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Comments

wts global

The OECD Proposal for a new tax order

Comments on the of the Secretariat Proposal for a "Unified Approach" under Pillar One

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Summary

The tax challenges of the digitalisation of the economy were identified as one of the main areas of focus of the Base Erosion and Profit Shifting (BEPS) Action Plan, leading to the 2015 BEPS Action 1 Report. Policy discussions on those challenges remain an important part of the international agenda. The OECD/G20 Inclusive Framework on BEPS provides for two pillars to be developed with a consensus solution to be agreed upon by the end of 2020. Pillar One focuses on the allocation of taxing rights and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules. The proposals articulated so far, would entail solutions that go beyond the arm's length principle. To help expedite progress towards reaching a consensus solution to Pillar One issues, the Secretariat prepared a proposed "Unified Approach" for public consultation.

WTS Global has taken advantage of this opportunity to comment on the proposed "Unified Approach" to deal with Pillar One.

I Overall comments and fundamental issues

In this section we provide our overall comments in respect of the Consultation Document, and highlight our key concerns with what may constitute fundamental issues.

A A global 'solution' to which issue?

Firstly, we understand that the OECD wishes to establish global consensus for reshaping the global tax landscape, and thereby preventing unilateral measures. We are very much in favour of the OECD taking a firm position against such unilateral measures as they undermine the consistency, reliability and certainty in taxing principles that are essential for international cross-border trade and investment.

The OECD should therefore continue to facilitate discussions between governments in their efforts for reaching global consensus on the subject matter, based on a thorough analysis (e.g. impact of the policy changes proposed) and taking into account the (future) full effect of the earlier BEPS initiatives to better align taxation with value creation internationally, as this alignment of taxation with value creation and the tax challenges of the digitalisation of the economy do not appear to be the main guiding principles of the Consultation Document.

We are wondering how an equitable solution can be found to a problem that apparently cannot be delineated accurately. We urge the OECD to not forego the evidence-based analysis for defining the issue precisely, taking into account the aforementioned effects currently being deployed, before developing a 'solution'. We also ask the OECD to focus on and be transparent in communicating the (evidence-based) impact assessment (of the proposals), and link it to the 'issue(s)' that are believed to be 'solved' in the next stages of the project.

B About timing and legitimacy

Secondly, building further on the aforementioned issue, we believe that the time path given to the OECD is overly optimistic. Implementing such significant changes to the international tax landscape without proper analysis would most likely lead to unexpected effects and increased uncertainty and complexity – resulting in more tax disputes.

Also, we are of the view that it would be more appropriate to **have the effects of the earlier BEPS initiatives, and in particular in relation to transfer pricing (Actions 8-10) fully incorporated and reviewed,** before 'adding' another layer of complexity. In essence, the updated transfer pricing guidelines provide for a justified basis, or at least carry the potential to resolve the issues of double non-taxation and double taxation in most cases. Therefore, we would suggest awaiting the analyses and review of the implementation thereof to define the remaining issues, if any.

In conclusion, if there continues to be no agreement about having a reasonable timeline to (i) review earlier BEPS measures, (ii) provide for an evidence-based analysis to accurately delineate remaining issues (if any), and if then required (iii) discuss actual solutions to genuine issues, we foresee problems with the legitimacy of the proposal discussed today, and any robust, consistent and equitable change to the global tax system that is acceptable for all.

Indeed, what lies on the table now has far-reaching consequences in this regard. Today, an entity non-tax resident of a certain country is taxed by this country based on territoriality and, thus, a territorial connection (link) with the hosting country justifies the exercise of taxation. With the lack of any link of the activities carried out by the entity with the country, the exercising of taxation by the latter would represent an arbitrary act (i.e. an act of expropriation rather than an act of taxation). The link is a limitation of the taxing rights of the countries and it is generally accepted that it should be drawn to reflect the use of the public services made available by the country, and as a means to have the non-resident participating in the public expenses in connection with the "contribution duty" that everyone has with respect to the community to which it is linked and for the public services to which it has access.

C Minimum requirements for any solution

Notwithstanding, we have major concerns in view of the timing and legitimacy of the proposed "solution" to the "issue". We assume that the political agenda and decision-making forces have a broader basis than merely solving BEPS issues.

In this respect, we have treated the willingness of the governments to come to a conclusion as a given, assumed the Pillar One initiative to be a zero-sum game, and, despite our concerns, have formulated the following minimum requirements for a Pillar One solution from the stance of corporations involved in cross-border trade and investments:

- Any "solution" should be **equitable** and **flexible:**
  - From an individual country perspective:
    - A broad consensus is required amongst all members of the Inclusive Framework.
    - The OECD should provide all members with an evidence-based impact analysis on a per jurisdiction basis so that all members can make an informed decision. Such analysis should also be made public (and open for comments).
    - The impact analysis should not solely be based on the impact of expected tax collection, but also on the level of (a.o.) foreign direct investments, overall competitiveness, investment in future technologies in particular, etc.

