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OF THE
UNITED STATES OF AMERICA

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Organisation for Economic Co-operation and Development (OECD)
Tax Policy and Statistics Division
Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris Cedex 16
France

RE: Comments on Secretariat Proposal for a "Unified Approach" under Pillar One

Dear Sir or Madam:

The U.S. Chamber of Commerce appreciates the opportunity to present the following comments to the Organisation for Economic Co-operation and Development (OECD) on the Secretariat Proposal for a "Unified Approach" under Pillar One regarding taxation of the digital economy.

I. In General

The Chamber believes it is important to maintain the coherence of the international tax system and, as such, we encourage continuing broad engagement to meaningfully address digital tax issues. We want any solution to this issue to be sustainable and are extremely concerned that the failure of this process or the non-universal adoption of a new solution would yield significant tax and trade disruptions. Further, any agreement needs to be long-term, rather than treated as a "first step" in raising more tax revenue or moving toward formulary apportionment.

The Chamber believes that any proposal should require:

- Withdrawal of unilateral measures (DSTs, DPTs, ORT, MAALs, equalization levies, etc.).
- An economic impact assessment be completed and made public before any agreement is made on an approach.
- That some form of binding dispute resolution mechanism be implemented before any final consensus agreement on digitalization is reached.
- Alignment and harmonization between Pillars 1 and 2 to mitigate risks of multiple taxation.
- That, subject to transition rules for pre-effective date losses, any provisions need to be prospective, without any inference intended with respect to prior years.

II. 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:

As a threshold matter, Chamber members have differing views on the merits of the Amount A proposal. For example, some companies are concerned that the selected allocation key may be susceptible to future efforts by countries to reset the thresholds. Additionally, they note that a properly structured economic nexus rule in combination with the Pillar 2 principles could obviate the necessity for Amount A. Other members believe Amount A is a reasonable approach to prevent the proliferation of unilateral DSTs.

a. Interaction with Consumers/Users?

The Chamber supports limiting the scope of Amount A to the consumer facing businesses, as proposed by the Secretariat. While there is still much work to do to define consumer facing, it seems clear that the types of businesses that sell goods or services that are in no way marketed to or directed at individual non-business consumers are not intended to be the focus of additional allocation of profits to market jurisdictions for tax purposes.

Additional clarity is needed on a variety of issues, not the least of which is the definition of "consumer facing" businesses. For example, paragraph 19 expresses a concern with businesses that "interact with their consumer base and create meaningful value without traditional physical presence in the market." A broader focus is indicated in paragraph 20, to include "large consumer-facing businesses" such as "businesses that generate revenue from supplying consumer products or providing digital services that have a consumer-facing element." As such, additional clarity is needed on the level of consumer (including user) interaction, and how value without traditional physical presence is measured, that brings a business within scope.

Further, additional clarity should be provided by the OECD with regard to companies that have multiple lines of business in which (i) one may be consumer facing while another line of business may not be consumer facing (for example, a company which sells both OTC medicines as well as regulated pharmaceuticals to government health services); or (ii) one may be operated entirely within a single jurisdiction while another line of business may be operating in multiple jurisdictions. Defining how these companies need to be treated is important as a lack of clarity will result in skewed results under the Unified Approach. Consideration also should be given to adopting a de minimis rule so that companies with only a small percentage of sales attributable to activities that would otherwise be subject to Amount A would be treated as wholly excluded from the requirement to measure and allocate Amount A.

Further guidance is needed on other issues, including but not limited to:

- <u>Trademarks, Logos, and Copyrights of Non-Consumer Businesses</u>: Many business-to-business (B2B) companies incur marketing costs with visible logos and consumer brand recognition which may not necessarily correlate to consumer interaction or value and

therefore should not be in scope of Amount A. Some companies have significant value attached to their historic brand and trademarks that may not be relevant to ongoing businesses and that should not be considered if Amount A measures value of brands, trademarks, etc.

