STELLUNGNAHME

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Association of German Chambers of Commerce and Industry (DIHK)

DIHK contribution to the public consultation document

Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two

We would like to thank you for the opportunity to comment on the consultation document referred to above.

A. General Remarks

The OECD's proposals are intended to establish an internationally applicable minimum level of taxation for corporate profits. The aim is to minimise incentives for multinational enterprises (MNE) to shift profits and tax bases to jurisdictions where they are subject to no or very low taxation. To this end, the fiscal authorities of the group parent companies are to receive a "***right to tax back"*** if subordinated group units abroad are taxed below an internationally agreed level of taxation. The same applies if tax-deductible payments of a group member are only taxed to a small extent in the target country.

The Association of German Chambers of Commerce and Industry (DIHK) shares the view that exclusively tax-driven profit shifting within a group do not make economic sense and result in allocation distortions. Furthermore, a harmful "race to the bottom" tax competition can be triggered, which inevitably leads to welfare losses and can impair the financing of national budgets.

The reasoning behind Pillar Two is therefore understandable, provided that all the measures proposed in the consultation paper are limited to making ***tax-motivated profit shifting within a group*** more difficult. The measures under discussion may therefore only be applied in the case of group matters, since only here tax-driven profit shifting is possible.

The phenomenon of "profit shifting" is only possible because some jurisdictions levy a very low tax rate on corporate profits or waive taxation altogether. If, however, the 135 countries participating in the Inclusive Framework consensually regard profit shifting as undesirable and instead advocate compatible tax competition, then the ***means of first choice*** *should be* ***the elimination of no- or very low-tax regimes***. According to the DIHK, the cause of profit shifting can only be eliminated by reducing the worldwide tax rate differential between states. – In contrast, the measures proposed in the consultation paper are questionable, as they do not address the root causes, but only the symptoms. It is precisely the considerable technical complexity of the proposals that makes it clear that this is the wrong way to go. It should also be noted that the sanctioning of no- and very low-tax regimes is carried out on the ***backs of companies*** and not face-to-face between the member states of the Inclusive Framework.

The DIHK advocates well-ordered ***competition between states for the best investment conditions*** for companies. This means that states must strive for good tax conditions for their companies and use tax revenue in a targeted and economical manner. As a matter of principle, it is at the discretion of the states to design their tax system and determine the level of taxation for citizens and companies.
However, the DIHK recognises that excessive, harmful tax competition can lead to significant micro- and macro-economic side effects. The threshold above which a so-called ***harmful race to the bottom*** is defined must not, however, be determined by so-called high-tax jurisdictions, as otherwise positive tax competition would also be restricted. Instead, it is advisable to set the limit where national tax levels (tax base with tax rate) are ***far below the average worldwide corporate tax burden***. In view of the 9% corporation tax burden – which is also widespread within the European Union – a threshold of 5% could be applied.

The paper of the OECD now proposes a four-stage approach, by means of which the fiscal authorities would have additional tax access to corporate profits if the corresponding jurisdiction taxed below a minimum level of taxation that is yet to be determined:

- A so-called "Income Inclusion Rule" should enable the tax authorities of a Group parent company to impose additional taxation if a foreign subsidiary is subject to taxation which is below the minimum level of taxation.
- If the subordinate unit is a permanent establishment (branch) or an immovable property, an exemption imposed by a DTA should be refused by a "switch over" rule and corresponding profits partially included in the taxation of the higher-level unit.
- With an "under-taxed payment rule", tax-relevant payments of a Group unit to another Group member can be excluded from the deduction of operating expenses if taxation in the target jurisdiction is below the minimum tax level.
- In these cases, it is also planned for the source state to be able to carry out a withholding tax by means of a "Subject to Tax Rule".

The proposals submitted in the consultation document meet with considerable concerns on the part of industry. The most important points of criticism and comments from the companies are as follows:

- Regarding the scope of application of the new rules, it is necessary to limit them to ***intra-group activities***, as unwanted profit shifting can only be organised within a Group.
- The new, extended taxation rights should only apply to ***very large multi-national Corporate Groups (MNE)*** because only these companies have the necessary financial, material and human resources to implement the new regulations. In the opinion of the DIHK, small and medium-sized enterprises must be excluded from the scope of application and a suffi-

ciently high threshold must be drawn up. All proposals would result in far-reaching changes in the international tax system. This would impose a considerable bureaucratic burden not only on tax administrations, but also on all businesses. At very many enterprises, almost all tax investigation procedures and the entire exchange with the tax authorities would need to be set up again. Small and medium-sized enterprises in particular would be faced with special challenges because these businesses often do not have the necessary resources to implement such extensive rule changes. ***Exemptions for small and medium-sized enterprises*** are therefore urgently needed.

