ITI Response to OECD Public Consultation: Addressing the Tax Challenges of the Digitalisation of the Economy

March 6, 2019

The Information Technology Industry Council (ITI) hereby submits feedback to the Organisation for Economic Co-operation and Development (OECD) on its consultation document on *Addressing the Tax Challenges of the Digitalisation of the Economy*. ITI represents the leading information and communications technology companies from around the world. As the global voice of the high-tech and tech-enabled community, we advocate for policies that advance technology, promote innovation, open new access to new and emerging markets, protect and enhance consumer choice, and foster increased global competition. ITI's member companies include wireless and wireline network equipment providers, computer hardware and software companies, Internet and digital services providers, mobile computing and communications device manufacturers, consumer electronics, and network security providers.

ITI thanks the OECD for the opportunity to provide comments on this critical workflow. Tax is a priority issue for our members, who rely on clear and established international tax rules to innovate and grow their operations around the world. As such, our broad objective is to ensure a functioning and dependable international tax system that promotes investment and innovation, while providing certainty and predictability for businesses. ITI strongly supports the OECD as the best forum to achieve a multilateral agreement on any significant reforms to long-standing international tax rules.

At the outset, we recognize the complex nature of this undertaking and appreciate the OECD's continued leadership on this issue, which occurs against the backdrop of unilateral actions being contemplated by multiple countries. Instead of countries moving ahead with a patchwork of policies, we believe the OECD should continue to examine these issues and work to forge consensus. Reaching a multilateral solution is paramount, as fragmentation of the global tax system would be a significant step backward for the long-held international tax principles of ensuring certainty for businesses, minimizing administrative burdens for taxpayers, and avoiding double taxation.

It is crucial to acknowledge the substantial strides the OECD has made in addressing complex issues through multi-national collaboration and successfully presenting tax solutions for its member countries to adopt. In 2013, the OECD was commissioned by the G20 to develop a comprehensive action plan to introduce and reinforce international tax standards to help countries tackle base erosion and profit shifting, or BEPS. Broadly speaking, the BEPS Project was aimed at reducing the ability of companies to shift profits to low-taxed jurisdictions, ensuring profits are reported where the economic activities that produce them take place, and increasing transparency within the international tax system.

Global Headquarters
1101 K Street NW, Suite 610
Washington, D.C. 20005, USA
+1 202-737-8888

Europe Office
Rue de la Loi 227
Brussels - 1040, Belgium
+32 (0)2-321-10-90

info@itic.org
itic.org

This effort, requiring significant inter-country dialogue and cooperation, culminated in an agreed-upon package of fifteen separate work streams, or Actions, which more than 115 jurisdictions have contributed to and committed to implementation of the four minimum standards through their participation in the BEPS "Inclusive Framework." Notably, this concerted multilateral initiative represented the first significant reform of global tax standards in nearly a century.

Over the past few years since the BEPS project was initiated and subsequent recommendations were released, countries around the world have worked to reform their domestic tax regimes to address certain aspects of the BEPS Actions. A wide array of countries, from the United States with the Tax Cuts and Jobs Act (TCJA), to Europe with the Anti-Tax Avoidance Directive (ATAD), and jurisdictions elsewhere, have adopted new tax rules in response to the BEPS recommendations. Many of these rules go beyond the BEPS minimum standards.

The successes of the BEPS project to date are compelling in favour of a multilateral process through the OECD. They also exemplify the fact that considerable progress can be made by working within the existing system of international tax principles. We feel it essential to note some of the approaches under consideration seem to operate at cross-purposes with recently agreed-to BEPS reforms, including critical changes to transfer pricing practices related to so-called DEMPE functions and potentially questioning the structures approved by BEPS Action 5 (e.g. patent boxes). This apparent fact implicates a broader question about how the current work stream will relate to the tremendous changes already underway as a result of BEPS. The OECD makes its best contributions when it can present consistent, clear guidelines that allow for the smooth-functioning of cross-border commerce. We ask that you first be mindful of the number of reforms currently underway and then work to strengthen and clarify existing standards to the greatest extent possible to address any remaining issues.