- De Minimis Standard: The Chamber believes there should be some de minimis standard related to remote access (such as for online banking or similar remote access activities) to ensure businesses that interact remotely with consumers predominantly within the same country are not included in scope.
- Government Contracting: The Chamber believes it should be clarified that businesses that sell articles and services to governments should be out of scope of the Unified Approach.

b. Defining the MNE Group

The Chamber urges that any definition of 'MNE groups' be defined in the same way as on the consolidated financial statements. This is critical if the Unified Approach intends to leverage parent company consolidated GAAP reporting to determine, among other things, the existence and amount of Amount A. Further, the Chamber urges clarification that, with regards to less than 100% owned subsidiaries or joint ventures, taxpayers should take into account a proportionate pro-rata portion of profits (for purposes of determining Amount A) or revenue (for purposes of any revenue-based allocation of Amount A).

c. Covering Different Business Models (Including Multi-Sided Business Models) and Sales to Intermediaries

The Chamber believes that sales to unrelated distributors should be treated as business to business transactions that are out-of-scope of Amount A. For example, consider where Company X frequently sells products or services to an unrelated distributor (i.e., Company Y). In this example, Company Y does not further manufacture the goods, but generally has discretion to determine the price range and location of the sale to consumers. Consequently, Company X does not know the ultimate sales price, nor does it receive confirmation from Company Y regarding the final destination of sale to consumers. This situation does not allow Company X to track and collect the type and level of data associated Company Y's final consumer sales that is required under the Unified Approach. If Company X were to receive this information from an unrelated distributor (i.e., Company Y), it could have significant anti-trust and competition law implications.

d. Size of the MNE Group, Taking Account of Fairness, Administration, and Compliance Cost

The Chamber believes that applying a threshold of €750M or more appears appropriate and is consistent with the CbC report filing requirements. Only revenues that are in scope should be considered in determining whether a group satisfies the threshold.

e. Carve Outs That Might Be Formulated

The Chamber appreciates that the "Unified Approach" recognizes that certain industries or sectors may merit carve outs from Amount A and new nexus. Carve outs would require clear definitions and well-reasoned policy explanations for why certain industries or transactions are out of scope.

For instance, the "Unified Approach" suggests that extractive industries would be defined out of scope. The Chamber supports this approach as such industries generally are not consumer facing and there is a strong policy driver for taxation in the source country. Likewise, the Chamber also supports other carve outs contemplated in the "Unified Approach," such as the commodities carve out. Commodities are homogenous products with no value created by market intangibles and commodities are not marketed to consumers.

The Chamber also believes, as suggested in the Unified Approach, further discussion "should also take place to consider whether other sectors … should also be carved out, taking into account the tax policy rationale as well as other practicalities." For instance, as suggested in the Unified Approach, the Chamber believes financial services (which includes banks, insurance companies, and asset management companies) may merit a carve out.

However, the Chamber also believes that there are other instances, as contemplated by the Unified Approach, where carve outs may be appropriate. Rather than try to produce a finite list of sectors or situations where carve out is appropriate, it is more practical for the Chamber to share a list of factors that could indicate a reasonable basis for exclusion. Those characteristics include, but are not limited to:

- Where a taxpayer is required to have a physical presence for regulatory reasons;
- Where a taxpayer is prohibited from marketing directly to consumers;
- Where a taxpayer has a legally restricted ability to change prices or sells significantly to government programs at government mandated pricing;
- Where industrial goods and services are sold directly to other manufactures, governments, business entities, hospitals, and distributors that have no interaction or engagement with individual consumers;
- Where a line of business generates substantially all of its profits within one jurisdiction;
- Where the product produced is a component and, as such, has been incorporated into another product during the manufacturing process by unrelated entities and does not represent a consumer-facing endeavor; or
- Where the taxpayer's customer is only temporarily in the jurisdiction using the services of an in-country supplier to the taxpayer.

