1 April 2022

Attn Mr Gerassimos Thomas
Director General DG TAXUD
European Commission
1049 Bruxelles
Belgium

Dear Mr. Thomas

Subject: PwC Feedback on the Proposal for a COUNCIL DIRECTIVE on ensuring a global minimum level of taxation for multinational groups in the Union.

PwC International Ltd on behalf of its network of member firms (PwC) welcomes the opportunity to provide feedback on this proposal for a Council Directive.

PwC supports the efforts of the European Commission in legislating the OECD Pillar Two Model Rules in the EU via a Directive. Since the publication of the draft Directive, a compromise text has been published with some amendments, most notably, to have the rules coming into effect on 31 December 2023. PwC responds to the request for feedback with comments on both the draft Directive of 22nd December 2021 and the compromise text of 12th March 2022, and we refer to both documents collectively as the "draft Directive".

In responding to this request for feedback, we distinguish between conceptual and legal issues in an Appendix, with a summary of our points outlined below for reference:

- PwC is deeply concerned about the enormous complexity of the Model Rules and hence the draft Directive, which will lead to high compliance costs for taxpayers and high costs for tax administrations to administer the rules, and to uncertainty for taxpayers and tax administrations. Safe harbours and administrative guidance on how to implement the Model Rules are essential to reduce complexity, compliance costs and uncertainty and to prevent the Model Rules collapsing under its own weight;
- Issues about compatibility of the draft Directive with EU secondary law, and with the Charter of fundamental rights of the European Union and double tax agreements could lead to uncertainty for taxpayers and tax administrations;

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- Furthermore, PwC sees a need for further and rolling guidance on items that do not follow exactly the OECD Model Rules approach and a need to ensure a dynamic application of the OECD's interpretation of the Model Rules for EU rules that do exactly follow the Model Rules;
- There is a potential for double taxation as a result of the transition rules where assets move between associated constituent entities, even where tax is paid on any gain generated from the transfer;
- Given the importance of being able to determine which countries are regarded as having a Qualified Income Inclusion Rule, it is suggested the Commission provide further clarity as soon as possible in the form of an indicative list of countries.

These issues preferably ought to be considered in advance of progressing the draft Directive.

With this letter we kindly invite you to take our observations into consideration during the finalisation of the proposals. We stand ready to discuss the issues raised in this letter in more detail, if that would be helpful at any point - please do not hesitate to contact me or one of the individuals set out below.

Yours sincerely,

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PwC IL is registered under number 60402754518-05 in the EU Transparency Register

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Appendix

1. Complexity of the rules

In our view, the rules are complex and will represent a significant and unprecedented administrative challenge, they will have a financial impact for business affected and they will result in additional recruitment costs for in-scope businesses to apply[1].

The collection and recording of the data points needed to calculate any additional top-up tax will prove a significant challenge, given that most businesses do not readily keep foreign entity-level financial statements in the same financial reporting standard as the UPE, or keep details of tax attributes in more than one reporting standard. It would seem that the rules are prepared on the basis that there would be limited effort involved in calculating the ETR and Top-Up Tax by reference to another accounting standard, or that any differences in accounting treatments that might arise would be minimal or immaterial - this is not the case.

In particular it would be helpful to get an understanding of what safe harbour rules the Commission might propose, noting that we are unlikely to see guidance from the OECD on such safe harbours before the end of the year.

2. Compatibility of the Directive with EU secondary law, the Charter of fundamental rights of the European Union and double tax agreements

We note that any EU secondary law instrument, including Council's directives in direct tax matters under Article 115 TFEU, must comply with EU primary legislation and in particular with the Treaty on European Union and Treaty on the Functioning of the European Union as well as the Charter of fundamental rights of the European Union.

When assessing the draft Directive against the freedom of establishment under Article 49 TFEU, we consider that certain differences in the treatment between domestic and multinational groups might trigger discrimination concerns. Firstly, the 5-year reduction of any top-up tax to Nil for large-scale domestic groups creates a difference of treatment with MNE's (although we note it is necessary to ensure equality of treatment with MNE in their initial phase of expansion).

