ICGN
International Corporate Governance Network

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ICGN Response to the Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One

The International Corporate Governance Network (ICGN) is pleased to respond to the Organisation of Economic Cooperation and Development (OECD) Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One.

Led by investors responsible for assets under management in excess of US$34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. Our policy positions are guided by the ICGN Global Governance Principles[1] and the ICGN Global Stewardship Principles (GSP)[2], both of which have been developed in consultation with ICGN Members and as part of a wider peer review. For more information on ICGN please see: https://www.icgn.org.

ICGN, through its Ethics and Systemic Risk Committee, has been engaged in the debate on responsible tax policy from a corporate governance perspective—and through the lens of institutional investors.[3] We understand the concerns – and complexities—that come with defining a fair framework for taxing companies with digitalised business models, allowing them to make electronic sales in one jurisdiction that are produced in other jurisdictions. We appreciate the challenging public policy questions that have given rise to this debate and recognise the systemic risks that relate to tax abuse, including the impact on public sector finances in some jurisdictions and the public trust in business more generally.

ICGN notes that for investors, corporate tax policy can present a quandary. On the one hand, tax efficiency, managed legally, can bolster profitability, at least in the short term. On the other hand, reputational and commercial risks can present themselves at companies that are in fact, or perceived to be, abusing even legitimate tax obligations.

Over time, short term any benefits of tax efficiency might have longer term commercial consequences by negatively affecting brand value and stakeholder relations (customers, employees, civil society,

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[1] See: ICGN Global Governance Principles: http://icgn.flpbks.com/icgn_global_governance_principles_jpn/
[2] See: ICGN Global Stewardship Principles: https://www.icgn.org/sites/default/files/ICGN_Global_Stewardship_Principles_JPN_1.pdf
[3] See ICGN Viewpoint on Corporate Tax Policy (2018) https://www.icgn.org/policy/viewpoints/corporate-tax-policy
And ICGN Viewpoint on Tax Arbitrage (2014): https://www.icgn.org/policy/viewpoints/tax-arbitrage

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governments, and regulators) business that are critical for a company's long-term success. In extreme cases, negative consequences could affect a company's license to operate.

Investors have a stake in the evolving 'responsible tax' debate in at least four respects:

1. as owners of companies that in turn pay tax, investors have a vested interest in any corporate activity affecting profitability;
2. reputational and commercial risks arising from aggressive tax avoidance can form part of the battery of corporate risks investors should monitor and question when necessary;
3. corporation tax can be seen as a 'levy on the profit a company earns for its shareholders' and should therefore be properly viewed as, at least in part, a tax on shareholders;
4. from a broader societal perspective, the tax base of a country is fundamental to the individual country's ability to provide infrastructure, legal protections and social services that help to build and develop an economy and support its citizens. This, in turn, improves markets and provides further opportunities to individual companies.

In sum, taking a long-term perspective, investors expect companies and their boards to take a responsible approach to its tax practices. If a company's business model is dependent in some form on tax minimisation strategies that cynically exploit existing tax loopholes, then long-term investors may determine that the sustainability of that business model may not stand the test of time.

In this context we support the OECD's initiative to develop a robust and fair framework to address taxation of digital businesses. At the same time, we note this is a very ambitious project and involves a technical discussion that extends into details beyond ICGN's own articulated policy positions relating to corporate governance and stewardship. With this caveat, we would like to address questions that the OECD has put forward for public comment.

Scope

It is important to define the scope for this proposal appropriately. We believe the current definition of scope as it stands remains vague and will call for further sharpening. At one level the current definition of "large consumer facing business" may be too broad in that it may encompass companies whose business models are not digitalised in the way that reflects the underlying concerns about tax avoidance/abuse. At the same time, it may be too narrow in its focus on retail business models to individual consumers, while not addressing similar concerns in non-consumer business models.

New nexus rule

Conceptually, there is a clear logic in looking at sales thresholds in individual jurisdictions as a way to approach or define a taxable presence. That is a sensible starting point, though as noted below the great challenge comes in linking these sales with costs in a fair and meaningful way. Companies that come under that scope of this proposal may share certain similarities in terms of conducting digital businesses in many countries; however, they may also be operating in different sectors with differing competitive dynamics and cost structures. This suggests that sales volume alone may be too general or crude a measure to trigger whether or not a company should come under the scope of this legislation.

Profit allocation

The idea of "residual profit" also has conceptual appeal, but as your consultation document notes its definition may be problematic in practice to ensure fair and reasonable outcomes. This reflects the considerable attention in the consultation that is presented in the three tiers of Amount A, Amount B and Amount C – as well as the hypothetical illustration and the details on profit allocation presented in the Appendix. We applaud the depth of this analysis but remain concerned that there will be challenges in defining a fair basis of transfer pricing and profit allocation that is universal to all companies in all business models in all sectors. We also note the complexities this will bring to many companies, and that administrative processes alone are likely to result in incremental costs to address the management of tax liabilities in a wide range of jurisdictions. While increased costs to companies may be inevitable, over time we would hope that greater tax certainty for companies may offset at least some of the financial and administrative burdens that they encounter. But it is of paramount importance both for companies and investors that double taxation of any sort is avoided.

While investors are able to understand corporate finance and to link it to company risk assessments and valuations, they have less line of sight with regard of taxation and it is very difficult for investors to determine whether a company's tax policy is appropriate or overaggressive. Similarly, investors will also face difficulties in assessing the specific merits or deficiencies as presented in Amount A, Amount B and Amount C. Might there be merit for investors, and other stakeholders as well, if the consultation process were to include a third party assessment by an audit firm or independent body to provide a better understanding of the costs and benefits of the proposed Unified Approach?

One of the roots of the current problem relates to policies by some governments to attract businesses to establish a physical presence in their country by competing with lower tax rates. We appreciate the challenges in coordinating agreements between different countries to remove these tax arbitrage incentives.

As long as discrepancies of this nature exist there will be the temptation for corporations to exploit lower rate regimes.

We hope these comments are useful in your deliberations. If you would like to follow up with us with questions or comments, please contact our Policy Director George Dallas: george.dallas@icgn.org

Yours sincerely,

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