

## **Subject 1: Group approach and separate entity approach in domestic and international tax law**

During the panel held on the 5<sup>th</sup> of September, the panelists addressed the fundamentals and the implications deriving from two of the main approaches inspiring international and domestic tax rules: the group approach and the separate entity approach.

In fact, most of the current domestic tax systems were developed under a separate entity approach, which has become a globally recognized standard of corporate taxation and relies on the arm's length principle. The group approach has been considered, to some extent, at the time of updating said tax systems to the latest international tax developments in view of the globalization of the economy and the increase of transactions between related parties.

The discussion started with the intervention of the German Secretary of Finance, who highlighted how digitalization is impacting taxation, insisting on the need to review the current tax rules to achieve a fair taxation worldwide. Said review of tax rules may imply a shift towards a group approach, which is the thinking behind the rules within Pillars I and II, although those pillars do not aim at fully replacing the separate entity approach.

On this matter, the general reporters have concluded that the current tax systems already combine rules, which are based on the separate entity approach and on the group approach, with a tendency towards the group approach at the time of enacting new tax rules. The same holds true with respect to the latest developments at OECD, EU and US levels. It was also raised that the co-existence of both principles may cause distortions leading to situations of double taxation, higher administrative and compliance costs, as well as generate inconsistencies and complexity for the concerned groups.

Developing countries do not have an objection in principle against the group approach. However, they state that some of the latest developments based on this approach, i.e. Pillars 1 and 2, contain elements of particular concern for their tax systems. "Developing countries generally welcome Pillars 1 and 2 solutions but they suggest reviewing and extending the scope of some of the rules in both pillars to meet their tax policy interests to the largest extent possible". However, developing countries generally prefer a tax system based on withholding taxes and on a proper transfer pricing regime, rules which are rather based on the separate entity approach.

The main preliminary conclusions from the analysis, as presented during the session, could be summarized as follows:

- The separate entity approach bears risk of double (non)taxation and gives international tax planning leeway to erode the tax base in source jurisdictions;
- The group approach appears simpler on the surface but there are challenges in the detail and it may (i) fall short of the tax policy objectives; (ii) not stabilize the international tax environment; and (iii) cause important distortions against the tax neutrality.

In conclusion, important work has been done with respect to the transition from the separate entity approach to a more group approach-based tax system, but there is room for further developments and improvements. It is however clear to most of the panelists that the group

approach will not totally replace the separate entity approach. It is therefore likely that both approaches will continue to co-exist for the foreseeable future.