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DIGITALEUROPE's Submission to the OECD Public Consultation: Reports on the Pillar One and Pillar Two Blueprints

Introduction

DIGITALEUROPE is the leading trade association representing digitally transforming industries in Europe. Our membership represents over 35,000 businesses who operate and invest in Europe. It includes 77 corporations which are global leaders in their field of activity, as well as 40 national trade associations from across Europe.

DIGITALEUROPE strives for a Europe where digital technologies, innovation and artificial intelligence can provide Europe's people with competitive jobs, better health and better public services. We stand for a regulatory environment that enables European businesses and citizens to prosper from digital technologies. We wish Europe to grow, attract and sustain the world's best digital talents and technology companies.

DIGITALEUROPE has followed the work of the OECD Inclusive Framework on BEPS since its inception, and wishes to continue being a positive partner as this work continues. We fully support OECD efforts towards renewing tax systems at the global level to make them fit for the digital age.

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General comments

- DIGITALEUROPE welcomes the ambitious work and important progress made by the OECD Inclusive Framework to achieve a multilateral consensus-based solution in mid-2021, with the aim to sustainably address the tax challenges arising from the digitalisation of the economy.

- We commend the members of the Inclusive Framework for attempting to develop a unified taxation approach for consideration by 137 jurisdictions based on corporate profits rather than gross revenue.

- DIGITALEUROPE urges the Inclusive Framework to redouble efforts to find political consensus, which is necessary before deciding on the appropriate technical guidance for either Pillar.

- DIGITALEUROPE believes that as part of the consensus on Pillar 1 and Pillar 2, there should be explicit agreement from all countries to remove existing and proposed Unilateral Tax measures and not to implement any such measures in the future. This commitment should be backed up by clear mechanisms (e.g. a list of measures to be phased out), and become binding as of agreement, rather than at implementation.

- DIGITALEUROPE underscores that a comprehensive and coherent reform of the international taxation system will promote legal certainty, reduce disputes and avoid risks of double taxation.
- In order to underpin these reforms, DIGITALEUROPE calls for strong dispute resolution mechanisms for both Pillars, such as mandatory binding arbitration, to resolve disputes in both a clear and timely manner.

Detailed comments

Pillar 1

The Blueprint guidance is not always clear on the underlying principles behind the proposed Pillar 1 rules. Simplification, while an important objective, is not a principle that should automatically override the proper application of existing tax principles.

The activity test to define the scope of Amount A

- DIGITALEUROPE believes that any Pillar 1 solution should not "ring-fence" the digital economy. A clear and unambiguous scope is required to enable certainty for tax authorities and taxpayers alike.
- Inclusive Framework countries should look for opportunities to simplify these proposals without requiring ring-fencing.
- The Blueprint discussion of the positive and negative lists to simplify the determination of in-scope and out-of-scope activities suggests that individual jurisdictions will be able to make unilateral changes to these lists. This will greatly increase uncertainty, disputes, and the potential for double taxation.
- The scope of Amount A should not discourage investment in digital innovation, productivity tools, or energy and carbon efficient technologies. An exemption should be considered for business-to-business (B2B) transactions in the digital space, similar to that proposed in the non-digital space. Such an exemption should apply to both licensed business software and cloud computing services. The latter should be considered productivity tools and do not fit within the criteria for inclusion in Amount A. All cloud service businesses are digitalised so there is no competition with non-digitalised businesses. The whole economy will become digitalised and will become increasingly reliant on cloud services for growth.
- Dual use intermediate products and components are predominantly sold to businesses for integration into end products, and therefore should be

entirely excluded from Amount A. The Blueprint's articulation of the policy underpinning Amount A recognises that components incorporated into a finished product should be out of scope of Amount A. To the extent that the product itself is a component, the business is unlikely to have engaged with the market jurisdiction end-users. Just like the Blueprint concludes that finished goods are fundamentally consumer-facing, the inverse should also be true: that component parts are fundamentally business-facing, and appropriately out of the scope of Amount A. We also note that sales of dual use intermediate products and components to consumers are typically effectuated through multiple intermediaries. In such a scenario, the multinational enterprise (MNE) will face serious compliance challenges arising from its inability to separate consumer sales from business sales.