  - From a globally competing corporate perspective:
    - Whereas the digital economy is not to be ring-fenced as it may be in competition with traditional economy, or de facto as many corporates run hybrid business models (clicks & bricks), the solution should be grounded in the key BEPS principle of ***value creation*** for the company concerned, rather than arbitrary measures that may distort competition and/or sound investment decision-making which would be harmful to the economy on the whole and may raise issues in terms of discriminations.
    - Where a company can demonstrate that the targeted rules (in view of the importance attributed to 'market jurisdictions' under the proposed Unified Approach) do not reflect (in full or in part) the reality of their value creation (i.e. that the company cannot derive value and accordingly no profit from the market jurisdiction as such), a company should be able to substantiate such a position in order for the targeted rules to be not (fully/partially) applicable, and preferably such position can be ruled in a multilateral advance tax ruling amongst jurisdictions involved or can be subject to multilateral binding arbitration to ensure each profit is taxed no more or no less than once.

- Any "solution" should be **unambiguous** with a primary focus on **principle-based certainty:**
  - In order for new rules to be unambiguous, in our view they should be ***simple.***
  - Unambiguous rules are also the prerequisite for ***certainty.***

- Any "solution" should be **proportionate** and **effective:**
  - As stated before, the current state of the Consultation Document and state of non-consensus on scope in particular, clearly is an indication of the inability to define the taxation issue. For a solution to be proportionate to the issue it intends to resolve, first a precise (evidence-based) delineation of the taxation issue is to be agreed upon.
  - Proportionality and the effectiveness of the proposed rules in view of the envisaged issues to be resolved, must be included as key parameters in the impact assessment referred to above.

- Any "solution" should be **sustainable:**
  - The existing principles of international taxation, such as taxation of business profits, taxation on the basis of representation / presence, and the arm's length principle, have been well-founded and have a long track record, whilst being subject to review periodically without altering the foundation on which they are based.
  - A significant reform of the international tax system's underlying principles should be reviewed against sustainability – ***stable*** and ***lasting*** – over a long period of time, avoiding the need to review the underlying principles themselves.

- Any "solution" should limit the **administrative burden** that such reform brings, and provide for a **transition period** in which companies can adopt their business models to such new rules without adverse consequences:
  - We assume that new taxing rights will bring an increased administrative burden. Such administrative formalities should be minimised to the highest extent possible. We suggest that a simplified and globally consistent filing form is provisioned.
  - Where the Unified Approach results in a nexus in many countries for MNEs, leading to registration and filing obligations in all these countries, the related increased costs could lead to a lower readiness to be compliant.

- We suggest introducing a one-stop-shop solution like the VAT MOSS or the filing for CbCR. Furthermore, the number of responsible taxpayers within a group should be as low as possible. As a standard rule, the group or business line parent could be defined as a responsible taxpayer, with alternatives to nominate others – comparable to CbCR.
- It is also crucial to have a simultaneous implementation by all jurisdictions, but also a clear and lean implementation scheme to facilitate the application by taxpayers, the control by tax authorities and the dispute resolution by tax courts.
- Furthermore, an adequate balance should be found between accuracy and applicability of the tax collection process.
- Finally, such a substantial change to the underlying principles of international taxation as envisaged under the Unified Approach today should provide for a transition period that gives affected companies the chance to review their business models in advance without triggering adverse consequences (in terms of exit taxation and business restructurings).

D Comprehensiveness of the current proposal

Notwithstanding, we have expressed our fundamental concerns above. These relate to providing for any solution for the alleged problem, and do not solely concern the Unified Approach as such. In respect of the Unified Approach proposed in particular, we wish to address the following fundamental concern we have in view of how this proposition fits into the historic evolution of the arm's length principle (ALP).

Since the first edition of the OECD TP Guidelines in 1979 through to the one in 2010, the ALP has been fixed as the principle, resolving any issue about transfer pricing, and the ALP has been constantly defended as the natural opposite to global formulary apportionment (GFA) methods, constantly rejected by the OECD. Effective 2015 with the outcome of BEPS, it seems to us that there is a tendency to weaken the ALP, encouraging a wider use of profit split, revising the role of dependent agents, the non-consensus draft on financial transactions that includes non-arm's length propositions, and (refutable) presumptions that are not in line with the general guidance on the ALP as contained in the latest version of the OECD TP Guidelines.

It seems clear to us that the Unified Approach as proposed opens the doors to GFA methods even further. If this would be the direction of choice, i.e. that the world indeed should move to GFA and make the ALP redundant, it is in any case necessary that the transition is clear and wide. Arguments to introduce GFA partially, just for particular businesses, and not for any other business are very weak at least under three different points of view:

- What is the delimitation of the businesses impacted and those not impacted? How could this differentiation be justified?
- Are there concrete arguments to sustain the needs of two opposite alternatives (ALP vs GFA)? In other words, if GFA now works for certain kinds of business, concretely, why should it not work for others?
- The existence of such two opposite models (ALP vs GFA) significantly increases the risk of double taxation.

Therefore, the OECD should make a comprehensive (evidence-based) analysis on the ALP vs. GFA, and on that basis inform the stakeholders of a comprehensive decision – that is, not ALP for one sort of business, and GFA for other types of business – or, as is the case with the Unified Approach proposed, to go further with what seems to be a mix of both. The introduction of a parallel system or mix of systems brings additional complexity and uncertainties that are not desirable.

A contemplated change to such an extent deserves a fundamental analysis and discussion, and a lasting and clear way forward, whereas at present the agenda is unclear as to where the reforms will end.

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Irrespective of the aforementioned fundamental concerns we have, and the significant list of minimum requirements that a solution should entail in our view, we will address the specific questions raised in the Consultation document hereafter. Our comments are therefore inherently limited to the Unified Approach as referred to in the Consultation Document.

