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Verizon Communications Inc.
The Walt Disney Company

August 13 2021

The Honorable Janet L. Yellen
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Inclusive Framework Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy

Dear Secretary Yellen:

ACT is a coalition of leading American companies across a broad array of industries whose principal mission is securing an internationally competitive tax system. ACT believes a corporate tax system that is aligned with the tax systems of our major trading partners will promote greater U.S. investment, increased employment, and higher wages.

The July 1, 2021, Statement of the Inclusive Framework on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy proposes to make sweeping changes to the century-old international tax architecture. ACT members support a multilateral agreement that would address the issues discussed in the Statement and promote U.S. interests.

In a July 21, 2021, speech to the National Association of Business Economists, Treasury Deputy Assistant Secretary for Multilateral Negotiations, Itai Grinberg, likened the Statement of the Inclusive Framework to a "term sheet" for which implementation details remain to be agreed. In this regard, Mr. Grinberg invited constructive comments from the business community.

The purpose of this letter is to share ACT's high-level comments on the Inclusive Framework Statement. More detailed comments that ACT made to the OECD Secretariat last December on the Pillar One and Two Blueprints are attached for your reference.

As it always has been, ACT's main concern remains assuring any international tax agreement advances U.S. national interests and the economic welfare of the American people. Act's comments below are intended to advance that objective.

Pillar One

The United States should insist on repeal of all existing and prohibition of any new digital services taxes (DSTs) and other unilateral measures by other countries given the highly disproportionate burden of Pillar One on U.S. companies. Two recent papers have analyzed the effect of Pillar One, as outlined in the Inclusive Framework Statement: a policy brief[1] by Oxford University Prof. Michael Devereux and co-author Martin Simmler, and an article[2] by PwC economist Kartikeya Singh. Both papers find, *inter alia*:

- U.S. companies would account for over 60% of the income reallocated under Amount A of Pillar One – over twice the U.S. share of global GDP (24.2%); and

- The U.S. company share of the income reallocated under Pillar One would be six times greater than China's share, even though Chinese companies outnumber U.S. companies in the 2021 Global Fortune 500 by 135 to 122.

In view of the highly disproportionate tax burden that would be imposed by Pillar One on U.S. companies and given that the reallocation of taxing rights under Pillar One is intended to replace DSTs and similar unilateral measures, the United States should insist that these unilateral measures be repealed for all companies (including those not in Scope of Amount A) when an agreement to Pillar One is announced and that no new such measures be adopted after that date.

In view of the complexity of Pillar One, the new mechanisms of international coordination needed for their effective administration, and the time required for necessary legislative and treaty changes, repeal of DSTs and other unilateral measures should not be delayed by the implementation process.[3]

The impact of Pillar One will depend to a large extent on the details required to implement this new international tax regime, including carve outs, segmentation, and double taxation relief rules. The United States should insist these details are negotiated in a manner that creates a level playing field for U.S. companies.

Relief from international double taxation. The principle underlying the reallocation of taxing rights under Pillar One is formulary apportionment. Under this approach, a jurisdiction has the right to tax an allocable portion of a taxpayer's income based on its share of the taxpayer's apportionment factors (e.g., sales). Taxation of the same income by more than one jurisdiction is avoided, without foreign tax credits, because reallocated income should not be subject to tax in the ceding jurisdiction.

Consistent with the formulary approach adopted in Pillar One, income that is reallocated away from a jurisdiction should not be subject to tax in that jurisdiction. In particular, income that is reallocated to the United States from other jurisdictions should be exempt from taxation by those other jurisdictions and income that is reallocated to the tax bases of other countries from the United States should be exempt from U.S. federal and state tax.

[1] Michael Devereux and Martin Simmler, "Who will pay Amount A?" Oxford University Centre for Business Taxation, July 2, 2021, *EconPol*, Policy Brief 36 (2021), available at: https://www.econpol.eu/publications/policy_brief_36

[2] Kartikeya Singh, "Amount A: The G-20 Is Calling the Tune and U.S. Multinationals Will Pay the Piper," *Tax Notes International*, vol. 103, August 2, 2021.

[3] If the Administration is unable to demonstrate the two-pillar solution will protect the interests of the U.S. fisc as well as U.S. companies and their workers, approval by Congress of the necessary legislative and treaty changes cannot be assumed.