The design of a specific Amount A revenue threshold

- DIGITALEUROPE agrees that it is important for Tax Administrations that Amount A is limited to a manageable number of multi-national groups. We support the use of appropriate revenue thresholds to provide certainty to business so that they can easily determine whether they are in-scope. The thresholds need to be carefully determined so that they do not result in a concentration of in-scope businesses from the digital sector, or of businesses located in a particular country.

- Whilst we understand there is no political agreement on the outline or allocation formula, we noted the repeated use of one formula as an example (20% of the MNE's profits in excess of a 10% profit margin). Consistent with our understanding of the purpose of this effort, adoption of this formula would not result in an allocation of a "modest" portion of non-routine marketing intangible returns to the market. The simplified profit allocation formulas should be based on principles in order to be sustainable. The simplified allocation factors (e.g. a percentage of revenue) should be determined primarily by the application of the "arms-length" principle.

The development of a nexus rule

- The Pillar 1 Blueprint establishes a new concept of enhanced nexus, granting taxing rights to countries where businesses do not necessarily have a permanent establishment. Implementing this approach will require changes to tax treaties and countries' domestic law.

- We believe the treaty changes creating this new nexus rule should explicitly state that the rule is purely for the purposes of Amount A and does not create nexus for other tax purposes or any other non-tax or regulatory purposes. In this regard, we welcome the clarification in paragraph 189 of the Blueprint and recommend that VAT is explicitly added as an example.

- We note that having a higher nexus standard for Consumer Facing Businesses (CFB) compared to Automated Digital Services (ADS) risks reinforcement of ring-fencing. If ADS and CFB are both in scope, both should have "plus factors" which should be limited to those that are clearly related to marketing/sales functions.
- If already compensating an in-market entity above the common return a Limited Risk Distributor would earn, the affiliate is already compensating the market for a nonroutine return, and the marketing and distribution safe harbour should minimise or eliminate any incremental Amount A reallocation to the market.
- The Inclusive Framework must also agree that the profits reallocated under the Pillar 1 rules should not create any deemed payment transaction. Implementation of Amount A should not allow countries to assert deemed payments to which VAT, WHT, or other taxes are applied.

The development of revenue sourcing rules

- DIGITALEUROPE believes that the revenue sourcing rules should be consistent with the information MNEs already collect and not require the collection of additional data solely for the purpose of compliance with Pillar 1. In addition, the requirement to use or retain personal data needs to be consistent with privacy rules e.g the GDPR in the EU.
- The location determination made for the purposes of Sales Tax or VAT should also be acceptable for the purposes of Pillar 1.
- DIGITALEUROPE welcomes the simplifying changes to the sourcing hierarchy along with elevating the customer billing address indicator to the number 2 position in the list. The recognition in the outline that customers/users can refuse to provide location data should push geolocation lower in the hierarchy.
- Companies should not be required to rely on information collected by, and passed to them by, another taxpayer to determine sourcing. Even if such an obligation to collect and transmit such data does not violate privacy (e.g EU GDPR) requirements, it is not likely that current agreements with third parties allow MNEs to request such information. Accordingly, including such a requirement would lead to significant administrative costs for both parties e.g, to collect, store and process additional data, and renegotiate contracts. Indeed, the obligation to gather this data would be virtually impossible for companies to fulfil, to the extent that the relationship

between an MNE and an intermediary is such that the MNE does not normally collect or track information from such intermediaries that would enable it to determine the jurisdictions into which products are ultimately sold, and the extent to which they are ultimately sold to consumers. Current taxation regimes already allow market jurisdictions to tax retailers who are generating income in those jurisdictions from the sales of physical products, and who have perfect visibility into the location of the end user. Thus, revenue sourcing rules should exclude products sold through intermediaries. In addition, its likely legislation changes would be required in some countries so that collecting and handing over the data to the MNE is acceptable.

The framework for segmenting the Amount A tax base – segmentation

- DIGITALEUROPE supports the Blueprint's expressed objective of minimising the need for segmentation to increase simplification in the application of the Amount A rules. The general default rule should be for MNCs to use global consolidated financial statements as the basis for their amount A allocation computation.
- Segmentation should be allowed at the option of the taxpayer. It should only be mandated if necessary to accomplish the objectives of Amount A, or to eliminate competitive distortions. In such cases it should be based on the MNC's public financial reporting segmentation.

