Brussels, March 6, 2019

VIA ELECTRONIC TRANSMISSION

Tax Policy and Statistics Division, Centre for Tax Policy and Administration
Organization for Economic Cooperation and Development
2 rue André Pascal, 75016 Paris, France

Re: CCIA response to the OECD consultation on the possible solutions to the tax challenges of digitalisation

The Computer & Communications Industry Association (CCIA) is an international, nonprofit association representing a broad cross section of computer, communications and Internet industry firms. CCIA remains dedicated, as it has for over 40 years, to promoting innovation and preserving full, fair and open competition throughout our industry. Our members employ more than 750,000 workers.[1]

CCIA welcomes the opportunity to provide input into the OECD's public consultation on addressing the tax challenges of the digitization of the economy. The international community is making important progress and CCIA supports the OECD's great efforts to achieve a global consensus.

CCIA warns against unilateral actions that would undermine such a consensus based approach and would lead to double taxation and potential trade retaliations. The OECD is the optimal forum to review the current international tax framework and to seek global consensus-based solutions. The proposals under discussion represent significant but untested changes to the current international tax framework. CCIA therefore urge the OECD and governments to conduct a thorough analysis and continued consultation with all impacted stakeholders.

CCIA's attached comments offer; (1) recommendations on the best approach forward, (2) overarching tax design principles against which the proposals should be tested; and (2) a discussion of the benefits and challenges under the OECD's proposed approaches to developing new taxation rules.

Thank you for the consideration of these comments.

Sincerely,

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[1] A full list of CCIA members is available at: www.ccianet.org/members

Computer & Communications Industry Association
Tech Advocacy Since 1972

CCIA COMMENTS ADDRESSING TAX CHALLENGES OF THE DIGITALISATION OF THE ECONOMY

I. EXECUTIVE SUMMARY AND RECOMMENDATION

The OECD is the optimal forum to review the current international tax framework and to seek a global consensus-based solution. CCIA believes that the OECD should present a single, clear recommendation, rather than a selection of options for countries to choose from. Out of the proposals contemplated by the OECD's public consultation document, CCIA believes that the marketing intangibles proposal has the highest chance of achieving global consensus and addressing new dynamics in international taxation.

With any changes, dispute resolution will be vital to maintaining certainty and consistency of approach. The OECD should require that any country adopting these new rules agrees to update mandatory binding arbitration for dispute resolution.

CCIA believes that neither the user participation option nor the significant economic presence option are likely to be acceptable as the basis of a new consensus. The user participation proposal is not grounded in sound economic analysis and seeks to draw a ring-fence around a section of the economy. With the rapid digitalization of the whole economy, this definition will quickly become outdated. It is not a viable long-term solution. The proposal on significant economic presence would represent a change in the entire approach to profit apportionment. A similar approach has been attempted in the past, such as the EU's proposal on CCCTB, and it has not been successful even with a smaller group of countries. CCIA does not believe such an approach could be agreed at a global level.

Only the marketing intangibles proposal can be applied proportionately across all businesses and result in the modest adjustment to the allocation of residual non-routine profit, which appears to be the main driver of this process. CCIA believes that this is the only proposal that can be designed in a way to be in line with the overarching design principles as outlined in the following section.

II. OVERARCHING TAX DESIGN PRINCIPLES

For the consideration of the optimal design of a 21st century taxation system, CCIA offers the following overarching tax design principles that should guide discussions on the various proposals.

- **Multilateralism:** The OECD is the optimal forum to review the current international tax framework and to seek a global consensus. A consistent global approach must be achieved to avoid double taxation and any damage to the multilateral order including possible retaliatory measures. Protectionist, unilateral tax measures should be abolished and avoided.

- **Evidence-based:** CCIA urges that all proposals be thoroughly analyzed and based on solid evidence. For instance, when considering the location of value creation under a value-based approach, it is important that these efforts are based on strong evidence and consider the place of functions, assets, and risks.

- **Business model neutrality:** The OECD has long ago concluded that the digital economy cannot and should not be "ring fenced". Any changes to the international taxation system should operate across all industries and all forms of business activities and business models. Taxation should not be targeted at a subsection of digital services.

- **Profit-based:** Any tax on corporate activities should be based on economic profits generated, and not on revenues.

- The framework should seek to **prevent double taxation and unintentional non-taxation**.

- **Simplicity and predictability:** The framework should provide tax rules that are clear, simple to administer and predictable. The administrative burdens should be proportionate to the tax revenues generated. The outcomes should be predictable and the framework should offer strong dispute resolution mechanisms.

III. CCIA COMMENTS ON THE OECD PROPOSALS

Pillar 1: Revised Profit Allocation and Nexus Proposals

The three proposals under pillar one constitute fairly major changes to the international tax structure. These changes include the abandonment of the concept of taxable nexus based solely on physical presence, a move away from the arm's length principle, and a departure from entity-specific towards group-wide parameters for determining the tax liability and compliance obligations. None of these proposals have been tested before in a global context. Governments are cautioned to be prudent in their analysis and take care in how these proposal will impact the international tax system and well-established concepts. The "marketing intangible" proposal would likely be the best option of the three proposals and it is also the most likely to achieve global consensus.

A. The Marketing Intangibles Proposal

This proposal would allocate some value to a marketing intangible that is deemed to be created by interaction with or adaptation to local customers in the local markets. It allocates an element of non-routine return of the group to the market countries.