Another area which does not appear to have been expressly addressed, lies in the jurisdictional blending. Indeed, the impossibility to blend the income and taxes between constituent entities located in different Member States result in a difference of tax treatment between international and domestic situations, hence to a possible restriction.

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[1] The Business@OECD ("BIAC") group has already made a submission noting the technical and policy issues which may need to be addressed. PwC supports the views and comments expressed in this document The submission is available here.

Moreover, although we understand that the European Commission considered that the GloBE rules fall into the scope of the freedom of establishment based on the accounting consolidation criteria (e.g. IFRS control test), we believe the free movement of capital could be in point in particular situations. In light of the SGI (C-311/08) and Itelcar (C-282/12) judgements, the compatibility of the draft GloBE directive with the free movement of capital requires further assessment.

PwC believes that the compatibility of the provisions of the draft GloBE directive with the Charter of fundamental rights of the European Union requires thorough analysis (beyond simply the right to protection of personal data). For example, as a result of Article 20(5) of the directive, a company resident in a high tax country having the same amount of permanent differences (i.e. differences between domestic taxable result and the GloBE result, due for instance to exempt income) will be treated differently depending on whether it is in a loss situation (in this case it would be subject to top up tax) or in a profit situation (in this case it will not necessarily be subject to top up tax). This result is due to the mechanical application of the rules. In addition, companies in a loss situation and suffering top up tax have no access to the substance based carve out. We believe there is no obvious reason for such differences in treatment and indeed could lead to a breach of the principle of equality provided for by Article 20 of the EU Charter of Fundamental Rights. This EU Charter has to be observed, insofar as any provisions are based on EU law (cf. ECJ, 26 February 2013, Case C-617/1, Åklagare v Hans Åkerberg Fransson, [2013] ECR I1-05).

Finally, we believe that the GloBE rules could give rise to concerns regarding the norms and rules of customary international law since the rules have extra-territorial effect and thereby potentially encroach on other States Sovereignty.

Under Article3(5) TEU, the EU is to contribute to the strict observance of international law. According to the settled case law of the Court of Justice, when the EU adopts an act it is bound to observe international law in its entirety, including customary international law, which is binding upon the institutions of the EU (see, for instance, Case C-366/10 Air Transport Association of America (Grand Chamber), para 101).

The jurisprudence moreover recognises the established principle of international law that, as an essential feature of sovereignty, a State has absolute and exclusive power to determine taxes within its territory (or related to its nationals) and that any exceptions must be made with the sovereign consent of that State: Case C-58/04 Köhler, Opinion of Advocate General Maduro, para 21.

As a matter of fact, there is a lack of nexus in the application of the rules set out in the Directive between the resident entity paying the tax and the low tax entities on whose profit the top up tax is calculated. The political agreement of October 2021 is in our view insufficient to be regarded as the legal consent of sovereign States and in any event was conditional upon a two pillars solution; the Directive addresses only one of the Pillars.

In summary, whilst as identified above there may be certain aspects requiring further consideration, there has been analysis of the risk of incompatibility with EU primary law, the potential infringement of the Charter and customary international law may require further detailed consideration and PwC suggests the Commission undertake a review of these issues.

It is also necessary to consider the interaction between the Directive and existing intra-EU and third-country double tax agreements. Neither the Model Rules nor the draft Directive consider a mechanism to provide for a parallel adaptation of countries' tax treaty networks to support the top-up taxation mechanism with a corresponding distribution of additional taxing powers. This raises the question as to whether the envisaged top-up taxation (charge to tax) under the IIR and UTPR can be effectuated in tax treaty scenarios (right to tax), both intra-EU and – particularly – in third country scenarios. That is important, because if the treaty compatibility proves problematic here, the complication arises that any Pillar Two top-up taxation charge under domestic law would become a paper tiger in those countries that do not allow for treaty overrides under their constitutional law. To illustrate, the question of the application of the IIR to PE profits requires in some situations to amend the tax treaty between the UPE Member State and the PE state. A number of related issues have been considered in a recent article "Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification".[2]

The legal basis for application of top-up tax under the UTPR and the application of tax treaties would need to be clarified where there is no nexus between a low tax entity and the taxpayer.