The scope and relevance of possible double counting issues arising from interactions between Amount A and existing taxing rights on business profits in market jurisdictions.

- Amount A should not result in double taxation nor the market jurisdiction being excessively or "over" rewarded. If a business is already in a country and compensating the country at an appropriate "arms-length" amount, no additional return should be allocated to the market.
- DIGITALEUROPE welcomes the inclusion of a sales and marketing safe-harbour. A mechanism to eliminate double counting and double taxation by imposing a cap on the Amount A re-allocation is a critical component of any agreement but more refinement is required. In order to eliminate double counting, its important to clarify the point at which the marketing and distribution profits safe harbour applies
- The mechanism for determining taxing rights under Amount A should take into account Withholding taxes levied by the market jurisdiction. If a market Jurisdiction wishes to participate in the Amount A allocation it should agree

to dis-apply its withholding taxes. If it fails to do so, it should not benefit from an Amount A allocation.

- If withholding taxes are maintained then they should be creditable as follows: the extent that withholding taxes relate to the revenue generating nonroutine profits in the local market jurisdiction, they should be applied against local tax on the Amount A re-allocation.
- A withholding tax on royalties (and in-scope dividends) by definition is a return in the market and should be credited against amounts otherwise due under Amount A.

The development of a process to identify the entities in an MNE group that bear the Amount A tax liability (the paying entities) for the purpose of eliminating double taxation

- For double taxation to be avoided, it is crucial that the Amount A rules are clear, unambiguous, free from interpretation, consistently applied and the agreement adhered to by all members of the Inclusive Framework.
- The Blueprint recommends that both the exemption and credit methods may be used, which will create confusion. DIGITALEUROPE favours an exemption approach and does not support a credit system. An exemption approach would bias towards simplicity whereas a credit approach will be unnecessarily complex and will inevitably lead to double taxation.

The issue of scope of Amount B and definition of baseline marketing and distribution activities

- DIGITALEUROPE believes that in order to obtain certainty and simplification through Amount B, the definition of baseline marketing and distribution activities should be sufficiently broad to minimise the likelihood of market jurisdictions asserting more revenue due to additional functions being performed in the market that are not included in the Amount B scope.

The appropriate profit level indicator for calculating Amount B, and how it should be calculated assuming Amount B is based on a narrow scope

- The Amount B profit level indicator should be consistent with the “arms-length” principle and should cover the vast majority of local country affiliates which is also important for an effective marketing and distribution safe harbour.

- We note that agreeing a fixed percentage for Amount B for all situations will be extremely complex. Therefore, the specified percentage returns under Amount B should not be designed to apply to all different fact patterns or be mandatory. If the facts are non-standard or outside the definition, then existing transfer pricing principles should apply.
- In addition, if countries cannot agree on Amount B this should not prevent the remainder of the Pillar 1 solution being agreed to and implemented.

The development of an early tax certainty process to prevent and resolve disputes on Amount A

- The suggestion for a phased approach, beginning with the largest MNEs, should only be considered if applied on a voluntary basis. DIGITALEUROPE has concerns about how this approach would be implemented - without bias against sectors such as digital, or specific jurisdictions - particularly without a testing phase..
- The Amount A review and determination panels must be conducted under confidentiality rules and information should not be used for other purposes.
- It is important for the MNE's lead tax administration to participate in the determination panel under rules that do not allow other countries to override the lead tax authority by majority vote. A single aggressive country could delay and thwart review and determination panels.

The introduction of new approaches to provide greater certainty beyond Amount A

- In order to underpin any of these reforms, DIGITALEUROPE calls for strong dispute resolution mechanisms for both Pillars, such as mandatory binding arbitration, to resolve disputes in both a clear and timely manner.

Pillar 2

General comments

The world is currently enduring a global financial crisis due to the COVID-19 pandemic. As a result, the need for pro-growth tax policies is particularly acute. In order to minimise the negative effects on cross-border trade and investment, the scope of Pillar 2 should be limited and the minimum tax rate should be low.