Finally, the Chamber urges consideration of carve out related matters. For instance, consideration should be given to whether a carve out is needed where "substantially all"[1] profits are derived from one or more activities subject to another carve out (extractive, commodities,

[1] "Substantially all" could be defined as more than 75%.

etc.) and any remaining profits relate to "ancillary activities." Additionally, the Chamber believes any profit attributable to amounts carved-out (i.e. extractive, commodities) should be removed for purposes of calculating the presence of excess return for application of Amount A.

III. 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

The Chamber is concerned about the creation of a new economic nexus standard. If there is a new nexus standard, it should be on a stand-alone basis with sufficiently high revenue thresholds and limited to cases where there is "a sustained and significant involvement in the economy of a market jurisdiction." In addition, the new nexus standard should require at least three or more consecutive years of revenue in a jurisdiction to ensure that only "sustained" involvement in an economy is identified. Further, applying a revenue threshold avoids applying the new taxing right to companies that generate a relatively small amount of revenue in a jurisdiction, thereby saving the costs of compliance and tax administration for small amounts of tax for both taxpayers and tax authorities. However, revenue thresholds should not be done on a per country basis because it would create substantial compliance burdens. However, if some scaling is necessary to recognize the circumstances of smaller countries, a more administrable tiering approach should be considered. Moreover, each of a company's lines of business should be considered separately to determine if that line of business has a nexus in a particular jurisdiction.

The new nexus standard also should require some interaction with the market jurisdiction in addition to a sales threshold. For instance, one could consider material marketing activities, advertising, or other direct-outreach to the market jurisdiction. The use of sales activities on its own is not an appropriate indicator.

b. Miscellaneous Issues

The Chamber recommends that clarification be provided that new nexus does not create other obligations or filing requirements in-country (VAT, GST, customs) or create any other legal nexus on non-tax matters. Additionally, to avoid double taxation, the Unified Approach needs to definitively state that Amount A payments and changes in profit and/or sales cannot trigger "exit taxes" under local country tax law. If this is not definitively stated, the profit could be double taxed if year-over-year changes were characterized as "exits" from countries or shifts in business from one country to another.

The Chamber has concerns on the imposition of withholding tax as a mechanism to collect Amount A from market jurisdictions in which there is no physical presence:

- Allocations: Withholding taxes apply a fixed percentage to a base amount. However, Amount A would result from the allocation of a portion of the non-routine profits generated by an enterprise. Thus, the withholding tax could not easily estimate the amount of the tax due from such allocation. It appears unreasonable to require withholding tax at the time of a transaction and require a company to file for a refund, as many countries have historically refused to issue refunds of excess withholding tax.
- Losses: As withholding taxes are applied on a gross-income basis, a withholding tax does not take into account losses, either of the taxpayer or of any related group member or consolidated group member who generates losses in the current year or who apply loss carryovers from other years. It appears unreasonable to impose a withholding tax and subject a company to tax on Amount A when such company is entitled to a reduction in its tax liability through economically generated losses.
- Gross versus Net Taxation: Withholding tax is a tax on gross income rather than net income. A gross-income tax does not take into account actual profit margins generated by a business but applies a fixed margin to all transactions. Such a tax is inconsistent with determining Amount A based on an allocated amount of a portion of non-routine net profit.
- Consumer Transactions: The Pillar One Proposals focus on taxing value generated in market jurisdictions by consumers. However, it is difficult to expect a high compliance rate of individuals acting as withholding agents on payments related to their online purchases and downloads.

IV. 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?

The Chamber believes that earnings before taxes (EBT) derived from consolidated financial statements would be an appropriate measure of group profits as the financial statements audited under Generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS) for large companies with over €750 million in revenue as they are not easily manipulatable. However, adjustments should be made to reflect partial ownership of minority investments and partnerships. If the minority-owned entities and partnerships themselves pay income tax at the entity level, such ownership should be removed from the financial statement tax base.

The Unified Approach should also clarify how various business situations should be considered within the determination of Amount A including, but not limited to, licensing of intangibles between two unrelated companies, material economic events (i.e., hyperinflation), joint ventures, divestitures and acquisitions, extraordinary business events, force majeure, etc.

b. 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?

