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International Co-operation and Tax Administration Division,
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The law firms submiting this document, Chiomenti and Cuatrecasas, welcome the opportunity to contribute to the public consultation on the OECD Secretariat proposals under Pillar Two concerning the taxation challenges of the digitalising economy.

CUATRECASAS

Cuatrecasas is present in 13 countries, with a strong focus on Spain, Portugal and Latin America. With 1,000 lawyers, we advise on all areas of business law, applying a sectoral approach and covering all types of business. We have 16 offices on the Iberian Peninsula and 12 international offices, as well as 20 international desks. Thanks to our close collaboration with leading law firms in other countries, we offer a team to meet every client's needs and every scenario. We have a solid track record working side by side with leading companies, advising them on their day-to-day activity and on major transactions. In 2019, as in 2018, we have been considered the "Most innovative law firm (outside UK)" in the FT Innovative Lawyers Awards.

CHIOMENTI

Chiomenti has over 300 attorneys and tax advisers and has offices in Rome, Milan, Turin, London, Brussels, New York, Beijing, Shanghai and Hong Kong.
The Firm provides legal advice in civil, corporate, commercial, banking, finance, capital markets, litigation, tax, administrative, real estate, employment, EU, competition, public utilities, copyright, financial markets regulation, trusts, intellectual property, data protection and criminal law.

Chiomenti was one of the first Italian law firms to offer a full range of assistance in connection with domestic and international tax law and practice.
The high-quality legal assistance provided by Chiomenti has been rewarded by recognition in the specialized press. Chiomenti and several of its professionals are ranked among the foremost leaders in the tax, corporate, M&A, banking practice areas by the most recently published Chambers Global, The European Legal 500 and IFLR 1000 rankings.

QUESTION 1

a) **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?**

Yes. We believe that audited financial accounts could give an appropriate estimation of the income base of different companies in a given jurisdiction.

b) **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?**

The use of the consolidated accounts of the ultimate parent entity is the simplest way to have a full financial picture of the entire Group. As in order to consolidate the financial statements of the ultimate parent entity it is necessary to report the financial information from the subsidiaries using the same financial reporting standards, in our opinion the ultimate parent company should have the information from all the subsidiaries with the same financial standards. This would be very useful for GloBe proposal.

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

In our opinion, a financial standard is an appropriate standard for determining the tax base in those cases in which the commonly accepted financial accounting standards are followed, i.e. IFRS, US GAAP, etc.

d) **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?

This may happen, however the result of a given Group in a given period time (e.g. 10 years) should be very similar regardless the financial accounting standard used.

e) 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?

This may be an issue. In this regard, we propose to establish a threshold under which a MNE would not be subject to this proposal. Carve-outs are necessary.

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

We believe that it should be mandatory to establish a financial accounting standard in those jurisdictions in which there are no obligation to have financial statements.

QUESTION 2

a) 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?

The most common permanent differences arise from the following expenses and incomes:

- Expenses which represent a remuneration of equity.

- Expenses arising from accounting for Corporate Income Tax. Revenue arising from such accounting is not considered as income.

- Criminal and administrative fines and sanctions, surcharges for legal collection proceedings and surcharges for the late filing of return-assessments and self-assessments.

- Gaming losses.

- Donations and gifts, with some exceptions when it comes to expenses related to attentions to clients or suppliers.

- Expenses which are contrary to legal order.

- Service expenses corresponding to operations performed with persons or entities resident in tax havens countries, or which are paid through persons or entities resident therein, unless the taxpayer proves that the expense accrued corresponds to a transaction which has actually been carried out. This permanent difference might not be required in a GloBE framework.

- The financial expenses accrued in the tax period, derived from debts with group entities, with the aim of the acquisition, to other entities of the group, of shares in the capital of any type of entities, or to make capital contributions of other entities of the group, unless the taxpayer proves that there are economic reasons for doing such operations.

- The expenses derived from the termination of the employment relationship exceeding, for each recipient, a specific amount.

- The expenses corresponding to "hybrid transactions" done with related-parties that, as a result of a different tax classification, do not generate income or generate an exempt income or subject to a nominal tax rate of less than 10%. This permanent difference might not be required in a GloBE framework.

- Transfer pricing adjustments from the difference between the market value and the book value (primary and secondary).

- Dividends received from resident and non-resident entities.

- Gains and losses on the resident and non-resident entities' stock sales.

- Positive and negative income from a permanent establishment. This permanent difference should be reconsidered according to decisions following Question 7 in a GloBE framework.

- Gain on the sale of a permanent establishment. This permanent difference should be reconsidered according to decisions following Question 7 in a GloBE framework.

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

It should be done through a positive or negative adjustment, depending on the case, to the financial accounting income of the tax-period when the permanent differences have been accrued.