- The most important factor for a sufficient level of acceptance of the regulations to be drawn up is that a ***clear, simple and practically*** implementable solution can be found. This applies both to companies that have to implement and comply with the new regulations and to the 135 jurisdictions participating in the Inclusive Framework which must administer the regulations. Furthermore, simple and easy-to-handle rules reduce the number of disputes, ensure legal certainty and avoid double taxation.
- In all the proposals put forward, companies see considerable risks of double taxation. The reason for this is that in many cases, the measures are unlikely to be coordinated in detail in terms of content and timing. All solutions to be developed by the OECD/Inclusive Framework must therefore be consistent and clearly described in themselves so that all jurisdictions can ensure a uniform interpretation and application. **Tax certainty** for companies has to be the most important yardstick for the development of solution proposals. In particular, the various national tax authorities with their very different structures are likely to make the uniform application of new rules more difficult.
- There are currently no ***binding dispute settlement procedures*** for all jurisdictions. In order to counter the risk of double taxation, the establishment of such dispute settlement procedures is essential. These must ensure that double taxation does not come about as far as possible and – if it does occur – that any double taxation that arises is removed within a short period of no more than one year.
- It would therefore be important to create a “single authority” – as a sort of **one-stop shop**, so to speak. This could make the relevant determinations concerning whether the low taxation of certain income, the extent of the necessary corrective taxation and the identification of the jurisdictions involved should be mandatory and monitor the national corrective measures.
- The application of the internationally agreed solutions for Pillar Two must occur ***simultaneously*** and **uniformly in all countries** covered by the Inclusive Framework.
- Ultimately, many companies are very critical of the excessive speed with which work is being carried out on the implementation of these measures. Because changes to the international taxation system have far-reaching consequences for companies, it would be better to work out co-ordinated proposals without any time pressure. The target set by the OECD/Inclusive Framework for itself of developing a final proposal for a solution by mid-2020 may be understandable from the political point of view. However, the approach carries the risk that technically good solutions cannot be sufficiently worked out and that an agreement will ultimately be arrived at on the basis of a "***quid pro quo***".

In the view of the DIHK it is important to state the following: Owing to the short consultation period (November 11 – December 2, 2019) and the considerable complexity of the issues involved, it is not possible to arrive at a final assessment of the proposed options with the initial evaluation presented here. Ultimately, there is also a lack of detailed information on the individual proposals, so that it is not possible to estimate the expected fiscal burden for different companies. The potential impacts on companies and their business models need to be examined in greater detail. In any case, further steps should only be taken by the OECD/Inclusive Framework when much greater knowledge of the impacts of the proposed measures is available. No rash, long-term problematic new regulations should be adopted as a result of short-term political pressure. In particular, greater consideration should be taken of the bureaucratic burden caused by the new regulations in the future analyses of the situation. Fundamental changes to the international tax system cause a comparatively heavy bureaucratic burden, especially for the small and medium-sized enterprises found in the German SME sector that are affected in many cases in Germany.

B. The measures in detail

1. Scope

It is of considerable importance to define the scope of application of the measures according to Pillar Two precisely in order to tackle non-desirable profit shifting.

a) The planned and targeted exploitation of tax rate differentials and the shifting of tax substrate to no or very low-tax jurisdictions is only possible within a group of companies. The adoption of such targeted allocation measures pre-supposes that corresponding decisions can be executed within the group. For this purpose, ***control*** is required as standard in the form of a shareholding of more than 50%.
The “right to tax back” of the jurisdictions provided for in the consultation document should therefore only apply to controlled companies which belong to the group, but not to related companies with shareholdings below this threshold.

b) With regard to the definition of the group of companies, a uniform OECD definition that is binding on all states should be found.

c) In view of the considerable administrative burdens which are triggered by additional tax access under Pillar 2, only ***very large corporate groups*** should be covered by the field of application. In the opinion of the DIHK, a threshold turnover of EUR 750 million, which is known from the worldwide country-by-country reporting (CBCR) that is already implemented, is not sufficient. In view of the exponentially developing turnover of corporate groups, especially in the digitalized sector, a higher threshold of at least EUR 1 billion should be implemented.

2. Tax Base Determination

Pillar 2 would provide jurisdictions with a right to "tax back" if the taxation of relevant income abroad has occurred below an internationally agreed minimum tax level. The starting point for

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calculating the minimum tax level should therefore be a ***uniform basis for assessment*** which can be accepted by all the fiscal authorities involved and applied administratively. It would not be expedient if different assessment bases were used.

In view of the large number of different national accounting and tax statements under commercial and fiscal law, the use of ***IFRS*** as an internationally known and proven set of rules would be suitable.

