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**OECD Secretariat Global Anti-Base Erosion Proposal under Pillar Two: Tax Challenges Arising from the Digitalisation of the Economy**

***Response to the Consultation by the Charity Tax Group***

**2 December 2019**

**Introduction**

1. The Charity Tax Group (CTG) has over 700 members of all sizes representing all types of charitable activity in the United Kingdom. The organisation was set up in 1982 to make representations to charity taxation and it has since become the leading voice for the UK charity sector on this issue.

2. CTG welcomed the opportunity to respond to the consultation on Pillar One and outline our views on Pillar Two below.

3. CTG is not directly affected by this proposal, but our comments are informed by feedback from our members who believe that they are. We have liaised with UK partners including the British Universities Finance Directors Group (BUFDG) and support the detailed representations that have been made on behalf of UK universities.

**Comments**

4. Pillar Two focuses on the base erosion and profit shifting issues that Pillar One does not, and aims to equip jurisdictions with a right to "tax back" when other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation. The consultation, focusing on three main issues, considers:

   - the extent to which financial accounts can determine the tax base
   - the extent to which multinationals can combine income and taxes from different sources to determine the effective (blended) tax rate
   - what carve-outs and thresholds should be considered.

5. Whereas Pillar One was targeting international business activities, there is a risk that the proposals in Pillar Two could be applied to any multinational entity (MNE), whether engaged in business activities or not, without a suitable carve-out. Bearing in mind that the OECD's definition of a MNE for country-by-country (CbC) reporting purposes covers any entity with one or more branches or subsidiaries in another territory, several of the proposals in the Programme of Work set out in Annex B are potentially troubling for charities and other tax-exempt entities:

   - an income inclusion rule
   - the imposition of a minimum or blended income tax rate
   - a tax charge on payments that are deemed to erode the tax base because they are "undertaxed" or not "subject to tax".



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While all efforts are made by the Charity Tax Group to give assistance to its members, it is not qualified to give technical advice on fiscal matters and cannot therefore be liable in any way for any such advice given.

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6. The Charity Tax Group supports moves which tackle tax avoidance and abuse. However, we believe it is also important that measures to tackle avoidance are proportionate and do not have an adverse impact on not for profit organisations like charities. Although the Programme of Work calls for consideration to be given to the appropriateness of carve-outs for specific sectors, it does not suggest that any sector deserves a carve-out. The Charity Tax Group proposes that a carve-out for charities would be appropriate, as we explain below.

***Question 11 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.***

7. UK charities can trade globally in pursuit of their charitable objectives and their UK profits are exempt from tax if applied for charitable purposes. Where charities operate across borders, they are typically faced with the problem that the host country does not accord them a tax status that is equivalent to the charity relief that they are granted in their home country. Consequently, such groups are likely to comprise a mix of tax-exempt and taxable entities. It would be extremely artificial for countries to apply to this type of group structure the new tools that are being designed to counter tax avoidance by MNEs. More seriously, it would risk damage to the growing markets in cross-border charitable services, grantmaking and other forms of charitable support. Its application to the provision of educational activities also needs careful consideration to avoid creating an uneven playing field between different providers in the commercial, charitable and public sectors (e.g. if there were to be a carve-out for state-owned entities this would benefit only universities that are publicly owned).

8. The "income inclusion rule" would seek to tax the income of overseas branches or subsidiaries of UK headquartered charities in the parent jurisdiction, if that income is not subject to tax at a sufficiently high tax rate in the overseas jurisdiction. In principle, this could apply where the overseas branch or subsidiary is also exempt from tax as a charity in its local jurisdiction. We understand the intended effect of the income inclusion rule is to protect the tax base of the parent jurisdiction. However, given the relevant tax base in the parent jurisdiction is exempt from tax, there is effectively no tax base to erode in the parent jurisdiction.

9. The "tax on base eroding payments" could deny tax deductions or treaty benefits on payments to UK charities as they would not be subject to a sufficiently high effective tax rate in the UK. For UK charities that trade through overseas affiliates the proposal could result in disproportionate withholding tax charges (with no credit in the UK), or disproportionate disallowances at the local rate for local tax purposes. It is not clear whether Pillar Two catches payments from third parties (there is a note of a "risk" at 1(d) on page 35); however, if in scope, remittance from overseas of investment returns on endowment funds could similarly attract significant levels of overseas tax. To the extent that the host country is at risk of its tax base being artificially depleted by payments to a foreign parent charity – which is the real concern of some countries but in practice may be a relatively unlikely scenario – we would argue that the more appropriate remedy is for the country concerned that such a risk really exists to levy a withholding tax on targeted payments that complies with the existing principles of international tax policy.

10. While charitable exemptions differ around the world, they are generally considered to be in the public interest. Many countries recognise the desirability of supporting non-profit organisations by granting

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some degree of tax exemption. Tax reliefs support the work of charities and allow them to amplify the public benefit they provide. We believe, therefore, that excluding charities from the Pillar Two requirements would allow them to sustain their existing level of activity to the wider benefit of society. The application of a minimum or blended tax rate to a group including charitable entities is likely to produce an artificial result and risks undermining the home country's policy of granting tax privileges to entities that genuinely pursue charitable activities. This would be the case whether the additional tax is imposed on a charitable parent entity or a taxable subsidiary, since the subsidiary's activities are ultimately intended to fund or otherwise further the charitable activities of its parent.

11. We would propose that such a carve-out could be operated by referring to the tax administration in the home jurisdiction to confirm that the taxpayer's income is not subject to tax under a domestic legislated exemption for charities, in the same manner that certificates of residence are issued under the existing treaty network to exempt or reduce withholding taxes on certain cross-border payments. Alternatively, a whitelist or approved exemption regimes could be agreed. The UK currently has legislation in place (sections 259A to 259NF TIOPA 2010) to counter the use of payments with a hybrid character to deplete its tax base, but these include a carve-out for payments that are not taxed in the recipient's hands as a consequence of its charitable status. So far as we are aware, charities have not encountered problems in the application of these rules so I would suggest that this approach is suitable for adoption by other countries. Some care is required in the definition of a recipient that is eligible for a carve-out because, for example, a "subject to tax" test would be prone to differing interpretations by different countries.

12. We think that a charitable exemption is the most appropriate way forward, but, if this is not possible, one possible approach could be to introduce a *de minimis* carve-out for smaller MNEs. This might take the form of a minimum annual revenue (income plus capital gains) threshold similar to the €750m threshold for CbC reporting, which would be likely to take all but the largest charities out of scope. However, the consequences of breaching a size threshold under the Pillar 2 proposals would be far more costly for the charity than merely having to file a CbC report, and the question why a charity should be penalised on account of its size needs to be asked.

**Charity Tax Group**
**2 December 2019**

***To discuss any of these responses in further detail please contact 02072221265 or [info@charitytaxgroup.org.uk](mailto:info@charitytaxgroup.org.uk)***