The Chamber believes that any approach to segmentation should adhere to the following principles:

- Businesses must be permitted to use aggregated financial statements; there should be no forced segmentation.
- Businesses should be permitted to segment on their own, provided that they do so consistently (i.e., use the same segmentation in all jurisdictions). It seems reasonable that there be some kind of multi-year consistency requirement, although there may be some practical challenges in the case of acquisitions, dispositions, or business reorganizations. Allowing a company to adopt a line of business approach is necessary to ensure that out-of-scope sales (either because they are not consumer facing or subject to industry or de minimis carve-outs) are not subject to reallocation.
- Taxing authorities may not force segmentation or force changes to segmentation; segmentation should only be audited by the tax authorities of the country where the parent company is located, and adjustments made only prospectively to avoid the potential for hundreds of amended returns.
- Taxpayers can use their ordinary books and records to segment down to EBT, using a reasonable allocation method, consistently applied, to allocate corporate expenses among business line segments.

V. 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?

The Chamber is concerned challenges could arise if: (i) the allocation formulas do not reflect the normal returns generated by the industry or industries in which the enterprise operates, or (ii) different countries apply different percentages from the international standard or classify a business as operating in a different industry than classified by other countries and thus different percentages are applied. To avoid both double taxation and non-taxation of income, countries' application of formulas and industry classification should be consistent, and the OECD should offer a proactive mechanism/approach amongst its Inclusive Framework countries to ensure conformity in adoption.

As a policy matter, the Amount A "deemed residual profits" to be allocated to market jurisdictions should not include income attributable to trade intangibles. As noted by the OECD, trade intangibles do not possess "an intrinsic functional link with market jurisdictions."[2] Accordingly, the Chamber recommends that the level of "deemed routine profits" be set

[2] OECD, Public Consultation Document: *Addressing the Tax Challenges of the Digitalisation of the Economy*, ¶34 (Feb. 2019).

sufficiently high to ensure that market jurisdictions are not allocated income attributable to trade intangibles.

Further, the approach of using sales as the sole allocation key appears reasonable, as long as the definition of sales is consistently defined across jurisdictions. Using a combination of sales with other factors, such as payroll or property would (i) be inconsistent with the purpose of the OECD Proposal, which is to allocate some portion of excess return to markets; (ii) result in inevitable double taxation, unless a unified allocation key were adopted in all markets; (iii) add complexity and the risk of controversy, and (iv) reduce incentives to create jobs or make capital investments. Increasing payroll and property in an apportionment factor would increase the amount of income tax due in that jurisdiction and thus provide a disincentive to hire or to invest.

Additionally, as Amount A is determined as a share of the deemed residual profit of the enterprise, no allocation to market jurisdictions would be made under Amount A in the year an enterprise is in a loss position. In order to take losses into account in determining the profit allocable under Amount A, the deemed residual profit subject to the Amount A reallocation should be determined net of any losses carried over from other years.

VI. 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. Building on Existing Mechanisms of Double Tax Relief, Such as Tax Base Corrections, Tax Exemptions or Tax Credits?

The Chamber believes that taxpayers should report and be audited with respect to Amount A only in the country where the parent company is located. This would help with administration, simplicity, would help avoid double taxation, reduce compliance costs, preserve the use of tax mechanisms for the relief of double taxation, and prevent the taxation of losses. In order to prevent double taxation, a deemed deduction should be allowed in the surrender jurisdiction in which the resident entities whose income is included in Amount A are taxpayers. Neither credit or exemption mechanisms are likely to substantially reduce the anticipated burden of double taxation which would otherwise arise.

b. Ensuring That Existing Mechanisms for Eliminating Double Taxation Continue to Operate Effectively and As Intended?