We hope that the current consultation is a helpful step towards reaching global consensus. Before addressing each of the four proposals, we offer key guiding principles that should underpin any new international tax framework: 1) acknowledge the digitalisation of all businesses, 2) align with widely-held international tax norms, 3) minimize administrative burdens, and 4) reflect a comprehensive, global consensus. These points are discussed below.

Acknowledge the Digitalisation of All Businesses: As companies across diverse sectors leverage data and information and communications technology to enhance their daily business operations, we continue to see the "widespread diffusion of the digital economy within the whole economy."[1] Whether it is in advanced manufacturing, automotive, construction, energy, financial services, healthcare, or other sectors, companies of all sizes rely on data flows and innovative technologies to deliver products and services more efficiently to consumers across borders and compete more effectively in the global marketplace. We therefore agree with the conclusion of the 2015 BEPS

[1] The Commission High Level Expert Group on Taxation of the Digital Economy, "Report of the Commission Expert Group on Taxation of the Digital Economy," May 2014

Action 1 report on the impossibility of "ring-fenc(ing) the digital economy from the rest of the economy for tax purposes."[2]

It appears the modern digitalised economy has created a desire by some countries to realign taxing rights between jurisdictions and revisit international tax norms to ensure taxation is keeping pace with the evolving nature of the global economy. We urge that any new rules pertaining to businesses without a physical presence in jurisdictions be clear, measurable, predictable and applied neutrally across all industries and all business models.

Align with Widely-Held International Tax Norms (including avoiding double taxation): Given the complex and interconnected nature of the global economy, any solution should be aligned with the existing international tax norms of avoiding double taxation, taxing net income rather than revenues, complying with tax treaties (either existing or as revised), and upholding the longstanding principles of permanent establishment, nexus, and transfer pricing based on the arms-length standard. Any rules for attributing profits or losses to a jurisdiction in a manner that deviates from the arm's length principle should be specific in scope, clear and administrable in application giving due regard to value creating activities and business investment that take place in other jurisdictions. Any changes should be built upon the existing international framework and not discard principles that have been in place and previously agreed upon at the global level for many years.

Specifically regarding the concept of "value creation," we would encourage any re-examination to be undertaken within and against existing "non-digital" principles to ensure that all value creating activities undertaken by companies – regardless of specific sector or business model – are rewarded appropriately and proportionately.[3] Any solution to address this issue should seek to align taxing rights with value creation within the parameters of making adjustments to and building on existing principles.

Minimize Administrative Burdens*:* It is important that any solution require all participants in the Inclusive Framework to minimize the administrative burdens on taxpayers and taxing authorities by providing clarity as to where there is a taxable presence, the method of determining tax due, and filing obligations and requirements, as well as provide for mandatory robust, effective and practical dispute resolution mechanisms (including mandatory binding arbitration as a minimum standard subject to peer review) and appropriate thresholds and safe harbors. Accounting for, and effectively reducing, undue administrative burdens and complexities will be critical in achieving widespread adoption and implementation across the broader international community.

Reflect a Comprehensive, Global Consensus: Lastly, we urge that all Inclusive Framework participants agree to be bound by, and to implement, the new consensus to ensure that all income is properly taxed once across jurisdictions so that any unilateral actions are not necessary. The propagation of unilateral tax proposals over the past year – which may vary significantly in terms of

[2] OECD/G20 Base Erosion and Profit Shifting Project, "Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report," October 2015.
[3] Business at the OECD, "Business Principles for Addressing the Tax Challenges of the Digitalizing Economy", January 2019.

both general principles and precise scope and applicability – raises significant concerns around global fragmentation in the tax space.

Comments on Proposals

User Participation

The first proposal under consideration creates a new nexus standard for businesses around so-called "user participation." The foundation of this policy is the notion that users generate value for the business on digital platforms that can then be identified and isolated for tax purposes.

We believe this idea is problematic in several regards. Targeting only certain companies or industries goes against the tenet of neutral, fair, and efficient tax policy. Companies across all industries are increasingly leveraging customer and user data to optimize their business activities. Focusing solely on user participation is an incomplete proxy for value creation that is not supported by economic analysis. We are skeptical that the Inclusive Framework could agree on a uniform definition or application of "value of users" because there is no existing consensus or principle to guide such an allocation while, at the same time, ensuring an appropriate return on value-creating activities and investments, such as research and development, product development, or other valuable intangibles.