Mandatory, binding, and prompt multilateral dispute resolution procedures. Grafting a new formulary apportionment regime (Amount A) onto the existing arm's length pricing system, including adopting a new tax base and new destination-sourcing principles, will be highly complex. Despite the best intentions of the Inclusive Framework, Pillar One inevitably will lead to an increase in controversies among taxing authorities, with U.S. companies (due to their disproportionate share of Amount A) often caught in the middle of fights among countries over taxing rights. Consequently, as a condition of agreeing to Pillar One, the United States should insist that all countries agree upon and implement mandatory, binding, and prompt dispute settlement procedures.

We do not believe these dispute settlement procedures should be limited to Amount A. Other countries may attempt to circumvent the application of mandatory dispute resolution procedures by characterizing the areas of disagreement with a taxpayer as "not Amount A." Further, because the determination of Amount A is inextricably interrelated with other aspects of a taxpayer's income tax computations, limiting dispute resolution to Amount A will itself become a source of uncertainty, controversy, and unresolved double taxation, in addition to being extremely time- and resource-consuming for both taxpayers and tax authorities. Such conflicts can best be avoided by requiring all countries participating in Pillar One not only to agree upon, but also actually to implement, mandatory, binding dispute resolution procedures on all matters potentially giving rise to double taxation.

Pillar Two

The importance of a level playing field. ACT does not seek more favorable tax treatment for U.S. companies than applies to their foreign-based competitors. However, ACT does seek a truly level tax playing field that would allow the most innovative and productive companies to win in the global marketplace.

As the United States currently is the only country that imposes a foreign minimum tax on active business income (i.e., GILTI), ACT welcomes an international agreement on Pillar Two so that the active business income of foreign competitors also would be subject to a foreign minimum tax. However, agreement by the Inclusive Framework and the actual implementation of Pillar Two minimum taxes are very different things.

To assure a level playing field for U.S. companies, the United States should take no action to increase the burden of the existing GILTI regime unless and until Pillar Two compliant regimes are adopted by major competitor countries, including all other G7 countries.

In addition, the United States should not unilaterally adopt GILTI rules that are more stringent than those included in the Pillar Two agreement unless all other major competitor countries both agree to, and implement, similarly stringent rules.

Moreover, while we believe that a multilateral dispute resolution mechanism should also exist for Pillar Two, at the very least, in order to assure ongoing compliance with Pillar Two, a monitoring process should immediately be established to review and report regularly on the implementation and enforcement of Pillar Two minimum taxes in all countries.

We note that no other country has announced its intention to enact and implement a Pillar Two minimum tax this year. As a result, we believe it would be both premature and harmful to the competitiveness of U.S. companies and workers for the United States to make any changes to the existing GILTI regime that would further increase the tax burden on U.S. companies.

Conclusion

The Inclusive Framework's two-pillar proposal would make foundational changes to the international tax system. In response to Mr. Grinberg's request, ACT is eager to engage constructively to achieve a multilateral agreement that would advance U.S. national interests and the economic welfare of all Americans.

* * *

Sincerely,

Alliance for Competitive Taxation

Attachment: ACT letter to OECD Center for Tax Policy and Administration regarding Pillar One and Two Blueprints, December 11, 2020

cc: Richard Neal, Chairman of the House Ways and Means Committee
Ron Wyden, Chairman of the Senate Finance Committee
Kevin Brady, Ranking Member of the House Ways and Means Committee
Mike Crapo, Ranking Member of the Senate Finance Committee

Member Companies
3M
Abbott Laboratories
ADP
Alcoa Corporation
American Express Company
Bank of America Corp.
Boston Scientific Corp.
Carrier Global Corp.
Caterpillar Inc.
Cisco Systems, Inc.
The Coca-Cola Company
Corteva Inc.
Danaher Corporation
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The Dow Chemical Company
DuPont
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General Mills Inc.
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Honeywell International Inc.
IBM Corporation
International Paper Company
Johnson & Johnson
Johnson Controls, Inc.
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Kellogg Company
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Raytheon Technologies Corp.
S&P Global Inc.
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Texas Instruments, Inc.
United Parcel Service, Inc.
Verizon Communications Inc.
The Walt Disney Company

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December 11, 2020

Center for Tax Policy and Administration
Organization for Economic Cooperation and Development
2, rue Andre Pascal
75775 Paris Cedex 16
France

By email to: cfa@oecd.org

Dear Sir or Madam:

The Alliance for Competitive Taxation ("ACT") is a coalition of leading American companies, from a wide range of industries, that supports a globally competitive corporate tax system that aligns the United States with other advanced economies.