II Our topical answers to the questions raised in the Consultation Document

1 Scope. Under the proposed "Unified Approach", Amount A would focus on, broadly, large consumer (including user) facing businesses. What challenges and opportunities do you see in **defining and identifying the businesses in scope,** in particular with respect to:

- **a** their interaction with consumers/users;
- **b** defining the MNE group;
- **c** covering different business models (including multi-sided business models) and sales to intermediaries;
- **d** the size of the MNE group, taking account of fairness, administration and compliance cost;and
- **e** carve outs that might be formulated (e.g., for commodities)?

The term "consumer-facing business" currently is extremely vague and allows a very wide interpretation. In the interest of certainty, we ask for a **clear and narrow definition** of the scope so as to facilitate simplicity in applying the Unified Approach; the scope should be defined in the new treaty provision or Article 3 of the OECD-MC.

Moreover, the scope of application should be addressed solely to highly digitalised MNE, so that the application of the new system is modest. When due consideration is given to the fundamental concerns, and with reference to the BEPS Action 1 report where it was stated that *"because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes."*, we generally are not in favour of ring-fencing a portion of the digital economy and other consumer-facing businesses. Accordingly, our suggestion to very much restrict and narrow the scope of application is founded from the lack of a sound underlying analysis and well-defined issue that is generally required before a solution can be developed.

If the "Unified Approach" would be based on a broad definition of large consumer-facing businesses, a risk of including also low digitalised businesses is high, and this should not be the scope of Pillar One.

Furthermore, it could be difficult to qualify the 'user/consumer' (e.g. whether to include any individual, legal person or virtual user/consumer, for example fraudulent registrations, robots etc.), to determine which data are relevant for the digitalised business, and to allocate value to the single user/consumer, since it varies across businesses and market jurisdiction and is difficult to quantify. Monitoring and auditing the data may be complex and inaccurate to apply on the tax authorities' side.

The definition of the ***MNE group*** could be taken from the Country-by-Country Reporting rules.

As far as the ***size*** of the MNE group is concerned, reference may also be made to the Country-by-Country Reporting rules. The threshold for the application of the Unified Approach should be limited indeed to large multinational enterprises with a turnover threshold similar to the Country-by-Country Reporting (CbCR) i.e. more than 750m euros (or equivalent) since the burden of applying a hybrid combination of partial GFA and ALP would be beyond the capacity of most small and mid-sized businesses. They should be permitted to apply the nexus and ALP as already substantially updated by the BEPS project, which presumably would have addressed much of the BEPS issues. Aligning the threshold to CbCR reporting has the advantage of aligning it to a threshold that is already a minimum standard under BEPS and aligning the Unified Approach to the CbCR.

The issue related to ***carve-outs*** would be of minor relevance if the general definition is addressed to a more specific target of businesses. Again, a too broad definition should be avoided.

In order to guarantee fairness, however, MNEs within the scope of the Unified Approach must have the possibility to exclude business lines from the application of the Unified Approach, if those business lines are not consumer-facing. Otherwise multi-industry focused MNEs could be discriminated against competitors focusing only on non-consumer-facing products.

Financial services should be considered for carve-out due to its highly regulated nature. In particular, the Basel and Solvency rules govern how risks should be measured, the booking of loans and trading positions and capital provided against it means that there is little scope for tax avoidance planning at the risk of falling foul of the regulators. More pragmatically, the limited resources of tax administrations could be better deployed to other areas instead of trying to understand and audit complicated areas such as derivative transactions and funds transfer pricing within banks.

2 New Nexus. Under the proposed "Unified Approach", a new nexus would be developed not dependent on physical presence but largely based on sales. What challenges and opportunities do you see in defining and applying a new nexus, in particular with respect to:

a defining and applying country specific sales thresholds; and

b calibration to ensure that jurisdictions with smaller economies can also benefit?

The Unified Approach suggests that a "new nexus rule" would be applicable in all cases where a business has a **"sustained and significant involvement in the economy"** of a market jurisdiction, such as through consumer interaction and engagement, irrespective of its level of physical presence. Given the obvious challenges in defining such an involvement in a jurisdiction, a "sales-based" nexus is being proposed given the perceived simplicity of such a measure. In addition to the caveats as defined in Section I of this letter, the general challenges and opportunities that are apparent to us are summarised below, followed by a blueprint of a possible approach related to the proposed "new nexus".

General challenges and opportunities

Based on the wording on the subject of the new nexus, as included in the proposed Unified Approach, there are multiple general challenges that can be identified, of which the most prominent are listed below. This list is not meant to be exhaustive, but it does provide an insight into the main considerations in applying a new nexus largely based on sales.

1 Is sales revenue an appropriate measure to determine whether there is a "sustained and significant involvement in an economy"?