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

In order to guarantee legal certainty to taxpayers and reduce dispute with the tax administration, it should be necessary to define exactly the concept of each permanent differences considered and identify the accounting number of these differences at the accounting standard finally applied.

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

Depending on the blending option adopted, other adjustments may be applied. For instance, in the case of the jurisdictional or entity blending approach, it should be needed to consider the application of adjustments derived from local tax group regime in order to incorporate or eliminate intercompany transactions until the entities involved exit from the MNE group.

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?**

We believe that this approach is highly challenging to implement in practice, due to compliance and monitoring costs, especially regarding the problem of determining the amount of tax due derived from permanent differences (which we understand that it could not be offset by a credit derived from temporary differences).

Finally, fair transitional rules could be difficult to establish, especially in cases in which large amounts of temporary differences have been applied before the implementation of the GloBE.

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

We believe that this system is the simplest way of eliminating the effect of the temporary differences, as it has no relevant additional costs of implementation.

We are aware of specific difficulties that can be found in practice (for instance, in recognizing deferred tax assets arising from the carry-forward of unused tax losses[1]) as described in paragraph 51 of the document. However, this system has a first review done by the auditors of the company as a way of making MNE obliged to justify their judgment (in this regard, it will be crucial to guarantee their independence).

The main problem could be the different approaches to applying "*deferred tax accounting*". It is true that the temporary difference approach focused on the difference between the accounting and tax base of assets or liabilities is widely used. In any case, we believe that, when determining accounting principles acceptable for GloBE purposes, this aspect should be reviewed.

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[1] See ESMA public statement of July 15, 2019

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?

We think that this approach has a relevant burden of implementation due to the fact that in the first year of using this approach, it should be calculated the average effective tax rates of previous years.

Moreover, MNE composition can change during the years taken into account by this approach, which could create some distortions on the average effective tax rate to be applied. These issues would require detailed rules to be dealt with. We also think that these rules could generate important implementation issues.

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?

We think that the more limitations imposed on "*normal financial accounting rules,*" the more difficulties will arise on the application of this method mainly because auditors would not be obliged (by existing rules) to verify these additional adjustments.

A proper study has to be performed to asses if the result of the "*normal financial accounting rules*" is acceptable. At the end of the day, it could not be perfect, but it could provide a traceable and straightforward solution.

e) Do you see opportunities for potential abuse in any of the approaches for addressing temporary differences described above? Do you have suggestions for designs to prevent those abuses?

We think that a sensible approach would be testing in practice the simpler approach (deferred tax accounting) and decide if any adjustment is required to solve any potential loophole that could arise.

f) Do you have any suggestions for alternative mechanisms for dealing with temporary differences?

No, we do not have any suggestions.

g) **Do you have any additional comments on Section 2, including comments based on experiences with existing regimes that you suggest should be adopted or avoided?**

We do not have additional comments.

QUESTION 4

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?

Worldwide blending seems to be the most fair, efficient and reasonable, mainly because of:

1. Consistency

GloBe's goal is to establish a **global** minimum taxation that discourages profit shifting and base erosion strategies and limits tax competition among jurisdictions. Consequently, we believe the reasonable way of measuring whether this global goal is achieved is by taking the worldwide (global) blended tax rate as a starting point. This would allow for and recognize certain specific incentives that different jurisdictions may implement based on their tax policies, but they would be limited from a global perspective to avoid abuse.

Also, the main social concern behind GloBe's goal has more to do with MNE not paying taxes at all than with the specific distribution of these taxes. This also suggests that a worldwide approach may be more adequate (and avoid the lack of consensus that a jurisdiction-by-jurisdiction analysis may bring to the table).

Also, the possibility of resorting to consolidated financial accounts would ease calculation.

2. Compliance costs

For a MNE present in multiple jurisdictions, a jurisdiction-by-jurisdiction analysis (or even worse, entity by entity) would imply an excessive workload that does not seem justified by the goal.

QUESTION 5

a) In the absence of any of the approaches for addressing temporary differences discussed in Section 2, do you consider that a worldwide approach would be effective at managing the volatility issues discussed above?

Volatility is mitigated by the size of the MNE. The bigger the MNE (i.e., the more aggregated taxable bases and the more heterogeneous nature of the entities comprised), the more difficult that a temporary difference will affect the tax rate. A worldwide approach should reduce volatility –even more so if consolidated accounts are used as a basis.

This is another element that suggests the need to limit the GloBe proposal to big MNE.

