, thresholds could be introduced for ‘net permanent differences’ determined under national reconciliation procedures not exceeding a defined value or percentage, as those differences might be regarded as immaterial for GloBE purposes.

2c) Do you have any comments on the practicality of making adjustments for permanent differences?

As described above, permanent differences will always exist to different degrees, for different reasons and in different situations. Whereas some non-tax-deductible expenses might seem to be rather stable over time, tax-free subsidies and the degree of tax-exemptions for corporate dividends or gains on the sale of corporate shareholdings is predestined to be subject to modification resulting from political or economic changes and interests. Thus, we recommend applying thresholds or simplification procedures as previously described – or in any other form – in order to align practicality and practicability with cost-efficiency and compliance requirements.

2d) Do you think any other adjustments to the financial accounts require attention?

As mentioned above, we suggest that special consideration be given to tax incentives and subsidies related to research and development expenses as they necessarily lead to permanent differences and will moreover gain further importance and be a major competitive instrument for attracting international investment in the future.

Additionally, some countries (and especially in the EU) have introduced notional-interest deduction schemes, which allow the deduction of a fictitious interest expense in respect of the entity’s equity. These schemes (as implemented in Belgium or Italy) are intended to achieve a better financing neutrality as between debt and equity. As this is an incentive solely for the purposes of corporate income tax, notional interest regimes lead to a permanent difference between financial accounting and tax figures.

Question 3

a) Do you have any comments on the use of carry-forward of losses and excess tax as a mechanism for addressing temporary differences under the GloBE proposal?

The current proposal foresees three different accounts for the treatment of excess taxes and losses, a ‘subsidiary tax’ account, a ‘group’ account and a ‘subsidiary loss’ account.

In our view, all three accounts are necessary to achieve a proper evaluation of whether a group achieves the agreed minimum tax rate, but the scope of the accounts should be expanded. The proposal states that the ‘subsidiary tax’ account is mainly seen as a means of reflecting temporary differences between the financial accounting and the tax accounting rules.

This accounting for excess taxes is also necessary in cases where no differences between financial and tax accounting exist. In Example 1 set out in Annex A to the Public Consultation document, the tax rate in Country B is set at 20% whereas the minimum tax rate is assumed to be 15%. As a result, even if financial and tax income were completely equal, a carry-forward of excess taxes should be created on the level of the subsidiary. Otherwise and from a systematic perspective, the necessary intra-period evaluation of the appropriateness of the tax payments will be restricted to one period only. This might thus falsify the perceived fairness of the group’s tax payments. Such an extension of the respective accounts is especially necessary if a jurisdictional or entity-blending approach would be agreed on.

Generally, it should be noted that the administration of three additional accounts per entity, given moreover the complexities of accurately measuring financial and tax-accounting differences, might lead to a heavy administrative burden.

b) Do you have any comments on the use of deferred tax accounting as a mechanism for addressing temporary differences under the GloBE proposal?

As stipulated in the previous question, the system with three different accounts can lead to very high compliance costs. Compared to this, the use of the existing deferred-tax accounting framework as stipulated in IFRS and other accounting standards could be seen as an easier way to measure the appropriateness of tax payments. However, this choice also depends on the agreed blending approach. The worldwide blending approach would easily be compatible with this issue whereas deferred-tax accounting on an entity or jurisdictional basis would require additional calculations and a higher administrative effort as different consolidation levels must be considered.

c) Do you have any comments on the use of a multi-year approach to measure the average effective tax rate as a mechanism for addressing temporary differences under the GloBE proposal?

A multi-year approach for the calculation of the average effective tax rate is in our opinion an overly simplified measure for addressing the goals associated with the GloBE proposal. From our point of view, using consideration of the effective tax rate measured as total taxes paid divided by the total income over several years as the sole criterion does not accordingly reflect the possible implications of temporary differences. For example, under IFRS goodwill is not amortised over a certain time period. Instead, the appropriate value has to be determined based on a yearly examination (IAS 38). In contrast, tax rules in different countries do prescribe a certain time period over which full amortisation has to take place. Therefore, the concept of solely relying on several years may overlook so-called quasi-permanent differences entirely. These differences can exist over a very long-time horizon.

d) Do you have any comments on what limitations (if any) should be imposed on the normal financial accounting rules for deferred tax assets and liabilities and the practicalities of imposing those limitations?