The Economic Impact Assessment found that the impact of Pilar 2 would largely fall on MNEs engaging in profit shifting. We understand the assessment largely utilises data from 2016 and 2017 which pre-dates implementation of many of the BEPS measures as well as US Tax reform. Accordingly, the impact assessment should be updated using more current data so that the aforementioned developments can be fully evaluated before implementing further onerous provisions.

For international tax rules to be stable and sustainable they must be underpinned by sound principles. The stated aim of pillar two is to address remaining BEPS issues. A global minimum level of tax was not a part of the BEPS initiative and the foundations on which Pillar 2 is built are not clear.

There is no discussion of the minimum effective tax rate. This would appear fundamental to the proposal and should be subject to consultation.

Although the inclusion of proposed simplification measures is welcomed, they do reinforce that the Pillar 2 proposals are extremely complex and will be difficult and costly to administer.

Given the objective of simplification, a global blending approach for the IIR under Pillar 2 would be preferable to a jurisdictional blending approach. Streamlined compliance and simplified administration would be significant benefits to adopting a global blending approach. Jurisdictional blending imposes significant complexity into the regime. It would be worthwhile to consider global blending, potentially with other changes to the GloBE rules, in order to achieve similar results.

GILTI co-existence

- US companies are subject to the GILTI regime which imposes a minimum tax on global intangible income. The Blueprint suggests that GILTI may be considered a compliant Income Inclusion rule for the purposes of the GLoBE rules. For simplicity, it would be more appropriate to treat GILTI as a compliant rule for the purposes of the GLoBE (i.e., for the Income Inclusion Rule, the Undertaxed payment rule, and Subject to Tax rules). Based on the Secretariat’s own observation that GILTI is a more onerous provision and raises more revenue than GloBE, a comprehensive exception for GILTI taxpayers should be consistent with the Pillar 2 objectives. Similarly, other existing rules which have a similar practical effect as the Income Inclusion Rule should also be grandfathered.

- Assuming it is determined that GILTI is a compliant income inclusion rule, there needs to be clarity around how GILTI would co-exist with Pillar 2. What would cause GILTI to cease to be a compliant regime? Would minor amendments to the GILTI regime invalidate the exemption? Are there certain features of GILTI that must be retained to maintain the exemption?

ETR Calculation

- Due to the materiality of capital-related timing differences across all industries, it is of utmost importance that the ETR calculation rules provide a solution to address timing differences and to reduce the required amount of work for the credit and carry-forward rules.
- While DIGITALEUROPE believes that either the DTA approach or adjustment of the ETR for tax depreciation could address timing differences related to accelerated depreciation, we note that the DTA approach is more suited to comprehensively address timing issues arising from book tax differences in general and to address non-timing related book tax differences. However, given the complexity and challenges with either method, a robust carry-forward regime needs to be maintained to address remaining issues.
- We would prefer to generally rely on deferred tax accounting principles in dealing with temporary differences, because of the countervailing simplicity offered. The deferred tax model is not without its challenges. Therefore, a carry-forward regime will still be required for some taxpayers. In addition, guidance would need to be developed to deal with adjustments necessary in this model just as with any other model. Some of the key items that would need development include removing the impact of valuation allowances and addressing non-recognition of deferred taxes, addressing uncertain tax positions, changes in statutory tax rates, foreign exchange, deferred taxes related to OCI, and addressing initial recognition exceptions.

Formulaic carve-outs

- The formulaic carve-out for tangible assets should be based on the carrying value of the assets rather than on depreciation. A return-on-assets approach provides a robust method for determining a routine return to business investment. This is recognised by the OECD Transfer Pricing Guidelines, which provide that a return on assets is appropriate in evaluating the profits of manufacturing or other asset-intensive activities, and that cost-based indicators should be used only in those cases where costs are a relevant indicator of the value of the functions, assets, and risks of a business. A return-on-assets approach is also consistent with sound economic and finance theory (pursuant to which returns are earned on investments, not expenses). While there is a mathematical relationship between depreciation expense and carrying value, a “routine” markup on depreciation expense is likely to fall far short of a routine return on the carrying value of long-lived assets in a capital-intensive business.

