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DET3 INPUT TO PUBLIC CONSULTATION DOCUMENT ON UNDER PILLAR TWO

Dear acting International Cooperation and Tax Administration Division

We hereby present our coordinated observations about the questions posed for public comments in the consultation document recently released by the Secretariat in respect of the Global Anti-Base Erosion Proposal ("GloBE") under Pillar Two.

Our aim has been to be concise but clear in our response and in expressing our positions and suggestions, and in pointing out the relevant question marks generated by some points of the GloBE proposal.

We remain at your disposal for any further conversation or clarification.

Sincerely,
Ignacio Longarte
Chairman – In representation of DET3 board

DET3 Think Tank founders are: Telefónica, BBVA, Iberdrola, Amadeus and Prisa, multinational companies whose ultimate parent is resident in Spain

EXECUTIVE SUMMARY OF DET3 KEY COMMENTS:

- We do agree with using the consolidated financial accounts prepared with ultimate parent accounting standards as starting point for this exercise.

  This is objective audited information that is consistent and homogeneous. The possibilities to manipulate it are rather limited and it is a set aligned with the starting point of Pillar 1 final potential solution.

- Our position relies on not taking in account any type of differences between accounting and tax.

  We do consider that the annual consolidated net result before taxes is the indicator that can better measure & reflect the economic capacity of a group for GloBE purposes over time.

- Analyzing the 3 options to address or smooth the impact of timing differences, we consider that computing the annual worldwide (WW) Effective Tax rate (ETR) through the consolidated average corporate taxes accrued over a 3 years period would provide simplicity and ease execution and review. We, therefore, endorse this practical option.

- We are supportive of a <u>worldwide blending approach as the first option</u> for the MNE group. Yet, we suggest giving <u>the group the option to</u> <u>select the jurisdictional level as a second default option,</u> if needed.

- Two key benefits of the proposed approach for ETR formula determination:

  - Simplicity due to the removal of complex calculations, tracking and potential carry over by jurisdiction or entity in respect of taxable bases / tax attributes / Intragroup dividends & intercompany transactions.

  - The result would be based on an objective perspective of the group economic capacity.

- <u>We support considering qualitative / “behavioral” carve outs</u> based on either a “Responsible & sustainable taxpayer index”, a “Substance index”, or a combination of both. These two (or mix of) indexes are industry agnostic and aligned with the main Pillar 2 objective of addressing remaining BEPS challenges.

USE OF FINANCIAL ACCOUNTS IN TAXABLE BASE DETERMINATION:

In principle we do agree with using the consolidated financial accounts as starting point for this exercise and specifically those prepared with ultimate parent accounting standards.

By using those the main benefit is that the starting point for any Pillar 2 finally required calculation would be using information that has already been audited, it is consistent and homogeneous.

This has also the benefit of facilitating consistency in the starting point with what the Pillar 1 final potential solution could be.

What are the material permanent differences that should be removed from the tax base without undermining the policy intent of the GloBE proposal?

In our perspective it would not be appropriate to remove just selected material permanent differences due to the arbitrary and unpredictable result this option could lead to.

How to deal with permanent differences?

Considering the background explained in the consultation document, our position would be more aligned not to consider any type of accounting to tax differences at all.

We do consider that the annual consolidated net result before taxes it is the indicator that can better measure & reflect the economic capacity of a group, incorporating on it over time many of the effects whose impact is being analyzed.

Comments and preferences between the 3 options to address temp differences

- i) Carry-forward of excess taxes and tax attributes:
- We appreciate the logic of this option, and the initial benefit of more accurately reflecting the economic capacity to be taxed in each

moment, and understand it under the traditional tax compliance, review and enforcement principles.

But we think that when as in our case the number of legal entities to be involved in the exercise is high, the administration burden of creating and maintaining a track record of those tax attributes can be costly while it does not totally remove the potential interpretation complexities.

- Clear rules and process for the interplay of excess taxes, income inclusions and losses carried forward per entity would be required.