The current rules under IFRS have some discretion regarding the inclusion of loss carry-forwards. This might be a point to consider in the further discussion of the proposal.

Question 4

a) How would you assess the general compliance costs and economic effects of a GloBE proposal that is based on either an entity, jurisdictional or worldwide blending approach?

The GloBE proposal includes different blending options in order to include rules as to how taxpayers could mix low-tax and high-tax income within the same entity or across different entities within the same group at the entity level, at a jurisdictional level and at global group level.

We consider that a blending mechanism is essential for developing an integrated set of global minimum tax rules to ensure that the profits of internationally operating businesses are subject to a minimum tax rate and thus reduce the incentive for taxpayers to engage in profit shifting, but still manage to avoid the risk of double taxation.

All three proposed blending mechanisms differ in their principles, but in general the jurisdictional and entity approaches are considered to be more complex for MNEs as compared to the worldwide blending approach, whereby the MNE would be required to pay an average minimum rate of tax on all its foreign income. Therefore, it can be anticipated that the worldwide blending mechanism should have lower compliance costs as compared to the other two mechanisms, in which the complexity of calculations would be higher to a certain degree. The worldwide mechanism could in general generate more benefits for larger MNEs that have significantly diversified operations/activities in a larger number of low- and high-tax jurisdictions, because the level of administrative burden for the larger MNEs could be extensive if they had to deal with the granular complexities of the jurisdictional or even more of the entity blending approaches.

On the other hand, with the greater granularity of blending, for certain MNEs such mechanisms could under certain circumstances lead to a lower total tax impact at the global group level in circumstances under which the risk of double taxation is eliminated. In order to exclude such ‘incentives’ for MNEs to look for solutions that would decrease their total tax burden, the worldwide blending approach should be implemented in a way that avoids the risk of double taxation at all levels for taxpayers, makes the lower administrative burden more attractive for MNEs than the potential of decreasing the total tax burden and offers MNEs a long-term sustainable global tax mechanism.

We can also assume that the worldwide blending approach could be more easily correlated with the approach of computing the income base from the financial accounts as discussed in the previous questions 1 to 3. However, the challenges with respect to the differences between financial and tax accounting would have to be addressed in a more complex way in order to be able to assess the most effective method.

A reasonable comparison for the GloBE proposal could be the adopted global intangible low-taxed income (GILTI) regime, which the United States has recently implemented. The GILTI is subject to a worldwide minimum tax rate of between 10.5% and 13.125% on an annual basis and the regime has adopted a worldwide blending mechanism. The purpose of GILTI is mainly to reduce the incentive to shift corporate profits out of the United States by using intellectual property. Given that the United States has already adopted the GILTI regime, it is arguable that US MNEs will be affected by an increased tax burden once the GloBE proposal is implemented, which brings us to a more important issue, namely that the document does not include more details on the mechanism of income-inclusion rules, undertaxed-payments rules and on how the risk of double taxation is to be avoided.

From our perspective, it is essential that the proposed document take into account the relevant provisions of double tax treaties, the Multilateral Instrument or even the BEPS actions and that it analyse how the risk of double taxation can be eliminated at the entity level (e.g. tax grouping or consolidation regimes), the jurisdictional level (e.g. double tax treaties) and the global level (e.g. BEPS Actions). In order to minimise compliance costs and maximise economic effects it is essential that the proposal address the abovementioned issues and perform a thorough analysis of the rules.

Question 10

a) Assuming that the starting point for calculating the income of the MNE under the GloBE proposal is based on the financial accounts do you have any comments on the practicality of dealing with taxation of dividends under worldwide, jurisdictional and entity blending approaches? b) Do you have any comments on how the taxation of dividends should be dealt with under the GloBE proposal? c) Are they any other issues that you wish to highlight regarding worldwide, jurisdictional or entity blending?

Dividends are tax-exempt for the recipient in many countries (in order to avoid double taxation), unless the payor has not paid income tax (i.e. the payor is resident in a tax haven): we think that the tax-exempt dividend should not be normally included in the tax base for GloBE purposes.