Benefits

- This proposal is more likely to achieve a global consensus for several reasons. It does not explicitly seek to target any particular business sector, but instead proceeds an multinational enterprise (MNE) group's residual profit attributable to marketing intangibles. It also contemplates an allocation of some or all the residual profit of MNE groups attributable to marketing intangibles across market jurisdictions based on an agreed metric.

- It could be relatively quick to implement if changes were made solely through the existing transfer pricing framework as it can coexist with principles already established under the arm's length principle. It would not require changes to tax treaties and only require relatively minor adjustments to local laws, unless a new nexus standard would be required, which could be considered as a later phase development.
- Existing transfer pricing guidelines could be adapted for local entities of an MNE to more easily update return allocable.

Considerations for OECD on Marketing Intangibles Approach

- A marketing intangibles approach could be straightforward and easy to apply but how the approach can and will be administered will be critical. The following should be considered to account for any administrable challenges:
  - Using financial data that is readily accessible for taxpayer and tax authorities to implement this option (not a separately prepared document) – *i.e*. published and audited global financial statement information, or disclosed segment data.
  - Using a more formulaic approach to allocating a portion of non-routine profits/losses to market countries to promote certainty. At the least, countries could agree to recognize the value of the market through a flat percentage of worldwide operating profit.
  - The determination of the amount of the relevant group's total profit, as well as its residual profit attributable to marketing intangibles, should be based on the accounting standards of the parent company entity.
  - *De minimis* thresholds should be included so as to manage administrative burdens.
  - Any proposal should recognize that the loss should also be economically borne by market countries through allocation methodology.
- Exceptions should be provided for structures that do not rely on the local development of intangibles.
- Distinctions of marketing intangibles should be considered. The proposals being considered could have the effect of increasing the share of business profit allocated to countries where users or customers are located. However, value is not always created at a local level beyond what would be remunerated for under existing arm's length principles.
- Considerations should be given to business models with longer value changes such as the case in integrated manufacturing where DEMPE functions in relation to design, development, and products is conducted by a single entity. This makes allocating among the various activities difficult.

B. The "User Participation" Proposal

Challenges

- The proposal focuses on only a handful of so-called "highly digitalized business models", thereby effectively "ring-fencing" a part of the economy in conflict with OECD recommendations. Given the digitization of all business models it would be very challenging, if not impossible, to identify which business models that should be covered and which should not.
- Similar proposals have not achieved consensus at EU level and are thus unlikely to achieve consensus at global level.
- It would require changes to tax treaties and domestic laws which would be cumbersome and cause implementation to be significantly delayed.
- Countries would have difficulties enforcing the new rules.
- There would be greater administrative burden on taxpayers as new systems would need to be created to employ this approach.

C. The Significant Economic Presence Proposal

Challenges

- The proposal is essentially a form of global formulary apportionment with expanded concepts of nexus in market jurisdictions based on factors other than physical presence. It represents the most radical divergence from current principles (including both nexus and profit attribution) than international discussions warrant.
- The proposal would eliminate, rather than build on the arm's length principle, which would require an unrealistic effort for governments and taxpayers to implement.
- For these reasons it is highly unlikely that this proposal could achieve global consensus.

Pillar 2: Global Anti-Base Erosion Proposal

The "global anti-base erosion" or "minimum tax" proposal under Pillar two is a move away from the primary focus of BEPS which was to ensure that tax jurisdiction would apply where value was created. It is not clear that the proposal would solve any alleged mismatch between taxing jurisdiction and the location of value creation.

Benefits

- The second pillar addresses base erosion concerns by effectively setting a minimum effective tax on profits of MNEs.

- It should build on existing frameworks notably the U.S. policies of GILTI and Base Erosion and Anti-Abuse Tax (BEAT). CCIA suggests that the U.S. GILTI regime be acknowledged as a starting point for further refinement.

Challenges

- This proposal appears to more akin to a BEPS related measure than a question of profit apportionment. Before proceeding with any changes under this pillar, governments should wait until BEPS has been fully adopted and the results of BEPS can be properly assessed.
- It will likely not work as a stand-alone solution as it does not address perceived concerns that there is an inability to levy local taxes where MNEs only have limited local presence, e.g. local customer or sales base.
- It includes an income inclusion rule and a base-eroding payment rule. It is critical to address how those two rules should interact with one another. CCIA recommends that in cases where there are two tax jurisdictions, the "tie" should be broken in favor of the income inclusion rule. This would mean that if the MNE's parent country invokes the income inclusion rule and taxes at the parent level, the source country should not be able to invoke the base-eroding payments rule. This would provide clarity, e.g. for a company that is headed by a parent in a country that has adopted the income inclusion rule. The parent country would also be better placed to give double taxation relief for any tax that may have been imposed by the source country.
- A minimum tax regime implemented on a jurisdiction-by-jurisdiction basis risks undermining tax sovereignty of countries by negating benefits such as research and development tax credits or expensing. Rather than using a percentage to determine the minimum rate, there should be a fixed rate that countries can agree to.
- A minimum taxation regime presents significant implementation and administration challenges both for taxpayers and public authorities.

IV. CONCLUSION

CCIA welcomes the OECD's important efforts to address the tax challenges arising from the digitalization of our economies through an inclusive and consensus-driven process. CCIA encourages the OECD, and participating governments, to reach consensus on a truly ambitious, comprehensive and a long term solution. This solution should prevent double taxation and ring fencing of the so-called "digital economy" and it should seek simplicity for authorities and firms that will need to implement it and strong dispute mechanisms.

CCIA remains optimistic that the end result can solve taxation challenges worldwide and provide certainty needed to enhance investments, trade and growth globally. The international tech industry is committed to this important process and stands ready to provide further input.