- "Sales" as such (solely) is not necessarily an indicator of value contribution and sustained and significant involvement in the economy – i.e. there may be instances where revenues are reported but they do not lead to a sustainable (and significant) involvement.
- Although under the Unified Approach there would no longer be the requirement to be physically present in the country, having mere sales in a jurisdiction in our view also is not directly linked with value creation per se. One could consider an alternative measure of presence that is required to be applicable as well as a de minimus rule – e.g. local online presence (localised web shop, localised customer support, localised payment modalities, locally tailored service offerings, etc.) and proven localised (remote) sales soliciting efforts (compared to general, global sales solicitation).
- Indeed, where reliance on a single factor of sales may have the advantage of simplicity, this may furthermore give rise to the following issues:

  i It is difficult to calibrate a universal appropriate level of sales for all countries. For example, sales of $1m may be insignificant for a large industrialised economy, but may be very significant for a small or emerging economy. Having a bright-line common threshold, whilst more administrable from a global perspective, will likely prove to be too high and too low respectively for different sets of countries.

  ii The departure from a principles-based concept of permanent establishment (PE) e.g. fixed place of business, dependent agent etc. to one based on numerical sales figures can lead to a blurring of the lines between PE and Transfer Pricing (TP). For example, if $Xm of sales will cross the threshold, then it may be difficult to conclude that there does not need to be any allocation of profits, whereas under the pre-existing separation of Article 5 and TP principles, one can clearly have a PE but no TP allocation because the PE may already be earning arm's length returns.

  iii Stability of the consensus could come under strain within a few years. With Asia growing at 6% or more and the Eurozone growing at 0.5%, a sales-driven factor could mean many more taxable nexuses in fast-growing Asia than may have been initially

contemplated when arriving at the global consensus. The issue then is whether the resulting shift in taxing rights to Asia is something that is contemplated or will be accepted in the future by countries that sign up to the consensus.

2 How do we define the sales revenues that have to be taken into account for a threshold test?

→ The definition of relevant sales revenues realised in the market jurisdiction might not be as straightforward as it seems. Especially considering our (fairly) recent experiences with the difficulties in applying the "revenue" definition for the purpose of Country-by-Country Reporting, whilst this revenue definition is arguably a lot less complex than sales revenue definition for the sake of the new nexus rule.

→ The sales thresholds should take into consideration the economy of each country, as the same number of "items" sold could provide a wide range of sales amounts (in €). Accordingly, for instance, if the sales thresholds are assessed under the "gross amount of sales", smaller economies could be out of scope.

3 The new nexus rules and related thresholds should, in some way, take into consideration that start-up losses are realised in the start-up country of a company, or more generally speaking, businesses that require significant upfront investments before (potentially) attaining a level of sustainability and significance – e.g. the pharmaceuticals industry.

→ The new nexus rules and related thresholds should take into consideration the fact that losses are usually recognised in the beginning of a company's lifetime (i.e. start-up losses). Typical for such a period is that there is minimal economic presence in market jurisdictions (i.e. limited to no revenue in other markets). In these cases, the allocation of losses to other market jurisdictions might be limited. However, when a company is realising significant profits (i.e. a later moment in the business cycle) it is usually significantly present in other market jurisdictions. To prevent an imbalance in the allocation of profits and losses, the new nexus rules should also consider, in some way, start-up losses/investments realised in the start-up country of a company. In respect of the pharmaceuticals industry example, we note the existence of significant 'pre-marketing' efforts without the guarantee of success. From the perspective of the start-up country, there might be a good argument to limit the use of thresholds or to consider a mechanism in the allocation of profits so that the start-up country is compensated for this risk.

4 How can we ensure a "fair" new nexus rule but limit the administrative burden for MNEs?

→ Considering the current scope of the "Unified Approach", it seems very likely that not only digital MNEs will be impacted. An economy-wide application of the new nexus rule seems envisaged. It is therefore of considerable importance to ensure that the administrative burden is not greater than required. Furthermore, the application of the new nexus should therefore be pragmatic and not overly complex.

5 What principle can be used as a guideline to identify small and big economies and to differentiate between them while remaining pragmatic?

→ As is clear in the initial report, smaller economies should also benefit from the "Unified Approach" and the introduction of the new nexus. However, which pragmatic but objective principle can serve as a guideline to identify and differentiate small and big economies?

6 How can we determine significant economic presence in an economy and also take into consideration the relative size of an economy?

→ From the initial report is seems that significant economic presence is relative to the overall size of an economy. For example; a significant economic presence in the Netherlands in terms of sales seems to be lower from a significant economic presence in Germany. How should such a factor be included in the new nexus rule?

→ Moreover, doesn't it seem legitimate to not only take the sheer size of the economy into account, but also its stage of development, and potentially how this stage has been achieved (in view of public debt)? E.g. the prime consumers of technology (mobile communications, internet) will rapidly be incremental in Africa in the future…

7 How can we ensure a "fair" new nexus rule so that smaller economies can benefit in an equal manner?

→ As indicated, one of the main challenges in creating a new taxing right is fairness. At present, this fairness is focused on the fact that smaller economies should also be able to benefit from the new taxing right. However, this should also be considered from the perspective of MNEs. The creation of the new taxing right should take into consideration that markets may be distorted as a consequence of applying revenue thresholds.

8 The new nexus rule should be a robust framework from which MNEs can derive a certainty.

→ Although we understand that the introduction of a new taxing right will bring its challenges, uncertainty for MNEs should be limited as much as possible. The new taxing right should therefore not be overly complicated. Also, consensus agreement between all the countries is of crucial importance in establishing certainty for businesses.

Although the application of the proposed new nexus faces these challenges, there is also an opportunity to create a robust long-term framework which can be applied in practice and which can be relied on by both tax authorities and MNEs with certainty. The opportunity would therefore be to create an approach that is not overly complex, limits the compliance burden for MNEs and is acceptable for jurisdictions with smaller economies. More information on such a possible (direction of) approach is provided below.