Simplification measures

- If the Effective tax rate of an MNE on a consolidated basis is above a certain threshold, the Pillar 2 provisions should not apply, since the objective of ensuring an appropriate level of taxation would already be met.
- The Blueprint indicates that the Inclusive Framework is considering a simplification measure based on the Country-by-Country Report (CBCR). The CBCR report is solely a high- level risk assessment tool and the information included is prepared on this basis. Were the CBCR data to be used to comply with the Pillar 2 proposal, as indicated in the Blueprint, a number of adjustments would be required to the data before it would be meaningful. Accordingly, utilising CBCR data is unlikely to lead to reduced compliance costs or efficiencies. In addition, once the adjusted CBCR data is made available, it may be used by Tax Authorities for purposes for which the report is not intended, leading to more disputes and unintended outcomes.
- The Blueprint suggests the use of Administrative guidance as a simplification measure in those jurisdictions with a tax base similar to the GLoBE and a sufficiently high rate. This would be a welcomed simplification. Consideration should be given to whether administrative guidance could also be extended to cover the Subject to Tax Rule.

UTPR

- UTPRs should not be applied to payments to the UPE of an MNE. First, the objective of Pillar 2 is to ensure a minimum level of tax on foreign income earned by MNEs so as to address remaining international base erosion and profit shifting issues. The home jurisdiction of an MNE typically is the center of that MNE's economic interests and the place of ultimate management of the MNE. The home jurisdiction is more appropriately considered to be the natural location of the residual profits arising from the operation of the business, rather than a place to which profits are shifted to minimise tax.
- Second, and relatedly, while all jurisdictions have a sovereign right to determine their own tax systems, that right is especially pronounced with regard to the system for taxing resident MNEs (as recognised implicitly by the design of the IIR, which permits the home jurisdiction of an MNE to impose a top-up tax on low-taxed foreign subsidiaries). The home jurisdiction of an MNE should have the right to determine the appropriate manner of taxing the domestic income of its resident UPE, balancing revenue concerns with tax incentives to encourage positive economic activity within its jurisdiction. Applying the UTPR to payments to UPEs

would inappropriately encroach on the right of the home country to balance these domestic policy interests.

- An obvious solution to this issue is to exempt payments to UPEs from the UTPR. To the extent there is a concern that such an exemption could facilitate profit shifting, for example in cases in which the UPE is not located in a jurisdiction that represents the center of its economic activities, targeted rules can be designed to mitigate such concerns. For example, the exemption for payments to UPEs can be limited for UPEs located in jurisdictions identified as “investment hubs” by the OECD (FDI to GDP of 125%), unless the UPE’s activities in its home jurisdiction met objective substance-based criteria (e.g., relative headcount or tangible assets).

Subject to Tax Rule

- The Subject to Tax Rule (STTR), which applies in priority to the GLoBE rules, would levy a gross basis withholding tax on a wide range of payments. As such it sets a bad precedent and represents a departure from long-established principles for profit-based taxes advanced by the OECD. It will likely lead to double taxation.
- The STTR is not a minimum tax provision and as such does not fit well with the objectives of Pillar 2. We would recommend it is removed from Pillar 2 and presented as an optional provision that bilateral treaty partners can decide whether to adopt.
- There is consideration being given to expanding the scope of the payments covered by the STTR. The scope is already wide, and its application should be narrowed (e.g. limited to interest and royalties) and a clear articulation of why such payments are included within its scope.

Certainty and administrability

- The proposed Pillar 2 rules are extremely complex. They will be difficult and costly for companies to implement and for tax authorities to administer.
- The provision of certainty and elimination of double taxation requires all tax authorities to interpret and implement the Pillar 2 rules in the same way. Will it be possible to avoid disputes given the complexity and breadth of the proposed rules?

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About DIGITALEUROPE

DIGITALEUROPE represents the digital technology industry in Europe. Our members include some of the world's largest IT, telecoms and consumer electronics companies and national associations from every part of Europe. DIGITALEUROPE wants European businesses and citizens to benefit fully from digital technologies and for Europe to grow, attract and sustain the world's best digital technology companies. DIGITALEUROPE ensures industry participation in the development and implementation of EU policies.

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