- ii) Deferred tax accounting

- Use of deferred tax accounting rules can indeed eliminate swings in the ETR calculation caused by the temporary differences of the different legal entities of the group, but due to the multiple origin-routes a deferred tax can have the result of the computation is still subject to produce a level of arbitrary results.

- Clear rules and steps for the application of this option would be required.

- A non-negligible amount of work would still be demanded in this case.

- iii) Multiyear averaging

- We agree on the fact that computing the annual ETR by including in the formula the total corporate taxes accrued at consolidated level for the relevant subsidiaries over a multi-year period that includes the current year and a specified number of preceding years would address in a good part some of the temporary differences effect while providing simplicity and ease of administration and review and therefore endorse this option.

- A potential period of three (3) years to add up in total for these purposes seems to be a reasonable practical alternative for the averaging period.

LEVEL OF INCOME & TAX EXPENSE BLENDING AND VOLATILITY EFFECT:

General compliance costs and economic effects of a GloBE proposal that is based on either an entity, jurisdictional or worldwide blending approach

Do you consider that a worldwide approach would be effective at managing the volatility issues discussed above?

- We understand that the potential mixing of low & high tax income for purposes of calculating an ETR can introduce distortions in the calculation of the potential MNE additional GloBE taxes (Top-up tax), and we are also aware that temporary differences can produce volatility in the calculation of the ETR.

- But to be consistent with the arguments explained before on the tax to accounting adjustments part, we are supportive of a worldwide blending approach as the first option for the MNE group, providing nonetheless capacity for the group to select the jurisdictional level as a second default option if needed.

  In case the need arises for the group to select the jurisdictional level option, such selection should come with an obligation to apply it consistently during a minimum period of time.

- It is a fact that the total Top-up Taxes to be paid by a group could be different depending on the blending level chosen, with several variances possible, but:

  - we consider the effect of such differences could be smooth to a certain point with the adequate calibration when fixing the minimum tax percentage at a later stage

- both jurisdiction level and entity level approaches are likely to generate difficulties in executing the computations but also potential distortions in the ETR determination overtime in any case, so simplicity should prevail

- **Use of consolidated financial accounting information**

  - **Assuming that MNE already prepares consolidated financial accounts, what are to be the compliance implications in separating the income and taxes at each of the described blending levels?**

  - In simple visual terms, this is our perspective on the compliance and workload implications of each of the proposed options.

COMPLEXITY in admin the system and Tax Differences			
			VERY HIGH
			MID / HIGH
			LOW
WW	Jurisditional	By entity	
BLENDING LEVEL			

  - **How would these compliance implications change if the income for purposes of the GloBE proposal was determined by reference to the rules used for calculating the tax base in the shareholder jurisdiction?**

  - In practical terms this option would require having to reconcile entity by entity accounting profit numbers converted first to the parent company accounting standards and then apply the parent country tax required adjustments to those.

    Compliance burden would exponentially increase.

  - As we have indicated before, we are in general supportive of limiting the complexity of the system by using the net income before taxes from the consolidated books for this exercise, with potentially a multi-year consolidated accounting books tax accrued figure average computation to determine the ETR.

- **Crediting taxes that arise in another jurisdiction.**
  How would you suggest dealing with attributing taxes that arise in another jurisdiction or entity under a jurisdictional or entity blending approach?

- As previously exposed we consider that dealing with that specific issue through credit-transfer mechanics would be possible but complex at jurisdictional base level and extremely complex and cumbersome at entity by entity level approach.

- Conflicts of interpretation between different countries Tax Administrations are to be expected.

- We therefore favor the worldwide blending as first group choice, to allow the group to consider any foreign tax on foreign income creditable in the system with certainty in the cases where Pillar 2 were to be applicable.

General DET3 comments on ETR determination

A reasonable practical perspective on the Effective Tax Rate (ETR) determination for these purposes can be summarized as follows:

Denominator of the calculation: Annual Consolidated net income before taxes result of the whole group.

Numerator of the calculation: Average of a multi-year period net corporate tax expense accrued in the consolidated accounting books figure, which comprises both the current and deferred taxes integration.