Every taxpayer that is required to make an allocation under Amount A and is required to use a fixed percentage to determine Amount B has a potential for double taxation if a jurisdiction determines it should receive a higher amount of profit attributed to it under Amount C. Amounts A and B would not be based on the arm's-length principles, while Amount C would be based upon such principles. As the basis for profit attribution under the three Amounts would be based

upon different approaches, the risk for double taxation would be high for all taxpayers subject to the Unified Approach, making robust, binding multilateral dispute resolutions mechanisms, including binding mandatory arbitration, a necessity.

The Chamber recognizes that, although the Unified Approach is designed to affect the allocation of income across market countries in a multilateral context, many taxpayers would remain in bilateral disputes. The historical concerns about existing bilateral mutual agreement procedures ("MAP") remain, including timely resolving disputes.

An effective mechanism to encourage countries to resolve bilateral MAP cases has been to provide a two-year time-frame for countries to endeavor to resolve disputes before triggering a mandatory binding arbitration. Although some countries are resistant to such binding arbitration due to sovereignty concerns, we recommend providing for binding arbitration after a two-year window. The intent is to respect national sovereignty and allow countries a reasonable period of time to resolve MAP cases before providing certainty to taxpayers that their cases will be resolved.

The Unified Approach will also give rise to the creation of multilateral disputes. A mechanism, similar to bilateral MAPs, should be included within existing frameworks or as a part of guidance for the Unified Approach in order to address such situations where there is an increased number of stakeholders.

VII. 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).

Any approach under amount B should be formulated as safe harbors for taxpayers, rather than prescriptive percentages. The Chamber generally believes that while a fixed return approach is intended to bring simplicity, a co-equal goal should be to approximate results under the arms' length standard. As such, if a fixed method were employed, businesses would need flexibility in making adjustments to the fixed return, or alternatively a cap should be imposed on Amount B such that it does not exceed a certain percentage of total profits (perhaps together with a floor which was reasonable across all industries and profit levels). Further, the Chamber believes a singular fixed return across all industries would not work as it would not take into consideration low margin business vs. high margin businesses.

VIII. Amount C/Dispute Resolution and Prevention - 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? c. mandatory binding MAP arbitration?

The Chamber believes the successful implementation of the Unified Approach must require a forceful emphasis on avoiding double taxation. As a back-stop to ensure profits are only taxed once, the Chamber supports the OECD's clarification that the application of any binding dispute resolution mechanism must be available to all taxpayers and applicable to all approaches. The Chamber is concerned that the existing bilateral system of dispute resolution is not workable in a multilateral environment where profit is allocated across jurisdictions. If one country challenges an allocation or changes the fixed percentage it is attributed, then such change impacts all other countries that receive such allocation and an adjustment is necessary. There also should be mechanisms, e.g., surrender mechanisms[3] built in to avoid double tax – otherwise taxpayers are double-taxed up front and need to seek recovery after the fact.

Accordingly, the Chamber recommends a new multilateral binding dispute resolution mechanism be developed, either through a multilateral forum or organization designated or designed to timely resolve such challenges. The Chamber believes that mandatory binding arbitration is a practical and reasonable solution for resolving such multilateral disputes, as the views of all parties could be taken into consideration by a third-party arbitrator. Regardless, the Chamber believes any solution should avoid the historical problems inherent in the bilateral MAP process by (i) allowing enterprises to participate in the resolution process, (ii) requiring dispute resolution within a timely basis, such as two years, before triggering a binding arbitration process, and (iii) providing for remedies (other than tariffs) for countries to pursue against other countries that fail to abide by the commitments. Any shift to a non-physical presence nexus should grant appeal rights and access to the judicial systems but only with respect to any additional tax owed under Amount A in each jurisdiction – even in the absence of a physical presence.

The Chamber appreciates the opportunity to offer these comments and is ready to provide additional input as appropriate.

Sincerely,

Caroline L. Harris

[3] Such mechanism would have to be negotiated between countries for what, in essence, is a country "surrendering" or giving way to another for taxing rights on the same income. It would be defined by the countries and it could include an offsetting deduction to address double tax issues.