ACT appreciates the opportunity to submit the attached comments on the Pillar One and Two Blueprint Reports in connection with the public consultation scheduled January, 14-15, 2021.

Your sincerely,

Alliance for Competitive Taxation

Attachment: ACT Comments on Pillar One and Two Blueprint Reports

ACT COMMENTS ON PILLAR ONE AND TWO BLUEPRINT REPORTS

INTRODUCTION

The Alliance for Competitive Taxation (ACT) is a coalition of leading American companies from a wide range of industries that since 2012 has worked to achieve a competitive US corporate tax system. ACT has been monitoring the Inclusive Framework's progress on taxation of the digitalization of the economy, recognizing that it implicates potential changes in US tax law, regulations, and treaties.

We appreciate that the Blueprints incorporate a number of recommendations included in prior ACT submissions. In particular, the Pillar One Blueprint: provides some initial clarity regarding the identification of paying entities for Amount A; determines Amount A based on pretax profits net of all expenses (other than income taxes); designs the new nexus rule as a standalone provision to limit spill-over effects on other tax and nontax rules; and includes a carryforward mechanism for losses.

Also, consistent with ACT's prior submissions, the Pillar Two Blueprint: orders the Income Inclusion Rule (IIR) before the Under-Taxed Payment Rule (UTPR); limits imposition of the IIR to the country where the Ultimate Parent Entity (UPE) resides; provides a carry-forward for losses and IIR credits; includes a substance-based carveout; accounts for taxes imposed under Controlled Foreign Corporation (CFC) and withholding tax regimes in determining the applicable Effective Tax Rate (ETR); and sets a €750 million threshold.

This letter restates principles ACT believes should guide the development of international tax standards, recommends a process for implementation, and makes technical comments.

KEY POINTS

Process

1. If Pillar One is agreed, ACT supports a phased-in/transitional approach to implementation that <u>initially</u> tests Pillar One with a limited number of companies on a voluntary and information-only basis before full implementation to allow adequate time for issuing comprehensive guidance, building administrative capacity, and implementing newly required corporate data collection and retention procedures.

Pillar One

2. The right of a jurisdiction to receive an allocation of Amount A should be conditioned on removal of unilateral actions (e.g., digital services taxes). The Pillar One agreement should set forth the criteria for identifying unilateral actions and include a comprehensive, country-specific list of unilateral actions that would need to be removed.

3. Amount B should approximate the results determined under the arm's length standard.

4. Particularly in view of the losses that some companies have incurred as a result of COVID-19, ACT recommends a transition rule that allows taxpayers to carry forward pre-effective date losses until fully utilized.

5. To avoid over-taxation of companies with cyclical profitability, ACT recommends that Amount A be modified by (1) allowing taxpayers to net profit shortfalls against residual profits in future years, or (2) determining residual profits based on a multi-year moving average.

6. Of the two methods proposed in the Blueprint for relieving double taxation of Amount A (i.e., taxation by both the paying and receiving countries), ACT recommends the exemption over the credit method as it entails much lower compliance and administration burdens.

7. ACT generally supports the marketing and distribution safe harbor; however, as currently proposed, the potential for double counting residual profits in the market jurisdiction may not be mitigated fully. In addition, Amount A allocations may overlap with income subject to withholding taxes. These overlaps should be addressed so that residual profits are not taxed twice by the same market jurisdiction.

8. The Blueprint explicitly identifies several sectors that should be exempt from Amount A. All sectors that produce goods and services with similar characteristics should be treated similarly. For ease of administration, ACT also recommends that a multinational enterprise (MNE) with only de minimis in-scope revenues be excluded entirely from Amount A.

9. MNEs should not be required to create alternative segmentation or, at the very least, such segmentation only should be required where there is a high degree of materiality and there are extraordinary circumstances. If ACT's recommendation for a de minimis exception (Point 8, above) is not accepted, an MNE should be allowed to segment based on books and records where the in-scope activities are below the materiality threshold for financial statement segmentation.

10. ACT recommends the tax base for purposes of Amount A be adjusted for the same book-tax differences that are made for purposes of Pillar Two.

Pillar Two

11. The US Global Intangible Low-Taxed Income (GILTI) regime predates the Pillar Two proposal, has similar objectives and overlapping scope, achieves broadly equivalent results, and often imposes higher tax burdens. Consequently, ACT strongly recommends the GILTI regime be considered an equivalent IIR under the coexistence principle discussed in the Blueprint.

12. ACT recommends the OECD Secretariat assess whether and how the prior BEPS recommendations and minimum standards should be coordinated with, modified, or eliminated as a result of implementing Pillar Two, which has overlapping objectives.