Possible (direction of) approach

Taking the challenges and opportunities as listed above into account, we have considered an initial approach for the application of the new nexus. This proposal should not be reviewed as an exhaustive analysis, but merely as an indication of a possible direction for further discussion. For completeness' sake, first the playing field of any viable approach is sketched, followed by a starting point for a pragmatic nexus approach.

It should be noted that the outer ranges of an approach could be either having (1) no threshold in place (i.e. any revenue derived in a market jurisdiction would create a nexus), or (2) a high threshold with limited consideration to the relative size of a market jurisdiction. In this respect, having no (sales-based) threshold would – at least from a theoretical perspective – be straightforward and also attractive for jurisdictions with smaller economies as, irrespective of the magnitude of the local presence, they would get a piece of the pie. On the other hand, in our view, such an approach would deviate from the principle of a "sustained and significant involvement" in the economy of a jurisdiction and would lead to a (very) significant incremental administrative burden for MNEs.

On the other side of the spectrum, there could be a relatively high threshold that is also not specific to a particular market jurisdiction. Such an approach would be simple and would thereby significantly reduce any administrative burden for MNEs. That said, an approach of this nature will lead to a reduced benefit for smaller economies. Any viable approach should therefore range between these options and should both limit complexity and the administrative burdens for MNEs.

Considering the key principle of requiring a "sustainable and significant involvement in the economy", we are of the view that the threshold should lie at the upper end of the range. Moreover, the threshold should be sensitive to the incremental compliance cost, as well as country-specific parameters.

A way to define and apply a country-specific sales threshold, which is particular to (smaller) countries' economies, is to apply a measure relative to the size of an economy. Here, a measure such as the Gross Domestic Product (GDP) could be considered to identify the size of the economy. It is an objective standard which is seen as one of the most common indicators for estimating the size of an economy. No additional calculations are therefore required when using GDP as a size indicator. To further limit complexity, the application of "buckets" of economy sizes could be considered. By using a bucket approach, the risk of having to deal with a wide variance of country-specific thresholds – thus increasing complexity (compared to pure index-based derivation) – can be limited.

Of course, this bucket approach would need additional thorough economic analyses, but an example could be that the first bucket contains countries with a GDP greater than EUR X (or a near equivalent amount in domestic currency), the second bucket would include countries with a GDP between X and Y trillion, and so forth.

In this approach, every bucket would have its own specific threshold. As mentioned above, such an approach might simplify the process by limiting the threshold applied. A consideration might be to update these buckets every few years (e.g. every five years) – which would provide additional certainty on this subject for this fixed period of time. The example below gives an idea of what such an approach might look like in practice. Please note that this is of course a mere simplified (and hypothetical) example meant for discussion purposes.

Bucket	GDP	Threshold
1	> X trillion	Highest threshold
2	> Y trillion < X trillion	Lower threshold than under 1
3	> Z trillion < Y trillion[1]	Lower threshold than under 2
Etc...	Etc...	Etc...

Naturally, the specific threshold per bucket is dependent on the determination of what constitutes a significant presence in a market jurisdiction, and should take into account the incremental compliance burden for MNEs that operate on a global basis. We have raised multiple challenges with respect to determining this threshold. To start with, it should be determined whether sales revenue is the best parameter to determine (significant) economic presence. Furthermore, once a parameter has been established, it should be agreed upon as to what can be considered significant, specific to a market jurisdiction.

A certain percentage of the market value might be a viable option. However, there would be an inherent difficulty in defining the market's value. For example: should this be the market value for a certain product, an industry or the total market value? As a pragmatic approach, one might consider a percentage of the overall market value of a country (e.g. GDP), and an even more pragmatic approach would be to use fixed thresholds.

1 It could be considered appropriate to gradually apply a smaller range for lower buckets, considering the number of countries per bucket gradually decreases.

3 Calculation of Group Profits for Amount A. The starting point for the determination of Amount A would be the identification of the MNE group's profits. The relevant measure could be derived from the consolidated financial statements. In your view, what challenges and opportunities arise from this approach? Please consider in particular:

- **a** what would be an appropriate metric for group profit;
- **b** what, if any, standardised adjustments would need to be made to adjust for different accounting standards; and
- **c** how can an approach to calculating group profits on the basis of operating segments based on business line best be designed? Should regional profitability also be considered?

A Metric for group profit?

In our view, the most appropriate metric for group profit would be the profit before tax (PBT), taken from the worldwide consolidated and audited financial statements in U.S./local GAAP or IFRS (with adjustments to be made for material book to tax differences) as a starting point (on a reported segmented basis where applicable).

In this respect, there should be a clear definition of which Ultimate Parent Company should be taken into consideration. This would be pragmatic and in accordance with the general practice of using group consolidated accounts at the headquarter level as the basis for CbCR preparation.

B What, if any, standardised adjustments would need to be made to adjust for different accounting standards?

We believe that the consolidated financial statements would already reflect the necessary adjustments to cover possible different accounting standards. If it would be necessary/advisable to make adjustments to adjust for different accounting standards, they would introduce a certain degree of uncertainty as it could become unclear and/or arbitrary to establish the best time for these adjustments to be carried out effectively.