In a jurisdictional or entity approach, withholding taxes paid on distributed dividends that are considered exempt for the payee should be treated as an additional tax on the earnings of the distributing entity.

Question 11

a) Do you have any comments, based on your own experience, as to the preferred design of a carveout taking into account factors such as simplicity, compliance costs, certainty, incentives and behavioural impacts?

We consider that carve-outs are essential for the administrative impact and compliance costs of Pillar Two to be reasonable for all stakeholders.

Given that there are already significant complexities in both the Pillar One and Pillar Two proposals, we consider that whilst introducing carve-outs is essential, the number of separate carve-outs should be limited, and the design should be simple and clear. There are already numerous elements to both Pillar Two and Pillar One, and so limiting the number of carve-outs, each requiring additional compliance cost and time, is desirable.

Taxpayers are already likely to have to determine whether they meet certain thresholds for the purposes of their own local jurisdiction, for instance the carve-outs for the US BEAT and GILTI regimes. We consider it would best assist taxpayers to comply with the proposed Pillar One and Two if the carve-outs used are familiar already from other OECD BEPS Actions.

We consider the OECD best placed to consider the behavioural impact of carve-outs but generally we consider that aligning carve-outs with existing BEPS regime carve-outs will make it easier for taxpayers to comply, which should broadly in turn facilitate positive relationships between taxpayers and tax authorities.

b) Are there any technical or compliance considerations that would make you concerned about a particular type of carve-out (i.e. based on facts and circumstances or on a formulaic approach), or suggest that there should be no carve-outs at all? If so, please explain based on your own experience.

We do not have any specific concerns regarding carve-outs at this stage, but we reiterate that carve-outs should be designed with simplicity in mind.

In our opinion, there should certainly be carve-outs from the proposed GloBE proposals in order to ensure that the cost and time associated with administration is reasonable for tax authorities and taxpayers.

c) Would you favour thresholds based on the size of the taxpayer? If so, please give your reasons and suggest a metric that you think should be used.

Thresholds based on the size of taxpayers are widespread and well understood by taxpayers and tax authorities. It seems clear to us that there should be a size threshold for the application of the GloBE proposals.

Determining what size threshold should apply should balance the overall aims of the GloBE proposal with simplicity and fairness.

In terms of simplicity it would make sense to align the size threshold with other BEPS Action thresholds and / or the threshold that is eventually included in Pillar One. As suggested in our response to the Pillar One consultation, we suggest that the threshold used for the CbC reporting regime could be used, which would mean that stakeholders need understand one size-threshold test only.

However, as we have commented in our response to Pillar One, as we do not have access to detailed information on the economic effect of imposing such a threshold, we cannot give our opinion as to whether the precise level of the threshold under the CBCR is appropriate for Pillar Two. In particular, once the proposed tax rate for the GloBE proposals is determined, this should be taken into account when designing the size-threshold test in order to ensure that the scope of the rules is in line with the overall aims.

d) Would you favour any de minimis carve-outs? If so, what type of carve-out do you consider would result in the right balance between compliance costs and benefits?

A de minimis carve-out should be introduced to ensure that both taxpayers and tax authorities are not burdened by compliance costs where there are only small amounts of tax at stake, or no tax at all.

e) Would you favour a carve-out for specific sectors or industries? If so, please state the sector or industry, explain your reasons and share thoughts on how such a carve-out could be operated with as little compliance cost and uncertainty as possible.

As with our comments for Pillar One, we consider industry-specific carve-outs should include only industries subject to specific tax regimes such as oil and gas ring-fencing or shipping tonnage tax.

We consider that any other attempts to implement carve-outs based on industry or sector will add too much subjectivity and make the carve-out too complex.

f) Do you have any additional comments on carve-outs, including comments based on experiences with existing regimes that you suggest should be adopted or avoided?

We have no further comments at this stage.

Concluding remarks

We are grateful for the opportunity to provide our comments and would be pleased to discuss or clarify our response. In that event please contact either of the two signatories below. Their contact details are listed overleaf.

Yours faithfully

On behalf of MGNL

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We should also like to acknowledge the work of the following persons who contributed their answers, views and comments to the above:

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