13. All income of a CFC attributable to US shareholders should be treated as subject to an equivalent IIR regime because income excluded from GILTI either is comparable to the substance-based carveout from the IIR rule or generally is taxed at a higher rate than is contemplated for the IIR top-up tax.

14. There are a number of material, long-tailed book-tax timing differences that may not reverse for an extended period of time in a growing business. ACT recommends the Secretariat review these timing differences and treat them consistently with accelerated depreciation.

15. To address temporary book-tax differences, at a minimum, an excess tax carryforward mechanism, like that applicable for purposes of the IIR, should be allowed for purposes of the UTPR.

16. As a key purpose of the UTPR is to incentivize countries to adopt IIRs, the UTPR's application should be limited to payments to UPEs and constituent entities of MNEs that are tax residents in countries that have <u>not</u> adopted qualified IIRs. If there is concern that excluding payments to UPEs from the UTPR would risk abuse, ACT recommends that either (1) an allowed list approach, or (2) a statutory tax rate test (rather than the ETR test) be used for purposes of applying the UTPR, subject to an anti-abuse rule for special regimes.

17. The STTR is inconsistent with Pillar Two's stated purpose, which is to address remaining base erosion and profit shifting issues (and not the reallocation of taxing rights, which is the purpose of Pillar One). Moreover, in its current form, the STTR prioritizes gross basis over net basis taxation, contrary to sound tax policy. Consequently, ACT recommends the STTR be deleted or, alternatively, ordered after the IIR.

18. In its current form, the extraordinary complexity of Pillar Two would impose heavy burdens on taxpayers and administrators and would risk inconsistent implementation, controversy, and double taxation. Much of the complexity of Pillar Two is attributable to the country-by-country calculation of ETRs and country-by-country tracking of loss and credit carryovers. The objectives of Pillar Two could be achieved, at a much lower cost of compliance and administration, if global blending (as under GILTI) were allowed. If global blending is not allowed, ACT recommends the IIR, UTPR, and STTR regimes be applied on the basis of an allowed list or, alternatively, statutory tax rates (rather than ETRs), with an anti-abuse rule for special regimes. This simplification would be particularly appropriate under the UTPR in situations where payments are made to a UPE that is a tax resident of a country that has a qualified IIR regime.

GUIDING PRINCIPLES

Pillar One includes proposals that would overturn fundamental features of the international tax architecture; in particular, the arm's length standard and the permanent establishment threshold, that have provided certainty and promoted international investment and economic growth in developed and emerging market economies for almost a century. In view of the revolutionary scope of Pillar One and its potential to have adverse impacts on global commerce and economic growth, ACT previously recommended the development of the Pillars be guided by the following principles:

1. Conduct a thorough economic impact assessment,
2. Achieve global consensus,
3. Adhere to a principle-based approach,
4. Avoid multiple taxation,
5. Address cyclical and start-up businesses,
6. Minimize compliance and administration costs, and
7. Avoid and effectively resolve international tax disputes.

ACT reiterates these principles and urges rejection of measures that overtly or implicitly are intended to discriminate against US-headquartered companies.

PROCESS

If an agreement on Pillar One is attained, ACT supports implementation on a phased-in/transitional basis. Pillar One would impose significant resource requirements on both taxpayers and tax authorities. A testing phase, starting with a limited number of in-scope companies, would allow time for tax authorities to build administrative capacity without diverting scarce resources from other critical revenue programs. The experience gained from the test phase would be useful to identify gaps in the interpretive rules and to determine best practices for tax administration that are critical to the long-term success of the Pillars. To avoid competitive distortions, the testing phase should be voluntary and limited to information collection.

ACT understands many members of the Inclusive Framework believe that agreement upon, and implementation of the Pillars is a matter of urgency. However, ACT views Pillar One as perhaps the most sweeping change in international tax standards since the formation of the OECD, and we are concerned that an artificial deadline may come at the expense of agreement on clear and administrable rules. Consequently, ACT recommends the schedule for the digitalization project allow adequate time for testing the Pillars (especially Pillar One), issuing comprehensive guidance, building administrative capacity, and developing systems and processes to comply with the new rules.