QUESTION 6

a) Assuming that the MNE's income for purposes of the GloBE proposal would be determined by reference to financial statements (adjusted as necessary) and assuming further that an MNE already prepares consolidated financial accounts, what are likely to be the compliance implications for MNEs in (i) separating the income and taxes of their domestic and foreign operations under a worldwide blending approach, (ii) separating the income and taxes to a jurisdictional level, or (iii) breaking down income and taxes to an entity level?

The level of complexity is considerable and seems to increase as the graininess level of the approach is increased - from (i) to (iii) - and, as a consequence, the overall costs of compliance could rise between the three approaches envisaged under the GloBE proposal.

However, the worldwide blending approach – that appears to be the less burdensome approach - requires in any case the same level of information needed to implement the jurisdictional or entity blending approach.

In other terms, the type and magnitude of the information requested under the GloBE proposal is the same among the three approaches; the differences lie in the fact that in the worldwide blending approach the information is processed as a whole, while, according to the jurisdictional/entity approach, the information is considered per State/entity level.

Also, the compliance implication of the three blending approach is directly linked to the corporate structure of the group; administrative cost will reasonably be higher for highly decentralized MNE groups.

Moreover, it seems that the compliance implication is not disproportionate in relation to the GloBE objectives. Indeed, a somehow similar effort seems to be required for the drafting of the Country-by-Country Report.

Having said that, a worldwide blending approach seems to us the more appropriate criteria in relation to the cost-benefit ratio.

b) 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?

At first, referring to the tax rules of the shareholder jurisdiction may trigger additional compliance costs and administrative work but, given the purposes of the GloBE, it appears more consistent in order to determine the tax base for GloBE purposes compared to the solutions based on the financial statements (adjusted pursuant to Chapter 2 of the GloBE Discussion Draft Report).

Secondly, in our opinion, between the two alternatives, it seems easier to have the tax base determined on the basis of the tax results rather than using the financial statements. This since the parent company, in certain cases, may be required to calculate the income of the foreign entity under the CFC regime applying the domestic tax rules and, in addition, to re-determine the same income under the GloBE provision. Thus, it may lead to a double effort not in line with the goals of the project.

QUESTION 7

a) **How would you suggest to apportion the income of an entity between the branch and the head office and do you think it should follow what is done for tax purposes?**

The interaction between Pillar Two and Pillar One would be crucial so income and profit allocation should be aligned.

However, the basic premise would be to treat a permanent establishment as a fully independent and separate entity for tax purposes.

This implies the consistent application of the arm's-length principle to internal dealings between the permanent establishment (PE) and its head office and between permanent establishments of the same company.

Generally, the application of the OECD's AOA might be more attractive to States if its application is restricted to these cases were the AOA is more applicable.

For the Digital Economy MNEs, income attribution for permanent Establishment should be based on the arm's length principle but should take into account its singularity in the value creation drivers (marketing intangibles).

Finally, a successful framework should envisage a special regulation is required to the international profit attribution with respect to banks and insurance companies, global trading of commodities and extractive industries.

QUESTION 8

a) **How would you suggest to apportion the income of a transparent entity and do you think it should follow what is done for tax purposes?**

If the GloBE proposal does not aim to change the tax status of entities under domestic law, a look-through approach is hardly avoidable as it is inherent to the tax treatment of the entity in the jurisdiction in which it is organized or incorporated. Thus, the income of a transparent entity would not be relevant for the assessment of the tax status of the entity itself under the GloBE proposal but for the assessment of the member of the entity (i.e., it is in the hands of the member where the income is allocated and the minimum taxation is ensured).

The income of a transparent entity should be apportioned to its members in accordance with the terms of the partnership. Different apportionment criteria would be artificial as it would not have been agreed among the members and would not be a valid proxy regarding their ability to pay taxes.

b) What are the compliance implications of such an allocation under a worldwide, jurisdictional and entity blending approach?

The main compliance implication would be to identify whether an entity is considered tax transparent (as, in some cases, it is a taxpayer decision), to identify its members and the apportionment basis. Given that the members of the transparent entity may resident in different jurisdictions and not be part of the same MNE group, this is a common problem for any blending approach. Once this is done, the compliance implications are the general compliance costs addressed in question 4.

c) Is the compliance impact smaller for those MNEs that are subject to CbC reporting requirements and that are already required to report the income of a transparent entities separately even where no such requirement exists under financial accounting rules?

Yes, given that in those cases the income of transparent entities is already identified.

QUESTION 9

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

A fair solution would be that taxes paid in a jurisdiction concerning income derived from another jurisdiction should be attributed - for GloBE purposes - in such latter jurisdiction.

In this respect, taxes paid in a jurisdiction different from the one in which the income arose should be fully attributed to this latter jurisdiction and not subject to any quantitative limitation (as under the GILTI rules) because, otherwise, double-taxation issues may arise.