For example, there are major, over-arching design questions left to be answered that would have a critical impact, including but not limited to how to measure profit, what the base is for determining profit, which intangibles should be included in the profit split, and how profit is ascertained based on a multi-entity approach as compared to the single-entity approach used under current law. The answers to these questions are crucial determinants in whether any proposal is workable, fair, or an improvement on the existing system. Notwithstanding these items, we are concerned whether ***all*** tax authorities represented in the Inclusive Framework have the expertise or capability to administer such an approach. This is a critical question, as such capability would require ***all*** such tax authorities to administer for this to be workable.

Further, implementation would also likely be exceptionally difficult for both businesses and tax administrations. It is not clear how companies could effectively track or confirm the size of a mobile user base, and whether doing so would be in compliance with GDPR or other privacy standards. Overall, establishing the size of a user base in a particular jurisdiction to the satisfaction of a taxing authority seems nearly impossible.

As identified by the proposal itself, calculating non-routine return across a MNE with multiple lines of business – each of which may be included or exempt from this proposal, and each of which is likely to have a different level of value generated from user participation – if any – is exceptionally complex. Identifying activities that are appropriately in-scope or out-of-scope for a proposal such as this one that is limited to certain types of business models presents an extreme challenge.

Therefore, it is unlikely that this proposal can be the foundation of a global and durable consensus framework.

Marketing Intangibles

The consultation document includes a so-called marketing intangibles proposal. Broadly, the proposal would allocate additional modest profits to jurisdictions based on non-routine income from marketing intangibles such as customer lists, trade names or proprietary market intelligence.

Our members question how this policy idea could work in application. We recognize that a number of ITI companies are spending time working with the OECD and other stakeholders on the design. Overall, we look forward to analyzing additional details as this process proceeds.

In the meantime, we offer a few initial thoughts. As is the case with the user participation proposal, a number of design questions remain. We question how non-routine marketing intangible profit will be measured, what the correct base is for determining such profit, which intangibles would be included in the marketing-related profit allocation analysis, how profit would be ascertained under a multi-entity approach (as opposed to the single-entity approach used under current law), and how to define a marketing intangible as compared to a trade intangible, especially with some business models.

Any approach needs to respect the considerable investments companies make in research and development, physical infrastructure, technology, employees and their products and understand the difference between a trade intangible and a marketing intangible under all types of business models. How these questions are answered will be the linchpin in defining whether an approach is fair, administrable, or an improvement to the existing system.

We further note the consultation suggests the need to analyze business-to-business (B-to-B) transactions and how this proposal will distinguish certain transactions of that nature as compared to business-to-consumer (B-to-C) transactions. As this concept is developed, we suggest further considerations for different types of business models where there is very limited or no involvement of the marketing intangibles in the location of consumption. In many instances, the arm's length-standard and existing transfer pricing principles that have been enhanced through BEPS may be sufficient. As you hone in on these types of scenarios, we would note that many companies' operations are wholly or partially integrated and would find it all but impossible to distinguish between them for tax purposes. Given the complexities in this space, we would encourage further in-depth analysis in trying to find the correct approach. Relative marketing intensity varies for all businesses depending on their products, services, business models, product lines, markets and customers.

Significant Economic Presence

The next proposal under consideration suggests a formula-based approach based on a "significant economic presence" test, which would calculate taxing rights based on certain key factors as local users, a local website, billing in local currency and other factors.

We believe a significant economic presence test is problematic for multiple reasons. First, all Inclusive Framework countries would be required to establish the same criteria with the same applicable definitions, which based on experience with the U.S. states and within the EU, would

appear an impossible task. Secondly, any controversy over apportionment would require a global audit of the multinational enterprise by the tax authorities in each jurisdiction that challenges the apportionment, while any audit adjustment would require filing amended returns with each of the other taxing authorities, which could again open up another global audit and repeat the cycle. We are skeptical that the Inclusive Framework could agree on such global standards or develop effective dispute resolution mechanisms to administer such global apportionment.