PILLAR ONE BLUEPRINT

Unilateral Measures

It is envisioned that agreement on Pillar One must include a commitment by members of the Inclusive Framework to withdraw relevant unilateral actions and to refrain from future adoption of such actions (para. 848). To assure the effective implementation of this commitment, clear guidance must be provided on the criteria for discerning unilateral actions. In addition, the right of a jurisdiction to receive allocations of Amount A should be contingent upon removal of relevant unilateral actions. For the avoidance of controversy, ACT recommends the Pillar One agreement include a comprehensive list of country-specific unilateral measures that would need to be removed before a jurisdiction could receive any allocations of Amount A.

Arm’s Length Standard

The arm's length standard has an important economic efficiency rationale, i.e., if properly implemented it is neutral between integrated and non-integrated business models. Moreover, the arm’s length standard has served as a widely accepted and well-developed international tax norm for almost a century. Where data on comparable transactions between independent parties exist, the arm's length standard works well. For these reasons, ACT recommends the Amount B benchmarks approximate the arm’s length standard.

Loss Carry-forward Rules

ACT appreciates the inclusion of carry-forward rules for post-effective date losses in the Pillar One Blueprint and notes that consideration is being given to allowing taxpayers to carry forward pre-effective date losses. Particularly in view of the losses that some companies have experienced in 2020 as a result of COVID-19, ACT recommends that a transition rule be provided that allows taxpayers to carry forward pre-effective date losses until fully utilized.

Profit Shortfalls (i.e., Negative Amount A)

For various reasons, companies may report profits that exceed the profitability threshold for Amount A in some years and not in others. Unless a mechanism is provided to take account of profit shortfalls (i.e., negative Amounts A), a taxpayer with profits that in an average year are less than the profitability threshold will nevertheless be subject to Amount A reallocation in years when profits exceed the threshold, with no offset for years when profits fall below the threshold.

To address this issue, ACT recommends that (1) taxpayers be allowed to net profit shortfalls against excess profits (i.e., in excess of the profitability threshold) in future years, or (2) excess profits be determined based on a multi-year moving average. ACT notes that Pillar Two addresses a similar issue by allowing taxpayers to credit foreign taxes paid in excess of the minimum tax rate against the top-up tax in a future year when the foreign tax rate is below the minimum tax rate.

Double Tax Relief

The Pillar One Blueprint discusses two options for providing relief from double taxation of Amount A in both the paying and receiving countries: (1) the exemption method, and (2) the credit method.

As noted in the Blueprint, the exemption method simply requires the paying country to exempt Amount A (because the receiving countries have the right to tax this income).

By contrast, the credit method requires a taxpayer to track the amount of tax paid in each Amount A receiving country that is attributable to income reallocated from each Amount A ceding country, and subsequently to seek a credit in each ceding country, presumably limited to the amount of tax paid in the receiving countries on the reallocated income. Excess credits would need to be tracked at the ceding entity level and carried forward. The complexity of this approach would be multiplied if the foreign tax credit limitation is required to be calculated in each ceding country on a per-country rather than an overall basis.

Thus, ACT strongly recommends the exemption method be adopted to avoid the excessive and unnecessary compliance burden of the credit method.

Overlap of Amount A and Distributor Returns

The Pillar One Blueprint acknowledges (para. 533) that to avoid double counting, “Amount A should be allocated to a market jurisdiction that is not allocated residual profits under existing profit allocation rules, but where a group already allocates and actually earns residual profit in the market on in-scope revenue then there should be no Amount A allocation.” Thus, if the existing arm’s length profit allocation for marketing and distribution (M&D) activities exceeds the fixed return for baseline-level M&D activities, the Amount A allocation to the market jurisdiction should be reduced by the excess (i.e., residual profits), as proposed in section 6.4.2 of the Blueprint (“the marketing and distribution profits safe harbor”).

ACT generally supports this safe harbor but has two comments. First, the Blueprint suggests, as an example, that the return on routine in-country M&D activities would be four percent and that there could be regional and industry adjustments. To avoid double counting, the fixed return on baseline M&D activities that is used for the M&D safe harbor should be in line with returns earned by comparable third-party distributors. This could be accomplished, without additional burden, by using Amount B as the fixed return, because the aim of Amount B is to remunerate related party distributors that perform baseline M&D activities in a manner that approximates the arm’s length standard. Where M&D activities are outside the scope of Amount B, the fixed return should equal the arm’s length return to marketing and distribution activities that has already been agreed for the taxpayer through a tax certainty process, where applicable, (e.g., by the Pillar One enhanced dispute resolution mechanism or by existing treaty mutual agreement procedure or APA), and where there is no such agreement in place for a taxpayer, a fixed safe harbor percentage should be used (e.g., the four percent return suggested in the Blueprint).