C How can an approach to calculating group profits on the basis of operating segments based on business line best be designed? Should regional profitability also be considered?

Operation segments could be assessed taking into consideration the products/services to be supplied. The regional profitability could be influenced by large economies and smaller economies, so we understand that this parameter may bring with it deviances. On the other hand, when the region's profitability also houses the control function (physically) in relation to the (remote) sales solicitation effort that would fall under the targeted rules for a particular market jurisdiction, the controlled dedicated territory of (remote) markets could be considered an appropriate sub-consolidation perimeter. In fact, this would enable a focus on the specific profitability referred to the underlying circumstances.

4 Determination of Amount A. In determining Amount A, the second step would exclude deemed routine profits to identify deemed residual profits. The final step would allocate a portion of the deemed residual profits (Amount A) to market jurisdictions based on an agreed allocation key (such as sales). In your view, what challenges and opportunities arise from this approach?

In our view, the terminology of "routine" and "residual profits" should not be applied here, since they have the connotation of being aligned with the ALP principle, which clearly they cannot be as they are to be "deemed" applicable to a broader set of companies than the specific taxpayers involved in the accurately delineated controlled transaction. If it is decided to implement a GFA policy, we suggest refraining from using ALP-based terminology (at least to avoid misunderstandings) to start with. Alternatively, but a more fundamental issue, we believe that the ALP and transfer pricing principles have the potential to be used in an equitable manner. The use of fixed percentages, is clearly a step away from the ALP, unless operationalised as safe harbours only.

However, if fixed percentages are chosen as a means, for instance, to reach a higher level of certainty of correctness of the calculations, the percentages should still be different for different industries and regions, and subject to frequent updates in our view. The source for these percentages should be well-founded and agreed upon consistently on a global scale. Sales seem to be a simple allocation fee, but as mentioned earlier, there are many issues that could arise by introducing such simplicity in view of aligning profit allocation (amongst old and new taxing rights) in line with effective value creation. Therefore, the key issue is not the calculation of Amount A but rather finding an equitable (both from the perspective of the jurisdictions involved, and from the perspective of the companies) means of allocation.

We also wish to draw your attention to a number of jurisdictions that have already been adopted in legislation or in tribunal and court cases; positions that expand the taxing rights of the market. Examples of such principles include location savings, market premium and the line of court cases in regard to excessive advertising, marketing and promotion expenses. To avoid double taxation, these jurisdictions should agree that such concepts would be unnecessarily given the new taxing rights or that they form a subset or part of the new taxing rights that are allocated to them as market jurisdictions. An undesirable outcome would be that these specific market-favourable domestic tax principles continue to be asserted over and above the consensus of the Unified Approach.

5 Elimination of Double Taxation in Relation to Amount A. What possible approaches do you see for eliminating double taxation in relation to Amount A, considering that the existing domestic and treaty provisions relieving double taxation apply to multinational enterprises on an individual-entity and individual country basis? In particular, which challenges and opportunities do you see in:

a identifying relevant taxpayer(s) entitled to relief;
b building on existing mechanisms of double tax relief, such as tax base corrections, tax exemptions or tax credits; and
c ensuring that existing mechanisms for eliminating double taxation continue to operate effectively and as intended.

In our view, the risk of double taxation will be really high in cases involving more than two jurisdictions, because tax treaties are designed to work on a bilateral basis (notwithstanding the MLI efforts initiated by the OECD). For instance, if country 1 and 2 reach an agreement on the proper amount of profits to tax in their jurisdictions, but country 3 does not agree with the approach used by the first two countries, how may the current International Tax Law provide relief from double taxation?

Indeed, due to a different interpretation of treaties and differing national tax laws, double taxation already today is a huge challenge in the system currently in place. Adding a new nexus and a new layer to profit distribution will certainly increase the risk of further double taxation. Such risk particularly exists in the area of royalties and services, where many international disputes are happening already. Taking into consideration Article 12a UN-MC and comparable existing treaty provisions, the new nexus adds a completely new set of potential conflicts and double taxation.

History suggests that it may be challenging to achieve widespread adoption by tax administrations of a common approach to computing Amount A and granting corresponding relief. By way of example, the US tax reform is one where the changes to the foreign tax credit rules could override any prior treaty commitments.

The interactions of the new nexus and existing treaty provisions need to be substantially evaluated, and the OECD should provide clear guidance on how to approach conflicts in this area. It is questionable whether this will be doable within the ambitious timeframe the OECD has given itself for the consensus on the Unified Approach. After the final reports of the BEPS project were issued, CbCR was introduced at overwhelming speed. At the time the first reports were due, clients still had to deal with many – at this stage – unanswered questions, as guidance from tax authorities and the OECD was lacking. Due to the complexity of the Unified Approach, we are worried that this might happen again if consensus and implementation are conducted too fast. This would be even more fatal, because – contrary to CbCR – the Unified Approach will directly influence the worldwide profit attribution and taxes payable of MNEs.

From a practical perspective, as soon as the taxable entity is identified ("owner" of Amount A), it should be that the entity pays the respective tax in the relevant Country and proceeds with the necessary steps to mitigate the double taxation. We understand, however, that the main problem is to set up the procedures to identify the "owner" of Amount A. Subsequently, the relevant taxpayer ("owner" Amount A) should be able to ask for a foreign tax credit or exemption in its country of residence, regardless of whether such provision is (not) foreseen in the relevant Tax Treaty. Exemption could provide a simpler procedure to fully mitigate the double taxation. As we understand that no new mechanism is deemed to be established to accommodate the elimination of the double taxation regarding Amount A, the existing mechanisms should continue to be used and further refined.