However, the provisions of financial accounting, in particular under IFRS, are not suitable for taxation purposes without further adaptation due to the different purpose of the regulations. Instead, further ***modifications*** would have to be carried out subsequently – which were binding for all jurisdictions. In particular, these should prevent

- unrealised profits being included in taxation,
- loss carry-forwards and carry-backs not being considered.

3. Blending

The consultation paper defines "blending" as the "mixing of income from different sources". Here it needs to be determined at which level income components are aggregated and then checked whether the minimum tax level has been reached. Three basic models would be conceivable:

- "entity blending" (taxation of the specific business unit)
- "jurisdictional blending" (taxation of all group members in a jurisdiction) and
- "worldwide blending" (total burden of the entire group (MNE) across all units and all jurisdictions)

Against the background that all proposals under Pillar Two are exclusively intended to sanction profit shifting within the group, ***worldwide blending*** is recommended for reasons of practicability and simplification, as no further calculation steps would be required for this.
If it is not possible to reach a consensus on this within the Inclusive Framework, all consolidation steps in the Group would have to be reversed and an additional re-calculation of the group result at lower (entity or jurisdiction) levels would have to be carried out. This would only be possible at considerable expense and would require a large number of re-calculations, which would be susceptible to dispute.

4.) Carve Outs

With ***BEPS Action Point 5*** adopted in October 2015, the participating states have already defined criteria for harmful tax practices and laid down various pre-conditions for when national tax measures must be accepted internationally. However, if these approved preferential regimes result in taxation below the GloBE minimum tax ceiling, the positive vote of the international community must also apply to Pillar Two. Any other assessment would lead to valuation discrepancies and would not be consistent.

In principle it would be conceivable to forego additional taxation under Pillar Two if there were a sufficient ***return on tangible assets***. However, this would require extensive calculations.

Regarding the additional taxation of payments made into a no or very-low tax jurisdiction (“tax on eroding payments”), it is necessary to establish ***thresholds*** so that not every payment is included in the complex calculation and taxation procedure according to GloBE. In view of Pillar Two's intention to prevent worldwide profit shifting and tax avoidance within a group, a total amount per entity of EUR 1 million could be expedient.

Any exclusion of ***specific sectors or industries*** would lead to considerable demarcation difficulties, which would be susceptible to dispute. It would also require reasonable and consistent argumentation, which could justify the unequal treatment of different business activities. This would have to comply with specific judicature of the European Court of Justice.

The additional taxation of corporate profits by foreign jurisdictions according to Pillar Two triggers considerable concerns regarding compliance with ***EU fundamental freedoms***. The reason for this is that companies could be disadvantaged if they make use of the EU Single Market and develop business activities in countries that are members of the European Union. The DIHK therefore strongly recommends that special attention be paid to the recommendations of the Commission of the European Union during the discussions in the Inclusive Framework. Furthermore, we believe it is essential to involve the ***European Court of Justice (ECJ)****,* since ultimately it will decide whether the corresponding regulations within the current 28 member states of the European Union are contrary to European fundamental freedoms.

5. Further Remarks

In view of the large number of jurisdictions involved in taxing an MNE, the uniform and binding application of the regulations is mandatory. First of all, it is necessary to establish ***simple, clear and easy-to-use definitions***, including definitions of terms. It also makes sense to define and co-ordinate the various national tax measures by Pillar Two, e.g. in a multi-level Group, in a uniform and centralised procedure.

Furthermore, a ***mandatory dispute settlement procedure*** is required, which must be completed within a short period of time – ideally within one year. The procedures laid down in some double taxation agreements can be continued, although these procedures need to be significantly improved and shortened.

Therefore, the DIHK advocates the creation of a "***competent authority***" to regulate the application of Pillar 2 in a binding manner for all participating jurisdictions. This "competent authority" should also be the only point of contact for the respective company in all disputes (“one-stop-shop”).

C. Contact persons with contact data

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D. DIHK - Who we are

The Association of German Chambers of Commerce and Industry (Deutscher Industrie- und Handelskammertag, DIHK e.v.) is the central organization for 79 Chambers of Commerce and Industry, CCI (Industrie- und Handelskammern, IHKs) in Germany. All German companies registered in Germany, with the exception of handicraft businesses, the free professions and farms, are required by law to join a chamber.

The DIHK speaks for more than three million entrepreneurs. They include not only big companies but also small and medium-sized enterprises. It does not represent any specific corporate group but all commercial enterprises in Germany. Thus, the DIHK opinions are equilibrated and well-balanced taking into account the whole business' requirements.

The DIHK also coordinates the network of the 130 German Chambers of Commerce abroad as wells as delegations and representative offices of the German economy in 92 countries.

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