3. Request for further guidance on a rolling basis

The guidance issued on the OECD Model Rules clarifies a number of questions that naturally arise as one reads through the Model Rules. It is also helpful that the draft Directive states that the commentary should be used as a source of illustration and in helping to interpret the rules. Given the assurances in the draft Directive that the objective is to align the EU and OECD rules insofar as possible, we would expect that the OECD commentary would be the basis (and not just a source) for interpreting the EU draft Directive, at least for articles that are identical.

However, guidance is needed for specific areas of the EU Directive, most notably where the approach in the draft Directive differs from the Model Rules. Examples include assessing whether a regime can be regarded as a Qualified IIR, or how to create a QDMT.

Providing further practical examples would be very helpful in understanding particular chapters such as Chapters 3, 4, 5 and 9. There are many new concepts (e.g on the adjustments needed to determine the GloBE income, the specific deferred tax accounting rules, the

[2] "Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification", Maarten de Wilde (Erasmus School of Law, PwC), published by Kluwer International Tax Blog and available via [this link].

substance based exclusion) and methodologies included in the draft Directive and further explanations will be needed to ensure taxpayers can apply the rules appropriately and any unintended consequences can be addressed as soon as possible. The OECD has published illustrative examples, but they have not yet been approved by the Inclusive Framework (yet). A set of examples on the application of the EU rules would be very helpful, certainly if they had been approved by the Member States.

PwC suggests the Commission to provide guidance on the application of the sections of the draft Directive that have not been covered by the OECD commentary on the GloBE rules. We suggest that the Commission commit to a process of ongoing consultation and engagement on the practical application of the rules on a rolling basis throughout the initial years of implementation.

4. Deferred Tax Attributes and the Transition Period

A particular area of concern is the deferred tax treatment of assets that are transferred during the transition period.

Article 45(3) of the draft Directive introduces a concept of re-basing deferred tax assets and liabilities at a rate other than the rate at which the assets are reflected in the financial statements (requiring a re-base to the lower of the 15% minimum effective tax rate or the applicable domestic tax rate). This may result in an artificially low ETR for entities that are tax resident in a country with a domestic rate higher than 15%.

The requirement under Article 45(5) of the draft Directive to maintain the transferor's carrying value in assets transferred between entities after 15 December 2021 and before the commencement of a Transition Year, could result in double taxation where tax has been paid by the transferor on the disposal. The rules may impact businesses' ability to get correct recognition for tax write offs for the full amount paid for an asset.

The policy justification for this rule, according to the OECD commentary, is to prevent a tax-free asset transfer between constituent entities creating a step-up in basis for the transferee (to the amount paid for the asset, typically market value) which would allow the transferee to recognise the tax attributes based on the stepped-up amount. However, this is not a sound justification noting that:

1. A transferee would have been able to recognise an increased tax value for the asset had the entity acquired the asset from a third party at the same price and
2. The language used in Article 45(5) of the draft Directive does not refer to a gain, meaning that even if the asset transfer had attracted a taxable gain for the transferor, the transferee is nonetheless precluded from claiming the tax value based on the price paid.

This creates significant potential for double taxation.

PwC suggests that the Commission confirm that this rule will not apply to

transferees in the event that the asset transfer has generated a taxable gain in the hands of the transferor.

5. Qualified Income Inclusion Rule

It remains unclear whether the current or an amended US GILTI regime would be a Qualified IIR for the purposes of the top-up tax calculation and the application of the IIR and UTPR collection mechanisms under Article 51 of the draft Directive. Certainty would be greatly enhanced by eliminating as much subjectivity as possible in the determination of whether a country has introduced a Qualified IIR (QIIR) and/or a Qualified Domestic Minimum Tax (QDMT).

PwC suggests the Commission make available, as soon as possible, a list of the regimes it regards as meeting the criteria set out in the draft Directive.