Hence, the only concrete solution to avoid double taxation, burdensome litigations and bilateral procedures would be to delegate tax audits to ultra-national tax commissions operating within fixed and tided delivery terms or to leave the burden of a bilateral agreement to tax administrations, notifying the taxpayer once the agreement within the concerned countries has been agreed. Also, in such an 'ideal world', procedures of this nature cannot take more than a few months, as to date the big issue related to dispute solutions is the timing and uncertainty of such procedures.

6 Amount B. Given the large number of tax disputes related to distribution functions, Amount B of the "Unified Approach" seeks to explore the possibility of using fixed remunerations, reflecting an assumed baseline activity. What challenges and opportunities does this approach offer in terms of simplification and prevention of dispute resolution? In particular, please consider any design aspects and existing country practices that could inform the design of Amount B, including:

a the need for a clear definition of the activities that qualify for the fixed return; and

b a determination of the quantum of the return (e.g., single fixed percentage; a fixed percentage that varied by industry and/or region; or some other agreed method).

As a general note, we doubt whether Amount B will lead to more certainty and fewer tax disputes. If a fixed remuneration is determined for marketing and distribution functions, tax audits and tax disputes might shift to other functions. This could especially be true for countries which lose taxing rights.

It is questionable on what grounds the simplification (Amount B) is conducted only for this limited amount of routine functions. Furthermore, we are in doubt whether a global understanding of "What is routine and what is not?" exists. Therefore, the term routine functions will need clear guidance. Moreover, we fear that different distribution models are not sufficiently taken into account. The structure of MNE groups rarely is as simple as in the example given in the Consultation Document.

An allocation based on marketing expenses might add complexity in determining the expenses to consider and how to account for capitalised investment into a jurisdiction, especially in the early years.

Whilst fixed remunerations will greatly simplify administration and compliance, experience points to the difficulty of getting countries to adopt the Low Value-Added Services 5 per cent safe-harbour advocated in BEPS Actions 8-10. It will be difficult, therefore, to achieve consensus. Instead of completely abrogating the arm's length principle, it is submitted that analysis under existing arm's length principles can still be very useful as a complementary secondary analysis to backstop situations where both jurisdictions cannot come to agreement on the amounts to be computed under the Unified Approach or where the outcomes of a formulaic Unified Approach are clearly non-commercial. In our view, Amount B should therefore, and under the Unified Approach as formulated now, be a safe haven that enables the taxpayer to demonstrate that another amount is more in line with the "at arm's length" principle. If the route of switching to GFA is consistently followed (upon evidence-based analysis), Amount B has to be fixed in the framework of the formulary apportionment of Amount A incomes.

7 Amount C / Dispute Prevention and Resolution.
In the context of Amount C of the "Unified Approach", what opportunities do existing and possible new approaches to dispute prevention offer to reduce disputes and resolve double taxation? In particular, what are your experiences with existing prevention and resolution mechanisms such as:

a (unilateral or multilateral) APAs;
b ICAP; and
c mandatory binding MAP arbitration?

This point is key. Having a clear procedure to put all states involved around the table in a dispute resolution procedure is essential to avoid this becoming a "tax penalty" for certain MNEs. We repeat that the only concrete solution to avoid double taxation, burdensome litigations and bilateral procedures is to delegate tax audits to ultra-national tax commissions operating within fixed and tided delivery terms or to leave the burden of a bilateral agreement to tax administrations, notifying the taxpayer once the agreement within the concerned countries is agreed. Also, such procedures should follow a limited timeline.

The Consultation Document emphasises that "these changes would need to be implemented simultaneously by all jurisdictions". Uniformity of law or uniform rules adopted by the parties are two forms of international conflict avoidance. Opposing parties can approach a conflict in two different main ways: the preventive approach of conflict avoidance and the resolving approach of conflict solution. In the Consultation Document at issue, both the fixed remuneration and the safe harbour (i.e. minimum threshold) can be considered as preventive tools.

In the name of conflict avoidance, all the countries are asked to standardise their own domestic tax rules not under general acceptable principle (as the arm's length) but introducing fixed remuneration, thresholds and formulas. The OECD should consider that the conflict avoidance discipline is based on the existence of similarities among the different legal systems, and applies the "comparative method".

On the contrary, the Consultation Document is asking all countries to introduce simultaneously the same tax rule in jurisdictions with completely different legislative systems and backgrounds.

The creation of any new taxing right in favour of countries that today do not levy taxes on profits from these digital businesses means a cooperative approach among all parties involved.

Cooperation is a joint action and represents more than "coexistence" or "coordination". It means proactively working together, serving common objectives that cannot be attained individually. We do not believe that the shifting of existing taxing rights from one country (1 or 2) to another country (3) due to the new nexus can be considered the best strategy for promoting reciprocal cooperation among countries. The agreement on the Unified Approach may have to be a process of "give-and-take", where the tax authorities of the different contracting states must be willing to work together in cooperation so as to reach a mutually acceptable method and result. The mutual agreement is based on the allocation of key, fixed remuneration, minimum thresholds etc. born out of the desire to create this new taxing right both fairly and more efficiently.