Importantly, the SEP requires a significantly greater divergence from existing transfer pricing principles than the other options discussed and would require consensus around far more variables and economic principles. As such we believe that the SEP is highly unlikely to achieve a consensus solution that could alleviate concerns about certainty, potential double taxation, and administrability, and would lead to greater fragmentation and controversy in the international economy.

Minimum Tax and Global Base Erosion Proposal

Turning from the proposals outlined in Pillar One, the proposals outlined in Pillar Two are not focused on ensuring that income is being taxed where value is created. Rather, they are more broadly concerned with ensuring that profits are sufficiently taxed in general, through minimum tax rules and anti-base erosion rules related to foreign payments. These proposals do not reflect the changes that have occurred since BEPS implementation and U.S. tax reform, regarding the reduction in opportunities for companies to shift profits to low- or no-tax jurisdictions or convert profits into stateless income. We believe that these opportunities, as well as the instances of "stateless income," have been considerably reduced.

The OECD BEPS Project made significant strides to ensure that all income is subject to an appropriate level of taxation by putting new international norms in place to prevent double-non-taxation of profits, eliminate the ability to shift profits artificially away from where value is being created, and reduce the ability to take advantage of loopholes and mismatches in countries' tax systems. While these efforts are still being implemented, there have been significant changes in corporate taxpayer behavior, and our international system has been strengthened considerably within the framework and principles that the system has been based on for many years. Importantly, because of the legislative, administrative, and treaty changes required to fully implement the BEPS Actions, several of which go well beyond the BEPS minimum standards, we do not yet have the full picture of how comprehensively these changes have been able to address concerns related to base erosion and insufficient taxation of profits. We recommend that the OECD thoroughly evaluate how implementation of the BEPS Actions has already addressed these concerns before drawing final conclusions about additional major policy changes that should be made.

Critically, tax reform passed by the United States in 2017 – the Tax Cuts and Jobs Act – not only included a number of provisions to implement the BEPS Actions, but also included a global minimum tax on above-routine returns (known as "Global Intangible Low-Taxed Income" or "GILTI"), as well as a Base Erosion and Anti-Abuse Tax ("BEAT") designed to address what were viewed as excessive base-eroding payments to foreign related parties. Implementation of these provisions has been complex and remains in progress, but they are clearly helping ensure appropriate taxation of more mobile

income streams. The GILTI regime, in particular, ensures that non-U.S. profits of U.S. groups are taxed at a rate of at least 13.125 percent and, in many cases, substantially in excess of that minimum threshold due to complexities in how foreign tax credits are computed. The EU's Anti-Tax Avoidance Directive also represented a significant step in implementing the BEPS Actions.

We believe it is important to consider data from BEPS implementation and post-U.S. tax reform to determine whether concerns with unduly low, or untaxed income have already been addressed. New rules as proposed will add considerable complexity and cause uncertainty and potential double taxation. Avoiding double taxation remains an important goal for the OECD.

Indeed, it is clear from both the implementation of the work thus far at the OECD and the implementation of the policies included in U.S. tax reform and other similar initiatives that there is a high level of complexity to even smaller-scale adjustments designed to ensure a base level of taxation for profits worldwide, and a very high level of complexity in implementing a minimum tax proposal. The level of complexity in implementing a minimum tax is only escalated when every country has a minimum tax, creating high potential for disputes among countries as to taxing rights, double or even triple or quadruple taxation, significant confusion as to how to establish the rate of tax paid on a particular stream of income, and considerable audit risk for companies who are trying to meet their obligations. These concerns would be escalated exponentially if countries were to put in place country-by-country minimum taxes or look at tax rates on a payment-by-payment basis. Additionally, minimum taxes computed on a jurisdiction-by-jurisdiction basis have the potential to negate countries' tax sovereignty by eliminating the benefits of their domestic tax incentives, including those for research and experimentation, or capital investment.

Given these concerns, we urge the OECD to proceed with great caution in evaluating or moving forward with the proposals contained in Pillar Two.

***

Thank you for your consideration of our comments. Please do not hesitate to reach out for any additional information or questions to Jennifer McCloskey, Vice President, Policy at jmccloskey@itic.org.