We are of the opinion that taking into consideration for these purposes any measure relative to a Cash Tax Rate is not appropriate due to many reasons, including the complexity of computing the potential payments on account, extraordinary contributions or refunds etc...

There could exist extraordinary transactions like business combinations / participated group entities impairment and others impacting the ETR, but we propose to mitigate the impact of those through the mentioned multi-year ETR computation.

Two key benefits of this approach:

- Simplicity due to the removal of complex calculations, tracking and potential carry over by jurisdiction or entity in respect to:

    - taxable bases
    - tax attributes
    - Intragroup dividends and other IC transactions

- The result would be based on an objective and audited perspective of the group economic capacity and the possibilities to alter or manipulate it are rather limited

CARVEOUTS AND THRESHOLDS

- **Options for design of thresholds and carve-outs to restrict GloBE application:**

    - **Preferred design of a carveout taking on account simplicity, compliance costs, certainty, incentives and behavioral impacts?**

      We agree that facts & circumstances based carveouts are more difficult to design and may generate uncertainty.

      In case of a potential <u>qualitative / behavioral carveouts</u> being considered, it would have to be based on a combination of the following factors that are easily measurable:

        - <u>Total group qualitative carveout</u>:

            - A minimum level of substance demonstrable in the majority of the jurisdictions of operations of the group.

For instance based in objective accounting and payroll / HR driven indicators or salaries or SG&A to income ratios. Country by Country Report available data can be certainly useful in this context also.

- A responsible and sustainable taxpayer index created with a combination of simple factors like total paid corporate & equivalent taxes ratio to total tax contribution over a period of time.

• <u>Partial qualitative carveout</u>:

A potential qualitative carveout to adjust or remove from the calculation net income / taxes from activities - entities that legitimately enjoy tax incentives from preferential regimes that have been effectively validated at OECD level under BEPS Action 5 perspective could be an option, but:

- We appreciate that if those activities are not clearly segregated accounting wise that could lead to uncertainty in application and review

- Any approach that leads to partial carveouts will likely play against the principle of simplicity driven by the world-wide blending approach we support

- **Would you favour thresholds based on the size of the taxpayer? Why and suggest metric.**

Thresholds based on the turnover or other indications of the size of the group are necessary indeed. A good starting point can be using the same revenue threshold than the OECD Country by Country Reporting.

- **De *minimis* thresholds to exclude transactions or entities with small amounts of profit or related party transactions.**

  We support it.

- **The appropriateness of carve-outs for specific sectors or industries.**

  As a difference to Pillar 1, in this Pillar is more difficult to sustain differentiation of treatment based on specific industries.

  That is an additional reason why a qualitative carve out based on the "Responsible & sustainable taxpayer index" or "substance index", if easily objectivized, can deserve consideration, because:

  - Those are industry agnostic
  - Those are totally aligned to the main Pillar 2 objective of addressing remaining BEPS challenges

OTHER DET3 GENERAL REMARKS

- In our previous comments we are striving for simplification and clarity in the terminologies to be applied to provide certainty and ease of operation in the potential GloBE application, all smoothed through a multi-year average in a component of the formula.

  But even in this case we suggest including guidelines to address disproportionally large type or transactions such as an acquisition or disposition that we can qualify as a "one-time life company event" because of its magnitude and potential impact in the calculations.

- Please clarify how system operates with non-consolidated joint-ventures or similar figures.

- Providing clear practical ways to implement the final rules from a reporting perspective will be very important, including how to incorporate potential transparent entities, tax Permanent Establishments, and Pillar 1 Amounts.

- Please consider the establishment of a one-stop shop kind of procedure whereby the ultimate parent jurisdiction Tax Authority is the one collecting the potential top-up tax and settles what is necessary with the rest of the affected Tax Administrations, simplifying at most the process to the Taxpayer.

- Necessary to clarify what happens when there is a later tax audit assessment at local entity level that could significantly alters the tax charge of that entity for past years.

  The same strive for simplification could defer this to rely on the recording of its impact on the consolidated financial statements, but some reflection / guidance will be useful.

- Please also consider binding arbitration to shore up the certainty of the GloBE system when applicable.