The legislators of the different states attempt to maximise total government revenue (including taxes, interests and penalties) net of audit and other administrative costs. The issue is considered to be solved when an "efficient" equilibrium is reached. Such an equilibrium is the best response so that neither the competent authorities nor the taxpayers have an incentive (unilaterally) to change their strategies.

The purpose of this comment is to illustrate that the introduction of a new nexus into "game theory" that explicitly integrates taxpayers and competent authorities offers considerable opportunities for the Consultation Document's effectiveness; opportunities that are not possible in the standard analysis of the enforcement of the law.

Equity also becomes important in increasing the use and the effectiveness of the mutual agreement procedure. It seems to be beyond doubt that dispute resolution mechanisms may increase the equity of new tax rules. If interpretations differ, an entity is being treated unequally and this might be an effective deterrent to cross-border activities.

It is evident that the Proposal increases the number and complexity of tax rules all over the world and uncertainty in the business and private sphere. Divergent understanding may also deal with the "person" who is deriving the relevant income. The attribution of income to the right person(s) is important also for the identification of the applicable treaty(ies). In this scenario, international tax disputes will increase dramatically, not only between the taxpayers and governments, but also between governments themselves.

Statistics[2] on the resolution of tax treaty disputes, through the Mutual Agreement Procedure (MAP), disclose the fact that the number of disputes being resolved by tax administrations is increasing worldwide. Statistics also reveal that the number of unresolved tax treaty disputes reflects the same tendency. Tax practitioners recognise them as ineffective, i.e. complicated, costly, time-consuming and leading to uncertainty. In fast-changing economies, such ineffectiveness has a negative impact on multinational groups, trade and investments.

On the other hand, arbitration procedures offered by the MLI provided significant amendment in resolving disputes related to international taxation. Positive impact of the MLI on the taxation of multinational groups is expected. In particular, taxpayers expect more certainty and predictability in such cases. MLI arbitration procedure is a new institution; nevertheless, countries are ahead of their implementation and practical execution. Consequently, the practice in this respect is limited.

However, in our opinion such new approaches to the resolution of tax disputes should be recognised as the right step towards increasing their effectiveness in terms of time and costs. Therefore, we are of the opinion that mandatory binding MAP arbitration should constitute a basic tool applicable in the case of Pillar One disputes.

Similar observations concern APA procedures. Statistics published by national tax administrations show that the actual application of such dispute prevention tools varies from country to country. In general, increasing tendency of using APA for the purpose of ensuring the transfer

2 https://www.oecd.org/tax/beps/oecd-releases-2017-global-mutual-agreement-procedure-statistics.htm

pricing certainty of cross border business is also expected. Regardless of the fact that there are areas of improvements in terms of accessibility in particular countries, in our opinion APA procedures should also be applicable as a way of preventing disputes concerning profit allocation among interested countries.

The use of existing tools aimed at preventing and resolving disputes in the analysed area, instead of attempts to develop new ones, will shorten the time needed to reach the consensus on the "Unified Approach" and its implementation.

Generally speaking, we do welcome the efforts to expand joint audits, horizontal monitoring, MAPs, ICAP and comparable measures. However, currently many of those measures are quite tedious and burdensome. A main challenge we see in this area is that tax authorities do not have the (people) resources to deal with the increasing amount of international prevention and resolution mechanisms, which are also becoming more complex. Additionally, the need for multinational dispute prevention and resolution will increase with the Unified Approach. Disputes over Amount A will inevitably affect more than just two jurisdictions. The implementation of the Unified Approach must therefore be bound to a minimum standard of mandatory binding dispute prevention and resolution mechanisms, offering taxpayers easy access. A short timeframe of only several months for such mechanisms would also be desirable. Since Amount A highly depends on Amounts B and C, the interaction between those amounts needs to be further elaborated, especially so as to avoid double taxation.

It is clear from BEPS that many countries are hesitant about or even strongly resisting (often citing tax sovereignty of each state) the adoption of mandatory arbitration. The OECD should consider proposing the adoption of taxpayer – tax administration mechanisms similar to investor-state dispute resolution mechanisms common in bilateral investment treaties. Since the new taxing rights are allocated on a global basis, the headquarters of the impacted multinational enterprise should be given the right to challenge market countries that receive the additional allocation of profits. This will help level the playing field for taxpayers.

III Closing remarks

We are very concerned that an insufficient amount of time has been granted to the OECD to firstly, based on evidence, perform and make public the analysis of the accurately delineated issue(s) for which then (and only then) well-founded and lasting solutions are to be formulated on the basis of global consensus. First of all, we are of the view that following the recent implementation of the BEPS measures – in particular in the field of transfer pricing – these must be first analysed and reviewed before deciding to implement a hybrid taxation system or a mix of both the arm's length principle (ALP) and global formulary apportionment (GFA), and applicable to (broadly or narrow) ring-fenced businesses. Otherwise, we are concerned that any solution would not be equitable for countries and companies involved, thereby not legitimate, and accordingly distort global trade and cross-border investments. If such an analysis points to either the ALP or GFA, it should be implemented in a comprehensive and lasting manner that takes into consideration a reasonable transition period to enable a switch to GFA, where businesses and governments can adapt to the potential new reality without incurring adverse consequences.

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