Second, ACT notes Amount A may include residual returns from both marketing and manufacturing intangibles. Consequently, where the existing arm’s length profit allocation for a taxpayer with both in-scope M&D and manufacturing activities in a market jurisdiction is greater than a routine return on baseline M&D and manufacturing activities, Amount A allocations may duplicate residual returns already allocated to the market jurisdiction. To eliminate double counting, it should be clarified that Amount A allocations are reduced by all residual returns in the market (not just residual returns on M&D activities).

Overlap of Tax on Amount A and Withholding Taxes

Many countries impose withholding taxes on payments for royalties and technical services. This is a way that some source countries currently tax income attributable to intellectual property (IP). This same income often is the source of residual profits of an MNE. Where the source country is also the market country, it is allocated taxing rights under Amount A for a portion of residual profits. In such cases, the country would have the right to tax the same residual profits twice – by withholding as the source country and by Amount A allocation as the market country. ACT does not believe an international tax standard should be created that results in a country taxing the same income under both its withholding tax rules and the Pillar One regime.[1]

Carve-outs

The Blueprint notes that many of the goods and services sold by certain sectors are not in scope of Amount A. For the sake of clarity, the Blueprint explicitly identifies sectors that would be excluded on a segment basis from Amount A, either in whole or in appropriate part, viz., natural resources, financial services, construction (including infrastructure), sale and leasing of residential property, and international airline and shipping businesses. The Blueprint delineates the boundaries of these exclusions and sets forth the policy rationale for each. ACT believes that all sectors that produce goods and services with similar characteristics to those specifically carved out from Amount A should be treated similarly.

For ease of administration, ACT also recommends that an MNE with only de minimis in-scope revenues be excluded entirely from Amount A.

Segmentation

Financial accounting standards require public companies to segment their consolidated financial statements consistent with how the company is managed, subject to a materiality threshold. According to the Blueprint, without regard to segmentation in the consolidated financial statement, MNE groups will be required to further segment consolidated Profits Before Tax (PBT) if they do not qualify for an exemption or safe harbor and display certain hallmarks.

ACT wishes to stress that the cost and complexity of creating alternative segmentation of consolidated financial statements may be very substantial for some MNEs, particularly those with multiple layers of consolidation, potentially requiring a wholesale change in the company's enterprise resource planning software. Consequently, ACT recommends that MNEs not be required to create alternative segmentation or, at the very least, that such segmentation only be required where there is a high degree of materiality and under extraordinary circumstances.

The segmentation shown in consolidated financial statements may combine product lines or geographic regions with materially different profit margins. Consequently, to avoid distortion, a company should be able to calculate Amount A using segmentation based on product line or region based on its books and records.

If not addressed by ACT's recommendation for a de minimis exception (discussed in the prior section on carveouts), ACT recommends that an MNE with only a small share of in-scope revenues be allowed to segment based on books and records where the in-scope activities are below the materiality threshold for segmentation of the consolidated financial statement.

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[1] One simple way to address this double counting issue would be to condition receipt of Amount A allocations on elimination of withholding taxes on payments related to IP or, alternatively, to allow an offset for withholding tax collected on IP-related payments against tax on Amount A allocations.

Tax Base

The tax base for Amount A is PBT determined from the consolidated financial statement without adjustments for book-tax differences. By contrast, the tax base for determining the ETR for purposes of Pillar Two, also starts with consolidated PBT but makes adjustments for certain material book tax differences (e.g., accelerated depreciation and stock compensation). ACT recommends the tax base for purposes of Amount A be adjusted for the same book-tax differences that apply for purposes of Pillar Two.

PILLAR TWO BLUEPRINT

General Comments

The Pillar Two Blueprint in its current form is overly complex and would impose heavy burdens on taxpayers and governments. Given the intricate design and cascading rules, there is a risk that countries would apply the rules inconsistently, resulting in double taxation. Below, ACT makes recommendations that would substantially simplify Pillar Two with little sacrifice to its policy objectives.

Pillar Two addresses many of the same base erosion and profit shifting concerns that are the focus of the 15 BEPS measures agreed in 2015. Pillar Two is proposed as an additional BEPS Action, but without consideration of the extent to which it would overlap with, and potentially obviate the need for previous BEPS Actions. To avoid duplication and unnecessary compliance burdens, ACT recommends the OECD Secretariat undertake an assessment of whether and how any of the prior BEPS recommendations and minimum standards should be coordinated with, modified, or eliminated as a result of implementing Pillar Two.