The above criteria should be adopted with both the jurisdictional and entity blending approach.

b) **What comments, if any, do you have on the practicality of crediting taxes paid in an intermediate jurisdiction or entity, such as under a CFC rule, against income of the subsidiary or branch?**

From a practical point of view, it is relatively simple to calculate the overall amount of the taxes paid during a fiscal year in a jurisdiction being this kind of information generally available of the level of the parent company.

We do not envisage any practical issues in allocating income taxes payable for instance under a CFC regime in a home State jurisdiction as corporate taxes ordinarily paid in the CFC State.

However, further guidance should be provided in order to identify which "taxes" are necessary to be considered as eligible to be credited under the GloBE approach. In this respect, a reference should be made to the taxes listed in the relevant Double Tax Treaty in force between the two jurisdictions, where applicable.

QUESTION 11

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

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.

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.**

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?**

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.**

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?**

1. **General principle**

The main objective of this proposal is to make sure there is a minimum taxation worldwide, no matter where the investments or activities take place or the sectors affected. From a BEPS perspective we can understand the reasoning behind this initiative as the only option some countries have in order to make sure that investment does not take tax driven business decision.

However, although it might be a solution for those countries, it may also impact negatively in those decisions as certain ones might not be worth taken under certain circumstances.

Some countries do have entry barriers in their markets, such as lack of legal certainty, unregulated markets… and they might require either big companies entering into those markets or some kind of flexibility for smaller business.

If this new Tax does not take into account the special characteristics of different markets, industry sectors or size of the entities, it might stop, or at least decrease the level of investment in many jurisdictions.

2. Substance: is this concept abandoned by this new Tax?

The BEPS Action Plan has been very much focused on substance or economic activity as the key element to be considered in many of the proposals; a good example would be Action 5, with the nexus as the key characteristic in order to accept certain regimes as valid.

This new Tax tries to forget about this concept and omits its existence when building its technical structure. Does this make sense? We have been modulating the tax systems in the last decade around substance; it is worth remembering the transfer pricing guidelines where the business driven policies have been the most important principles (functions, risks, assets). The main reasoning behind this is that direct taxes should consider the economic capacity, the real benefit obtained through that economic activity.

The new proposal forgets about this principle and wants to tax without considering what it is being performed, how and where.

If this new Tax was to be implemented, we do think that some carve outs should be considered, from different perspectives.

3. Tax Neutrality and compliance costs

One of the arguments the document mentions in order not to consider any carve outs, apart from the policy one, is that it may affect the tax neutrality and increase the compliance costs.

This is something that it is not new in the Tax Systems. There is no tax system in the world that only imposes one tax rate without taking into account different industries or sizes of entities. Every country has pension funds with zero taxation, investment funds with no or very low taxation, special treatment for non profit organizations, associations or similar entities, even REITS have a very special tax treatment and a lower tax rate is established for Small Business.

Does this affect tax neutrality? It recognizes different industries, diverse type of entities and this is needed in order to offer similar options for development and encourage certain type of investment.

At the same time, we have to accept that having this differentiation in the legislation adds some uncertainty and additional compliance costs; some interpretation issues arise, definitions have to be clear in order to make sure those special regimes are correctly applied and general antiabuse rules need also to be incorporated.

Even though, this is still necessary in our systems.

Consequently, we have to recognize that this potential carve-outs could affect Tax Neutrality and increase compliance costs but, at the same time, this is something we have already dealt with in the past and it is necessary in order to make sure that the new Tax does not affect negatively investments that today are healthy.

4. Quantitative carve out

The new Tax should consider the possibility to exclude its application in certain cases:

- Business where there is a certain return on assets: this reflects quite well the real activity of the company in a certain country and its circumstances. In this case, a country by country analysis should be performed and it might require an adjustment if a Global blending approach is considered.

- Minimum turnover: this carve out could be drafted in order to make sure that Small Business do not get too punished by this minimum tax and they have more flexibility to diversify the investment. If a Group does not meet the threshold, it could be excluded from the application of this Tax.

5. Qualitative carve out

- By industry: as we mentioned before, many sectors have already been identified by different tax systems as very sensible to a high tax rates. Those sectors or industries could be excluded from the application of this Tax.

- Tax incentives for certain business activities established by many countries: this forms part of the tax policy of every country and if it is not taken into account by the resident countries, it would erase its positive effects. It is important to distinguish between those Preferential regimes that do not intend to attract real activity from those that do; this is something Action 5 has been working on and should be taken into account. The recommendation at this point would be to continue working on it and exclude from this tax any special regime that meets the requirements approved by the OECD in this respect. This kind of exclusion would need to be adjusted in case a Global blending approach is considered.

We would welcome a constructive dialogue with you on this subject and remain available to discuss this further at your convenience.

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