GILTI Co-existence

ACT strongly recommends GILTI be treated as an equivalent IIR regime under the coexistence principle discussed in the Blueprint. GILTI predates the Inclusive Framework's Pillar Two proposal. Moreover, GILTI and Pillar Two have similar objectives and overlapping scopes and, as discussed in a recent article by Junge and Villeneuve, have broadly equivalent results.[2] The Junge-Villeneuve article also discusses a number of technical coordination issues that would need to be addressed under a coexistence framework.

The GILTI regime, unlike the IIR, allows global blending, and the GILTI minimum tax rate (currently 10.5 percent) is less than the IIR rate assumed in the EIA (12.5 percent); however, as explained below, the GILTI regime often will be more burdensome than the IIR and thus should be treated as an equivalent regime.

First, a credit is allowed for only 80-percent of foreign taxes imposed on GILTI, so US tax is imposed on GILTI unless the foreign tax rate exceeds 13.125 percent (as compared to the 12.5 percent IIR rate assumed in the EIA). Second, the foreign tax credit limitation with respect to GILTI is reduced by an allocable share of the interest and stewardship expenses of the US parent. Due to expense allocation, tax on GILTI continues to be imposed even when the foreign tax rate exceeds 13.125 percent. Third, excess GILTI foreign tax credits do not carry forward or back and, instead, are permanently foregone, unlike the carry-forward of excess foreign taxes under the IIR regime. Fourth, foreign losses do not carry forward under GILTI as they do under the IIR regime. Fifth, the substance-based carve out under the GILTI regime includes neither a payroll component nor a return on land as does the IIR regime. Sixth, the effective GILTI rate is 21 percent for taxpayers that lose the benefit of the 50-percent GILTI deduction due to a lack of taxable income in the year the GILTI deduction arises (as it does not carry over). Finally, the GILTI rate is scheduled to increase from 10.5 percent to 13.125 percent after 2025, so that top-up tax

[2] *See,* Aaron Junge and Ege Berber Villeneuve, "Coordinating Pillar 2 With the U.S. GILTI Regime", *Tax Notes International*, Vol. 100, October 5, 2020.

always would be imposed when the foreign tax rate is less than 16.406 percent (and would continue to be imposed when the foreign tax rate exceeds 16.406 percent due to expense allocation).

The GILTI regime does not include all of the income of CFCs. In particular, GILTI excludes: a 10-percent return on qualified business asset investment (QBAI), income taxable under the CFC regime (or excluded from the CFC regime due to taxation at a foreign rate in excess of 18.9 percent), income for which the high tax exclusion (HTE) applies, and foreign oil and gas income. For the reasons below, none of these exclusions should preclude all of the income of a CFC from being treated as subject to a qualified IIR:

- QBAI is a narrower exception than the substance-based carveout in the Blueprint which, unlike QBAI, includes a rate of return on payroll and land;
- Income taxable under the CFC regime is subject to US tax at the 21-percent US corporate tax rate and income excluded from the CFC regime due to the high-tax exception is taxed at a foreign rate in excess of 18.9;
- Income eligible for the HTE also is taxed at a foreign rate in excess of 18.9 percent; and
- Foreign oil gas income typically is subject to high tax rates in source countries.

As the income excluded from GILTI almost always is taxed at a rate higher than is being contemplated for the IIR top-up tax, such income should be considered as subject to an equivalent IIR.

Calculating the ETR

The Pillar Two Blueprint provides few adjustments for temporary book-tax differences and, instead, relies on the carry-forward of IIR credits to provide an offset when the temporary difference reverses. The Blueprint states, and ACT concurs, that in the case of accelerated depreciation, book-tax differences may be material and, due to continuous reinvestment, may not reverse for an extended period of time, resulting in over-taxation and accumulation of unused IIR credits (para. 220).

The Blueprint considers two methods of addressing accelerated depreciation for purposes of calculating the ETR: (1) deferred tax accounting for property eligible for accelerated depreciation, and (2) the use of local income tax depreciation rather than book depreciation. The Blueprint favors the latter approach and justifies the use of tax depreciation rules, notwithstanding the added complexity and departure from the policy of relying on financial accounts, on the grounds that this would reduce the frequency and amount of IIR credits due solely to temporary differences (noting that the proliferation of IIR credits also would be a source of compliance and administrative burden).

In addition to accelerated depreciation, there are a number of other book-tax timing differences that for some companies are material and of long duration (e.g., insurance companies and banks) and, due to continuous growth of the business, may not reverse for an extended period of time. For reasons similar to accelerated depreciation, consideration should be given to address other significant book-tax timing differences.

The Undertaxed Payment Rule

Unlike the IIR, which provides a credit for excess taxes, the UTPR has no similar mechanism. As a result, payments to a foreign entity that in an average year are taxed at an ETR above the UTPR threshold would, nevertheless, be treated as nondeductible under the UTPR in years when the foreign entity's ETR falls below the threshold. To address this issue, at a minimum, an excess tax carryforward mechanism, like that which applies for purposes of the IIR, should be allowed under the UTPR. To more fully address the concerns of companies with cyclical ETRs, a carry back (or refund) should be provided for both the UTPR and the IIR.

As currently proposed, the UTPR would apply to payments from foreign subsidiaries to related parties in the jurisdiction where the UPE resides, even where that jurisdiction imposes a qualified IIR. As a key purpose of the UTPR is to incentivize countries to adopt IIRs, the UTPR's application should be limited to payments to the UPEs and constituent entities of MNEs that are tax residents of countries that have not adopted qualified IIRs.

If there is concern that excluding from the UTPR payments to UPEs would risk abuse, ACT recommends that either (1) an allowed list approach, or (2) a statutory tax rate test (rather than ETR test) be used for purposes of applying the UTPR, subject to an anti-abuse rule for special regimes.[3] As discussed below, ACT believes Pillar Two could be significantly simplified, while still achieving its objectives, by more generally allowing use of a allowed list or a statutory tax rate approach.

The Subject-to-Tax Rule

As noted in the Cover Statement by the OECD/G20 Inclusive Framework on BEPS, Pillar One is focused on nexus and profit allocation whereas Pillar Two is focused is intended to address remaining BEPS issues. However, the Pillar Two Blueprint proposes that the STTR apply before the IIR (unlike the UTPR). This has the effect of reallocating taxing rights on income subject to the STTR from the UPE jurisdiction to the jurisdiction imposing the STTR rule, and thus is inconsistent with the stated purpose of Pillar Two. Moreover, in its current form, the STTR prioritizes gross basis taxation over net basis taxation, contrary to sound tax policy. Consequently, ACT recommends deleting the STTR from Pillar Two.

If the STTR is not deleted, as ACT recommends, it should be limited to income sourced within the payee jurisdiction (generally interest, rents, and royalties) and apply after the IIR (like the UTPR), with the result that the STTR would not apply to a payment where the recipient entity is subject to a qualified IIR. In no case should the STTR and the UTPR both apply to the same payment.

Simplification

Pillar Two's complexity has implications beyond the administrative burden on taxpayers and tax administrators (although that burden would be enormous). The extraordinary complexity presented by the Blueprint almost certainly will prevent consistent implementation and, indeed, must be viewed as an existential threat to the success of the project. Therefore, it is incumbent upon the OECD/G20 Inclusive Framework to simplify significantly the current approach to bolster the prospects of its success.

One mechanism for achieving such simplification would be to apply the IIR, UTPR, and STTR regimes on the basis of statutory tax rates (rather than ETRs), with an anti-abuse rule for special regimes. A multilateral monitoring process, such as the Forum on Harmful Tax Practices, could be used to identify special regimes. A similar approach would be to limit the application of the IIR, UTPR, and STTR regimes to entities that are tax residents of countries that are on a denied list (or are not on an allowed list), where this is determined through a multilateral monitoring process.

Other approaches also could be considered. Pillar Two's complexity is, to a significant degree, attributable to the need to measure ETRs on an country-by-country basis and to track loss and credit carry-forwards on a country-by-country basis. Substantial simplification could be achieved by allowing global blending, as is the case under GILTI. Global blending provides some relief from book-tax timing differences and limits the ability of MNEs to benefit from low-tax jurisdictions, although the limitation is somewhat less restrictive than jurisdictional blending. If desired, an equivalent level of restriction could be achieved under global blending, with far less complexity, through adjustments to other features of the Pillar Two regime (e.g., the minimum tax rate or the substance-based carveout).

[3] This recommendation is particularly important for MNEs that are U.S. tax residents for the following reason: the UTPR only applies where the paying entity's ETR is at or above the IIR threshold. However, US MNEs will not know the ETR of their foreign affiliates because GILTI is calculated using global rather than jurisdictional blending. It would be costly and, in ACT's view, unnecessary for US MNEs to calculate ETRs on a jurisdictional basis solely for the purpose of applying the UTPR.